



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Report Number:
07-128-04

Space Planning and Leasing Process

Department of Management and Budget

Released:
May 2005

The Department of Management and Budget's (DMB's) Strategic Asset Management is responsible for analyzing the State's current real estate holdings and interests, conducting long-term planning, and disposing of surplus property. Its responsibilities also include evaluating agency space requests, identifying facilities to meet agency needs, requesting and evaluating bids, and administering leases.

Audit Objectives:

1. To assess the effectiveness of ARCHIBUS (DMB's computerized facility management system) in providing information necessary to analyze currently owned and leased property.
2. To assess DMB's effectiveness in ensuring that its process for leasing property results in meeting user needs while minimizing State costs.
3. To assess the effectiveness of DMB's long-term planning process.

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Audit Conclusions:

1. We concluded that ARCHIBUS was moderately effective in providing information necessary to analyze currently owned and leased property. We noted a reportable condition related to the completeness and accuracy of ARCHIBUS information (Finding 1).

2. We concluded that DMB was moderately effective in ensuring that its process for leasing property results in meeting user needs while minimizing State costs. We noted a reportable condition related to the lack of documentation in lease files (Finding 2).
3. We concluded that because DMB did not have a long-term plan, we could not determine the effectiveness of DMB's limited planning activities. We noted reportable conditions related to the lack of a strategic plan and the Statewide land database and surplus property disposal (Findings 3 and 4).

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Agency Response:

Our audit report contains 4 findings and 6 corresponding recommendations. DMB's preliminary response indicated that it agrees with all of our recommendations.

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May 27, 2005

Mr. Mitch Irwin, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Irwin:

This is our report on the performance audit of the Space Planning and Leasing Process, Department of Management and Budget.

This report contains our report summary; description of process; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Process

The Department of Management and Budget's (DMB's) Strategic Asset Management is responsible for performing real estate functions, including the planning and leasing of work space for State agencies. Strategic Asset Management consists of the Strategic Development and Real Estate Divisions.

The Strategic Development Division (SDD) is responsible for analyzing the State's current real estate holdings and interests, conducting long-term planning, and disposing of surplus property. The surplus property disposal process starts when a State agency notifies SDD of property that is surplus to its operational needs. SDD then initiates either the transfer of the property to another State agency or the sale of the property to a local unit of government or private party.

The Real Estate Division (RED) is responsible for evaluating agency space requests, identifying facilities to meet agency needs, requesting and evaluating bids, and administering leases. The space request process begins when a State agency determines a need to expand or reduce existing space, relocate or consolidate operations, or renew commitments to current spacing levels. The agency notifies RED of its space needs. RED then analyzes the current available space options within the inventory of State-owned and leased facilities or identifies the potential need for a new building or lease. RED's goal is to work with the State agency to meet its needs while minimizing State costs. Once space is identified, RED handles the lease negotiations and facilitates the agency's move. The State agency is responsible for making required lease payments.

DMB uses a computerized facility management system (ARCHIBUS) to manage State-owned and leased property. ARCHIBUS data consists of information on leases for space in privately owned buildings and space assignments of departments in State-owned buildings.

Executive Order No. 2002-20, which became effective on January 4, 2003, gave DMB sole responsibility for providing lease services to State agencies. The Executive Order also provided for the transfer of all real estate related positions from other State agencies to DMB to carry out this responsibility. According to RED management, RED

received only two positions from one department as a result of the Executive Order. We determined that since the effective date of the Executive Order, the number of positions in RED has decreased from 16 to 13.

As of January 2004, the State had approximately 650 leases for nine million square feet of space in various types of property throughout the State. The annual cost of these leases to the State agencies was approximately \$124 million.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Space Planning and Leasing Process, Department of Management and Budget (DMB), had the following objectives:

1. To assess the effectiveness* of ARCHIBUS in providing information necessary to analyze currently owned and leased property.
2. To assess DMB's effectiveness in ensuring that its process for leasing property results in meeting user needs while minimizing State costs.
3. To assess the effectiveness of DMB's long-term planning process.

Audit Scope

Our audit scope was to examine the Department of Management and Budget's space planning and leasing process and related records. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, conducted from February through June 2004 and in February and March 2005, generally covered the period October 1, 2001 through June 30, 2004. We conducted a preliminary review to obtain an understanding of the space planning and leasing process and to plan our audit that consisted of interviewing staff and reviewing legislation, regulations, policies, procedures, and reports related to space leasing and assignment.

To assess the effectiveness of ARCHIBUS in providing information necessary to analyze currently owned and leased property, we met with agency staff to develop an understanding of the information contained on ARCHIBUS and the uses of the information as well as the ability of staff to modify reports that the system generates.

* See glossary at end of report for definition.

We selected a random sample of lease files for testing data in ARCHIBUS to determine the completeness and accuracy of lease data.

To assess DMB's effectiveness in ensuring that its process for leasing property results in meeting user needs while minimizing State costs, we met with agency staff to discuss the process for obtaining leased space and for deciding to use existing space or acquire new space. We selected a sample of lease files to gain an understanding of the information that was included in the files and to determine that rules and regulations related to securing space were followed. Also, we researched the market value of office space in various areas of the State and compared this information with existing leased space costs to determine the reasonableness of the cost of currently leased space.

To assess the effectiveness of DMB's long-term planning process, we met with agency staff to discuss and review DMB's long-term planning process. We obtained and reviewed files on selected surplus property waiting for disposal to determine its disposal status and the timeliness of the disposal. We obtained State-owned property listings from selected counties for comparison with State property records in an attempt to verify the accuracy of the State property records.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 4 findings and 6 corresponding recommendations. DMB's preliminary response indicated that it agrees with all of our recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1280.02 require DMB to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

Within the scope of this audit, we followed up 1 of the 6 audit recommendations from our June 2002 performance audit of the Real Estate Division, Department of Management and Budget (#0712601). DMB had not complied with the prior audit recommendation, which was rewritten for inclusion in this report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

ARCHIBUS

COMMENT

Audit Objective: To assess the effectiveness of ARCHIBUS in providing information necessary to analyze currently owned and leased property.

Conclusion: We concluded that ARCHIBUS was moderately effective in providing information necessary to analyze currently owned and leased property. We noted a reportable condition* related to the completeness and accuracy of ARCHIBUS information (Finding 1).

FINDING

1. Completeness and Accuracy of ARCHIBUS Information

The Department of Management and Budget (DMB) did not include complete and accurate data on State-owned and leased property on ARCHIBUS (its computerized facility management system). As a result, ARCHIBUS was of limited use in assisting DMB in managing State-owned and leased buildings. Also, DMB uses ARCHIBUS information to classify and record leases for financial statement purposes and to charge departments for building occupancy. Inaccurate and incomplete data may result in financial reporting and billing errors.

ARCHIBUS data consists of information on leases for space in privately owned buildings and space assignments of departments within State-owned buildings. DMB uses ARCHIBUS data to manage leases and to report space leased by State agencies to the Legislature. Data in ARCHIBUS on space assignments to departments within State-owned buildings consists of floor plan layouts and square footage of each floor assigned to the respective departments. We selected data fields in ARCHIBUS for testing that we believe would allow DMB to effectively manage Statewide lease data and to provide adequate reporting to the DMB Office of Financial Management. We determined:

- a. During the period October 1, 2001 through May 15, 2004, DMB entered 25 new leases. We selected a sample of 15 lease files for comparison with information recorded in ARCHIBUS. We noted that the fair market value

* See glossary at end of report for definition.

reported in ARCHIBUS was either missing or incorrect for all (100%) files, the breakdown of lease and operating costs reported in ARCHIBUS was estimated rather than based on actual data in 13 (87%) files, and monthly payments in ARCHIBUS were incorrect for 4 (27%) leases. Accurate fair market value and a breakdown between lease and operating costs would allow DMB to properly classify capital leases* and operating leases* and to compare the costs of leases.

- b. During the period October 1, 2001 through May 15, 2004, DMB recorded 71 lease renewals. We selected a sample of 15 renewal lease files for comparison with information recorded in ARCHIBUS. We noted that the fair market value and breakdown of lease and operating costs reported in ARCHIBUS was either missing or estimated rather than based on actual data in all (100%) files. In addition, lease duration in ARCHIBUS did not agree with lease duration documented in 2 (13%) files.

RECOMMENDATION

We recommend that DMB include complete and accurate data on State-owned and leased property on ARCHIBUS.

AGENCY PRELIMINARY RESPONSE

DMB agrees and will comply by June 30, 2005 with a plan for obtaining the fair market value and the breakdown of lease and operating costs on all current and future DMB leases.

DMB will continue efforts to improve the accuracy and completeness of the ARCHIBUS database for State-owned and leased facilities.

DMB will work with the Office of Financial Management and the Office of the Auditor General to determine the information related to fair market value and breakdown of lease and operating costs necessary for the classification of capital and operating leases in the *State of Michigan Comprehensive Annual Financial Report*.

* See glossary at end of report for definition.

SPACE LEASING PROCESS

COMMENT

Background: As a result of the recent economic downturn, DMB was instructed to cancel leases wherever possible and to negotiate reductions in lease payments to property owners to reduce State expenditures. In response to this request, DMB has canceled 70 leases and negotiated reductions in lease payments of 110 leases. These cancellations and negotiated reductions have had immediate as well as long-term effects on reducing State expenditures. DMB informed us that cancellations and negotiated reductions have resulted in a savings of approximately \$1.0 million for fiscal year 2002-03 and are expected to result in reductions of approximately \$4.4 million for fiscal year 2003-04, with a total savings over the life of the leases of approximately \$17.3 million.

Audit Objective: To assess DMB's effectiveness in ensuring that its process for leasing property results in meeting user needs while minimizing State costs.

Conclusion: We concluded that DMB was moderately effective in ensuring that its process for leasing property results in meeting user needs while minimizing State costs. We noted a reportable condition related to the lack of documentation in lease files (Finding 2).

FINDING

2. Documentation in Lease Files

DMB did not maintain documentation to support decisions for acquiring new leases and renewing existing leases. In addition, DMB should modify its procedure to require a market rate analysis* and an operating cost analysis for all new and renewal leases. The lack of documentation and these analyses limits DMB's ability to demonstrate that it has secured leases at the lowest cost to the State while meeting user needs.

Michigan Administrative Code R 18.502 requires lease contracts to be competitively bid unless the DMB director waives the requirement. If the bid requirement is waived, DMB is to perform a market rate analysis to substantiate

* See glossary at end of report for definition.

the lease rate amount. DMB Administrative Guide procedure 0110.03 provides for DMB to contact State agencies and local units of government to determine if space is available in existing facilities and to use a bidder's list and public advertisement in locating available space to lease. Section 18.1221 of the *Michigan Compiled Laws* requires that the Joint Capital Outlay Subcommittee approve leases when the space or facility either exceeds 25,000 square feet or has an annual base lease cost greater than \$500,000. However, along with the competitive bid process, a market rate analysis and an operating cost analysis for all leases would assist DMB in determining that bids received and non-bid leases are at the lowest cost obtainable for the geographic area.

During the period October 1, 2001 through May 15, 2004, DMB recorded 25 new leases and 71 lease renewals. We selected a sample of 15 new leases and 15 lease renewals to determine if DMB's files contained documentation to support activities required in the DMB Administrative Guide and the *Michigan Administrative Code*. Our review of new lease and renewal lease files noted:

- a. Five (33%) new lease files did not contain documentation that DMB competitively bid the leases or obtained a waiver of the bidding requirement from the DMB director. In addition, DMB did not document that a market rate analysis was completed for these leases to ensure that DMB secured the lowest cost lease that met user needs.
- b. Six (40%) new lease files did not contain documentation that DMB contacted other State agencies or local units of government when it was identifying possible locations for agencies to lease. Coordinating with other State agencies and local units of government helps to ensure that government agencies maximize space and results in efficient use of State and local government resources.
- c. Fourteen (93%) new lease files did not contain documentation that DMB performed an operating cost analysis to evaluate the reasonableness of the operating and square footage costs in the total lease costs. Instead, DMB estimated the portion of total lease costs that it applied to operating costs and square footage costs. Accurate allocation of operating and square footage costs is necessary to allow DMB to compare lease proposals and select the lowest cost lease.

- d. Three (20%) new lease files did not contain documentation that identified specific agencies needing new lease space prior to DMB entering into a lease arrangement. DMB informed us that these 3 leases (Cadillac Place in Detroit, Constitution Hall in Lansing, and One Division Building in Grand Rapids) were proposed by developers and were not initiated based on State agency requests. We determined that 2 of the lease files did include documentation of a market rate analysis to support that the proposals provided space at a reasonable price to allow State agencies to consolidate into one location. The Joint Capital Outlay Subcommittee approved these 3 leases.
- e. None (100%) of the 15 renewal lease files contained documentation that either a market rate analysis or an operating cost analysis was conducted. Although there is no requirement that DMB conduct market rate and operating cost analyses when exercising lease renewals, such analyses would help to ensure that lease renewals are in the best interest of the State.

Because DMB's new lease and renewal lease files did not contain documented information demonstrating that the lease rates were at the lowest cost to the State, we obtained current market rates for geographic areas in the State from a national commercial real estate brokerage company and compared them to rates the State paid for 71 leases. We determined that 68 (96%) of the lease rates were within an acceptable range for the geographic location.

RECOMMENDATIONS

We recommend that DMB maintain documentation to support decisions for acquiring new leases and renewing existing leases.

We also recommend that DMB modify its procedure to require a market rate analysis and an operating cost analysis for all new and renewal leases.

AGENCY PRELIMINARY RESPONSE

DMB agrees with the first recommendation and informed us that it has complied by revising procedures for all new leases and future lease renewals. DMB recognizes that past practice did not always ensure compliance with competitive bidding requirements (or the director's waiver of that requirement) and requirements for notifying State agencies and local units of government. DMB informed us that it has implemented procedures.

DMB agrees with the second recommendation and informed us that agencies were previously not required to supply, and did not supply, an operating cost analysis; however, since early 2003, DMB requested agencies to report operating cost data. DMB indicated that the acquisition of major office space was sometimes driven by factors other than agency needs for space; however, since early 2003, changes have occurred to engage agencies prior to major space acquisitions. As an example, DMB informed us that it recently completed a major relocation and consolidation of Department of Community Health office space following a competitive bid process for the agency-defined space needs. DMB will conduct market rate and operating cost analyses for lease renewals as recommended by the auditors.

LONG-TERM PLANNING

COMMENT

Audit Objective: To assess the effectiveness of DMB's long-term planning process.

Conclusion: We concluded that because DMB did not have a long-term plan, we could not determine the effectiveness of DMB's limited planning activities. We noted reportable conditions related to the lack of a strategic plan* and the Statewide land database and surplus property disposal (Findings 3 and 4).

FINDING

3. Strategic Plan

DMB had not developed a long-term strategic plan for State-owned and leased property (land and buildings). As a result, DMB cannot ascertain that it is managing resources effectively and maximizing State resources with its current property and lease portfolio.

A strategic plan could provide direction for DMB's property acquisition, disposal, and leasing activities. Such a plan could identify State agencies' short-term and long-term space needs and assist DMB in developing goals related to disposing of surplus property or consolidating leases for office and/or warehouse space in an area.

* See glossary at end of report for definition.

DMB maintains a short-term plan for utilization of space in State-owned buildings that outlines planned moves for State agencies during the upcoming year. This short-term plan does not address long-term space needs for all State agencies in State-owned and leased property. We noted:

- a. DMB analyzed existing leases and was able to cancel 70 leases by consolidating State agencies' space to reduce leasing costs during fiscal years 2002-03 and 2003-04. A strategic plan would assist DMB in routinely identifying opportunities to consolidate space and reduce costs.
- b. DMB did not adequately consider user needs when it executed a new lease in downtown Grand Rapids in 2002 for office space. As a result, State agencies identified to occupy this new leased space declined to move from existing leased space, leaving 95,000 (69%) square feet of the new leased space vacant. DMB subsequently sublet this unused space to a federal agency to avoid having to continue paying lease payments for unused space. A comprehensive strategic plan could have helped DMB avoid leasing space that did not meet user needs.

In January 2004, DMB contracted with an outside firm to develop a long-term plan for State-owned and leased properties. In January 2005, DMB was provided with a five-year plan that contained recommendations for improving space usage in State-owned and leased buildings. However, now that a long-term plan has been developed, DMB needs to implement and utilize the plan to minimize costs while meeting State agencies' space needs.

RECOMMENDATION

We recommend that DMB develop, implement, and utilize a long-term strategic plan for State-owned and leased property.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it has initiated and completed a comprehensive long-term strategic real estate plan and is in the process of implementing this plan.

DMB informed us that in 2003, it recognized that a comprehensive strategic real estate plan was critical to effective managing of the State's space needs. Primarily for that reason, DMB released a competitive bid request for proposal for

professional real estate services to perform, among other things, the development of a strategic plan. DMB indicated that an innovative performance-based contract was executed with a private vendor in January 2004 and, following extensive input from State departments and agencies, a real estate strategic plan was completed in January 2005 and is being implemented.

FINDING

4. Statewide Land Database and Surplus Property Disposal

DMB, in conjunction with other State agencies, had not completed the development of a central system to maintain information on State-owned land. In addition, DMB did not have a sufficient process to help ensure that it disposed of surplus property in a timely manner. The lack of a central system could hinder DMB's efforts to coordinate the acquisition, use, and disposal of land. The delays in disposing of surplus property could result in the State incurring unnecessary costs to maintain the surplus property.

DMB, along with the Departments of Natural Resources, Transportation, and Military and Veterans Affairs, is responsible for maintaining information on State-owned land. We determined that each of the four departments utilizes a different automated system or paper files to account for land. The Department of Information Technology procured an automated Statewide land database that would allow all four departments to record all land owned by the State in a central location. However, although this database was purchased in 2000, it was not operational during our audit and was still being developed by the Department of Information Technology. Maintaining a Statewide land database would facilitate DMB and other State agencies in the purchase, use, and sale of property.

In addition, we reviewed files for 4 of 24 plots of property that were deemed surplus and had been authorized for disposal by the Legislature. We noted:

- a. One plot of property, authorized for disposal in December 1996 and appraised in July 1997, had not been disposed of as of June 2004. We noted that there was no correspondence in the file after 1997 and no explanation as to why DMB had delayed disposal action.

- b. Two plots of property, declared surplus in 1996, remained unsold as of June 2004. The files contained correspondence dated September 2003 from an interested buyer who was willing to purchase the property at the appraised price. There was no explanation in the file as to why DMB had not sold this property.

- c. One plot of property, declared surplus in 1997 and authorized for disposal in 1999, remained unsold as of June 2004. The legislation authorizing the disposal of this property required DMB to sell the property at its fair market value in the open market. Since DMB received authority to sell this property in 1999, four appraisals have been performed. The last appraisal, in September 2003, established the value at \$2.6 million. However, there was no explanation in the file as to why DMB had not sold the property. Information in the file did disclose that maintaining this property costs the State approximately \$480,000 annually.

RECOMMENDATIONS

We recommend that DMB, in conjunction with other State agencies, complete the development of a central system to maintain information on State-owned land.

We also recommend that DMB improve its process to dispose of surplus property in a timely manner.

AGENCY PRELIMINARY RESPONSE

DMB agrees with the first recommendation and informed us that it supports the central system concept and is providing data for all DMB-managed buildings, land, and leases to the Department of Information Technology's Center for Geographic Information. DMB indicated that since early 2003, it has been working with the Center for Geographic Information to improve information on State-owned land as part of the existing Statewide Land Database System. DMB also indicated that it recently initiated an interagency workgroup to promote participation by all State agencies responsible for managing real property to better coordinate the identification of surplus parcels and strategies for improving surplus property disposition.

DMB agrees with the second recommendation and informed us that it has complied and that a system has been developed to ensure that disposal of surplus property

is initiated in a timely manner. DMB recognized the need for, and established a separate division responsible for, the disposal of surplus property. DMB indicated that final disposition of property is dependent upon many factors beyond DMB's control, including the buyer's ability and willingness to complete a transaction timely; local government approval; lawsuits interfering with the process and prohibiting disposition; and environmental cleanup requirements and statutory limitations, which have required amendments. DMB also indicated that standard operating procedures have been developed and implemented and standard language has been finalized and recommended to the Legislature to maintain consistency among conveyance statutes. Also, DMB informed us that barriers to sale closings have been identified, addressed through amending or repealing legislation, and included in the standard conveyance language drafting. Finally, DMB informed us that invitation to bid and purchase agreements have been standardized and a monthly report is prepared documenting the current disposal status of all surplus property assigned to DMB for disposal.

GLOSSARY

Glossary of Acronyms and Terms

capital lease	A lease that, in substance, is a purchase in which the resulting assets and liabilities are recorded at the lease's inception.
DMB	Department of Management and Budget.
effectiveness	Program success in achieving mission and goals.
market rate analysis	The conclusion reached through the comparison of rental rates on similar properties taking into account established market costs for differences in services provided.
operating lease	A lease that constitutes a rental agreement with the resulting expenditures recognized as incurred over the term of the lease.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
RED	Real Estate Division.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
SDD	Strategic Development Division.
strategic plan	A management tool that helps an organization do a better job as a result of focusing its energy.

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