

Joint Legislative Audit and Review Commission



Overview of Contract Modifications & Financial Penalties

Senate Finance Committee

General Government Subcommittee

July 13, 2009



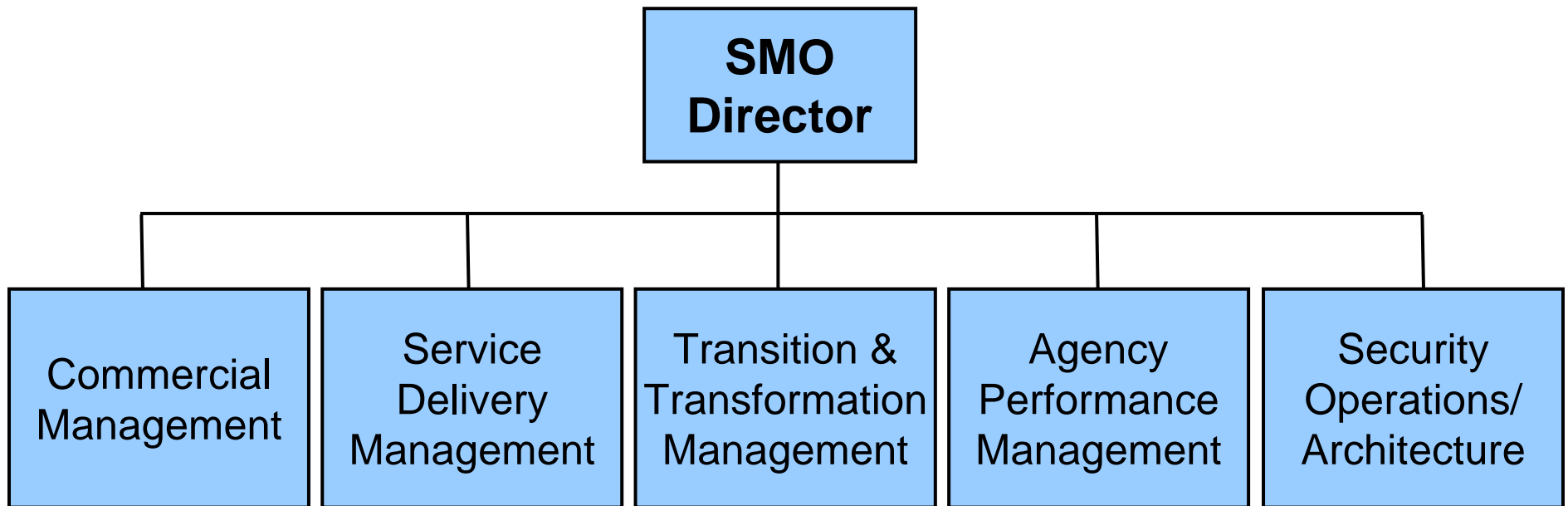
JLARC

In This Presentation

- VITA's Service Management Organization Manages Contract with NG
- VITA Has Used Amendments & Financial Penalties to Manage Contract
- VITA's Approach to Contract Management Changed in FY09



Service Management Organization (SMO) Manages Northrop Grumman (NG) Contract



SMO Staff Have IT Outsourcing, Contract Management, & Engineering Experience

- SMO director has experience with IBM and Honeywell plus federal & VA State government
- Senior staff have public & private sector experience
 - IBM, Capital One, Verizon Communications, Honeywell
 - Armed Services & VA State government
- SMO costs less than comparable organizations
 - Similar contracts allocate 5-7% of annual cost to contract management (Gartner & PA Consulting)
 - NG contract allocates 1.7% of annual contract cost to SMO

SMO Manages the Comprehensive Infrastructure Agreement (Contract)

- NG contract consists of 151-page agreement, 51 amendments, 29 schedules, 17 appendices, 17 addendums, and 6 attachments
 - <http://www.vita.virginia.gov/itpartnership/default.aspx?id=451>
- Other key documentation includes
 - Procedures manual
 - Disaster recovery plan
 - Technology refresh plan
 - Data collection documents
- NG must also comply with designated State policies

Contract Includes 72 Milestones

- Milestones cover major project activities
 - Security, help desk, network, data center, messaging, desktop computers, administrative & billing
- 53 of 72 milestones are tied to a specific payment
 - Ranges from \$103,000 to \$18.4 million
 - 19 milestones are not tied to a payment
- 16 of 72 milestones are “Critical”
 - VITA assesses NG a penalty if a milestone is late
 - NG earns a credit if another milestone is early



Contract Amendments Follow a Defined Process

- Contract gives VITA authority over amendment process (Section 27.5)
 - ITIB not formally involved in contract amendments
- VITA or NG may submit description of proposed amendment to the other party
- SMO reviews the impact of all proposed amendments
 - Rely on technical experts within VITA
 - Consult with Office of the Attorney General when necessary
- SMO & NG then negotiate and sign amendment

VITA & NG Have Agreed to 51 Amendments

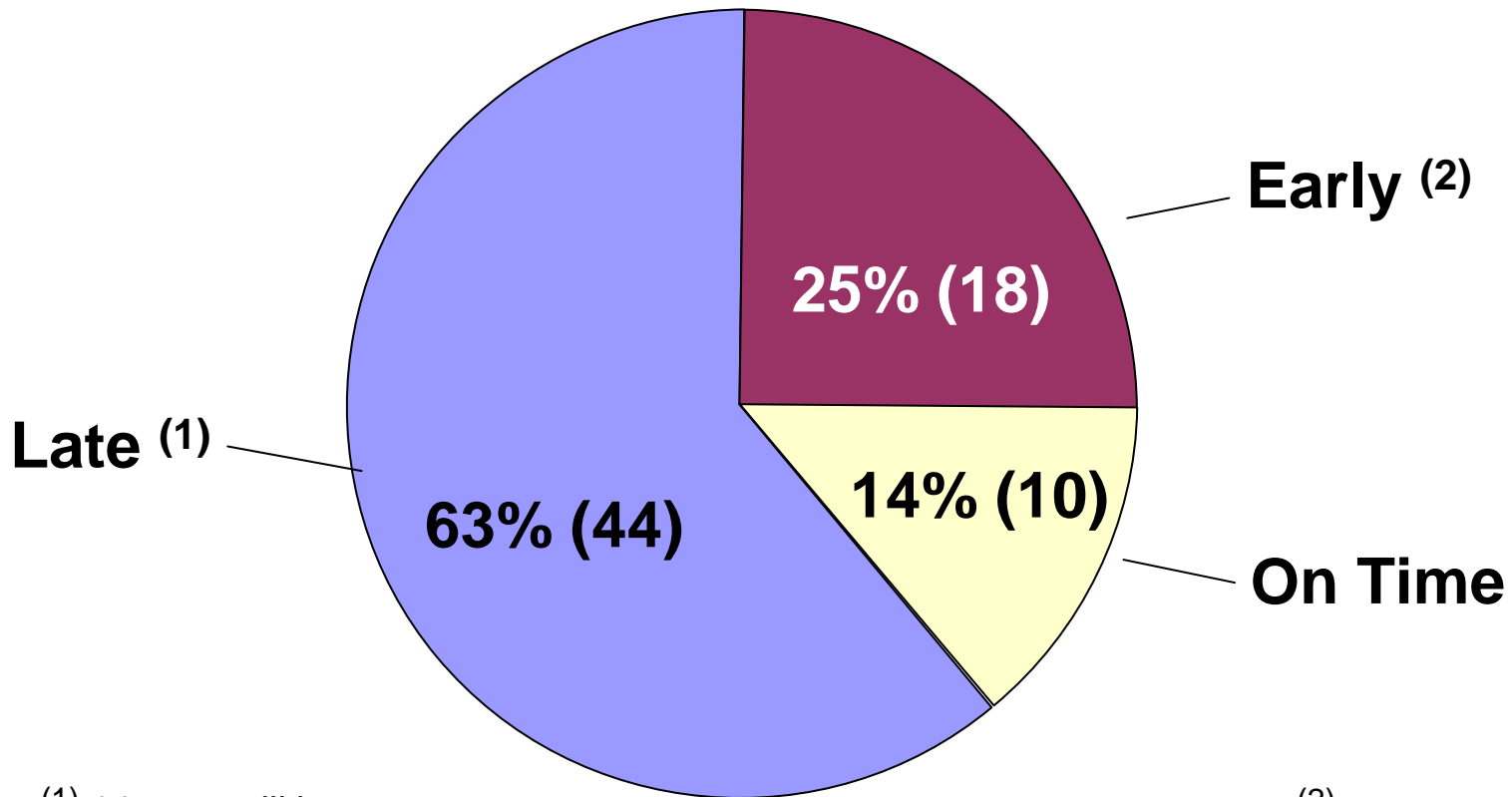
- 7 amendments have extended milestone deadlines
 - In total, 31 of 72 milestone deadlines extended
 - Extensions given for data centers, network, & help desk
- 2 amendments reduced services required of NG
 - Help desk & messaging (email) services
- Other contract amendments were administrative
 - Ex: change NG's SWAM reporting from weekly to monthly
- All but one amendment signed by SMO director
 - CIO signed one amendment in director's absence

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63% of Milestones Have Been Late

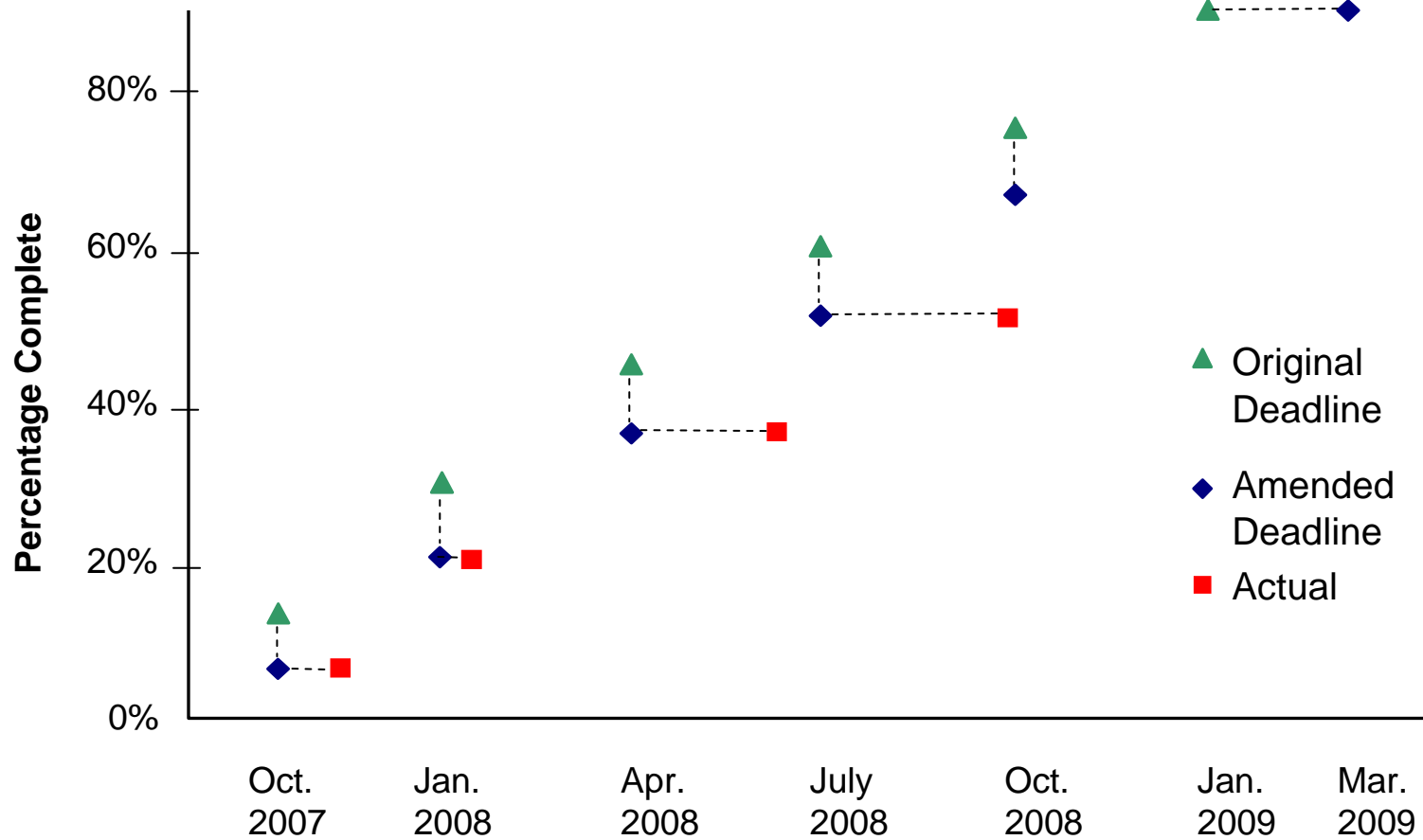


(1) 14 were still late despite deadline extension

(2) 11 would not have been early under original deadline

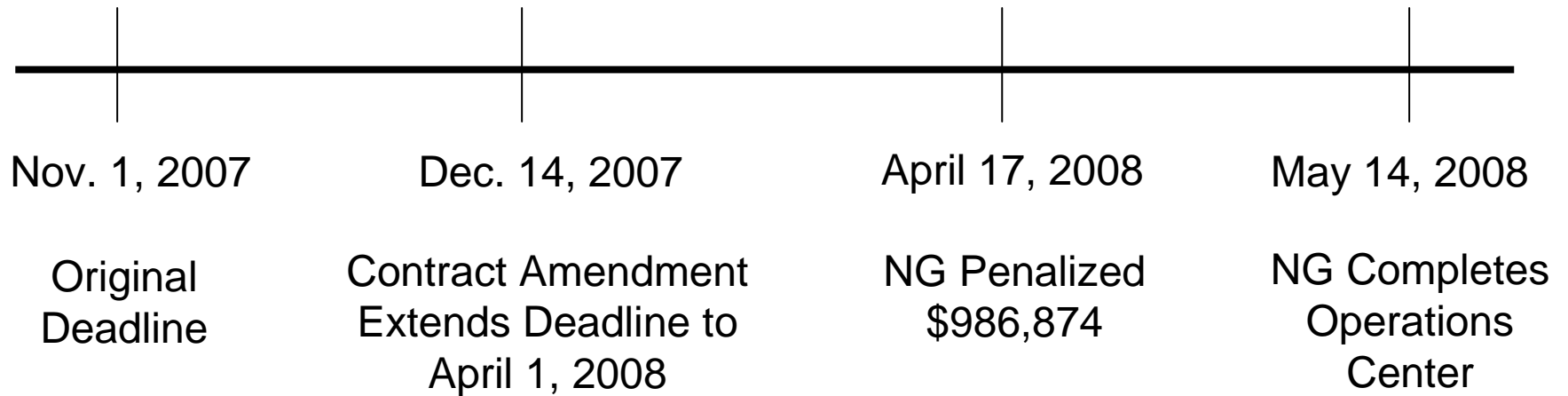


New Network Is Overdue Despite Contract Amendments Which Gave NG Extensions



NG Penalized \$987,000 for Delay in Completing Network Operations Center

Timeline for Development of Operations Center



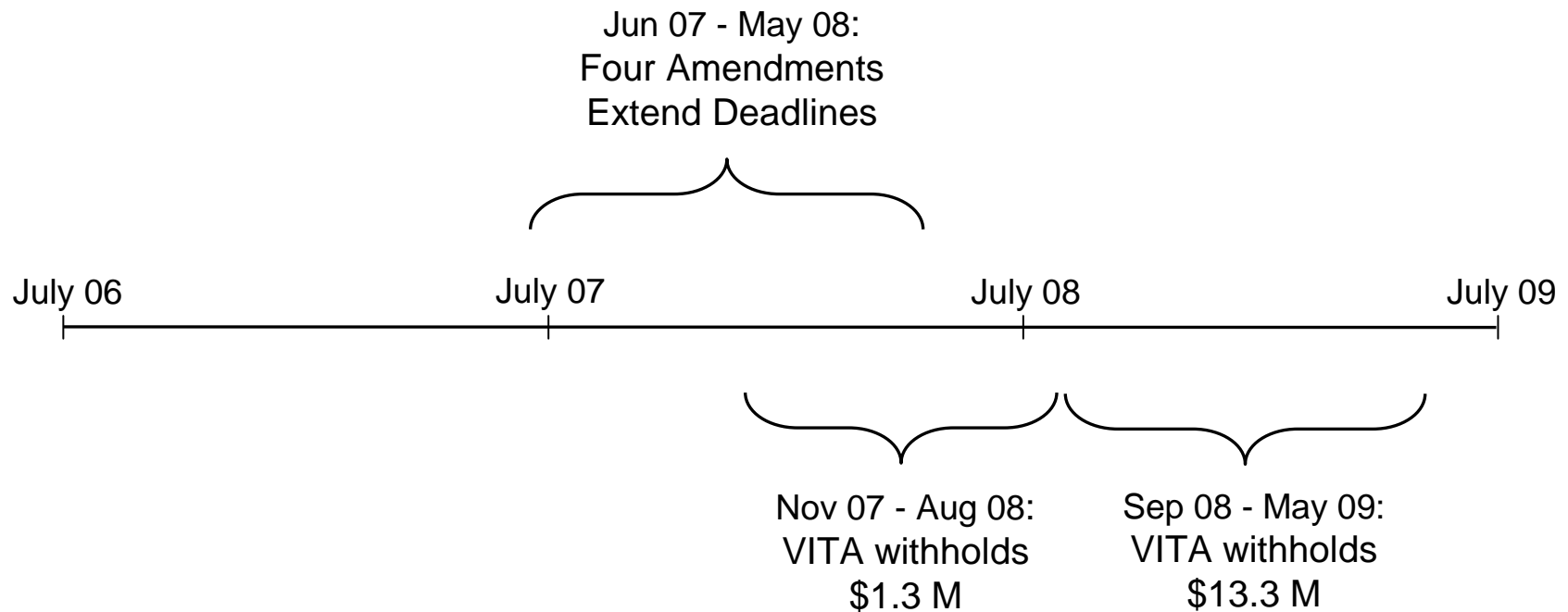
NG Has Offset Penalties by Delivering Some Milestones Early

- VITA assessed \$1.4 million in penalties against NG for late delivery of milestones
- NG has accrued \$1.8 million in “earn backs” for early delivery of other milestones
 - NG currently has \$435,000 in earn backs to offset any future performance credits
 - 11 milestones were early because contract deadlines were extended
- Even when a milestone is delivered late, contract generally allows NG to receive full payment

Other Financial Penalties Include Withholds and Shortpays

- Contract allows VITA to permanently withhold payments disputed in good faith (Section 10.5)
 - VITA has withheld \$14.4 million in payments
 - Withholds have occurred every month since November 2007
- Over time, VITA treated withholds as temporary, allowing NG to be paid if issues are resolved
 - \$5.6 million of 14.4 million in withholds has been paid
- However, more recently VITA has proposed permanently withholding \$6.8 million (a “shortpay”)

Deadline Extensions and Payment Withholds Addressed Transformation Delays



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NG Missed Key Deadlines in June 2008

- Deadline for new invoice in FY09 missed because of previous missed deadlines
 - “Hard” inventory of physical assets
 - “Soft” inventory of other assets
 - Tools to ensure ongoing verification of inventory
- Senior VITA staff gave “pre-brief” to ITIB members in June 2008
 - ITIB Chair (Mr. McGuirk) & Chair of ITIB’s Infrastructure Committee (Mr. Pomata)
 - Discussed recurring monthly withholds & shortpays to address billing & scheduling concerns
 - Pre-briefs to these two members had occurred since contract’s inception

Escalation Occurred Within VITA & NG

- NG sent VITA several letters from July to October 2008 (next slide)
- Pre-brief before October 2008 ITIB meeting discussed letters from NG & increased withholds
 - VITA withholds \$6.4 million of \$14 million from Sept 2008 invoice
 - ITIB Chair recently told JLARC staff he disagreed with some withholds, but left operational decisions to VITA
- VITA staff & Infrastructure Committee Chair appeared to agree that VITA should handle contract issues
 - SMO to reply to NG's letters, with AG's assistance
 - CIO to begin meeting with NG corporate staff

Letters Between NG & VITA Reflect Increasing Disagreements

- NG requested continued allowance of 14% markup on purchased goods & services (July – Oct. 2008)
 - VITA says that contract does not allow markups after FY08
 - In response, NG says it will stop fulfilling some procurement requests from State agencies (in-scope P2P & RFS)
 - VITA replies that contract bars NG from halting any services even if a dispute arises (Section 24.2)
- NG stated agency-induced delays means that work done after June 2009 will be out-of-scope (Sept. – Oct. 2008)
 - VITA replies that delays are because NG has not met deadlines
 - Also, NG has not provided required notice of any State-induced delays (Section 16.4)

VITA & NG Developed Desired Contract Changes

- Proposals appear to result from talks between CIO & NG corporate officers in October & November 2008

- VITA's proposals included
 - Tiered services
 - Discounted price for virtual servers
 - Full end user support services (24 x 365)

- NG's proposals included
 - Use reconciled inventory but keep existing fees
 - 3-year contract extension without \$90 M savings
 - Eliminate requirement for agency signoff on inventory

VITA Escalated to ITIB to Discuss Withholds & Potential Shortpays

- In January 2009, VITA talked with NG about withholds
 - VITA expresses intention to change some temporary withholds of funds to permanent shortpay
 - NG asserts that “Gentleman’s Agreement” regarding month-to-month payment of invoice excluded withholds & shortpays
- In February 2009, CIO & VITA staff met with ITIB Chair & Chair of Infrastructure Committee
 - VITA proposes monthly shortpay of 20% (\$2.6 million)
 - ITIB members apparently propose 25% shortpay instead

ITIB Members Discussed Contractual Concerns with NG

- February 2009, ITIB Chair & Chair of Infrastructure Committee talked with NG about Transformation
 - In March, VITA told not to shortpay NG invoice
- In April 2009, closed session of ITIB discussed NG Recommendations for contract changes
 - ITIB Chair informs JLARC staff that clear message of Board was to stay within the \$236 million cap
 - Discussions between ITIB members & NG continue into May
- During this time (Feb. – April), VITA staff reported that NG stopped participating in rebaselining activities

Discussions Begin Between VITA & NG

- In early May 2009, NG proposed contract teams & their objectives
- ITIB Chair edited NG's proposal & sent to CIO to implement
- Four primary contract teams
 - Transformation (objective: complete transformation)
 - Billing (objective: finish inventory)
 - Service stability (objective: achieve SLA targets & satisfactory help desk)
 - Negotiations (objective: “take framework & make it reality”)

Talks Between VITA & NG Affected by Contractual Considerations

- During May 2009, CIO repeatedly informed ITIB Chair that NG has stopped some talks

- NG apparently had condition that VITA “implement contract modifications to incorporate agreements reached during executive discussions held between NG & the Commonwealth on April 3rd & May 4th”
 - Extend contract for 3 years but remove \$90 M in savings
 - Modify contractual requirements in exchange for annual cost savings for NG as documented in the April 3rd briefing
 - Identify in-scope & out-of-scope work consistent with May 4th briefing
 - Release all withholds

Talks Between VITA & NG Affected by Contractual Considerations (continued)

- ITIB Chair agreed with CIO's concerns, & repeatedly contacted NG during May on VITA's behalf
- Talks resumed and appear to be on-going
 - Major focus is extension of Transformation deadline
 - Other potential changes appear to be secondary



CIO Proposed Invoice Return in May 2009

- VITA staff asserted that invoice return is most defensible approach under the contract
 - Approach developed in consultation with AG staff
 - Concern that new transformation deadline of Dec. 2009 may be missed
- Cashflow issues appeared to be concern for VITA & NG
 - VITA reports declining reserves & potential federal audit exception
 - ITIB Chair informs CIO that cash flow is key concern of NG
- Following May 22 meeting of ITIB's Finance & Audit Committee, CIO proposed returning invoice
 - ITIB Chair disagreed & issue taken to ITIB in June 2009

ITIB Appeared to Reject Invoice Return at June 2009 Meeting

- No vote or other action was taken in open session
 - ITIB Chair informs JLARC staff vote was not necessary because Board could not prevent CIO from taking action
- CIO was replaced with Interim CIO & invoice was paid
- Subsequently, VITA informed NG of contract breach
 - NG's reply disputes breach notification, promised new transformation plan within 60 days



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