

Chapter

7

Acquisition of Leased Office Space

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Acquisition of Leased Office Space

Main Points

What we examined

Public Works and Government Services Canada (PWGSC) is responsible for providing office accommodation to some 100 federal departments and agencies. In 2002, we audited the Department and examined its strategic planning, its management practices, and its analysis of options for providing office space.

To assess the progress made since then, we audited the Department's analysis of options for providing office space and the steps it has taken to strengthen the integrity and availability of information. We also examined a sample of lease transactions to see whether PWGSC had fully considered all options—including construction, lease-purchase, purchase, and lease—in order to identify the most cost-effective office accommodation solution in each case. Finally, we assessed the risk management practices of the Real Property Branch, including the way it is managing the risks associated with the federal government's objective of reducing the cost of real property management by about \$1 billion over the next five years. We did not assess progress made by the Department in performance measurement, investment planning, and reporting to Parliament. These areas are under review by the Department, with a view to adopting its new business strategies.

Why it's important

PWGSC manages 6.6 million square metres of rental space and spends \$3 billion annually to manage real property. The Department handles some 500 lease transactions a year. It needs complete, accurate, and timely information to support good decision making, strategic management, and risk management. The Department's commitment to achieve the government's cost-reduction goal makes strong management practices even more vital for the Branch.

What we found

- PWGSC has made unsatisfactory progress in response to the recommendations that we followed up on this audit. While the Department has made satisfactory progress in analyzing the long-term cost of long-term options, there are still gaps in its financial and management information systems. These gaps may pose significant risks to the Department in achieving the government's cost-savings target by 2010.

- Responsibility for decisions affecting the cost of office accommodation is shared among PWGSC, client departments, and the Treasury Board. The Treasury Board must approve decisions for those projects that exceed the delegated authority of the Minister of PWGSC. As a result of this shared responsibility and the use of funding mechanisms that are not consistent with financial analysis, it is sometimes difficult for PWGSC to impose and adhere to its office accommodation standards pertaining to quality and square metres per person. In addition, we noted instances where the Department did not enforce its standards.
- The financial analysis used by the Department to assess accommodation options considers the cost of a lease over its life, while the government's funding mechanisms focus on annual cash spending. We noted cases where a lack of capital funding prevented the selection of the recommended option.
- Although PWGSC has taken some first steps to identify risks in its management of real property, it has not yet fully incorporated risk management into its day-to-day operations. Its risk management systems do not deal adequately with corporate-wide risks that could jeopardize its cost-savings objective.

The Department and the Treasury Board Secretariat have responded. Public Works and Government Services Canada and the Treasury Board Secretariat are in general agreement with our recommendations. Their responses are included throughout the chapter.

Introduction

Responsibilities of Public Works and Government Services Canada

7.1 Public Works and Government Services Canada (PWGSC) provides a range of services to client departments to help them achieve their program objectives. These services include securing office space.

7.2 The Department's Real Property Branch manages office accommodation in some 1,900 locations across Canada. About 250 of these sites are Crown-owned office buildings. The Branch handles about 500 lease transactions a year.

7.3 Of the 6.6 million square metres of space that the Branch manages, 52 percent is Crown-owned, 41 percent is leased, and 7 percent is **lease-purchased** accommodation. Offices comprise 5.7 million square metres of this space. The remaining 0.9 million square metres consist of laboratories, warehouses, and other specialized facilities. The Branch manages its existing inventory and acquires new space by constructing new buildings, acquiring existing facilities, and leasing.

7.4 The Department's real property business line employs 4,100 employees and manages an annual business volume of about \$3 billion.

7.5 Providing office accommodation for the federal public service is a complex and difficult task. The responsibilities for office accommodation costs are shared among PWGSC, client departments, and the Treasury Board (Exhibit 7.1).

7.6 The Real Property Branch provides a mandatory service—the provision of office space—to client departments. This service is financed through PWGSC's annual appropriation. The Branch also provides optional services, such as architectural and engineering services, to departments for a fee. Individual departments pay for those services from their own budgets. The Branch maintains a **revolving fund** to manage the revenues and expenses associated with these optional services.

7.7 The Branch's share of the Department's appropriation covers basic building costs in Crown-owned assets. These costs relate to buildings' operation, maintenance, repair, and capital improvement, throughout the buildings' life cycles. Appropriation funding also covers the leasing and **fit-up costs** of leased assets. Clients pay for their own equipment and furniture.

Lease-purchase—A lease wherein the lessee of the real property has the right or option to purchase the property upon termination of the lease contract.

Revolving fund—A means by which Parliament provides continuing authorization for an operation that is funded completely by users, or partly by users and partly by subsidization (the latter usually taking the form of an annual appropriation).

Fit-up costs—Expenses incurred to prepare space for initial occupancy or to alter space previously occupied by another tenant. These costs include, but are not limited to, those for interior walls, doors, windows, partitions, washrooms, basic wiring for power and telephone outlets, and related changes to basic building systems.

Exhibit 7.1 Responsibilities for office accommodation costs**Public Works and Government Services Canada**

- Selecting accommodation alternatives that balance client requirements with principles of competition, prudence, probity, and value for money
- Developing accommodation strategies, including establishing and enforcing the standards for allowable square metres per person and quality of space

Client departments

- Certifying demand for office space, based on operational and functional requirements
- Providing information on the forecasted number of employees

Treasury Board

- Approving lease transactions that exceed \$30 million
- Establishing the administrative policy framework of government, including real property policies

Treasury Board Secretariat

- Advising on real property plans and expenditures of all departments and individual real property projects and contracts
- Reviewing the use of real property from a central perspective

Source: Public Works and Government Services Canada—Framework for Office Accommodation and Accommodation Services; the Treasury Board—Real Property Management Framework

7.8 The Treasury Board Use of Real Property Facilities Policy requests that PWGSC provide facilities within established standards to meet the operational needs of the user departments. PWGSC's Framework for Office Accommodation and Accommodation Services limits the quantity of space that the Branch will provide to client departments. As well, PWGSC will only fund office improvements according to the established standards. If client departments want extra space or have additional requirements, they must pay for them from their own budgets.

Initiatives since 2002 to transform real property management

7.9 PWGSC began a renewal project shortly after our 2002 audit. The project was directed at modernizing the way the Department conducted its business. Since 2003, several events have added momentum to that renewal effort. Principally, the federal government's Expenditure Review Committee has identified the real property business line as the source of about \$1 billion in savings over the next five years. The Department's strategic initiative related to this financial goal is referred to as **The Way Forward**.

The Way Forward—The term used by Public Works and Government Services Canada to describe its department-wide “strategic initiative whose objective is to find innovative ways to deliver services smarter, faster, and at a reduced cost, and to improve how the Government of Canada does business.”

Fit-up standards—Standards applied to prepare space for initial occupancy or to alter space previously occupied by another tenant. The approach of Public Works and Government Services Canada to fit-up is guided by the Department's Framework for Office Accommodation and Accommodation Services. The Framework covers standards for fit-up components, support spaces, and funding accountability.

7.10 PWGSC is to realize those savings primarily by spending less. For example, the Real Property Branch plans to reduce clients' average use of space from its current level of 21.6 square metres per employee to 18 square metres, as provided by the Department's Framework for Office Accommodation and Accommodation Services. The Department intends to apply its **fit-up standards** consistently to all departments. These measures are expected to reduce accommodation costs by \$500 million over the next five years. The Branch also plans to use its "holdings more efficiently by consolidating the needs of federal departments" and by "improving the management of its lease portfolio." The Department sets out in its Report on Plans and Priorities that "improved portfolio management and leasing strategies will help achieve expenditure reductions approaching \$300 million" over five years. Other savings, from reducing overhead costs, are expected to reduce costs by about \$175 million.

Focus of the audit

7.11 The focus of our audit was to assess the progress that PWGSC had made in responding to our 2002 audit observations and recommendations. In our 2002 audit, one of our main findings was that the Department needed to strengthen its management information systems in order to provide managers with key operational and financial information.

7.12 In our current audit, we also assessed whether the Department had adequately incorporated principles of risk management into its strategic plan to acquire leased office space. In addition, we assessed the extent to which the Real Property Branch identified and managed key risks that could affect its ability to achieve its strategic objectives.

7.13 Finally, we assessed whether PWGSC had fully considered its long-term options for providing accommodation by examining a sample of high-value lease transactions. More details on the audit objective, scope, approach, and criteria are in **About the Audit** at the end of the chapter.

Observations and Recommendations

Responsibility for costs of office space

Shared responsibility for costs of office space impedes efforts to reduce costs

7.14 PWGSC, client departments, and the Treasury Board share responsibility and accountability for the cost of office accommodation. PWGSC tries to provide appropriate office accommodation to meet the needs of client departments. The Real Property Branch identifies options that, depending on a client's needs, may include short-term leases or longer-term alternatives. These options include Crown-owned space, lease-purchase arrangements, and long-term leases. The most cost-effective option may involve moving a client department's staff to a different building—or it could mean leaving them where they are. We expected that PWGSC and departments would work co-operatively to select the most cost-effective option in acquiring office accommodation and preparing it for occupancy.

7.15 A combination of decisions by PWGSC, client departments, and the Treasury Board affects the cost-effectiveness of office accommodation options. This shared responsibility for the cost of office accommodation can result in project delays and/or additional costs. Although the Real Property Branch has the authority under the Treasury Board Real Property Management Framework Policy to impose accommodation solutions, it has not always done so. Exhibit 7.2 provides an example of how a client's request and PWGSC's decision not to enforce standards have affected the cost of accommodation.

7.16 PWGSC's real property management framework specifies that office space should be allocated at a standard rate of 18 square metres per full-time employee. According to a September 2004 PWGSC report, the use of office space averaged about 21.6 square metres per person. The report notes that because "some client departments view office accommodation as a 'free good,' they have little incentive to economize on the size of their space." The Department states that the current use of space has now decreased to 20.4 square metres per person. The ability of clients to choose more costly alternatives could undermine PWGSC's objective of obtaining the best value.

7.17 The Department states in its reports on plans and priorities (RPP) that it "will more consistently apply standards and work with departments toward reducing the average space use to 18 square metres per employee, leading to an overall space reduction of 450,000 square metres." The Department also notes that it "will more consistently apply fit-up standards to office space." It will be important

Exhibit 7.2 A client's request and a decision by Public Works and Government Services Canada not to enforce standards results in additional cost of \$4.6 million

800 Place Victoria, Montréal, Quebec

The Economic Development Agency of Canada for the Regions of Quebec had been a tenant in Place Victoria for many years. The Agency's lease at Place Victoria was to expire in 2003. In 2001, the Agency worked with Public Works and Government Services Canada (PWGSC) to initiate a competitive tendering process to obtain the required accommodation for the Agency. The Agency's landlord at Place Victoria bid on the tender and was ranked fourth in the bid evaluation process. Two weeks after the tendering process had closed and the winning bidder had been selected, the Secretary of State for the Agency sent a letter to the Minister of PWGSC asking him to renew the lease at Place Victoria. The Minister of PWGSC approved the renewal of the lease at Place Victoria.

Despite the fact that PWGSC's guidelines require an economic advantage to the Crown to exist in order to justify a direct non-competitive negotiation of a lease and despite the absence of any economic advantage to the Crown, PWGSC entered into direct negotiations to renew the lease with the landlord at Place Victoria.

Because of the potential for recourse from the winning bidder in the tendering process, PWGSC also entered into a lease with the lowest bidder, even though it did not have a tenant for the space. Renewing the lease at Place Victoria cost \$2.5 million more than the winning bid in the tendering process, and PWGSC paid \$2.1 million in unproductive rent to that bidder while trying to locate tenants for the additional space. Some space in that building is still unoccupied.

The Agency's request not to move, combined with the lack of adherence to established guidelines, has cost taxpayers an additional \$4.6 million.

for the Department to enforce its standards to achieve the savings objectives of the Way Forward initiative. This will be a particular challenge given that, as reported in its RPP, "the amount of office space allocated per employee is greater in the federal government than it is in many areas of the private sector."

7.18 In some of the lease transactions we examined, we found instances where departments paid funds from their own budgets for fit-ups that cost more than government standards allowed. This practice has two consequences. First, it adds to the total cost of accommodation. Second, it hinders accountability because it obscures the full cost of leased office space, making it difficult to identify the full cost of office accommodation and report it to Parliament.

7.19 In our view, the shared responsibility for decisions that affect the cost of office accommodation impedes the federal government's efforts to reduce costs in this area. If the government is to meet its expenditure reduction target, PWGSC, client departments, and the Treasury Board, through its oversight role, will have to co-operate to reduce costs. Further, PWGSC will have to enforce the government's established standards.

7.20 Recommendation. In its departmental performance report, Public Works and Government Services Canada should include progress against projected savings and the cost of those instances where the most cost-effective accommodation option was either not accepted or not enforced.

Public Works and Government Services Canada's response. Shared responsibilities inevitably give rise to some inefficiency. There is now a renewed effort, supported by the Treasury Board Secretariat, to enforce standards for space and fit-up, and this is resulting in savings to the government. We will work with the Secretariat to include more reporting to Parliament on this issue.

Assessing options

PWGSC adequately analyzes the costs of accommodation options

7.21 In our 2002 audit, we reported that PWGSC needed to strengthen its consideration of long-term options. We found that the Department had made satisfactory progress in this regard (Exhibit 7.3).

Exhibit 7.3 Progress in addressing our recommendation from our 2002 Report

Recommendation	Progress
The Real Property Services Branch should review its methods of options analysis to ensure, where practical, that long-term options are considered fully. (December 2002 Report, Chapter 8, paragraph 8.61)	●

- Satisfactory**—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.
- Unsatisfactory**—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

7.22 In our current audit, we noted that in assessing the options for providing accommodation to departments, PWGSC is required, as per the Real Property Framework and Processes for Leasing, to prepare an Investment Analysis Report for each transaction that it completes. This report analyzes the full cost of each option over the expected life of the requirement—often 15 to 25 years. The options generally include construction, lease-purchase, purchase, and lease.

Funding mechanisms can preclude selection of the most cost-effective option

7.23 We expected that the government would select the most cost-effective option in meeting the long-term requirements of client departments. We also expected that funding mechanisms would help

to select the most cost-effective option. However, this was not always the case.

7.24 The financial analysis of an option considers the full cost of that option over its estimated useful life, while funding decisions consider the cash expenditure at the time of the transaction. We noted that the government does not always select the most cost-effective alternative to meet the accommodation requirements of the client department (Exhibit 7.4). This occurs because a decision on funding accommodation transactions focusses on the availability of cash-based funding rather than on accrual-based funding (see paragraph 7.25). This can result in additional cost to taxpayers.

7.25 The Treasury Board Secretariat is studying the implementation of accrual-based budgeting and appropriations, and its impact at the departmental level. If a complete accrual approach to budgeting and appropriation were adopted, the accrual method would recognize budgeting and funding for a transaction when the underlying economic event is expected to occur, rather than when cash is expected to be paid. The objective of the accrual method is to ensure that transactions are budgeted and funded in the periods in which they occur, rather than in the periods in which the payment is made. For example, with accrual-based budgeting and appropriations, the expenses related to the purchase of a building would be spread over the life cycle of the asset. Presently, with cash-based budgeting and appropriations, the government funds the full expenditure against its cash appropriation in the year that it acquires the building, even though it will use the asset over a number of years.

Exhibit 7.4 Funding mechanisms do not always support selection of the most cost-effective option

55 Bay Street, Hamilton, Ontario

The Investment Analysis Report that Public Works and Government Services Canada (PWGSC) prepared for this transaction recommended leasing and exercising a purchase option in the second year of the lease. The Treasury Board would not approve the purchase; rather, it approved an alternative to lease the property for 15 years—the most expensive option in the Investment Analysis Report. Choosing this option may cost the Crown an additional \$13 million.

7575 8th Street, Calgary, Alberta

PWGSC officials prepared an Investment Analysis Report that determined the least expensive option was for the Crown to purchase the building for \$27 million. However, in the absence of the necessary capital funding, PWGSC recommended the second-best option, at \$31.4 million. This option recommended leasing the building for five years, with an option to purchase in year six. Selecting the second-best option may cost the Crown an additional \$4.4 million.

7.26 Recommendation. The Treasury Board Secretariat should develop a plan for departments to use financial information based on an accrual-based budgeting and appropriations approach in planning, budgeting, and reporting.

The Treasury Board Secretariat's response. The Treasury Board Secretariat agrees that there are limitations associated with annual capital appropriations. The Secretariat is addressing the issues through two initiatives.

The first initiative, as mentioned in the chapter, is the engagement of an independent contractor to conduct a comprehensive study of the concepts of accrual accounting to determine whether, and if so, how, they should apply to the development, documentation, and execution of the budgets and appropriations of the federal government.

The Treasury Board Secretariat will use the study to make an informed recommendation to the Treasury Board as well as the Department of Finance and the Privy Council Office (given their central roles in Budget planning) on the extent and manner of the implementation of accrual concepts in the budgeting process and/or the appropriations at the government-wide and departmental levels. The government can approve changes to the budgeting process; however, Parliament must approve changes to appropriations.

The second initiative is a pilot project under development for non-lapsing capital appropriations. The pilot project proposes allowing up to three departments to carry forward unexpended asset funds from one fiscal year to the next, beginning as soon as next year. This will provide departmental managers with more flexibility in planning their operations and remove the current short-term focus of the planning horizon for asset and associated resources.

The absence of accrual appropriation has long-term financial implications

7.27 The financial impact of entering into a series of short-term leases to meet long-term space needs can be significant due to the incongruities between the funding methods and the financial analysis of the cost of accommodation. In the sample of leases that we audited, we noted instances where a series of short-term leases were used to meet long-term accommodation needs, even though the financial analysis prepared by PWGSC indicated that Crown ownership would have been more cost-effective. In these cases, the federal government, at the end of its current lease obligations, will have rented the premises

for more than 40 years. These cases illustrate the long-term effect that can occur when funding methods do not facilitate the selection of the most cost-effective options (Exhibit 7.5).

Exhibit 7.5 Selection of accommodation options results in additional costs

Centennial Towers, Ottawa, Ontario

Centennial Towers was built in 1965. The federal government has been its primary tenant for all but five of the subsequent years. Beginning in 1983, Public Works and Government Services Canada (PWGSC) entered into a series of 10-year leases. The current lease runs from 2003 through 2013. In its most recent lease renewal, the Department's analysis indicated that the present value of the cost of accommodation was \$261 million, or \$81 million more than the most cost-effective alternative that it had identified in 2001 (Crown-purchase option). The departmental calculations were based on a 25-year time horizon.

Jean Edmonds Towers, Ottawa, Ontario

Jean Edmonds Towers was constructed in 1974. Since then, PWGSC has entered into a series of leases. The federal government has been the sole tenant and is committed to leasing the space through 2015. In its most recent lease renewal, the present value of the cost of accommodation was \$158 million, or \$12.5 million greater than the least-cost option identified in the financial analysis. The Department's calculations were based on a 10-year time horizon.

7.28 Recommendation. The Treasury Board Secretariat and Public Works and Government Services Canada should ensure that funding methods support the selection of the most cost-effective option that meets the long-term accommodation requirements.

Public Works and Government Services Canada's response. We are pleased that the Auditor General has found that Public Works and Government Services Canada adequately analyzes the cost of accommodation options before decisions are made. The issue of how funding mechanisms affect rational decision making is an important one. We agree with the recommendation and will continue to work with the Treasury Board Secretariat and other parties to ensure that, wherever possible, funding mechanisms support the most cost-effective solution that meets the long-term accommodation requirements. We recognize that this may take some time to resolve since it represents a fundamental change to government accounting and budgeting.

The Treasury Board Secretariat's response. The Treasury Board Secretariat recognizes that, in some instances, current funding mechanisms may limit the ability of Public Works and Government Services Canada (PWGSC) to select the most cost-effective option for long-term accommodation requirements.

The Capital Asset Review (CAR), conducted in 2004 as one of the federal government's expenditure management reviews, raised this same issue in the broader context of capital asset management. Responding to the CAR, the Secretariat is considering a more flexible funding mechanism, known as non-lapsing capital appropriations, and it has developed a pilot program with three departments to confirm the anticipated benefits of this option.

Subject to this experience, the Secretariat will consider expanding the pilots to other departments and agencies, including PWGSC, providing they meet the participation criteria. The Secretariat will keep departments and agencies, including PWGSC, informed of progress in this area.

Irrespective of the potential change toward non-lapsing capital appropriations, PWGSC is responsible for managing its investment program, within existing reference levels. This must be done in accordance with key Treasury Board policies related to assets management, namely the Policy on Long-term Capital Plans, the Project Management Policy, and the Real Property Policy Suite, including the Treasury Board Real Property Investment Policy, all of which support least-cost best-value decisions.

Management information

Problems with management information systems continue

7.29 In 2002 we reported that PWGSC needed to strengthen both the integrity and availability of information to support the management of the acquisition of office space. In our current audit, we expected the Real Property Branch to have complete and accurate management and financial information to support decision making and the management of its real property portfolio.

7.30 A number of documents we reviewed indicated that the Department had not fully addressed our previous observations about weaknesses in its management information systems. PWGSC's 2004 Report on Real Property Renewal, its draft 2005 National Portfolio Plan, and the government's 2003 Report on Expenditure Management Review all noted problems concerning a lack of information for management purposes. For example, the Report on Expenditure Management Review reported that managers are reluctant to rely on the Department's existing information systems. The report also noted that the Department lacked basic information about the costs that client departments had incurred either for extra space beyond what was allocated in the policy (Framework for Office Accommodation and Accommodation Services) or for higher standards of fit-up.

7.31 The Report on Real Property Renewal acknowledged that the Department's information systems are cumbersome and expensive. It also noted that the Department spends about \$50 million on these systems each year, yet the systems do not provide the information or allow the input that would enable managers to make well-informed decisions about managing the real property portfolio. According to the renewal report, PWGSC cannot accurately and routinely report the full costs of its real property operations. The Department informs us that these systems are only one source of information; however, it agrees that its many systems need to be overhauled and integrated.

7.32 The fit-up costs for the leased portfolio of buildings are a significant component of the total cost of providing office space. Thus, we expected that the Department would be able to provide us with the budgeted costs, with any revisions to original budgets, and actual expenditures for the fit-up costs for our sample of leases. We asked for this information to see whether original budgets had changed and to determine the reasons for any changes. Departmental officials advised us that this information was not readily available and would require extensive manual intervention to accumulate.

7.33 This persistent difficulty in aggregating financial information is even more important now, given that the Department is obliged, under its Way Forward initiative, to generate significant savings in managing the real property business line.

Better information is required to manage the portfolio strategically

7.34 Departmental documents indicate that the Real Property Branch has much work to do to modify its information systems. Currently, PWGSC's numerous systems operate in "silos"—that is, they do not share information. Moreover, they are not designed to capture certain information that will be essential to managing the portfolio on a strategic basis.

Some improvements have been made

7.35 We found that PWGSC is taking action to address its management information requirements. In March 2004, the Department established a Governance Framework for Information Management and Information Technology. It has also started a project to improve data integrity. These initiatives are important first steps. Nevertheless, the overall progress in addressing our previous recommendations is unsatisfactory (Exhibit 7.6).

Exhibit 7.6 Progress in addressing our recommendations from our 2002 Report

Recommendation	Progress
The Real Property Services Branch should introduce more discipline and rigour into its collection and use of information, including demand information, in managing the acquisition of office space. It should ensure that the required reports are available to decision makers for each transaction and that decisions are fully documented. (December 2002 Report, Chapter 8, paragraph 8.71)	○
The Branch should develop an accurate management information system to ensure the completeness and accuracy of its financial and operational information. (December 2002 Report, Chapter 8, paragraph 8.81)	○

- **Satisfactory**—Progress is satisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.
- **Unsatisfactory**—Progress is unsatisfactory, given the significance and complexity of the issue, and the time that has elapsed since the recommendation was made.

7.36 We noted that the Department initiated a process to revise the way it manages its real property portfolio. A recently issued Request for Proposal seeks advice on the best business model for all aspects of its real property operations. The Department has indicated that it will upgrade its information systems after policy decisions and the related business model have been finalized.

7.37 Recommendation. Public Works and Government Services Canada should continue to improve the availability, accessibility, and reliability of information to support sound decision making for real property investments.

Public Works and Government Services Canada's response. We agree with this recommendation. While current systems enable Public Works and Government Services Canada to control costs incurred by the Department on individual projects, we recognize that our systems are cumbersome for overall management and acknowledge that improvements remain to be made.

Managing real property risks

7.38 The risk management component of our audit assessed the Real Property Branch's practices to see how it managed risks in acquiring leased office space throughout the life cycle of the lease. We expected that the Department would have identified and assessed the risks of the Branch and established and documented appropriate risk mitigation procedures to meet the requirements of

- the Treasury Board Secretariat's Integrated Risk Management Framework, and

- the risk management specifications of the Treasury Board Secretariat's Management Accountability Framework.

7.39 In examining the Department's risk management activities, we also assessed the extent to which the Branch identified and managed key risks that could affect the ability to achieve the strategic objectives of its Way Forward initiative.

A variety of risks can affect leasing

7.40 There are several types of risks that can affect leasing (Exhibit 7.7). Accordingly, we expected to find a formal and consistent process in the Department for identifying and managing the risks that can arise in leasing decisions, which may span up to 60 months from inception to occupancy. However, we did not find such a process.

Exhibit 7.7 Risks that can affect leases

Risks can occur throughout the life cycle of a lease—from planning, to fit-up, to moving staff into their offices. The following are examples of typical risks that can arise at various points in a leasing transaction.

Client-related risks. A client department may change its requirements for the amount and type of space and its fit-up specifications. If this situation arises, the change may result in delays and increased costs.

Legal risks. Potential legal risks may arise in the tendering process of Public Works and Government Services Canada (PWGSC). Examples of these risks include changing the bid process midstream or accepting an unsolicited proposal from a bidder.

Contractor-related risks. Part way through a project, a general contractor may not be able to finish a building because of bankruptcy. The attendant risks include cost overruns, delays, and potential liability for the Crown.

Landlord-related risks. At the end of a lease, a landlord of an occupied building may not be willing to renegotiate at favourable terms or may not want to modify buildings to meet PWGSC's project schedule. These risks may result in increased costs and delays.

Internal risks. Many PWGSC staff are involved in leasing projects, and numerous changes to projects can occur. A lack of co-operation among all involved can result in delays and cost overruns.

Risk management strategies lack key information

7.41 A department's ability to manage risk on an organization-wide basis increases its ability to achieve its objectives. Integrated risk management helps departments better manage their programs and contributes to achieving better value for money, thereby helping to make the public service more effective.

7.42 PWGSC has begun to develop an integrated risk management framework. This includes establishing some preliminary procedures and identifying high-level risks associated with the Real Property Branch.

7.43 The Department's identification of risks has highlighted the need to manage such ongoing risks as balancing organizational change with ongoing priorities and human resource challenges. These risks, if not addressed effectively, could prevent the Department from achieving its goal of reducing accommodation costs of the real property business line.

"Regional and community-based investment strategies are part of the Real Property National Investment Strategy (NIS) of Public Works and Government Services Canada. The Strategy provides the planning framework for all of the Department's investments in real property on behalf of its clients, tenants, and the Government of Canada. The regional and community-based investment strategies provide essential input to NIS and are also key mechanisms for its delivery."
—Public Works and Government Services Canada, *Real Property Solutions*

7.44 We reviewed **regional investment strategies** to assess the nature and extent of risk information included in them. We noted that **community-based investment strategies** developed to address accommodation requirements within a region do not always contain information on the risks associated with the strategies. For example, an integral part of the Vancouver Community-Based Investment Strategy was to build office space in the downtown core. The strategy did not include an analysis of the risks associated with the government neither owning land nor having an option to acquire land. As well, there were no contingency plans to implement if space could not be constructed.

Risk information in leasing transactions needs to be documented

7.45 PWGSC staff engaged in the leasing process have considerable experience in leasing office space. However, we noted that in their negotiation of lease transactions, staff do not always document the nature of the risks and the action taken to manage them. As a result, senior managers do not have a complete view of leasing-related risks that leasing officers are dealing with. The Branch had no documented aggregate view of the risks associated with either individual leases or leases across their life cycle, to correspond with the Treasury Board Secretariat's Integrated Risk Management Framework.

7.46 With the exception of the risk posed by scheduling delays, which the Branch identifies quarterly in the Planned Leasing Action Report, staff do not document information that would give senior managers a view of the leasing-related risks of the entire real property portfolio. For example, the Branch needs to identify and document risks associated with specific clients, landlords, and owners of buildings. Such information is critical if the Department is to manage its leasing activity on a portfolio basis.

7.47 The Integrated Risk Management Framework encourages departments to identify, address, and monitor risks across an organization as a key component of effective management.

Risk management training is needed

7.48 Key components of integrated risk management are developing and delivering appropriate training and implementing risk management tools. The Real Property Branch has developed a training program and an automated tool to help staff identify and manage risk over the life of a lease. Both the program and the tool were well designed and include the elements needed to comply with the Treasury Board Secretariat's Integrated Risk Management Policy.

7.49 However, neither the training program nor the automated tool has been implemented to date. We noted that PWGSC's Client Accommodation Service advisors have received only limited formal training in risk management. We are concerned about this because those administrators, who work closely with client departments that lease space, are well-positioned to contribute to managing risk. However, we found no evidence that they play a formal or lead role in managing and co-ordinating risk information. Moreover, the number of administrators is declining, as are other resources that could improve risk management in the Department.

Risk information is needed to analyze options

7.50 The Investment Analysis Report is a major planning tool that helps the Branch decide how it will acquire office space—for example, by leasing, building, buying, or entering a lease-purchase agreement. A leasing project's planning phase can span up to five years, particularly for major, complex leases. We expected that these reports would be complete and would be updated throughout this phase to ensure that emerging risks are taken into account.

7.51 We found that once reports were developed, they were rarely updated to reflect changes in related risks. This creates a significant risk that the ultimate investment decision may not be based on the most current information. We understand that the Department is reviewing the Investment Analysis Report's template and design and will incorporate guidance about the need for continuous risk management.

7.52 We also found that the Branch does not include an analysis of the risks associated with each option in the report (whether to lease, build, buy, or negotiate a lease-purchase agreement). Therefore, decision makers are not weighing the relative risks when deciding which option to pursue.

7.53 Recommendation. Public Works and Government Services Canada should

- continue its efforts to develop guidance and to implement continuous risk management as part of the process for acquiring office accommodation, and
- provide staff with the necessary training in risk management.

Public Works and Government Services Canada's response. We agree with this recommendation. Public Works and Government Services Canada has made considerable progress in this area and will continue to do so. In areas of great importance, such as managing the risk related to achieving our five-year cumulative savings target of \$150 million from leasing operations, we have implemented compensating controls. These controls include the establishment of a Strategic Transformation Branch to monitor and control achievement of our goals. In addition to implementing more rigour in its leasing practices and providing ongoing training to its staff, the Real Property Branch has implemented a Lease Savings Tracking System to monitor net transaction savings on a monthly basis. As a result of these measures, we have already achieved, as of 1 January 2006, more than half of our five-year cumulative savings target of \$150 million, and will continue to monitor our progress carefully.

Conclusion

7.54 Public Works and Government Services Canada has made unsatisfactory progress in responding to the recommendations we made in 2002. In 2005, we found that many of the Department's practices did not allow it to manage the costs of its leasing projects effectively. If the Department is to meet its commitment to reduce the costs of providing office space over the next five years, it must manage its leasing projects strategically, across the entire portfolio. However, the Department will have difficulty doing so because the basic information that managers need to make critical strategic decisions does not exist, is inadequate, or is difficult to access. In addition, the government must implement accrual appropriations so that funding mechanisms support the selection of the most cost-effective accommodation options.

7.55 The federal government needs to make fundamental changes in its accountability structure for providing office space. Currently, the shared responsibility among PWGSC, client departments, and the

Treasury Board makes it difficult for PWGSC to impose and adhere to government-wide standards for the quantity and quality of office accommodation. The Department has not always enforced those standards, which has resulted in additional costs for taxpayers. Clearly defined accountability and support from the Treasury Board for enforcing these standards should help PWGSC to meet its cost-saving objectives. It is important that the government move quickly to implement accrual-based appropriations.

7.56 Although the Department has identified major risks that affect the management of real property, its existing risk management systems are new and do not yet deal adequately with common, corporate-wide risks that could affect the Department's achieving its \$1 billion cost-saving objective.

About the Audit

Objectives

The objectives of our audit were

- to assess the progress that Public Works and Government Services Canada (PWGSC) has made in responding to the observations and recommendations in our December 2002 Report, Chapter 8; and
- to assess whether the Department has adequately incorporated principles of risk management into its strategic planning for acquiring leased office space.

Scope and approach

The focus of our audit was to follow up on recommendations made in our 2002 chapter that were of greatest significance and risk—namely, that long-term options were fully considered and that progress was being made to improve information systems and the information provided to decision makers. We supplemented this work by examining leasing activities since our previous audit.

We also assessed the Department's risk management practices at the operational and strategic levels, with an emphasis on leasing of office accommodation.

Finally, to assess whether PWGSC considered all available long-term options for providing accommodation, we selected a sample of 27 of the 43 high-value leases the Department had entered into since our 2002 audit. We defined high-value leases as those with total payments of more than \$1 million per year.

Criteria

The following criteria guided our audit work:

- The Real Property Branch should have appropriate tools to anticipate future needs, analyze a range of available options, and support its decisions. These tools should include strategic plans and models, policies and guidance, and management information and processes related to the acquisition of office space.
- In meeting the needs of client departments, the Branch should use the tools appropriately and consistently and follow relevant acts and regulations, Treasury Board policies and guidelines, and departmental policies.
- The Branch should have complete and accurate operational and financial information to support its managers' decisions.
- The Department should have identified and assessed risks flowing from its mandate to secure office space, and should have established appropriate risk mitigation procedures.

Audit work completed

Audit work for this chapter was substantially completed on 15 September 2005.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 7. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Department's response
<p>Responsibility for costs of office space</p> <p>7.20 In its departmental performance report, Public Works and Government Services Canada should include progress against projected savings and the cost of those instances where the most cost-effective accommodation option was either not accepted or not enforced. (7.14–7.19)</p>	<p>Public Works and Government Services Canada's response. Shared responsibilities inevitably give rise to some inefficiency. There is now a renewed effort, supported by the Treasury Board Secretariat, to enforce standards for space and fit-up, and this is resulting in savings to the government. We will work with the Secretariat to include more reporting to Parliament on this issue.</p>
<p>Assessing options</p> <p>7.26 The Treasury Board Secretariat should develop a plan for departments to use financial information based on an accrual-based budgeting and appropriations approach in planning, budgeting, and reporting. (7.23–7.25)</p>	<p>The Treasury Board Secretariat's response. The Treasury Board Secretariat agrees that there are limitations associated with annual capital appropriations. The Secretariat is addressing the issues through two initiatives.</p> <p>The first initiative, as mentioned in the chapter, is the engagement of an independent contractor to conduct a comprehensive study of the concepts of accrual accounting to determine whether, and if so, how, they should apply to the development, documentation, and execution of the budgets and appropriations of the federal government.</p> <p>The Treasury Board Secretariat will use the study to make an informed recommendation to the Treasury Board as well as the Department of Finance and the Privy Council Office (given their central roles in Budget planning) on the extent and manner of the implementation of accrual concepts in the budgeting process and/or the appropriations at the government-wide and departmental levels. The government can approve changes to the budgeting process; however, Parliament must approve changes to appropriations.</p>

Recommendation	Department's response
<p>7.28 The Treasury Board Secretariat and Public Works and Government Services Canada should ensure that funding methods support the selection of the most cost-effective option that meets the long-term accommodation requirements. (7.27)</p>	<p>The second initiative is a pilot project under development for non-lapsing capital appropriations. The pilot project proposes allowing up to three departments to carry forward unexpended asset funds from one fiscal year to the next, beginning as soon as next year. This will provide departmental managers with more flexibility in planning their operations and remove the current short-term focus of the planning horizon for asset and associated resources.</p> <p>Public Works and Government Services Canada's response. We are pleased that the Auditor General has found that Public Works and Government Services Canada adequately analyzes the cost of accommodation options before decisions are made. The issue of how funding mechanisms affect rational decision making is an important one. We agree with the recommendation and will continue to work with the Treasury Board Secretariat and other parties to ensure that, wherever possible, funding mechanisms support the most cost-effective solution that meets the long-term accommodation requirements. We recognize that this may take some time to resolve since it represents a fundamental change to government accounting and budgeting.</p> <p>The Treasury Board Secretariat's response. The Treasury Board Secretariat recognizes that, in some instances, current funding mechanisms may limit PWGSC's ability to select the most cost-effective option for long-term accommodation requirements.</p> <p>The Capital Asset Review (CAR), conducted in 2004 as one of the federal government's expenditure management reviews, raised this same issue in the broader context of capital asset management. Responding to the CAR, the Secretariat is considering a more flexible funding mechanism, known as non-lapsing capital appropriations, and it has developed a pilot program with three departments to confirm the anticipated benefits of this option.</p> <p>Subject to this experience, the Secretariat will consider expanding the pilots to other departments and agencies, including PWGSC, providing they meet the participation criteria. The Secretariat will keep departments and agencies, including PWGSC, informed of progress in this area.</p>

Recommendation	Department's response
	<p>Irrespective of the potential change toward non-lapsing capital appropriations, PWGSC is responsible for managing its investment program, within existing reference levels. This must be done in accordance with key Treasury Board policies related to assets management, namely the Policy on Long-term Capital Plans, the Project Management Policy, and the Real Property Policy Suite, including the Treasury Board Real Property Investment Policy, all of which support least-cost best-value decisions.</p>
<p>Management information</p>	
<p>7.37 Public Works and Government Services Canada should continue to improve the availability, accessibility, and reliability of information to support sound decision making for real property investments. (7.34–7.36)</p>	<p>Public Works and Government Services Canada's response. We agree with this recommendation. While current systems enable Public Works and Government Services Canada to control costs incurred by the Department on individual projects, we recognize that our systems are cumbersome for overall management and acknowledge that improvements remain to be made.</p>
<p>Management property risks</p>	
<p>7.53 Public Works and Government Services Canada should</p> <ul style="list-style-type: none"> • continue its efforts to develop guidance and to implement continuous risk management as part of the process for acquiring office accommodation, and • provide staff with the necessary training in risk management. (7.38–7.52) 	<p>Public Works and Government Services Canada's response. We agree with this recommendation. Public Works and Government Services Canada has made considerable progress in this area and will continue to do so. In areas of great importance, such as managing the risk related to achieving our five-year cumulative savings target of \$150 million from leasing operations, we have implemented compensating controls. These controls include the establishment of a Strategic Transformation Branch to monitor and control achievement of our goals. In addition to implementing more rigour in its leasing practices and providing ongoing training to its staff, the Real Property Branch has implemented a Lease Savings Tracking System to monitor net transaction savings on a monthly basis. As a result of these measures, we have already achieved, as of 1 January 2006, more than half of our five-year cumulative savings target of \$150 million, and will continue to monitor our progress carefully.</p>