REVIEW OF
THE MANAGEMENT AGREEMENT
BETWEEN
CGI AND DEPARTMENT OF TAXATION

AS OF

NOVEMBER 2013

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Executive Summary

Pursuant to Chapter 806, 2013 Acts of Assembly, this report provides the results of a financial and operational review of CGI and its subcontractors related to the Enterprise Applications Master Services Agreement (PPEA). We have reviewed the management agreements between CGI and state agencies and institutions pursuant to the PPEA's Statements of Work Six and Seven and the performance of CGI and its subcontractors with regard to measured service levels.

Statements of Work Six and Seven (Statements) were designed to provide a funding mechanism to defray the cost of the implementing enterprise systems. CGI currently has no other revenue producing work under the PPEA other than the Department of Taxation's (Tax) use of the Statements to support CGI's performance of outside collection services, and this is not producing meaningful revenue to offset the Commonwealth's costs of enterprise systems. As such, the PPEA and Statements no longer serve the purpose for which they were intended.

Tax has not instituted effective performance monitoring techniques, nor are they completing annual documented contract evaluations over CGI, a best practice in contract management. Additionally, CGI's management of outside collection agencies, whose collections represent about seven percent of Tax's total annual delinquent account collections, carries higher fees than when Tax managed outside collections services themselves. We estimate the Commonwealth may save more than $1 million annually by returning the management of the outside collection services to Tax, or competitively procuring these collection services independent from the PPEA.

While the Commonwealth expected to use the Statements as a means to pay for enterprise systems, as of June 30, 2013, only $394,453 has been recouped since the Statements inception in 2008. A recent contract modification initiated by Tax in 2012 resulted in the deposit of those funds, but still the Commonwealth is paying fees well above the costs when Tax managed the collection agencies internally; resulting in a decrease in net revenue from outside collection activities when compared to net revenue achieved prior to CGI.

-T A B L E O F C O N T E N T S-

Introduction and Objectives

On January 4, 2006, the Commonwealth of Virginia and CGI, a private information technology service provider, entered into the Enterprise Applications Master Services Agreement (PPEA). Under this PPEA, CGI intended to upgrade and transform the state's current information technology systems and develop statewide enterprise applications. CGI's winning proposal included a plan to offset costs of this PPEA with funds from enhanced tax collections (Statements of Work Six and Seven), a program that CGI and the Department of Taxation (Tax) began in April 2008. This program authorized CGI to contract with Tax to manage their outside collection agencies' activities, which on average, accounts for approximately seven percent ($33 million of $462 million) of Tax's annual delinquent account collections. The enhanced tax collection program is formalized through a management agreement and it is the only active revenue producing program under the PPEA.

Objectives:

- To evaluate the operations and financial performance of CGI and its subcontractors related to the enhanced collection activities program (Statements of Work Six and Seven),
- To evaluate the competitiveness and added value of CGI's enhanced collection services,
- To determine whether CGI and its subcontractors have established and implemented adequate controls over the Commonwealth's data.

Background

Chapter 3, 2006 Special Session I Acts of Assembly, included the creation of the Virginia Enterprise Applications Program (VEAP), under the oversight of the Information Technology Investment Board (ITIB), to manage the PPEA. CGI won the PPEA contract in part due to its proposed methods of cost sharing and cost recovery for the project. Included in these methods was the enhanced collection activities CGI proposed to perform for delinquent accounts at Tax and other agencies. Of the agencies CGI envisioned participating in the enhanced collection activities, only Tax actually engaged CGI and created a management agreement under Statements of Work Six and Seven to begin that venture.

The PPEA, including VEAP, was originally funded with $26.4 million of General Fund appropriations from fiscal years 2007 through 2010, and drew $11.6 million from a working capital advance meant to bridge operations until alternative funding options, such as the enhanced collection activities, produced sufficient revenue. Later activities by VEAP, including the development of the Commonwealth's Cardinal system and Performance Budgeting initiative, resulted in the total drawdown of approximately $27 million from the working capital advance.

Originally CGI and Tax agreed on a baseline collection amount of $39.8 million per year. Any collections each fiscal year above the baseline amount would be deposited into the Technology Infrastructure Fund (TIF) and would be available to be spent by the VEAP to help repay the working capital advance and fund PPEA activities. As time went on, CGI was never able to reach the original baseline collections amount and until July 2012, no funds were deposited into the TIF by this venture. Tax initiated a reduced fee rate program in July 2012 following the second renewal of the management agreement in February 2012, which allowed for the deposit of a fee reduction into the TIF. This reduced fee rate program and its related TIF deposits are discussed in more detail in the section titled, "*Collection Activities*."

Eventually, the VEAP required other funding alternatives, and it was agreed that the PPEA would not be used to develop the Commonwealth's enterprise financial management and budgeting systems. Instead, the Department of Transportation and the Department of Planning and Budget took over developing the enterprise financial management and budget systems while the VEAP focused on defining data standards for the Commonwealth. Ultimately, the VEAP was folded into the Virginia Information Technologies Agency, but the original $27 million working capital advance has not yet been recovered. A more detailed history of the CGI PPEA is available in the Virginia Enterprise Applications Program Report issued by the Auditor of Public Accounts in September 2008.

Scope / Methodology

CGI is responsible for approximately seven percent of Tax's annual delinquent account collections under the enhanced collections management agreement pursuant to Statements of Work Six and Seven. The remaining 93 percent of delinquent account collections are carried out by Tax and not part of this special review.

We reviewed the available financial records of CGI and Tax as they relate to the enhanced collections management agreement. Although CGI's expenses related to the management agreement were not available for review, we tested revenue recorded by CGI for fiscal years 2012 and 2013. Most of CGI's expenses are composed of fees they pay to their subcontractor Performant Financial Corporation (Performant), but the nature and amount of these fees are proprietary and are not subject to review by the Commonwealth. According to CGI, the remaining expenses are not significant enough to track at a project level, so they are charged against overhead and; therefore, were also unavailable for review. We also reviewed Tax's reconciliation of the monthly invoice from CGI to their Accounts Receivable System to evaluate the controls around the billing process.

We compared fees paid for CGI's services to: collection fees and costs paid by Tax prior to the management agreement; other collection contracts already in place in the Commonwealth; and to collection rates previously researched by our office and described in an earlier collection report issued by our office. In conjunction with the fee comparison, we also examined net revenue retained by the Commonwealth as a result of collections activities.

Finally, we reviewed the Independent Service Auditor's Report (SOC 1) for CGI as well as Performant because Performant receives individual taxpayer account data from Tax. Therefore, it was important to ensure that Performant's internal controls adequately complied with the Commonwealth's Information Security Standard (SEC 501). The results of this review are detailed in the sections below.

Collection Activities

The only active revenue producing management agreement pursuant to the PPEA is the VEAP Collection Outsource Agreement, or enhanced collection activities with Tax. This agreement was expected to increase the Commonwealth's tax revenues by raising collection rates of delinquent accounts (the collection process is documented in the *Appendix B* at the end of this report). The excess funds from these enhanced activities were expected to help fund VEAP activities.

The VEAP Collection Outsource Agreement with CGI provided services to Tax related to managing their outside collection agencies. It is important to note that CGI does not actually perform collection activities for Tax; instead they manage the collections process and CGI's subcontractors, primarily Performant, who perform the actual collections. With the volume of delinquent accounts owned by Tax and the resources needed to actively manage those accounts, the agreement provided a potentially valuable service to Tax. The transfer of management activities enabled Tax to redeploy three staff to other jobs and permitted subsequent vacancies to be carried to absorb budget reductions. CGI's services led to an initial increase of collections since they collected on previously written off debt, but it also raised the fees Tax was paying for collection services, resulting in an overall net decrease in revenue in recent years as the collection of written off debt subsided. (*Illustration 1*).

Illustration 1

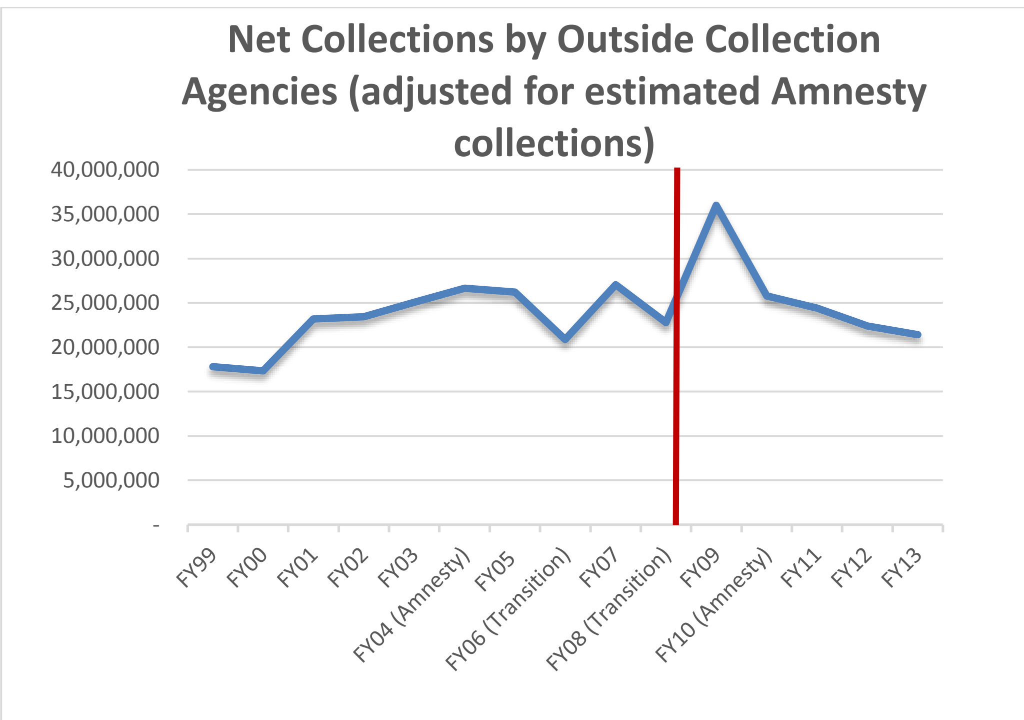

Illustration 1 shows collections, net of fees, of delinquent debt by outside collection agencies by Fiscal Year. This Illustration is adjusted to remove the effects of two Amnesty Programs which increased collections, but were not reflective of outside collection agencies' activity. The red line indicates when the management agreement with CGI began.

Illustration 2

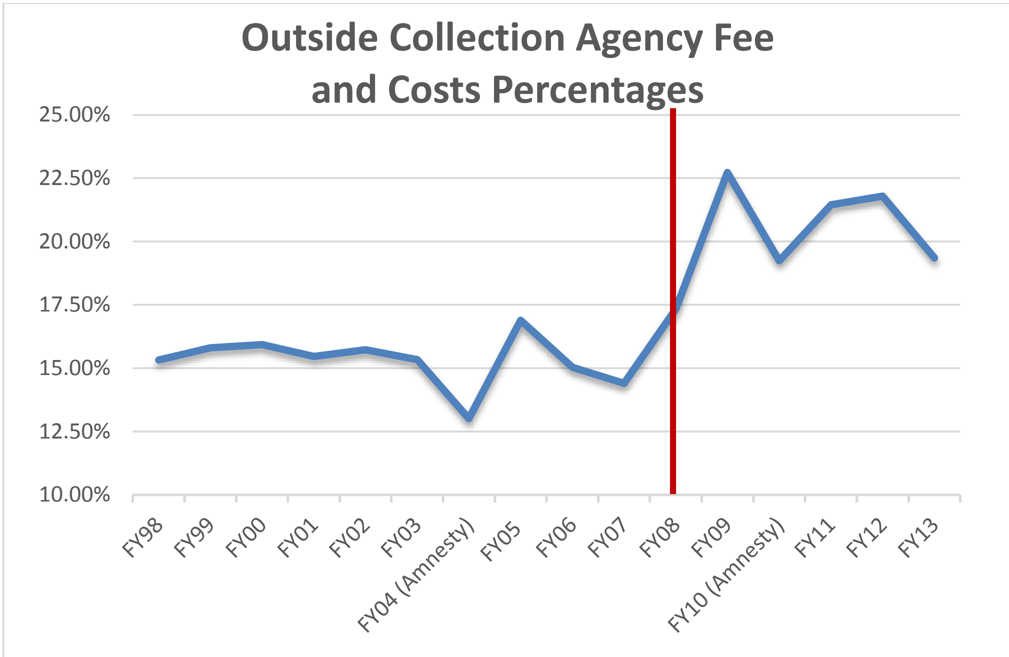

Illustration 2 shows the average fee for collection services paid each year based on information provided by Tax. The red line indicates when the management agreement with CGI began. Since the CGI rates include a management function previously performed internally by Tax, to improve comparability, we increased the rates shown prior to FY08 to account for Tax's internal staffing cost, estimated to be $213,000 per year, incurred to manage the outside collection agencies in-house. On average, this internal staffing cost increased the rate by 0.81 percent per year in those years.

Overall, fees and costs rose by approximately 5.6 percent (*Illustration 2*), and although net collections increased initially, amounts for the fiscal year 2013 have returned to fiscal year 2001 levels and are trending downward as shown in *Illustration 1*. For analysis of the net collections, in *Illustration 1*, we removed Tax's estimated increase in collections of 30 percent due to tax amnesty programs in fiscal year 2004 (prior to the agreement) and fiscal year 2010, as this was not a result of collection agency efforts but of Tax initiated amnesty programs that enticed debtors to come forward. We noted two declines in collections, fiscal year 2006 and fiscal year 2008, which were caused by transitional periods that caused collections activity to cease while Tax switched accounting systems (2006) and then collection agencies (2008). These transitions each lasted approximately six months, and the second transition contributed to the peak of activity seen in fiscal year 2009, when collection activities resumed after that transition. (Unadjusted net collections can be found in *Illustration 4 – Baseline comparison*.)

The management agreement provided an original baseline for net collections of $39.8 million per year, which was based on discussions between Tax and CGI. The baseline was the collection level above which collections would be deposited into the TIF and used to repay the VEAP working capital advance. It was expected that the baseline would be adjusted annually based on changes to economic conditions and receivable inventory levels. The baseline was set at $39.8 million despite net collections in fiscal year 2006 of $20.9 million and fiscal year 2007 of $27 million. In the first two full fiscal years of the program, CGI produced net collections totaling $36 million in fiscal year 2009 and $34.5

million in fiscal year 2010 (an amnesty year), but has averaged $22.7 million over the three most recent fiscal years.

After calculating and adjusting the baseline to $45.7 million during the second full year of the agreement (fiscal year 2010), Tax did not complete recalculations in the subsequent years because collections did not approach the adjusted baseline. In comparing performance over the past three years, CGI's $22.7 million average net collections is lower than the $23.8 million average for the ten years prior to the management agreement (1998-2007, excluding 2004 in which amnesty collections would have artificially increased prior results). Until July 2012, no funds were deposited into the TIF by this venture. In July 2012, Tax initiated a reduced fee rate program, following the second renewal of the management agreement in February 2012, which allowed for the deposit of the fee reduction into the TIF. In addition to the reduced fee rate, Tax removed the baseline altogether. As of June 2013, a total of $394,452 had been deposited into the TIF after a full fiscal year of the fee reduction modification. While this contract modification has produced funds for the TIF, net revenue from outside collection activities is still below levels prior to the management agreement.

The CGI management agreement increased the costs paid by Tax by approximately 5.6 percent annually. Specifically, from fiscal years 1998 to 2007, Tax paid average fees and costs of 15.3 percent annually, which was comprised of fees to outside collection agencies of 14.48 percent and internal staff costs to manage them of approximately 0.81 percent. This is compared to average annual fees under the CGI agreement of approximately 20.9 percent since 2008. Amnesty programs in fiscal year 2004 and fiscal year 2010 contributed to lower fee rates in those years, shown as dips in *Illustration 2*. In February 2012, Tax and CGI agreed to a reduced rate contract modification beginning in July 2012 which lowered fees by approximately 1.5 percent and put that savings directly towards the TIF as discussed below in the *Contract Performance Section*.

In reviewing fees paid for collections activities, we found several collections scenarios that charged lower fees than the CGI management agreement (*Illustration 3*). First, we looked at fees paid by Tax prior to the management agreement which averaged 14.48 percent (15.3 percent when including Tax's internal management costs) and were fairly consistent from 1998 to 2007. As seen in *Illustration 2*, the average rate for CGI is 20.9 percent. Tax's own Court Debt Collections Office has a 17 percent fee structure and although the nature, age, and complexity of the court debt is different than the debt managed by CGI, it does provide some comparison of rates charged for services. The Department of General Services (DGS) has procured two collection contracts for use by any Commonwealth agency. The first contract, and most prevalently used, is with NCO Financial Systems, Inc. (NCO). This contract provides a fee of 10.95 percent on all collections. The second contract, with J.C. Christensen & Associates, Inc. (JCC), provides similar collection services for a 12 percent fee. It is important to note that the DGS contracts have lower rates because they do not require the collection agency to conform to necessary IRS regulations and do not anticipate very old and complex debt; nonetheless, they do provide a starting point for the comparison of fees and determination of the premium required to comply with Tax's requirements and needs.

Illustration 3

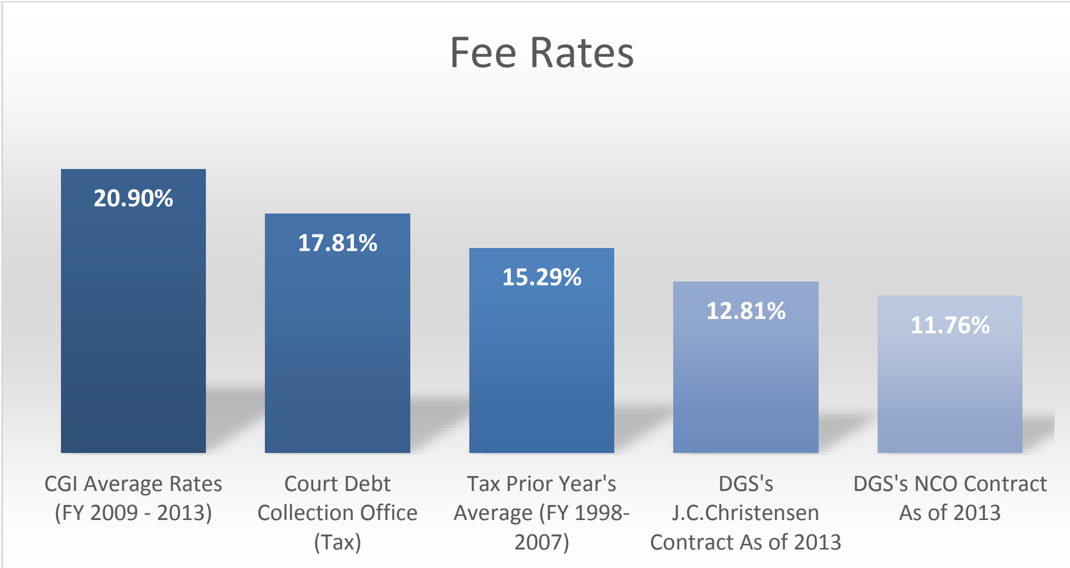

Illustration 3 shows fee rates for CGI and other available collections options. Other options were increased by the estimated costs for Tax to manage collections themselves (0.81 percent as discussed below) for comparison purposes, since CGI's rate includes the management function. Note: CGI rates are based on actual data through fiscal year 2013, their rate structure is actually a three-tiered structure based on the age and experience of the debt collected. Court Debt Collection Office Rates are derived from the 2012 Courts Accounts Receivable Report issued by the Auditor of Public Accounts.

Prior to the relationship with CGI, Tax employed four tax collection representatives and one team leader to manage up to five outside collection agencies. Under the current relationship with CGI, Tax employs one team leader and one additional full-time equivalent position to manage the relationship. If Tax reverted to managing the outside collection agencies internally, Tax would likely have to hire three additional full-time equivalent positions. Using the mid-point salary range for estimation purposes, Tax would likely incur a cost of approximately $213,000 (or 0.81 percent of collections) annually to fill the additional three full-time equivalent positions. However, based on the 5.6 percent average increase in costs since the CGI management agreement, we estimate Tax could save the Commonwealth over $1 million per year if it returned to performing these services internally.

Recommendation 1

Tax should review options available to mitigate costs related to collecting past due debts. Viable options include bidding the service out through the Request for Proposal (RFP) process or handling management activities in-house. Allowing other companies to bid on the contract through the RFP process would encourage competition and potentially lower fee rates. If Tax chose to again manage the collection activities in-house, we estimate the savings would far exceed the cost of hiring additional staff at Tax to perform these services. Nonetheless, this option would require the budgetary authorization to hire approximately three full time employees as well as an appropriation.

Contract Performance

The CGI enhanced collection activities were expected to contribute operating funds to the TIF in the first full year of its implementation, fiscal year 2009. The amount contributed was to be the net revenue above $39.8 million in the first year and then adjusted from that year forward based on various factors. Two adjustments to the baseline have occurred since the management agreement's inception: 1) it was raised to $45,744,332 in fiscal year 2010, then 2) eliminated altogether in fiscal year 2013. *Illustration 4* shows net collections as compared to the original baseline of $39.8 million and the adjusted baseline of $45.7 million in fiscal year 2010 and $0 in fiscal year 2013.

Illustration 4

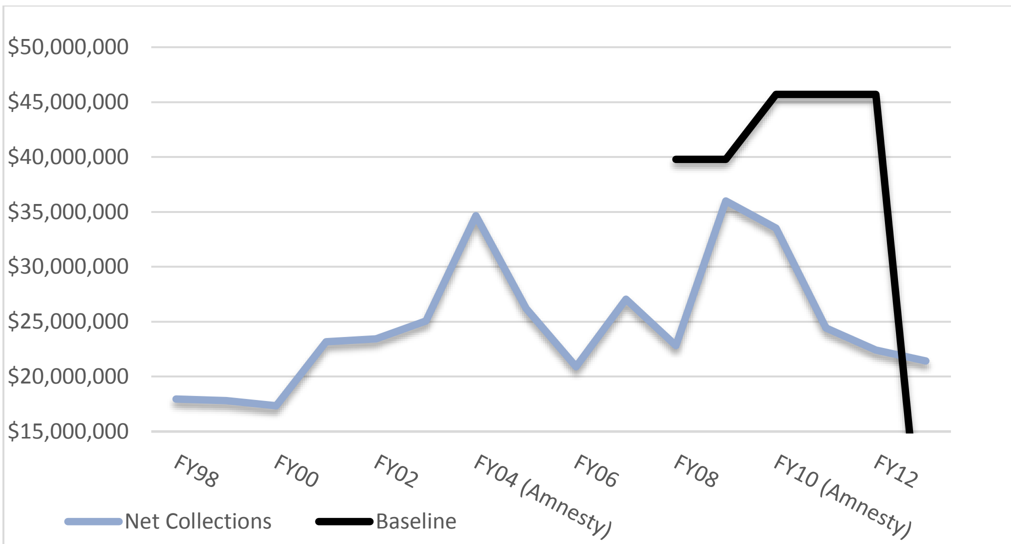

Illustration 4 shows net collections from fiscal year 1998 through fiscal year 2013 along with the adjusted baseline amount.

The CGI management agreement requires quarterly performance reviews by Tax focusing on the preceding 12-month liquidation rates (percent of allocated accounts the agency is successful in collecting) and account placement levels. Discussions with Tax determined they have not been documenting quarterly or annual performance reviews for this agreement. Tax and CGI meet quarterly, but CGI's presentations do not include sufficient useful performance data to effectively evaluate their performance. Additionally, Tax has been unable to agree data provided by CGI to their own records, due mostly to timing differences, which made the CGI data difficult to rely on and ineffective.

In reviewing Statement of Work Six and Seven, and the CGI management agreement, we found that although Tax is a party to the agreement, the real beneficiary is the TIF. Tax does benefit by being relieved of the responsibility for managing this portion of its delinquent account collections, but all increased collections would produce funds for the TIF; nonetheless, monitoring of CGI's performance is Tax's responsibility. Our review found that Tax did not complete regular documented performance enforcement activities or contract evaluation activities.

Recommendation 2

Tax should establish a performance review process, incorporating quantifiable collections goals and monitoring benchmarks to evaluate CGI's collections processes and determine effectiveness. There are several methods available including Net Back Recovery Rates (amount collected net of fees divided by accounts assigned), Vintage Recovery Rates (how much of each block of assigned accounts is collected each period), and others that will allow for performance comparison and evaluation. The review process should include, at a minimum, documented annual evaluations comparing actual performance to industry standards or preset goals to allow the agency to make an informed decision on CGI's performance.

Status of the Enterprise Application Master Services Agreement (PPEA)

On August 27, 2012, the PPEA was renewed by the Office of the Governor for a term of three years, until December 21, 2015. Discussions with CGI revealed that there are some activities under the PPEA beyond the management agreement with Tax, involving other Statement of Work areas. However, this work is short-term in nature and is not of the scale under which the original PPEA was accepted. The original PPEA was intended to replace large Commonwealth enterprise applications such as financial management, human resources, payroll, and facilities management. The first initiative, financial management, was cancelled in 2009 due to a lack of funding and instead the Commonwealth partnered with the Department of Transportation to build the Commonwealth's new financial accounting system, known as Cardinal, and will soon begin a roll-out to state agencies. There are no plans by the Commonwealth to begin replacing any other major enterprise applications.

Additionally, the Commonwealth had planned to use enhanced collections deposited to the TIF to repay the VEAP's working capital advance drawdowns of approximately $27 million. Instead, the majority of the working capital advance will be repaid by state agencies through fees charged for using the Cardinal and Performance Budgeting systems. As discussed in the introduction, the original purpose of the enhanced collections activities was to offset the working capital advance and reduce the financial burden of developing enterprise applications. Because CGI was unable to meet its goals under the enhanced collections agreement, the financial burden of repaying the working capital advance is being absorbed by state agencies.

Recommendation 3

The Enterprise Application Master Services Agreement (PPEA) no longer serves its original purpose and the Commonwealth should consider terminating it or allowing it to expire. To increase competition and generate cost savings, the Commonwealth should competitively procure IT consulting services as statewide contracts rather than using this PPEA, which was accepted in 2006 for a purpose other than providing short-term IT consulting services. In addition, the only revenue generating management agreement under the PPEA (enhanced collection activities with Tax) would be better served if competitively procured by Tax or brought back in-house. The Commonwealth has already moved to spread the costs of the VEAP programs to the state agencies due to the failure of the management agreement to produce the expected increased revenue. Also, the attempts to recoup costs (the rate reduction modification) have resulted in reducing costs, but have not increased net revenue from collection activities to levels achieved prior to the management agreement and; therefore, are not actually benefiting the Commonwealth as intended.

Information Security Standards

To perform collection activities, CGI's subcontractor, Performant, has access to the most sensitive data about citizens of the Commonwealth. This data is required in order for them to effectively carry out their collection activities and they meet IRS regulations to receive this data. In addition, they are required by the PPEA to maintain levels of security equal to the Commonwealth's standards. According to the Independent Service Auditor's Report (SOC 1) for Performant dated January 10, 2013, Performant's management asserts that they follow NIST standard SP 800, upon which the Commonwealth's Security Standard (SEC 501-07.1) is based. After reviewing the SOC 1 report, we found that only minor, immaterial findings related to Performant's security controls were discovered. The service auditor found that Performant's controls were consistently applied as designed and manual controls were applied by competent personnel.

Review Results

Our review found that CGI's available financial records related to the management agreement with Tax appeared to be materially correct. CGI's revenue materially agreed with fees paid by Tax and amounts recorded in the Commonwealth Accounting and Reporting System (CARS) for fiscal years 2012 and 2013. Tax reconciles CGI collections amounts monthly and their accounting system tracks and reports the fee owed to CGI, which is then confirmed by CGI prior to invoicing Tax. This methodology is reasonable and allows Tax to determine the amount owed and prevents overcharges.

In on our review of collections activity performed under the management agreement and prior to it, we found several areas of opportunity to improve the outside collection process (*Recommendations 1-3* above). Tax's outside collections process, which is performed by CGI under the management agreement resulting from the PPEA, has resulted in higher fees, lower net collections for the Commonwealth, and insufficient oversight of contract performance. Tax should review the costs and benefits of the management agreement, review other available options to ensure that services are retained at competitive rates, and take action to produce the highest return available to the Commonwealth rather than following the current course of operating under the PPEA.

This report includes responses from the Department of Taxation, the Governor's Chief of Staff, and CGI. Our comments to CGI's response are included in *Appendix A*.

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

November 26, 2013

The Honorable Robert F. McDonnell
Governor of Virginia

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

Pursuant to Chapter 806, Item 427 A.3, 2013 Acts of Assembly, we are pleased to submit our report entitled **Review of the Management Agreement between CGI and the Department of Taxation**. This report provides the results of a financial and operational review of CGI and its subcontractors related to the Enterprise Applications Master Services Agreement (PPEA). The scope of our review was limited to a management agreement executed under the PPEA between CGI and the Department of Taxation (Tax) as no other management agreements exist under Statements of Work Six and Seven.

To conduct this review we performed research and analysis and also interviewed Tax and CGI management and obtained financial and operational information from both. Our review included an examination of CGI's performance under the agreement, including accounts receivable collection rates and fees both prior to and since initiating the agreement. Additionally, we make recommendations that may result in future increased collections and lower collection fees if implemented.

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

AUDITOR OF PUBLIC ACCOUNTS

KKH/clj

COMMONWEALTH of VIRGINIA

Department of Taxation

November 20, 2013

Ms. Martha S. Mavredes
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

The Department of Taxation (TAX) appreciates the opportunity to comment on a draft of the Review of the Management Agreement between CGI and the Department of Taxation. A short summary of Taxation's plans to address the report findings follows:

Recommendation 1-Review options related to the collection of past due accounts

As noted accurately in the report, CGI accounts for a small percentage (about seven percent) of TAX's delinquent collections. TAX began using CGI in April 2008 to collect predominately out-of-state and other, difficult to collect accounts during these challenging economic times. From FY 2009 to FY2013, TAX and CGI together collected almost $2.5 billion in compliance revenue. As always, TAX must balance the need to maximize collections and the impact on the state's general fund revenue with the cost of those collections. Therefore by October 1, 2014, TAX will perform a cost benefit analysis comparing options for the collection of out-of-state and other difficult to collect accounts. Once the analysis is performed, the most cost beneficial option, that maximizes revenue, will be implemented in an expedient manner.

Recommendation 2- Establish a performance review process

Depending upon the option selected to manage and collect difficult accounts as noted in the response to recommendation 1; TAX will implement an appropriate review process with quantifiable collections goals and benchmarks. This corrective action will be implemented at the completion of the correction action to address recommendation 1.

Again, thank you for the opportunity to review and comment. Please let me know if you have any questions.

Sincerely,

Craig M. Burns
Tax Commissioner

cc: The Honorable Richard D. Brown, Secretary of Finance

From: Martin Kent, Governor McDonnell's Chief of Staff
Date: November 21, 2012

Response to Recommendation #3 in your report:

It should be noted that the extension of the agreement originally entered into in 2006 is not a mandated service provider agreement but rather an option to state agencies when they determine that such a service is needed. They remain free to separately procure the service under the regular procurement process should another vendor or vendors be determined to provide the service better and/or at a lower cost. The incoming administration should also review the performance under the contract prior to the renewal date and make a determination as to whether it is operationally and/or cost beneficial to extend the agreement.

Thanks for the opportunity to respond.

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November 21, 2013

Ms. Martha S. Mavredes
Auditor of Public Accounts
Post Office Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes:

Thank you for the opportunity to comment on the proposed draft Review of the Management Agreement between CGI and the Department of Taxation (the Report).

The Commonwealth of Virginia (Commonwealth) Department of Taxation (Tax) and CGI Technologies and Solutions Inc. (CGI) have jointly and successfully modernized Tax's internal and external collections, which resulted in an increase of revenue for the Commonwealth. Based on the Management Agreement performance criteria and CGI's twice a year customer satisfaction survey, Tax has been satisfied with CGI's performance over the years. For this reason, and the other reasons set out in more detail in this letter, CGI respectfully objects to the Report's implication that CGI somehow failed in its provision of the enhanced collection services and that this alleged failure required the Commonwealth to absorb financial burdens. Moreover, CGI respectfully objects to the Report's resulting recommendation that the Commonwealth terminate and/or not renew the Enterprise Applications Master Services Agreement (PPEA) (again, for the reasons set out in more detail in this letter). Specifically:

- The conclusion that Tax could recognize large savings by bidding the work out or bringing it in-house was based on a set of incomplete facts.
- The conclusion that CGI's failure to perform resulted in a financial burden for the state agencies is incorrect, and the resulting recommendation that the Commonwealth not renew the PPEA is based on this incorrect conclusion.

CGI believes that the Report should be based on all of the relevant facts and should evaluate the facts in an "apples to apples" fashion in order for the Auditor of Public Accounts (APA) to make the proper determination on which recommendations are appropriate and beneficial to Tax and the Commonwealth. Our response focuses on the recommendations that are made in the Report and the reasons why CGI believes they are based on incomplete facts and/or incorrect conclusions. We hope this response is received in the spirit of providing constructive feedback and additional factual background off which the APA may make its recommendations.

1 APA's Recommendation #1

> Tax should review options available to mitigate costs related to collecting past due debts. Viable options include bidding the service out through the Request for Proposal (RFP) process or handling management activities in-house. Allowing other companies to bid on the contract through the RFP process would encourage competition and potentially lower fee rates. If Tax chose to again manage the collection activities in-house, we estimate the savings would far exceed the cost of hiring additional staff at Tax to perform these services. Nonetheless, this option would require the budgetary authorization to hire approximately three full time employees as well as an appropriation.

The Report recommends putting the work out for competitive bid (RFP) for an estimated savings of over $1 million per year. However, this savings calculation does not take into account all of the relevant factors such as the costs of transition, ongoing management oversight and other benefits from our partnership with Tax, including modernization and streamlining, and it is therefore not a balanced comparison.

We believe the conclusions regarding CGI's performance in the Report are, in some cases, factually incorrect. We respectfully bring the following key points to your attention:

- The current contractual rate for CGI's collections fee is 18.5% for primary placements, which are the primary focus of the collection effort and the baseline, not the 20.9% average rate used in the Report.
- CGI offers the rate of 18.5%, which is also used in the State of Louisiana as a comparative basis for the APA's analysis.
- The baseline that the Report uses for determining whether or not CGI performed as expected is based upon an assumption of $230 million per year in new referrals. The actual amount of new referrals has ranged from $102 million to $165 million. With less than half the dollar amount of referrals than the number used to determine the baseline, it follows that the dollar amount collected would also be substantially lower.
- Notwithstanding the substantially lower amounts referred—57% of what was expected to be referred—CGI and its partner Performant have nonetheless collected 92% of the baseline.

The Report characterizes a partnership that is very successful as something that is not working. The facts do not back this up. Tax has one of the highest recovery rates of most state taxing authorities in the country, including both internal and external collections.

The Report implies in several instances that the PPEA was set up for the purpose of providing a mechanism for funding enterprise systems. That is not correct. The PPEA was established for the purpose of modernization of "enterprise applications addressing finance, human resource and other central systems" (CIO Report to the Governor and the Joint Commission on Technology and Science - October 1, 2006). Numerous documents, reports and presentations by a variety of Executive and Legislative Branch agencies support this fact.

CGI proposed a series of early modernization projects with the potential to generate significant dollars through centralization and enhancement of debt collection (thus the inclusion of Statements of Work 6 & 7). While this may have been one of many differentiators between CGI's PPEA proposal and that of its competitor, it was not the sole reason that the Commonwealth undertook the procurement of an enterprise applications contract. Many, if not most, enterprise applications are of the magnitude that their costs could not be funded through such a contractual vehicle and only partially offset at best. Developing a funding stream for application development was never the underlying, nor was it the most important, purpose of the PPEA as conceived and negotiated.

It is also important to note that CGI's estimate of money available from increased collections (as proposed in our PPEA proposal) was based upon the Commonwealth moving ahead with the proposed centralization of debt collection and associated enhancements. To date, the Commonwealth has not decided to proceed with this proposal. As a result, the full magnitude of the estimates of money available from increased collections cannot be attained nor factored into any analysis.

2 APA's Recommendation #3

> The Enterprise Application Master Services Agreement (PPEA) no longer serves its original purpose and the Commonwealth should consider terminating it or allowing it to expire. To increase competition and generate cost savings, the Commonwealth should competitively procure IT consulting services as statewide contracts rather than using this PPEA, which was accepted in 2006 for a purpose other than providing short-term IT consulting services. In addition, the only revenue generating management agreement under the PPEA (enhanced collection activities with Tax) would be better served if competitively procured by Tax or brought back in-house. The Commonwealth has already moved to spread the costs of the VEAP programs to the state agencies due to the failure of the management agreement to produce the expected increased revenue. Also, the attempts to recoup costs (the rate reduction modification) have resulted in reducing costs, but have not increased net revenue from collection activities to levels achieved prior to the management agreement, and therefore are not actually benefiting the Commonwealth as intended.

On Page 10 of the Report it states: "Because CGI was unable to meet its goals under the enhanced collections agreement, the financial burden of repaying the working capital advance is being absorbed by state agencies." This statement is not supported by the facts. Yet, the Report's recommendation to terminate the PPEA is based upon this conclusion.

CGI has been successful in meeting its performance obligations under the PPEA. For example:

- The Management Agreement had an agreed upon recovery percentage of 12.94%, 24 month out on a batch basis. The average batch that has reached that maturity is at 13.93%. This is an 8% improvement over the target.
- The 2nd Placement (Recall) target over 24 months was 3.6% and the team achieved 11%.
- The Write Off portfolio target over 24 months was 1.8% and the team achieved 2.73% (or 30% more than expected).
- CGI and Performant have met or exceeded the contracted performance targets on 97% of the placements received from Tax.

Notwithstanding the implication created by the Report, CGI did not decide to initiate the Cardinal and Performance Budgeting projects, CGI did not determine what working capital advances to draw down for such projects, and CGI did not benefit in any way from such projects (including receipt of any funds for such projects).

The state agencies' responsibility for repaying the working capital advance has no direct correlation to CGI's performance. The conclusion that CGI's performance (or lack thereof) resulted in the state agencies' obligation to repay working capital advances is flawed and the resulting recommendation that the Commonwealth therefore terminate the PPEA is unfounded.

CGI supports the APA and the Commonwealth's examination of each of its partnerships from time to time to ensure that vendors' performance is not just acceptable, but exceptional. CGI has engaged with TAX each quarter to review the collections project including for example: issues, risks, liquidation rates, customer complaints, call handling, interfaces, recovery projections, upcoming TAX priorities and needs, etc. CGI is happy to discuss how this process could be improved or modified to adhere to APA's Recommendation #2.

CGI respectfully disagrees with the recommendations that bidding the Tax collections work out will result in at least $1 million per year in savings and that the Commonwealth cancel the PPEA or allow the PPEA to expire. We believe that an examination of accurate information and data related to CGI's partnership with Tax and the PPEA re-affirms the value to Commonwealth taxpayers. CGI believes that the PPEA remains an important tool for the Commonwealth as it continues to look at enterprise-wide systems and processes. While we are disappointed that this agreement has not been utilized as first outlined to us, we have in good faith endeavored to keep our commitments to the Commonwealth. It is important to note that excluding Tax, there have been dozens of other statements of work under the PPEA across multiple executive branch agencies, including several active statements of work, that have assisted the Commonwealth.

CGI is proud to have its U.S. headquarters in Virginia, where our roots run deep. Thank you for your consideration of our concerns with the draft Report. We look forward to continuing to assist the Commonwealth in the years to come.

Sincerely,

Mark Boyajian
Senior Vice President of Consulting Services
CGI Technologies and Solutions Inc., Mid-Atlantic Public Sector

Appendix A – APA Comments to CGI's Response

The CGI response characterized certain aspects of our report as factually incorrect and below is our response to those items.

- *The current contractual rate for CGI's collections fee is 18.5 percent for primary placements, which are the primary focus of the collection effort and the baseline, not the 20.9 percent average rate used in the Report.*

Our report accurately states CGI's actual average rates from fiscal year 2009 through 2013 as 20.9 percent and page 5 describes that Tax negotiated a 1.5 percent rate reduction with CGI beginning in fiscal year 2013. CGI's response properly describes the fee for primary placements at 18.5 percent; but, it fails to note that the current fee provides for a sliding scale that ranges from 18.5 percent to 32.5 percent. The sliding scale allows CGI to assess a larger fee percentage on older and complex debts. Although the lowest collection fee rate during fiscal year 2013 was 18.5 percent, the actual fees paid by the Commonwealth for fiscal year 2013 totaled 19.4 percent, due to the sliding scale fee structure.

- *CGI offers the rate of 18.5 percent, which is also used in the State of Louisiana as a comparative basis for the APA's analysis.*

CGI provided the APA with documentation that Performant assesses a flat 18.5 percent collection fee add-on to the amount owed by delinquent taxpayers in Louisiana. In Virginia, the collection fee is not an add-on to the debtor, but is instead paid to CGI from actual gross collections. Also, the documentation related to Louisiana's rate provides no context regarding the age and complexity of the debt being collected by Performant. In addition, Performant's rate for Louisiana is set at 18.5 percent whereas CGI's rates in Virginia range from 18.5 percent to 32.5 percent. Finally, since CGI subcontracts the collections work to Performant, we requested that CGI provide its negotiated rates with Performant for Virginia's collections. We believed having these rates would provide the best comparison to CGI's rates. CGI would not provide us with these rates.

- *The baseline that the Report uses for determining whether or not CGI performed as expected is based on an assumption of $230 million per year in new referrals (accounts). The actual amount of new referrals has ranged from $102 million to $165 million. With less than half the dollar amount of referrals than the number used to determine the baseline, it follows that the dollar amount collected would be substantially lower.*

Our report does not describe how the baseline was determined and whether the Commonwealth made any guarantees to CGI regarding the quantity of Tax's accounts they would work. We attempted to obtain information from both Tax and CGI as to how the baseline was set and neither provided evidence. CGI's response discusses that it did not achieve the baseline because Tax did not provide them with sufficient delinquent accounts, which would in turn generate collections to at least the baseline level.

Tax staff indicate that CGI independently set the baseline and that Tax did not promise a specific quantity of delinquent accounts. Tax staff said there was never any intention to give CGI easily collectable delinquent accounts, such as those that are less than 90 days past due, because it's most cost effective for Tax to work them using its in-house collections staff. As described in our report, Tax's in-house collections staff accounts for 93 percent of the total delinquent account collections, representing about $420 million in General Fund tax dollars in fiscal year 2013. If these easy to collect accounts had been turned over to CGI, the Commonwealth's General Fund would have been reduced by the fees of at least 18.5 percent paid to CGI.

- *Notwithstanding the substantially lower amounts referred – 57 percent of what was expected to be referred-CGI and its partner Performant have nonetheless collected 92 percent of the baseline.*

The baseline for fiscal years 2008 and 2009 was $39.8 million and increased to $45.7 million in fiscal years 2010 and 2012. In fiscal year 2013 Tax removed the baseline as part of its fee renegotiation with CGI. We estimate CGI's net collections, which is the amount against which the baseline is measured, averaged around 60 percent from 2008 through 2012, not the 92 percent mentioned by CGI. Illustration 4 in our report accurately shows CGI's actual annual net collections compared to the baseline.

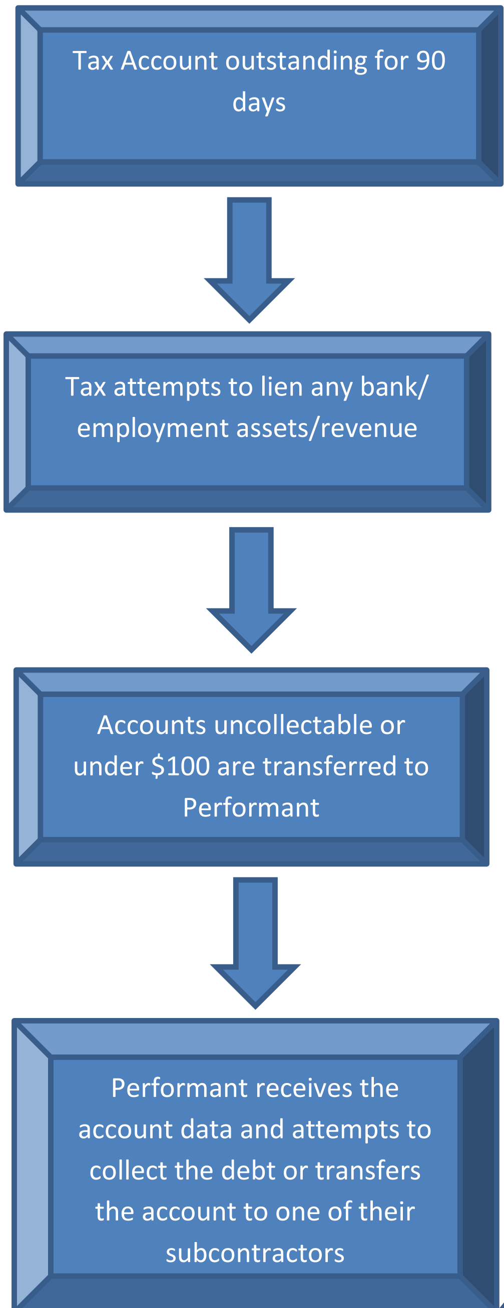
- *The report implies in several instances that the PPEA was set up for the purpose of providing a mechanism for funding enterprise systems. That is not correct. The PPEA was established for the purpose of modernization of "enterprise applications addressing finance, human resources and other central systems".*

Page 1 of our report accurately describes that under the PPEA, CGI intended to upgrade and transforms the state's current information technology systems and develop statewide enterprise applications. We also explain that CGI's winning proposal included a plan to offset costs of this PPEA with funds from enhanced tax collections under Statements of Work Six and Seven, which is the subject of this report.

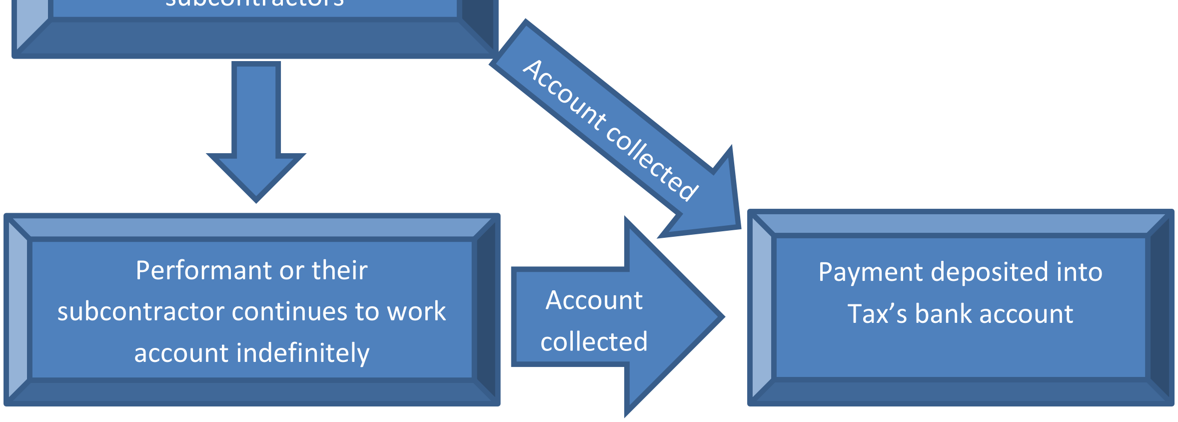
- *On page 10 of the Report it states: "Because CGI was unable to meet its goals under the enhanced collections agreement, the financial burden of repaying the working capital advance is being absorbed by state agencies." This statement is not supported by the facts. Yet, the Reports recommendation to terminate the PPEA is based upon this conclusion.*

We recommend the termination or expiration of the PPEA because is not serving the purpose for which it was initially accepted, which was to replace Commonwealth enterprise applications such as financial management, human resources, payroll, and facilities management. Agencies have occasionally used the CGI PPEA to obtain short-term IT consulting services; however, we believe the Commonwealth may generate cost savings by competitively procuring statewide IT consulting contracts from several vendors for agencies to use. This is similar to how the Commonwealth currently provides statewide contracts for other IT services, including software, storage, web applications, website design, cabling, and broadband.

Appendix B -- Collections Process



The collections process between Tax and CGI follows a relatively predictable and expected course. The taxpayer is billed for their tax liability and once past due, Tax attempts to collect on the receivable with in-house personnel. Once the account becomes past due by 90 days, Tax will attempt to place a lien on any available assets, including wages, through use of information provided by the Virginia Employment Commission (VEC), bank accounts, or by use of available federal information from the Internal Revenue Service. If assets cannot be found, the amount is insufficient to satisfy the amount due, or if the total amount due is less than $100, Tax will send the account to Performant (CGI's main subcontractor – CGI provides management services, they do not actually collect the debt and do not handle account information) to be placed with one of their subcontractors. Business accounts are only sent to Performant if the business can no longer be located or has moved out of state, as such, very few business accounts are referred to Performant. The subcontractors will continue to work the accounts indefinitely. CGI receives fees based on the type of account collected. The highest percentage fee is for accounts written off by Tax, followed by "second placement" accounts which have been recalled from another collection agency (accounts assigned prior to this contract), and then "first placement" accounts which have only been worked by in-house Tax personnel.



RESPONSIBLE OFFICIALS

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Virginia Tax Commissioner

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