

Joint Legislative Audit and Review Commission



**Interim Review of the
Virginia Information Technologies Agency**

Senate Finance Committee

General Government Subcommittee

June 29, 2009



JLARC

Study Mandate

- Senate Joint Resolution 129 (2008) & Item 29 E of the 2008 Appropriation Act direct JLARC to examine VITA
 - Impact on agencies from partnership with Northrop Grumman
 - Relationship between VITA & its oversight body
 - VITA's exercise of its statutory procurement authority
 - Management of IT systems development projects by VITA's Project Management Division
 - Potential for VITA to play a greater role governing expenditures & functions now performed by agencies

In This Presentation

- Background
 - Savings from Partnership Are Not Anticipated
 - VITA's Implementation of Rates May Increase Costs
 - Progress Toward Managed Services Is Mixed
 - Contract Provides Several Grounds for Termination
 - Emerging Management & Governance Issues

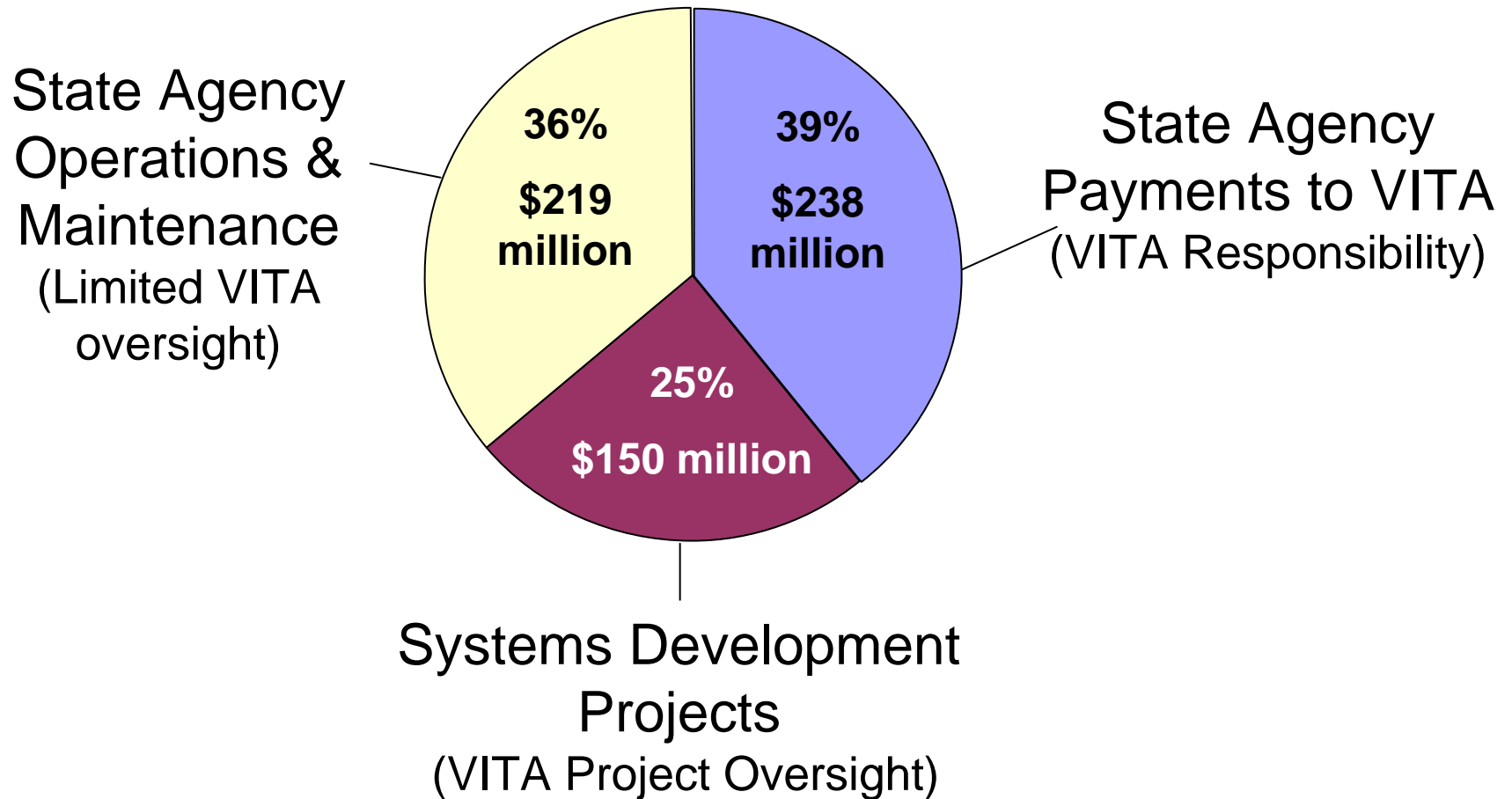
Two Reports Led to IT Reforms in 2003

- JLARC report on systems development recommended
 - Information Technology Investment Board (ITIB) to approve projects
 - Chief information officer (CIO) hired by ITIB to oversee project management
- Secretary of Technology's report recommended creating VITA to improve IT services & reduce cost
- Governor introduced, & General Assembly enacted, legislation that combined these recommendations
 - House Bill 1926 (Nixon)
 - Senate Bill 1247 (Stosch)

Only Infrastructure Consolidated, Not Applications

- Some IT was consolidated into VITA
 - **Enterprise** infrastructure (hardware) such as personal computers & servers. Support staff also consolidated
- Operation of all other IT remains with State agencies
 - **Agency-specific** infrastructure such as traffic-light management or point-of-sale systems
 - **Enterprise** applications (software) such as CARS (financial) & CIPPS (payroll)
 - **Agency-specific** applications such as the Medicaid or offender management systems

Responsibility for IT Expenditures Is Diffuse (FY 2007)



ITIB Supervises Information Technology

- Statutorily responsible for “planning, budgeting, acquiring, using, disposing, managing, and administering” IT
- ITIB has 9 voting members (reflects 2009 changes)
 - Secretary of Finance
 - Secretary of Technology
 - 3 citizens appointed by the Governor
 - 4 citizens appointed by the General Assembly
 - Auditor of Public Accounts (non-voting)

2003 Legislation Also Created Full-Time CIO

- Employed by ITIB under a five-year contract
- CIO is chief administrative officer of VITA “under the direction and control of the Board”
- CIO & VITA have oversight responsibilities
- CIO directs policies, procedures & standards for IT security
- VITA has sole statutory authority to procure IT goods & services, and manage IT contracts
- Project Management Division must provide consulting support & oversight for IT projects

In 2005, VITA Formed a Partnership With Northrop Grumman Information Technology

- 10-year, \$2 billion partnership with subsidiary of NG
- NG provides enterprise infrastructure services formerly provided by VITA
 - Mainframe & server computers
 - Disaster recovery services
 - Personal computer services
 - Data & telecomm. (email, Internet, cell phones)
- VITA continues to provide
 - Some supply chain management (procurement)
 - Geographic information systems (GIS)
 - Radio communications engineering for E-911

Partnership Is Novel Approach to Modernizing IT

- IT will now be centrally managed & regularly funded
- Other states have consolidated, but Virginia is on the leading edge of IT outsourcing
 - NG made all upfront capital investments
 - State allowed to use NG data centers in Chesterfield & Russell Counties
 - State purchases services, but does not own assets
- Rights & obligations of each partner are detailed in Comprehensive Infrastructure Agreement (contract)
 - <http://www.vita.virginia.gov/itpartnership/default.aspx?id=451>

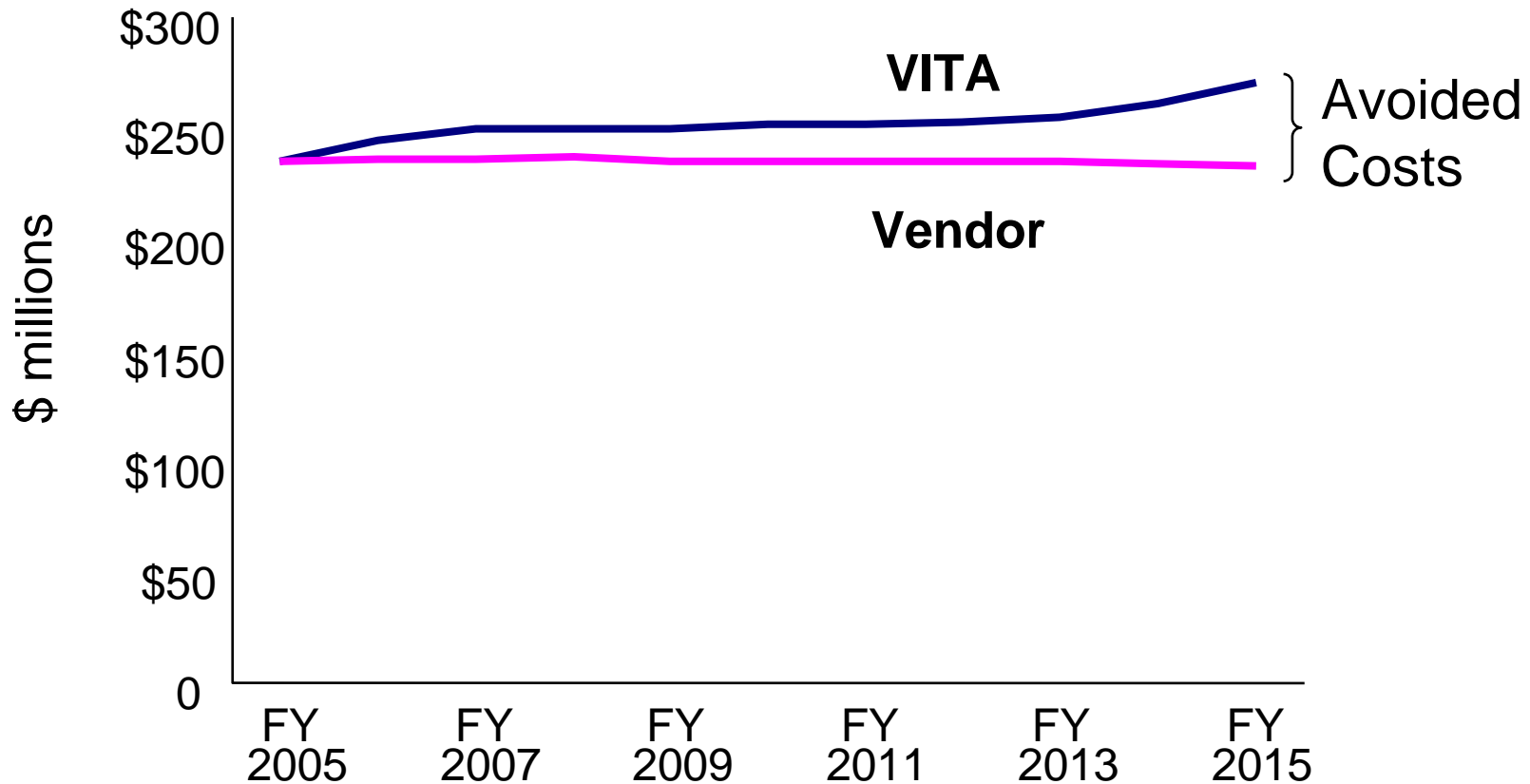
VITA Has 216 “Retained” FTEs

Division Name	Number of Positions
Finance & Administration	75
IT Investment & Enterprise Solutions	69
Service Management Organization	24
Security & Risk Management	15.5
Communications and Executive	16
Customer Account Management	11
Internal Audit	5.5
Total	216

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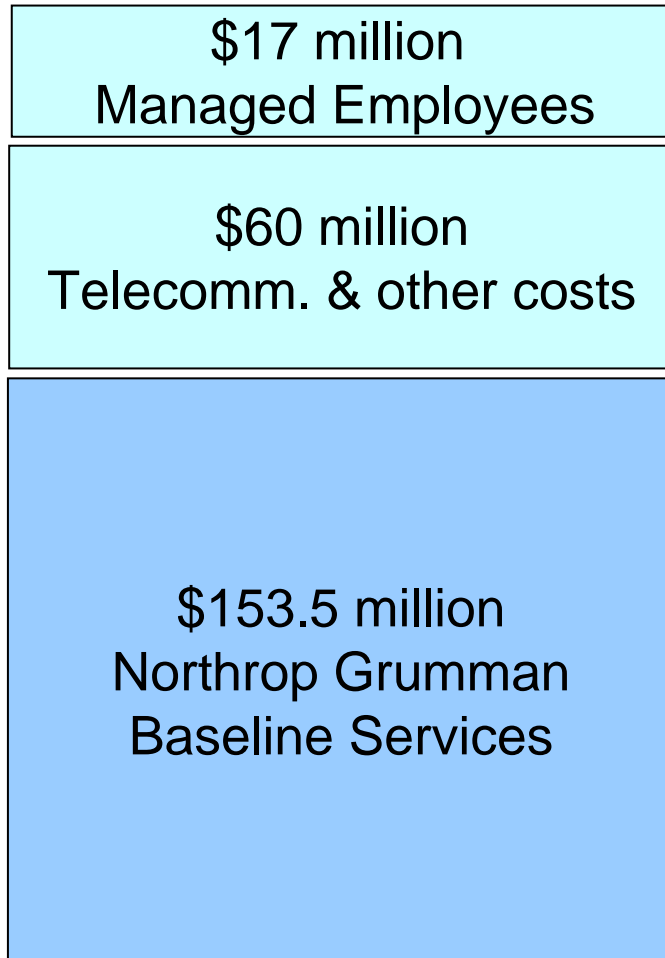
NG Contract Is Based Upon Avoided Costs, Not Savings



Basis for calculating avoided costs may no longer apply if inflation adjustments are granted

NG Payments for Some Services Capped at \$236 Million (FY 2008 Payments)

\$236 million Cap



\$7.5M – New NG Services



Contract Allows NG Payments to Increase or Decrease

- Payments to NG can increase beyond cap
 - NG requests inflation adjustment
 - Agencies request additional services
 - Upon the imposition of any new taxes
- Payments to NG can decrease if
 - State's use of IT services declines, or deflation occurs
 - Best 25% of rates in industry are lower than NG rates
 - Prices & terms offered to other U.S. customers of NG subsidiary are lower

Contract Includes Other Potential Savings and Benefits

- Savings of \$30 million per year may occur if contract is extended beyond initial 10-year term
- If NG can provide services at lower cost, without affecting service levels, then both partners receive a portion of the savings
- NG is required to improve service levels at no additional cost
 - Continuous improvement over time
 - Must keep pace with technological improvements

NG Is Guaranteed Minimum Annual Payment Equal to 85% of Fees for Baseline Services

Fiscal Year	Projected Annual Payment (\$ millions)	Minimum Annual Payment (\$ millions)
2009	\$208	\$177
2010	\$214	\$182
2011 - 2016	\$203	\$173
2017 - 2019	\$176	\$149



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VITA's Revenues and Expenditures Are Primarily From its Internal Service Fund (ISF)

Fund	FY 2008 Revenues (\$ millions)	FY 2008 Expenditures (\$ millions)
Internal Service	\$262	\$278
Enterprise	51	49
Special Revenue	9	10
General	3	3
Federal	0.5	1
Total	\$325	\$342

Agencies with Ten Highest ISF Charges (FY 2008)

Agency	ISF Charge (\$ millions)
Department of Social Services	\$50
Department of Transportation - Central Office	39
Department of Corrections	21
Department of Health	19
Department of Motor Vehicles	19
Department of Taxation	12
Virginia Employment Commission	8
Department of Alcoholic Beverage Control	6
Department of Juvenile Justice	5
Department of State Police	5
Subtotal	\$184
Percent of Total ISF Revenues	70.4%

VITA's ISF Rates Are Approved by JLARC and U.S. Dept. of Health & Human Services (HHS)

- VITA has over 235 rates, & many include administrative fees
 - 12 to 21% for NG
 - 10% for VITA
- New or modified rates must be approved by JLARC
- Federal regulations require HHS approval, to ensure federally funded agencies pay same rate
 - In Spring 2006, VITA developed rates based on MOUs
 - HHS objected to these rates

Federal Regulations Require Same Rate for Same Service

- VITA submitted new rates in December 2006
- 2006 rates have three service options:
 - Option 1: includes prepayment of replacement assets & labor for IT support
 - Option 2: **excludes** prepayment of replacement assets
 - Option 3: **excludes** IT support labor

VITA's Approach to Implementing Rates May Increase IT Costs for Some Agencies

- Agencies billed under lower option 2 rate are not paying in advance for their replacement assets
 - \$9.7 million in new annual IT costs once assets are replaced
 - Affects DSS, VDH, VEC, DMV, DRS, DGIF, VDOT, DMME, DOC, & DBVI
- Some agencies still provide their own IT support labor & therefore should be billed under option 3 instead of higher option 1 rate
 - Affects DSS

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Contract Requires Transformation of Legacy IT Services by July 1, 2009

- Several tasks must be completed by this deadline
 - Inventory reconciliation (overdue from April 2008)
 - Volume-based billing system (overdue from July 2008)
 - Re-baselining of prices & quantities
 - Modernization of IT services
 - Implementation of Service Level Agreements (SLA)
 - Attainment of SLA performance measures
- NG must also ensure stability of all services (legacy & transformed)
 - Agencies note concerns with timely procurement (RFS)

Completion of Inventory Is Mixed

- “Hard” assets are physical equipment (computers, printers)
 - 104 of 106 agencies have signed off on inventory
 - DSS & DFS remain (19% of all assets)
- However, APA has raised concern that inventory has errors & changes from month-to-month
- “Soft” assets are intangible (virtual servers, network ports, number of CPUs, units of storage)
 - Soft inventory may not be completed until November & quantity of some items (storage) are disputed

NG's Monthly Invoices Are Based on Fixed Fees Not Volume of Services Used

	Tower Code	Billing Element	Total
<u>Managed Services Interim Billing</u>			
Account Management & Administration	1	N/A	\$ 1,387,081.00
Data Center (Mainframe/Server)	2	N/A	\$ 4,347,093.98
Desktop Computing	3	N/A	\$ 3,449,798.06
Messaging	4	N/A	\$ 693,363.87
Data Network	5	N/A	\$ 3,519,095.81
Voice Network	6	N/A	\$ 484,222.20
Security	7	N/A	\$ 615,064.44
Help Desk	8	N/A	\$ 821,099.23
Internal Application/Chargeback	9	N/A	\$ 83,088.13
Facilities	10	N/A	\$ 563,744.26
<u>ECP Additions</u>			
Microsoft		N/A	\$ 1,003,522.76
Less Retained Costs			\$ (2,658,991.00)
		Subtotal	\$ 14,308,182.74
		Credit: Industrial Funding Adjustment (1%)	\$ 143,081.83
Total Invoiced Fees			\$ 14,165,100.91

PAY THIS AMOUNT:	\$	14,165,100.91
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Transformation of Legacy IT Services Is Mixed

- NG reports % of its work completed by task
 - Help Desk 90-95 %
 - Network 91 %
 - Desktop computers 57 %
 - Security 36 %
 - Email 33 %
- However, VITA & agencies have not reviewed these percentages nor do they include work by agencies
- Also, task may be complete but not meet required level of service

Tools to Measure Northrop Grumman's Performance Are Partially Implemented

- NG's performance is measured by SLAs
- If SLAs are not met, VITA will earn "performance credits" to offset NG's fees
- NG required to report data for all SLAs by June 2009
- Because NG & VITA are still discussing measurement of some SLAs, not all services are covered by an SLA
- Not all services are performing to their contractual SLA targets

VITA Has Identified Problems With NG's Planning

- Original approach focused on tasks, but was unworkable. New approach focuses on agencies
- Overall transformation plan from June 2006 not updated
- Agency-specific transformation plans not provided
 - Plans would allow agencies to coordinate transformation activities with daily business operations
- Complexity of some State agencies becoming more apparent
 - Agencies have limited control over local agencies
 - Agencies may rely heavily on federal & grant funding

State Agencies Have Delayed Key Elements of Transformation Process

- Agencies have cited concerns with Northrop Grumman's monitoring software (Altiris)
 - Altiris used to remotely manage IT infrastructure
 - Agencies fear confidential data will be compromised
- Agencies have delayed transformation activities over errors in asset inventory & billing overcharges
- VITA reports some agencies are reluctant to cooperate with transformation for other reasons
 - Move toward standardization means IT services at some agencies may decline

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State's Ownership of Assets Depends Upon How Contract Ends

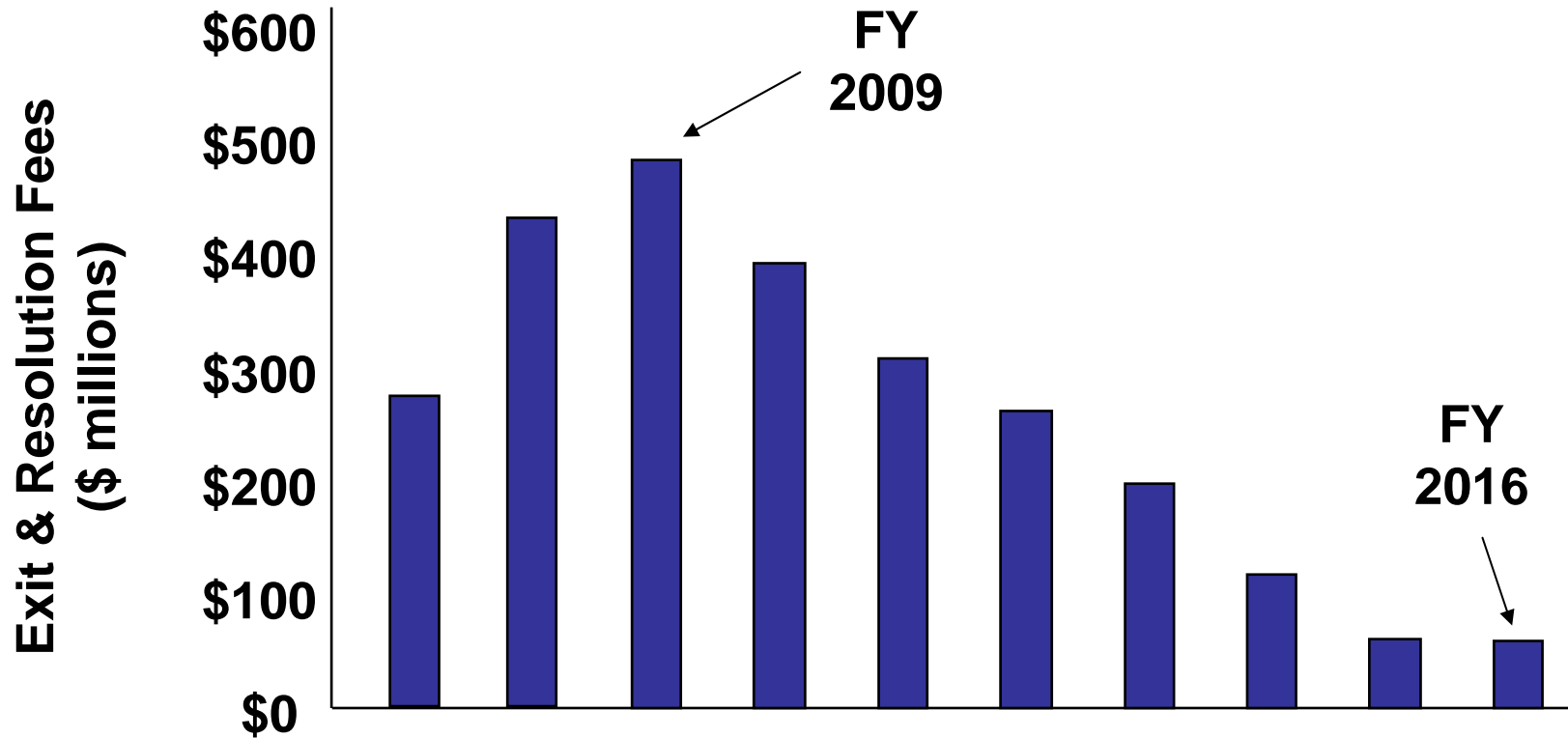
- **Will** own most IT assets at end of full contract term
 - State will own desktops, laptops, servers, & other equipment at no additional cost
 - State must negotiate purchase price for primary data center in Chester
- **Will not** own IT assets if contract is terminated
 - State has option to purchase assets at cost plus markup specified in contract
 - Required resolution fees include cost of leasing IT assets & data centers for remainder of Term

State Has Six Grounds for Terminating Contract

Means of Termination	Cost to State of Termination (FY 2009)
Default by NG	\$0
Commonwealth's Lack of Funds	\$0
Incurred Liability by NG	\$0
Change in Control of NG	\$468 million
Force Majeure Events	\$474 million
Convenience of Commonwealth	\$474 million

- NG can terminate only if State owes more than \$100 million in unpaid fees

Cost to State of Terminating Contract Declines Substantially Over Time



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Partnership Has Provided Benefits but Challenges Remain

- Creation of VITA, followed by two contracts to modernize IT, is a tremendous undertaking
- Partnership has achieved successes
 - Data centers have created new jobs, allowed consolidation of servers, & improved security
 - Some agencies note that modernized IT has produced many benefits
- However, tension exists between centralization & State agency autonomy

Agencies Cite Concerns With Services Provided by VITA & NG

- VITA has not provided services promised in 2006 MOU
- VITA is reported to not understand business needs of agencies
- Delays in procurement process reported to hinder business functions
- Partnership has not provided necessary services

Potential Shortcomings May Limit Effectiveness of Current Governance Structure

- Agencies state that business operations require CIO to be accountable to Governor
- Project Management Division may be focused more on project oversight than support. Also, some agencies are evading its oversight
- Recommended Technology Investment Projects (RTIP) process may not adequately prioritize systems development projects
- Chief Application Officer's role and reporting relationship have been questioned

Contract Negotiations Have Been Underway

- High level discussions have occurred between board members & NG executives
 - ITIB was briefed on NG's proposals at April 16th closed session
- Talks are also underway between VITA & NG staff
 - Definition of when transformation is complete
 - Plan to achieve new objectives, including penalties
 - Measurement of SLAs
 - Identification of in-scope vs out-of-scope tasks
 - Adjustments to prices & resource units

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