

Office of the Auditor General
Performance Audit Report

Design and Construction Division
Department of Technology, Management, and Budget

November 2017

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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Office of the Auditor General

Report Summary

Performance Audit

Design and Construction Division (DCD)

Department of Technology, Management, and Budget

Report Number:
071-0125-16

Released:
November 2017

DCD administers the State's capital outlay, special maintenance, and miscellaneous operating projects. DCD provides professional management and direction for new facility construction, additions, renovations, and environmental cleanup projects. DCD approved 694 State agency projects with estimated costs of \$156.7 million from February 1, 2015 through January 6, 2017. DCD expended \$4.8 million through August 31, 2017 to administer these projects and had 46 employees.

Audit Objective			Conclusion
Objective: To assess the effectiveness of DCD's monitoring of State agency projects.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
DCD did not have procedures to ensure that project files contained complete documentation and were properly maintained. We noted missing and inaccurate information in the files for 12 projects with costs of \$64.5 million (Finding #1).		X	Agrees
DCD could improve its process to ensure the propriety of service fees charged to user State agencies. We identified potential undercharges of \$55,393 (Finding #2).		X	Partially agrees
DCD could improve its process to identify and select indefinite scope, indefinite delivery (ISID) contractors used to provide professional services to user State agencies. The current practice could allow for favoritism when using ISID contractors (Finding #3).		X	Agrees

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Doug A. Ringler, CPA, CIA
Auditor General

November 22, 2017

Mr. David L. DeVries, Director
Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. DeVries:

This is our performance audit report on the Design and Construction Division, Department of Technology, Management, and Budget.

Your agency provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

Doug Ringler
Auditor General

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AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

MONITORING STATE AGENCY PROJECTS

BACKGROUND

The Design and Construction Division (DCD) administers capital outlay, special maintenance, and miscellaneous operating projects* (MOPs) for all requesting principal State departments, universities, and community colleges. DCD also manages a wide range of nonroad projects for State agencies that include remodels, repairs, alterations, and additions to existing structures. Although DCD's level of involvement varies from project to project, most projects include these four primary phases:

Initiation & Pre-Design

DCD reviews all project requests submitted by agencies. For approved projects, DCD assists with determining project scope, estimated cost, and funding availability.

Design

DCD obtains professional service contractors through a competitive proposal process using requests for proposal (RFPs) or indefinite scope, indefinite delivery (ISID) contractors* to design the project plan, depending upon the project scope and urgency.

Construction

DCD obtains contractors through competitive bidding to construct projects according to plan. The design contractor, DCD project directors (PDs), and DCD field representatives (FRs) oversee construction to validate project progress and authorize agencies to process contractor payments.

Completion

DCD ensures that key documentation generated during the project is appropriate, complete, and accurate and that it is provided to the agency prior to taking ownership. Documentation includes notice of substantial completion, punch lists approved by an FR, and turnover documents (as-built drawings, system maintenance requirements, guarantee of indebtedness, and contractor certifications).

User State agencies fund DCD's service costs* based on a percentage of estimated project cost and DCD required services for the project using a standardized fee schedule from 1.5% to 5%.

* See glossary at end of report for definition.

AUDIT OBJECTIVE

To assess the effectiveness* of DCD's monitoring of State agency projects.

CONCLUSION

Moderately effective.

**FACTORS
IMPACTING
CONCLUSION**

- PDs monitored State agency projects from initiation to completion. DCD also required the project service consultants and FRs to oversee the design and construction phases to assist the PDs with project monitoring.
- DCD competitively bid large project design contracts and all project construction contracts.
- DCD ensured that the proper project design and construction activities were performed prior to approving for State agency payment.
- All three State agencies we interviewed indicated that they coordinated effectively with DCD to monitor project activity. Two of these three State agencies maintained their own list of projects to reconcile with DCD.
- Three reportable conditions* related to developing procedures to ensure and maintain complete project file documentation (Finding #1); improving the process to ensure proper service fee charges (Finding #2); and improving the process to identify and select ISID contractors for professional services (Finding #3).

* See glossary at end of report for definition.

FINDING #1

DCD did not have procedures to ensure that project files contained complete documentation and were properly maintained.

Procedures needed to ensure and maintain complete project file documentation.

Formal procedures that address the development and maintenance of necessary documentation would help ensure that project files contain a complete and accurate project history to effectively monitor the State's capital outlay and MOP projects. The procedures should, at a minimum, indicate the needed documentation, who is responsible for maintaining it, and where it is to be maintained.

In each stage of a project, DCD generates and receives documentation regarding project progress that it maintains in electronic files, hard copy files, and its Project Information Management System* (PIMS), including:

- RFPs
- Vendor bids
- Bid evaluations
- Bid bonds
- Certifications
- Liability insurances
- Contracts
- Design phase plans
- Progress meeting minutes
- Daily reports
- Schedules
- Payment vouchers
- Change orders
- Correspondence
- Project closeout information

DCD informed us that it did not have formal procedures that identified the required organization for project information. Since our prior audit, DCD's informal procedures have shifted toward maintaining information in an electronic format. However, the storage methods vary greatly among DCD staff, including e-mail, individual hard drives, shared drives, PIMS, and others.

During our fieldwork:

- a. We reviewed 12 project files for projects completed as of January 31, 2017, with project costs of \$64.5 million and noted:
 - (1) Essential project information, as determined in consultation with DCD management, was missing from the electronic or hard copy files:

Document	Number Reviewed	Number Missing	Percentage Missing
Work order/MOP request	12	1	8%
Project planning partnership meeting minutes	12	8	67%
Project plans	12	3	25%

* See glossary at end of report for definition.

Document	Number Reviewed	Number Missing	Percentage Missing
Design contract	12	3	25%
Contract modifications	12	2	17%
Approved payment requests - Design	12	5	42%
Construction contract	12	2	17%
Change orders	12	2	17%
Approved payment requests - Construction	12	4	33%
Field reports	12	4	33%
Progress meeting minutes	12	4	33%
Notice of substantial completion	11	2	18%
Punch list	11	2	18%
Turnover documents	10	6	60%
Guarantee of indebtedness	9	2	22%

(2) Project information maintained in PIMS did not always match the electronic or hard copy files:

Project Information	Number Reviewed	Number Missing or Inconsistent in PIMS	Percentage Missing or Inconsistent in PIMS
Work order/MOP request	12	6	50%
Design contract	12	1	8%
Design contract modification	12	4	33%
Construction contract	12	1	8%
Construction payments	12	5	42%
Construction change orders	12	7	58%
Approved final payment	9	8	89%

(3) PIMS contained inaccuracies in and omissions of data for the 12 project files reviewed. For example:

- For 4 (33%) projects, DCD omitted approved revisions in PIMS to reconcile budgeted and actual project costs.
- For 3 (25%) projects, DCD inaccurately recorded payment information in PIMS.

- b. We obtained PIMS data, from January 31, 2015 through January 31, 2017, which includes 28 data fields (categories of information) that DCD uses to monitor projects. We noted data missing in 24 (86%) of the 28 fields, resulting in no data in 14,169 (42%) of the 34,077 data fields.

We noted similar findings related to project and PIMS information in our prior audit (07-125-02), released in July 2003. DCD responded that it would comply by documenting record requirements, documenting management and individual responsibility for record maintenance throughout the life of a project, and training staff accordingly. DCD also responded that it would implement Phase II of PIMS to improve data accuracy and completeness.

The Office of Internal Audit Services (OIAS), State Budget Office, also noted similar findings in its review in April 2011. DCD responded that it would retain temporary staff to assist with the current backlog of project closeouts and records management. DCD also noted that PIMS's design did not match the work processes involved in project management, contracting, contract change management, or value-added metrics gathering and was investigating other application options.

DCD attempted to modify another State department's database in an effort to replace PIMS. DCD informed us that during fiscal years 2014 through 2016, it expended approximately \$410,000 on these efforts. In October 2017, the Department of Technology, Management, and Budget (DTMB) entered into a contract for \$5.3 million that included 7 different modules, 1 of which is to replace PIMS. DCD estimated that the PIMS replacement module will cost \$750,000 (\$150,000 annually for 5 years).

RECOMMENDATION

We recommend that DCD develop procedures to ensure that project files contain complete documentation and are properly maintained.

AGENCY PRELIMINARY RESPONSE

DTMB provided us with the following response:

DTMB agrees with the recommendation. DCD will develop procedures, conduct training and implement periodic management reviews of project folders to ensure that project files contain complete documentation and are properly maintained. DCD will simplify the standard electronic file structure by reducing the number of folders to the four primary project stages; initiation, design, construction and closeout, and rely on document naming to sort and group documents. To help with increasing the effectiveness and efficiency of operations, DCD has procured a new information technology (IT) system to replace the 20 year old PIMS.

FINDING #2

Improvements needed to ensure that proper service fees are charged to user State agencies.

DCD could improve its process to ensure the propriety of service fees* charged to user State agencies.

Appropriations act boilerplate allows DCD to receive and expend funds for architectural, design, and engineering services provided to other principal executive departments or State agencies, the legislative branch, or the judicial branch. DCD revised its standardized fee schedule to charge user State agencies a percentage of project costs based on a third-party business process redesign project recommendation. DCD's annual service fees averaged \$5.3 million during fiscal years 2015 and 2016.

Our review disclosed:

- a. DCD did not have documentation to support deviations from the standardized fee schedule for 6 (40%) of 15 judgmentally selected MOPs initiated from October 2014 through February 2017. These projects generated \$177,219 in service fees but were potentially undercharged by \$55,393.
- b. DCD collected service fees from projects at different times and potentially in different fiscal years rather than when DCD actually incurred the service costs. For example:
 - DCD collected fees for work projects at the end of the projects that could span multiple fiscal years.
 - DCD collected fees for MOPs and other projects at the beginning of the projects that could span multiple fiscal years.

The matching concept in accounting requires the recording of revenue in the same time period as the provision of the associated service. Also, if federal funds financed any of these examples, the State agency may be at risk of noncompliance with federal cash management requirements if it received federal reimbursement prior to incurring the actual cost.

- c. DCD did not require its FRs and PDs to record time spent on projects to help validate the service fee charges to user State agencies for these services. We reviewed the time recorded in PIMS from January 2015 through May 2017 and noted that 12 (92%) of 13 FRs consistently recorded their time in PIMS. However, only 4 (25%) of 16 PDs recorded any time in PIMS. Without knowing the actual staff time spent on each project, DCD was unable to periodically validate that its standardized fee schedule effectively approximated the actual costs for services provided to user State agencies.

* See glossary at end of report for definition.

DCD informed us that it did not monitor the sufficiency of service fees collected.

RECOMMENDATION

We recommend that DCD improve its process to ensure the propriety of service fees charged to user State agencies.

**AGENCY
PRELIMINARY
RESPONSE**

DTMB provided us with the following response:

DTMB partially agrees with the recommendation. While all fees reviewed were in accordance with the standard fee schedule or agency memorandums of understanding, DCD agrees that variations from the standard schedule were not always documented. DCD has implemented new processes to ensure that any variations are documented on the project initiation document.

DCD maintains that the current process in which fees are collected is the most effective and efficient based on the design and construction industry. The industry standard is a fee based on a percentage of the project cost. Since the project duration is not known at the beginning of the project, it is difficult to pro-rate the fee. Fees for operating funded projects are collected at the beginning of the project to ensure that funds are available. In addition, DCD's customers prefer the certainty of a percentage fee versus hourly billing of time, as well as a single transaction paying the fee. DCD has adjusted fee collection when necessary to meet federal funding requirements. Upon the retirement of PIMS and implementation of its newly procured IT system, DCD will track time.

FINDING #3

Improvements needed to identify and select ISID contractors for professional services.

DCD could improve its process to identify and select ISID contractors used to provide professional services to user State agencies. The current practice could allow for favoritism when using ISID contractors.

Section 18.1237b of the *Michigan Compiled Laws* states that DCD shall select professional services contractors based on a competitive, qualifications-based selection process.

DCD selects ISID contractors to provide professional services from a preapproved list for small dollar projects or in emergency situations. DCD has delegated authority to approve a selected contractor for contracts of up to \$250,000 before seeking approval from the State Administrative Board. DCD utilized ISID contractors on 486 contracts to provide services exceeding \$23 million from October 1, 2014 through November 11, 2016, over \$9 million of which were for environmental services and over \$8 million for general architecture and engineering services.

We noted:

- a. DCD did not have sufficient documentation to support the initial addition for 8 (47%) of 17 randomly selected contractors to its prequalified list. These 8 were all general architecture and engineering ISID contractors. DCD preapproves these contractors using a pass/fail concept based on the attainment of minimum criteria.
- b. DCD did not have documentation to support a competitive evaluation for 17 (100%) of 17 randomly selected contractors.
- c. DCD had 143 prequalified ISID contractors as of November 11, 2016; however:
 - (1) 57 (40%) ISID contractors had yet to be awarded any contracts. Of the 57 ISID contractors, 34 (60%) were added in June 2016.
 - (2) Of the 86 (60%) ISID contractors that had been awarded contracts, 8 (9%) were awarded 167 (34%) of the 486 contracts, totaling \$10.5 million (45%).

DCD informed us that the ISID process allowed for greater efficiency when entering into professional services contracts for small or emergency projects. DCD believes that, if competitive bidding was used with ISID contractors, the contractors would use shortcuts in their proposals in attempts to win low bid contracts. However, DCD is required by statute to ensure that professional services contracts are bid and awarded using competitive proposals.

RECOMMENDATION

We recommend that DCD improve its process to identify and select ISID contractors used to provide professional services to user State agencies.

**AGENCY
PRELIMINARY
RESPONSE**

DTMB provided us with the following response:

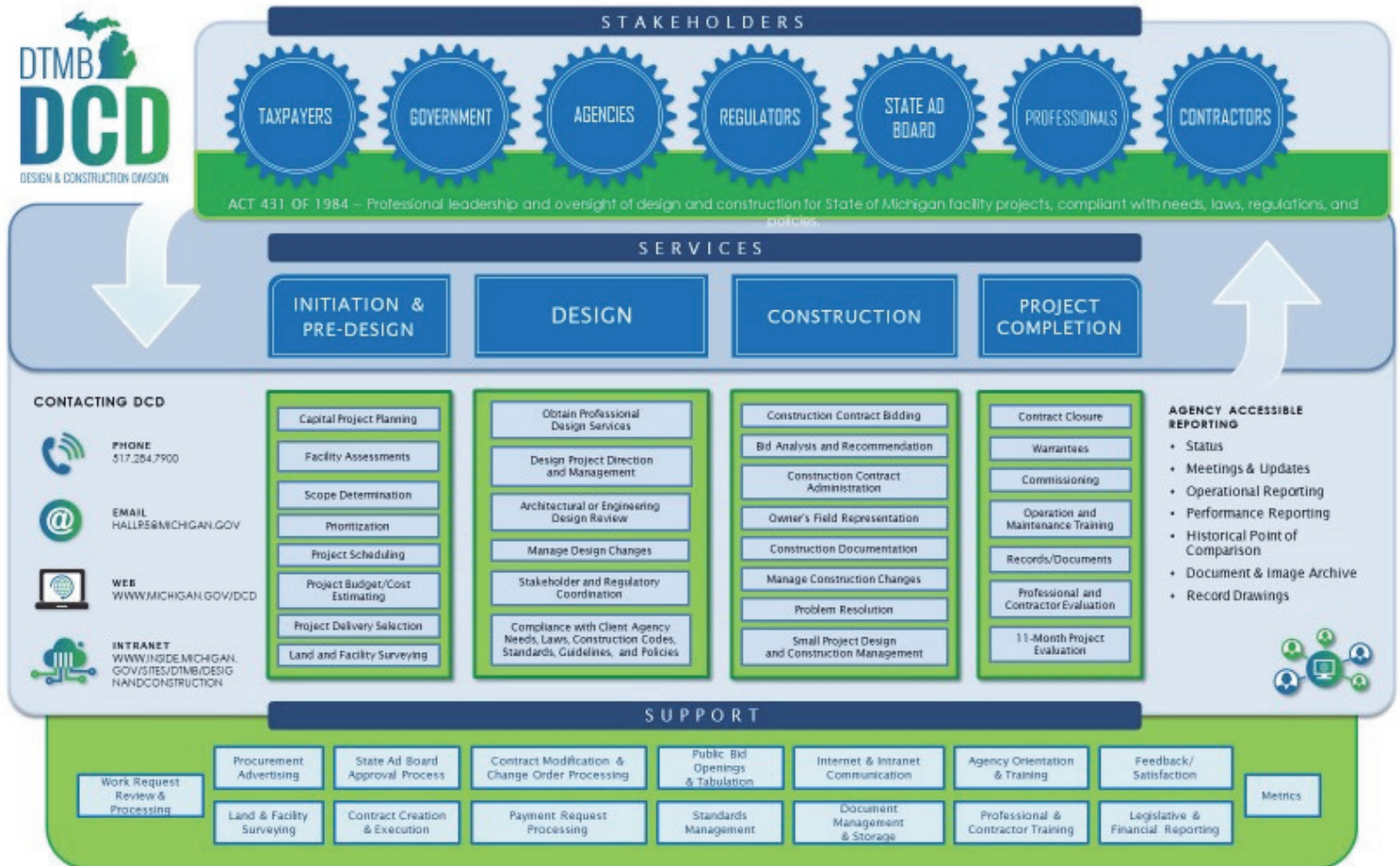
DTMB agrees with the recommendation. DCD will improve its process to identify and select ISID contractors used to provide professional services by reviewing "best practices" within the industry to determine a process that eliminates the possibility of favoritism. DCD believes the current implementation of the ISID selection process, for both initial contract and assignments, complies with the "...competitive, qualification-based selection process" requirement of the law. However, DCD recognizes the potential for favoritism or at least the perception of favoritism.

SUPPLEMENTAL INFORMATION

UNAUDITED

DESIGN AND CONSTRUCTION DIVISION Department of Technology, Management, and Budget

DCD Process Flow Chart



WWW.MICHIGAN.GOV/DCD

Source: Prepared by Plante Moran, 2013.

AGENCY DESCRIPTION

DCD administers the State's capital outlay projects, special maintenance projects, and MOPs in accordance with Sections 18.1237 - 18.1262 of the *Michigan Compiled Laws*. DCD provides professional management and direction for new facility construction, additions, renovations, and environmental cleanup projects. DCD services include contract procurement, project management, direction of contractors and consultants, complete construction oversight, environmental project management, land surveying, cost and budget analysis, problem-solving, and technical consultation. DCD manages a wide range of projects and project types, from park buildings, fish hatcheries, prisons, prison camps, armories, and psychiatric hospitals to more standard office buildings, security systems, and HVAC (heating, ventilation, and air conditioning) improvement projects. Most projects are remodels, repairs, alterations, and additions to existing structures.

DCD staff consist of architects, engineers, surveyors, construction inspectors, and contracting staff. PDs (licensed architects and engineers) establish design contracts with private architectural and engineering firms through a competitive selection process or utilizing preapproved ISID contractors. DCD bids construction projects with private construction firms, and the projects are generally delivered through an industry standard design-bid-build process. DCD also administers construction contracts and directs project progress.

DCD delegates project management responsibilities for specific projects with defined scope to agencies with internal engineering and architectural expertise, including the Michigan Department of Transportation, the Department of Environmental Quality, and the Department of Military and Veterans Affairs. DCD maintains memorandums of understanding with these agencies outlining the specific projects, dollar limitations, and project management responsibilities.

DCD approved 694 State agency projects from February 1, 2015 through January 6, 2017 with estimated costs of \$156.7 million. DCD expended \$4.8 million through August 31, 2017 to administer these projects and had 46 staff.

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine the records and processes related to DCD's monitoring of State agency projects. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on our audit objective.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered February 1, 2015 through June 30, 2017.

METHODOLOGY

We conducted a preliminary survey of DCD activities to formulate a basis for establishing the audit objective and defining our audit scope and methodology. During our preliminary survey, we:

- Interviewed various DCD and DTMB staff to obtain an understanding of their responsibilities and services provided to monitor State agency projects.
- Reviewed applicable laws, policies, procedures, and manuals.
- Reviewed evaluation reports of DCD performed by OIAS in April 2011 and an outside consulting firm in 2013 to determine the status of compliance with findings and recommendations.
- Analyzed project and financial information available for monitoring State agency projects from October 2012 through January 2017.
- Analyzed DCD projects approved from February 1, 2015 through January 6, 2017 and contracts awarded from October 1, 2014 through December 6, 2016.
- Analyzed DCD's process to assess and record the collection of agency service fees for work projects and MOPs used to fund DCD's service costs. This included reconciling the service fees collected with service costs in the Michigan Administrative Information Network* (MAIN) for fiscal years 2015 and 2016.

* See glossary at end of report for definition.

- Analyzed fiscal year 2016 travel expenditures and judgmentally selected 5 employees to determine the propriety of reimbursement using premium mileage rates.
- Reviewed 12 judgmentally selected projects that were substantially completed from October 1, 2013 through September 30, 2016 from DCD's electronic files to determine if key project information was in the supporting files and was consistently reported in PIMS for project monitoring. Because we initiated our judgmental selection of these projects from DCD's electronic files, we did not project the sample results to the overall population.
- Obtained an understanding of DCD's efforts to replace PIMS.
- Analyzed DCD's list and use of ISID contractors with contracts awarded from October 1, 2014 through November 11, 2016.

OBJECTIVE

To assess the effectiveness of DCD's monitoring of State agency projects.

To accomplish this objective, we:

- Observed site inspections for a judgmental selection of 10 of 13 FRs to determine the methodology for performing and documenting monitoring of State agency projects. We reviewed project information generated from these site inspections to determine if it was consistent with our observations.
- Reviewed travel expenditures for 4 judgmentally and 2 randomly selected FRs from January 1, 2015 through December 31, 2016 to validate that expected work activities occurred to support the reported travel.
- Reviewed the 12 projects judgmentally selected in our preliminary survey to validate the contractor project payments recorded in PIMS to the contractor project payments recorded in MAIN.
- Analyzed PIMS data to determine the completeness of data available to monitor projects.
- Inquired of three judgmentally selected State agencies to obtain an understanding of their experiences working with DCD.
- Reviewed 15 judgmentally selected MOP projects initiated from October 2014 through February 2017 to determine if the service fees collected were consistent

with the DCD standardized fee schedule. Because our judgmental selection included only multi-year and federally funded projects, we did not project the sample results to the overall population.

- Analyzed data to determine if DCD staff recorded time spent on projects from January 2015 through May 2017 to evaluate costs of providing services to State agencies.
- Compared the list of 143 prequalified ISID contractors as of November 11, 2016 with the list of 486 contracts DCD awarded to ISID contractors from October 1, 2014 through November 11, 2016 to determine the frequency of individual ISID use.
- Reviewed a random sample of 25 of the 486 ISID contracts awarded to evaluate DCD's processes to prequalify ISID contractors and to ensure a competitive element in the selection of prequalified ISID contractors. Our random sample was selected to eliminate any bias and to enable us to project the results to the population.
- Inquired of DCD, two State agencies, and the State Budget Office regarding their roles in the MOP process.

CONCLUSIONS

We base our conclusions on our audit efforts and any resulting material conditions* or reportable conditions.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

AGENCY RESPONSES

Our audit report contains 3 findings and 3 corresponding recommendations. DTMB's preliminary response indicates that it agrees with 2 of the recommendations and partially agrees with 1 of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

* See glossary at end of report for definition.

**PRIOR AUDIT
FOLLOW-UP**

Following is the status of the reported findings from our July 2003 performance audit of the Capital Renewal Division and the Design and Construction Division, Department of Management and Budget (07-125-02):

<u>Prior Audit Finding Number</u>	<u>Topic Area</u>	<u>Current Status</u>	<u>Current Finding Number</u>
1	Project Information Management System (PIMS)	Rewritten*	1
2	Documentation in Project Files	Rewritten	1
3	Oversight of Community College and University Projects	Not in scope of this audit.	
4	Project Administration Billing Rates	Rewritten	2
5	Project Supervision Hours Charged to Projects	No longer applicable.	

**SUPPLEMENTAL
INFORMATION**

Our audit report includes supplemental information. Our audit was not directed toward expressing a conclusion on this information.

* See glossary at end of report for definition.

GLOSSARY OF ABBREVIATIONS AND TERMS

DCD	Design and Construction Division.
DTMB	Department of Technology, Management, and Budget.
effectiveness	Success in achieving mission and goals.
FR	field representative.
indefinite scope, indefinite delivery (ISID) contractor	Preapproved contractor for design service contracts for small or emergency projects.
IT	information technology.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
Michigan Administrative Information Network (MAIN)	The State's automated administrative management system that supports accounting, purchasing, and other financial management activities.
miscellaneous operating project (MOP)	A construction project that is not accounted for within an agency's operating appropriation and is not considered capital outlay expenditures for budgetary or financial reporting purposes.
OIAS	Office of Internal Audit Services.
PD	project director.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

Project Information Management System (PIMS)

The system used by DCD to record, report, and manage certain project information.

reportable condition

A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

rewritten

The current circumstances and problems noted require that the recommendation be rewritten rather than remain essentially the same.

RFP

request for proposal.

service costs

DCD administrative costs incurred for providing project design and construction services to State agencies.

service fees

State agency fees paid to DCD for administrative costs incurred for providing project design and construction services.



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