



## COMMONWEALTH of VIRGINIA

*Joint Legislative Audit and Review Commission  
Suite 1100, General Assembly Building, Capitol Square  
Richmond, Virginia 23219*


*Philip A. Leone  
Director*

*(804) 786-1258*

November 30, 2006

### MEMORANDUM

TO: Internal Service Fund Subcommittee

FROM: Glen S. Tittermary 

SUBJECT: Approval of Rates for Decentralized Services

On November 21, 2006, the Virginia Information Technologies Agency (VITA) submitted a request for the Commission's approval of new rates for decentralized services. The request from VITA is included as Attachment A. This request replaces the current direct bill methodology for hardware, software and personnel costs associated with supporting desktop devices, network equipment, and servers located at agencies statewide.

The direct bill methodology assessed charges based on amounts negotiated through Memoranda of Understanding (MOU) between VITA and individual customer agencies designed to maintain costs at agencies' FY 2006 expenditure levels. While this approach was not supported by the JLARC subcommittee, the subcommittee did not object to its implementation. The current approach has not proven to be a workable chargeback mechanism for reasons including:

- reservations by the U.S. Department of Health and Human Services (DHHS)' Division of Cost Allocation (DCA) about using MOUs to assess IT charges for State agencies with full or partial federal funding,
- customer agency concerns with equipment inventories and proposed charges, resulting in a reluctance to sign MOUs, and
- insufficient revenue to support current and planned activities of the Northrop Grumman partnership.

Therefore, VITA has requested that the Commission approve new decentralized service rates retroactive to July 1, 2006. The overall impact of these proposed rates appears cost-neutral to the Commonwealth, while the impact on specific agency budgets for these services is unclear. The financial impact on agency budgets should be addressed through language within the 2008 Appropriation Act allowing the Department of Planning and Budget to reallocate funding for this purpose.

## **Background**

Since its inception in 2003, VITA has used several approaches to charge agencies for information technology-related labor, goods, and services pertaining to its server, and personal computing (desktop-related) platforms, network, and associated operations. Initial efforts to develop a decentralized services rate structure—approved by JLARC—were abandoned because it would significantly increase costs for some agencies.

When VITA absorbed IT personnel and assets from executive branch agencies in 2005, a direct bill chargeback mechanism was employed to recover both the direct and indirect administrative expenses associated with delivering IT goods and support services. This approach was implemented on a temporary basis in order to begin consolidation of the Commonwealth's IT infrastructure.

Shortly thereafter, VITA began developing two proposed rate schedules for these services, one for labor and the other for goods and services. Development of this approach was discontinued in 2006, due to cost impacts on some customers as well as the pending agreement between VITA and Northrop Grumman.

In 2006, VITA began using negotiated Memoranda of Understanding (MOUs) to replace the direct bill method for charging its customer agencies for labor and services. With limited historical spending data upon which to base the charges, attempting to determine accurate and mutually acceptable charges was challenging. The amounts paid by VITA's customers under the MOU chargeback methodology are derived from (1) their respective FY 2006 actual expenditures under direct bill, and (2) in some cases, agency spending plans for FY 2007 submitted in response to a VITA request. As a result, each agency's MOU charge relates directly to its unique IT services (labor used, equipment purchased / maintained / operated).

Due to problems with customer acceptance of MOUs (primarily related to agency concerns about the total number of devices used for determining annual charges) and in securing federal government approval of the associated Cost Allocation Plan, VITA accelerated its efforts to submit statewide decentralized service rates to JLARC for approval during FY 2007, to be effective this year and in FY 2008.

## **Federal Concerns with Cost Allocation Plan**

In August 2006, VITA submitted to the U.S. Department of Health and Human Services' (DHHS) Division of Cost Allocation (DCA) a new Cost Allocation Plan (CAP) based upon the use of MOUs. The DCA is designated by the Office of Management and Budget (OMB) as responsible for reviewing and negotiating cost allocation plans. The CAP depicted rates for each agency that VITA believed satisfied the pertinent federal cost allocation requirements delineated in OMB Circular A-87. However, DCA disagreed. They responded by

letter dated September 29, 2006, enumerating several concerns regarding VITA's plan (Attachment A).

Specific concerns raised by DCA included:

- Monthly billing amounts are not reflective of actual costs,
- Lack of itemized billing invoices; and
- Inability to accurately reconcile costs at end of fiscal year.

DCA found that that VITA did not present a methodology for assigning and billing costs that were compliant with federal regulations and recommended that all federal agencies impacted by the proposed methodology consider deferring payments until the cost allocation plan is corrected.

DCA indicated that it would be satisfied with VITA reestablishing the direct bill methodology as an acceptable alternative to MOUs. However, it is not feasible for VITA to go backward as VITA's automated billing system no longer accommodates direct bill. As a result, the current CAP proposal is predicated on JLARC approval of the proposed decentralized services rates.

Other issues for agencies with significant federal funding include: (1) rate increases this year are out-of-cycle for immediately requesting more federal dollars; and (2) even if they could, federal grantors might not give agencies more now, where existing spending plans already reach the maximum of the authorized grant administrative cost cap.

### **Decentralized Services Rates**

The VITA proposal requests the implementation of rates for decentralized services comprised of the hardware, software and personnel costs associated with supporting infrastructure devices located at agency locations statewide. Supported device types fall in the categories of personal computing (desktop and laptop), servers, network equipment and shared local area networks (LANs).

There are several rate options for supported devices within each category. The rate options are generally full service, service excluding purchase, and service excluding direct labor. For servers and LAN devices, several levels of rates within each service category are established based on the purchase price of the asset. Individual rates for each category are included in Attachment A.

VITA proposes implementing flat monthly rates to recover both the operational and capital costs standard rates for the various categories of decentralized services VITA pro-

vides. Individual agency charges will be assessed based on the number of devices for which service is provided. Expenses recovered by these rates include the cost of hardware, annual maintenance of hardware, cost of software, annual license fees for software, direct staff support and allowable indirect expenses (Attachment A).

The rates included in this proposal seek to recover an estimated \$129,708,916 in expenses for fiscal years 2007 and 2008 (Table 1), approximately 40 percent of VITA's projected expenses of \$323 million. Remaining expenses are currently recoverable through existing rates primarily for data, voice, and video services (21 percent); data center charges (17 percent); and other general, special or enterprise funding sources (22 percent).

VITA does not consider this service rate structure to be permanent. Additional revisions are anticipated each year, including the adoption of a charge system based on a consolidated IT infrastructure delivering a range of standard services utilizing standardized equipment. Furthermore, revenues recovered from the implementation of these rates are anticipated to change each year as infrastructure inventory's are refined (Northrop Grumman is required to verify State technology infrastructure by June 30, 2007).

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**Table 1: Estimated Decentralized Services Rate Recoveries**

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Rate	Estimated Recovery
Desktop and Laptop Computers <sup>1</sup>	\$ 67,578,856 <sup>2</sup>
Windows and Unix Servers <sup>3</sup>	31,121,121
Shared LAN Devices <sup>3</sup>	5,499,093
Network Access Rates	25,509,846
<b>Total</b>	<b>\$ 129,708,916</b>

<sup>1</sup> Service tiers include full service, service excluding purchase, and service excluding labor

<sup>2</sup> Includes \$17, 675,843 for payments to Northrop Grumman.

<sup>3</sup> Service tiers based on initial purchase price.

Source: JLARC staff analysis of Virginia Information technologies Agency proposed decentralized services rates.

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Northrop Grumman has made significant upfront investments in the partnership agreement, and they seek to recover some of these through obtaining "milestone" payments from VITA in the first two years upon reaching certain targets or events. The costs of these milestone payments are allocated across the various rate structures. For fiscal years 2007 and 2008, milestone payments totaling \$54 million are due to Northrop Grumman for 24 events occurring between July 2006 and April 2007. Of the proposed \$129.7 million, more than \$17.6 million (14 percent) is dedicated for payments to Northrop Grumman. These expenditures are proposed to be recovered through the desktop services rate.

### **Impact on Agency Budgets**

Implementation of statewide decentralized services rates will establish uniformity and consistency in VITA charges for these services. However, because agency charges are based on the number of devices in each service category, each agency will see changes in current charges. Analysis of estimated agency impacts—included in Attachment A—indicates that the Departments of Corrections, Transportation, Taxation, Motor Vehicles and Emergency Management, as well as the Virginia State Police will show a reduction in expenditures from current annual IT spending for these services of more than \$1 million. Conversely, agencies including the Departments of Mental Health (Central Office), General Services, Social Services, Health, Juvenile Justice and the Virginia Employment Commission may see substantial increases in the costs of these services.

While the overall statewide impact of the proposed rates appears to be revenue neutral, there will be some variations in costs and savings for specific agency budgets. Determination of asset inventory—upon which estimated recoveries from each agency are based—has been challenging, and there is a degree of dissent between agencies and VITA. According to VITA staff, asset totals used in assessing individual agency impacts of this proposal were current as of October 2006. However there is uncertainty in any actual reduction in statewide expenditures that may be attributable to implementation of these rates. In addition, Northrop Grumman documentation of statewide inventory through June 30, 2007 will refine the total revenues recovered through these rates and has the potential to impact statewide reductions in expenditures. Based on JLARC staff discussions with the Department of Planning and Budget, it appears DPB plans to provide some flexibility in redirecting costs and savings from the General Fund to cover operational costs for those agencies which experience increased costs.

### **Reduced Rates Exclude Capital Replacement for Some Agencies**

As a result of federal concerns related to charging the full costs (including replacement) for devices that may have been recently purchased with federal funds, and in an effort to mitigate the impact of increases through the implementation of decentralized services rates, VITA staff established rates that recover only support services until the equipment is replaced. One of the intentions of the Northrop Grumman contract is to aggressively refresh State personal computing devices within the first three to five years of the contract. The assumed policy decision is that the refresh for federally funded computers will begin in year three of the contract.

As shown in Table 2, for seven primarily federally funded agencies, annual totals recovered from agency charges are lower for rates excluding purchase prices for equipment until the devices are replaced through the Northrop Grumman replacement cycle. Consequently, more than \$20 million in additional federal funding will be required to fully recover expenses associated with decentralized service rates for these agencies. Moreover,

through this approach, revenues recovered through these rates may be as much as are reduced by approximately \$16 million in the first three years of the rate being implemented.

**Table 2: Recoveries for Selected Agencies**

	Current FY2006 Expenditures	Projected Reduced Rate	Projected Full Rate	Difference Reduced Rate	Difference Full Rate
Department of Labor and Industry	\$181,708	\$393,659	\$551,859	(211,951)	(370,151)
Virginia Employment Commission	\$2,399,781	\$3,704,996	\$6,643,836	(1,305,215)	(4,244,055)
Department of Rehabilitative Services	\$1,758,975	\$1,240,473	\$2,112,798	518,502	(353,823)
Department of Game and Inland Fisheries	\$1,357,668	\$987,535	\$1,486,624	370,133	(128,956)
Department of Mines, Minerals and Energy	\$294,486	\$678,808	\$1,045,297	(384,322)	(750,811)
Department of Health	\$13,399,125	\$13,472,639	\$15,899,253	(73,514)	(2,500,128)
Department of Social Services	\$11,152,888	\$14,227,840	\$23,500,057	(3,074,952)	(12,347,169)
<b>TOTALS</b>	<b>\$30,544,631</b>	<b>\$34,705,950</b>	<b>\$51,239,724</b>	<b>(4,161,319)</b>	<b>(20,695,093)</b>

Source: JLARC staff analysis of Virginia Information Technologies Agency (VITA) proposed decentralized services agency impact

## Conclusions

Based on the review of documentation submitted by VITA and interviews with VITA and DPB staff, JLARC staff draw the following conclusions:

1. The rates proposed and projected revenue appear reasonable.
2. The impact on individual agency budgets is uncertain; however the overall impact on the State budget is estimated to be revenue neutral. Differences in agency charges are largely due to potential fluctuations in agency owned equipment. Northrop Grumman will provide a physical update of inventory by June 30, 2007.
3. The financial impact on agency budgets should be addressed by budget language allowing the Department of Planning and Budget to reallocate funding for this purpose.

GST/jwp



# COMMONWEALTH of VIRGINIA

## Virginia Information Technologies Agency

Lemuel C. Stewart, Jr.  
CIO of the Commonwealth  
Email: cio@vita.virginia.gov

110 South 7<sup>th</sup> Street  
Richmond, Virginia 23219  
(804) 371-5000

TDD VOICE -TEL. NO.  
711

November 21, 2006

Mr. Phillip Leone, Director  
Joint Legislative Audit and Review Commission  
Suite 1100  
General Assembly Building  
Richmond, Virginia 23219

Dear Phil:

Three years ago VITA first brought to JLARC a request for rates to recover the costs of new services provided under the consolidation of IT infrastructure services in Executive Branch agencies. Since then VITA has employed several interim chargeback methodologies, but the objective of implementing statewide service rates has never changed. Recent events – most prominently, customer and federal government concerns with our current Memoranda of Understanding (MOU) planned approach to chargeback – have prompted us to prepare and submit for the Commission's consideration an updated statewide rate proposal for decentralized remote services.

There are several facets of this request I want to bring to your attention. We are requesting that this rate schedule, if approved, be retroactively made effective on July 1, 2006. The proposal incorporates the rates for security management that JLARC approved on December 12, 2005, as the new rate structure uses a similar asset-based customer cost calculation.

Concurrent with this rates request VITA is working (1) with the federal government to obtain approval of the associated cost allocation plan and (2) the Governor's Office to identify the cost impact of the new rates. We expect these actions will address customer agencies capacity to pay the new rates, if approved. The attachment is intended to apprise you of the scope and intent of these efforts, in addition to describing the covered services, their cost basis, and the proposed rates.

I welcome a meeting with you and your staff to review any of the documentation presented. If you have any questions, please give me a call on 343-9057.

Sincerely,

A handwritten signature in black ink, appearing to read 'James T. Roberts'.

James T. Roberts  
Director of Finance and Administration

Attachment

cc: Glen Tittermary  
Lemuel C. Stewart, Jr.

## **Statewide Service Rates Proposal**

This overview addresses the background for VITA's proposal, discusses key issues relating to rate development and implementation, and presents the details of the proposed rate structure.

### **Background**

#### ***1. Recent Changes in Chargeback Methodology***

In 2006 VITA replaced its direct bill methodology (approved by JLARC on June 14, 2004, and effective July 1 of that year) with chargeback agreements in Memoranda of Understanding (MOU) between VITA and individual customer agencies. The MOU chargebacks were designed to maintain costs at customers' FY 2006 expenditure levels, except in cases where agencies submitted plans for increased IT expenditures. Annual expenditures were divided into twelve equal monthly payments. Advantages of the MOU approach included assuring consistency of VITA's revenue flow for remote services for desktop devices, networks, and servers; and offering customers the ability to improve budgeting for these same IT services.

However, MOUs have not proven to be a workable chargeback mechanism. Inherent problems with continued reliance on MOUs include the following:

- VITA's customers have not uniformly supported this approach. Customer agency concerns were anticipated. However, for some the reluctance to sign MOUs has been quite protracted and a few have not signed their agreements even months after they were proffered, in spite of good-faith efforts by VITA to negotiate and respond to each agency's unique concerns.
- The cognizant federal agency, the U.S. Department of Health and Human Services (DHHS)' Division of Cost Allocation (DCA), has recently expressed strong reservations about using MOUs to assess IT charges for state agencies with full or partial federal funding. Implementation of service rates, on the other hand, is an approach DCA has indicated willingness to accept. Concurrent with preparation of this rates submission, VITA has collaborated with key customer agencies and DCA to develop a workable and equitable charging mechanism for IT service delivery, i.e. one that will pass muster with all stakeholders. This effort is discussed in greater detail below.
- MOUs are not producing sufficient revenue to support the current, and planned future, activities of the IT partnership. This is a result of the two preceding bullets. While most of VITA's customers have accepted the MOU process as inherently fair and consistent with their historic IT spending patterns, a significant minority have not embraced it with consequences as described above. The absence of an unambiguous federal response to VITA's MOU-based cost allocation plan has induced additional customer unwillingness to pay for VITA services, negatively impacting revenue.

#### ***2. Federal Cost Allocation Plan Actions***

In August 2006 VITA submitted to DHHS' Division of Cost Allocation a new Cost Allocation Plan (CAP) based upon the use of MOUs. This CAP depicted effective rates by agency that VITA believed satisfied the pertinent federal cost allocation requirements delineated in U.S.

Office of Management and Budget (OMB) Circular A-87. However, DCA disagreed. They responded by letter dated September 29, 2006, enumerating several concerns regarding VITA's plan (please refer to Appendix A for a copy of this correspondence).

In order to address these concerns, which DCA staff indicated in subsequent communications would result in their non-acceptance of the August 2006 CAP submission, VITA, with the assistance of several state agencies, mounted a comprehensive effort to prepare and provide a revised CAP for state fiscal year 2007. This effort has included:

- *Inviting federally-funded state agencies (stakeholders) to participate in developing the CAP.* Representatives of four affected agencies worked with VITA staff on a regular (weekly or more frequent) basis to guide the project and review outputs. Additionally, VITA has met weekly with a larger stakeholder group to both solicit their input and to brief them on progress.
- *Maintaining regular contact with key officials in DCA to guide and assist with VITA's cost allocation approach.* These contacts have been an essential and valuable element in developing the revised CAP submission provided to DCA on November 16, 2006.
- *Providing information to vital stakeholders at all levels of Virginia state government.* These stakeholders include the Governor and his financial advisers, the legislature and its staff agencies, VITA's governing board (the Information Technology Investment Board (ITIB)), and state executive agency heads.
- *Working with VITA's partner, the Northrop Grumman Corporation (NG), the provider of the services covered in the CAP.* Development of the statewide service rates structure described herein coincides with the initial stages of the Commonwealth's far-reaching transformation of IT infrastructure service delivery. The partnership with NG commenced on July 1, 2006, with a transformation schedule spanning three years from that date.

The CAP revision did not occur in a vacuum, however. VITA's ability to effectively provide IT infrastructure services, under its Internal Service Fund (ISF) operating model, is wholly dependent upon adequate and consistent state revenue and federal funding streams. Several other actions are being undertaken to make the new rate structure operational. In addition to submitting the rates proposal to JLARC for consideration at its December 11, 2006, meeting these include the following efforts:

- *Working with state executive budget decision makers to secure adequate appropriations to address the state share (general fund) of the costs of revised charges.* Because many agencies will experience charges that vary significantly from what they have been paying for IT infrastructure services under the existing MOU chargeback model, and because in a number of cases these charges will exceed current agency budgets, the provision of additional state funding is essential. VITA submitted the pertinent requests to the Department of Planning and Budget (DPB) in October, and provided DPB with information on the associated by-agency cost impacts in mid-November.
- *Keeping state legislative budget decision makers apprised of the current actions and projected state funding requirements associated with new rates.* As the legislature has the ultimate say in funding matters, VITA considers it critical to keep them continuously informed and up-to-date on the CAP and rates issues. Their understanding of the impact of these on IT transformation enhances the probability of obtaining adequate funding for VITA's customers.

- *Collaborating with federally-funded agencies and DCA to communicate the anticipated impact of new rates to the cognizant federal grantor agencies.* It is recognized that the federal funding cycle will preclude immediate relief to state agencies whose grants may be affected by the new rates structure, yet it is also expected that adequate notice and advance coordination can facilitate future adjustments to grants, as required. While this action is in its initial stages, it will need to be vigorously pursued in the coming months.

### ***3. Service Rates History***

Since its inception in 2003, VITA has developed a succession of strategies to charge state agency customers for information technology-related labor, goods, and services pertaining to its server, and personal computing (desktop-related) platforms, network, and associated operations—responsibilities it inherited as a result of the Commonwealth’s IT consolidation and transformation direction. The initial effort to develop a shared services rate structure—while approved by JLARC—ultimately had to be abandoned because it would have significantly increased costs for some customers, and the state’s financial health at the time precluded any assistance to agencies.

Beginning in FY 2005 when VITA absorbed IT personnel and assets from executive branch (in-scope) agencies, a “direct bill” methodology was employed to recover the direct and administrative expenses associated with delivering the IT goods and support services VITA is charged with providing. This methodology was implemented as a temporary chargeback mechanism in order to begin the transformation of the Commonwealth’s IT infrastructure to a consolidated environment.

Shortly thereafter, VITA again began developing, in coordination with customer agencies, two proposed rate schedules for these services, one for labor and the other for goods and services. This shared services rates proposal was shelved in early FY 2006 due, once again, to prohibitive cost impacts on some customers. Another factor was the impending agreement between VITA and the selected PPEA vendor, which was certain to affect VITA’s cost recovery and billing processes. (The decision to defer implementation of rate schedules occurred before Northrop Grumman was selected and the Comprehensive Infrastructure Agreement was confirmed).

Consequently, another interim measure was developed. In 2006 VITA began using negotiated Memoranda of Understanding (MOUs) to replace the direct bill method for charging its customer agencies for labor and services. Because there was a paucity of historical spending data upon which to base the charges, attempting to determine accurate and mutually acceptable charges was a difficult task.

Due to problems with customer acceptance of MOUs and in securing federal government (DCA) approval of the associated CAP, VITA accelerated its plan to develop statewide standard rates and submit the associated proposals to DCA and JLARC for approval during FY 2007, to be effective this year and in FY 2008. Approval of a statewide standard rate structure will (1) assure that the IT partnership is adequately funded—critical to providing services to customers; (2) improve the fairness and equity of per-agency and federal grantor shares of the costs; and (3) alleviate concerns about federal government approval of cost allocations.

In summary, VITA's objective can be stated as "to develop an equitable rate structure reflecting the actual/projected costs of providing decentralized remote services to customers in the current and future IT partnership environment, that can satisfy the needs/concerns of: (1) JLARC; (2) federal DCA (HHS), and other federal grantors; (3) state agencies using IT services; (4) executive branch decision-makers; (5) the General Assembly; and (6) VITA's partner/primary vendor, Northrop Grumman (NG)."

#### ***4. Next Steps***

VITA does not consider this service rate structure to be permanent. Additional revisions are anticipated each year upon reconciliation, including the adoption of a charge system based on a consolidated IT infrastructure delivering a range of standard services utilizing standardized equipment. VITA's chargeback methodology will change as the partnership with NG evolves, with the focus on leveraging NG's methodologies to reduce the complexities of cost allocation and avoid redundant data capture.

The challenges in designing the next level of service rates and processes include providing superior service at a competitive cost, gaining customer and funding authority (pertinent state and federal government entities) acceptance, enhancing VITA's business growth model, and assuring that VITA maintains a sufficient and consistent ISF revenue stream to support the expense of contracting with a vendor over multiple years. At the same time, VITA will be pursuing a rate system and structure that is simpler, and more transparent, stable, and predictable.

### **Issues Affecting Rates Development and Implementation**

#### ***1. Challenges***

A number of concerns have precipitated VITA's acceleration of the statewide service rate proposal and its request for implementation retroactive to July 1, 2006. These concerns, as well as obstacles inherent in developing rates at this time, are summarized below:

##### **A. Federal Government Concerns**

- The federal authority's (DCA) concerns with MOUs and subsequent disapproval of associated charges is a significant event driving rates development. VITA's ability to ultimately obtain approval by DCA and other federal agencies of the November 16, 2006 CAP submission and associated rates structure, is a variable that may affect the timing of new rates implementation (assuming JLARC approves this submission).
- DCA indicated they would be satisfied with VITA reestablishing the direct bill methodology as an acceptable alternative to MOUs. However, it is not feasible for VITA to go backward – the automated billing system has been revised and no longer accommodates direct bill; sweeping operational and financial structure changes were made in response to commencement of the partnership with NG on July 1, 2006; and over the past year there has been an ongoing transition to a shared services environment, e.g. use of labor pools vs. IT staff members dedicated to specific agencies they were transferred from.

### B. VITA Financial Issues

- VITA is experiencing negative cash flow. Considerable cash flow fluctuations were expected (e.g. the agreement between VITA and NG requires a number of milestone payments to NG, which are irregular in timing and amount) but, overall, the regular monthly payments established by the MOUs were intended to minimize these. However, disagreements with some customers on the MOUs, exacerbated by DCA's direction to federally-funded agencies to not pay these bills pending resolution of the CAP have had a significant and growing adverse impact on cash flow.
- There are challenges in moving to standard rates prior to completing IT transformation. Using the MOUs as an interim chargeback measure for up to two years was intended to provide the time needed to address these issues before implementing the statewide service rate structure. With the acceleration of service rates implementation, VITA, JLARC, and other decision makers will need to be flexible and proactive in modifying the rates structure as these issues are resolved
- VITA must assure an adequate and consistent revenue stream to support the costs of the service agreement with its partner, NG, as well as support other ongoing central operations (IT governance, security, E-911 service, Geographic Information Systems (GIS) programs, IT contract administration and associated general management and administration).

### C. Customer Issues

- VITA has encountered poor customer acceptance of MOUs as a charging mechanism, which has been exacerbated by customers' uncertainty about federal acceptance of VITA's CAP. MOU-related issues are described in detail in the Background section above.
- Limitations on customer agencies' funding resources and flexibility, particularly when some have historically paid for IT needs through reliance on turnover and vacancy savings and under-expenditures in other areas rather than specifically budgeting for them, are key variables affecting implementation of statewide service rates. VITA is working with DPB to identify associated changes to customer's IT costs for remote decentralized services. It is not known at the time of this submission whether, in response to statewide service rates' cost impact, the Governor will recommend general fund appropriations to augment the IT budgets of negatively-affected agencies. A related, and as yet unaddressed, issue is what to do for/with those agencies that rely heavily or wholly upon non-general revenue and which therefore cannot obtain adequate relief through targeted general fund appropriation increases.
- Successful implementation of the proposed new rates will be affected by widely held customer perceptions of the cost of doing business with VITA. The creation of the agency, and subsequently its partnership with NG, are believed by many to be primarily rooted in achieving direct, immediate cost savings for customers. Rather, the Commonwealth's comprehensive IT transformation program is expected to benefit customers over time via a number of achievements, of which cost savings is but one component. Please see below for details regarding the value of VITA:

*Improved IT investment management and oversight, including establishment of Commonwealth priorities for technology investment, enhancement of project management, and centralization of IT procurements to make process improvements and better leverage the Commonwealth's purchasing power.*

*Promotion of enterprise systems and collaboration. In partnership with customer agencies and localities VITA is working towards solutions that can be developed once,*

*and then be deployed many times. Examples include consolidation of e-mail systems, adoption of enterprise licensing for hardware and software, development of enterprise-level geographic information systems, and integrated learning management systems.*

*Value-added services for citizens, including “24/7” anytime, anywhere access to “Virginia.gov”, Virginia’s state web portal, and the development of interactive web services (for permits and licenses, voter registration information, etc.)*

*Value-added programs and support for customer agencies and localities, including improved Data Center performance and availability, enhanced telecommunications services, strengthened security, and better outreach to localities.*

*Financial benefits (information technology-related cost savings, and cost avoidances, realized through consolidations, standardization, and rate reductions and statewide discounts).*

## **2. What’s At Stake**

The Commonwealth and VITA are at a crossroads. Creation of the agency and support for its employment of a private partner to provide IT infrastructure services evidence support for a centralized approach, yet many uncertainties remain. Successful modernization and transformation of the Commonwealth’s IT infrastructure is VITA’s driving force. Use of a private partner is intended to leverage a level of resources otherwise unavailable to the state to accomplish this expeditiously, while at the same time avoiding most of the vagaries of state revenue fluctuations and reliance on state budget cycles for ongoing approval.

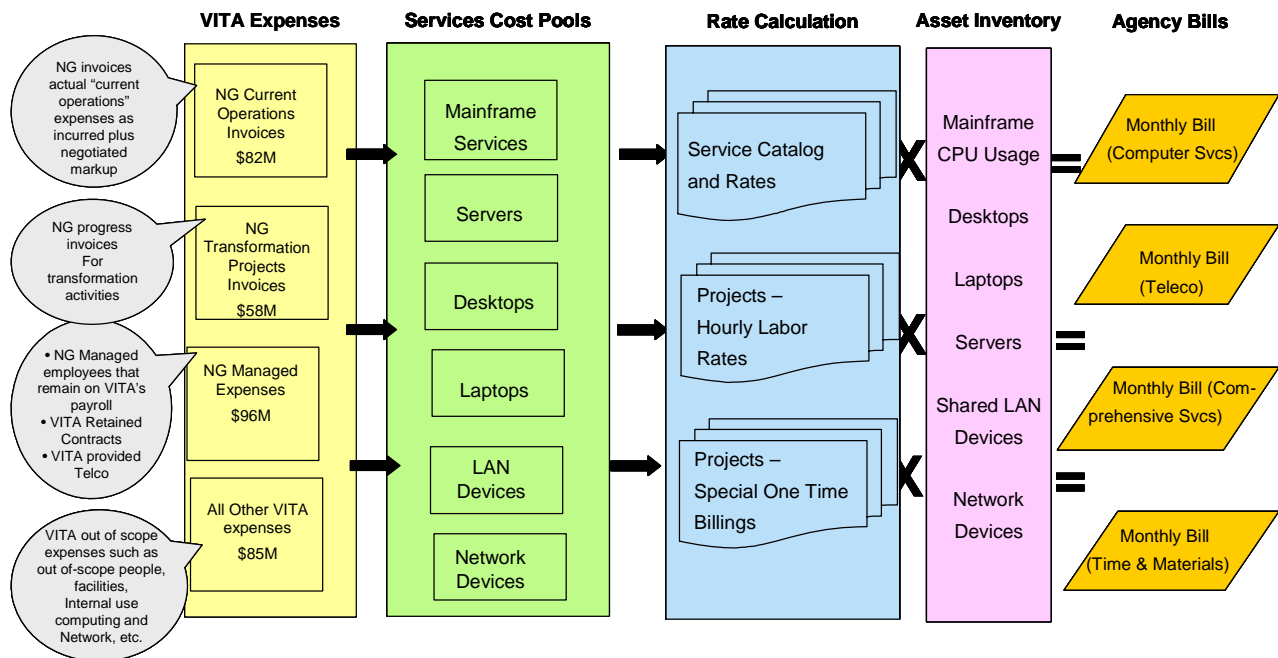
VITA is the pioneer for validating the PPEA model as a viable means of obtaining significant private sector assistance to efficiently provide goods and services to a statewide customer base. Consider this scenario: if VITA lacks adequate revenue to pay NG, the near-term consequence could be abrogation of the service agreement, resulting in significant termination costs and disruption of IT services to agencies and citizens. Long term, this would likely cause other private sector organizations to be reluctant to work with the Commonwealth given NG’s experience. Additionally, the Commonwealth’s opportunity to position itself as a national leader in creating value through innovative partnerships would be foregone.

At the most basic level, absent approval and implementation of these rates, VITA will not likely be able to continue on the path that has been set out. To meet the needs of increasingly technology-savvy and technology-reliant consumers (citizens) the necessary IT infrastructure support enhancements and assurance of data reliability and security must be provided. These, in turn, depend upon the IT partnership’s accelerated drive to transform the environment. VITA’s experience with implementing first direct bill, and then negotiated MOUs, as chargeback mechanisms raises the question of whether customer agencies possess either sufficient resources or the commitment to rely upon a central state agency and its partner to meet their IT infrastructure service needs.

## **3. VITA’s Financial Health**

The agency’s financial situation also has a significant impact on consideration of the rates proposal. Financial factors include:

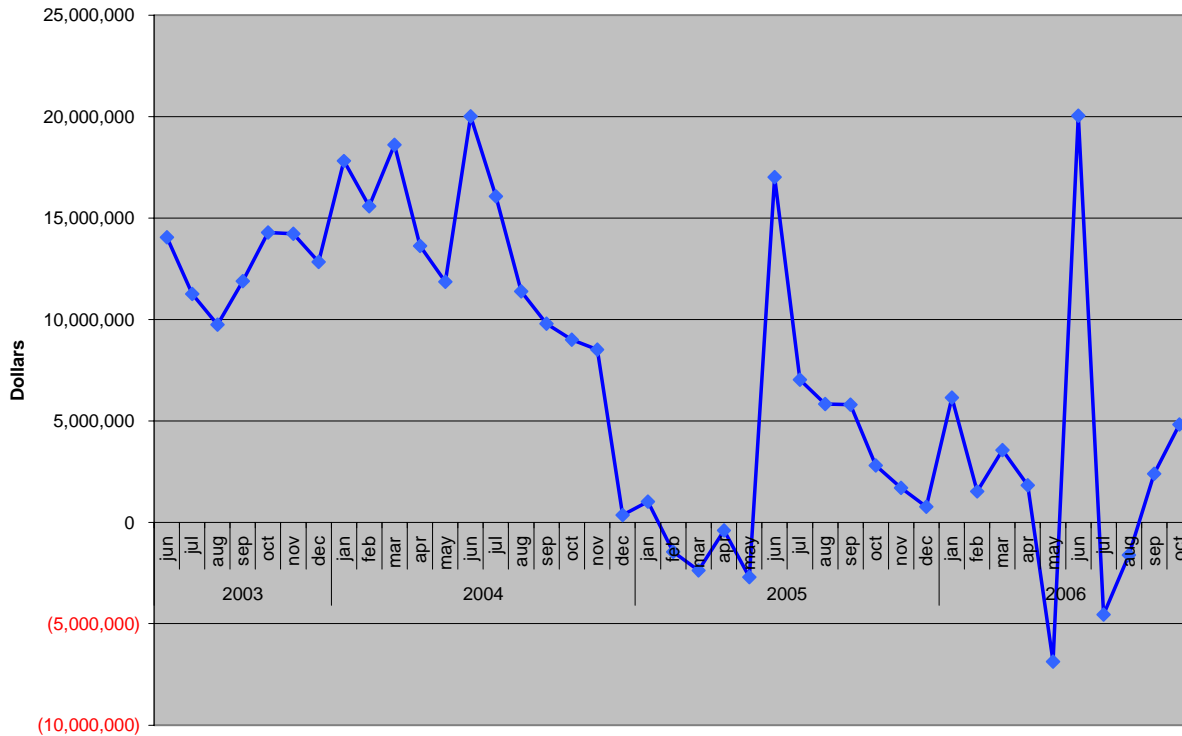
- The agreement with NG specifies a \$236M upper limit or cap on state spending. While the absolute floor is, according to the agreement, 20% below this amount, reduced spending equals reduced services and would impede timely transformation. The diagram below summarizes the cap's components and how the funding will be employed.



Northrop Grumman has made significant upfront investments in the partnership, and they seek to recover some of these through obtaining "milestone" payments from VITA in the first two years for reaching certain targets or events. Please see Appendix B for details on this year's milestone payments and the associated activities and costs.

- In accordance with guidance from JLARC, VITA's attempts during the past two years to secure additional funding for its needs have focused solely on increases to the internal service fund (ISF). Use of the ISF offers obvious benefits to the state re: limiting IT transformation's impact on the general fund, because costs are shared equitably across the customer base's funding sources, which include significant non-general funds. It is not viewed as equally advantageous, however, by customers, who face an increasing budget burden associated with IT support costs.
- As noted above, VITA has been plagued since its creation with cash flow difficulties due to almost complete reliance on the customer payments which comprise its ISF revenue. The graph below demonstrates this:

VITA - ISF Cash On-Hand (end of month)



- The relatively brief existence of the “transitioned organization” (i.e. VITA’s absorption of staff and other IT resources from about 90 executive agencies) makes it quite difficult to develop equitable rates proposals. VITA is dedicated to containing customers’ IT infrastructure costs within existing levels, but this has been easier said than done given the inadequate customer historical expenditure data that it can access.
- VITA recognizes that its management and administration costs, passed on to customers as overhead on top of direct service expense, represent an added funding burden. Accordingly, the agency has mounted considerable efforts to reduce the size and costs of the “retained organization” (the structure that remains state-operated and outside of NG’s responsibilities). About \$2.5M in cost reductions are being effected in FY 2007, with continued attention to identifying additional internal savings opportunities this year and in the future.
- The ISF financial statement for FY 2006 is provided in Appendix C.

#### 4. Potential Customer Concerns

- Some customers would pay less and some would pay more under the proposed rates. This would create immediate concern for those whose VITA charges increase. The state has already demonstrated a commitment to provide general fund assistance where applicable (part of Central Appropriations adjustments in Chapter 3 of the Appropriation Act), but agencies that rely heavily or wholly on non-general funds have legitimate worries about their inability to budget/pay for any cost growth in IT services.

- Issues for agencies with significant federal funding include: (1) rate increases this year are out-of-cycle for immediately requesting more federal dollars; and (2) even if they could, federal grantors might not give agencies more now, where existing spending plans already reach the maximum of the authorized grant administrative cost cap. Other agencies that depend on special fund revenues may maintain that they may have to raise rates to their customers to cover IT cost increases—an administrative process that can be lengthy and requires stakeholder buy-in.
- Customers paying more for IT will expect—rightfully so—to see immediate service improvements (indeed, these improvements are the IT partnership’s underlying premise). Positive changes in service levels to customers will have to occur quickly; and if they don’t, customers may assert that their services are being cut if they believe they are getting the same, or less, for more money. VITA and NG will have to proactively address this concern through demonstrable progress.

## **Rates Proposal Details**

### ***1. Decentralized Remote Services***

This proposal requests the implementation of rates for decentralized remote services. These services are comprised of the hardware, software and personnel costs associated with supporting the infrastructure devices located at agency locations statewide. Supported device types fall in the categories of personal computing (desktop), servers, network equipment and shared local area networks (LANs). Based on more than a year of historical spending data by each agency and analysis of more than 80,000 assets now recorded in the inventory system, VITA has developed a new chargeback methodology to replace the MOU process. With this rates submission, VITA proposes implementing standard rates for the various categories of decentralized services VITA provides. The metric used as the basis for charging is the asset (device) to which service is provided.

Expenses recovered by these rates include the cost of hardware, annual maintenance of hardware, cost of software, annual license fees for software, direct staff support and allowable indirect expenses as indicated in the cost allocation spreadsheet shown in the section below on Cost Allocation Methodology Details. Additionally, statewide IT security management expenses, currently being charged separately on a standard cost per desktop basis (approved by JLARC on December 12, 2005), are incorporated in this proposal. At the end of the various assets’ life cycles, VITA, through NG, would also be responsible for purchasing replacement equipment in accordance with established standards. Flat monthly rates are proposed to recover both the operational and capital costs.

### **Decentralized Remote Services Algorithm**

Client quantity of desktops X Desktop Rate

Client quantity of laptops X Laptop Rate

Client quantity of Windows tier 1 servers X Windows Tier 1 server Rate

Client quantity of Windows tier 2 servers X Windows Tier 2 server Rate

Client quantity of Windows tier 3 servers X Windows Tier 3 server Rate

Client quantity of Windows tier 4 servers X Windows Tier 4 server Rate

Client quantity of Windows tier 5 servers X Windows Tier 5 server Rate

Client quantity of Unix tier 1 servers X Unix Tier 1 server Rate

Client quantity of Unix tier 2 servers X Unix Tier 2 server Rate

Client quantity of Unix tier 3 servers X Unix Tier 3 server Rate

Client quantity of Unix tier 4 servers X Unix Tier 4 server Rate

Client quantity of Unix tier 5 servers X Unix Tier 5 server Rate

Client quantity of tier 1 Shared LAN Devices X Tier 1 LAN Rate

Client quantity of tier 2 Shared LAN Devices X Tier 2 LAN Rate

Client quantity of tier 3 Shared LAN Devices X Tier 3 LAN Rate

Client quantity of Network connected devices X Network Access Rate

## ***2. Cost Allocation Methodology Details***

With this rates proposal, VITA is providing detailed information regarding all allowable expenses, both direct and indirect, that are necessary to provide the full range of services offered to its customers. A condensed version of the cost allocation methodology is provided on the following pages. Due to the size and complexity of the allocations, an electronic version depicting in detail all expense items and allocation methods can also be provided, should JLARC staff so request.

**SUMMARY OF PROJECTED DIRECT AND INDIRECT COSTS, ALLOCATIONS, AND RATES  
FISCAL YEAR 2007**

	Personal Services	Contractual	Assets	Transfer Payments	All Other	Total	See Detail Allocations Disk			Total Expenses
							Allocate Indirect Expenses Summary	Allocate Milestones Summary	Allocate to Services Summary	
<b>***Does Not Include Unallowable Expenses***</b>										
<b>Indirect Costs by Administrative Directorate</b>										
Chief Information Officer	\$1,140,734	\$384,512	\$30,555	\$0	\$8,450	\$1,564,251	(\$1,564,251)	\$0	\$0	\$0
Business Development	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Customer Relations Management	\$810,951	\$2,400	\$2,100	\$0	\$300	\$815,751	(\$815,751)	\$0	\$0	\$0
Service Management Organization	\$2,826,672	\$2,432,831	\$0	\$0	\$13,750	\$5,273,253	(\$5,273,253)	\$0	\$0	\$0
Technology, Strategy and Solutions	\$3,019,427	\$3,107,162	\$219,590	\$0	\$7,540	\$6,353,719	(\$6,353,719)	\$0	\$0	\$0
Audit	\$378,266	\$35,975	\$10,000	\$0	\$1,850	\$426,091	(\$426,091)	\$0	\$0	\$0
Administration and Finance	\$4,123,537	\$1,616,889	\$182,545	\$2,500	\$2,576,622	\$8,502,093	(\$8,502,093)	\$0	\$0	\$0
Enterprise Security and Risk Management	\$1,944,405	\$1,052,370	\$83,375	\$0	\$20,180	\$3,100,330	(\$3,100,330)	\$0	\$0	\$0
	<u>\$14,243,992</u>	<u>\$8,632,139</u>	<u>\$528,165</u>	<u>\$2,500</u>	<u>\$2,628,692</u>	<u>\$26,035,488</u>	<u>(\$26,035,488)</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<b>***Does Not Include Unallowable Expenses***</b>										
<b>Charges for Milestone Payments</b>										
Mgmt. & Admin. Prep for Service Commencement	\$0	\$2,736,937	\$0	\$0	\$0	\$2,736,937	\$0	(\$2,736,937)	\$0	\$0
Data Center Service Commencement	\$0	\$4,390,527	\$0	\$0	\$0	\$4,390,527	\$0	(\$4,390,527)	\$0	\$0
Desktop Service Commencement	\$0	\$2,794,066	\$0	\$0	\$0	\$2,794,066	\$0	(\$2,794,066)	\$0	\$0
Messaging (email) Service Commencement	\$0	\$3,948,306	\$0	\$0	\$0	\$3,948,306	\$0	(\$3,948,306)	\$0	\$0
Data Network Service Commencement	\$0	\$1,665,188	\$0	\$0	\$0	\$1,665,188	\$0	(\$1,665,188)	\$0	\$0
Voice Service Commencement	\$0	\$182,864	\$0	\$0	\$0	\$182,864	\$0	(\$182,864)	\$0	\$0
Security Service Commencement	\$0	\$817,689	\$0	\$0	\$0	\$817,689	\$0	(\$817,689)	\$0	\$0
Help Desk Service Commencement	\$0	\$916,865	\$0	\$0	\$0	\$916,865	\$0	(\$916,865)	\$0	\$0
Chargeback Service Commencement	\$0	\$206,434	\$0	\$0	\$0	\$206,434	\$0	(\$206,434)	\$0	\$0
Mgmt. and Admin. Procedures Manual	\$0	\$2,736,937	\$0	\$0	\$0	\$2,736,937	\$0	(\$2,736,937)	\$0	\$0
Infrastructure Operation Center	\$0	\$8,781,052	\$0	\$0	\$0	\$8,781,052	\$0	(\$8,781,052)	\$0	\$0
VITA Data Center Server Consolidation	\$0	\$3,292,895	\$0	\$0	\$0	\$3,292,895	\$0	(\$3,292,895)	\$0	\$0
Desktop and Asset Mgmt System Development	\$0	\$1,397,033	\$0	\$0	\$0	\$1,397,033	\$0	(\$1,397,033)	\$0	\$0
Desktop Refresh Preparation and First Quarter	\$0	\$6,985,165	\$0	\$0	\$0	\$6,985,165	\$0	(\$6,985,165)	\$0	\$0
Messaging Single Agency Address List	\$0	\$3,948,306	\$0	\$0	\$0	\$3,948,306	\$0	(\$3,948,306)	\$0	\$0
Data Network -Temporary NOC Established	\$0	\$4,995,564	\$0	\$0	\$0	\$4,995,564	\$0	(\$4,995,564)	\$0	\$0
Data Network Architecture Network Blueprint	\$0	\$832,594	\$0	\$0	\$0	\$832,594	\$0	(\$832,594)	\$0	\$0
Interim Security Incident Tracking	\$0	\$817,689	\$0	\$0	\$0	\$817,689	\$0	(\$817,689)	\$0	\$0
Incident Security Mgmt. System WEB Access	\$0	\$916,865	\$0	\$0	\$0	\$916,865	\$0	(\$916,865)	\$0	\$0
Chargeback Process and Procedures	\$0	\$103,217	\$0	\$0	\$0	\$103,217	\$0	(\$103,217)	\$0	\$0
Chargeback Migrate Projects	\$0	\$103,217	\$0	\$0	\$0	\$103,217	\$0	(\$103,217)	\$0	\$0
Complete Internal Apps Transformation	\$0	\$472,609	\$0	\$0	\$0	\$472,609	\$0	(\$472,609)	\$0	\$0
	<u>\$0</u>	<u>\$53,042,019</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$53,042,019</u>	<u>\$0</u>	<u>(\$53,042,019)</u>	<u>\$0</u>	<u>\$0</u>

**SUMMARY OF PROJECTED DIRECT AND INDIRECT COSTS, ALLOCATIONS, AND RATES**

FISCAL YEAR 2007

	Personal Services	Contractual	Assets	Transfer Payments	All Other	Total	See Detail Allocations Disk			Total Expenses
							Allocate Indirect Expenses Summary	Allocate Milestones Summary	Allocate to Services Summary	
<i>***Does Not Include Unallowable Expenses***</i>										
<i>Shared Direct plus Allocations from Indirect</i>										
10 IBM SHARED	\$1,382,973	\$1,165,336	\$313,254	\$0	\$2,201,803	\$5,063,366	\$0	\$0	(\$5,063,366)	\$0
20 UNISYS SHARED	\$1,037,829	\$287,969	\$21,522	\$0	\$5,539	\$1,352,859	\$0	\$0	(\$1,352,859)	\$0
30 CSB DIV OVERHEAD	\$1,878,110	\$3,627,572	\$983,001	\$0	\$3,643,313	\$10,131,996	\$4,268,869	\$19,810,271	(\$34,211,136)	\$0
40 DESTOP AND END USER OVERHEAD	\$0	\$0	\$0	\$0	\$0	\$0	\$16,821,221	\$9,881,028	(\$26,702,249)	\$0
600 BILLABLE SYSTEMS	\$0	\$0	\$0	\$0	\$0	\$0	\$391,303	\$69,982	(\$461,285)	\$0
50000 TELECOM DIV OVERHEAD	\$429,282	\$245,976	\$130,926	\$0	\$436,426	\$1,242,610	\$710,296	\$2,078,169	(\$4,031,075)	\$0
50080 Network Data Services overhead	\$0	\$0	\$0	\$0	\$0	\$0	\$1,558,355	\$1,786,539	(\$3,344,894)	\$0
50070 Voice Services overhead	\$0	\$0	\$0	\$0	\$0	\$0	\$1,602,576	\$1,723,739	(\$3,326,315)	\$0
50060 Video Services Overhead	\$0	\$0	\$0	\$0	\$0	\$0	\$38,866	\$9,741	(\$48,607)	\$0
50040 UNIX-NT INTERNET SU	\$66,348	\$59,800	\$0	\$0	\$0	\$126,148	\$25,459	\$6,707	(\$158,314)	\$0
	<u>\$4,794,542</u>	<u>\$5,386,653</u>	<u>\$1,448,703</u>	<u>\$0</u>	<u>\$6,287,081</u>	<u>\$17,916,979</u>	<u>\$25,416,944</u>	<u>\$35,366,176</u>	<u>(\$78,700,099)</u>	<u>\$0</u>

*\*\*\*Does Not Include Unallowable Expenses\*\*\**

*Direct Plus Allocations from Service Areas to Services*

Data Center (82005)

01 IBM-CPU SERVICE	\$1,041,715	\$884,984	\$328,094	\$0	\$984,647	\$3,239,440	\$0	\$0	\$10,877,635	\$14,117,075
03 IBM-REMOTE PRINT	\$23,455	\$13,688	\$0	\$0	\$3,758	\$40,901	\$0	\$0	\$137,340	\$178,241
04 IBM-TAPE USAGE	\$12,653	\$313,877	\$306,178	\$0	\$21,950	\$654,658	\$0	\$0	\$2,198,260	\$2,852,918
05 IBM-TAPE STORAGE	\$55,359	\$298,877	\$70,798	\$0	\$32,288	\$457,322	\$0	\$0	\$1,535,630	\$1,992,952
06 IBM-DISK STORAGE	\$219,455	\$130,037	\$67,838	\$0	\$0	\$417,330	\$0	\$0	\$1,401,342	\$1,818,672
07 IBM-ON-LINE TRANS	\$817,088	\$187,367	\$4,342	\$0	\$364,143	\$1,372,940	\$0	\$0	\$4,610,161	\$5,983,101
11 UNISYS-CPU SERVICE	\$138,337	\$860,430	\$2,434,232	\$0	\$144,329	\$3,577,328	\$0	\$0	\$10,202,797	\$13,780,125
13 UNISYS-REMOTE PRINT	\$0	\$0	\$5,000	\$0	\$0	\$5,000	\$0	\$0	\$14,260	\$19,260
14 UNISYS-TAPE USAGE	\$101,636	\$42,078	\$16,777	\$0	\$0	\$160,491	\$0	\$0	\$457,732	\$618,223
15 UNISYS-TAPE STORAGE	\$11,792	\$51,827	\$6,837	\$0	\$42,650	\$113,106	\$0	\$0	\$322,586	\$435,692
16 UNISYS-DISK STORAGE	\$215,997	(\$48,689)	\$8,377	\$0	\$0	\$175,685	\$0	\$0	\$501,066	\$676,751
17 UNISYS-ON-LINE TRANS	\$262,229	\$16,743	\$9,328	\$0	\$0	\$288,300	\$0	\$0	\$822,252	\$1,110,552
18 TAPE VAULTING	\$19,289	\$24,984	\$0	\$0	\$0	\$44,273	\$0	\$0	\$112,405	\$156,678
99 DEDICATED PASSTHROUGH	\$0	\$0	\$1,500,000	\$0	\$0	\$1,500,000	\$241,436	\$0	\$0	\$1,741,436
21 TAPE STORAGE-SERVER	\$66,123	\$44,076	\$26,431	\$0	\$0	\$136,630	\$0	\$0	\$346,890	\$483,520
22 OTHER-LOCAL PRINT	\$136,208	\$226,732	\$25,895	\$0	\$72,269	\$461,104	\$0	\$0	\$1,170,699	\$1,631,803
23 UNIX	\$978,106	\$678,770	\$83,022	\$0	\$10,500	\$1,750,398	\$0	\$0	\$4,444,092	\$6,194,490
26 EBARS	\$98,947	\$234,309	\$236,570	\$0	\$0	\$569,826	\$0	\$0	\$1,446,733	\$2,016,559
28 DISK STORAGE-SERVER	\$0	\$0	\$10,036	\$0	\$0	\$10,036	\$0	\$0	\$25,480	\$35,516
	<u>\$4,198,389</u>	<u>\$3,960,090</u>	<u>\$5,139,755</u>	<u>\$0</u>	<u>\$1,676,534</u>	<u>\$14,974,768</u>	<u>\$241,436</u>	<u>\$0</u>	<u>\$40,627,361</u>	<u>\$55,843,566</u>

**SUMMARY OF PROJECTED DIRECT AND INDIRECT COSTS, ALLOCATIONS, AND RATES**

FISCAL YEAR 2007

	Personal Services	Contractual	Assets	Transfer Payments	All Other	Total	See Detail Allocations Disk			Total Expenses
							Allocate Indirect Expenses Summary	Allocate Milestones Summary	Allocate to Services Summary	
XX1 Desktop	\$14,391,694	\$9,603,800	\$6,027,973	\$0	\$6,869,369	\$36,892,836	\$0	\$17,675,843	\$13,010,177	\$67,578,856
XX2 Server	\$9,556,288	\$5,851,336	\$9,200,118	\$0	\$521,989	\$25,129,731	\$0	\$0	\$5,991,390	\$31,121,121
XX3 Shared LAN	\$1,735,016	\$853,769	\$1,707,537	\$0	\$144,094	\$4,440,416	\$0	\$0	\$1,058,677	\$5,499,093
XX4 Network	\$8,403,268	\$3,694,459	\$8,176,806	\$0	\$324,197	\$20,598,730	\$0	\$0	\$4,911,116	\$25,509,846
61 Remote Infrastructure Time and Materials	\$400,000	\$0	\$0	\$0	\$100,000	\$500,000	\$0	\$0	\$119,209	\$619,209
62 Dedicated Mainframe Ops Time and Mate	\$2,252,644	\$0	\$0	\$0	\$0	\$2,252,644	\$0	\$0	\$537,072	\$2,789,716
63 Dedicated Pass Through	\$1,476,412	\$2,124,673	\$906,149	\$0	\$0	\$4,507,234	\$0	\$0	\$1,074,608	\$5,581,842
	<u>\$38,215,322</u>	<u>\$22,128,037</u>	<u>\$26,018,583</u>	<u>\$0</u>	<u>\$7,959,649</u>	<u>\$94,321,591</u>	<u>\$0</u>	<u>\$17,675,843</u>	<u>\$26,702,249</u>	<u>\$138,699,683</u>
Billable Services Out of Scope (82007)										
60 IT SERVICE GROUP G	\$375,111	\$9,000	\$0	\$0	\$0	\$384,111	\$0	\$0	\$134,613	\$518,724
85000 ITIM	\$686,847	\$151,677	\$570	\$0	\$570	\$839,664	\$0	\$0	\$294,263	\$1,133,927
35230 TELECON-OTHER	\$65,927	\$12,429	\$12,022	\$0	\$2,100	\$92,478	\$0	\$0	\$32,409	\$124,887
	<u>\$1,127,885</u>	<u>\$173,106</u>	<u>\$12,592</u>	<u>\$0</u>	<u>\$2,670</u>	<u>\$1,316,253</u>	<u>\$0</u>	<u>\$0</u>	<u>\$461,285</u>	<u>\$1,777,538</u>
Network-Data Services (82201)										
73000 PRIVATE CIRCUITS	\$71,223	\$8,216,321	\$0	\$0	\$0	\$8,287,544	\$0	\$0	\$1,671,582	\$9,959,126
78000 DIT VAN ACCESS	\$5,246	\$195,780	\$0	\$0	\$0	\$201,026	\$0	\$0	\$40,547	\$241,573
81000 ROUTER SERVICES	\$530,658	\$1,333,298	\$787,225	\$0	\$0	\$2,651,181	\$0	\$0	\$517,561	\$3,168,742
82000 DIAL-UP ROUTER SVCS	\$18,139	\$25,489	\$0	\$0	\$0	\$43,628	\$0	\$0	\$8,517	\$52,145
83000 COVANET FRAME RELAY	\$58,804	\$15,887,518	\$0	\$0	\$0	\$15,946,322	\$0	\$0	\$3,216,342	\$19,162,664
84000 INTERNET & WEB SVCS	\$0	\$21,540	\$12,515	\$0	\$0	\$34,055	\$0	\$0	\$6,648	\$40,703
	<u>\$684,070</u>	<u>\$25,679,946</u>	<u>\$799,740</u>	<u>\$0</u>	<u>\$0</u>	<u>\$27,163,756</u>	<u>\$0</u>	<u>\$0</u>	<u>\$5,461,197</u>	<u>\$32,624,953</u>
Voice Services (82203)										
31100 CELLULAR SERVICE	\$0	\$6,328,408	\$0	\$0	\$0	\$6,328,408	\$0	\$0	\$1,192,765	\$7,521,173
32000 LOCAL SERVICE	\$221,053	\$12,945,559	\$0	\$0	\$0	\$13,166,612	\$0	\$0	\$2,481,616	\$15,648,228
36000 OTHER CHARGES/CREDIT	\$35,320	\$842,158	\$0	\$0	\$0	\$877,478	\$0	\$0	\$165,385	\$1,042,863
37000 VERIZON SVC ORDER	\$37,779	\$0	\$0	\$0	\$0	\$37,779	\$0	\$0	\$7,121	\$44,900
49000 UNIVERSAL SVCE FEE	\$0	\$404,138	\$0	\$0	\$0	\$404,138	\$0	\$0	\$0	\$404,138
71000 LONG DISTANCE SERVI	\$158,816	\$7,921,372	\$0	\$0	\$0	\$8,080,188	\$0	\$0	\$1,522,937	\$9,603,125
72000 SHARED VOICE ACCESS	\$68,674	\$18,187	\$0	\$0	\$0	\$86,861	\$0	\$0	\$16,371	\$103,232
	<u>\$521,642</u>	<u>\$28,459,822</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$28,981,464</u>	<u>\$0</u>	<u>\$0</u>	<u>\$5,386,195</u>	<u>\$34,367,659</u>

**SUMMARY OF PROJECTED DIRECT AND INDIRECT COSTS, ALLOCATIONS, AND RATES**

FISCAL YEAR 2007

	Personal Services	Contractual	Assets	Transfer Payments	All Other	Total	See Detail Allocations Disk			Total Expenses
							Allocate Indirect Expenses Summary	Allocate Milestones Summary	Allocate to Services Summary	
Video Services (82204)										
35330 AUDIO-RING DOWN NTWK	\$11,243	\$8,234	\$0	\$0	\$0	\$19,477	\$0	\$0	\$6,571	\$26,048
35340 AUDIO TELECONFERENCI	\$60,348	\$20,338	\$35,830	\$0	\$747	\$117,263	\$0	\$0	\$39,563	\$156,826
35410 VIDEO-ORIGINATING	\$11,282	\$15,000	\$0	\$0	\$0	\$26,282	\$0	\$0	\$8,867	\$35,149
35420 VIDEO-RECEIVING	\$11,243	\$0	\$0	\$0	\$153	\$11,396	\$0	\$0	\$3,845	\$15,241
35600 ANALOG/AD HOC SATELL	\$8,795	\$0	\$0	\$0	\$0	\$8,795	\$0	\$0	\$2,967	\$11,762
	<u>\$102,911</u>	<u>\$43,572</u>	<u>\$35,830</u>	<u>\$0</u>	<u>\$900</u>	<u>\$183,213</u>	<u>\$0</u>	<u>\$0</u>	<u>\$61,813</u>	<u>\$245,026</u>
<b>*** Includes Unallowable Expenses***</b>										
<b>All Other Funds</b>										
General	\$1,871,419	\$4,049,376	\$2,000	\$0	\$98,851	\$6,021,646	\$79,293	\$0	\$0	\$6,100,939
Special *	\$3,173,122	\$935,341	\$10,906	\$0	\$111,595	\$4,230,964	\$20,520	\$0	\$0	\$4,251,484
Enterprise	\$499,072	\$10,340,587	\$3,750	\$37,556,902	\$59,363	\$48,459,674	\$277,294	\$0	\$0	\$48,736,968
Federal Grants	\$0	\$398,786	\$0	\$0	\$0	\$398,786	\$0	\$0	\$0	\$398,786
	<u>\$5,543,613</u>	<u>\$15,724,090</u>	<u>\$16,656</u>	<u>\$37,556,902</u>	<u>\$269,809</u>	<u>\$59,111,070</u>	<u>\$377,107</u>	<u>\$0</u>	<u>\$0</u>	<u>\$59,488,177</u>
<b>Grand Total</b>	<u>\$69,432,366</u>	<u>\$163,229,474</u>	<u>\$34,000,024</u>	<u>\$37,559,402</u>	<u>\$18,825,335</u>	<u>\$323,046,601</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$323,046,601</u>

* Unallowable expenses are recognized in the Special Fund. The Internal Service Fund billing rates do not include unallowable expenses. The following is a list of unallowable expenses funded through the	
Portions of cost center 721 Communications Management	\$120,902
All of cost center 735 Service Outreach Division	\$268,120
Portionns of 763 Web Development services	\$115,871
Entire VITA 3.0 unbilled support to cost center 381 Governor's Office	\$109,745
Portions of cost center 789 Supply Change Management	\$1,513,304
Portions of cost center 791 Facilities management	\$102,095
<b>Total projected unallowable expense recovered by the Special Fund</b>	<u><u>\$2,230,037</u></u>

**SUMMARY OF PROJECTED DIRECT AND INDIRECT COSTS, ALLOCATIONS, AND RATES**

**FISCAL YEAR 2007**

<b>Service</b>	<b>Service Unit</b>	<b>Service Forecast</b>	<b>Breakeven Rate</b>
01 IBM-CPU SERVICE	Per CPU Second	7,018,480,473	\$0.00201
03 IBM-REMOTE PRINT	Per 1000 Lines	2,744,429	\$0.06
04 IBM-TAPE USAGE	Per Second	58,850,385	\$0.048
05 IBM-TAPE STORAGE	Per Megabyte/Month	1,247,887,634	\$0.001597
06 IBM-DISK STORAGE	Per Megabyte/Month	19,166,938	\$0.09
07 IBM-ON-LINE TRANS	Per 1000 Transactions	819,010	\$7.31
11 UNISYS-CPU SERVICE	Per CPU Second	1,997,541,355	\$0.0069
13 UNISYS-REMOTE PRINT	Per 1000 Lines	94,863	\$0.20
14 UNISYS-TAPE USAGE	Per Second	28,414,817	\$0.022
15 UNISYS-TAPE STORAGE	Per Megabyte/Month	161,231,089	\$0.00270
16 UNISYS-DISK STORAGE	Per Megabyte/Month	2,114,450	\$0.32
17 UNISYS-ON-LINE TRANS	Per 1000 Transactions	551,221	\$2.01
18 TAPE VAULTING	Per Megabyte/Month	616,920,000	\$0.0003
99 DEDICATED PASSTHROUGH	Pass Through	\$1,500,000	16.1%
21 TAPE STORAGE-SERVER	Per Megabyte/Month	1,404,440,000	\$0.0003
22 OTHER-LOCAL PRINT	Per 1000 Lines	169,411	\$9.63
23 UNIX	Based on service levels described in Memorandum of Agreement		
26 EBARS	Per Megabyte/Month	1,128,605,769	\$0.00179
28 DISK STORAGE-SERVER	Per Megabyte/Month	200,000,000	\$0.0002
XX1 Desktop	Device Count	See "rate calcs" sheet	
XX2 Server	Device Count	See "rate calcs" sheet	
XX3 Shared LAN	Device Count	See "rate calcs" sheet	
XX4 Network	Device Count	See "rate calcs" sheet	
61 Remote Infrastructure Time and Materials	Hourly Rate	9,500	\$65.18
62 Dedicated Mainframe Ops Time and Materials	Hourly Rate	55,000	\$50.72
63 Dedicated Pass Through	Vendor Charge	\$4,507,234	23.8%
60 IT SERVICE GROUP G	Per Hour (varies)	6,957	\$74.57
85000 ITIM	Hours	15,000	\$75.60
35230 TELECON-OTHER	Miscellaneous Per Unit	1,357	\$92.01
73000 PRIVATE CIRCUITS	Vendor Charge	\$8,791,463	11.7%
78000 DIT VAN ACCESS	Per Circuit/Speed	3,000	\$80.52
81000 ROUTER SERVICES	Per Port/Speed	3,950	\$802.21
82000 DIAL-UP ROUTER SVCS	Per Port	1,013	\$51.48
83000 COVANET FRAME RELAY	Vendor Charge	\$16,999,644	11.3%
84000 INTERNET & WEB SVCS	Per Month	35,354	\$1.15
31100 CELLULAR SERVICE	Vendor Charge	\$7,277,669	3.3%
32000 LOCAL SERVICE	Vendor Charge	\$14,240,115	9.0%
36000 OTHER CHARGES/CREDIT	Vendor Charge	\$842,158	23.8%
37000 VERIZON SVC ORDER	Per Order	4,278	\$10.50
49000 UNIVERSAL SVCE FEE	Pass Through	\$404,138	0.0%
71000 LONG DISTANCE SERVI	Vendor Charge	\$8,713,509	9.3%
72000 SHARED VOICE ACCESS	Per Minute	38,588,000	\$0.003
35330 AUDIO-RING DOWN NTWK	Per Minute	13,077,300	\$0.002
35340 AUDIO TELECONFERENCI	Per Minute	66,035,800	\$0.002
35410 VIDEO-ORIGINATING	Per Hour	14	\$2,510.65
35420 VIDEO-RECEIVING	Per Hour	12	\$1,270.07
35600 ANALOG/AD HOC SATELL	Vendor Charge	\$4,148	283.6%

### 3. Schedule of Proposed Rates

Proposed rates for desktop devices, servers, shared LAN, and networks are described in the tabular format shown directly below. Within each category, the rates options generally are full service, service excluding purchase, and service excluding direct labor. For servers and LAN devices, the wide range of purchase prices of the assets demanded further granularity. Accordingly there are several levels of rates within each service category, based on the purchase price of the asset.

#### Calculations of Proposed Rates Decentralized (Remote) Services *(All Rates Are Per-Month)*

Rate Calculation for PC's						
Target recovery amount (annual)					\$67,657,942	
Service Types	Desktops	Projected Quantity			Proposed Rates	
		Laptops	PDA's	Desktops	Laptops	PDA's
<b>Desktops</b>						
full service	47,714	11,322	2,169	\$86.90	\$121.99	\$12.88
Excluding purchase (allowing for one-time spending)	530	269	1	\$66.94	\$85.33	\$8.34
Excluding direct labor (allowing for T&M support)	440	90	1	\$42.35	\$62.59	\$4.54

Rate Calculation for Servers						
Target recovery amount (annual)					\$31,157,542	
Service Types	Projected Quantity		Proposed Rates		Projected Annual Revenue	
	Windows	Unix	Windows	Unix	Windows	Unix
<b>full service</b>						
< \$2K	154	42	\$704	\$854	\$1,301,714	\$430,583
\$2K-\$5K	882	321	\$704	\$854	\$7,455,271	\$3,290,882
\$5K-\$10K	692	75	\$940	\$1,184	\$7,809,671	\$1,065,367
\$10K-\$20K	191	49	\$1,311	\$1,648	\$3,005,502	\$968,966
\$20K-\$35K	61	32	\$1,866	\$2,305	\$1,365,664	\$884,952
\$35K-\$60K	23	11	\$2,709	\$3,250	\$747,621	\$428,996
>\$60K	12	8	\$2,709	\$3,250	\$390,063	\$311,997
					\$20,773,793	\$6,951,160
<b>excluding purchase price</b>						
< \$2K	12	9	\$641	\$791	\$92,285	\$85,407
\$2K-\$5K	30	17	\$641	\$791	\$230,712	\$161,324

\$5K-\$10K	27	19	\$804	\$1,048	\$260,608	\$238,856
\$10K-\$20K	21	14	\$1,039	\$1,376	\$261,841	\$231,109
\$20K-\$35K	15	11	\$1,367	\$1,805	\$245,977	\$238,318
\$35K-\$60K	7	6	\$1,847	\$2,388	\$155,118	\$171,925
>\$60K	3	2	\$1,847	\$2,388	\$66,479	\$57,308
					\$1,220,735	\$1,098,841

**excluding direct support (labor)**

< \$2K	1	1	\$291	\$338	\$3,490	\$4,058
\$2K-\$5K	11	7	\$291	\$338	\$38,390	\$28,407
\$5K-\$10K	7	5	\$487	\$539	\$40,888	\$32,313
\$10K-\$20K	3	3	\$817	\$874	\$29,428	\$31,452
\$20K-\$35K	2	2	\$1,332	\$1,147	\$31,960	\$27,526
\$35K-\$60K	2	2	\$2,135	\$2,218	\$51,231	\$53,224
>\$60K	2	3	\$2,135	\$2,218	\$51,231	\$79,836
					\$243,129	\$252,760

**excluding VITA central hosting services provided under MOA**

< \$2K	0	0	\$116	\$338	\$0	\$0
\$2K-\$5K	31	18	\$116	\$338	\$43,183	\$73,047
\$5K-\$10K	16	9	\$487	\$539	\$93,459	\$58,164
\$10-\$20K	7	4	\$817	\$874	\$68,666	\$41,936
\$20-\$35K	4	3	\$1,332	\$1,147	\$63,920	\$41,290
\$35-\$60K	1	1	\$2,135	\$2,218	\$25,616	\$26,612
>\$60K	2	1	\$2,135	\$2,218	\$51,231	\$26,612
					\$346,075	\$267,661

**\$31,154,153**

Rate Calculation for Shared LAN Devices			
dollar ranges based on purchase price	Target recovery amount (annual)		\$5,505,528
Service Types	Projected Quantity	Proposed Rates	Projected Annual Revenue

**LAN attached (LAN capable) printers, plotters, scanners, etc**

full service			
< \$500	680	\$47.85	\$390,456
\$500-\$1,500	1,382	\$47.85	\$793,544
\$1,500-\$3K	1,702	\$103.95	\$2,123,075
\$3K-\$6K	521	\$193.05	\$1,206,949
\$6K-\$10K	210	\$323.40	\$814,968
> \$10K	34	\$323.40	\$131,947

Excluding purchase (allowing for one-time spending)

< \$500	1	\$29.70	\$356
\$500-\$1,500	1	\$29.70	\$356
\$1,500-\$3K	1	\$63.11	\$757
\$3K-\$6K	1	\$111.38	\$1,337

\$6K-\$10K	1	\$178.20	\$2,138
> \$10K	1	\$178.20	\$2,138

Excluding direct labor (allowing for T&M support)

< \$500	1	\$33.00	\$396
\$500-\$1,500	60	\$33.00	\$23,760
\$1,500-\$3K	6	\$74.25	\$5,346
\$3K-\$6K	1	\$148.50	\$1,782
\$6K-\$10K	1	\$264.00	\$3,168
> \$10K	1	\$264.00	\$3,168

3,924 **\$5,505,642**

<b>Rate Calculation for Network expenses</b>			
<b>Target recovery amount (annual)</b>			<b>\$25,539,700</b>
<b>Service Types</b>	<b>Projected Quantity all devices</b>	<b>Proposed Rates all devices</b>	<b>Projected Annual Revenue all devices</b>

**Network attached devices, servers, enterprise devices, LAN devices, PC's**

Applicable devices include all the above plus network devices (routers, switches, etc) and enterprise devices (disk, tape, backup equipment)

full service	75,548	\$28.00	\$25,384,128
excluding labor	649	\$20.00	\$155,760
			<b>\$25,539,888</b>

Network expenses recovered by a Network access charge applied to all devices attached to a VITA supported network including the network devices themselves

#### ***4. Reconciliation of Variances Between Revenues and Expenses***

VITA monitors costs incurred by service with actual billings by service on a monthly basis to evaluate the effectiveness of published rates, and to identify any rate adjustments that may be required to correct actual or projected over/under recoveries. Rate adjustments may be made on an annual or more frequent basis as the analysis indicates. Rate adjustments, as with new rates, require JLARC's formal approval.

Following the end of the fiscal year, VITA will conduct a reconciliation of actual expense to actual revenue using the same cost allocation methodology as that which was presented above in the Cost Allocation Methodology Details section. For each service, estimated expenses will be replaced with actual expenses and reconciled with actual revenue to determine the extent of over or under recovery. The results of this reconciliation for the preceding year will be submitted to the DCA as a part of VITA's Cost Allocation Plan submission for the upcoming year. The reconciliation will also be submitted to the Virginia Department of Accounts for inclusion in the Statewide Indirect Cost Allocation Plan (SICAP) under "Section 2 – Billed Central Services".

In recent years, any over-recoveries by VITA have been treated as profits in the Statewide Indirect Cost Allocation Plan. The reconciliation of the statewide plan has served as the means by which the federal share of VITA over-recoveries has been returned. VITA has proposed to DCA continuing this method of returning the federal share of over-recoveries.

#### ***5. Projected Impact of Rates on Customers***

The amounts paid by VITA's customers under the extant MOU chargeback methodology are derived from (1) their respective FY 2006 actual expenditures under direct bill, and (2) in some cases, agency spending plans for FY 2007 submitted in response to a VITA request. As such, each agency's MOU charge relates directly to its unique IT services (labor used, equipment purchased/maintained/operated, etc.) environment.

Implementation of statewide rates will impose greater uniformity and consistency. VITA has attempted to mitigate the impact of standardized rates on its customers by offering a number of options in each service category. Nonetheless, some agencies will be "outliers"; i.e. their approach to IT service provision – which VITA essentially inherited upon transition – is either considerably above or below the norms established in the proposed rates.

In every case agencies will experience, relative to MOU charges, either cost savings or cost increases in their decentralized remote IT bills as a consequence of the proposed rate structure. Some are insignificant and can be readily accommodated within an agency's resource base, while others will tax an agency's ability to pay VITA, given their higher-priority mission spending requirements. The Issues section, above, discusses the potential implications and solutions in detail.

A chart, to be sent under separate cover, depicts the projected cost impact on each customer agency. It uses the current asset inventory, with the assets distributed into the pertinent rates pools (i.e. personal computing (desktops), servers, and networks) and subdivided within these categories by level of service based on purchase price (see Schedule of Current Rates, above, for details). The rate for a given pool is applied to determine the rate pool charges per agency. An agency's totals for all pools are used to determine its monthly charges. These new projected charges are compared to total current charges (MOU 1 for labor; and MOU 2 for the May 2005 through April 2006 spend by agency to assess annual agency spending for goods and services) to gauge the projected impact.

## ALLOCATION OF MILESTONE PAYMENTS MADE TO NORTHROP GRUMMAN

<b>Milestone Title/Components</b>	<b>Date</b>	<b>Amount in \$</b>	<b>Milestone Description (Work Performed by NG)</b>	<b>Milestone Allocation Basis</b>
<b><i>Account Management &amp; Administration Transition</i></b>				
Service Commencement	SCD + 0 Months <i>SCD = July 1, 2006</i>	2,736,937	Worked with VITA on: chart of accounts, invoice format, bill process, VITA billing elements, reconciliation process, transfer of assets, transfer of contracts, transition schedule	allocated across all service areas based on direct expenses
Procedures Manual (Critical)	SCD + 3 months	2,736,937	Worked with VITA on developing and implementing the joint operating processing and procedures manual	allocated across all service areas based on direct expenses
<b><i>Data Center (Mainframe/Server) Transition</i></b>				
Service Commencement	SCD + 0 months	4,390,527	Worked with VITA on: understanding current configuration of and preparing to assume responsibility for two mainframe computers, more than 200 servers and the associated hardware and software currently operational in the VITA central data center.	allocated to services provided out of the VITA data center (mainframe and server)
Infrastructure Operation Center (Interim) (Operational Implement HPOV at MCI for monitoring Server services)	SCD + 4 months	8,781,052	NG development and implementation of the HP OpenView infrastructure and associated support services, enabling initial server monitoring and management	allocated to services provided out of the VITA data center (mainframe and server)
Richmond Plaza Building Server consolidation in-place	SCD + 7 months	3,292,895	Consolidation of more than 200 existing servers in the Richmond Plaza Building (RPB) completed per approved plan. This activity will refresh the data center servers, and reduce risk when workloads are moved to the Commonwealth Enterprise Solutions Center (CESC).	allocated to VITA data center server services and network services
<b><i>Desktop Computing Transition</i></b>				
Service Commencement	SCD + 0 months	2,794,066	Worked with VITA on developing service, support, transition and equipment refresh plans for more than 60,000 PC's in 200+ locations across the Commonwealth.	allocated to desktop services

## ALLOCATION OF MILESTONE PAYMENTS MADE TO NORTHROP GRUMMAN

<b>Milestone Title/Components</b>	<b>Date</b>	<b>Amount in \$</b>	<b>Milestone Description (Work Performed by NG)</b>	<b>Milestone Allocation Basis</b>
Desktop and asset management system operational	SCD + 6 months	1,397,033	Complete the Altiris system installation, provide operational procedures, and train operations staff to support program requirements for desktop management and asset management	allocated to all services utilizing assets included in the inventory (decentralized services)
Begin desktop refresh (Critical)	SCD + 8 months	5,588,132	Establish the Desktop Staging Center, complete refresh plan, provide operational procedures, and train field staff to implement the refresh of more than 60,000 desktops and laptops (or installation of image critical software on recently installed devices) across the Commonwealth.	allocated to desktop services
Quarter 1 Refresh	SCD + 9 months	1,397,033	Complete the refresh of 7,200 (approximately 12%) desktops and laptops.	allocated to desktop services
<b><i>Messaging Transition</i></b>				
Service Commencement	SCD + 0 months	3,948,306	Worked with VITA to develop plans for a single messaging (email) solution for the Commonwealth using standard software and configurations	allocated to desktop services
Single agencywide address list (Global Address List) Should be "Commonwealth-wide" (Critical)	SCD + 9 months	3,948,306	Complete construction of email domain servers and creation of a single "Commonwealth wide" directory.	allocated to desktop services
<b><i>Data Network Transition</i></b>				
Service Commencement	SCD + 0 months	1,665,188	Worked with VITA to develop plans for a single Commonwealth wide network infrastructure to replace numerous existing and disparate "stove pipe" agency networks.	allocated across all services dependent upon the network infrastructure
Temporary NOC	SCD + 4 months	4,995,564	Develop and implement a Temporary Network Operations Center with total network monitoring capabilities using HP OpenView system and other tools. The TNOC will operate in parallel with the current VITA central NOC to ensure the most effective network support possible until the Enterprise NOC is fully deployed within the new data center.	allocated to VITA central and remote network services
Submit Arch Network Blueprint Addressing Plan	SCD + 7 months	832,594	Provide architectural network blueprint (design) for conversion of the Commonwealth's legacy networks to the proposed enterprise Multi-Protocol Label Switching (MPLS) network	allocated to VITA central and remote network services
<b><i>Voice Transition</i></b>				

## ALLOCATION OF MILESTONE PAYMENTS MADE TO NORTHROP GRUMMAN

<b>Milestone Title/Components</b>	<b>Date</b>	<b>Amount in \$</b>	<b>Milestone Description (Work Performed by NG)</b>	<b>Milestone Allocation Basis</b>
Service Commencement	SCD + 0 months	182,864	Worked with VITA to understand the current voice services utilized within the Commonwealth and begin developing plans for standardization.	allocated to voice services
<b><i>Security Transition</i></b>				
Service Commencement	SCD + 0 months	817,689	Worked with VITA to understand the current security practices and procedures and begin developing plans to improve and enhance.	allocated across all service areas based on direct expenses
Interim Security Incident Tracking and Management System	SCD + 3 months	817,689	Establish a server and database that will be used as a back-end repository to the current web site for reporting all COV security incidents whether in or out of scope to VITA/NG services. This will facilitate better analysis and management of security incidents.	allocated across all service areas based on direct expenses
<b><i>Help Desk Transition</i></b>				
Service Commencement	SCD + 0 months	916,865	Worked with VITA to prepare for assuming responsibility for operations of multiple help desk locations and begin developing plans to consolidate.	allocated across all service areas based on direct expenses
Incident management system Web accessible (interim incident management system)	SCD + 1 months	916,865	Develop and implement Peregrine (trouble ticket management system) for initial use by VITA's central help desk, the VCCC.	allocated across all service areas based on direct expenses
<b><i>Data Center Buildings</i></b>				
		<b>0</b>		
<b><i>Chargeback Applications</i></b>				
Service Commencement	SCD + 0 months	206,434	Worked with VITA to understand and prepare to assume responsibility for VITA's billing systems, support, processes and procedures.	allocated across all service areas based on direct expenses
Process Cutover	SCD + 6 months	103,217	Update Internal Application Documents and Procedures to CMMI Level 3 standards. This task in preparation for moving to the new data center which will have a security rating of level 3.	allocated across all service areas based on direct expenses
Migrate existing projects into maintenance umbrella	SCD + 8 months	103,217	Develop and implement maintenance process and procedures for VITA's billing and chargeback system.	allocated across all service areas based on direct expenses
Internal Apps Transformation Complete	SCD + 9 months	472,609	Complete the Internal Applications transformation achieving level 3 compliance. Provide operational procedures, and train applications support staff to support development and maintenance requirements	allocated across all service areas based on direct expenses



**Virginia Information Technologies Agency  
Combining Statement of Revenues, Expenses,  
and Changes in Net Assets  
Internal Service Funds  
For the Period Ended: June 30, 2006**

Program (Layout): VITA8039

	<u>Enterprise Solutions</u>	<u>Computer Services</u>	<u>Telecommunications</u>	<u>Totals 2006</u>
<b>Operating Revenues</b>				
Charges for Services	\$ 635,461.57	\$ 157,208,646.79	\$ 70,097,102.50	\$ 227,941,210.86
Total Operating Revenues	<u>635,461.57</u>	<u>157,208,646.79</u>	<u>70,097,102.50</u>	<u>227,941,210.86</u>
<b>Operating Expenses</b>				
Personal Expenses	231,056.99	66,486,232.33	7,577,307.05	74,294,596.37
Contractual Services	254,836.63	50,075,219.36	54,394,636.06	104,724,692.05
Supplies and Materials	-	1,383,175.96	85,721.02	1,468,896.98
Educational Assistance and Transfer Payments	-	8,855.82	2,076.36	10,932.18
Rent, Insurance & Other Related Charges	-	8,904,474.76	713,476.97	9,617,951.73
Depreciation	2,135.34	8,604,485.20	2,556,271.20	11,162,891.74
Expendable Equipment/Improvements	-	29,003,043.81	491,426.78	29,494,470.59
Total Operating Expenses	<u>488,028.96</u>	<u>164,465,487.24</u>	<u>65,820,915.44</u>	<u>230,774,431.64</u>
<b>Operating Income (Loss)</b>	<u>147,432.61</u>	<u>(7,256,840.45)</u>	<u>4,276,187.06</u>	<u>(2,833,220.78)</u>
<b>Nonoperating Revenues(Expenses)</b>				
Interest	-	(113,989.93)	(76,455.66)	(190,445.59)
Depreciation	-	(4,586,506.17)	-	(4,586,506.17)
Reimbursement to Federal Government	-	-	-	-
Revenue from the Sale of Recyclable Materials	-	138.12	51.85	189.97
Realized Gain -- Assets	-	4,586,508.95	-	4,586,508.95
Proceed from Insurance Recoveries	-	1,644.98	-	1,644.98
Sale of Surplus Property	-	-	-	-
Loss on Fixed Asset Disposal	-	-	-	-
Total Nonoperating Expenses	<u>-</u>	<u>(112,204.05)</u>	<u>(76,403.81)</u>	<u>(188,607.86)</u>
<b>Income (Loss) Before Transfers</b>	<u>147,432.61</u>	<u>(7,369,044.50)</u>	<u>4,199,783.25</u>	<u>(3,021,828.64)</u>
<b>Transfers</b>				
Transfers from Other Funds	-	-	-	-
Transfers to the General Fund of the Commonwealth	-	(31,854.96)	(11,962.05)	(43,817.01)
Transfers from the General Fund of the Commonwealth	-	-	-	-
Total Transfers	<u>-</u>	<u>(31,854.96)</u>	<u>(11,962.05)</u>	<u>(43,817.01)</u>
<b>Increase (Decrease) in Net Assets</b>	<u>147,432.61</u>	<u>(7,400,899.46)</u>	<u>4,187,821.20</u>	<u>(3,065,645.65)</u>
<b>Total Net Assets, July 1</b>	<u>268,039.16</u>	<u>19,456,476.79</u>	<u>12,535,564.96</u>	<u>32,260,080.91</u>
<b>Total Net Assets, June 30</b>	<u>\$ 415,471.77</u>	<u>\$ 12,055,577.33</u>	<u>\$ 16,723,386.16</u>	<u>\$ 29,194,435.26</u>

Run: October 12, 2006 at 01:57 PM



DEPARTMENT OF HEALTH & HUMAN SERVICES

Program Support Center  
Financial Management Service  
Division of Cost Allocation

Cohen Building-Room 1067  
330 Independence Avenue, S.W.  
Washington, DC 20201  
PHONE: (202)-401-2809  
FAX: (202)-619-3379

September 29, 2006

Lemuel C. Stewart, Jr.  
Chief Information Officer  
Virginia Information Technologies Agency  
Richmond Plaza Building, 3rd floor  
110 South 7th Street  
Richmond, Virginia 23219

Dear Mr. Stewart,

This is to inform you that the Division of Cost Allocation (DCA) which is located within the Department of Health and Human Services (HHS), Program Support Center (PSC), has performed a review of the cost allocation methodology proposed by the Virginia Information Technology Agency (VITA). Our review consisted of reviewing: the proposed methodology; the Northrop Grumman contractual agreement with VITA; along with having several meetings and discussions with VITA representatives regarding the implementation of the proposed methodology. The proposed methodology is designed to bill state agencies for services rendered based on agency specific rates derived from historical expenditure levels instead of the previous direct billing methodology which was based on standard service rates.

HHS (of which DCA is a part of) is designated by the Office of Management and Budget (OMB) as the cognizant federal agency for reviewing and negotiating facility and administrative (indirect) cost rates, fringe benefit rates, special rates as determined to be appropriate, research patient care rates, statewide cost allocation plans, and public assistance cost allocation plans. States are required to submit a statewide cost allocation plan to DCA on an annual basis for its review and approval. The statewide cost allocation plan generally consists of Section I and Section II (billed) central services. The purpose of the plan is to identify, assign, allocate and bill costs on a reasonable and consistent basis in accordance with 2 CFR Part 225-Cost Principles for State, Local and Indian Tribal Governments (OMB Circular A-87).

DCA is responsible for reviewing the statewide cost allocation plan to ensure that the proposed costs and allocation methodologies are in compliance with 2 CFR Part 225 before it can be approved. Our review of the methodology proposed by VITA for the purpose of billing state agencies for services rendered does not appear to be in compliance with 2 CFR Part 225 for the following reasons:

- The monthly billings that VITA are imposing on state agencies is not reflective of actual charges resulting from standard service rates, they are reflective of historical costs incurred during the previous year's accounting cycle for each specific agency. This concept can be interpreted to mean that state agencies are going to be billed for services based on past expenditures rather than the actual cost of providing goods and services.
- The method does not provide a basis for state agencies to specifically identify billed services (i.e. labor, help desk, network and enterprise applications) to benefiting programs due to the lack of itemized billing invoices that would reflect the type of services that are actually rendered. An itemized billing invoice would serve as an instrument that would assist state agencies in their attempt to properly allocate and charge programs accordingly. To be compliant with 2 CFR Part 225, state agencies must be able to properly allocate costs to particular cost objectives for goods and services that were actually received.
- Because the proposed method will be based on agency specific rates, we believe that it will not be feasible for VITA to properly reconcile costs at the end of an accounting cycle by function which should be done to comply with 2 CFR Part 225. The inability to reconcile costs is a result of the contract VITA has with Northrop Grumman. It is our view that the nature and structure of the contract VITA has with Northrop Grumman have made it unallocable by design.

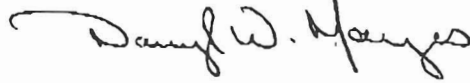
Consequently, at this time it is our conclusion that VITA has not presented DCA or other Federal agencies with a methodology for assigning costs and billing costs to agencies that complies with 2 CFR Part 225. We would recommend that VITA consider implementing a billing methodology that would allow state agencies to fairly allocate costs to benefiting programs accordingly. In the mean time we would suggest that all Federal agencies who may be impacted by this proposed methodology to consider deferring payment until such time VITA provides sufficient information on equitable charges it assesses State agencies. It will be the responsibility of the individual government authorized representatives and contracting officers of the various Federal organizations to determine if they will reimburse some, none or all of the VITA expenses assigned to their programs. In addition, to the extent that VITA's billings are included in any indirect rate proposals, DCA will review these costs and in the absence of proper support documentation DCA may consider these costs as unallowable.

Mr. Stewart Jr.

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If you or any State or Federal agencies have any questions regarding this matter, please call Christian Poole, Branch Chief, State and Local Units of Government at (202) 401-2763 or me at (202) 401-0215.

Sincerely,



Darryl W. Mayes  
Director, Mid-Atlantic Field Office  
Division of Cost Allocation

cc: See Addressees



# COMMONWEALTH of VIRGINIA

## Virginia Information Technologies Agency

Lemuel C. Stewart, Jr.  
CIO of the Commonwealth  
Email: [cio@vita.virginia.gov](mailto:cio@vita.virginia.gov)

110 South 7<sup>th</sup> Street  
Richmond, Virginia 23219  
(804) 371-5000

TDD VOICE -TEL. NO.  
711

October 10, 2006

Mr. Darryl W. Mayes, Director  
Mid-Atlantic Field Office  
Division of Cost Allocation  
Cohen Building Room 1057  
330 Independence Avenue, S.W.  
Washington, D.C. 20201

Dear Darryl:

I am writing in response to your letter dated September 29, 2006 regarding the Virginia Information Technologies Agency proposed interim cost allocation plan for information technology central services to the several Executive Branch agencies in Virginia. I understand that our agency specific rate proposal does not appear to meet the requirements of OMB Circular A-87, and that we need to evaluate alternatives to address the expressed concerns in your letter.

I know you understand from our discussions over the past year not only how important our transformation initiative is to achieving a more secure and efficient operating environment in Virginia but also the challenge of doing so without additional taxpayer dollars. I would ask for your indulgence as we work through this period of transition, and your assistance in helping with the development of an alternate plan. What I propose is the following:

- Considering in your judgment we only appear non-compliant, that you and your colleagues in the various federal offices hold in abeyance any action on your September 29 letter for 60-90 days. That will give us time to work with you and our agencies on acceptable alternatives or modification. It will also avoid any interruption of federal and state program services since we will be unable to provide such services without revenue to support them.
- Second, I plan to convene a group of 6-8 seasoned agency financial officers to assist us craft a new solution.
- Third, I plan to bring in an experienced and objective third party that can help us guide the development of a new plan.
- Finally, I appreciate your offer and opportunity to meet with you in the next couple of weeks so that we may jointly assure that we are proceeding on the proper path.

Mr. Darryl W. Mayes  
October 10, 2006  
Page Two

I will appreciate the favor of a reply at your earliest convenience on this and welcome any other suggestions you may have. Also, feel free to contact me anytime you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Lemuel C. Stewart, Jr.", written in a cursive style.

Lemuel C. Stewart, Jr.

c: Alfonso H. Lopez  
Director, Virginia Liaison Office



# COMMONWEALTH of VIRGINIA

## Virginia Information Technologies Agency

110 South 7<sup>th</sup> Street  
Richmond, Virginia 23219  
(804) 371-5000

TDD VOICE -TEL. NO.  
711

Lemuel C. Stewart, Jr.  
CIO of the Commonwealth  
Email: [cio@vita.virginia.gov](mailto:cio@vita.virginia.gov)

October 27, 2006

Mr. Darryl W. Mayes, Director  
Mid-Atlantic Field Office  
Division of Cost Allocation  
Cohen Building Room 1057  
330 Independence Avenue, S.W.  
Washington, D.C. 20201

Dear Darryl:

I am writing as a follow-up to your letter dated September 29, 2006, and my response to you dated October 10, 2006, regarding the Virginia Information Technologies Agency's (VITA) proposed cost allocation plan. Specifically, I ask for a clarification of the point made in your letter where you state "...we would suggest that all federal agencies who may be impacted by this proposed methodology consider deferring payment until such time as VITA provides sufficient information ...".

It is my understanding that the scope of your concern in reviewing VITA's most recent Cost Allocation Plan submission, and therefore your advice to the various agencies, is specifically related to only that portion of our proposal involving Virginia state agency based information technology services, the Memorandum of Understanding based plan.

My concern is that there are other rate based programs set forth in our Plan, telecommunications and mainframe computing for example, where billing and charge-back methods have been in place for many years. Our proposal included no change to those methods and continuing practices. Given that, I ask if it was your intent to have agencies consider deferring payments related to those legacy services programs, or to specifically limit the guidance to the new element of our plan involving agency based services only. It is my belief that the latter is the case, and if you agree we will appreciate your sharing that information with the agencies.

In closing, let me take the opportunity to thank you for your time and attention to these matters. I would especially like to thank Christian and June for their insights, and the time they took earlier this week to work with us toward a successful conclusion, which is what I know all of us are striving for.

Mr. Darryl Mayes  
October 27, 2006  
Page Two

I look forward to hearing from you.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lemuel C. Stewart, Jr.", written in black ink.

Lemuel C. Stewart, Jr.

c: The Honorable Aneesh P. Chopra  
Secretary of Technology  
The Honorable Jody M. Wagner  
Secretary of Finance



**DEPARTMENT OF HEALTH & HUMAN SERVICES**

Program Support Center  
Financial Management Service  
Division of Cost Allocation

Cohen Building-Room 1067  
330 Independence Avenue, S.W.  
Washington, DC 20201  
PHONE: (202)-401-2808  
FAX: (202)-819-3379

October 30, 2006

Lemuel C. Stewart, Jr.  
Chief Information Officer  
Virginia Information Technologies Agency  
Richmond Plaza Building, 3rd floor  
110 South 7th Street  
Richmond, Virginia 23219

Dear Mr. Stewart,

At your agency's request, and upon further clarification with VITA regarding the extent of the billing and reconciliation transformation currently underway, DCA is at this time able to give a limited approval for the proposed billing methodology for specific services billed by VITA which have not been impacted thus far by any changes that violate 2 CFR Part 225-Cost Principles for State, Local and Indian Tribal Governments (OMB Circular A-87) and would preclude a Federal Agency from considering reimbursing for these billed services. This new guidance only affects previously approved rate based services. DCA is at this time is giving limited approval for the following services:

- o Legacy computer services billed monthly on computer services (Statewide standard rate) bills, such as CPU charges, disk storage charges, and transaction handling charges,
- o Legacy telecommunications services billed on monthly telecommunications bill, such as local and long distance services, and private circuit charges,
- o Other legacy services, such as shared email, tape vaulting charges, and EBARS,
- o Specific agency requested time and material charges.

This approval is a recognition of the assurances VITA has given DCA that there are methodologies in place that have been previously approved and remain unchanged for capturing the level of service activity, identifying the cost of providing these services, and reconciling the cost to revenues generated at the end of the fiscal year. As VITA has not yet submitted an approvable agency-wide proposal for handling VITA's administrative expenses, this limited approval does not include the previously approved 5.52% administrative support costs.

We appreciate the level of cooperation present in the past weeks and we look forward to working with you and your staff on resolving the remaining issues and being able to approve your cost allocation plan in its entirety.

If you or any of the State Agencies or Federal grantees have any questions regarding this matter, please feel free to have them call Christian Poole, Branch Chief, State and Local Units of Government at (202) 401-2763 or myself at (202) 401-0215.

Sincerely,

A handwritten signature in black ink that reads "Darryl W. Mayes". The signature is written in a cursive style with a large, sweeping initial "D".

Darryl Mayes  
Director, Mid-Atlantic Field Office  
Division of Cost Allocation



# COMMONWEALTH of VIRGINIA

## Virginia Information Technologies Agency

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CIO of the Commonwealth  
Email: cio@vita.virginia.gov

110 South 7<sup>th</sup> Street  
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November 1, 2006

### **MEMORANDUM**

**TO:** AITRs and Agency Finance Officials

**FROM:** Lem Stewart

**SUBJECT:** Cost Allocation Plan Update

VITA received a letter dated September 29 from the U.S. Department of Health and Human Services (HHS) questioning our current billing methodology for agency-based IT services. The letter further encourages agencies to consider deferring payment of VITA fees if federal funds are involved.

I write today to provide you with information on how Virginia will address this issue, and to provide some perspective on the matter.

First, please understand that HHS was responding to a routine annual plan submission reconciling actual revenue and expenditures for the past year and setting forth any changes in agency charge-back methodologies. This happens every year.

The September 29 letter is neither official approval nor denial of our latest plan submission. It also is not an official disallowance of the use of federal funds. Instead, it basically asks the Commonwealth to take a different path for agency IT support and charge back methods than the transitional one that we were proposing. HHS has indicated that it wants to see the new structure for agency based services as a single central statewide rate, with a strong reconciliation component at the end of each fiscal year. This is the model that has been used for years for such services as mainframe computing, and it is the model we had planned to move to in FY 08 to allow for transition and transformation of the state IT infrastructure through the state contract with Northrop-Grumman.

On October 10, I responded to the federal office asking for 30-60 days to work with them and fiscal experts from many of the affected state agencies on acceptable alternative methodologies. I am confident that we have developed a strategy to address HHS concerns. On October 30, HHS-Division of Cost Allocation (DCA) responded to me saying HHS was pleased with the level of cooperation on developing a new submission, and to clarify that HHS concerns centered on the new, agency based Memorandum of Understanding 2 component of our proposal. Specifically, the October 30 letter clarifies that HHS has no objection to agencies continuing to

MEMORANDUM

November 1, 2006

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use federal funds for the legacy IT services billings that have not changed from the previous model.

A work group of financial experts from state agencies representing each Secretariat has been formed and began meeting two weeks ago. In addition, we will be collaborating with the Governor's Cabinet and federal officials in the coming weeks.

To assist us with the task at hand, considering potential constraints on VITA's cash flow, I ask that to the extent possible you make only essential or emergency requests for non-legacy type IT services and incremental new requests for services during the next 30 to 60 days while we work to resolve these issues. We will, of course, work with each of you to address any mission critical needs that may arise in the interim.

As a final note, I want to share something with you. Information Technology Investment Board Vice Chair Hiram Johnson, who 20 years ago served as VDOT IT Director, recently reminded me that he responded to a federal challenge involving mainframe services during his earlier tenure. At that time, federal officials considered withholding funds. However, they did not take such action after hearing details on how the Commonwealth was approaching the funding issues. Virginia has had a federally approved shared cost allocation plan for more than 20 years without a single federal audit exception.

I hope each of you will feel free to call or e-mail me directly with any comments or suggestions. I especially want to thank those of you who have permitted your staff members to devote time to work with us toward a successful resolution to this issue.