Interim Review of the Virginia Information Technologies Agency

Senate Finance Committee
General Government Subcommittee
June 29, 2009
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)

- **State Agency Operations & Maintenance (Limited VITA oversight)**: 36% of $219 million
- **Systems Development Projects (VITA Project Oversight)**: 25% of $150 million
- **State Agency Payments to VITA (VITA Responsibility)**: 39% of $238 million
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)
VI TA Has 216 “Retained” FTEs

<table>
<thead>
<tr>
<th>Division Name</th>
<th>Number of Positions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance &amp; Administration</td>
<td>75</td>
</tr>
<tr>
<td>IT Investment &amp; Enterprise Solutions</td>
<td>69</td>
</tr>
<tr>
<td>Service Management Organization</td>
<td>24</td>
</tr>
<tr>
<td>Security &amp; Risk Management</td>
<td>15.5</td>
</tr>
<tr>
<td>Communications and Executive</td>
<td>16</td>
</tr>
<tr>
<td>Customer Account Management</td>
<td>11</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>216</strong></td>
</tr>
</tbody>
</table>
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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)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northrop Grumman Baseline Services</td>
<td>$153.5 million</td>
</tr>
<tr>
<td>Telecomm. &amp; other costs</td>
<td>$60 million</td>
</tr>
<tr>
<td>Managed Employees</td>
<td>$17 million</td>
</tr>
<tr>
<td></td>
<td>$236 million Cap</td>
</tr>
<tr>
<td></td>
<td>$7.5M – New NG Services</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Projected Annual Payment ($ millions)</th>
<th>Minimum Annual Payment ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$208</td>
<td>$177</td>
</tr>
<tr>
<td>2010</td>
<td>$214</td>
<td>$182</td>
</tr>
<tr>
<td>2011 - 2016</td>
<td>$203</td>
<td>$173</td>
</tr>
<tr>
<td>2017 - 2019</td>
<td>$176</td>
<td>$149</td>
</tr>
</tbody>
</table>
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VI TA’s Revenues and Expenditures Are Primarily From its Internal Service Fund (ISF)

<table>
<thead>
<tr>
<th>Fund</th>
<th>FY 2008 Revenues ($ millions)</th>
<th>FY 2008 Expenditures ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Service</td>
<td>$262</td>
<td>$278</td>
</tr>
<tr>
<td>Enterprise</td>
<td>51</td>
<td>49</td>
</tr>
<tr>
<td>Special Revenue</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>General</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Federal</td>
<td>0.5</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$325</strong></td>
<td><strong>$342</strong></td>
</tr>
</tbody>
</table>
### Agencies with Ten Highest ISF Charges (FY 2008)

<table>
<thead>
<tr>
<th>Agency</th>
<th>ISF Charge ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Social Services</td>
<td>$50</td>
</tr>
<tr>
<td>Department of Transportation - Central Office</td>
<td>39</td>
</tr>
<tr>
<td>Department of Corrections</td>
<td>21</td>
</tr>
<tr>
<td>Department of Health</td>
<td>19</td>
</tr>
<tr>
<td>Department of Motor Vehicles</td>
<td>19</td>
</tr>
<tr>
<td>Department of Taxation</td>
<td>12</td>
</tr>
<tr>
<td>Virginia Employment Commission</td>
<td>8</td>
</tr>
<tr>
<td>Department of Alcoholic Beverage Control</td>
<td>6</td>
</tr>
<tr>
<td>Department of Juvenile Justice</td>
<td>5</td>
</tr>
<tr>
<td>Department of State Police</td>
<td>5</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$184</strong></td>
</tr>
<tr>
<td><strong>Percent of Total ISF Revenues</strong></td>
<td><strong>70.4%</strong></td>
</tr>
</tbody>
</table>
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
VI TA’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

<table>
<thead>
<tr>
<th>Tower Code</th>
<th>Billing Element</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Account Management &amp; Administration</td>
<td>$1,387,081.00</td>
</tr>
<tr>
<td>2</td>
<td>Data Center (Mainframe/Server)</td>
<td>$4,347,093.98</td>
</tr>
<tr>
<td>3</td>
<td>Desktop Computing</td>
<td>$3,449,798.06</td>
</tr>
<tr>
<td>4</td>
<td>Messaging</td>
<td>$693,363.87</td>
</tr>
<tr>
<td>5</td>
<td>Data Network</td>
<td>$3,519,095.81</td>
</tr>
<tr>
<td>6</td>
<td>Voice Network</td>
<td>$484,222.20</td>
</tr>
<tr>
<td>7</td>
<td>Security</td>
<td>$615,064.44</td>
</tr>
<tr>
<td>8</td>
<td>Help Desk</td>
<td>$821,099.23</td>
</tr>
<tr>
<td>9</td>
<td>Internal Application/Chargeback</td>
<td>$83,088.13</td>
</tr>
<tr>
<td>10</td>
<td>Facilities</td>
<td>$563,744.26</td>
</tr>
</tbody>
</table>

**ECP Additions**

<table>
<thead>
<tr>
<th></th>
<th>N/A</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microsoft</td>
<td></td>
<td>$1,003,522.76</td>
</tr>
<tr>
<td>Less Retained Costs</td>
<td></td>
<td>$(2,658,991.00)</td>
</tr>
</tbody>
</table>

**Subtotal**

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$14,308,182.74</td>
</tr>
</tbody>
</table>

**Credit: Industrial Funding Adjustment (1%)**

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$143,081.83</td>
</tr>
</tbody>
</table>

**Total Invoiced Fees**

|             | $14,165,100.91 |

**PAY THIS AMOUNT:**

|             | $14,165,100.91 |
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
VI TA 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

<table>
<thead>
<tr>
<th>Means of Termination</th>
<th>Cost to State of Termination (FY 2009)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default by NG</td>
<td>$0</td>
</tr>
<tr>
<td>Commonwealth’s Lack of Funds</td>
<td>$0</td>
</tr>
<tr>
<td>Incurred Liability by NG</td>
<td>$0</td>
</tr>
<tr>
<td>Change in Control of NG</td>
<td>$468 million</td>
</tr>
<tr>
<td>Force Majeure Events</td>
<td>$474 million</td>
</tr>
<tr>
<td>Convenience of Commonwealth</td>
<td>$474 million</td>
</tr>
</tbody>
</table>

NG can terminate only if State owes more than $100 million in unpaid fees.
Cost to State of Terminating Contract Declines Substantially Over Time

Exit & Resolution Fees ($ millions)

FY 2009

FY 2016
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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
J LARC Staff for This Report

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