Public Works and Government Services Canada
Travaux publics et Services gouvernementaux Canada
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Final Report

2009-710
Audit of Costing and Determination of Fees

September 8, 2011

Office of Audit and Evaluation

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MAIN POINTS

What we examined

i. **Costing** is the various steps and analysis taken to understand the resources needed to provide a service, whereas, **fee determination** is a process used to establish a price or rate charged to clients to recover the cost of services. Costing and fee determination are required by operating units (i.e. branches and special operating agencies) within Public Works and Government Services Canada (PWGSC) to recover the cost of services delivered.

ii. The Treasury Board, Treasury Board Secretariat, and PWGSC have each established policies and guidelines that govern costing and fee determination activities. The Treasury Board *Common Services Policy*, Treasury Board *Policy on Service Standards for External Fees*, Treasury Board *Policy on Special Revenue Spending Authorities*, Treasury Board Secretariat *Guide to Costin*g and PWGSC *Policy on Cost Management* contain guidelines that should be followed by individuals performing costing and fee determination functions within PWGSC.

iii. This audit examined costing and fee determination policy requirements, specifically focusing on documentation of assumptions and methodologies, consistency and transparency of costing and fee determination, timeliness and accuracy of invoicing in accordance with agreements, existence of procedures and guidance documents and a strong control environment to ensure appropriate costs are recovered.

Why it is important

iv. PWGSC provides mandatory and optional services to internal and external clients. Services such as translation, information technology, real property and audit were established to centrally manage services to the Government of Canada, Canadians and to the Department. For these services, the Department must recover a portion of the cost and, in some cases, the full cost associated with delivering the service.

v. PWGSC is dependent on revenues to deliver its common services mandate. In 2009/2010, approximately 59% ($3.8 billion) of the Department’s total expenditures ($6.4 billion) were funded through revenue generated from clients. Without strong costing and fee determination practices that recover appropriate costs, there is a risk of unexpected year-end deficits or surpluses and inappropriate recovery of amounts from clients.

vi. It is important to have a good understanding of costs and to ensure that the appropriate fees and prices are charged to recover these costs. Strong costing and fee determination practices promote fairness, transparency and accuracy while striving for fiscal balance within the Department.

What we found

vii. The operating units assessed during the audit have different business objectives and requirements and provide various types of services. Because of these distinct business objectives and services, each operating unit employs unique costing and fee determination practices. Regardless of these differences, collectively they generally comply with relevant federal policies and guidelines. In addition, most invoices reviewed were accurate and fees were charged in accordance with agreements with client organizations. However, areas of improvement were observed. These areas include:

- Translation Bureau:
  - Procedures for using the activity-based costing tool, to determine the full cost of each service provided on an ongoing basis, were not documented and knowledge of this tool was not sufficiently disseminated. Due to unexpected turnover in staff, the tool could not be used and as a result actual costs were not known and could not be used to update fees for 2009/2010.
  - Service Level Agreements and/or invoices lack transparency on calculation of hours billed. Therefore, clients may be led to believe that the hours billed are actual hours rather than based on a calculation according to a production rate.

- Information Technology Services Branch (ITSB):
  - Costing information used as the basis to estimate cost of services for the 2009/2010 and 2010/2011 fiscal years is outdated, i.e. 2007/2008 actual costs were used as a cost base for 2009/2010 and 2010/2011. The rationale for using 2007/2008 data was that the raw costing data in 2008/2009 and 2009/2010 was of poor quality due to expenses being inappropriately coded in the first two years after the transition to the new departmental financial system, SIGMA. This led to delays in producing appropriate unit costs.
  - Periodic assessments to ensure that revenues earned are linked to costs incurred at the sub-service line and client level were not conducted, which could mean cross-subsidization of services and over or undercharging some clients.
  - Invoices issued by ITSB lacked sufficient detail to support transparency. This could lead to client dissatisfaction.

- Real Property Branch: Special Purpose Allotment:
  - Clients were invoiced based on market rates as per Real Property Branch Special Purpose Allotment's mandate. However, there is no centrally administered guidance and oversight on the methodology

that should be used in determining these market rates. This increases the risk of inconsistencies in fee determination.

- Departmental Oversight Branch: Audit Services Canada:
  - The costing methodology used by this sector did not consider time spent by executives on various client engagements. Therefore, the organization may not be recovering its full costs.

Management Response

Management accepts the findings of the report as being a fair and accurate representation of the costing and determination of fees practices during the audit period. We are pleased to report that we have already made a number of improvements in some of these areas and that, in some other areas, actions were already planned as part of some branches' business plan for the upcoming fiscal year.

Recommendations and Management Action Plan

Recommendation 1: The Chief Executive Officer, Translation Bureau, in collaboration with the Chief Financial Officer, Finance Branch, should:

1.1 Document the procedures for using the Translation Bureau activity-based costing tool and ensure that knowledge of this tool is appropriately disseminated to staff that perform costing-related functions.

1.2 Review the level of information contained in Service Level Agreements and/or invoices to ensure transparency on the methodology used to calculate text translation services fees.

Management Action Plan 1.1.1: Develop the operational framework and the accountability structure (data interpretation and analysis) for the Translation Bureau's activity-based costing model.

Management Action Plan 1.1.2: Develop a procedural guide for users of and employees carrying out the functions of the activity-based costing model.

Management Action Plan 1.1.3: Develop the training material and train the users of and employees carrying out the functions of the activity-based costing model.

Management Action Plan 1.2.1: In light of the strategic and administrative reviews underway in Government of Canada departments and agencies, the Translation Bureau will, in the next fiscal year, examine the organizational business model, develop a new pricing strategy and review all billing procedures. The Bureau is aiming to:

- streamline its billing methods;
- review how *Billware* is used; and
- create a sustainable, transparent and consistent approach for all its clients.

Management Action Plan 1.2.2: In light of the strategic and administrative reviews underway in Government of Canada departments and agencies, the Translation Bureau will establish clear guidelines that will help Bureau clients understand the billing process. The guidelines will then be added to service agreements.

Recommendation 2: The Chief Information Officer, Information Technology Services Branch, in collaboration with the Chief Financial Officer, Finance Branch, should:

2.1 Establish appropriate controls to ensure costing information is accurate and current.

2.2 Formalize a process to periodically assess and link revenues with costs at the service level.

2.3 Review the level of information contained in invoices to ensure transparency by improving the link between the invoice and the Service Level Agreement.

Management Action Plan 2.1: The ITSB Business Plan Fiscal Year 2011/2012 calls for the implementation of the common costing and pricing framework as per Branch Activity Based Costing including the implementation of a regular review of costing models and coding practices to ensure that costs are current and accurately captured.

Management Action Plan 2.2: The ITSB Business Plan Fiscal Year 2011/2012 calls for the development of a Service Level Management Quality Assurance Plan, which includes developing a process, governance, and review cycle to assess how revenues are aligned with pricing categories identified in the Service Level Agreements.

Management Action Plan 2.3: Review of invoice (revenue) information generated to ensure consistency with the Service Level Agreement pricing sheet.

Recommendation 3: The Assistant Deputy Minister, Real Property Branch, in collaboration with the Chief Financial Officer, Finance Branch, should provide national functional guidance related to market rate determination for rents.

Management Action Plan 3.1: Establish a national procedure on the rental rates for occupancy in PWGSC space describing and confirming a methodology that would recognize:

- Consistent approach and calculations (standardized format - spreadsheets, reports, documentations);
- Practice through market data, analysis or appraisals of fully serviced rental values;
- Rental rates for unique space or when market comparables are not available.

Recommendation 4: The Assistant Deputy Minister, Departmental Oversight Branch should establish a framework for charging executive's time on engagements.

Management Action Plan 4.1: Based on the results of this audit and other recent reviews, the Chief Executive Officer of Audit Services Canada has instructed his senior management team to charge their time spent on client activities. Executives are now charging for activities such as:

- proposal/Memorandum Of Understanding preparation;
- project management;
- provision of advice;
- file reviews and report sign-off; and
- client meetings.

All executives are resourced to projects in Audit Services Canada's time reporting and project management systems.

Furthermore, for fiscal 2011/2012, management accords between Audit Services Canada Chief Executive Officer and Directors will include a requirement that 15% of an Audit Services Canada executive`s time be billable to clients. This percentage was established based on an analysis of historical trends and tasks and will be updated annually.

Recommendation 5: The Chief Financial Officer, Finance Branch, should provide additional functional leadership to ensure a consistent approach to PWGSC cost recovery practices, including determination of fees (full or marginal cost recovery). Furthermore, the Chief Financial Officer, Finance Branch, should develop minimum standards for invoicing (e.g., frequency, level of disclosure, etc.).

Management Action Plan 5.1: Assess all PWGSC cost recovery initiatives to ensure that they are aligned with the Treasury Board approved PWGSC Cost Recovery Framework.

Management Action Plan 5.2: Coordinate with Branches to address gaps identified in 5.1 above.

Management Action Plan 5.3: Ensure Chief Financial Officer sign-off on departmental revenue plan for purposes of recommendation to the Deputy Minister. This revenue plan is to include for each Branch:

- A revenue plan by program;
- The related implementation strategy; and
- The related basis for cost recovery.

Management Action Plan 5.4: Develop and communicate Billing Standards.

Management Action Plan 5.5: Exercise monitoring to ensure continued alignment to the Treasury Board approved PWGSC Cost Recovery Framework and, compliance to the existing Departmental Procedures on Costing, the new Procedures on Charging and the Billings Standards (to be developed in 5.4 above).

INTRODUCTION

1. Ernst & Young conducted the Audit of Costing and Determination of Fees in close collaboration with the Office of Audit and Evaluation of PWGSC. Ernst & Young was responsible for the planning, fieldwork and reporting phases of the audit.

2. The *Department of Public Works and Government Services Act* of 1996 established the Department and outlined the legal authorities for services. The *Act* transformed PWGSC into a common service agency providing government departments, boards and agencies with services in support of their programs. These services include:

   - Acquisition of goods and services;
   - Office accommodation and facilities;
   - Architectural and engineering services;
   - Construction, maintenance and repair of building operations and federal real property;
   - Provision of translation, information technology, telecommunications, and industrial security service; and
   - Administrative and other services such as auditing services.

3. A variety of legislation and policy instruments exist that govern costing and fee determination within the federal government. These include:

   - Treasury Board *Common Services Policy;*
   - Treasury Board *Policy on Service Standards for External Fees;*
   - Treasury Board *Policy on Special Revenue Spending Authorities;*
   - Treasury Board Secretariat *Guide to Costing;*

4. In addition, PWGSC has developed departmental policies and frameworks to assist the organization with costing and fee determination practices.
   - PWGSC *Policy on Cost Management;*
   - PWGSC *Policy on Revenue, Receipts and Accounts Receivable*;
   - PWGSC *Procedures on Costing;*
   - PWGSC *Procedures on Charging;*
   - PWGSC Cost Management Framework; and
   - PWGSC Cost Recovery Framework

5. The Chief Financial Officer (CFO) "is responsible for ensuring that the Department's financial management and control framework has the capacity to produce integrated comprehensive, relevant, timely and accurate cost information that enables plans, performance and accountability reports to reflect the full cost of mandated products/services and related outputs and outcomes and to provide functional direction, advisory and support services to facilitate the efficient and effective use of cost information by managers and their stakeholders"[1]. In addition, "the implementation of the Chief Financial Officer model within PWGSC specifies the role that the Chief Financial Officer organization plays with respect to providing both advisory and challenge functions to costing; as well as providing corporate sign-off for all submissions where costs are implicated. The Cost Based Management Directorate is the centre of expertise within the Chief Financial Officer organization." Operating units (i.e. branches and special operating agencies) within PWGSC that provide services are required to recover costs from clients based on Treasury Board and Departmental guidance.

6. The PWGSC's *Policy on Cost Management* and the Cost Management Framework provide costing guidance and define roles and responsibilities for costing activities within PWGSC. The Policy and Framework are intended to address the requirements for a consistent and recognized costing methodology and an overall approach to cost management by providing the theoretical framework for using cost information to assist in decision-making. Finances' roles related to cost management include providing direction, assistance, guidance and advice to Branches and Special Operating Agencies in design, development, implementation and operation of their cost management approach. Branches and Special Operating Agencies are responsible for the development, maintenance and effective use of cost information and the monitoring of their cost management practices in compliance with the Policy and Framework

7. PWGSC also has a Cost Recovery Framework which is specific to services funded through cost recovery. This framework ensures that all cost recovery activities are legitimate (i.e. obtain government approval), use the appropriate funding regime (e.g. revolving funds vs. net-vote) and follow the departmental costing practices to ensure the appropriate costs are recovered from clients.

8. PWGSC's Cost Recovery Framework obtained Government approval in fiscal year 2010/2011. The Framework requires that all proposals for fees and rates for cost recovery initiatives be reviewed by the CFO and departmental committees before being submitted to the Treasury Board for approval. Finally, the Framework also requires that all clients' invoicing be in accordance with Treasury Board and PWGSC financial policies and best practices.

[1] PWGSC Policy on Cost Management - Section 7.3.1

9. Costing a service is an essential function, and the initial step when determining fees for clients that use the services provided by operating units of PWGSC. Given that Treasury Board policy does not allow for a profit element on cost recovery, it requires knowledge of costs, understanding of competitive market rates as well as organizational business strategies.

10. Accurate and timely costing information, combined with transparent and supported fees that reflect full cost recovery, is important to PWGSC as a large portion of the Department's expenditures depend on revenue generated from other federal departments and agencies and external clients (approximately $3.8 billion in 2009/2010). In addition, accurate, timely and transparent invoicing in compliance with agreements ensures that clients can easily understand that the right amounts are being charged for the requested services.

FOCUS OF THE AUDIT

11. The objective of the audit was to determine whether PWGSC costing and fee determination practices comply with relevant federal policies and guidelines.

12. The audit examined costing and fee determination practices in five programs within four operating units. These operating units and applicable funding models reviewed included:

    - Translation Bureau – Revolving Fund
    - Information Technology Services Branch – Net Vote (appropriation and revenue)
    - Real Property Branch – Revolving Fund and Special Purpose Allotment
    - Departmental Oversight Branch (Audit Services Canada) – Revolving Fund

13. More specifically, we examined costing and fee determination assumptions, methodologies, relevant policies, procedures and the method in which they are communicated to staff involved in the costing and fee determination. We also reviewed the strength and effectiveness of the control environment to determine if adequate controls over the costing and fee determination processes were in place to recover the full cost of services for operating units using a revolving fund model and appropriate cost for Net Vote and Special Purpose Allotment funding models.

14. Invoices from clients receiving similar services were selected for testing. Services were selected based on the total amount of revenue they generated for the operating unit, with the focus on higher revenue generators. Clients were selected based on their total billing for the selected service, with the focus on the higher billing totals. A random sample of fiscal year 2009/2010 invoices per selected client was tested for accuracy, transparency and timeliness of billing, to determine whether they reflected

the Service Level Agreement or the Memorandum of Understanding and if they were consistent between clients. The number of invoices tested varied between operating units due to their frequency of invoicing. Generally, eight to twelve invoices were reviewed per operating unit.

15. The audit did not compare the fees charged for services offered by these operating units with market prices as comparables for such services were not easily accessible. The audit also did not verify the accuracy of the data used in each organization's costing exercise. The audit did not include a review of regions and interviews were conducted with staff located in the National Capital Region.

16. PWGSC announced, on June 20, 2011, the winding down of Audit Services Canada. In addition, on August 4, 2011, the Federal Government announced the creation of a new organization, Shared Services Canada. Information Technology Services Branch's functions related to information technology shared services and its supporting units will form the core of this new agency. These two announcements were subsequent to the end of the audit examination phase and have therefore not been reflected in the report.

17. More information on the audit objective, scope, approach and criteria can be found in the section "About the Audit" at the end of the report.

STATEMENT OF ASSURANCE

18. The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

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

OBSERVATIONS

20. **Costing** refers to the various steps and analysis taken to understand the resources needed to provide a service, whereas **fee determination** is a process used to establish a price or rate charged to clients to recover the cost of services. Costing and fee determination are required by operating units within PWGSC to recover the cost of services delivered.

21. The audit examined costing and fee determination policy requirements, specifically focusing on documentation of assumptions and methodologies; consistency and transparency of costing and fee determination; timeliness and accuracy of invoicing in accordance with agreements; existence and communication of procedures and guidance documents; and a robust control environment to ensure appropriate costs are recovered.

22. Accurate, timely costing information supports many types of business management decisions and performance monitoring. Through accurate and timely costing information, justification for fees are better supported and better aligned with actual costs.

23. Accurate and timely costing information, combined with transparent and supported fees that reflect the full cost of services, is important to PWGSC as a large portion of the Department's expenditures depends on revenue generated from other federal departments and agencies and external clients.

24. We expected that operating units' costing, fee determination and invoicing practices would take into consideration the unique nature of their business and the needs of their clients. As such, we did not expect that these practices would be identical across all operating units. However, we expected that all PWGSC costing, fee determination and invoicing practices were compliant with relevant policies and guidelines. More specifically, we expected that:

    - Costing and pricing documentation and methodology exist and are used consistently.
        - Individuals responsible for costing and fee determination of services maintain supporting documentation of underlying assumptions and methodology used to determine costs and fees;
        - Where the same service is provided, costing and fee determination is conducted in a consistent manner;
        - Costing and fee determination policies, procedures, guidelines and directives are complete and communicated to appropriate management and staff.

- Services to client departments are accurately billed in a timely manner.
  - Invoices are accurate, complete, transparent, and sent to clients in a timely manner;
  - Fees are charged in accordance with agreements with client organizations and;
- A robust control environment exists to ensure that the full cost of services is recovered as required.

TRANSLATION BUREAU

25. The Translation Bureau is an optional special operating agency established under the *Translation Bureau Act*. The Bureau provides services in French and English to support the government in respecting its obligations related to Canada's two official languages. The Bureau also offers services in over 100 other languages to support other government services or activities. Translation Bureau programs are broken down into five main categories:

    - Management of Translation Function;
    - Terminology Standardization;
    - Translation and Other Linguistic Services;
    - Translation and Interpretation to Parliament; and
    - Conference Interpretation Services.

26. The Translation Bureau's financial resources, with the exception of those of Translation and Interpretation to Parliament, are managed through a Revolving Fund on a full cost-recovery basis. Over 85% of the Translation Bureau's revenues, planned according to Annual Reference Level Update (2009/2010), were associated with the Revolving Fund. The total amount of fees recovered by the Translation Bureau Revolving Fund in fiscal year 2009/2010 was $216 million. The Revolving Fund had a deficit of $3.6 million in 2009/2010 and a surplus of $4.6 million in fiscal year 2008/2009 (on an accrual basis).

27. Through preliminary risk assessment, the Translation and Other Linguistic Services program was selected as the service offered by the Translation Bureau that would be reviewed during the audit. The main costs in the Revolving Fund included the salaries for staff responsible for translation functions and the flow-through of cost for third-party contractors.

Costing and fee determination assumptions and methodologies were documented and key controls were in place

28. A number of good costing and fee determination practices were observed in the Translation Bureau. We observed that costing and fee determination assumptions

were maintained and a methodology was documented and followed for costing and fee determination practices. The unit fee for official languages translation services was updated annually and was approved by the Vice-President of Client Services and the Senior Management Committee. Monthly monitoring and reporting of revenues and expenses were conducted throughout the year to verify that business volumes and fees were recovering full cost.

Procedures on using the activity-based costing tool were not documented and knowledge was not properly disseminated

29. The objectives of the activity-based costing tool are to provide financial information to support management decisions including internal control decisions. The activity-based costing tool is capable of computing full cost per sub-service line (e.g. general text or specialized text translation). Additionally, using historical financial data, the tool serves as a base for determining fees for the upcoming year.

30. We noted that knowledge of the tool was limited to only one individual who subsequently left the Translation Bureau. In addition, we found that knowledge of the tool was not passed on to others. As a result, the tool was not used for costing analysis purposes for fiscal year 2009/2010. Actual costs by sub-service line for the current year were not known prior to finalizing the new fees. Departure of personnel without mitigating processes in place, such as documented procedures to lessen the risk of loss of corporate knowledge, weakens the operational and financial health of the Translation Bureau.

Service Level Agreement and invoices lack transparency

31. In the case of text translation services, clients are billed based on estimated hours calculated from a word count using a pre-established production rate of words / hour. This production rate is set using historical productivity data based on number of words and hours worked by translators. The production rate is the pace at which a translator must work in order for all his or her costs to be fully recovered.

32. We observed that invoices for text translation services do not indicate that the hours charged are based on a production rate. We also found that the Service Level Agreement between the Translation Bureau and its clients contains no information regarding the use of a production rate to calculate the hours billed to clients. Even though this was identified as a common industry practice, given that the use of a production rate is not mentioned on the invoices nor is it explained in the Service Level Agreement, clients may be led to believe that they are billed based on actual hours worked.

33. In the case of modified text translation (i.e. translation of a portion of an already translated text), the Translation Bureau uses another method to charge translation

fees. Since only a portion of the entire document needs to be translated, the production rate is not applied to calculate the hours billed to clients. Instead, translators record actual hours worked on the document for the purpose of billing. However, we found that the actual hours worked by the translators are marked-up using a factor calculated by the *Billware* application. This mark-up factor is added to the actual hours worked by the translators to reflect the full costs of the translation (e.g. overhead). However, there are no indications of this pricing practice on the invoice, nor is it mentioned in the Service Level Agreement with clients. As such, clients may be led to believe that the hours billed are the actual hours worked on their translation. For both text translations and modified text, the Service Level Agreement and the invoice lack transparency on the methodology used to calculate the hours billed to clients.

Overall, invoices tested were accurate, consistent and reflective of terms and conditions outlined in the Service Level Agreement

34. The testing of invoices identified that fee determination was performed consistently between clients who shared similar services; invoices were accurate and reflective of the terms and conditions outlined in the Service Level Agreement.

INFORMATION TECHNOLOGY SERVICES BRANCH

35. The Information Technology Services Branch (ITSB) within PWGSC is mandated to deliver a number of information technology services for the Government of Canada. Revenue generated in fiscal year 2009/2010 was approximately $381 million. The products and services offered by ITSB can be categorized as four distinct offerings. These include:

    - Data Centre Services;
    - Distributed Computing Environment;
    - Telecommunications; and
    - Information Technology Security.

36. Through a preliminary risk assessment, the Data Centre Services service line was selected as the service offered by ITSB that would be reviewed during the audit.

37. Data Centre Services provides federal organizations with a shared technology infrastructure, housed in secure facilities, for the delivery of their services. It is funded through the Net Vote (all cost recovery). Data Centre Services includes:

    - Facilities Management: Data centres are the specialized buildings required to sustain the delivery of information technology services that support Government of Canada programs and services for Canadians;

- Application Hosting and Utility Computing: PWGSC manages and operates the computer equipment used to deliver government programs, and associated information repositories; and

- Business Continuity and Information Technology disaster recovery services for government departments and agencies.

38. Costing for Data Centre Services products and services is conducted within two sectors: the Service Management and Delivery sector for infrastructure direct costs, and the Business Planning and Management Services sector for indirect costs. Each product or service delivered is considered either a technical product or a client-specific service. A costing model, with multi-step calculations completed for all product lines that include direct and indirect cost inputs, supports the costing process.

39. Fee determination is the responsibility of the respective Product Executives and is coordinated by the Horizontal Planning and Integration group within the Product Management Sector. Horizontal Planning and Integration develops and maintains a fee determination sheet and a fee determination model for the purpose of highlighting the direct costs, indirect costs, and fees.

Costing and fee determination assumptions and methodologies were documented, and user guidelines were in place

40. A number of good costing and fee determination practices were observed through a review of ITSB. Supporting documentation of assumptions and methodology was maintained for the costing and fee determination analysis, and user guidelines were provided to individuals using the pricing sheet template when calculating unit fees for clients.

Expenses were inappropriately coded to the financial system resulting in inaccurate cost base for subsequent fiscal years

41. We noted that expenses were not properly coded to the correct cost centre in the financial system in fiscal years 2008/2009 and 2009/2010. The audit team was informed that approximately 13% of all coding in the financial system related to ITSB expenses were coded incorrectly. This was a result of procedures and training not being in place for individuals who were responsible for coding expenses related to the new financial system (SIGMA) implemented on April 1, 2008. Improper coding caused inefficiencies when the Service Management and Delivery sector used the cost data from the financial system to determine the cost base for the upcoming year. As a result, accurate costing information was not obtained in a timely manner as the Service Management and Delivery sector had to conduct its own analysis to

ensure expenses were coded to the correct cost centres. Without timely and accurate costing information, there is a risk of inaccurate pricing as well as non-recovering of appropriate cost of services for the upcoming year.

42. The 2008/2009 and 2009/2010 fiscal years' costing data was of poor quality because of coding errors in the first two years after the transition to SIGMA. Therefore, the data used to estimate cost of services in the 2009/2010 and 2010/2011 fiscal years was the financial information of the 2007/2008 fiscal year. Without timely and accurate costing information, there is a risk of inaccurate pricing as well as non-recovering of appropriate cost of services.

Costs could not be clearly linked to revenues

43. According to the Treasury Board Secretariat *Guide to Costing*, costs must be linked to outputs. A periodic assessment should be conducted to ensure that revenues earned are linked to costing. Although supporting documentation of the costing and fee determination methodology was maintained and an analysis to link revenues earned with costs incurred was conducted at the branch level, an assessment at the sub-service line (e.g. Data Centre Services) and client level was not conducted. As a result, it could not be determined if the final price, which is made up of both cost and price mark-up, funded the appropriate costs. This could mean that cross-subsidization was occurring without being identified.

Fees for similar services were consistent but invoices lacked transparency

44. The testing of invoices identified that fee determination was performed consistently between clients who shared similar services; invoices were calculated accurately and issued in a timely manner. However, the 12 invoices tested did not provide adequate transparency (e.g. details of usage and cost per client). Also, for two invoices tested, a link between the Service Level Agreement and the invoice could not be determined. As such, we could not determine if the invoice accurately reflected the Service Level Agreement financial terms. The lack of transparency of invoices could lead to client dissatisfaction.

REAL PROPERTY BRANCH (REVOLVING FUND)

45. The Real Property Branch within PWGSC is mandated to provide real property leadership and stewardship as the custodian of federal office and common-use facilities, various engineered public works (e.g. bridges), national landmarks and other heritage assets across Canada. The Branch also provides strategic advice as well as professional and technical real estate services.

46. The Revolving Fund is the funding mechanism for the Professional and Technical Services program within the Real Property Branch. Revenue generated in fiscal year 2009/2010 was approximately $1.6 billion, with a $19-million surplus. The Revolving Fund had a surplus of $9.8 million for fiscal year 2007/2008 and a surplus of $15.6 million for fiscal year 2008/2009.

47. This program provides three broad categories of real property services to other government departments, as well as other PWGSC real property programs. These services include:

    - Advisory services (leasing, real estate, construction);
    - Project delivery (projects that include construction activity); and
    - Property and facility management (operation and maintenance of existing facilities).

48. Through a preliminary risk assessment, the project delivery service, specifically the Non-Alternate Form of Delivery, was selected as the service offered by the Real Property Branch Revolving Fund that would be reviewed during the audit.

49. The project delivery service line is delivered through two different forms, Alternate Form of Delivery and Non-Alternate Form of Delivery.

50. Non-Alternate Form of Delivery projects are managed by Real Property Branch employees. Costs are recovered through charging clients the Hourly Billable Rate and a mark-up factor of 1.8. The 1.8 mark-up factor is made of a Direct Cost Pool (Direct labour cost) and Indirect Costs Pools (Administrative Time, Real Property Indirect Costs, Charges from other PWGSC branches, Occupancy Costs and Unrecoverable Charges). For direct labour hours, clients are charged based on actual hours incurred in accordance to timesheets. The Hourly Billable Rate is calculated by dividing the employees' occupational group annual salary (including benefits) by the expected yearly billable hours.

Costing and fee determination assumptions and methodologies were documented and guidelines were complete and communicated

51. A number of good costing and fee determination practices were observed through a review of the Real Property Branch Revolving Fund. The Real Property Branch completed an exercise to calculate the mark-up required to meet the full cost-recovery requirements of the Revolving Fund. The factors included in this analysis were indirect service delivery personnel costs, accommodation costs and an allotment for unrecoverable costs. The analysis concluded that a mark-up factor of 1.8 of labour fees would allow for full cost recovery. In addition, supporting documentation of assumptions and methodology was maintained for the Hourly

Billable Rate analysis and the labour mark-up factor of 1.8 of labour fees. Fee determination assumptions and methodologies were documented.

52. A comprehensive National Project Management System is in place for Real Property Branch employees to refer to when guidance is needed for areas such as establishing project charters and developing client agreements. The National Project Management System methodology documents formal control points including authorization limits and approvals. In addition, costing and fee determination guidelines are complete and were communicated to relevant employees.

Invoices were transparent and in accordance with the Agreement

53. We determined that the 10 invoices tested were transparent, issued in a timely manner and were reflective of the Service Level Agreement with client organizations.

54. We noted that manual intervention is sometimes required during the preparation of invoices. According to RPB, approximately 93% of the 2009/2010 total invoicing was processed using an automated process. The remaining 7% (or approximately $98 million) requires manual intervention.

55. Project managers are responsible for approving their project's direct costs (i.e. external costs such as contractors) and employees' time worked on the project (i.e. labour costs). This information is captured in SIGMA and is used by the financial support clerk to prepare the invoices. Invoices are not individually reviewed and approved by RPB's Project managers prior to issuance. However, oversight of project invoicing and revenues is performed at a macro-level. Project manager(s) review, on a monthly basis, the direct costs, time worked on projects, disbursements and invoicing. Upon project completion, the project manager conducts a final review of those elements to ensure that all costs have been recovered as per the agreement and makes adjustments to recover the outstanding amounts, if needed. In addition, RPB senior management conducts a monthly monitoring and oversight of the Real Property Services Revolving Fund financial results. This oversight primarily involves comparing revenue with the costs of the services. It is intended to ensure that all disbursements have been recovered and that the mark-up rate of 1.8 has been properly applied.

REAL PROPERTY BRANCH (SPECIAL PURPOSE ALLOTMENT)

56. Real Property Special Purpose Allotment provides accommodation services to government departments and agencies and non-governmental third parties. Accommodation services are funded by revenues generated from fully reimbursing

clients, commercial tenants, from occupancies signed under the Expansion Control Framework and by an appropriation for non-reimbursing clients.

57. Each time a non-reimbursing department seeks Treasury Board approval to increase its staffing level and access new funding a charge of 13% is levied on salaries and held in a central reserve to offset increases in PWGSC accommodation demands.

58. Decisions to reallocate existing internal resources to increase departments' personnel budget are not subject to the 13% accommodation charge. The non-reimbursing client does not receive invoices from PWGSC during the course of the fiscal year for its accommodation (space) and related accommodation services (operation, maintenance, utilities, taxes). However, when demands exceed the space envelope, non-reimbursing departments must pay for that additional space at the market rate.

59. The space envelope is the space entitlement established by the PWGSC Expansion Control Framework Policy and is approved by Treasury Board for each department and agency to deliver its programs. It reflects the total amount of space one department can occupy free of charges, based on funding received by PWGSC. PWGSC received funding to provide accommodation services to departments and agencies based on accommodation standards (i.e. quantity, quality and accommodation-related services).

60. Fully reimbursing clients are not charged the 13% levies on staff salaries. They pay for the accommodations directly from their operating budget. A fully reimbursing client is periodically billed based on market rates. Revenue generated from the funding models above totalled approximately $860 million in fiscal year 2009/2010.

61. For fully reimbursing clients (government departments, third parties), fee determination follows the guidance outlined in the Treasury Board of Canada Administrative Policy Manual. The general terms and conditions of occupancy of PWGSC-administered accommodation are outlined in this manual.

Costing and pricing assumptions and methodologies were documented and invoices were transparent, accurate and consistent between clients

62. A number of good costing and fee determination practices were observed in the review of the Real Property Special Purpose Allotment. Building Management Plans are completed annually outlining the costs for each Crown-owned and leased building. The Building Management Plan provides a breakdown of cost, building tenants and the amount of accommodation rent being collected from reimbursing tenants, non-reimbursing tenants and commercial tenants. The Building Management Plan is revised on an annual basis.

63. A costing analysis is conducted on an annual basis to determine if the 13% of personnel costs is adequate to cover the costs incurred for the accommodation and fit-up of new programs. A thorough costing exercise is conducted at the branch level and compared against the funding that would be received if a new program required accommodation services. Based on the variables and calculation of the 2010/2011 analysis, the annual cost of providing accommodation and one-time fit-up to programs is 14.4% of the average salary dollars, i.e. personnel costs.

64. A Market Analysis Report and market surveys are conducted to determine market fees. The Real Property Branch Valuation Group is responsible for establishing fees in the National Capital Region. In general, buildings are grouped into different classifications (e.g. A, B, C) based on the building's attributes and location and a range of rents is determined for each building's classification.

65. The methodology and assumptions used for determining market fees and building classification are maintained and documented for the National Capital Region; a methodology for converting Expansion Control Framework policy clients to non-reimbursing clients is in place and procedures and guidance documents exist in the following areas:
    - Preparing Occupancy Instruments;
    - Establishing the space envelope for non-reimbursing clients;
    - Billing process for Expansion Control Framework and fully reimbursing clients; and
    - Completing the annual Business Management Plan.

66. Testing of 11 invoices identified that invoices were transparent, accurate, issued in a timely manner, consistent between clients and reflective of the Occupancy Instrument. There were no issues noted.

A national guideline for determining market rates did not exist

67. Although the National Capital Region established a methodology for determining rental fees (i.e. office space, retail and storage space rent), we found that a national guideline for establishing rental fees did not exist. Rental fees in the National Capital Region are based on an annual assessment of market fees in the National Capital Region and classifying buildings owned by the Crown. The regional office, where market fees are used to determine the amount of rent to be charged for fully reimbursing clients, manages the establishment of rental fees. Without a comprehensive national guideline in place for all regions to follow, there is a lack of standardization and clarity around determining market rates. This increases the risk of inconsistencies in fee determination.

DEPARTMENTAL OVERSIGHT BRANCH - AUDIT SERVICES CANADA

68. Audit Services Canada provides auditing on a fee-for-service basis to departments and agencies. Audit services are also provided upon request to municipal, provincial and foreign governments and international organizations. Audit Services Canada is managed through a Revolving Fund on a full cost-recovery basis. The Consulting and Audit Canada Revolving Fund is made up of two sectors operating under two distinct branches: Audit Services Canada, which operated under the Departmental Oversight Branch, and Government Consulting Services, which operated under the Consulting, Information and Shared Services Branch. Revenue for the Consulting and Audit Canada Revolving Fund was $34 million, with a deficit of $3.3 million, which includes $16.9 million of revenue from Audit Services Canada in fiscal year 2009/2010. In fiscal year 2007/2008 and fiscal year 2008/2009, the Consulting and Audit Services Canada Revolving Fund had a deficit of $7.9 million and $4.6 million respectively.

69. Audit Services Canada's main service lines are:

    - Contract Cost Audits;
    - Transfer Payment Audits - with various federal departments;
    - Internal Audits; and
    - Special Investigations.

70. It was determined through a preliminary risk assessment that costing and fee determination is conducted at the sector level; therefore, the focus included each service line.
71. Costs are reviewed through the annual budgeting exercise. Regional Managers complete and present regional budgets to the Special Advisor to the Chief Executive Officer who consolidates them into one master budget. A group comprised of Audit Service Canada Regional Directors, the Special Advisor and the Chief Executive Officer reviews and challenges the assumptions. Based on these cost budgets, utilization targets and hourly billable fees are established for the following year.

72. The National Marketing Committee, which is made up of Regional Directors, is a sub-committee of the Agency Executive Committee whose main focus is to address all matters regarding the Agency's marketing process. One of the responsibilities of the National Marketing Committee is to discuss rate setting for the upcoming fiscal year. Similar to the costing exercise, Regional Directors prepare their forecasts to determine the utilization targets and billable fees. When the budgeting forecasts are complete, a meeting takes place between the Regional Directors and Chief Executive Officer to finalize fees for the upcoming year, and the Agency Executive Committee approves fees.

Costing and fee determination assumptions were documented and invoices were transparent and accurate.

73. A number of good costing and fee determination practices were observed through a review of Audit Services Canada. Supporting documentation of costing and fee determination assumptions is maintained, and hourly billable fees are consistent across each service line and customer. Tools are in place to monitor engagement budgets and key performance indicators such as staff utilization. Testing of eight invoices identified that invoices were transparent, accurate, and consistent between clients and were reflective of the terms and conditions outlined in the Memorandum of Understanding with client organizations. In addition, a risk analysis is performed before accepting new client engagements.

A framework for charging executive time did not exist

74. A framework for charging executive time, including procedures and key performance indicators for executive utilization, did not exist. Although executives (directors and above) contribute time to engagements, capturing and charging this time is not consistently conducted. On client engagements, executives are typically responsible for reviewing work products and deliverables, responding to client queries and ensuring objectives are met. Without a framework in place for charging executive time, the organization may not be recovering its full costs of services.

CONCLUSIONS

75. The operating units assessed during the audit have different business objectives and requirements and provide various types of services. Because of these distinct business objectives and services, each operating unit employs unique costing and fee determination practices. Regardless of these differences, collectively they generally comply with relevant federal policies and guidelines. In addition, most invoices reviewed were accurate and fees were charged in accordance with agreements with client organizations. However, areas of improvement were observed. These areas include:

- Translation Bureau:
    - Procedures for using the activity-based costing tool, to determine the full cost of each service provided on an ongoing basis, were not documented and the knowledge of this tool was not adequately disseminated. Due to unexpected turnover in staff, the tool could not be used and as a result actual costs were not known and could not be used to update fees for 2009/2010.
    - The Service Level Agreement and/or invoices lack transparency on calculation of hours billed. Therefore, clients may be led to believe that the hours billed are actual hours rather than based on a calculation according to a production rate.

- Information Technology Services Branch:
    - Costing information used as the basis to estimate cost of services for the 2009/2010 and 2010/2011 fiscal years was outdated, i.e. 2007/2008 actual costs were used as a cost base for 2009/2010 and 2010/2011. The rationale for using 2007/2008 data was that the raw costing data in 2008/2009 and 2009/2010 was of poor quality due to expenses being inappropriately coded in the first two years after the transition to the new departmental financial system, SIGMA. This led to delays in producing appropriate unit costs.
    - Periodic assessments to ensure that revenues earned are linked to costs incurred at the sub-service line and client level were not conducted, which could mean cross-subsidization of services and over or undercharging some clients.
    - Invoices issued by ITSB lacked sufficient detail to support transparency. This could lead to client dissatisfaction.

- Real Property Branch: Special Purpose Allotment:
    - Clients were invoiced based on market rates as per Real Property Branch Special Purpose Allotment's mandate. However, there is no centrally administered guidance and oversight on the methodology that should be

used in determining theses market rates. This increases the risk of inconsistencies in fee determination.

- Departmental Oversight Branch: Audit Services Canada:
  - The costing methodology used by this sector did not consider time spent by executives on various client engagements. Therefore, the organization may not be recovering its full costs of services.

MANAGEMENT RESPONSE

Management accepts the findings of the report as being a fair and accurate representation of the costing and determination of fees practices during the audit period. We are pleased to report that we have already made a number of improvements in some of these areas and that, in some other areas, actions were already planned as part of some branches' business plan for the upcoming fiscal year.

RECOMMENDATIONS AND MANAGEMENT ACTION PLAN

Recommendation 1: The Chief Executive Officer, Translation Bureau, in collaboration with the Chief Financial Officer, Finance Branch, should:

1.1 Document the procedures for using the Translation Bureau activity-based costing tool and ensure that knowledge of this tool is appropriately disseminated to staff that performs costing-related functions.

1.2 Review the level of information contained in Service Level Agreements and/or invoices to ensure transparency on the methodology used to calculate text translation services fees.

Management Action Plan 1.1.1: Develop the operational framework and the accountability structure (data interpretation and analysis) for the Translation Bureau's activity-based costing model.

Management Action Plan 1.1.2: Develop a procedural guide for users of and employees carrying out the functions of the activity-based costing model.
Management Action Plan 1.1.3: Develop the training material and train the users of and employees carrying out the functions of the activity-based costing model.

Management Action Plan 1.2.1: In light of the strategic and administrative reviews underway in Government of Canada departments and agencies, the Translation Bureau will, in the next fiscal year, examine the organizational business model, develop a new pricing strategy and review all billing procedures. The Bureau is aiming to:

- streamline its billing methods;
- review how *Billware* is used; and
- create a sustainable, transparent and consistent approach for all its clients.

Management Action Plan 1.2.2: In light of the strategic and administrative reviews underway in Government of Canada departments and agencies, the Translation Bureau will establish clear guidelines that will help Bureau clients understand the billing process. The guidelines will then be added to service agreements.

Recommendation 2: The Chief Information Officer, Information Technology Services Branch, in collaboration with the Chief Financial Officer, Finance Branch, should:

2.1 Establish appropriate controls to ensure costing information is accurate and current.

2.2 Formalize a process to periodically assess and link revenues with costs at the service level.

2.3 Review the level of information contained in invoices to ensure transparency by improving the link between the invoice and the Service Level Agreement.

Management Action Plan 2.1: The ITSB Business Plan Fiscal Year 2011/2012 calls for the implementation of the common costing and pricing framework as per Branch Activity Based Costing including the implementation of regular review of costing models and coding practices to ensure that costs are current and accurately captured.

Management Action Plan 2.2: The ITSB Business Plan Fiscal Year 2011/2012 calls for the development of a Service Level Management Quality Assurance Plan, which includes developing a process, governance, and review cycle to assess how revenues are aligned with pricing categories identified in the Service Level Agreements.

Management Action Plan 2.3: Review of invoice (revenue) information generated to ensure consistency with the Service Level Agreement pricing sheet.

Recommendation 3: The Assistant Deputy Minister, Real Property Branch, in collaboration with the Chief Financial Officer, Finance Branch, should provide national functional guidance related to market rate determination for rents.

> **Management Action Plan 3.1:** Establish a national procedure on the rental rates for occupancy in PWGSC space describing and confirming a methodology that would recognize:
>
> - Consistent approach and calculations (standardized format - spreadsheets, reports, documentations)
> - Practice through market data, analysis or appraisals of fully serviced rental values
> - Rental rates for unique space or when market comparables are not available.

Recommendation 4: The Assistant Deputy Minister, Departmental Oversight Branch should establish a framework for charging executive's time on engagements.

> **Management Action Plan 4.1:** Based on the results of this audit and other recent reviews, the Chief Executive Officer of Audit Services Canada has instructed his senior management team to charge their time spent on client activities. Executives are now charging for activities such as:
>
> - proposal/Memorandum Of Understanding preparation;
> - project management;
> - provision of advice;
> - file reviews and report sign-off; and
> - client meetings.
>
> All executives are resourced to projects in Audit Services Canada's time reporting and project management systems.
>
> Furthermore, for fiscal 2011/2012, management accords between Audit Services Canada Chief Executive Officer and Directors will include a requirement that 15% of an Audit Services Canada executive`s time be billable to clients. This percentage was established based on an analysis of historical trends and tasks and will be updated annually.

Recommendation 5: The Chief Financial Officer, Finance Branch, should provide additional functional leadership to ensure a consistent approach to PWGSC cost recovery practices, including determination of fees (full or marginal cost recovery). Furthermore, the Chief Financial Officer, Finance Branch, should develop minimum standards for invoicing (e.g., frequency, level of disclosure, etc.).

Management Action Plan 5.1: Assess all PWGSC cost recovery initiatives to ensure that they are aligned with the Treasury Board approved PWGSC Cost Recovery Framework.

Management Action Plan 5.2: Coordinate with Branches to address gaps identified in 5.1 above.

Management Action Plan 5.3: Ensure Chief Financial Officer sign-off on departmental revenue plan for purposes of recommendation to the Deputy Minister. This revenue plan is to include for each Branch:

- A revenue plan by program;
- The related implementation strategy; and
- The related basis for cost recovery.

Management Action Plan 5.4: Develop and communicate Billing Standards.

Management Action Plan 5.5: Exercise monitoring to ensure continued alignment to the Treasury Board approved PWGSC Cost Recovery Framework and, compliance to the existing Departmental Procedures on Costing, the new Procedures on Charging and the Billings Standards (to be developed in 5.4 above).

ABOUT THE AUDIT

Authority

The Audit and Evaluation Committee of Public Works and Government Services Canada (PWGSC) approved the audit as part of the 2008-2011 Risk-Based Audit and Evaluation Plan.

Objective

The objective of the audit was to determine whether PWGSC costing and fee determination practices comply with relevant federal policies and guidelines.

Scope and Approach

The audit was conducted from October 2009 to March 2010. It covered invoices that were issued between March 27, 2009 and February 18, 2010. The scope of the audit focused on the costing and fee determination practices of the higher-risk areas, as determined by the preliminary risk assessment, conducted during the audit survey phase, including testing of costing and fee determination key controls. Revenue streams testing included products and services with budgets greater than $10 million annually funded through appropriations (net vote), special purpose allotments and revolving funds. The following operating units and funding mechanisms were examined:

- Translation Bureau – Revolving Fund
- Information Technology Services Branch – Net Vote
- Real Property Branch – Revolving Fund
- Real Property Branch – Special Purpose Allotment
- Departmental Oversight Branch - Audit Services Canada – Revolving Fund

The audit was conducted in accordance with Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

During the examination phase, in-depth interviews were conducted with key departmental personnel located in the National Capital Region. Relevant processes, controls and documentation were reviewed and tested. For the sampling and the testing of PWGSC invoices, clients receiving similar services were selected. Services were selected based on the total amount of revenue generated for the operating unit, with the focus on higher-revenue generators. Clients were selected based on their total billing for the selected service, with the focus on the higher billing totals. A random sample of fiscal year 2009/2010 invoices per selected client was tested for accuracy, transparency and timeliness of billing, to determine whether they reflected the Service Level Agreement or the Memorandum of Understanding, and if they were consistent between clients. The number of invoices tested varied between operating units due to the frequency of invoicing per operating unit. Generally, eight to twelve invoices were reviewed per operating unit.

Based on analysis of the information and evidence collected, the audit team formulated audit observations, which were validated with the appropriate managers.

Criteria

Audit criteria were derived from the Treasury Board Secretary *Guide to Costing* and the Treasury Board *Common Services Policy*.

The criteria and sub-criteria were as follows:

- Costing and pricing documentation and methodology exist and are used consistently.
  - Individuals responsible for costing and fee determination of services maintain supporting documentation of underlying assumptions and methodology used to determine cost and fees.
  - Where the same service is provided, costing and fee determination is conducted in a consistent manner.
  - Costing and fee determination policies, guidelines, directives and procedures are complete and communicated to appropriate management and staff.
- Services to client departments are accurately billed in a timely manner.
  - Invoices are accurate, complete and transparent, and sent to customers in a timely manner.
- A robust control environment exists to ensure full cost of services is recovered as required.

Audit Work Completed

Audit fieldwork was substantially completed by March 31, 2010.

PWGSC announced, on June 20, 2011, the winding down of Audit Services Canada. In addition, on August 4, 2011, the Federal Government announced the creation of a new organization, Shared Services Canada. Information Technology Services Branch's functions related to information technology shared services and its supporting units will form the core of this new agency. These two announcements were subsequent to the end of the audit examination phase and have therefore not been reflected in the report.

Audit Team

The audit was conducted by Ernst & Young, overseen by the Director of Internal Audit and under the overall direction of the Chief Audit and Evaluation Executive.

The audit was reviewed by the quality assessment functions of Ernst & Young and the Office of Audit and Evaluation.