Management of an IT Outsourcing Contract
Follow-up Audit

Department of Veterans' Affairs

Canberra   ACT
5 December 2006

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Veterans' Affairs in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Management of an IT Outsourcing Contract Follow-up Audit.*

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Steve Chapman
Acting/Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra   ACT

AUDITING FOR AUSTRALIA

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Abbreviations

ANAO	Australian National Audit Office
DVA	Department of Veterans' Affairs
IBM	International Business Machines
IBMGS	International Business Machines Global Services
IT	Information Technology
ITCM	Information Technology Contract Management
RFT	Request for Tender
SISA	Strategic Information Services Agreement (1997–2002)
SISA2	Strategic Information Services Agreement 2 (2002–2007)

Summary

Summary

Background

1.   The Department of Veterans' Affairs (DVA) serves members of Australia's veterans and defence force communities, their widows or widowers, and eligible dependants, through programs of care, compensation, commemoration and defence support services. Currently DVA has around 470 000 beneficiaries who are veterans or dependants, and a further 60 000 beneficiaries (current and former defence personnel) through the Military Compensation and Rehabilitation Service. In the 2006–07 Budget, responsibility for compensation services for the Australian Federal Police moved to DVA.

2.   DVA has a national office in Canberra and operates through state and regional offices around Australia. It also deals directly with many hospitals and other care and transport providers in every state and territory. To support its activities, DVA operates a number of Information Technology (IT) systems. In 1992, DVA partially outsourced its IT services and signed further agreements for IT outsourcing in 1997 and 2002. It expects to sign a new contract in late 2006 for IT services that will be provided from April 2007.

3.   ANAO Audit Report No.46 of 2001–02, *Management of an IT Outsourcing Contract*, assessed how well DVA was managing its contract with International Business Machines Global Services (IBMGS) for the provision to the department of a range of IT services. The audit made five recommendations for improvement. DVA agreed with four of the recommendations, and agreed in principle with the other recommendation.

4.   The objective of this follow-up audit was to assess the extent to which DVA had implemented the recommendations from the original audit during the period 2002–06, including in its preparation of the IT outsourcing contract which will operate from 2007.

Key findings

5.   Table 1 summarises DVA's progress in implementing the recommendations from ANAO's previous audit report.

Table 1

DVA's progress in implementing recommendations of ANAO's 2002 audit

Audit Report No. 46 Recommendations	ANAO assessment of the implementation status		Reference in this report
	2002 Contract	Draft 2007 Contract	
1. ANAO recommends that, in either the renewed or a new contract, DVA ensure that the provisions give appropriate effect to DVA's IT strategic planning, and are based on robust estimates of its expected demand for IT services.	Implemented	Implemented	Chapter 2
2. ANAO recommends that, in preparing for contract extension or succession, DVA strengthen the role of IT for business enablement by: a) reviewing its approach to specification of required services in order to manage contract deliverables efficiently and effectively; and b) identifying clearly key service requirements and service standards that give effect to the department's business objectives.	Implemented	Implemented	Chapter 3
3. ANAO recommends that DVA benchmark its IT services, so as to have a sound basis for securing potential financial and service benefits specified in the current contract as being contingent on benchmarking, and to better prepare for any future market testing initiatives.	Implemented	Implemented	Chapter 4
4. ANAO recommends that DVA collect and review relevant performance data to enable it to effectively monitor contract performance. This should include impacts on DVA's outputs of interruptions to its IT services, and associated business costs.	Implemented	Implemented	Chapter 3
5. ANAO recommends that DVA maintain an up-to-date, consolidated contract, including variations, to facilitate ongoing management of changing requirements and ensure compliance with contract change procedures.	Implemented	Implemented	Chapter 2

Conclusion

6.   ANAO concluded that DVA had implemented all five recommendations of the original audit under its 2002–06 IT outsourcing contract and in preparing for the IT outsourcing contract which is scheduled to come into effect in April 2007.

7.   The ANAO makes no further recommendations in this report.

8.   During the audit, ANAO also identified some of the problems that government agencies may face in purchasing IT goods and services. As a result, ANAO compiled a list of some of the risks involved in the management of IT outsourcing and the key management actions which can contribute to achieving successful outcomes, for the benefit of other agencies involved with new tenders or renewing contracts.

DVA's response

9.   DVA notes and agrees with the ANAO assessment that the department has implemented all of the recommendations from the original audit during the period 2002 to 2006 and also in preparation for the IT outsourcing contract which will operate from 2007.

10.   The conclusion highlights the department's ongoing commitment to strategically managing its Information and Communication Technology environment and its outsourcing arrangements to ensure that government services are efficiently and effectively delivered.

11.   DVA notes that as part of the report, ANAO compiled a list of some of the risks involved in the management of an IT outsourcing contract and identified key management actions in achieving successful outcomes. DVA supports the identified actions and notes the department's achievement in addressing the majority of these for both the 2002 contract and in the draft 2007 contract.

12.   DVA advises that its Disaster Recovery Project has commenced with the outsourced provider having established a second site for a secure back-up for data systems. This is a multi-phase project with completion expected by mid 2007.

Audit Findings
and Conclusions

1. Introduction

Background

1.1   The Department of Veterans' Affairs (DVA) serves members of Australia's veterans and defence force communities, their widows or widowers, and eligible dependants, through programs of care, compensation, commemoration and defence support services. Currently DVA has around 470 000 beneficiaries who are veterans or dependants, and a further 60 000 beneficiaries (current and former defence personnel) through the Military Compensation and Rehabilitation Service. In the 2006–07 Budget, responsibility for compensation services for the Australian Federal Police moved to DVA, adding around 1 000 beneficiaries to DVA's responsibilities.

1.2   DVA has a national office in Canberra and operates through state and regional offices around Australia. It also deals directly with many hospitals and other care and transport providers in every state and territory. To support its activities, DVA operates a number of Information Technology (IT) systems. In 1992, DVA partially outsourced its IT services.

1.3   In 1996 the department invited tenders for the majority of its IT services, and Integrated Systems Solutions Corporation Australia Ltd (later to become International Business Machines Global Services (IBMGS)) won the contract. The Department of Finance and Administration and ComSuper joined the contract in September 1997. The contract, called the Strategic Information Services Agreement (SISA), was for five years.

1.4   DVA renewed its contract with IBMGS for a further three years from August 2002. This revised contract was termed the Strategic Information Services Agreement 2 (SISA2) to differentiate it from the original SISA contract.

1.5   DVA made significant changes to its IT infrastructure and systems under SISA2. As a result, DVA took responsibility for the provision of phone services, the printing systems in its offices and the management of software, other than systems software and most mainframe software. Subsequently, DVA also contracted its fixed line communications systems for two years; and signed a second contract for the provision of mobile phone systems and a third separate contract for the provision of nation-wide printing services.

1.6   In August 2004, DVA again extended its contract with International Business Machines (IBM), previously IBMGS, for a further year, taking its outsourcing with IBM to the maximum ten years the contract allowed.

1.7 DVA's total payments to IBM for IT infrastructure services and support over the period 2001–02 to 2005–06 was approximately $169 million, an average of some $33.8 million a year.

1.8 In February 2006, DVA invited companies to tender for the provision of IT services to the department. This new tender will be for the provision of services for four years, commencing in April 2007, and includes the option of two extensions, each of two years. For the purposes of this report, the new contract is termed the draft 2007 contract.

The original audit

1.9 In 2002, ANAO audited DVA's management of its contract with IBMGS.[1] The objective of the audit was to form an opinion on DVA's management of its IT outsourcing contract, SISA. The audit considered DVA's planning to meet its IT needs through the contract, the provisions of the contract, contract administration, management of the impact of the outsourced services on DVA's business, and the outcomes of DVA's approach to the contract.

1.10 The ANAO concluded that, while DVA had managed the contract with the aim of ensuring the ongoing delivery of its services, it needed to address some strategic and operational issues to improve contract management. The audit made five recommendations on ways in which DVA could improve its contract management. The department agreed with four of the recommendations and agreed in principle with the fifth recommendation.

The follow-up audit

Audit objective

1.11 The objective of this follow-up audit was to assess the extent to which DVA had implemented the recommendations from the original audit in its actions during the period covered by SISA2, including its preparation of the draft 2007 contract. The audit took into account changes in DVA's IT requirements since 2002.

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[1] ANAO Audit Report No.46 2001–02, *Management of an IT Outsourcing Contract, Department of Veterans' Affairs*, available at <www.anao.gov.au>.

Audit methodology

1.12   At the commencement of the audit, DVA provided ANAO with a written statement commenting on its progress in implementing the original audit recommendations. ANAO assessed DVA's implementation of the recommendations by analysing its statement, conducting interviews with staff in DVA and checking relevant files and documents. ANAO also interviewed current IBM staff, some former DVA and IBM personnel, and staff directly responsible for IT contracts in other government departments. ANAO carried out the fieldwork in Canberra and Melbourne between April and June 2006.

1.13   The audit was conducted in accordance with ANAO Auditing Standards at a cost of $190 000. The ANAO engaged a consultancy firm, Courage Partners Pty Ltd, to assist in conducting the audit.

Structure of this report

1.14   The remaining chapters of this report are as follows:

- Chapter 2 reviews the extent to which DVA was able to link the IT contract with its IT strategic plans, and assesses DVA's management of changes in the contract;

- Chapter 3 examines how DVA specified its service requirements in the IT contract, how the services were measured, and what action was taken when performance was below the required standards;

- Chapter 4 considers the measures taken by DVA to ensure that it obtained value for money in its IT services; and

- Chapter 5 contains a short summary, for the benefit of other agencies, of the management of risks in IT outsourcing.

2. IT Strategic Planning and Contract Management

Background

2.1 In the 2002 audit, ANAO found that DVA had not strengthened its management and procurement of IT services because it had not taken a sufficiently holistic review of its needs. Rather than continually relying on Additional Service Requests to satisfy its needs, DVA could have included such requirements in its contract, or renegotiated the provisions of the existing contract. Additionally, ANAO found that DVA had not always documented contract changes.

2.2 At that time, ANAO recommended that, in either the renewed or a new contract, DVA ensure that the provisions give effect to DVA's IT strategic planning, and be based on robust estimates of the expected demand for IT services in the agency (Recommendation 1). ANAO also recommended that DVA maintain an up-to-date consolidated contract, including variations, to facilitate ongoing management of changing requirements and to ensure compliance with contract change procedures (Recommendation 5).

2.3 In DVA's April 2006 statement commenting on its progress in implementing the previous audit's recommendations, it stated that it based the 2002 SISA2 contract on robust estimates of the expected demands for IT services to meet business needs. As part of SISA2, DVA had taken over responsibility for capacity management, and hence it was better able to judge its resource demands. DVA also stated that, with IBM, it had developed a reliable contract change management system, and it would continue to use this system under the draft 2007 contract.

ANAO's findings

Strategic planning

2.4 ANAO noted that DVA's 2002 and 2003 IT Strategic Plans provided guidance on the main developments and related activities to occur in the following five years, but the links between these plans and the services to be provided under SISA2 were unclear. However, this situation was indicative of the difference in nature of the two documents.

2.5   The 2003 IT Strategic Plan focused on DVA's objectives without describing in detail how DVA might achieve the various outcomes. The SISA2 contract described in detail the services DVA and IBM had agreed. SISA2's emphasis was on the practicalities of day-to-day operations, and ensuring that DVA could carry out its tasks successfully. However, the contract also included a section on future development which enabled DVA to work with IBM to make any changes required by its IT strategic plan. ANAO noted that the wording of SISA2 was precise and conducive to DVA and IBM agreeing interpretations.

2.6   When developing SISA2, DVA made a number of significant changes to what had been required under SISA to ensure that the new contract was responsive to meeting DVA's needs. These changes included the requirement to replace equipment with more modern versions which had greater capacity and higher speeds, and the opportunity to go outside the contract for the purchase of DVA-preferred equipment and software. DVA advised that it reviewed its priorities each time it required an additional service.

2.7   During 2005, DVA commissioned a major Service Delivery Review to determine how it could best deliver its services to veterans in a uniform manner. As a result of the review, DVA embarked on a program of re-organisation so that it had a standardised way of operating across all service areas, from health services to pensions, and across all states and territories. DVA called this change program 'oneDVA'.

2.8   DVA stated that it had to address two significant elements in implementing 'oneDVA'. The major element was preparing staff for organisational change. The second element was the introduction of a fully integrated national IT system, which would assist each DVA office in Australia to operate in the same way. DVA's IT Strategic Plan for 2006–09 provided guidance on how it would bring about the change to IT under 'oneDVA'. In his introduction to this strategic plan, the Secretary of DVA stated that IT would be the main instrument for implementing the change to 'oneDVA'.

2.9   ANAO noted that the contents of this recent plan were more noticeably reflected in the draft 2007 contract than the contents of the 2002 and 2003 plans were reflected in SISA2. Elements from the 2006 plan found in the draft 2007 contract included an allowance for changes (in terms of the number of terminals and software programs in use), and the ability to change the contract if DVA's operations were reduced due to a fall in numbers of persons for whom DVA provided services.

2.10 Schedule 10 of the draft 2007 contract (Transition Out Arrangements), contained comprehensive details of the actions the contractor would be required to undertake when the contract was due to end, be modified, or be terminated. However, it did not allow for the imposition of penalties, such as withholding payments, should the contractor fail to undertake any or all of these requirements. ANAO suggests that DVA consider the addition of appropriate wording on this matter to the contract before negotiations begin.

Disaster recovery

2.11 ANAO noted that although DVA's 2006–09 IT Strategic Plan stated that one major strategy was to improve its disaster recovery arrangements, DVA had not yet established a full Disaster Recovery Plan. In its 2004–05 Annual Report[2] the department stated that:

> a set of technical instructions to be followed in the case of a disaster were prepared and will be tested during 2005–06 to ensure integration of all recovery plans, including any changes that continue to be made in the IT infrastructure.

2.12 In March 2006, DVA's National Audit and Fraud Committee considered a submission detailing the preferred timeframes for restoring the various elements of its IT system following a disaster. This submission had not yet progressed to a clear plan. DVA advised that its Information Committee had approved the commencement of work on a draft implementation plan to deal with disaster recovery.

2.13 ANAO considered that the formulation and testing of the Disaster Recovery Plan were essential to ensure the uninterrupted operation that DVA requires. However, ANAO was unable to identify any evidence of the technical instructions for disaster recovery or of their testing. ANAO's Financial Audit Report No.48 of 2005–06[3] commented on the significance of DVA's weakness in this area.

Contract management

2.14 ANAO noted that DVA had made 59 Contract Change Requests since the start of SISA2. ANAO examined a sample of such requests, and tracked them in DVA's recordkeeping system from inception through to final

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[2] Department of Veterans' Affairs, Annual Report 2004–2005, Canberra, 2005, p. 211, available at <www.dva.gov.au>.

[3] ANAO Audit Report No.48 2005–06, *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2006*, p. 126, available at <www.anao.gov.au>.

agreement and implementation. ANAO considered that the methodology used in raising and negotiating Contract Change Requests was comprehensive and appropriate, and that each stage of the approval process was well documented. DVA plans to use the same system for contract changes which may arise once the new contract becomes operational.

2.15 ANAO noted that all IT Contract Management (ITCM) staff had received appropriate training and were encouraged to attend contract management seminars as part of their work. All relevant staff appeared to be well-versed in contract change procedures.

2.16 ANAO noted, however, that although ITCM staff had access to various working documents, there was no Procedures Manual. ANAO suggests that, given the scrutiny under which contract management is placed, a Procedures Manual would be an effective means of guarding against the risk of any deterioration in the management of the contracts.

2.17 DVA stated that it considered a major factor in its successful contract management was the relationship between the DVA and IBM staff. ANAO observed that there were regular meetings between DVA and IBM staff at various levels, and frequent phone discussions. ANAO found that these working relationships were sound and a major contributor to the satisfactory implementation of the SISA2 contract.

2.18 ANAO noted that, when some DVA staff were focused on preparing documentation for the draft 2007 contract in the period February 2006 to April 2007, only SISA2 contract changes which DVA deemed essential were to be negotiated. The annual price review (February 2006) was one such change. ANAO examined the documents related to that change in the contract and found the process and documentation to be satisfactory.

Conclusion

2.19 During the currency of SISA2 there were several changes within the department, the most significant being the move to 'oneDVA'. Changes in IT were an integral part of these changes. Thus, while SISA2 did not and largely could not, fully reflect the contents of DVA's IT strategic plans, there were adequate reasons for this. DVA designed SISA2 for staff to work from on a daily basis and the contract was primarily concerned with meeting needs identified in 2002. Nevertheless, DVA did subsequently amend SISA2 on 59 occasions in order to ensure the contract was better able to meet DVA's needs.

2.20 The draft 2007 contract covered the major elements of the 2006 IT Strategic Plan and it allowed for possible changes in DVA's organisation, and a likely reduction in client numbers. It also required comprehensive transition procedures in the event that DVA needed to amend or cancel the contract. The ability to make contract changes, as with SISA2, was retained, and this will be beneficial in assisting DVA to meet changing needs.

2.21 DVA, to the extent that circumstances permitted, had implemented ANAO's recommendations on the IT contract linkage to the IT Strategic Plan, and on the contract change system.

3.   IT Service Delivery

Background

3.1   In the previous audit, the ANAO found that there was a lack of clarity about the service level coverage under SISA. DVA considered that the contracted service levels applied to all IT infrastructure on which its various applications resided, irrespective of whether the applications existed at the commencement of the contract or were introduced at a later time. However, the contractor had advised that its obligations related to meeting the needs of DVA, as defined in the contract.

3.2   ANAO recommended that, in preparing for contract extension or succession, DVA strengthen the role of IT for business enablement by:

- reviewing its approach to specification of required services in order to manage contract deliverables efficiently and effectively; and

- identifying clearly key service requirements and service standards that give effect to the department's business objectives (Recommendation 2).

3.3   The audit also found that because DVA had no practical measures of the service provider's performance, there was limited monitoring of the impact of performance failures. ANAO recommended that DVA collect and review relevant performance data to enable it to effectively monitor contractual performance. This should include impacts on DVA's outputs of interruptions to its IT services, and associated business costs (Recommendation 4).

3.4   In its April 2006 statement commenting on its progress in implementing the recommendations of the previous audit, DVA advised that it had established a new range of IT services and had linked these to its business requirements. DVA checked IBM's performance against the required services on a daily, weekly and monthly basis. If service was below the required standards, DVA reviewed the situation and determined if it would seek service credits from its IT provider.

ANAO's findings

3.5   ANAO noted that Schedule 1 of SISA2 detailed the range of services that the contractor would provide and contained clear explanations of the levels of service that were required. Similarly, the draft 2007 contract included detailed specifications of the IT services and required levels of service to be

provided by the contractor. Both SISA2 and the draft 2007 contract detailed penalties that would apply if IBM did not meet the required service standards.

3.6   SISA2 included extensive tables covering the cost of each of the services provided by IBM. However, ANAO noted that DVA accepted some increases in hardware costs, even though the cost of hardware actually fell during the period of the contract (although capability and reliability increased). DVA stated that these cost increases could be justified by the increased cost of maintenance associated with the equipment purchased. ANAO suggests that, in its preparation for draft 2007 contract negotiations, DVA needs to consider how it could also benefit from any cost saving flowing from hardware cost reductions and how it could contain the associated maintenance costs.

3.7   As in most organisations, problems with IT services in DVA were reported in the first instance to a help-desk. ANAO found that both SISA2 and the draft 2007 contract contained clear definitions of how the problems received by the help-desk were to be categorised. Severity One problems were the most serious and required resolution within four hours, while Severity Two and Severity Three problems required less urgent attention. Severity Four problems required attention within ten working days. ANAO's examination of the monthly service levels achieved from 2004 to April 2006 revealed that problem resolution was generally above requirements.

3.8   ANAO noted that in preparing its draft 2007 contract, DVA had devoted considerable resources to ensure that it will fully meet organisational requirements and provide value for money. DVA estimated that the overall process of preparing the Request for Tender (RFT), evaluating bids, and then undertaking the final contract negotiations, will take a team of between six and 35 staff almost two years, and cost an estimated $1.8 million.

3.9   While DVA's Contract Advisory Unit had provided advice on the tendering for a new contract, the overall process required a resourcing level beyond the Unit's capacity. Therefore, DVA had contracted three external organisations as part of the RFT process, one to carry out benchmarking of the costings in tenders, and two others to check the probity and financial aspects of the contract. ANAO considers that as a result of this checking process, the draft 2007 contract contained detailed descriptions of the levels of service required, and the timeframes for resolving problems. However, ANAO noted that some expectations of contractor performance in the draft contract lacked clarity. ANAO suggests that DVA address this as part of contract negotiations.

3.10   The draft 2007 contract requires the contractor to provide the replacement and updating of DVA's equipment and software—this is termed refreshment. The contractor is able to take the initiative in this area. ANAO considers such an approach in a contract useful, although it may not always be sufficient to meet the department's business needs. In this regard, DVA should consider including in its draft 2007 contract an ability to specify its requirements during any refreshment and negotiate the costs.

3.11   To assess the standard of service provided to DVA, IBM collected and published performance data in its monthly, quarterly and annual service reports, and supplied these to DVA. The monthly report included an acknowledgement of any area in which IBM had not reached the required service standard. DVA carried out independent checks and produced its own performance figures. ANAO noted that there were generally some differences between the performance figures provided by IBM and DVA's figures, mainly due to the volume of system usage.

3.12   ANAO noted that where the difference in performance figures was not significant, DVA had confirmed IBM's figures and then made the monthly payment to IBM. However, where DVA's figures for performance differed significantly from those of IBM, DVA required IBM to investigate the discrepancy. Significant discrepancies occurred about once every three months. DVA stated that discrepancies had been resolved through negotiation and agreement on the application of a service credit.

3.13   Under SISA2, DVA was able to obtain a service credit—thereby claiming a deduction from the monthly invoice for the IT services provided—when IBM had not met the standards required by the contract. ANAO found that IBM had usually remedied service failures within a few minutes, with little cost, if any, to DVA in inconvenience or lost services. ANAO assessed examples of DVA's documentation of service credit calculation, and observed that in the instances where service failures made a noticeable impact on DVA's operations, DVA had sought service credits and IBM had agreed to them.

3.14   The method of calculating the amount of a service credit under SISA2 depended on the percentage of all DVA staff that had been affected by the service failure. DVA stated that this had proved satisfactory for some service credit calculations, but was inadequate for dealing with other situations. For example, when the telephone switchboard in one office was unserviceable for a day, the service credit would have been insignificant using this method of calculation.

3.15 ANAO noted that in 2004, DVA had renegotiated with IBM the method of calculating service credits. The revised method used data on the impact on the number of staff who were unable to work, the number of hours they were inconvenienced, and an average hourly staff cost. DVA stated that IBM had accepted this approach and that it had proved to be a more equitable way of calculating service credits.

3.16 Figure 3.1 illustrates the value of service credits claimed by DVA in each of the years 2001–02 to 2005–06. DVA claimed a total of $1.13 million in service credits over this period.

Figure 3.1

Service credits obtained by DVA
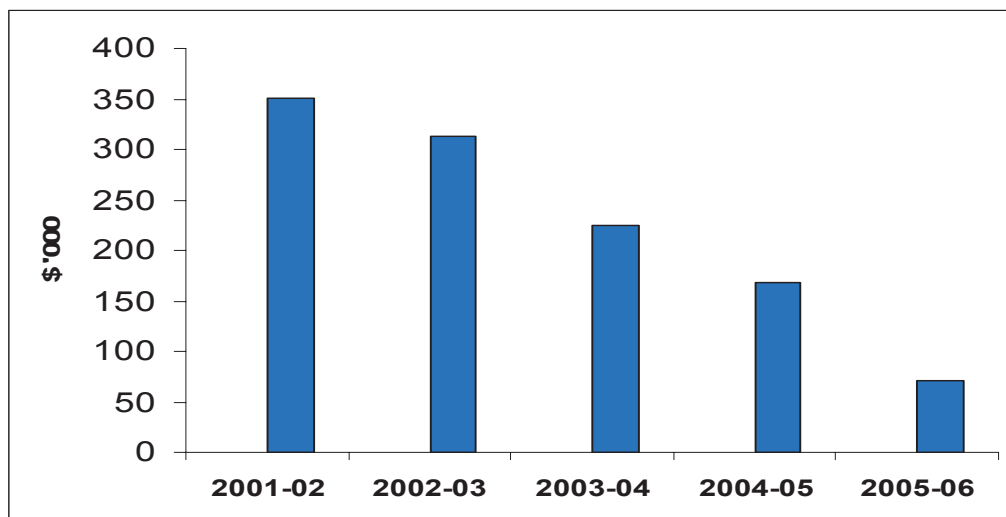
Source: DVA data.

3.17 The system of DVA claiming service credits if the contractor fails to deliver service to the required standards will continue under the draft 2007 contract. However, the contractor will also be able to accumulate service credit reductions where performance is above an Incentive Service Level performance target. The proposed performance targets differ between the various types of services. The service credit reductions will not allow the contractor to charge DVA more money, but will minimise any service credits which DVA may claim during the contract.

3.18 ANAO noted that DVA did not indicate in the draft 2007 contract what would happen should the contractor accrue more service credit reductions than could be offset by service credit claims. DVA advised that it did not

intend to pay a contractor for any unused service credit reductions at the end of the contract, and would consider making this explicit in the contract.

3.19   The draft 2007 contract also specified that 'service level measurement processes will be subject to regular audit'. ANAO suggested that more precise wording of this clause could avoid the risk of differences in interpretation under the contract. DVA advised that during contract negotiations, it will seek to include more precise terms concerning the regularity of audits, and specific reference to who would conduct the audits.

Conclusion

3.20   DVA acted upon ANAO's 2002 recommendation by including clearer specifications in SISA2 of its required services and the expected standards of service. DVA has further built on its experience with SISA2, in developing the draft 2007 contract. This level of specification by DVA has ensured that the draft 2007 contract is likely to be more responsive to DVA's needs.

3.21   DVA's monitoring ensured that it received services in line with contract payments, and also encouraged the service provider to provide the best possible service. The joint monthly reviews of performance resulted in DVA having a good working relationship with its service provider, benefiting DVA. DVA has implemented the ANAO's 2002 recommendation in specifying required services and required service levels in its SISA2 and draft 2007 contract, and it has also implemented the recommendation on monitoring performance levels.

4. Benchmarking

Background

4.1   During the original audit in 2002, DVA acknowledged that it had not carried out extensive benchmarking of its IT services. It claimed that benchmarking was difficult for a range of reasons, and that obtaining valid and meaningful comparisons was a problem. However, in deciding whether or not to extend its contract with IBM (in 2002), DVA had attempted to benchmark some of the required services.

4.2   At that time, ANAO considered that a more formalised and extensive approach to benchmarking would assist DVA in obtaining value for money in the services it required. ANAO recommended that DVA benchmark its IT services, so as to have a sound basis for securing potential financial and service benefits specified in the current contract as being contingent on benchmarking, and to better prepare for any future market testing initiatives (Recommendation 3).

4.3   In DVA's April 2006 comments on its progress in implementing the previous audit's recommendations, it stated that it had benchmarked its IT services when negotiating SISA2. This resulted in DVA having separate costings for hardware, software and services. Because it no longer allowed the contractor to cross-subsidise different parts of the contract, DVA had a clear picture of what each element of the contract was costing.

ANAO's findings

4.4   Benchmarking is the process by which an organisation seeks to determine and introduce best practice. Benchmarks can operate as standards or targets for performance levels by using comparisons of products, services, practices and processes with similar programs either within the same organisation (internal benchmarking) or within another organisation or country (external benchmarking).[4]

4.5   Benchmarking can provide a satisfactory means of comparing the quality of service and costs for different providers. However, there are significant challenges in benchmarking outsourced IT service providers. Such comparisons can be problematic because of differences in the IT needs of

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[4]   ANAO Better Practice Guide–*Performance Information Principles*, November 1996, available at <www.anao.gov.au>.

organisations; the types and number of systems and programs; the required speeds of access and processing; the age and capability of hardware; data output requirements; and what constitute 'changes' to computer systems.

4.6   However, ANAO noted that recent research in Australia suggested that those organisations which undertook benchmarking were more likely to enter into contracts which were successful.[5] The reasons were twofold. First, a tendering organisation which knew that its proposed costs and services would be compared was likely to keep its profit margins to a reasonable level. Second, preparing for benchmarking assisted the organisation to better understand, and thus describe, it own systems and processes prior to purchasing IT goods and services.

4.7   Prior to 2002, all the IT services provided to DVA by IBM were included in a single contract. This meant that IBM could cross-subsidise the various services that it provided and the cost of each service was not clear to DVA. Under SISA2, the costs of different services were detailed in the agreement. With IBM's agreement in 2002, DVA chose to make new arrangements for the provision of three of the services that IBM had previously provided—printing, capacity management and communications.

Printing services

4.8   The first service that DVA separated from the main contract was printing. DVA benchmarked printer services and subsequently contracted a national company to provide these services for all DVA offices. DVA stated that the new contractor had provided good service, and that the contract had worked well.

Capacity management

4.9   In order to have direct control of capacity management (how systems are used, and where and how data is stored), DVA excluded this service from SISA2 and implemented an 'in-house' management arrangement. This change indicated to the ANAO that DVA was concerned to get the best value for money from the various IT services.

4.10   DVA stated that having responsibility for capacity management in-house enabled it to optimise existing resources and thereby restrain costs. The department also now had more staff who were familiar with all IT

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[5]   Rouse A, *Information Technology Outsourcing Revisited; Success Factors and Risks*, University of Melbourne, 2002, p. 306.

activities. This was beneficial, particularly in the move to 'oneDVA' and the introduction of its new integrated IT application (called Cúram).[6]

Communications

4.11 The provision of voice and data communications was the third service which DVA separated in 2002. After negotiation and comparison of the services available from different providers, DVA contracted a national carrier to provide its communication services. Subsequent benchmarking by DVA in 2004 and 2006 resulted in further changes in those services, so that DVA has had contracts with three different carriers for its fixed line and mobile services.

Value for money

4.12 The Commonwealth Procurement Guidelines[7] require departments to obtain value for money in their purchases. Value for money can be difficult to measure in the case of services. ANAO noted that in the specific case of purchasing IT services, any assessment of value for money was not based on cost alone but also included an assessment of risk.[8,9] There is always an element of risk in using a company which had not established a reputation for reliability in its services, and for speedily rectifying any faults that arose. Reliability and quick resolution of problems are important considerations where the computer system is nation-wide and is operating 24 hours a day.

4.13 DVA stated that to minimise its exposure to risk, it assessed potential providers of IT services to ensure that they had a good record of providing relevant services. DVA advised that minimisation of risk was a primary consideration in the obtaining of value for money when DVA obtained IT services outside the SISA2 contract.

4.14 ANAO noted that DVA was also able to benchmark, and thereby assess whether it received value for money, through the provisions in SISA2 for DVA to purchase IT goods and services from other firms. The procedure for the acquisition of additional work, new software or extra equipment was for DVA to supply IBM with a Statement of Requirement. IBM then responded with a Letter of Offer, indicating how and at what cost it could meet the newly

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6   Cúram is a system for integrating several software programs so that information stored in an IT system is more readily accessible and easier to use.

7   Commonwealth Procurement Guidelines, 2005, p. 10, available at <www.finance.gov.au>.

8   Rouse A, op. cit., p. 319.

9   Tho J L, *Managing the Risks in IT Outsourcing*, Heinemann, London, 2005, p. 30.

identified need. If DVA chose to accept IBM's offer, it issued an Additional Service Request for IBM to action.

4.15   DVA stated that if it did not accept IBM's offer, it obtained the required services from another supplier at a lower cost. ANAO noted that examples of DVA obtaining value for money in this way were in its acquisition of major software programs and the acquisition of servers to operate Cúram. During the period 2002–06, DVA spent an average of $2.85 million a year on IT goods and services outside the contract.

4.16   ANAO noted that the draft 2007 contract requires the contractor to implement value for money procurement procedures, and to provide evidence that it is obtaining competitive prices where it purchases items for DVA.

Contracts

4.17   As noted in Chapter 2, DVA had described carefully the IT services it required in both the SISA2 and the draft 2007 contracts. ANAO also noted that DVA had undertaken some internal benchmarking with SISA2, and had engaged a firm to benchmark the costs provided in tenders for the draft 2007 contract. DVA considered it had undertaken sufficient benchmarking to ensure that it was obtaining value for money in the services it had purchased and was planning to purchase. ANAO acknowledges the efforts by DVA.

Conclusion

4.18   In the original audit, DVA agreed in principle to ANAO's recommendation on benchmarking. In this follow-up audit ANAO found that, from 2002, DVA had compared the costs of its contracted IT services with the costs of similar services available elsewhere. Some comparisons resulted in DVA obtaining better value for money in the provision to DVA of printing services and of voice and data communications services. Benchmarking was still being undertaken where DVA could find reliable data. In 2006, such benchmarking had resulted in a change of contractor for communications services.

4.19   In 2006, DVA employed an external organisation to compare and contrast the costs and services to be provided by organisations that were tendering for the 2007 contract. ANAO considers that DVA implemented the original recommendation. The ANAO's recommendation has also been addressed in DVA's examination of the responses to the RFT for the supply of IT services during the period 2007–2011.

5. Risks in the Management of IT Outsourcing

5.1   During the course of the audit, ANAO examined information on risks in government agencies purchasing IT goods and services. ANAO compiled a list of some of the risks involved in the management of IT outsourcing and the key management actions which can contribute to achieving successful outcomes. These are shown in Table 5.1.

5.2   ANAO assessed whether DVA acted in accordance with these success factors in its most recent management of the SISA2 contract following ANAO's previous audit findings, and the development of the draft 2007 contract. Table 5.1 also shows ANAO's assessment of DVA's actions.

5.3   In its recent management of the SISA2 contract, ANAO considered that DVA had taken action to address almost all of the risks associated with IT outsourcing. DVA had included in the contract adequate detail of the services and service levels required from the contractor, while enabling flexibility in the purchase and provision of services. It had monitored the contract, including recording changes and the performance of the contractor, through its contract management section. DVA had also successfully managed the client relationship with its contractor.

5.4   Similarly, ANAO considered that DVA's preparation of the draft 2007 contract had successfully addressed the risks that it could address prior to signing the contract. ANAO noted that DVA would need to take action to address the remainder of the risks once the new contract came into force in 2007.

5.5   The only risk that DVA had not fully addressed was the loss of operational capability, since it had not yet agreed on and tested a Disaster Recovery Plan.

Table 5.1

Management of IT Outsourcing

Risk	Management Action	DVA Action	
		SISA2 Contract	Draft 2007 Contract
Contract lacks details of services required	Devote adequate time and skilled resources to preparation of RFT.	✓	✓
	Develop tender evaluation process in concert with RFT preparation.	✓	✓
	Describe service requirements in detail.	✓	✓
	Define ownership of hardware, software, communication systems and related licences.	✓	✓
	Specify program for refreshment of equipment.	✓	✓
Contract does not specify service levels required	Specify required service levels.	✓	✓
	Develop means of measuring service levels, independently of contractor's measurements.	✓	✓
	Establish schedule for regularly monitoring/reporting performance.	✓	✓
	Develop penalty/reward system for when contractor fails to meet, or exceeds required service levels.	✓	✓
Contract not 'managed'	Establish contract management section to monitor all aspects of the contract.	✓	✓
No allowance for contract changes	Develop procedures for changing the contract and recording such changes.	✓	✓
	Allow for possible increases in staff numbers, programs and equipment.	✓	✓
Loss of flexibility	Include ability to purchase services and equipment outside the contract (at no penalty).	✓	✓
	Include provision for increasing or reducing the services provided.	✓	✓
Lock in to provider	Allow for contract to be terminated with appropriate advance notice.	✓	✓
	Include a transition-out requirement in the contract.	✓	✓
Loss of expertise and dependence on contractor	Keep sufficient IT expertise in-house (knowledge of all systems and IT developments). Monitor performance, manage capacity, develop software.	✓	✓
	Ensure contract management staff (including finance staff) are qualified.	✓	✓

Risk	Management Action	DVA Action	
		SISA2 Contract	Draft 2007 Contract
Not getting best service	Do not outsource completely. Have selective contractors with 'best of breed' providers. Outsource only mature systems and established technology; retain development work in-house.	✓	✓
	Require services to be individually costed and prohibit cross-subsidisation of services.	✓	✓
	When desirable, amend contract to ensure value for money in services provided, or contract other providers.	✓	✓
	Manage payments for outsourced IT services.	✓	TBA
Poor client relationship, provider behaves opportunistically	Have regular meetings with service provider, some weekly and some monthly.	✓	TBA
	Recognise and accept the difference in cultures between client organisation and provider organisation.	✓	TBA
	Recognise and accept the different motivations in client and provider organisations.	✓	TBA
	Enhance negotiation skills of all staff dealing with the provider.	✓	TBA
	Always negotiate with provider, looking for a mutually beneficial outcome.	✓	TBA
Lack of innovation	Require provider to innovate in line with client needs.	✓	TBA
	Retain sufficient in-house IT capability to promote innovation.	✓	✓
Loss of operational capability or data	Agree on, and test, the Disaster Recovery Plan.	x	x
	Require off-site, secure back up for data systems.	✓	✓
Security	Require provider to have formal security clearance procedures, and check that these are carried out.	✓	✓
	Require provider staff to sign appropriate agreements for access to sensitive material.	✓	✓

Source: ANAO.

TBA - To be arranged once the new contract comes into force in 2007.

Steve Chapman
Acting/Auditor-General

Canberra ACT
5 December 2006

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