



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

August 10, 2004

Control Number
ED-OIG/A02-D0015

Jack Martin, Chief Financial Officer
Office of the Chief Financial Officer
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Dear Mr. Martin:

This **Final Audit Report** presents the results of our audit of the 2001 *Virtual Data Center Transformation Task Order* (Task Order). An electronic copy has been provided to your Audit Liaison Officer. The objectives of our audit were to determine (1) if the Task Order was negotiated and awarded in accordance with the Federal Acquisition Regulation (FAR) and other Federal regulations; (2) if the first 14 Task Order modifications were properly executed; (3) the effectiveness of the monitoring by U.S. Department of Education (Department), Federal Student Aid (FSA), of Computer Sciences Corporation's Monthly Progress Reports, to ensure that the Department appropriately modified the Task Order based on computer usage trends; (4) if the Statement of Objectives (SOO) and related contract documents contained adequate performance measures; and (5) if the actual billed rates were consistent with the agreed rates of the Task Order and its modifications.

A draft of this report and, subsequently, a re-draft of one sub-finding were provided to the Chief Financial Officer (CFO) for comment. The CFO concurred with one of our recommendations but did not concur with our other two recommendations. We have summarized the CFO's comments after the Recommendations section, and we have included both of the CFO's responses as Attachments A and B to this report.

BACKGROUND

The Higher Education Amendments of 1998 (Public Law 105-244, enacted October 7, 1998) established a Performance-Based Organization (PBO) to manage operational functions supporting the programs authorized under Title IV of the Higher Education Act of 1965, as amended (HEA). Subject to the authority of the Secretary, the PBO exercises independent control of its budget allocations and expenditures, personnel decisions and processes, procurements, and other administrative and management functions.

The responsibilities of the PBO include integrating the information systems supporting the Federal student financial assistance programs; implementing an open, common, integrated

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system for the delivery of student financial assistance under Title IV; and developing and maintaining a student financial assistance system that contains complete, accurate, and timely data to ensure program integrity.

The Office of Management and Budget (OMB) issued Bulletin No. 96-02, "Consolidation of Agency Data Centers," on October 4, 1995. The Bulletin requires that agencies, including the Department, consolidate their data centers by June 1998. This OMB requirement resulted in the establishment of the Virtual Data Center (VDC).

In February 1997, the General Services Administration (GSA) selected Computer Sciences Corporation (CSC) as one of three VDC contract vendors. In October 1998, the Department awarded CSC four task orders, under GSA's Federal Computer Acquisition Center Government Wide Agency Contract program, to provide a consolidated data center. GSA delegated authority to the Department for negotiating any additional task orders and modifications under the GSA contract. Ultimately, the Department awarded a total of eight task orders. In September 2001, the Department re-negotiated the eight task orders to consolidate them into one Task Order amounting to an estimated \$493 million, including option years.

The objective of the Task Order was to provide efficient consolidated data center operations and to provide services and support to FSA systems that share common requirements. Also, the Task Order was designed to reduce costs by utilizing the central location of the CSC's Virtual Data Center in Meriden, Connecticut.

The Department did not consider other contractors when awarding the Task Order in 2001. Instead, the Department awarded the Task Order (ED-01-GS-0002) under GSA's Government Wide Agency Contract. The cost of the eight prior task orders was reduced from approximately \$71 million per year to \$56 million per year. This firm fixed unit price Task Order extends through September 30, 2005, with options through September 30, 2011.

AUDIT RESULTS

We found the Department negotiated and awarded the Task Order in accordance with the FAR and other Federal regulations, the first 14 Task Order modifications were properly executed, and the actual billed rates were consistent with the agreed rates of the Task Order and its modifications. However, our evaluation of FSA's monitoring of CSC's Monthly Progress Reports on computer usage disclosed the Department could improve the efficiency of the Task Order with additional performance measures to identify utilization of VDC servers. Also, the SOO and related contract documents contained inadequate performance measures. We found that the Task Order lacked a performance-based disincentive to encourage the contractor to increase efficiency and maximize performance. In addition, customer satisfaction surveys completed by Business Owners, Departmental employees responsible for projects run at the VDC, were an ineffective monitoring tool, primarily due to a lack of response by the Business Owners.

Finding The 2001 Task Order lacked adequate performance measures.

The performance measures for the Task Order were inadequate because they did not monitor underutilization of servers, the Task Order did not include a performance-based disincentive to encourage the contractor to increase efficiency and maximize performance, and Business Owners' customer satisfaction surveys were ineffective. As a result, the Department paid a fixed price for underutilized servers, paid an incentive fee that contained little disincentive for poor performance, and paid a portion of the incentive fee based on ineffective customer satisfaction surveys.

The primary performance measure for the Task Order was system availability. This performance measure represented 60 percent of CSC's incentive fee, and in general, this performance measure was met. However, additional performance measures could have been included to improve the efficiency of the Task Order.

Performance measures did not monitor underutilization of servers.

The performance measures set forth in the Task Order focused on the availability of the data systems, but not on the underutilization of the data systems. The Department or CSC could have achieved cost savings by modifying and/or consolidating underutilized servers. Server consolidation would have resulted in an adjustment to the amount of available space the Department paid for, thus saving the Department money. An additional performance measure to monitor server underutilization would aid in identifying servers for consolidation and could reduce the cost of operating the VDC.

The SOO states that the objective of the VDC is to provide efficient services to the Department through a performance-based contract that reduces costs while improving services. Further, the SOO required CSC to perform continuous analysis and develop recommendations for improvements in overall efficiency, and to make required Task Order adjustments. A performance measure for monitoring underutilization trends could have assisted CSC and the Department in accomplishing this requirement.

FAR § 37.601 states, "Performance-based contracting methods are intended to ensure that required performance quality levels are achieved and that total payment is related to the degree that services performed meet contract standards."¹

Per Section 142(c)(1) of the HEA, the Chief Operating Officer of the PBO "shall, to the extent practicable, maximize the use of performance-based servicing contracts, consistent with guidelines for such contracts published by the Office of Federal Procurement Policy, to achieve cost savings and improve service."

The VDC servers included Enterprise servers, which were used for mainframe applications such as the National Student Loan Data System; New Technology (NT) servers, which were used for

¹ Unless otherwise specified, regulatory citations to the FAR are to the September 2001 edition, as issued by the General Services Administration, Department of Defense, and National Aeronautics and Space Administration, including all Federal Acquisition Circulars through 97-27.

applications such as the Student Aid Internet Gateway (SAIG) Mailboxes; and UNIX servers used for applications such as the Free Application for Federal Student Aid (FAFSA on the web, or FOTW). We reviewed the Monthly Progress Reports' Infrastructure Availability Summaries for peak usage during the period, December 2001 through February 2003. We found peak usage for Enterprise servers remained consistent throughout the year, using almost all the available space, while peak usage for NT and UNIX servers, non-mainframes, was more variable.

For the 15 months tested, peak usage for 22 of 44 non-mainframe servers was significantly below the amount of available space. (Only non-mainframe servers with at least six months of peak usage reported were included in these numbers, and 7 of the 22 non-mainframe servers used more than 60 percent of available space for at least one month.) Under the definition we used, a server would have low peak usage if, for at least 80 percent of the months reported, the highest percentage of its use was less than 60 percent of the available space. For example, the Schools Portal Channel server had low peak usage because it used less than 6 percent of its available space for 12 of the 15 months tested. Further, the Schools Portal Channel server used less than 3 percent, on average, of its available space during the months of October, November, and December 2002.

We recognize that system availability was critical to the Department and an important performance measure. We also recognize that the Department conducted quarterly capacity planning meetings, which included reviews of system utilization in relation to availability. However, because the Task Order did not include a performance measure to identify underutilization, the Department continued to pay a firm fixed unit price for minimally used servers.

The Task Order lacked a performance-based disincentive.

The Task Order included a performance-based incentive fee, providing an additional payment of up to 1.9 percent of the base Task Order amount. However, the Task Order lacked a performance-based disincentive, to reduce the base amount paid to CSC if it performed poorly. A disincentive based on performance measures would further encourage the contractor to increase efficiency and maximize performance, as urged by the HEA, FAR, and guidance issued by the Office of Federal Procurement Policy (OFPP):

- Under FAR § 37.601(c), “Performance-based contracts . . . [s]pecify procedures for reductions of fee or for reductions to the price of a fixed-price contract when services are not performed or do not meet contract requirements”
- Under FAR § 37.602-4, “To the maximum extent practicable, performance incentives, either positive or negative or both, shall be incorporated into the contract to encourage contractors to increase efficiency and maximize performance”
- Section 142(c)(1) of the HEA requires the Chief Operating Officer to maximize the use of performance-based servicing contracts, to the extent practicable, consistent with guidelines published by the OFPP.

- *A Guide to Best Practices for Performance-Based Service Contracting*, issued by OFPP, provides, in its Appendix 3, the following minimum mandatory performance-based service contracting requirement: “If the acquisition is either critical to agency mission accomplishment or requires relatively large expenditures of funds, positive and negative incentives tied to the Government [Quality Assurance] plan measurements.”

The Task Order did not include a performance-based disincentive, but was structured with an incentive fee of 1.9 percent of the Task Order’s base amount. The amount of this additional payment, at the time of our audit, was based on four performance measures: availability (60 percent), Business Owner surveys (15 percent), Contract Officer Representative’s Discretion (15 percent), and General Manager surveys (10 percent). Successful performance under these measures would be a basis for a proportional incentive payment to CSC. Therefore, the incentive fee, not the Task Order’s base amount, would be reduced if CSC did not satisfy these measures.

Business Owners’ customer satisfaction surveys were ineffective.

Performance measures for Business Owners’ customer satisfaction surveys were ineffective because a large percentage of Business Owners did not respond to the surveys, a non-response to a survey was considered to be a positive response, and the results of the survey were not accurate. These surveys represented 15 percent of the 1.9 percent incentive fee pool.

We found 82 percent of the Business Owners’ customer satisfaction surveys were not returned for the 239 projects run at the VDC during the period, October 2002 through July 2003. Non-responses were considered positive responses for calculating the incentive fee. One Business Owner, who did not respond to the surveys, stated he was not aware that he failed to respond.

We judgmentally selected the two Business Owners with negative responses to the February-March 2003 Customer Satisfaction Survey. Neither of these Business Owners responded to the survey, but their responses were recorded as negative responses. Both Business Owners stated that their projects had not yet been run at the VDC at the time of the survey. The recorded responses were not accurate.

FAR § 37.602-1(b)(2) states, “When preparing statements of work, agencies shall, to the maximum extent practicable . . . [e]nable assessment of work performance against measurable performance standards”

The practice of considering all non-responses as positive responses did not enable an assessment of work performance, because the results of the assessment may not have been accurate.

Recommendations:

We recommend that the Chief Financial Officer ensure that any re-negotiation of the Task Order, and all similar performance-based Task Orders and contracts, include performance measures to

- 1.1 Monitor data on system usage to optimize server infrastructure;
- 1.2 Establish one or more performance-based disincentives, to the maximum extent practicable, that reduce the base amount paid to the contractor if it performs poorly; and
- 1.3 Assess customer satisfaction by using more effective methods.

CFO's response:

We provided a draft of this report to the CFO for comment. Based on the CFO's comments (Attachment A), we made changes to our report's sub-finding associated with Recommendation 1.2, "The Task Order lacked a performance-based disincentive." We provided a draft of the revised sub-finding and recommendation to the CFO and received additional comments (Attachment B).

In his comments, the CFO stated that the VDC project management team is managing the contract according to the appropriate performance measure and provides awards to the vendor commensurate with the quality of the product that is delivered. The CFO stated, in response to

- **Recommendation 1.1**, that no additional performance measures are appropriate for a contract of this nature. The objective of the contract is to make computing resources available for FSA systems. Since CSC cannot control factors that influence utilization, a utilization performance measure would not be appropriate. Contracting officers constantly monitor performance measures, not only to ensure that CSC is meeting the measures, but also to ensure that appropriate measures are contained in the contract. The contracting officers receive monthly system status reports (which include the information about server utilization used by the OIG auditors to identify the finding), and quarterly capacity planning reviews (meetings) are held for each application. If it is determined that the measures do not adequately meet the objectives of the contract, a change to the contract is negotiated. CSC recently consolidated functions onto servers that resulted in the retirement of 18 servers. Among other objectives, this consolidation was intended to reduce costs by eliminating or consolidating underutilized servers.
- **Recommendation 1.2**, as revised, (see Attachment B), that meaningful incentives and disincentives are a strong determinant to safeguarding against poor performance and that, if the Department elects to re-compete the FSA data center requirements, it will examine whether disincentives are an appropriate motivator for increasing efficiency and maximizing performance. However, the CFO also states that the Department is negotiating in a sole-source environment where the VDC contractor is neither motivated nor obligated to accept disincentives. The CFO also contended that it would not be practicable to incorporate disincentives in a re-negotiation with the current VDC contractor while attempting to negotiate a better price.

- **Recommendation 1.3**, that he concurred the surveys were not a strong determinant for awarding incentive payments. The CFO will examine better methods for ensuring customer satisfaction.

OIG's reply:

We considered the CFO's response, and made a change to our finding and recommendations. In response to the CFO's comments on

- **Recommendation 1.1**, the basis for our finding on server utilization was the monthly Infrastructure Availability Summaries, which reported peak usage. However, as of June 2003, this information was no longer reported by CSC. As a result, the contracting officers could not determine utilization properly. We agree that CSC cannot control FSA's need to use server space at the VDC; however the SOO does require CSC to perform continuous analysis, to develop recommendations for improvements in overall efficiency and to make required Task Order adjustments. The performance measure we recommend would help FSA measure CSC's success in accomplishing this requirement, and it would help FSA avoid overpaying for server availability. As we cite in our report, under FAR § 37.601(c) performance-based contracts "[s]pecify procedures for reductions of fee or for reductions to the price of a fixed-price contract when services are not performed or do not meet contract requirements" The example that the CFO provides of a recent consolidation of functions supports the value of the performance measure we recommend and the need to use that measure on an ongoing basis.
- **Recommendation 1.2**, we have revised our report and recommendation to clarify that performance-based disincentives are needed to increase the efficiency of the Task Order. FAR § 37.602-4, supports our position, and states, "To the maximum extent practicable, performance incentives, either positive or negative or both, shall be incorporated into the contract to encourage contractors to increase efficiency and maximize performance." Any re-competition or re-negotiation of the Task Order should include a consideration of the use of performance-based disincentives, to the maximum extent practicable, as encouraged by the regulations. These performance-based disincentives could provide greater assurance that critical systems at the VDC are available to meet the Department's mission.
- **Recommendation 1.3**, we agree that the CFO should evaluate customer satisfaction by examining more effective methods. However, our finding addressed the practices of the Task Order's survey, not the usefulness of customer satisfaction surveys in general. The CFO's examination to determine better methods for ensuring customer satisfaction could include customer satisfaction surveys, as long as the surveys were properly managed and monitored. We have changed the wording of our Recommendation 1.3, from "effective survey methods" to "effective methods", so that our recommendation does not appear to imply that a survey is the only effective method to assess customer satisfaction.

OTHER MATTERS

The Department did not consider other contractors when it restructured the prior eight task orders into one Task Order. During our review of the contract files, we found indications that the Department decided not to re-compete the prior eight task orders because the revised Task Order resulted in an estimated \$15 million in savings per year. We could not determine whether greater savings could have been achieved through new competition. Though we did not find that FSA's decision violated the FAR or any applicable statute, by considering one contractor, FSA may have missed an opportunity to realize greater savings.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine

1. If the 2001 VDC Task Order was negotiated and awarded in accordance with the FAR and other Federal regulations,
2. If the first 14 Task Order modifications were properly executed,
3. The effectiveness of the FSA's monitoring of CSC's Monthly Progress Reports to ensure that the Department appropriately modified the Task Order based on computer usage trends,
4. If the SOO and related contract documents contained adequate performance measures, and
5. If the actual billed rates were consistent with the agreed rates of the Task Order and its modifications.

To accomplish our audit objectives, we reviewed contract files and invoices maintained by Contracts and Purchasing Operations. We also interviewed the past and present contracting officers, the past and present Contracting Officer's Representatives, and other Department officials associated with the administration and monitoring of the Task Order. Additionally, we reviewed meeting minutes, incident reports, information obtained from the Federal Student Aid Internet, and from the period, December 2001 to February 2003, Monthly Progress Reports' Infrastructure Availability Summaries for peak usage. We did not test the reliability of the data provided in the Infrastructure Availability Summaries because our objective was to determine the effectiveness of the FSA's monitoring of reports that it received and not the reliability of the underlying data. We reviewed the FAR, OFPP publications, and industry news articles, as applicable to our audit.

We judgmentally sampled four Department employees (Business Owners) responsible for projects run at the VDC, based on the high dollar volume of their VDC operations, and two Business Owners, based on low usage. In addition, we judgmentally selected two Business Owners because of their negative responses to the February-March 2003 Business Owner's customer satisfaction surveys. Lastly, we interviewed two FSA General Managers, the VDC manager for the Department, and CSC representatives.

We obtained and reviewed the 21 Public Vouchers, from August 2001 to February 2003,² totaling \$91,319,168, and the respective supporting documentation. We also reviewed the first 14 modifications to the Task Order to determine whether they had been executed appropriately by the Department.

We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above. We conducted fieldwork at FSA's offices in Washington, D.C., during the period, June 9, 2003, through September 12, 2003. We held the exit conference on November 12, 2003.

STATEMENT ON MANAGEMENT CONTROLS

We did not assess the adequacy of management controls in the administration of the Task Order. We limited our review to gaining an understanding of the invoice payment controls. We relied on substantive testing of the invoice payments based on the public vouchers, other supporting documentation, and interviews of contract personnel in order to conclude that the controls were adequate for invoice payments for the Task Order.

ADMINISTRATIVE MATTERS

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). ED policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the finding and recommendations contained in this final audit report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

² Although the Task Order was signed in September 2001, ED paid the last vouchers of the previous Task Orders under the future Task Order.

We appreciate the cooperation given us during this review. If you have any questions, please call Daniel P. Schultz, Regional Inspector General for Audit, at (212) 637-6271.

Sincerely,

/s/

Helen Lew
Assistant Inspector General for Audit

cc: Theresa S. Shaw
Chief Operating Officer
Federal Student Aid

Attachment A



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

MAY - 5 2004

TO: Helen Lew
Assistant Inspector General for Audit

FROM: Jack Martin 

SUBJECT: Draft Audit Report *Virtual Data Center (VDC) Transformation Task Order*, Control Number ED-OIG/A02-D0015

This memorandum responds to the Office of the Inspector General (OIG) subject Draft Audit Report, dated March 18, 2004. The purpose of the audit was to review the VDC Task Order (contract) to determine if it was properly negotiated and executed; the effectiveness of the Department's monitoring of computer usage trends; whether the contract contained adequate performance measures; and, if billed rates were consistent with the agreed rates in the contract.

In general, the OIG found that the Department negotiated and executed the VDC contract and all modifications properly and that all billed rates were consistent with the agreed rates of the contract. However, the OIG review found that the VDC contract lacked adequate performance measures because they do not monitor underutilization of servers. As a result, the Department paid a fixed price for underutilized servers, paid an incentive fee that contained little disincentive for poor performance, and paid a portion of the incentive fee based on ineffective customer satisfaction surveys. Recommendations have been provided regarding monitoring computer usage and the performance measures currently under the contract.

The following addresses each of the OIG recommendations.

Recommendation 1.1 – Monitor data on system usage to optimize server infrastructure.

Contracting officers constantly monitor performance measures, not only to ensure that contractors are meeting the measures, but also to ensure that the appropriate measures are contained in the contract. If it is determined that what is being measured is not adequately meeting the objectives of the contract, a change to the contract is negotiated. The VDC contract was awarded to perform a single service, to make computing resources available for Federal Student Aid (FSA) systems to operate. The single performance measure for this service (the only output provided by the contract), as is the case with most computer facilities, is to measure system availability. The availability needed for one system is not necessarily the availability needed for another. At the VDC, there are

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Attachment A

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three service levels, and FSA systems have a service level assigned to each of them. No additional performance measures would be appropriate for a contract of this nature.

Server utilization was also monitored. The VDC contracting officer received monthly reports regarding system status, including utilization for each computing resource. This report was the source of information used by the auditors to identify low utilization as an issue.

When FSA migrated its systems to the VDC, each system was organized into its own task order. While this migration did provide some efficiencies and reduction in cost, each system was still on its own servers, mainframes, etc. The goal of the VDC transformation task was to combine these contracts and provide further consolidation of the servers and reduction in costs of more than 15%.

This transformation was successful, but during this same period, the FSA Modernization contractor was developing systems. When a system was designed, the computing resources were identified by the Modernization contractor and procured by the VDC on behalf of the Department. The Schools Portal, identified in the audit, is one such case where the computing resources were specified. Others included, but are not limited to, the Student's Portal, eCampus Based System and eZAudit. The VDC contractor recently completed a technology refresh that consolidated functions onto servers that resulted in 18 servers retiring. The primary objectives of the refresh were to: 1) replace old technology with new technology; 2) eliminate or consolidate underutilized servers to more efficiently utilize servers and reduce costs to FSA (ie. reduction to each system fixed unit- price); and, 3) simplify the environment so it could be managed more efficiently and for less cost.

Additionally, for each application, the VDC Project Management team and the contractor perform a quarterly capacity planning review. In these meetings, past utilization is reviewed and future utilization needs or changes are discussed and planned. Changes to utilization are typically driven by new requirements from the business, new features in an application, or some other external event that may cause usage to increase (i.e., a marketing campaign may drive traffic to a particular web site). At times, business utilization of an application is not well known in advance, and this can cause either the need to add capacity or an unexpected amount of spare capacity.

As previously stated, a performance measure for utilization would not be an appropriate measure of the service being delivered if for no other reason than the VDC contractor would not have control over the factors that could influence utilization.

Attachment A

3

Recommendation 1.2 – Establish a performance-based incentive fee that encourages the contractor to increase efficiency and to maximize performance.

The incentives placed in the VDC contract were not for the purpose of increasing the contractor's efficiency. The contract type selected (fixed-price) provides sufficient incentive. Fixed price contracts motivate the contractor to maximize efficiency in order to increase profit margins. For every dollar saved, the contractor makes an additional dollar in profit. Performance-based incentives in Federal contracts are meant to motivate a contractor to deliver added value to the Government. Relative incentives offered for improved performance, quality, or timeliness is an example. We therefore, believe that the incentives offered encourage maximum performance. The incentive fee of 60% is directly linked to the ultimate purpose of the VDC contract: availability of computing resources. This incentive rewards the VDC contractor for exceeding the agreed upon service levels of 99.7 and 99.9 percent availability. The remaining 40% incentive is to reward the VDC contractor for its ability to satisfy the users.

What is suggested by the OIG finding is that the incentives should be higher. Providing increased incentives, as the OIG finding suggests, would not be prudent. Any additional incentives or increased incentives would not achieve added value.

Recommendation 1.3 – Assess customer satisfaction by using more effective survey methods.

We concur that surveys are not a strong determinant for rewarding incentives. Without control over the process and the ability to ensure complete feedback, errors are possible. Contract incentives must be based on formulas as is the case of the contract incentive to ensure system availability. We will examine better methods for ensuring customer satisfaction.

In summary, OCFO believes that the VDC project management team is managing the contract according to the appropriate performance measure and provides awards to the vendor commensurate with the quality of the product that is delivered.

Thank you for this opportunity to respond. Should you have questions, please contact Glenn Perry, Director, CPO at (202) 708-8488.

Attachment B



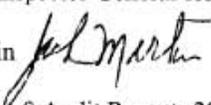
UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

JUL - 8 2004

TO : Helen Lew
Assistant Inspector General for Audit

FROM : Jack Martin 

SUBJECT: Revised Draft Audit Report, 2001 Virtual Data Center
Transformation Task Order, Control Number ED-OIG/A02-D0015

This memorandum responds to the Office of Inspector General (OIG) revisions to the subject audit sub-finding, "The Task Order lacked a performance-based disincentive," and Recommendation 1.2. In your revised report, you state in summary, that the Virtual Data Center (VDC) Transformation Task Order (Task Order) lacked a performance-based disincentive to reduce the base amount paid to the VDC contractor if it performed poorly. You argue that a disincentive based on performance measures would further encourage the contractor to increase efficiency and maximize performance.

As a result of this further finding, the OIG revises Recommendation 1.2 to ensure that any renegotiation of the Task Order, and all similar performance-based task orders and contracts, include performance measures to establish one or more performance-based disincentives that reduce the base amount paid to the contractor if it performs poorly.

In general, negotiating meaningful incentives and disincentives in a competitive contracting environment is a strong determinant to safeguarding against poor performance. The VDC contract currently has options through September 30, 2011. The Department simultaneously seeks to renegotiate with the VDC contractor for better pricing and to conduct market research to determine the availability of sources capable of performing full-service data center services. If the Department elects to re-compete the FSA data center requirements based on findings from the market research, the Department (factoring in customary practices in the commercial market) will examine whether disincentives are an appropriate motivator for increasing efficiency and maximizing performance.

However, to engage in a re-negotiation with the current VDC contractor to incorporate disincentives while attempting to negotiate better pricing is not practicable. The Department is negotiating in a sole-source environment where the VDC contractor is neither motivated nor obligated to comply with accepting disincentives; or, if the VDC contractor agrees with imposed disincentives, the VDC contractor could alternatively, request a re-negotiation of the incentives and/or feasibly mark-up the proposed pricing to

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Attachment B

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account for any potential loss in revenue. As mentioned in our earlier response, the incentives in place are appropriate for the service levels negotiated.

The Corrective Action Plan has been modified to incorporate an action item in response to revised Recommendation 1.2, and is attached to this memorandum.

Thank you for this opportunity to respond. Should you have questions, please contact Glenn Perry, Director, CPO at (202) 245-6289.

Attachment

The CFO's Attachment to Attachment B was not included with this report since it relates to a separate process from the audit report process.