

VIRGINIA INFORMATION TECHNOLOGIES AGENCY

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2011**



SUMMARY

Our audit of the Virginia Information Technologies Agency, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in VITA's internal PeopleSoft financial system; and
- one matter involving internal control and noncompliance necessary to bring to management's attention and that requires reporting under Government Auditing Standards.

Our prior audit included four findings and recommendations concerning inventory and billing accuracy, billing and collection procedures, and the oversight of technology procurements. We found during the course of our audit that VITA has resolved all prior findings.

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AUDIT FINDING AND RECOMMENDATION

Review Statewide IT Contracts

The Virginia Information Technologies Agency (VITA) maintains some standing contracts with various vendors to provide services to state agencies and institutions. One of VITA's service contracts is a contract for IT staff augmentation. The contract is with a vendor who provides access to IT staff augmentation services from a network of subcontractors. This allows agencies and institutions to employ the subcontractors' staff to provide in-house application development, maintenance and other IT services without hiring staff.

VITA entered into a two-year contract with the original vendor in November 2005 to provide IT staff augmentation services to the Commonwealth of Virginia. The terms of the contract allowed VITA to extend the contract for three one-year extensions without rebidding the contract. VITA extended the contract in 2007, in 2008, and finally in 2009. The contract expired on November 22, 2010.

In 2010, VITA was in the process of transitioning the state's IT staff augmentation services from the original vendor to a newly awarded contract with a different vendor. However, within nine months VITA terminated the contract with the new vendor for non-performance. Because the contract with the original vendor had not yet expired and to cause the least amount of disruption to agency IT projects, VITA began transitioning services back to the original vendor. VITA issued an emergency contract extension until December 31, 2011 to allow for sufficient time to transition staff and rebid the expiring original vendor's contract.

However, in April 2011, VITA determined that it could not complete the transition and rebidding process by December 31, 2011. VITA extended the contract without competitive bidding for another two years, expiring on December 31, 2013 with the option of one one-year renewal thereafter.

The Commonwealth paid approximately \$20 million for work performed under this contract in fiscal year 2011. During the first three quarters in fiscal year 2012, the Commonwealth paid an additional \$26.5 million. This increase does not indicate that the emergency extension is used to only complete projects already undertaken, as required by the Virginia Public Procurement Act.

As of May 2012, VITA indicates that limited resources may again delay the rebidding process. This may require VITA to invoke the one-year optional extension until December 31, 2014 to allow sufficient time to rebid the contract and transition staff. That extension will take the contract three years past its original emergency extension without competitive rebidding or negotiation.

We recommend that VITA allocate the necessary resources to perform timely reviews, solicitations, and negotiations of the Commonwealth's Information Technology contracts per the requirements of the Virginia Public Procurement Act.

BACKGROUND

Our audit had two purposes.

1. To follow-up on our last audit of VITA's inventory and billing processes, and oversight of technology procurement.
2. To review VITA's system of internal controls and compliance with state and applicable federal financial matters and determine whether financial transactions are properly recorded in applicable financial systems.

Since our last audits of VITA and the Partnership, there have been no significant changes in the Partnership or within VITA's management. Our previous audit noted that Northrop Grumman manages the Commonwealth's IT infrastructure per the Comprehensive Infrastructure Agreement (CIA). As prescribed by the CIA, VITA and Northrop Grumman use a fee-for-service billing model, which entails a specific price for each service related to the management of IT infrastructure regardless of the consumer.

On March 31, 2010, VITA and Northrop Grumman signed Amendment 60 to the CIA. This amendment established adjusted baseline quantities of statewide resource unit usage and the corresponding Northrop Grumman prices per unit of usage, otherwise known as the contract-adjusted baseline. The amendment also adjusted the contractual spending cap corresponding to the adjusted baseline at \$234.2 million annually for the next nine years. However, it is possible for the Commonwealth to exceed this spending cap through the acquisition of additional services above the baseline or outside the scope of the CIA.

Our prior audit included four findings and recommendations concerning inventory and billing accuracy, billing and collection procedures, and the oversight of technology procurements. We found during the course of our audit that VITA has resolved all prior findings. A summary of those resolved findings are in Appendix A at the end of this report.

AGENCY OVERVIEW

VITA has eight divisions and as of the time of our audit, VITA had 179 full-time and wage employees in the retained organization and 88 managed employees. The table below shows each division's expenses for fiscal years 2010 and 2011.

Table 1

Total Expenses by Department for Fiscal Years 2010 and 2011 (in thousands)

<u>Department</u>	<u>2010 Expenses</u>	<u>2011 Expenses</u>
Chief Information Officer	\$ 553	\$ 313
Legal and Legislative Service	609	400
Communications	716	675
Customer Service and Project Management	4,106	3,830
Finance and Administration	9,258	6,523
Enterprise Solutions and Governance*	65,441	57,215
COV Security and Risk Management	1,662	1,354
Internal Audit	575	218
Managed Expenses	60,272	57,272
Agreement Expenses	190,598	206,124
Pass Through Costs for Out of Scope Services	<u>21,961</u>	<u>23,032</u>
Total	<u>\$355,751</u>	<u>\$356,956</u>

Source: PeopleSoft Financial System Departmental Budget Report

*Enterprise Solutions and Governance includes Wireless E-911 fund expenses of \$47.5 million and \$43.7 million for fiscal years 2010 and 2011, respectively. Also included in these expenses are the Project Management Division's administrative costs, the costs associated with Enterprise Applications and the VA Geographic Information Network.

The following tables summarize VITA's actual funding and expenses by source for the fiscal years ended June 30, 2010 and June 30, 2011.

Table 2

Revenue and Expenses by Fund for Fiscal Year 2010 (in thousands)

<u>Fund</u>	<u>Revenues</u>	<u>Expenses</u>
General	\$ 2,381	\$ 2,381
Special Revenue	31	81
Industrial Funding Assessment	5,464	5,629
Geographic Information Systems	751	2,305
Enterprise Applications	945	8,314
Internal Service: Computer Services	188,641	225,673
Internal Service: Telecommunications	68,164	62,581
Internal Service: Out-of-Scope	426	1,013
Wireless E-911 Fund	53,015	47,729
Federal Funds	<u>43</u>	<u>45</u>
Total	<u>\$319,861</u>	<u>\$355,751</u>

Table 3

Revenues and Expenses by Fund for Fiscal Year 2011 (in thousands)

<u>Fund</u>	<u>Revenues</u>	<u>Expenses</u>
General	\$ 2,252	\$ 2,254
Special Revenue	815	9,563
Industrial Funding Assessment	5,744	4,916
Geographic Information Systems	389	2,644
Enterprise Applications	330	246
Internal Service: Computer Services	222,564	221,807
Internal Service: Telecommunications	81,238	75,939
Internal Service: Out-of-Scope	177	682
Wireless E-911 Fund	52,953	38,118
Federal Funds	<u>1,021</u>	<u>787</u>
Total	<u>\$367,483</u>	<u>\$356,956</u>

Table 2 and Table 3 Source: PeopleSoft Financial System: Fund Trial Balance

VITA receives most of its funds from agencies paying for IT infrastructure services in Internal Service Funds. We audit the Wireless E-911 Fund separately and its report is located on our website. General Funds supplement the operations of various VITA departments, including the Chief Information Officer's Office and Enterprise Solutions and Governance.

STATUS OF TRANSFORMATION

In March 2010, Amendment 60 addressed the issue of transformation at certain agencies not yet being complete. During the last audit, 11 agencies required further resolution of certain transformation issues such as incompatibility with Northrop Grumman-provided services and unwillingness to transform. However, those agencies were in the process of working with the Partnership to determine how to resolve these problems so that all agencies can completely transform.

Beginning in January 2011, outstanding non-transformed, partnership-serviced infrastructure began to incur higher monthly fees (referred to as legacy rates). Since it is more costly for the Partnership to maintain and support agency-owned assets, the legacy fees incurred were to offset the increased cost. Table 4 lists the remaining non-transformed agencies and their expected dates for completing transformation at the time of our audit along with the estimated amount of the monthly legacy fees these agencies incur.

Table 4

Remaining Agency Transformation Status as of June 29, 2012

Agency Name	Expected Date of Transformation	Estimated Monthly Legacy Rates Charged	Agency on track to meet transformation date?
Department of Medical Assistance Services	July 2012	\$ -	Yes
Virginia Employment Commission	To be Determined	\$32,207	To be Determined
Department of Emergency Management	To be Determined	\$24,704	To be Determined
Virginia State Police	To be Determined	\$49,013	To be Determined

Department of Medical Assistance Services is not subject to legacy fees due to a special provision. Per Amendment 60, legacy fees are applicable to all agencies not transformed by January 2011.



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

July 12, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon III
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia Information Technologies Agency (VITA)** for the year ended June 30, 2011. For inventory testwork, our audit period extended into December 2011 in order to have access to the most current inventory billings at each agency selected for testwork. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System and in VITA's internal PeopleSoft financial system, review the adequacy of VITA's internal controls, test compliance with applicable laws and regulations and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

VITA's management has responsibility for establishing and maintaining internal controls and complying with applicable laws, regulations, and contract provisions. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant business processes.

Cost Recovery and Inventory Validation
Billing Dispute Resolution Processes
General Expenses
General Application and Accounting Controls
Information System Security

We performed audit tests to determine whether VITA's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, and contract provisions. Our audit procedures included inquiries of management, inspection of documents, records, and contracts, and observation of VITA's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses. We confirmed inventory and accounts receivable balances with agencies selected for testwork.

Conclusions

We found that VITA properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in VITA's internal PeopleSoft financial system. VITA records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and PeopleSoft.

We noted one matter involving internal control and its operation and compliance with applicable laws and regulations that requires management's attention and corrective action. This matter is described in the section entitled "Audit Finding and Recommendation."

VITA has taken adequate corrective action with respect to audit findings reported in the prior year.

Exit Conference and Report Distribution

We discussed this report with management on July 10, 2012. Management's response to the finding identified in our audit is included in the section titled "Agency Response". We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

GGG/clj



COMMONWEALTH of VIRGINIA

Virginia Information Technologies Agency

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Samuel A. Nixon, Jr.
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July 11, 2012

Mr. Walter J. Kucharski
Auditor of Public Accounts
Post Office Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski: *Walt*

Thank you for the opportunity to respond to the Auditor of Public Accounts' audit of the Virginia Information Technologies Agency (VITA). We are pleased that you have reported on the significant progress we have made since our last suit. As for the report's finding and recommendation, we acknowledge the need for additional resources in this area and will strive to allocate the resources necessary to perform timely re-solicitation of any information technology contracts.

As always, we appreciate the professionalism of your staff. Thank you for working with us and seeking our input.

Sincerely,

Sam Nixon
Samuel A. Nixon, Jr.

c: The Honorable James D. Duffey, Jr., Secretary of Technology

VIRGINIA INFORMATION TECHNOLOGIES AGENCY

OFFICIALS AND MANAGEMENT

James D. Duffey, Jr.
Secretary of Technology

Samuel A. Nixon Jr.
Chief Information Officer of the Commonwealth

Judy Marchand
Director of Customer Services and Project Management

Dana Smith
Director of Finance and Administration

APPENDIX A: STATUS OF PRIOR YEAR FINDINGS

Our prior audit included four findings and recommendations concerning inventory and billing accuracy, billing and collection procedures, and the oversight of technology procurements made statewide. We found during the course of our audit, that VITA has resolved all prior findings.

Resolved Findings

Create a Time Frame for Resolving Inventory Disputes

During our previous audit, we found that the Partnership did not have a time frame for resolving billing disputes. VITA decided to write off approximately \$2 million of prior year receivables subsequent to June 30, 2010, due to incorrect inventory counts. We also found that some of the outstanding receivables dated back to the beginning of fiscal year 2008 with no resolution until the beginning of fiscal year 2011.

During the current audit period, we found that VITA developed and employed a billing dispute policy. The policy sets the dispute resolution timeframe to 60 days. If the resolution process discovers billing errors, VITA retroactively corrects bills issued within the last 120 days. VITA credits billing errors to the agency within 30 days after resolution. If the agency and VITA do not reach a resolution and VITA has exhausted all possible collection attempts, VITA sends the receivables to the Department of Accounts for further investigation and possible collection. We noted that undisputed receivables greater than 90 days in FY2011 decreased to \$454,787.

Maintain Adequate Oversight of Technology Procurements

During our previous audit, we found that although VITA had developed a plan to determine if agencies were appropriately routing IT purchase requests to Supply Chain for approval, VITA had not placed the process into effect during the audit period.

During our current year audit, we found that VITA is implementing their plan to ensure that agencies are routing all in-scope IT purchases to the Partnership for approval. VITA's efforts to properly route procurement purchases identified 49 instances, totaling \$73,563 in fees, of improperly routed purchases. These fees represent the fees that VITA would have collected had the agency properly procured those items through VITA managed contracts or other sources.

Strengthen Inventory and Billing Controls

During our previous audit, we found that agency billings were incorrect and based on incorrect inventory quantities. The Partnership has employed a verification and validation process that is ongoing to ensure inventory quantities remain as accurate as possible so that billings will reflect the most current inventory quantities at each agency.

During the current audit period, we found no instances of over or under billing. Agency billings were accurate and reflected current services for the period.

Ensure Cost Allocation Plan Recovers all Costs

The rate development process involves multiple calculations, historical data, and projections to determine an equitable rate based on the cost of providing services. Base rates, or Northrop Grumman charged rates, for each resource are noted in the contract, and include the base quantities, or agreed upon baseline usage for each resource unit.

When statewide usage rises above the baseline, this usage results in additional resource charges (ARCs) that decrease the per-unit price to the Commonwealth for resource units above the baseline. When statewide usage falls below the baseline, reduced resource credits (RRCs) are applied. RRCs do not completely take away the cost per unit of assets not in use, but rather decrease the cost per unit for units no longer in use. The Commonwealth is still responsible for a portion of the cost of the asset.

During our last audit, we found that when statewide usage decreased to an amount below the baseline, agencies were no longer responsible for these items; however, the Commonwealth still had responsibility for paying for a portion of the assets not in use. Also, when statewide usage increased to an amount above the baseline, state agencies were still paying a price that did not incorporate the additional resource credit. VITA was not incorporating these ARCs and RRCs into the rate development, which did not allow for recovery of all costs.

During the current audit period, we found that VITA is incorporating the ARC and RRC rates into the rate structure by using baseline rates adjusted for any cost of living allowances, actual or average resource unit usage, and ARC and RRC fees as a result of actual or average resource unit usage. This allows VITA to bill agencies based on actual quantities or average quantities based on historical usage at the ARC and RRC adjusted price. This means that agencies pay a discounted rate if usage is above the baseline and agencies pay a higher rate if usage falls below the baseline to allow for recovery of all costs.