Public Works and Government Services Canada
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Final Report

2013-710
Targeted Review of Lease Renewals (less than 2,000m^{2}u)

September 18, 2014

Office of Audit and Evaluation

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MAIN POINTS

What we examined

i. The Real Property Branch of Public Works and Government Services Canada (PWGSC) is the centre of expertise for office accommodation services for government departments and agencies. As custodian of mainly office buildings, the Real Property Branch is responsible for the stewardship and effective management of its diverse portfolio which includes the administration of leases.

ii. The PWGSC office space portfolio is composed of crown-owned buildings and leases. The flexibility provided by using a mix of crown-owned and leased office space helps to mitigate risks related to changing client requirements and fluctuating real estate markets. In accordance with the Real Property Branch *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals*, the delegated authority for administering leases less than 2,000m^2u (usable area[1]) lies with the Regional Directors General or a regional Project Authority (<1,000m^2u). Each region has an investment management board which oversees the review of planned real property investments in both crown-owned and leased space.

iii. We reviewed the *in situ* lease renewal[2] process for properties less than 2,000m^2u to assess how risks (e.g. ensuring enough time for negotiations, alternative solutions exist should negotiations fail, ensuring clients accommodation requirements are met, etc.) related to lease renewals are managed through governance, risk management and control processes. This process is guided by six principles:

- There is a demonstrable financial advantage to the Crown.
- The financial advantage is supported by a Market Analysis Report.
- Base building meets or will meet by a specified date, at no extra cost to the Crown, all the required base building standards.
- There is a continuing program need for the space.
- The lessor has met all obligations under the current lease.
- Negotiations must be conducted within a specific timeframe, thereby allowing PWGSC to implement alternative should negotiations fail.

Why it is important

iv. In managing a vast and diverse real estate portfolio across the country, the Real Property Branch supports other federal departments and agencies in carrying out their mandates by providing cost effective and productive office space.

[1] Usable Area (m^2u): the space that is available for the occupant to establish productive work environments.

[2] In Situ Lease Renewal: A new lease for the continued occupation of all or a portion of the leased premises, without any break in occupancy. The use of swing space to allow the refresh or the reconstruction of the fit-up of the space is not considered as a break in the occupancy.

v. To ensure consistent and practical real property solutions (e.g. renewal of existing leases, move to existing crown-owned buildings, construction of new crown-owned buildings, calls for new lease tender), it is important that the Real Property Branch have in place a well designed and robust investment framework that complies with rules, regulations and delegated accountabilities appropriately. Such a framework helps to ensure that appropriate investment decisions are made and meet the objectives of due diligence, value for money, timeliness and transparency.

vi. In 2012, the Deputy Minister requested that the Office of Audit and Evaluation (OAE) conduct a review of the lease renewal process for properties greater than 2,000m^{2}u. The review found that the governance and control processes in place were adequate and functioning as intended.

vii. Through the 2012 review, the OAE determined that, the lease renewal process for properties over 2,000m^{2}u represented approximately 20% of the actual volume of lease transactions the Department undertakes, although it represents approximately 70% of the rental payment. As at June 2013, the Real Property Branch's portfolio included 1,579 out of 1,930 leases that were less than 2,000m^{2}u which accounted for $265M out of $990M in total yearly rental payments. Based on this information, the targeted review of the lease renewals process for properties less than 2,000m^{2}u was included as part of the 2013-2018 Risk-based Audit and Evaluation Plan.

What we found

viii. Overall, we found that the lease renewal process for properties less than 2,000m^{2}u contained well designed and implemented governance and risk management frameworks.

ix. We found that a control process had been established and was understood. We found that the controls were implemented and functioned as required, ensuring compliance with the first five principles noted above. However, the regions did not consistently meet the leasing due date, a control which helps ensure compliance with the sixth principle.

x. We also found the Policy document and one of its attached annexes were inconsistent with regard to the process that is to be followed for leases that do not meet one or more of the six leasing principles and whether or not Ministerial approval is required before entering into negotiations.

xi. We found that all six regions (Atlantic, Quebec, National Capital Area, Ontario, Western and Pacific) have established investment management boards which effectively oversee and help ensure appropriate investment decisions are made. We found that the committees were consistent in terms of their mandates and the oversight and direction they provided in relation to the lease renewal process.

xii. We found that the regions consistently identified risks throughout the lease renewal process. Risk is identified as part of the definition phase or through the statement of requirements and also as part of the Investment Analysis Report (IAR). The IAR is a formal document that identifies the investment options and the potential risks associated with those options.

xiii. We found that all six regions have control processes in place and that the controls relating to the first five principles were adhered to. We found that one of the controls related to the sixth principle (e.g. Planned Leasing Actions Report (PLAR) lead times) acts as a guideline and consists of predetermined dates by which key activities in the renewal process should be completed. We found in 23 of 57 instances that the leasing due date identified as part of the PLAR lead times was not being met. By not meeting the PLAR deadline and not allowing adequate time to implement alternative solutions should negotiations fail, the Department is at risk of not being in the best negotiating position as possible with the lessor.

xiv. We also found an inconsistency within the Policy related to the process that is to be followed for leases that do not meet one or more of the six principles. The Policy states that *"all in situ lease renewals shall be assessed against the six principles. If one or more of the principles is/are not met, then ministerial approval is required to proceed with negotiations."* However ANNEX C, which is a process map within the Policy, does not identify ministerial approval as a required step within the lease renewal process for spaces less than 2,000m^2u. As long as this inconsistency exists there is a risk of misinterpretation and/or misapplication of the Policy.

Management Response

Management has had the opportunity to review the Chief Audit and Evaluation Executive's report, and agreed with the conclusions and recommendations found therein. Management also developed a Management Action Plan to address these recommendations.

Recommendations and Management Action Plan

Recommendation 1 (Moderate Priority): The Regional Directors General and Director General, National Capital Area (NCA) Portfolio Management should ensure that the leasing due dates are reviewed and updated on a periodic basis; monitored; and adhered to.

Management Action Plan 1.1: Regions to conduct a review of business processes and implement any changes necessary to ensure that PLAR planning target dates for all leases are being met and to ensure adherence to all 6 principles.

Management Action Plan 1.2: The PLAR champion in each Region will review all leases (less than and greater than 2,000 m^{2}u) to ensure that all information in PLAR is continually up-to-date.

Management Action Plan 1.3: Conduct a review of the PLAR planning timelines with each Region to ensure they reflect current process timelines and implement any required changes within WinFIS PLAR and NOVUS PLAR

Recommendation 2 (Moderate Priority): The Assistant Deputy Minister, Real Property Branch should ensure the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals* and ANNEX C of the Policy (*PWGSC Real Property Branch Approval Process)* are aligned in regards to the process that is to be followed for lease renewals (less than 2,000m^{2}u) that do not meet one or more of the six principles.

Management Action Plan 2.1: Amend the *Policy on Direct Negotiation of Lease Acquisitions and Lease Renewals* and ANNEX C to remove any inconsistencies with respect to the lease renewal processes for space less than 2,000m^{2}u and greater than, or equal to, 2,000m^{2}u. This action will remove the risk of misinterpretation and/or misapplication of the Policy.

INTRODUCTION

1. This engagement was included in the Public Works and Government Services Canada (PWGSC) 2013-2018 Risk-Based Audit and Evaluation Plan.

2. The Real Property Branch's mandate is to provide federal departments and organizations with cost effective, productive work environments. As manager of one of the largest real estate portfolios in the country, the Real Property Branch provides office accommodation and real property services to federal departments and agencies, makes payments in lieu of taxes on their behalf, and manages the purchase, construction, leasing and disposal of office accommodation and other real property assets.

3. PWGSC provides office accommodation for 109 departments and agencies, through a range of options including the purchase of buildings and the construction of buildings, to the management of leases for over 3.5 million m^2 of leased office space across Canada. With nearly 1,800 locations across Canada, the Department's portfolio consisted of 331 Crown-owned buildings, over 1,900 leases in 1,455 locations and nine lease-purchase buildings. The total PWGSC accommodation portfolio is approximately 7.4 million square metres (m^2), of which 3.5 million m^2 (47%) is Crown-owned, 3.5 million m^2 (48%) is leased, and 0.4 million m^2 (5%) is under lease-purchase agreements. The following table describes the entire PWGSC real property portfolio[3] of office and non-office (e.g. warehouse, training centres) facilities:

[3] Real Property Branch 2012-2013 report "Our Portfolio, Our Story"

Table 1
2012-2013 Real Property Branch Portfolio

Property Type	Data	Pacific	Western	Ontario	NCA	Quebec	Atlantic	Total
Crown-Owned	# of buildings	37	38	44	103	36	73	331
	Space (m²)	256,193	222,212	350,186	2,059,753	283,813	286,134	3,458,292
	% of total	3.5	3.0	4.7	27.9	3.8	3.9	46.9
Lease	# of locations	202	261	255	237	203	297	1,455
	Space (m²)	272,755	489,511	486,264	1,690,062	296,267	288,556	3,523,414
	% of total	3.7	6.6	6.6	22.9	4.0	3.9	47.7
Lease-Purchase	# of buildings	1	0	2	4	2	0	9
	Space (m²)	25, 524	0	12,926	288,165	70,746	0	397,360
	% of total	0.3	0	0.2	3.9	1.0	0.0	5.4
Total	# of buildings	240	299	301	344	241	370	1,795
	Space (m²)	554,472	711,724	849,376	4,037,980	650,825	574,690	7,379,066
	% of total	7.5	9.6	11.5	54.7	8.8	7.8	100

4. The Treasury Board *Policy on Management of Real Property* provides direction that helps federal organizations ensure that real property is managed in a sustainable and financially responsible manner. The Policy identifies Deputy Heads as being responsible for ensuring that real property decisions represent the best value to the Crown and are based on pre-determined financial and program criteria.

5. In line with the direction of the Treasury Board Policy, Real Property Branch's *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals* identifies the controls and processes to be followed as part of the lease renewal process. All lease renewals, regardless of size, are to be assessed against the following six principles:

   - There is a demonstrable financial advantage to the Crown.
   - The financial advantage is supported by a Market Analysis Report.
   - Base building meets or will meet by a specified date, at no extra cost to the Crown, all the required base building standards.
   - There is a continuing program need for the space.
   - The lessor has met all obligations under the current lease.
   - Negotiations must be conducted within a specific time frame, thereby allowing

PWGSC to implement other alternatives should negotiations fail.

6. From the period of 1997 to 2010, Ministerial approval was required to exercise lease renewals. In 2010, the Department proposed and the Minister approved a streamlined process. This resulted in the Assistant Deputy Minister of Real Property Branch becoming the delegated authority for lease renewal approvals in cases where all six principles are met and the total amount is within the Assistant Deputy Ministers delegated authority (Lease Project Approval greater than $20M and a Project Complexity and Risk Assessment at a level 1 or 2).

7. In 2012, to obtain assurance over the streamlined process, the Deputy Minister of PWGSC requested that the OAE conduct a review related to the direct negotiations of lease renewals over 2,000m²u. The 2012 review found that the Real Property Branch had the appropriate supporting documentation on file to substantiate its assertion that the six principles were met for lease renewals over 2,000m²u. We also determined that the governance structure put in place by Real Property Branch for the process related to the lease renewals over 2,000m²u was adequate and functioning as intended.

8. The scope of the 2012 OAE file review did not include the lease renewal process for leased properties less than 2,000m²u. As at June 13, 2013: 1,579 out of 1,930 leases were less than 2,000m²u representing $266M out of $990M annually in total yearly rent payments for leases. Based on this information, the Targeted Review of the Lease Renewals process for properties less than 2,000m²u was included as part of the 2013-2018 Risk-based Audit and Evaluation Plan.

9. The following table (Table 2) identifies the roles and responsibilities of the key stakeholders at the national and regional levels as they relate to the lease renewal process for space less than 2,000m²u.

Table 2
Roles and Responsibilities of Stakeholders in the Lease Renewal Process (less than 2,000m²u)

Roles	Responsibilities
Director General, Accommodation, Portfolio Management and Real Estate Services	• Ensure national compliance with the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals.* • Develop supporting policy-related documents.
Regional Directors General Director General, National Capital Area Portfolio Management	• Ensure regional/ National Capital Area compliance with the Policy • Approval to enter into direct negotiations with a potential lessor for lease renewals greater than 1000m²u and less than or equal to 2,000m²u that meet all six principles. (Noted

	on previous page).
Director, National Portfolio Management, Accommodation, Portfolio Management and Real Estate Services	• Provide strategic advice to regional personnel on the interpretation of the Policy.
Director, National Real Estate Services, Accommodation, Portfolio Management and Real Estate Services	• Provide guidance to regional personnel (i.e. Client Accommodation Service Advisor) on the implementation of the Policy at the operational level.
Regional Project Authority	• Approval to enter into direct negotiations with a potential lessor for lease renewals less than or equal to 1000m^{2}u that meet all six principles.
Regional Investment Management Boards	• Review and provide recommendations for approval of projects • Provide oversight in the development and management of real property in each region.

FOCUS OF THE TARGETED REVIEW

10. The objective of this targeted review was to determine whether risks (e.g. ensuring enough time for negotiations, alternative solutions exist should negotiations fail, ensuring clients accommodation requirements are met, etc.) related to Real Property Branch's lease renewals process for properties less than 2,000m^{2}u are managed through governance, risk management, and control processes.

11. Lease renewals for properties less than 2,000m^{2}u represents a small and specific segment of lease acquisitions[4] that the Real Property Branch undertakes. Given the engagement's narrow and targeted scope (lease renewals less than 2,000m^{2}u) it was decided to identify this engagement as a targeted review.

12. An audit provides a high, though not absolute, level of assurance by designing procedures so that the risk of an inappropriate conclusion being drawn based on the audit procedures performed is reduced to a low level through procedures such as inspection, observation, inquiry, confirmation, recalculation, re-performance and analytical procedures. A review provides a moderate level of assurance by designing procedures so that the risk of an inappropriate conclusion being drawn based on the review procedures being performed is reduced to a moderate level through procedures that are normally limited to inquiry, analytical procedures and discussion. Such risk is

[4] Acquisition: Transaction that adds new real property to the PWGSC inventory by purchase, lease (including lease renewal), exchange, gift, easement, expropriation, custody transfer, or any other means.

reduced to a moderate level when the evidence obtained enables us to conclude that the subject matter is plausible in the circumstances.

13. The review included all six regions: Atlantic, Quebec, National Capital Area, Ontario, Western and Pacific. As part of the examination phase we reviewed the regions' governance, risk management and control frameworks. We also sampled 57 judgmentally selected lease renewal files (less than 2,000m^{2}u) for compliance with the six leasing principles. This included 10 from each region except the Western region, which only had seven lease renewals less than 2,000m^{2}u during the period of review. We examined lease renewal files (less than 2,000m^{2}u) for the period of April 2012 to June 2013.

14. More information on the targeted review objective, scope, approach and criteria can be found in the section "About the Targeted Review" at the end of the report.

STATEMENT OF CONFORMANCE

15. The targeted review conforms with the Internal Auditing Standards for the Government of Canada, as supported by the results of the quality assurance and improvement program.

16. Sufficient and appropriate review procedures have been conducted and evidence gathered to support the accuracy of the findings and conclusions in this report and to provide a review level of assurance. The findings and conclusions are based on a comparison of the conditions, as they existed at the time, against pre-established criteria that were agreed upon with management. The findings and conclusions are only applicable to the entity examined and for the scope and time period covered by the targeted review.

OBSERVATIONS

GOVERNANCE FRAMEWORKS AND RISK MANAGEMENT PROCESSES

Governance frameworks are established in the regions and functioning as intended

17. Governance is the combination of processes and structures implemented by management to inform, direct, manage, support, and monitor the activities towards effective achievement of their objectives. For the lease renewal process this includes the implementation of processes and structures to ensure client satisfaction and the ability to achieve value for money.

18. A robust governance framework helps to ensure that appropriate lease renewal decisions are made and meet the objectives of due diligence, value for money,

timeliness and transparency. Given the continually changing real property market, it is important to have in place a governance structure which oversees investment decisions and makes informed decisions that take into account market conditions, client requirements and government plans and priorities.

19. Since the lease renewal process for properties less than 2,000m^2u is a regional process, we expected each region to have a governance structure in place to ensure sound management practices are adhered to and appropriate decisions related to the lease renewals process are made.

20. We found that all six regions had governance frameworks in place to help ensure appropriate investment decisions were made. The regional frameworks were comprised of investment management boards and strategic teams made up of operational personnel. The governance frameworks put in place by the regions were consistent in terms of the overall oversight and direction they provide in relation to the lease renewal process.

21. We found the investment management boards that were established in the regions each had a terms of reference which contained minimum lease requirements (i.e. dollar amount, size and term of lease) that had to be met in order for a lease to be presented to them. Although we found small nuances amongst the regions in terms of the thresholds, we found that they were consistent in terms of membership (senior management participation), mandates, and the oversight they were providing. The main document presented to regional investment management boards is the Investment Analysis Report (IAR) which is developed to identify a preferred course of action and the risks that are associated with it.

22. The IAR enables the regional investment management boards to make recommendations and senior management to make informed decisions on future courses of action. Its approval is confirmation that the recommended investment solution is accepted. The IAR is reviewed by the regional investment management boards for accuracy and also to ensure the recommended approach considered internal and external factors.

23. We also found that some of the regions had in place sub-committees which reviewed and validated the investment proposals prior to being presented at the regional investment management boards. The sub-committees provided strategic and functional guidance to Regional Project Authorities responsible for project approval and also acted as a recommending body for investment decisions above a certain threshold but below that required for them to be presented to regional investment management boards.

24. We found that for leases that were not presented to an investment board or sub-committee, a consistent review process was in place and applied across the regions. This review process mitigated any risk related to lease renewal files that were not

presented to any form of committee. The process consisted of strategic teams made up of operational personnel (e.g. Client Accommodation Service Advisors, Leasing Officer, Owner Investor Analysts) reviewing the IAR prior to sending it to the delegated authority to ensure the proposed investment option was appropriate, thorough and considered related risks.

25. We also found that roles and responsibilities of the key stakeholders involved in the process were documented in the regional investment management boards' Terms of References and the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals.* Based on our file review, responses to our questionnaire and our interviews with regional officials it was evident that these roles and responsibilities were understood and consistently followed. The Policy and the regional Terms of References provide a solid foundation for a governance structure which helps ensure effective delivery of the program.

26. Overall, the regional governance frameworks that have been put in place are adequate and functioning as intended. The roles and responsibilities for the key stakeholders are documented and understood, creating a consistent and effective process.

Risk management processes are in place across all regions

27. Risk management is a systematic approach to identifying, assessing and managing risks, including the identification and implementation of mitigation strategies. A properly defined risk management framework helps ensure appropriate processes are consistently followed, which in the lease renewal process is critical as each lease renewal has its own unique market risks. A properly applied risk management process will reduce the probability of unexpected issues negatively impacting the lease renewal process.

28. We expected the regions to have a risk management framework in place to mitigate the risks associated with the lease renewal process. Given that the nature of the risks associated with the lease renewal process are similar across all regions, we expected to see consistent identification and mitigation processes in place.

29. We found that the risk management framework process employed in each region were consistent in their risk identification, mitigation and response. The regions consistently identified risks as part of the definition phase of a lease renewal through the statement of requirements and also as part of the IAR which takes into account investment options and the potential risks that those options may face. By identifying risks in the IAR it enabled the regional investment management boards and strategic teams of operational personnel to make recommendations and senior management to make informed decisions on future courses of action commensurate with the associated level of risk.

30. We found that the Planned Leasing Actions Report (PLAR) is the main tool used by all regions to track leases and generate reports on lease projects. The PLAR utilizes an amount of building space and lease expiry date to create a timeline that identifies to management when key activities within the renewal process should be complete. These timelines are monitored and are used to identify risks with leases (i.e. leases at risk of being late), to ensure proper follow up and to keep Senior Management accurately informed. Other potential risks that are assessed in the PLAR include: difficulties in previous negotiations with a lessor, changing client requirements (reduction or expansion of staff) and low vacancy rates.

31. The risk management frameworks employed in the regions provide a systematic method for identifying, analyzing and assessing risk and implementing decisions which helps mitigate the key risks that are associated with the lease renewal process.

CONTROL PROCESSES

Control processes are in place however they are not always adhered to for one of the six principles (timeframe)

32. Controls are any actions taken by management or other parties to manage risk and increase the likelihood that established objectives will be achieved. For lease renewals, established objectives include obtaining suitable and cost effective accommodations for clients that meet or continue to meet their ongoing requirement for the space. To assist with the achievement of these objectives, internal controls must be in place as they represent actions imbedded in processes to manage risk and ensure compliance with requirements.

33. We expected the regions to have documented control processes in place to manage the risks associated with the lease renewal process. We expected an analysis to be conducted on the financial and non financial information to ensure management is provided with relevant information. We expected this information to be used by management to make informed investment decisions and also expected management to make those decisions in a timely manner. We expected that the Real Property Branch would review the underlying conditions of the key controls to ensure they remain relevant and appropriate.

34. We found that the regions have in place a documented control process to assist in mitigating the key risks associated with the renewal process. We found that the regions have an IAR review process in place to ensure internal and external factors are taken into consideration as part of the investment options and that the regions are in compliance with the six leasing principles as established in the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals*.

    - There is a demonstrable financial advantage to the Crown.
    - The financial advantage is supported by a Market Analysis Report.

- Base building meets or will meet by a specified date, at no extra cost to the Crown, all the required base building standards.
- There is a continuing program need for the space.
- The lessor has met all obligations under the current lease.
- Negotiations must be conducted within a specific time frame, thereby allowing PWGSC to implement other alternatives should negotiations fail.

First Five Principles

35. As part of our file testing of 57 lease renewals, we found that the regions consistently adhered to the first five leasing principles noted above. We found that the IARs included a financial analysis which took into consideration the full costs to the federal government for each leasing option that was identified and that financial advantage to the Crown was demonstrated. Additionally, we found that as part of the financial analysis, a Market Analysis Report was conducted which summarized relevant data that had been collected on the local commercial real estate market and determined the appropriateness of proposed rental rates by determining an acceptable range of rates.

36. We found that the IAR identified whether the base building[5] met all required standards (i.e. finishes, services and equipment) that form a part of the lessor's responsibility and are included as part of the rental rate. We found that the on-going requirement for the space was identified and that the current accommodation was validated to ensure it continues to meet the client's operational requirements. It was also evident, based on the file review, that the lessor's past performance (level of service) was taken into consideration prior to the renewal of a lease agreement.

Sixth Principle

37. Regions have put in place controls to help ensure they remain in compliance with the sixth leasing principle *"negotiations must be conducted within a specific time frame".* We found that the regions have instituted PLAR lead times which act as a guideline and consist of predetermined dates by which key activities (e.g. IAR start date, IAR completion date, leasing due date) in the renewal process are scheduled to be completed. The PLAR lead times culminate with the leasing due date, which is defined as the date, prior to lease expiry (including options), at which all required leasing approvals must be obtained so that the Leasing Officer can begin negotiations with the lessor. Ensuring there is enough time puts the Department in a stronger negotiating position with the lessor, as sufficient time will have been allocated to implement alternative solutions (e.g. acquire new leased space) should negotiations fail.

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[4]Base Building: completed building shell which is used to accommodate tenants. It includes all finished common area space such as floors and bearing, demising and enclosing walls, ceilings, and building systems consistent with the designed function and planned general use of the building, its age and location. In the case of office accommodation, the base building would include window coverings and primary identification signage.

38. We found that the majority of the regions have instituted similar leasing due dates with the exception of the Western region. For instance, all regions except Western, with leases between 0 - 499.9 m^{2}u (rentable meters squared) have a leasing due date of nine months while the Western region allows itself 16 months. For leases between 500m^{2}u – 1999.9 m^{2}u all regions except Western allow themselves 12 months while the Western region allows itself 24 months. The reason for the additional time in the Western region was that when the PLAR lead time schedules were put into effect in 2004/05, the Calgary, Edmonton, and Saskatoon markets had low vacancy rates and space was more difficult to obtain in comparison to other markets. Since PLAR only allows one schedule per region and some of the markets within the Western region fluctuate, the Western region decided to keep that additional time built into its schedule.

39. Although the regions implemented the PLAR lead times to help ensure leases adhered to their timeframe, the testing of our sample of 57 judgmentally selected lease renewal files[6] (less than 2,000m^{2}u) between April 2012 and June 2013 (inclusive) found that in 23 of 57 instances, the leasing due date guideline identified in PLAR was not being met. Failing to meet the leasing due date does not necessarily equate to non-compliance with the sixth principle since there may still be alternative solutions should the negotiations fail (e.g. moving the tenant to vacant Crown space or existing leased inventory). Non-compliance would occur when no alternative solutions have been identified and negotiations with the landlord of the current leased premise have failed. This could result in the Department being forced to enter a lease at an escalated price, or not being able to find space suitable to fulfill the operational needs (e.g. location, accessibility, dimensions, etc.) of the client.

40. The following (Table 3) is a regional breakdown of leases between 0 – 499.9 m^{2}u that exceeded the leasing due date and the number of months by which the due date was exceeded.

Table 3
Leasing Due Dates for Leases between 0 – 499.9 m^{2}u

Region	Number of months by which leasing due date was exceeded						
	Leasing Due Date	1-2	3-4	5-6	7-8	9+	Total Number of Instances
Atlantic	9 Months				2		2
Quebec	9 Months		2				2
NCA	9 Months	1	2		1		4
Ontario	9 Months						0
Western	16 Months	1	1	1			3
Pacific	9 Months			2			2

[6] Note: 10 lease files were requested from each region however Western only had 7in situ lease renewals (< 2,000m^{2}u) during the scope of the review.

41. The following (Table 4) is a regional breakdown of leases between 500 – 1,999.9 m^{2}u that exceeded the leasing due date and the number of months by which the due date was exceeded.

Table 4
Leasing Due Dates for Leases between 500 – 1,999.9

Region	Number of months by which leasing due date was exceeded						
	Leasing Due Date	**1-2**	**3-4**	**5-6**	**7-8**	**9+**	**Total Number of Instances**
Atlantic	12 Months			1			1
Quebec	12 Months			1		1	2
NCA	12 Months		1				1
Ontario	12 Months				1		1
Western	24 Months				1	1	2
Pacific	12 Months	1		1		1	3

42. The files that exceeded the leasing due date in both Table 2 and Table 3 by one or two months were at less of a risk of being in non compliance with the sixth principle than the files that exceeded the leasing due dates by three plus months.

43. Of the 23 files where the leasing due dates were not met, we found that two lease files failed to comply with the sixth principle. Both of these were in the Pacific region and in both cases, the clients' accommodation requirements had been transferred to the Pacific Region via a provincial agreement which resulted in significant delays as approvals from the client were difficult to obtain. This ultimately impacted PWGSC's ability to comply with the sixth principle.

44. Although the two leases were in non compliance with the sixth principle, we found that the rental rates agreed to with the lessor were within the market rental rate ranges that were identified in the Market Analysis Reports/Market Survey Reports which were established before the Leasing Officers received the mandate to begin negotiations. These market reports form a part of the IAR and are used to determine applicable market rental rates by using substantive cost estimates that are based on market data. Given that the rental rates agreed to remained within the market rental ranges, this mitigated any concerns regarding the Department's ability to obtain value for money.

45. We found that for the other 21 leases that did not meet their leasing due date, the value of the renewed lease also stayed within the market rental range that was identified in the IAR. Although these leases remained within the market rental range, by exceeding the leasing due date, it condensed the negotiating period which could have had a negative impact on the Department's ability to obtain value for money while fulfilling the operational needs of the client.

Inconsistent Policy Guidance

46. We were advised by both the Pacific region and the Accommodation, Portfolio Management Real Estate Services group that because the two leases that did not meet the sixth principle were less than 2,000m^{2}u, ministerial approval to proceed to negotiate was not necessary. This practice appears to be non-compliant with the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals* as the Policy states that *"If one or more of the principles is/are not met, then ministerial approval is required to proceed with direct negotiations."* However, we noted that the ANNEX C to the Policy, which is a process map, only identifies ministerial approval as a mandatory step for leases over 2,000m^{2}u that do not meet one or more of the six principles. We were advised by Accommodation, Portfolio Management and Real Estate Services, who are responsible for ensuring national compliance with the Policy, that the regions have been told that ministerial approval is only required for leases greater than 2,000m^{2}u that do not meet one or more of the six key leasing principles. The inconsistency within the Policy itself can create a risk of misinterpretation, misapplication and possible non-compliance of the Policy as it relates to the approval to negotiate if one or more of the six principles are not met.

47. The control processes in place surrounding the lease renewal process are well designed to help ensure risks are mitigated. In the 57 files reviewed all respected the first five principles. The regions however, did not consistently meet the leasing due date in 23 files, which could put the Department at a disadvantage when it comes to negotiating with the lessor and obtaining value for money. Despite the fact that the lease renewal amounts remained in the rental range for the renewals we tested, they still exceeded the PLAR due dates. The practice of exceeding the PLAR due dates represents a potential risk to the Department. Furthermore, the inconsistency within the Policy regarding the process to be followed for leases that do not meet one or more of the six leasing principles could lead to ambiguity within the process and improper interpretation and application of the Policy.

CONCLUSION

48. We found that all six regions have a governance structure in place which helps to ensure appropriate investment decisions are made. We also found that the regions have a process in place which consistently identified and documented risks related to individual leases via the Investment Analysis Report document that is prepared for all the lease renewals.

49. Overall, we found that the risks related to the lease renewals process for properties less than 2,000m^{2}u were adequately managed through well designed and established governance and risk management frameworks. We found that a documented control process was in place, and understood. We found that the controls were implemented and functioned to ensure compliance with the first five principles. However the regions did not consistently meet the leasing due date, a control which helps ensure

compliance with the sixth principle. We also found an inconsistency within the Policy regarding the lease renewal process for spaces less than 2,000m^2u and the requirement for ministerial approval if one or more of the leasing principles is/are not met.

MANAGEMENT RESPONSE

Management has had the opportunity to review the Chief Audit and Evaluation Executive's report, and agreed with the conclusions and recommendations found therein. Management also developed a Management Action Plan to address these recommendations.

RECOMMENDATIONS AND MANAGEMENT ACTION PLAN

Recommendation 1 (Moderate Priority): The Regional Directors General and Director General, National Capital Area (NCA) Portfolio Management should ensure that the leasing due dates are reviewed and updated on a periodic basis; monitored; and adhered to.

> **Management Action Plan 1.1:** Regions to conduct a review of business processes and implement any changes necessary to ensure that PLAR planning target dates for all leases are being met and to ensure adherence to all 6 principles.
>
> **Management Action Plan 1.2:** The PLAR champion in each Region will review all leases (less than and greater than 2,000 m^2u) to ensure that all information in PLAR is continually up-to-date.
>
> **Management Action Plan 1.3:** Conduct a review of the PLAR planning timelines with each Region to ensure they reflect current process timelines and implement any required changes within WinFIS PLAR and NOVUS PLAR

Recommendation 2 (Moderate Priority): The Assistant Deputy Minister, Real Property Branch should ensure the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals* and ANNEX C of the Policy (*PWGSC Real Property Branch Approval Process)* are aligned in regards to the process that is to be followed for lease renewals (less than 2,000m^2u) that do not meet one or more of the six principles.

> **Management Action Plan 2.1:** Amend the *Policy on Direct Negotiation of Lease Acquisitions and Lease Renewals* and ANNEX C to remove any inconsistencies with respect to the lease renewal processes for space less than 2,000m^2u and greater than, or equal to, 2,000m^2u. This action will remove the risk of misinterpretation and/or misapplication of the Policy.

ABOUT THE TARGETED REVIEW

Authority

This engagement was included in the Public Works and Government Services Canada (PWGSC) 2013-2018 Risk-Based Audit and Evaluation Plan.

Objective

The objective of this targeted review is to determine whether risks related to Real Property Branch's lease renewals process for properties less than 2,000m^{2}u are managed through governance, risk management, and control processes.

Scope and Approach

This targeted review covered the period from April 2012 to June 2013 and focused on the lease renewal process for properties less than 2,000m^{2}u that were renewed during that time. The review included all six regions: Atlantic, Quebec, National Capital Area, Ontario, Western and Pacific.

The targeted review assessed how risks related to these lease renewals are managed through governance, risk management and control processes.

This targeted review was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

As part of our testing procedures we examined a sample of 57 judgmentally selected lease renewal files (less than 2,000m^{2}u) between April 2012 and June 2013 (inclusive) We selected 10 files per region, however the Western region only had seven lease renewals (less than 2,000m^{2}u) during the review period. The file review included all six regions: Atlantic, Quebec, National Capital Area, Ontario, Western and Pacific region.

In addition, we interviewed Real Property Branch personnel in the regions and at headquarters and circulated a questionnaire to all the regions.

Criteria

The criteria used to assess the lease renewal process for properties less than 2,000m^{2}u were based primarily on Real Property Branch's *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals*; and the Office of the Comptroller General document *Audit Criteria related to the Management Accountability Framework: A Tool for Internal Auditors*.

The criteria were as follows:

Governance Process: a governance structure is in place to effectively manage the lease renewal process for leases less than 2,000m^2u.

- Oversight bodies are established to provide strategic direction and oversee the administration and management of the lease renewals process for leases less than 2,000m^2u.
- Roles and responsibilities including delegated authorities and accountabilities are established for the lease renewals process less than 2,000m^2u.
- Management is provided with accurate information to monitor the lease renewal process for leases less than 2,000m^2u.

Risk Management Process: sufficient processes are in place for the lease renewal process less than 2,000m^2u to manage risk.

- A systematic and documented approach to risk management is in place that includes the identification and documentation of risks, their assessment, mitigation and monitoring strategies related to the administration and management of direct negotiations of lease renewals less than 2000m^2u.
- Management monitors, mitigates and formally responds to existing and emerging risks.

Control Process: Controls are in place to mitigate the key risks inherent to the lease renewal process for leases less than 2,000m^2u.

- There is a defined and documented control process (standard operating procedures, policy requirements, etc.) that mitigates key risks and is consistently followed.
- The direct negotiations for lease renewals less than 2,000m^2u are in compliance with the six principles as established in the *Policy on Direct Negotiations of Lease Acquisitions and Lease Renewals*.

Targeted Review Work Completed

Audit fieldwork for this audit was substantially completed on March 18, 2014.

Targeted Review Team

The targeted review was conducted by members of the Office of Audit and Evaluation, overseen by the Director Procurement Audit and under the overall direction of the Chief Audit and Evaluation Executive.

The targeted review was reviewed by the quality assessment function of the Office of Audit and Evaluation.