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Case Study: How The Internal Revenue Service's VMO Drove Millions In IT Cost Savings

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EXECUTIVE SUMMARY

Like many private sector companies, the US Internal Revenue Service (IRS) has faced challenges achieving a centralized view of IT products and services spend across disparate requisition and contract management processes. In 2008, the IRS established an IT vendor management office (VMO) to address these challenges, and the results have been impressive — more than \$61.6 million in 2010 savings and \$58.7 million in 2011 budget reductions — a cumulative two-year total of \$120.3 million. This case study outlines the specific techniques used to achieve these cost savings and tips for success from the IRS's VMO.

SITUATION: ESCALATING COSTS DUE TO DECENTRALIZED CONTRACT MANAGEMENT

In some ways, the IRS's IT shop is no different than the IT organization of a large private sector company. Like large retailers, the IRS's transaction volumes skyrocket once a year, requiring massive IT scalability. As with financial institutions, data security and reliability are paramount. And, as with every large company, hundreds of expensive and sometimes redundant IT vendors have spread their tendrils across the different groups within the agency. This, compounded by the lack of centralized IT contract governance, led to spending and increasing costs that became unsustainable. Having contract periods aligned with the end of its own fiscal year put pressure on the agency to sign large quantities of deals in a compressed time period and placed leverage in vendors' laps. Having multiple processes for processing requisitions reduced visibility and encouraged noncompliant spending.

BEST PRACTICE: PROMOTE INNOVATIVE SOURCING PROCESSES

In 2008, the IRS established its VMO with a mandate to create savings by promoting innovative sourcing alternatives that generate the same or additional value. In 2009, the president issued a memorandum calling for federal agencies to improve the effectiveness of acquisition processes and achieve efficiencies.¹ Russell W. Lewis, the IRS's executive director of IT vendor and contract management, provided us with the key steps they put in motion. The IRS VMO:

- **Standardized and formalized the requisition process.** The agency went to a single requisition template and reduced the number of required approvals to four. In addition, the VMO is involved in the evaluation and approval path for all requisitions for contracts exceeding \$5 million.

- **Aligned selected large-dollar contract periods with vendors' fiscal years.** Not only did this shift the negotiating leverage to the IRS by putting time pressure on the vendors, it staggered the periods of performance, giving the VMO a better opportunity to evaluate individual expiring contracts in more depth. The VMO now has a master calendar that highlights contract expiration and renewal dates for the upcoming quarter, which helps to identify and prioritize opportunities to restructure contracts that are not competitively priced or no longer align with its business plans.
- **Eliminated/replaced obsolete/underutilized products.** The VMO conducted market research and collaborated with internal divisions to identify products that could be eliminated or replaced with more full-featured, cost-effective solutions.² The VMO's efforts resulted in similar or greater functionality and increased utilization at significantly lower cost by restructuring contracts to better align with current needs.³
- **Evaluated monthly burn rates for services contracts.** The VMO reviewed monthly invoices for large labor services, telecommunications, and maintenance contracts to identify areas where budget allocations exceeded contract needs. This allowed the IRS to reprioritize funding at a corporate level in lieu of project offices allocating the funds to low priority projects or potentially placing excess funds on the contract. In short, the VMO bridged the gap between budgeted amounts that were based on past utilization to reflect more current contract needs.
- **Collaborated with IT program managers to better monitor inventory.** The VMO led the process of better monitoring the inventory of hardware devices and software licenses to ensure that the IRS is not charged maintenance for products that are not in use. This was a fruitful effort and resulted in reduced Sun Microsystems and Cisco maintenance payments of roughly \$4.7 million.
- **Aggregated demand to drive volume discounts.** By aggregating server demand, the VMO acquired 10% greater computing power to respond to the increased tax filing season requirements, at a fraction of the previously negotiated pricing (\$1.4 million versus \$10 million). In other areas, the IRS went from 30 or more contract vehicles in certain areas to a single contract — and a single period of performance to monitor. This reduced administrative costs and eliminated reinstatement fees for missed renewals.

In conjunction with implementing process and governance improvements, the IRS increased visibility into and control over product-specific and vendor-specific spend. Some of the techniques used included:

- **Migrating from desktop to server-based software licensing.** The VMO identified and implemented opportunities to shift from a desktop- to a server-based software model that would

require fewer licenses for the same functionality. An example of this was the reduction of 45,000 Adobe Acrobat desktop licenses by using a server-based file generator that provides the same functionality to end users.

- **Consolidating procurement of raw disk storage.** The procurement of disk storage was previously spread out across multiple contracts, vendors, and organizations. By consolidating purchasing with fewer vendors and improving contract administration, the team generated \$7.6 million in savings in FY 2010 and FY 2011.

The IRS also set goals for future initiatives to include a centralized IT strategic sourcing strategy; spend rationalization; and vendor consolidation with mandated and measured continuous process improvement.

RESULTS: \$61.6 MILLION IN SAVINGS CERTIFIED BY THE CFO

As a result of VMO success in innovating acquisition strategies and collaborating across the IRS, the agency's CFO certified savings across almost 20 different initiatives. The IRS's VMO achieved:

- **Savings that cross multiple fiscal years.** In FY 2010, the IRS's CFO reported \$61.6 million in savings (one-time/non-base savings of \$15.8 million and base savings of \$45.8 million) — six times the initial \$10 million target given to the VMO. The IRS also anticipates FY 2011 base savings of \$45.8 million carried forward from FY 2010, and new savings of \$12.9 million from FY 2010 implemented savings initiatives.
- **Mandated savings ahead of schedule.** The June 2010 Treasury report on the Office of Management and Budget (OMB) savings target shows that the IRS had achieved 75% of the \$58.3 million OMB mandated reduction when only 67% of the fiscal year had passed. With a month remaining to reach the \$58.3 million goal, the VMO had exceeded it by \$3.3 million.
- **Added value to the entire organization.** The IRS IT organization, through the efforts of the VMO team, has produced 100% of the IRS savings reported in 2010, even though IT represented only about 49% of the FY 2008 IRS contract spending (the OMB savings baseline). In FY 2011, the IT organization experienced an \$88 million budget reduction, which was largely addressed through FY 2010 VMO savings initiatives.

RECOMMENDATIONS

VIGOROUSLY TRACK SAVINGS TO MARKET SUCCESS

At first, the young IRS VMO and the centralized procurement organization faced significant challenges in establishing a partnership due to perceived overlapping missions. The key to overcoming these difficulties was to clearly define roles and responsibilities and communicate them

effectively throughout all levels of the procurement organization. Jointly, the central procurement organization and the VMO identified and agreed on areas where the VMO could get more value for its dollar. Now that the IRS is better leveraging its buying power to get Ts and Cs and is receiving better prices based on aggregate volume, there is a stronger appreciation for the VMO's technology-driven, vendor-agnostic approach to strategic sourcing. Even though partnerships have been established with the VMO, ensuring stakeholder buy-in continues to be a significant focus. The VMO has found that measuring the success of its efforts and effectively communicating results generates enthusiasm and greater levels of internal support.⁴

ENDNOTES

¹ This memorandum requires agencies to take the following actions: 1) review their existing contracts and acquisition practices and develop a plan to save 7% of baseline contract spending by the end of FY 2011; and 2) reduce by 10% the share of dollars obligated in FY 2010 under new contract actions that are awarded with high-risk contracting authorities. Source: Executive Office of the President, Office of Management and Budget, "Memorandum For The Heads Of Departments And Agencies, Subject: Improving Government Acquisition," July 29, 2009 (http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_fy2009/m-09-25.pdf).

² Understanding which devices and applications people at your company are using — as well as the frequency and manner in which they are used — is invaluable to sourcing when planning IT purchases and driving contract negotiations. See the December 2, 2009, "Sourcing Professionals Need To Understand The Changing Requirements Of Users" report. [55839]

³ Vendor managers, facing onerous cost-reduction targets, want to cut the amounts they pay to software companies for annual maintenance. Our discussions with software companies show that many of them are reviewing their policies. See the May 8, 2009, "Yes We Can (Cut Our Software Maintenance Costs)" report. [47695]

⁴ For the VMO to ultimately succeed, the key internal stakeholders have to be its strongest advocates, not the VMO itself. As a first step, VMOs need to better understand what the current level of satisfaction is internally for the services they provide. To help VMOs toward this goal, Forrester has assembled a 40-question satisfaction survey designed to gather feedback after each sourcing event across important areas like RFP creation, vendor evaluation, negotiation, contract management, and vendor performance monitoring. See the January 20, 2010, "How Effective Is Your IT Vendor Management Office?" report. [56049]