Corporate Services – Property Services Lease Tracking Audit Report

September 2005

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1.0 Management Summary

Audit Services has completed a review of the leased property tracking process in York Region's (the Region's) Corporate Services Department - Property Services Branch.

Based on the work performed, we were able to highlight opportunities to introduce or enhance management internal controls relating to:

- Lease documentation – i.e. documentation of lease extensions, finalization of leases, follow up of charge-backs, follow-up of expired leases.
- Utilizing PeopleSoft to streamline and manage monthly recurring lease payments.
- Creating a corporate policy to identify Property Services as the branch responsible for property leases and the creation of a customer survey.
- Using a 'right to audit clause' in all lease agreements containing additional rents or common area maintenance fees.
- Establishing an upper limit for lease negotiation for Council approved property leases that have not yet been finalized.
- Collecting and maintaining insurance documentation for communications equipment leases.
- Finalizing service level agreements for transferred resources and responsibilities.
- Centralization of Health Services leases into Property Services.

Audit Services also reviewed a draft request for proposal for the procurement of facilities management software. A number of suggestions were made to Property Services management for their consideration.

A draft copy of this report has been discussed with Property Services Branch management. They have provided us with their comments and have agreed to take the necessary action to implement the noted recommendations.

Should the reader have any questions or require a more detailed understanding of the risk assessment and sampling decisions made during this audit, please contact the Director, Audit Services.

We wish to thank the Property Services Branch management and staff for their co-operation and assistance in providing Audit Services with requested documentation and timely responses.

2.0 Introduction

As part of our 2005 Audit Plan, which accommodates various types of audit projects, consulting engagements, and follow up requests from the Audit Committee and York Region management, the Audit Services Branch performed an audit of the Property Services lease tracking process.

The Audit Plan, approved by the Region's Audit Committee, is developed annually by the Audit Services Branch using a Risk Assessment Methodology that helps to define the different risks associated with the various processes here at the Region. It is one tool that Audit Services uses in assessing where best to allocate audit resources.

The Property Services Branch of Corporate Services was organized into its present form based on recommendations contained in the June 2001 Finance & Administration Committee report. Region management identified the need for a strategic approach to accommodation that included updating space and furniture standards, centralizing management of real property supply and demand, addressing accommodation needs at the corporate level to allow direct service departments to carry on with their core businesses, and professionally managing real property.

Centralized lease administration is provided through the Facilities unit. This unit provides consistency in the way leases are handled when negotiated, signed, and administered. Thus potential liabilities associated with inconsistency are reduced, and client departments can continue with their core businesses.

The Region currently leases 352,261 square feet in 45 properties at an annual cost of $6.14 million. These leases are presently recorded and tracked using a Microsoft Access database. Property Services management is preparing to issue a request for proposal for a more robust application that would also encompass repairs and maintenance functions. The benefits of more sophisticated software are an increased amount of lease information to be recorded for the purposes of interfacing with PeopleSoft, automating maintenance & repair requests, and providing management reporting not presently available without a high level of manual effort.

Lease document files, used to populate the Microsoft Access database fields, are being reviewed and reorganized and is ongoing. A consistent look and feel to any lease file makes working with the file and document storage easier and more efficient. The individual responsible is also the internal contact for landlords, creates work orders, and administers all leased property files. Through discussion with Property Services management we noted that these functions were originally performed by two individuals. However, with the departure of one employee the preventative and maintenance workload was beginning to impact the timeline to organize and update the document files and database.

The transition of operating and maintenance budget responsibilities in exchange for service contracts is ongoing and benefits are being recognized. For example, the transfer of utilities administration has allowed for an energy conservation program.

Communications equipment lease administration is in the process of being transferred to Property Services from Transportation & Works. The Region is currently landlord for 32 locations where outside parties are paying rent for the permission to erect their communications equipment on Region property. Most of these parties are cell phone companies. In addition, in late 2005 plans are for a transfer of operating and lease budget responsibility from Community Services & Housing to Property Services.

Health Services, which leases their long term care facilities and EMS stations, has transferred some of these responsibilities to Property Services. The EMS operating budget, but not the lease budget for EMS has been transferred. LTC has not transferred operating and maintenance budget responsibilities for the Newmarket and Maple Health Centres, however leases with parties occupying space within these facilities are currently being reviewed for transfer. Property Services is open to assuming all leased property responsibilities to further along one of the original goals, stated in the Finance & Administration Committee Report No. 7 to Regional Council in June 2001, of ensuring that department line staff are not taken away from their core business.

Given the relatively young age, and somewhat evolutionary nature of the Property Services Branch, management has decided to slowly transition resources and responsibilities from program delivery departments, as opportunities arise. This allows for a phased approach and readjustment of internal resources and workload.

However, service level agreements with program delivery departments have not yet been finalized. They remain in draft format.

3.0 Objectives and Scope

The objectives of this engagement included:

- To assess the completeness and accuracy of our lease tracking process.
- To ensure processed lease payments have adequate supporting documentation, are accurate, and appropriately authorized.
- To assess the lease renewal process.
- To assess the transfer of operating and maintenance budget responsibilities in exchange for service contracts with departments.

The audit objectives were accomplished through:

- A review of the process for capturing, recording and monitoring leases.
- Interviews with appropriate personnel.
- Review of disbursement files and other related documents.

4.0 Detailed Observations and Recommendations

4.1 Leased property file detailed review

Observation

A review of eleven files containing documentation for properties leased by the Region revealed the following opportunities to strengthen internal controls:

- Extensions of agreements based on verbal communications. Without a signed written agreement to acknowledge the extension of a contract, the Region's legal position is weakened should a matter come before the courts.
- Property Services is collecting documentation for some leases (YRP & YRTP), but otherwise has no involvement in the administration of the lease. This may result in the duplication of documentation files, as the administrator of the lease will have their own working documents. This also increases the risk that Property Services' file become out of date.
- Increases in rent were noted without supporting documentation to indicate the increase was agreed to by Region management (YRP). Documentation is not on file to indicate all increases in rent, not agreed to in the lease agreement, have been negotiated where possible.
- The leases for 1 West Pearce Street (YRTP), 280 Church Street (EMS), and 520 Cane Parkway (EMS) remains works in process and have yet to be finalized. The Region recently spent approximately $1 million in renovation for 520 Cane Parkway. Without a signed legal agreement, the Region's legal position is weakened should a matter come before the courts.
- Two requests for reimbursement of costs incurred by the Region on behalf of the landlords Transmark Development (4261 Highway 7) and Metrus (50 Hitech) were noted. On August 22, 2003 the Region incurred expenses of $735 for lock repair, and on December 10, 2004 at least $2,320 was incurred to replace defective hot water tanks. We were not able to determine if the Region had been reimbursed these expenses, and it did not appear that the claims were submitted to Finance as a receivable for collection.
- In one lease, the cost for parking stalls has been identified. Taxable benefits are accruing to the employees working on these premises. As per discussion with Finance Payroll, taxable benefits have not been allocated to these employees.

Recommendation

- Agreement extensions should be finalized with a written document signed by both parties. This would help to ensure that the Region's position in court remains strong.
- Property Services should attempt to enter into a service agreement with the related parties to clarify responsibilities and documentation requirements. This would help to reduce the possibility of out of date duplicate records and transfer workload appropriately.

- Any increases in rent, not agreed to in the lease agreement, should be finalized with supporting documentation to indicate the increase was agreed to by Region management. This would help to ensure that increases in rent have been negotiated where possible.
- Property Services management should choose a point in time and finalize the leases for 1 West Pearce Street (YRTP), 280 Church Street (EMS), 520 Cane Parkway (EMS) and 10 Riviera (EMS). Any subsequent changes to the lease can be dealt with through lease amendments. This would help to ensure that the Region's position in court remains strong.
- All charge-backs to landlords must be recorded through an invoice requisition. Once an invoice is created and billed, the Region can ensure timely follow up for payment.
- Property Services management should determine if any other leases exist that identify the cost for parking stalls. These leases, if any, should then be discussed with Finance Payroll to determine if any taxable benefits have accrued and require allocation.

Management Response

1. Agree. Action Plan – All extension agreements will be in writing and signed by both parties. Time Line – Effective immediately Q4/2005.
2. Agree. Action Plan – Continuing dialogue with client departments. Future of service agreements being discussed at Senior Management. Agreements will be signed when department is willing to enter one. Time Line – Under review.
3. Agree – However, YRTP Consultants are not subject to Regional Council approval once lease has been assigned. All Regional Lease increases are subject to Council approval. Time Line – Q4 2005
4. Agree. Action Plan – Assignment of 1 West Pearce lease to be finalized. Time Line - Q4/2005. Action Plan – Church Street EMS being discussed at Senior Management. Time Line – Under review.
5. Agree. Action Plan – Ongoing, as lease files are reviewed. Time Line – Q1/2006.
6. Agree. Action Plan – Immediately. Time Line – Q4/2005
7. Disagree – No other parking stalls exist in Property Services Branch leases. Vast majority of staff at 1 West Pearce are not Regional employees. Action – Q1 2006

4.2 Invoice Review

Observation

A review of 30 recent paid invoices for lease payments from a sample of 10 leased properties revealed the following:

- There were 15 invoices for five properties where the actual lease payment was different (higher or lower) than the lease payment tracked on the Total Cost Lease Report. The Total Lease Cost Report reflects contract documents held in Property Services.
- There were four invoices involving two properties where the cheque requisitions being submitted to Accounts Payable were authorized by an employee who no longer works

at the Region. Cheque requisitions were prepared and authorized ahead of time and submitted to release payments monthly.

- Approximately 12 cheque requisitions, or 40%, do not have supporting documentation. This documentation could be in the form of an invoice, calculations, and photocopies of contract documents.

Recommendation

Property Services management should:

- Ensure management reports are kept up to date and provide complete and accurate lease cost information. This would help to ensure reporting and decision making is made with good information.
- Ensure cheque requisitions authorizing recurring lease payments do not cover more than one fiscal year. This would help to ensure that authorizations are valid.
- Meet with Finance Accounting management to investigate using the PeopleSoft application to create and maintain recurring payments. This would help to streamline the payment process and reduce documentation that needs to copied and stored.

Management Response

1. Agree. However the majority of lease payments are made by the line departments who have budgetary control over most of these sites. Action Plan - An earlier audit recommended that all property budgets including leases be centralized with Property Services Branch. While some progress has been made, some lease budgets still reside within line departments. Time Line – Under review. Action Plan – Lease tracking database has been developed and all corporate lease data is currently being tracked. Time Line – Q3/2005 – completed.
2. Agree. Action Plan – Effective immediately cheque requisitions will be only authorized for effected fiscal year. Time Line – Q3/2005.
3. Agree. Action Plan – Property Services Branch staff to meet with Finance staff upon receiving full budgetary control. Time Line – Under review.

4.3 Expired leases

Observation

Lease agreements for 18 of the 45 Region leased facilities, or 40%, were expired at the date of our review.

Expired lease agreements result in:

- A weakened legal position in the event of a dispute.
- The Region being asked to vacate a location without being given the necessary time to find a new, suitable location at a reasonable price.

Property Services management is aware of the expired leases.

Recommendation

Property Services management should ensure that the expired leases are renewed as soon as possible. In addition, management should consider entering into interim agreements with the owners of the expired lease facilities until such time as a more formal, longer term agreement can be negotiated. This would help to ensure that the Region's legal position is not weakened, and help to reduce uncertainty.

Management Response

Agree. Action Plan – Dedicated lease and property co-ordinator was hired in late, 2004. Council report June – approved to renew number of leases. Time Line – Remainder to be completed – Q1/2006.

4.4 Right to audit clause

Observation

The Region does not use a Right to Audit Clause in leases that allow for additional rents and / common area maintenance fees. These charges normally contain expense items such as operating costs, administrative fees, taxes, common area maintenance costs, etc.

Without a right to audit clause, the Region cannot request supporting documentation from the landlord that would substantiate the fees being charged as additional rent. Thus the Region cannot ensure that the additional rents have been calculated correctly.

Recommendation

Property services management should adopt the use of a 'Right to Audit Clause' for future lease agreements. This would allow management to request supporting documentation to substantiate additional rent and common areas maintenance charges. An example of this clause, developed by Audit Services, follows:

> *The Region shall have the right to audit all books and records (in whatever form they may be kept, whether written, electronic or other) relating or pertaining to this contract or agreement (including any and all documents and other materials, in whatever form they may be kept, which support or underlie those books and records), kept by or under the control of the Landlord, including, but not limited to those kept by the Landlord, its employees, agents, assigns, successors and subcontractors. The Landlord shall maintain such books and records, together with such supporting or underlying documents and materials, for the duration of this contract or agreement and for at least two years following the completion of this contract or agreement, including any and all renewals thereof. The books and records, together with the supporting or*

underlying documents and materials shall be made available, upon request, to the Region, through its employees, agents, representatives, contractors or other designees, during normal business hours at the Landlord's office or place of business. In the event that no such location is available, then the books and records, together with the supporting or underlying documents and records, shall be made available for audit at a time and location in The Regional Municipality of York, Ontario, which is convenient for the Region.
This paragraph shall not be construed to limit, revoke, or abridge any other rights, powers, or obligations relating to audit which the Region may have by Federal, Provincial, or Municipal statute, ordinance, regulation, or agreement, whether those rights, powers, or obligations are express or implied.

Management Response

Agree. Action Plan – As landlords are reluctant to include such a clause in our leases however, further discussion with the Region's Legal Branch is required. Time Line – Q4/2005.

4.5 Upper limits for lease negotiation

Observation

The Region does not presently have an upper limit for negotiated terms that were previously approved, in concept, by Regional Council.

To illustrate, in July 2000 Regional Council approved leased office space in Georgina. Lease costs included additional rent of $4 to $5 a square foot. The final lease terms were subject to negotiation with respect to the initial term of the lease only.

The final negotiated additional rent was $5.60. Annual lease costs were calculated to be approximately $9,772 higher than they would have been at the $5 a square foot. Over the course of the lease term, in this case 15 years, the Region will be paying approximately $146,580 more for additional rents than originally anticipated.

The difference in annual additional rent costs represents approximately 3% of the current $335,492 the Region pays for leased office space in this building. While this is a relatively immaterial amount, the Region does not have a preset percentage and / or dollar amount for which Region management would be required to report back to Council for the increased costs – i.e. if the final negotiated additional rent costs represented 5%, 10%, or more of the total annual lease cost.

The currently Purchasing By-law specifically excludes leases.

Recommendation

We recommend an upper limit for lease negotiation be established by Property Services management and presented to Regional Council for approval. This would help to ensure that:

- Property Services management has clear guidelines when negotiating a lease, and
- Regional Council is made aware of any negotiated terms that have gone beyond an established upper limit.

Management Response

Disagree – Additional rent is not negotiated, it is estimated. Rates use variable based on actual market conditions and costs i.e. utilities, taxes and landlords costs for service. These additional rents are rarely subject to caps. Action Plan – Lease reports will reference the fact that additional rents are subject to market influences and we will ensure that contingency funds are provided for in the budget to cover additional costs. Timeline – Q4 2005.

4.6 Leases Administered Through Health Services

Observation

The Newmarket Health Center (NHC) presently administers five leases involving community agencies. The leases are based on a full cost recovery for the Region. Authorization to enter into lease agreements at Health Services Department facilities was granted to the Commissioner of Health Services in October 1997 by Regional Council in Clause 3 Report 8 of the Health and Social Services Committee.

A review of two lease agreements (Pal Care Network and York Region Food Network) highlighted the following concerns:

- One lease agreement was not signed, and the other agreement had expired.
- Insurance documentation had not been collected and submitted for one of the two agencies.

Insurance documentation for the three remaining agencies had also not been submitted. As per the lease agreement, the agencies are required to keep a specified level of insurance, but do not have to submit proof of insurance unless requested by the Region.

In addition, a sixth community agency presently operates from the NHC at no charge and without an agreement to limit any potential liability that might be incurred by the Region through the agency's operations.

Discussion with the Property Services Branch noted that they were unaware of any lease agreements at NHC.

Recommendation

Property Services should contact NHC management to discuss transferring the administration of the above lease agreements to the Accommodation Planning functional area of the Property Services Branch. In a Finance and Administration Committee Report to Regional Council in

June 2001 the Accommodation Planning area was created to provide a centralized lease administration service. There was concern that there was no consistency in the way leases were being handled. Real Estate, Facility Management, Legal and some direct service delivery departments had been negotiating, signing and administering their own leases. A centralized lease management function would not only better protect the Region from a liability perspective and provide consistency in dealing with the market; it would allow staff from the client departments to fully concentrate on their own core businesses.

We also recommend that:

- The lease agreement template being used by NHC be reviewed and updated where necessary by Property Services and Legal to help ensure consistency with other current lease agreements.
- The lease agreement template is updated to require insurance documentation to be submitted to the Insurance Risk Manager.
- All lease agreements be signed by the necessary parties.
- An agreement is created with the community agency occupying space at no charge to eliminate or reduce any potential liability that could arise by their occupying space at the NHC. The Legal Department should be consulted for this project.

Management Response

Response from Newmarket Health Center: Pursuant with your recommendation, we are prepared to discuss transferring the administration of the above lease agreements to the Accommodation Planning functional area of the Property Services Branch, subject to the development of a transition plan and process with Property Services. It is however important to note that our association with the agencies is not a market based relationship. We provide the space to the organizations on a cost recovery basis and in some cases the space is provided at no cost. Our goal in these relationships is to nurture and support the agencies capacity to provide health and social services to the citizens of York Region. In addition, we have developed service delivery partnerships with many of the agencies and use their co-location at the Centre to leverage enhanced service provision and delivery for our clients in the LTCSB.

In the interim, the following steps have been taken:

- We have reissued lease renewal requests to all of the agencies in question and are following up with the agencies to ensure that they are completed and returned to the Region. We anticipate that the outstanding lease agreements will be submitted by the end of next week.
- Our existing lease agreement policy has been updated to reflect the requirement that the insurance documentation is to be submitted to the Insurance Risk Manager.
- To protect the Region from potential liability arising from community agencies occupying space at no charge, we currently request that they sign a ‘no fee’ lease agreement subjecting them to the same terms and conditions as the agencies paying a licence fee, including the requirement for insurance coverage. This process was discussed with the Health Department Solicitor at the time it was implemented. As

recommended, we will review with template with Property Services to ensure consistency with other current lease agreements.

Response from Property Services Branch: Agree – Discussions with Health Department to occur in Q4 2005.

- Existing leases to be reviewed and updated in Q1 2006.
- Request delegated transfer of authority from Commissioner of Health Services to Commissioner of Corporate Services.

4.7 Corporate leasing policy & guidelines, and customer surveys

Observation

The Region does not have a corporate policy or guidelines to assist Region operating departments in determining responsibilities relating to leasing office space. A corporate policy and guidelines would help to ensure that all lease requirements are brought to the Property Services Branch as quickly as possible, thus allowing for a reasonable turnaround in lease negotiation.

Through discussion with Property Services management we noted that a customer survey has not yet been developed for the Property Services Branch. Development of a customer survey would help Property Services focus on areas of opportunity for enhancing service levels presently provided.

Property Services management is contemplating developing a corporate policy and guidelines for leasing. A customer survey is on the work plan for 2005.

Recommendation

Property Services management should:

1. Develop a Corporate Policy and guidelines for leases.
2. Obtain feedback from Customer Surveys to gauge service delivery.

Management Response

1. Agree. Action Plan – Corporate Lease Policy and Guidelines will be developed. Time Line – Q2/2006.
2. Agree. Action Plan – Customer Survey being developed. Time Line – Q1/2006.

4.8 Communication equipment leases – policy & boiler plate

Observation

With the transfer of lease tracking responsibilities from Transportation & Works to Property Services, the policy and the boiler plate used to enter into agreements with third parties may require review and adjustment to take into consideration these changes in responsibilities.

In March 2001 Regional Council approved a revised policy for Communications Installations on Regional Property - Item 4 of Report 3 of the Transportation & Works Committee.

Recommendation

Property Services management review the policy and boiler plate with Transportation & Works and Legal Services to make the necessary adjustments.

Management Response

Agree. Property Services Branch has only recently assumed responsibility from T&W for telecommunication leases. Recommendations will be implemented as files are received. Action Plan – Q2 2006.

4.9 Communications equipment leases – insurance documentation and periodic inventory

Observation

Audit Services requested that the Insurance Risk area review a status listing of various telecommunication structure license agreements to determine whether insurance certificates had been collected as per the agreements. The review highlighted the following concerns:

1. We do not have insurance certificates for Vaughan Hydro, Newmarket Hydro, and Aurora Hydro.
2. Expired insurance certificates.
3. A number of cases where:
   - We did not have an insurance certificate for the location.
   - We had no documentation on file.

Audit Services could not determine whether an inventory of communications equipment on Regional structures has ever been performed. Without a periodic update of the inventory of communications equipment on Regional structures, the Region cannot ensure that third parties are being invoiced the correct amount for leased space.

Without complete and adequate insurance documentation the Region cannot ensure that our structures are adequately covered from insurable risks.

Recommendation

To help ensure adequate insurance coverage, the Property Services should work with Insurance Risk for collection of all pertinent insurance documentation.

To help ensure all billings to lessees are complete and accurate, an inventory of communications equipment should be periodically performed.

Management Response

Agree. Property Services Branch has only recently assumed responsibility from T&W for telecommunication leases. Recommendations will be implemented as files are received. Action Plan – Q2 2006.

4.10 Inaccurate Total Lease Report calculations

Observation

The Total Lease Report, produced from a MS Access database that houses information relating to the Region's leased facilities, does not calculate total lease costs correctly.

The Total Lease Report is used primarily in the Property Services Branch. It does not appear that the report is distributed to outside departments.

Inaccurate management cost reports could result in erroneous decisions by management.

Recommendation

The Total Lease Report should be reviewed and the calculation formula corrected.

All reports being produced from MS Access databases should be periodically reviewed to ensure formulas remain valid and amounts are accurate.

Management Response

Agree. Action Plan – Reports to be reviewed for accuracy every quarter. Time Line - Beginning Q4 2005.

4.11 Service Level Agreements

Observation

Service level agreements with program delivery departments from which resources and / or responsibilities have transitioned to Property Services remain in draft format.

In an audit report dated February 2004, Property Services management 'agreed that service level partnerships between the Property Services Branch and other York Region departments need to be established to clearly define each party's responsibilities'.

Recommendation

Service level agreements with program delivery departments from which resources and / or responsibilities have transitioned to Property Services should be finalized. These agreements will help evaluate the ability of Property Service Branch to service these departments and gain further economies of scale for the Region.

Management Response

Agree. Action Plan – Property Services Branch supports Service Level Agreements, however the Corporation is reviewing the appropriateness of Service Level Agreements. Some line departments are not in favour of Service Level Agreements. Property Services Branch to sign agreements with those departments that are willing to enter into them. Time Line – Q1 2006.

Original Signed	*Original Signed*
Barry Crowe	**Jim Davidson**
Director Property Services Branch	**Commissioner Corporate Services**