

City of Minneapolis Interoffice Memorandum

To: Paul Ostrow, Chair, Ways & Means/Budget Committee

From: Patrick Born, CFO

Subject: Response to the Excipio Analysis of Unisys Outsourcing Contract

Date: January 22, 2007

CC: Ways & Means Committee Members

This memo highlights the financial implications pertaining to the Unisys outsourcing contract and responds to the recommendations presented to the Council in the "Performance and Compliance Review of Computing Resources" by Excipio Consulting. Although not a formal audit, the analysis provides the City with valuable information that will help us focus our efforts related to managing this and other contracts. We are pleased that the original business case for the outsourcing approach has been validated.

The report recommended actions that should be taken by the City and Unisys. The most important financial implications pertaining to the Unisys outsourcing contract include:

- **Contract Extension.** There are no automatic contract extensions.
- **Ownership of Infrastructure.** Upon expiration of the Unisys contract, the City, if it chooses to, would have to purchase the "Buy-Back Equipment" at a price equal to the unamortized purchase price over the expected installed life of the "Buy-Back Equipment."
- **Charges for IT Assets.** The City is still purchasing (via contract amendments and change orders), but not owning, IT assets, such as servers.
- **Disaster Recovery.** DR capability has not been fully implemented.
- **Network Security.** As identified in the SAS70 audit, Unisys is not performing regular network scans and Unisys is not performing a regular review of authorized users with the appropriate level of resources within City.
- **Asset Inventory.** Unisys does not appear to have a strong grasp on desktop assets inventories.
- **Cost of Service.** Contract amendments and change orders have increased the original contract from almost \$55,900,000 to over \$68,000,000. Corresponding levels of service have also increased.

Relating to Unisys contract, Excipio noted the following risk:

"In the event City ever decides to part ways with Unisys, City should expect a high cost of exiting from the relationship. The primary costs would be the acquisition or transfer of the assets that Unisys has placed in service plus the amortized cost of all the amendments and change orders that have been spread out over the life of the contract. If City were to terminate the Unisys contract in 2009, Excipio estimates that City would incur millions in upfront contractual obligations. This cost excludes the number of personnel that City would need to hire, train, and transition into the environment."

Outlined below are some of the details on financial costs associated with the outsourcing contract to Unisys.

RISK MITIGATION

In the original business case presented to Council, risk mitigation (disentanglement) was acknowledged:

The risk associated with recovering a privatized business function, if the outsourcing partnership fails, while formidable, is manageable. The risk is managed through disentanglement language in the contract covering both the transition period and the contract termination.

Contract Extension

The contract with Unisys expires seven (7) years from the start-up date, which will be January 1, 2010. The City is able to extend the contract beyond the seven years under terms *mutually agreed upon in writing by the Parties*. Pricing issues and any other revisions will be addressed at that time (there are no automatic contract extensions).

Ownership of Infrastructure

The original business case stated *the contract language will specify that the equipment (new and old) is returned to the City at its fully depreciated value.*

The contract does not specify that the equipment (new and old) is returned to the City at its fully depreciated value, rather the contract states, “upon expiration of the Term of Agreement, the Client may elect to purchase the Buy-Back Equipment at a price equal to the unamortized purchase price over the expected installed life of the Buy-Back Equipment.” (Section 4.3 (b)). This language indicates a potential cost not anticipated in the original business case.

The original business case also stated that *owning and maintaining IT assets is no longer considered a “core business function” in the mix of information services provided by governmental IS departments*

Charges for IT Assets

While the City may no longer own and maintain IT assets, the City is paying for the purchase – not the leasing - of IT assets. These costs are outlined in the contract amendments and change orders. Instead of paying for the purchase of new servers, the City could pursue coming up with a monthly price per unit that includes a regular hardware refresh interval every 48-60 months. Excipio notes the hardware pricing should include the Operating System, anti-virus, backup, monitoring software, hardware cost, and Unisys support.

Excipio noted in their analysis that *“although the operational cost savings are being achieved, significant room for improvement exists for both parties. These efficiencies will not lead to major dollar savings, but will result in improved service quality for the organization. The recommended improvements primarily focus on operational processes, which are often overlooked once the outsourcing is complete.”*

Regarding server support, Excipio noted that *“the City should pursue a server consolidation strategy with Unisys.”* They estimated 40%-60% of physical server instances could be consolidated, noting any hardware savings would likely be offset with increased software costs – but there would be true savings in reduced server administration as servers per administrator ratios would increase by 50%-75%.

Disaster Recovery

According to Excipio's analysis, "although the capability exists, the DR capability has not been fully implemented and City is still at risk. Based on information initially provided in the SAS70 audit, the required annual DR plan (Section 2.7.2.10) has yet to be completed. The lack of a tested DR plan is a material breach of the contract that places the organization at risk. Before any additional applications are placed in service, the DR plan needs to be completed, tested, updated, re-tested, and placed in service."

Network Security

Excipio noted that *"Unisys should be required to provide regular security audits, scans, and resiliency tests no less than once per year."* While this requirement may not have significant direct financial costs, the indirect costs could be monumental. With the passing of laws requiring the notification of when data has been compromised, the cost of such notification - and the fines associated with data loss/compromise - can exceed millions of dollars. Not to mention the costs associated with loss of trust and reputation.

Asset Inventory

In the area of Desktop Support and Asset management, Excipio noted that *"Unisys does not appear to have a strong grasp on desktop assets inventories. The physical desktop and laptop count varied as much as 25% throughout the engagement, which could yield inaccurate billings from Unisys. The City should require Unisys to automate asset and inventory management systems to eliminate data inaccuracies, coupled with a physical inventory once a year to validate the accuracy of the asset information."* Since an aspect of the Unisys contract is for the management of assets and the City is being billed based upon the number of assets, an accurate inventory should be required.

Cost of Service

When the City entered into this contract with Unisys in 2003, the cost of the contract was \$55,872,901. At the time of the Excipio analysis the approved change orders and amendments have brought the contract to \$68,087,665. This amount continues to grow and does not include additional contracts that have been signed with Unisys that are outside of the original outsourcing contract.

Conclusion

The most significant financial issue outlined in the Excipio analysis is how expensive it will be for the City to part ways with Unisys. Outlined above are details on this and issues with potentially significant financial impacts to the City, some of which can be addressed within the current contract and others that should be addressed in any future contracts (if the City continues to outsource the City's IT functions).

Issues that can be addressed in the current contract are to ensure security audits and network scans are regularly completed, to complete continuous review of authorized users, to guarantee an accurate and up-to-date asset inventory, and to fully implement the disaster recovery capability. Any changes to how the City pays for IT services may have to wait for future contracts.