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ELECTRONIC DATA PROCESSING EQUIPMENT
AND SERVICES PROCUREMENT PROCEDURES
FOR THE STEPHEN P. TEALE
CONSOLIDATED DATA CENTER

DECEMBER 1973

Joint Legislative Audit Committee

GOVERNMENT CODE: SECTIONS 10500-10504

California Legislature

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December 18, 1973

The Honorable President of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members:

Transmitted herewith is a report on an evaluation of the procedures used in the procurement of electronic data processing equipment and services for the Stephen P. Teale Consolidated Data Center.

The Business and Transportation Agency announced on December 3, 1973 the awarding of contracts to International Business Machines Corporation (IBM), Data 100, and Boeing Computer Services for a total amount of approximately \$21 million. IBM will receive about 95 percent of the two-year contract.

The Business and Transportation Agency has failed to conduct valid negotiations with all vendors interested in supplying electronic data processing (EDP) equipment and services for the Stephen P. Teale Consolidated Data Center. Such failure has resulted in a potential loss of cost savings of at least \$15 million. In the Auditor General's judgment, this failure to negotiate has also resulted in a violation of the legislative intent of Senate Bill (SB) 804.

IBM has agreed, as part of the Teale Data Center contract, to install its equipment and be capable of performing year-round vehicle registration in the Department of Motor Vehicles (DMV) by July 1, 1974. There are, however, no penalty provisions contained in the contract if this date is not met, nor has the agency obtained any separate performance guarantee of such date. Failure to meet this date would result in a one-time loss of revenues to the state of at least \$50 million, according to officials of the Business and Transportation Agency.

The Honorable Members of the Legislature
Of California
December 18, 1973
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A portion of the Teale Data Center contract provides for IBM to serve as EDP project manager for the Teale Data Center implementation at a cost of \$1.14 million. Project management should be conducted by state employees, who should have available time to perform the bulk of such duties once the procurement process is completed.

During the past 18 months, the Auditor General has observed and evaluated a total of four attempts to equip and implement the Teale Data Center. All of the procurements have lacked the objectivity and competitive environment which his staff feels is necessary to achieve the best solution for the state. This latest attempt is perhaps the poorest example of all in that SB 804 gave the agency the freedom to negotiate in the best interests of the state without the restraint of competitive bidding. This clearly has not occurred.

Respectfully submitted,



VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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SUMMARY OF FINDINGS,
RECOMMENDATIONS AND SAVINGS

FINDINGS

FAILURE TO CONDUCT VALID NEGOTIATIONS

The Business and Transportation Agency has failed to conduct valid negotiations with all vendors interested in supplying electronic data processing (EDP) equipment and services for the Stephen P. Teale Consolidated Data Center. Such failure has resulted in a potential loss of cost savings of at least \$15 million. In our judgment, this failure to negotiate has also resulted in a violation of the legislative intent of Senate Bill (SB) 804.

LACK OF NECESSARY PENALTY OR SEPARATE
GUARANTEE PROVISIONS IN CONTRACT WITH
INTERNATIONAL BUSINESS MACHINES CORPORATION (IBM)

IBM has agreed, as part of the Teale Data Center contract, to install its equipment and be capable of performing year-round vehicle registrations in the Department of Motor Vehicles (DMV) by July 1, 1974. There are, however, no penalty provisions contained in the contract if this date is not met, nor has the Agency obtained any separate performance guarantee of such date. Failure to meet this date would result in a one-time loss of revenues to the state of at least \$50 million, according to officials of the Business and Transportation Agency.

PERFORMANCE OF PROJECT MANAGEMENT HAS
BEEN UNNECESSARILY DELEGATED TO IBM

A portion of the Teale Data Center contract provides for IBM to serve as EDP project manager for the Teale Data Center implementation at a cost of \$1.14 million. Project management should be conducted by state employees, who should have available time to perform the bulk of such duties once the procurement process is completed.

RECOMMENDATIONS

1. Conduct valid negotiations immediately for the Teale Data Center procurement of the EDP equipment and services in order to:
(1) determine if cost savings of at least \$15 million should be realized, and (2) fully comply with the legislative intent of SB 804. If the contract with IBM has been signed, the Legislature should consider a refusal to appropriate further funding for the EDP procurement until such negotiations occur. \$4.3 million has already been appropriated for the procurement.
- 1a. If the Business and Transportation Agency concludes that conducting valid negotiations at this time would prevent meeting the deadline of July 1, 1974 for DMV, upgrade the existing DMV computer system on an interim basis prior to the entire Teale Data Center EDP procurement award.
2. Obtain from IBM, if the contract with this company is signed, a penalty provision or separate performance guarantee to ensure that the DMV date of July 1, 1974 is met.
3. Require state employees to perform project management for the EDP procurement at the Teale Data Center. If the contract with IBM is signed, the Legislature would have to refuse to appropriate any further funds for project management to effectively implement this recommendation.

COST SAVINGS

1. Potential cost savings of at least \$15 million could be realized if, subsequent to valid negotiations, an award of the EDP contract is made to the lowest bidder.
2. A significant portion of the \$1.14 million of project management costs to be paid to IBM might be saved if state employees assume project management responsibility.

INTRODUCTION

The history of the procurement of equipment and services for the Stephen P. Teale Consolidated Data Center started in May of 1972, when the state entered into a sole source agreement with IBM for three IBM 370-165 computers. The contract amount approximated \$7.2 million.

When the Legislature became aware of this sole source procurement, Section 4 of the Budget Act of 1972 (Ch. 156; Stats. 1972) was amended in order to require that EDP contracts over \$10,000 be competitively bid and that all awards be in the form of the model contract as outlined in Section 4960.1 of the State Administrative Manual.

However, the Legislature permitted the state to retain one IBM 370-165 as an upgrade to their existing equipment with the understanding that this computer would not be used to do any work which would prejudice other vendors for the forthcoming competitive procurement.

The Legislature enacted Chapter 787 of the Statutes of 1972 (SB 1503) as an urgency statute, which became effective August 11, 1972. The bill added Chapter 8 (commencing with Section 11775) to Part 1 of Division 3 of Title 2 of the Government Code. The chapter created the Stephen P. Teale Consolidated Data Center and three others for law enforcement, revenue, and human relations.

The Teale Data Center will have centralized EDP hardware and operations for 34 state departments.

In accordance with SB 1503, the Department of Finance issued Request for Proposal (RFP) 72-01 which was to be a competitive bid procurement to equip the Teale Data Center. Bids were received on January 9, 1973 from two bidders, IBM and Univac. Univac was declared nonresponsive and eliminated. In the March 1973 hearing before the Assembly Ways and Means Committee, representatives of the Office of the Auditor General testified that both vendors were unresponsive and, therefore, both should be disqualified, a position with which the Department of Finance agreed at a later date.

A new procurement attempt was commenced by the issuance of Invitation for Bid (IFB) 73-03 on April 30, 1973, to which only IBM responded. Univac filed a protest stating the requirements favored IBM hardware. Control Data Corporation (CDC) expressed an intention to bid, but later dropped out with the explanation they could not assemble sufficient equipment for the benchmark.

The Budget Act of 1973 continued the requirement for competitive bidding by requiring bids by at least two vendors using different manufacturers' mainframes as a condition to letting the contract. This precluded the award to IBM under IFB 73-03 since IBM had been the only bidder.

In order to encourage competition, but without requiring that at least two bids be obtained prior to awarding the contract, SB 804 was enacted on September 14, 1973. This legislation authorized and permitted the Business and Transportation Agency to negotiate:

"... with vendors seeking consideration and award the contract pursuant to such negotiation if such award is determined to be in the best interests of the state."

Pursuant to SB 804, RFP 73-04 was issued on October 1, 1973 with responses due in four weeks and benchmark tests to be conducted in six weeks, which, in our judgment, was an extremely tight time schedule for vendors who had not previously bid on IFB 73-03 in April 1973.

In response to RFP 73-04, 12 bids were received. Only IBM, CDC and Univac submitted bids covering all aspects of the contract. A 13th bid was received 24 hours late and disqualified.

Of the five bids received for hardware and software, four proposed to use IBM equipment. One of the four proposing to use IBM equipment was CDC, which manufactures a complete line of large scale computers.

Of the three vendors proposing to meet the entire requirement, IBM passed the benchmark test, Univac failed portions of the benchmark and CDC declined to benchmark.

The Business and Transportation Agency has awarded contracts in the aggregate amount of approximately \$21 million. This award is for a two-year period. It is estimated that total costs over a 58-month period will approximate \$38.5 million.

The recommended initial two-year award amounts were as follows:

<u>Vendor</u>	<u>Amount</u>	<u>Percent</u>
IBM	\$19,900,000	95%
Data 100	700,000	4
Boeing Computer Services	<u>250,000</u>	<u>1</u>
Totals	<u>\$20,850,000</u>	<u>100%</u>

Our review of this procurement was made in response to a legislative request for an examination of the bid specifications, vendor responses, selection process and available alternatives.

FINDINGS

FAILURE TO CONDUCT VALID NEGOTIATIONS

The Business and Transportation Agency has failed to conduct valid negotiations with all vendors interested in supplying electronic data processing (EDP) equipment and services for the Stephen P. Teale Consolidated Data Center. Such failure has resulted in a potential loss of cost savings of at least \$15 million. In our judgment, this failure to negotiate has also resulted in a violation of the legislative intent of SB 804.

In response to the state preference of passing a benchmark under RFP 73-04, only IBM of the three bids received for the entire Teale Data Center successfully passed the benchmark demonstration. As a result, an approximate \$19.9 million two-year EDP procurement for the Teale Data Center has been awarded to IBM. However, pages 10 and 11 of this RFP, which provides for an alternative to the benchmark test, clearly state:

"In the event a vendor is unwilling or unable to perform the above benchmark, the State is willing to accept in lieu of a benchmark demonstration an agreement by the vendor that he will indemnify and hold harmless the State from failure of the computer system (both hardware and software) to meet the workload capacity needs (at each annual point) of the Data Center or from the failure of the vendor to convert existing State computer programs to the language used by the new hardware/software system by the dates agreed upon. To ensure against any loss of revenue or any additional costs resulting from such failure, the vendor must furnish a surety bond in an amount commensurate with the potential loss of revenue or additional costs. The amount of the bond is a matter of negotiation between the vendor so proposing and the State."

In view of Univac's failure to pass the benchmark, on November 20, 1973, Univac's branch manager wrote to the Teale Data Center stating, "However, we repeat, it is Univac's intent to provide any reasonable guarantee the State may require".

The Business and Transportation Agency never entered into valid negotiations with Univac concerning this matter and in fact on November 27, 1973 wrote to Univac's branch manager and quoted page 8 of the RFP including the statement "All elements of the vendor's proposal (including price) are subject to negotiation only at the State's sole option...".

IBM's bid over a potential 58-month contract award is estimated to cost the state \$38,537,669, or \$15,956,347 in excess of Univac's bid of \$22,581,322. It is reasonable to assume that the initial contract award to IBM will be extended through the 58-month period. The Business and Transportation Agency has not evaluated this potential cost savings to the state.

In view of the significance of the difference between these bids, we believe valid negotiations with Univac concerning their proposed "reasonable guarantee" were, and are, mandatory. The Business and Transportation Agency's response to Univac that negotiations were "at the State's sole option" was a response that, in our judgment, was not in the state's best interest.

As previously noted, SB 804 permitted negotiations with vendors seeking consideration and permitted the award of the contract pursuant to such negotiations "... if such award is determined to be in the best interests of the state".

The Business and Transportation Agency did not determine the amount of Univac's proposed "reasonable guarantee", nor have they evaluated the significance of the differences in the IBM and Univac bids. In our judgment, valid negotiations, in the best interests of the state, would mandate these determinations, particularly when the agency's own RFP provided for the surety bond as an alternate to passing the benchmark. Further, we believe that while the agency may have legally complied with SB 804, it violated the legislative intent of this bill, which in our judgment, required valid negotiations.

The Business and Transportation Agency conducted a series of negotiations with only the three successful bidders, IBM, Data 100 and Boeing. Of the nine unsuccessful bidders, only five were even contacted by the agency after their bids had been submitted and such contacts were very limited in nature.

There are examples of failure to negotiate with potential vendors other than Univac. For example, Telex Corporation was excluded from bidding in several areas because they proposed a five-year contract. Although Telex offers many types of contracts including a two-year contract, the agency did not contact Telex and attempt to negotiate.

It could be that after valid negotiations, the best interests of the state would require an award to IBM. In our judgment, however, an award to IBM prior to such negotiations is premature.

The fact remains that such negotiations have not yet been conducted with Univac or with the eight other unsuccessful bidders. We, therefore, recommend that if the contracts have not been signed, such valid negotiations be conducted immediately in order to determine if the \$15 million of potential cost savings could be realized and in order to fully comply with the legislative intent of SB 804. If the contract with IBM is signed, we recommend that the Legislature consider a refusal to appropriate further funding for the EDP procurement until negotiations occur. \$4.3 million has already been appropriated for the Teale Data Center procurement.

It is anticipated that officials of the Business and Transportation Agency will maintain that a one-time increase in revenue of \$50 million resulting in the conversion of DMV to year-round registration capabilities by July 1, 1974 justifies the lack of valid negotiations because of the time pressure to realize such increase.

If these officials conclude that the conducting of valid negotiations at this time would prevent meeting this deadline date,* which has already been agreed to by IBM, then we recommend the existing DMV computer equipment which is rented from Univac be upgraded on an interim basis. This would permit the conducting of valid negotiations.

In our judgment, the upgrading of DMV on an interim basis is the approach which has the highest possibility of success. Univac selected

*It should be noted that the deadline date of July 1, 1974 was originally October 1, 1973 and was then slipped to June 1, 1974.

this approach, while IBM chose to convert DMV immediately to their ultimate configuration. SB 804 provides for this alternative by stating:

"In considering bids a separate contract or contracts may be entered into for the conversion of programs for the Department of Motor Vehicles, or any other agency, and for all other equipment, supplies and services pertaining to the initial procurement for the Stephen P. Teale Consolidated Data Center."

A study performed by the Department of Motor Vehicles, "Univac System Upgrade Pilot Study, July 19, 1973", established interim upgrade as a viable solution which can be accomplished at a cost very close to the department's equipment rental budget for fiscal year 1972-73.

The narrative of this study states:

"The upgrade was to be designed as a contingency plan to provide the Department with an executable alternative in the event that the Teale Center procurement, or implementation is delayed."

The summary of the report included:

"An attempt has been made to identify the major areas which are in need of further analysis. When completed, the plan that is outlined here will provide the Department with a logical, economical upgrade alternative. It will produce a system with the increased power necessary to meet planned workload increases as well as meeting currently unforeseen demands."

It is our judgment that if the time requirements of DMV conversion preclude a procurement for the Teale Data Center that is in the best interests of the state, then the DMV conversion should be separated to secure the one-time revenue increase of \$50 million and the remainder should be procured in an orderly fashion.

It should be stressed that any consideration of a DMV computer upgrade is an interim solution and not an alternative to consolidation. It is an alternative to the present procurement by which the acquisition of hardware and services for consolidation could be accomplished in a manner which would be in the best interests of the state.

LACK OF NECESSARY PENALTY OR SEPARATE GUARANTEE
PROVISIONS IN CONTRACT WITH INTERNATIONAL
BUSINESS MACHINES CORPORATION (IBM)

IBM has agreed, as part of the Teale Data Center contract, to install its equipment and be capable of performing year-round vehicle registrations in the Department of Motor Vehicles (DMV) by July 1, 1974. There are, however, no penalty provisions contained in the contract if this date is not met, nor has the Agency obtained any separate performance guarantee of such date. Failure to meet this date would result in a one-time loss of revenues to the state of at least \$50 million, according to officials of the Business and Transportation Agency.

Under IBM's award of the contract for the Teale Data Center, IBM was to install its computer equipment and have it fully operational by July 1, 1974. This equipment was to provide for year-round vehicle registration. The need for additional computer capacity for this registration is the reason used on numerous occasions by the Business and Transportation Agency to justify an extremely short time schedule for the procurement process.

Both agency officials as well as the State Data Processing Officer in the Department of Finance have stated that failure to meet the July 1, 1974 date will result in a one-time loss of state revenues of at least \$50 million.

There is a possibility that neither IBM nor anyone else can meet this short date on a permanent basis. Honeywell Corporation, a potential bidder which did not bid because of the July 1, 1974 date, stated in Assembly Ways and Means on September 13, 1973, that "no vendor can meet the conversion date for DMV".

While Univac has offered any "reasonable guarantee" of this date the state requires*, the proposed contract between the state and IBM does not call for any penalty should IBM fail to meet the conversion date, nor provide any bond or similar guarantee should they fail to do so.

In view of the possibility of a failure to meet the July 1, 1974 date and the potential magnitude of the loss should failure occur, we therefore recommend that if the state is to sign the contract with IBM it should contain a penalty or other separate performance guarantee so that the computer equipment for DMV will be installed and fully operational by July 1, 1974. If the contract has been signed without such penalty or guarantee, this would have to be considered by the Legislature in appropriating additional funds for the contract.

PERFORMANCE OF PROJECT MANAGEMENT
HAS BEEN UNNECESSARILY DELEGATED TO IBM

A portion of the Teale Data Center contract provides for IBM to serve as EDP project manager for the Teale Data Center implementation at a cost of \$1.14 million. Project management should be conducted by state employees, who should have available time to perform the bulk of such duties once the procurement process is completed.

*The nature, and if a bond, the amount, of this guarantee is undetermined as there have been no valid negotiations between the Agency and Univac.

While the definition of project management in the IBM proposal covers 143 pages, the primary function of project management, as set forth in the proposal, is "to establish control of schedules and technical performance from contract start through completion." A significant portion of project management, however, is the evaluation of performance under the contract.

The Business and Transportation Agency, therefore, is paying IBM \$1.14 million to, in significant part, tell the state how IBM, with in excess of 95 percent of the total EDP contract, is performing. In our view, there is serious question of the utility of paying IBM \$1.14 million to tell the state how IBM is performing.

Perhaps more importantly, since the state is the user and, therefore, bears the ultimate responsibility for performance under the contract, the delegation of authority for project management is unwise as well as unnecessary.

While Teale Data Center officials state that the state does not possess the expertise necessary for project management, it is our judgment that the state does possess sufficient expertise to perform the function of project management.

Within the Teale Data Center, the departments which use the center, and the EDP Control and Development Section of the Department of Finance which oversees the center, there exists a total of 557 data processing personnel. Salaries range up to \$31,000 per year. Table 1, which excludes computer operators, illustrates the available manpower pool.

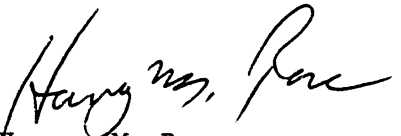
Table 1

	<u>Teale Center Users</u>	<u>Teale Center</u>	<u>Department Of Finance EDP Control</u>
DP Mgr IV or Higher	1	3	2
DP Mgr III	-	2	-
DP Mgr II	2	1	-
DP Mgr I	22	4	-
Supv or Sr SPSA	15	1	10
Staff DPSA	8	-	-
Assoc DPSA	107	-	-
Asst DPSA	60	-	-
EDP Supervisor	49	-	-
Prog II	143	-	-
Prog I	36	-	-
Applied Science Prog II	17	-	-
DP Tech Sup I	14	-	-
Sr DP Tech	17	-	-
DP Tech	<u>43</u>	<u>-</u>	<u>-</u>
Totals	<u>534</u>	<u>11</u>	<u>12</u>

In our judgment, this group of employees, if capable of properly monitoring and evaluating its procurement responsibilities, should be capable of performing project management under the contract.

Finally, it should be observed that a significant portion of this group of employees has been engaged in a lengthy, complicated process of evaluating proposals under the procurement. Such evaluation is a job function which should be eliminated or greatly reduced upon award of the contract. Therefore, it is logical to assume that a significant number of state employees will be available to perform project management. While we cannot say that the state will not have to hire additional employees for that task, it is our judgment that the requirement for any additional employees would be minimal and that the state might save a significant portion of the \$1.14 million to be paid to IBM for project management.

We, therefore, recommend that state employees be required to assume project management responsibilities for the Teale Data Center. If the contract with IBM is signed, a portion of the \$4.3 million could be spent prior to July 1, 1974 for project management. The Legislature would have to refuse to appropriate any further funds for project management in order to implement this recommendation.


Harvey M. Rose
Auditor General

December 11, 1973

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