

The Auditor-General  
Audit Report No.32 2009–10  
Performance Audit

# **Management of the Overseas Owned Estate**

**Department of Foreign Affairs and Trade**

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of Australia 2010

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Canberra ACT  
28 April 2010

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Foreign Affairs and Trade in accordance with the authority contained in the *Auditor-General Act 1997*.

Pursuant to *Senate Standing Order 166* relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Management of the Overseas Owned Estate*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office (ANAO). The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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# Abbreviations

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ANAO	Australian National Audit Office
BCP	Business Continuity Plan
DFAT	Department of Foreign Affairs and Trade
DIAC	Department of Immigration and Citizenship
HOM	Head of Mission
HVAC	Heating, ventilation and air conditioning
KPI	Key Performance Indicator
M&E	Mechanical and electrical
MER	Management expense ratio
MOU	Memorandum of Understanding
OH&S	Occupational health and safety
OPMG	Overseas Property Management Guide
OPMS	Overseas Property Management System
OPO	Overseas Property Office
PLV	Post Liaison Visit
PMM	Project Management Manual
PWC	Parliamentary Standing Committee on Public Works
R&M	Repairs and maintenance
ROI	Return on investment
SAO	Senior Administrative Officer



# **Summary and Recommendations**



# Summary

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## Introduction

1. The Department of Foreign Affairs and Trade (DFAT) is responsible for implementing the Australian Government's foreign and trade policy objectives. It does this through its head office in Canberra, its State and Territory offices and its network of 89 overseas diplomatic posts.
2. Australia's overseas posts occupy a mix of owned and leased properties. At 30 June 2009 the Australian Government's overseas owned estate comprised 404 properties in 60 overseas locations with a total value of \$1.7 billion. Properties included 35 chanceries, 51 Head of Mission (HOM) residences and 297 staff residences.
3. The selection and maintenance of suitable properties is important to the success of Australia's overseas missions. Appropriate and well-maintained properties help project a positive image of Australia, provide a safe and secure environment for staff and their families, and contribute to good working relations between the various agencies operating at the post.
4. In the late 1990s, the then Government decided that property management would be undertaken on a 'fully commercial' basis, with the full cost of properties charged to tenants, and with the domestic and overseas property portfolios required to achieve a commercial rate of return on their assets, benchmarked to industry standards.
5. Responsibility for the management of the overseas owned estate was subsequently transferred from the then Department of Finance and Administration (Finance)<sup>1</sup> to DFAT in November 2001, resulting in the creation of the Overseas Property Office (OPO). While having distinct funding arrangements from DFAT, OPO is part of DFAT's corporate management structure and reports to its Senior Executive.<sup>2</sup>
6. OPO acts as landlord of the overseas owned estate, leasing office and residential accommodation to Australian Government tenants—known as

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<sup>1</sup> The Department of Finance and Administration subsequently became the Department of Finance and Deregulation. In this report 'Finance' is used to denote both.

<sup>2</sup> The DFAT Senior Executive comprises the Secretary and four Deputy Secretaries.

‘attached agencies’—who have representatives at overseas posts. Its largest tenant is DFAT which pays 65 per cent of all rent collected.

7. OPO contracts out the delivery of a range of property management, facility management and financial services to a service provider. Among other things, the contracted service provider supplies on-site facility managers to 24 large posts which occupy owned chanceries.

8. OPO operates as a business unit and pays costs from a Special Account. Reserves in the Special Account are used to fund major construction projects, meet outsourced property management costs and operating costs, and pay annual dividends.

## **Audit objectives and scope**

9. The objective of the audit was to assess the effectiveness of OPO’s management of the overseas owned estate. In particular, the audit examined whether:

- sound arrangements are in place to effectively plan and oversight the management of the overseas estate;
- OPO effectively manages owned property on a day-to-day basis;
- the condition of the overseas owned estate is adequately maintained by structured and systematic repair and maintenance arrangements; and
- OPO has appropriate information to facilitate the effective management of the owned estate, and appropriately consults with stakeholders.

10. The audit focused on the overseas owned estate. The management of the overseas leased estate was excluded from this audit, although some management aspects which are common to both, such as strategic planning, were examined in this audit.

## **Overall conclusion**

11. The management of the overseas owned estate is a challenging task, involving some 400 properties in 60 overseas locations, with a total value of about \$1.7 billion. Some buildings are old and have heritage significance, which can make maintenance, and compliance with current standards, difficult and expensive. The requirement to manage the estate on a commercial basis and the increased priority given to security-related upgrades in recent years have added to the complexity of the task.

12. Against the background of these challenges, the administrative processes for planning, managing and maintaining the estate, and reporting on its performance, are not yet sufficiently developed to support the effective management of a property portfolio of the scale and complexity of the overseas owned estate. Some of the work required to strengthen the administrative processes is underway or has been identified, but will require close management oversight to achieve.

13. Since assuming responsibility for the management of the overseas owned estate in 2001, OPO has put in place the basic elements needed for effective estate management. These include a strategic planning process, arrangements to monitor the condition of properties and undertake repairs and maintenance, arrangements to review property compliance with building standards and occupational health and safety requirements, and a range of performance indicators to monitor the estate's performance.

14. However, weaknesses in the implementation of these elements are reducing their effectiveness. It will be important to address these, particularly given the significant additional challenges that OPO faces in managing major upcoming embassy relocations and construction projects in Jakarta and Bangkok, and the potential project in Kabul.

15. The ANAO has made four recommendations aimed at strengthening OPO's management of overseas property. In particular, OPO can better manage agency tenancy arrangements by improving the timeliness of lease renewals, reviewing and articulating its rent-setting policy, and developing a client services charter. Arrangements to maintain the estate could be significantly strengthened by improving the property condition rating system and the quality and consistency of annual inspection reports, reporting against repairs and maintenance benchmarks, and strengthening the approach to compliance auditing. In addition, the estate's performance indicators require review and strengthening to enable stakeholders to be able to form a view on whether its performance is currently satisfactory, and whether it has been improving or declining over time.

16. Overall, there are a number of issues that are impacting on the 'commercial' business model adopted for the overseas owned estate and causing tensions between OPO and its Australian Government agency tenants. These include: unresolved issues relating to the future of supplementary budget funding provided to tenant agencies to reflect the special value of diplomatic properties; responsibility for meeting the cost of shared space in

new chanceries; and rent increases for existing and new chanceries. These issues may have consequential impacts on the capacity of OPO's Special Account to fund relocations and refurbishments, maintain property to an appropriate standard, and pay annual commercially based dividends. The pressures that are emerging suggest that the self-funded commercial model, as currently constituted, would benefit from review.

## Key findings by chapter

### Strategic planning and guidance (Chapter 2)

17. OPO has established a strategic planning approach that incorporates many elements of sound practice. Plans are documented and updated annually, address performance and outcomes, and set out a five-year rolling program of activity. However, the planning process is largely reactive in nature and tends to result in a focus on projects that predominantly address current needs. The risk is that major projects are not built into the plans until they become urgent. At the time of the audit OPO was developing a 20-year forward plan to forecast major capital works which has the potential to substantially strengthen its strategic planning process.

18. Prioritisation of projects in the past has been largely ad hoc and driven by the need for security upgrades. Such an approach means that other important and/or more difficult projects are not given sufficient weight and could be overlooked. OPO advised that it will develop a more formal process to prioritise projects.

19. At the individual property level, detailed operational plans for individual properties have not been established as originally intended, although one pilot plan had been prepared. OPO advised that it has put in place management arrangements to ensure that plans are now developed in a timely manner and remain current.

20. At the strategic level, DFAT's agency-wide risk management register identifies a small number of high-level, property-related risks. OPO has not put in place a process to systematically identify and manage all strategic risks for the overseas estate. At the project level, risk management would benefit from a clearer and more formal identification of risk and remedial action. There was work under way to improve project risk management at the time of the audit.

21. OPO's key reference document—the Overseas Property Management Guide—provides property officers with useful and relevant guidance. OPO also provides ongoing support to posts on property issues. Posts generally reported OPO to be helpful and responsive to their needs. OPO also runs a mandatory pre-posting training course for property officers being posted overseas. While the training course is useful and well-presented, about one-third of staff do not attend.

### **Managing property projects and relations with tenants (Chapter 3)**

22. OPO is responsible for the development and delivery of projects, including the relocation, construction and refurbishment of chanceries. OPO's project management process reflects standard industry practice by following four key phases: concept and feasibility, development, implementation and finalisation. In addition, OPO follows good practice by undertaking lessons learned exercises for completed projects.

23. Major projects (over \$15 million) are required to be reviewed by the Parliamentary Standing Committee on Public Works (PWC). In addition, significant departures from the initial concept or cost should also be brought to the PWC's attention. A review of 13 OPO projects for compliance with these requirements found that while there had been significant increases to the scope and cost of one project, some of these had not been brought to the PWC's attention as required.

24. In addition to managing projects, OPO acts as landlord of the overseas owned estate, leasing office and residential accommodation to tenants (including DFAT), and deriving income of approximately \$150.6 million a year from the rents charged. Lease terms and conditions are set out in agreements with tenants, however, at the time of the audit, about 30 per cent of these agreements had expired, with some having expired over two years ago.

25. These lease agreements are administered by OPO's contracted service provider as part of the property services it provides to OPO. However, there was widespread dissatisfaction among tenants with the timeliness and accuracy of lease renewals and associated invoices.

26. Under the Australian Government Property Ownership Framework, proposals to acquire new property or construct new buildings are assessed by Finance against criteria which, among other things, involve agencies achieving value for money. This consideration, together with the requirement to manage property on a commercial basis, has resulted in OPO changing the basis of

rents for new chanceries, from market to economic rents. The impact of this change, together with the improved facilities inherent in new properties, is significantly increasing some rents, with implications for tenants' budgets.

27. About a quarter of OPO's rental income has come from supplementary budget funding provided to tenant agencies which was introduced in 1999 for a 10-year period to reflect the 'special value' or 'true cost' of properties at that time, over and above the market rent (termed building 'amortisation' by OPO and tenant agencies). However, there is a general lack of clarity about the intended status of the supplementation provided to agencies once the 10-year period ended in 2009. OPO considers that without the funding, the financial viability of the Special Account<sup>3</sup> would be undermined. The amortisation funding has been quarantined by Finance pending the Government's consideration of the issue.

28. There are a number of other unresolved rent-related issues that are causing tensions between OPO and its tenants and preventing the renewal of some leases. These include tenants' access to rent revaluations and disputes over tenant contributions to the cost of additional shared space in chanceries.

29. It is particularly important that OPO, as a monopoly provider of property services to Australian Government agencies overseas, has effective consultation arrangements in place with its tenants. OPO holds useful biannual briefings/forums for agency tenants. However, there are tensions, and in some instances OPO has not consulted with tenants prior to announcing key decisions. A more formal expression of service and client expectations through the establishment of a client service charter would assist in this regard.

## **Maintaining the owned estate (Chapter 4)**

30. OPO monitors the condition of the overseas owned estate through a property condition rating system which enables the condition of individual properties to be monitored over time and compared to other properties, and provides useful information to the Senior Executive on the overall condition of the estate. However, there is significant scope to strengthen the system to make it more robust and reliable, by documenting it, defining the ratings categories

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<sup>3</sup> A Special Account—the Overseas Property Account—was established in 2002 to provide the financial mechanism for the commercial management of the estate. Revenue into the Special Account is derived from rents paid by Australian Government agency tenants. OPO costs are met from the Special Account and reserves are used to fund construction projects and pay annual dividends to the Australian Government.

used, and taking into account the more systematic ratings identified by its contracted service provider in the provider's annual repair and maintenance inspection reports.

31. OPO proactively seeks to identify upcoming repair and maintenance requirements for each property through an annual inspection process which involves a regular and systematic approach to identifying requirements, and facilitates inter-year comparisons of property condition. However, many inspection reports are of poor quality and too brief to provide any real insight into the work that might be required and its timing. This undermines their usefulness to OPO in prioritising work.

32. The ANAO's visits to the Australian High Commission, London and the Australian Embassy, Washington identified that preventative maintenance had been ad hoc and inadequate in the past, resulting in some infrastructure that is old and overdue for replacement. Because of this, facility managers at the posts had a difficult job keeping the facilities running. While some upgrades to those chanceries are now being planned, a more systematic approach would involve identifying the expected life cycles of all mechanical and electrical equipment across the owned estate. OPO advised that it has initiated some work on life-cycle analysis.

33. Complementing the ongoing repair and maintenance program is the need to periodically review each property's compliance with building standards and occupational health and safety requirements. To this end, OPO commenced a program of compliance audits in 2004 to identify remedial work that might be needed.

34. Some compliance audit findings raise significant duty of care implications for DFAT. At the posts visited by the ANAO there was a lack of clarity as to who, if anyone, is required to certify that appropriate remedial action has been taken (or cannot be taken) to address a compliance issue.

35. Compliance audit inspections of Australia House, London in 2005 and 2007 found a range of significant deficiencies, including a lack of fire separation of floors and lift shafts; inadequate provision for escape from the building; a lack of internal fire hydrants; incomplete sprinkler systems; and inadequate smoke detection systems. While most deficiencies were rated as *Urgent*, and subsequently identified as needing remedial action within six months, some key work had not commenced at the time of the ANAO's visit in July 2009, and will not be completed until at least 2012–13, some seven or eight years after the deficiencies were identified.

36. Similarly, compliance audit inspections of the Australian Embassy, Washington, in 2005 and 2007 found a range of deficiencies, including penetrations between walls and floors requiring fire-stopping measures, a lack of internal fire hydrants/hose reels; and inadequacies in the smoke detection and emergency warning systems. Most deficiencies were initially rated as *Urgent*, although many were subsequently downgraded to *Medium* (requiring completion within 12 months). At the time of the ANAO's visit in July 2009 most work had not commenced, although funding for the fire safety compliance work had been provided for in 2009–10.

### **Assessing and reporting on the estate's performance (Chapter 5)**

37. OPO reports on five key performance indicators (KPIs) in the DFAT Annual Report, including three financial indicators. The indicators cover portfolio condition, tenant satisfaction, the annual dividend, the return on investment, and the management expense ratio. Combined, these indicators should provide a good picture of how the estate is performing, for example, whether property condition is being maintained or improved and whether the estate is being efficiently and effectively managed. However, the reporting of each has significant weaknesses. Some indicators do not have targets set in advance and those that do tend to be too vague. In addition, there is no sense as to whether the estate's performance over time, as measured by these indicators, is improving or declining. The current reporting of the three financial indicators, in particular, would not enable stakeholders to form a view on whether the performance of the estate is satisfactory.

### **Emerging issues impacting on the business model (Chapter 6)**

38. A number of inherent factors are limiting the ability of overseas property to be managed on the 'fully commercial' basis that was intended when the model was established in the 1990s. In particular, neither OPO nor agencies can behave in a fully commercial manner—OPO cannot let out vacant space to commercial tenants; agencies must operate from chanceries (OPO is a monopoly provider); and the Special Account cannot retain the proceeds of disposals, but meets the cost of acquisitions.

39. There are a number of indicators that the business model is under pressure. These relate to the future of funding for building amortisation payments; the impact of increased security measures on the funding reserves of the Special Account; and tensions between OPO and its tenants on a number of funding issues. These issues may have consequential impacts on the

capacity of the Special Account to fund relocations and refurbishments, maintain property to an appropriate standard, and pay annual commercially based dividends.

## Summary of agency response

40. The proposed report was provided to DFAT and an extract was provided to Finance for comment. The ANAO made four recommendations aimed at improving OPO's management of the overseas owned estate. All are agreed or agreed with qualification.

41. DFAT's full response to the audit is at Appendix 1. Its summary response is as follows:

DFAT welcomes the findings of the report, including that the Overseas Property Office (OPO) has put in place the basic elements needed for effective estate management. In particular, the report recognises that the management of the overseas estate is a challenging task in often difficult environments, and that maintenance of the estate to ensure compliance with current standards can be difficult and expensive. The report also notes that the necessary increased priority given to security related upgrades in recent years, and the requirement to manage the estate on a commercial basis, have added to the complexity of the task.

DFAT also welcomes the ANAO's acknowledgement of good practice in OPO's management of the estate, including implementation of a strategic planning process, monitoring of maintenance requirements, property compliance and indicators to monitor performance. The report also notes the high level of satisfaction of posts with OPO's response to their needs.

DFAT considers the report's four recommendations to be constructive in identifying opportunities for strengthening existing processes and procedures. The report's more general comments on the issues impacting on the current overseas estate management model, inherited by DFAT in 2001 from the then Department of Finance and Administration, are both relevant and timely. DFAT welcomes the recommended joint review of the funding model as a means to more fully define the Government's objectives for the overseas owned estate. DFAT also considers the suggested development, in consultation with tenant agencies, of a client service charter to be potentially useful in managing tenant agency expectations and obligations.

42. Finance's full response is at Appendix 2. It agreed with the three recommendations of relevance to it, and welcomed the opportunity to work with DFAT to improve the management of the overseas estate.



# Recommendations

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Set out below are the ANAO's recommendations aimed at improving OPO's management of the overseas owned estate.

## Recommendation No.1

### Para 3.92

#### Tenant Arrangements

The ANAO recommends that, in order to better manage agency tenancy arrangements, OPO:

- improve the timeliness of lease agreement renewals;
- articulate its rent-setting policy and, in conjunction with the Department of Finance and Deregulation, review the impact of the policy on tenant rents;
- review, in conjunction with DFAT and other tenants, the management of space in overseas owned properties to optimise its effective allocation, and review the shared space funding arrangement to determine if it is achieving its intended purpose; and
- develop, in consultation with attached agency tenants, a client service charter covering the provision of property services to agencies.

**DFAT response:** *Agreed, with qualification.*

**Finance response:** *Agreed.*

**Recommendation  
No.2**

**Para 4.72**

**Repairs and  
Maintenance**

The ANAO recommends that OPO strengthen the arrangements for maintaining the owned estate by:

- documenting and improving its property condition rating system;
- reporting against benchmarks for repairs and maintenance;
- improving the quality and consistency of annual inspection reports; and
- strengthening its approach to compliance auditing.

**DFAT response:** *Agreed.*

**Recommendation  
No.3**

**Para 5.43**

**Performance  
Indicators**

The ANAO recommends that OPO strengthen the performance indicators for the overseas owned estate by:

- reviewing, in conjunction with the Department of Finance and Deregulation, their usefulness as measures of the estate's performance;
- specifying targets or benchmarks against all performance indicators;
- reporting on achievements against those targets or benchmarks, including reporting changes and performance trends over time; and
- developing an indicator for space utilisation across overseas posts.

**DFAT response:** *Agreed.*

**Finance response:** *Agreed.*

**Recommendation  
No.4****Para 6.15****Business Model**

The ANAO recommends that the Department of Finance and Deregulation review the continuing effectiveness of the commercial model and overseas property framework in meeting the Government's objectives for the overseas owned estate, in conjunction with OPO and relevant stakeholders.

**Finance response:** *Agreed.*

**DFAT response:** *Agreed.*



## **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter provides an overview of the arrangements for the management of the overseas owned estate. It also outlines the audit approach.*

## Background

**1.1** The Department of Foreign Affairs and Trade (DFAT) is responsible for implementing the Australian Government's foreign and trade policy objectives. It does this through its head office in Canberra, its State and Territory offices and its network of 89 overseas diplomatic posts.<sup>4</sup> These posts contribute to the protection and advancement of Australia's national interests, provide consular and passport services to Australians overseas, and undertake public diplomacy activities.

**1.2** Australia's overseas posts occupy a mix of owned and leased properties. At 30 June 2009, the Australian Government's overseas owned estate comprised 404 properties in 60 overseas locations with a total value of \$1.7 billion. Properties included 35 chanceries, 51 Head of Mission (HOM) residences and 297 staff residences.<sup>5</sup> Other owned properties included land, recreation facilities and chancery annexes.

**1.3** The selection and maintenance of suitable properties is important to the success of Australia's overseas missions. Appropriate and well-maintained properties help project a positive image of Australia to the host nation and to visitors, provide a safe and secure environment for staff and their families (which in turn helps maintain staff morale), and contribute to good working relations between the various agencies operating at the post.

## Commercial model—background and overview

**1.4** In the late 1990s, the then Department of Finance and Administration (Finance)<sup>6</sup> was responsible for the management of both the domestic and overseas property portfolios. In the 1999–2000 Budget, the then Government

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<sup>4</sup> Post is a generic name given to Australian missions abroad. Missions include embassies, high commissions, consulates and multilateral missions.

<sup>5</sup> By way of comparison, the overseas leased estate comprised 506 properties across 83 locations, including 55 chanceries, 39 HOM residences and some 380 staff residences.

<sup>6</sup> The Department of Finance and Administration subsequently became the Department of Finance and Deregulation. In this report 'Finance' is used to denote both.

decided that property management would be undertaken on a ‘fully commercial’ basis, with the full cost of properties charged to tenants, and with the property portfolios required to achieve a commercial rate of return on their assets, benchmarked to industry standards.

**1.5** Ownership of property was governed by a set of ‘Property Principles’ which restricted the circumstances in which property could be owned. The principles are currently expressed in the Australian Government Property Ownership Framework (AGPOF), which Finance oversees.<sup>7</sup>

**1.6** Responsibility for the management of the overseas owned estate was transferred from Finance to DFAT in November 2001, resulting in the creation of the Overseas Property Office (OPO). OPO assumed responsibility for all overseas property functions, including acting as landlord to tenant agencies, and management and funding of:

- capital works, including construction projects for new chanceries, chancery refurbishments and relocations;
- overseas property acquisitions and divestments;
- the outsourced property contract; and
- repairs and maintenance for owned property.

**1.7** A Special Account—the Overseas Property Account—was established in 2002 by the then Minister for Finance and Administration to provide the financial mechanism for the commercial management of the estate. Revenue of the Special Account is derived from commercially based rents paid by Australian Government agencies that occupy space in overseas owned properties, with no funds separately appropriated to it.

**1.8** OPO operates as a business unit and pays costs (including staff costs and rent for space occupied in DFAT’s head office—the R G Casey Building, Canberra) from the Special Account. Reserves in the Special Account are used to fund major construction projects overseas, and meet outsourced property management costs and recurrent operating costs. Reserves are also used to pay

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<sup>7</sup> The AGPOF came into effect from 1 July 2005. Essentially it provides that the Government’s core business excludes property ownership unless one or more criteria are met. A proposal to own (or divest) a property is assessed by Finance and must be based on one or more factors, including: symbolic, heritage or environmental significance; the specialised nature of the property; national security considerations; or value for money. (See <<http://www.finance.gov.au/property/property/the-australian-government-property-ownership-framework.html>>.)

annual dividends, which are agreed between the Minister for Finance and Deregulation and the Minister for Foreign Affairs.

**1.9** While having distinct funding arrangements from DFAT, OPO is part of DFAT's corporate management structure and reports to its Senior Executive.<sup>8</sup>

## Managing the owned estate

**1.10** OPO acts as landlord of the overseas owned estate, leasing office and residential accommodation to Australian Government tenants—known as 'attached agencies'—who have representatives at overseas posts. Its largest tenant is DFAT which pays 65 per cent of all rent collected. In addition to DFAT, there are 24 other attached agency tenants such as the Department of Immigration and Citizenship (DIAC), the Department of Defence (Defence) and the Australian Trade Commission (Austrade). Ten other organisations occupy space and pay rent at some posts.<sup>9</sup>

**1.11** OPO contracts out the delivery of a range of property management, facility management and financial services to a service provider. Among other things, the contracted service provider supplies on-site facility managers to 24 large 'hub' posts which occupy owned chanceries. These facility managers also regularly visit and provide assistance to adjacent posts—known as 'satellite' posts—which occupy owned and leased property. In addition, OPO engages a wide range of contractors to provide other services such as project design, property valuation and property purchase and disposal.

**1.12** The management of overseas owned properties can be challenging. Some buildings are old and have heritage significance, which can make maintenance, and compliance with current standards, difficult and expensive. It can also be difficult to find skilled and competent workers to construct new buildings and maintain old ones, even in first-world countries. In addition, the construction, refurbishment and maintenance of some properties take place in high-risk environments, including war zones, which requires the careful management of that risk. In recent years, the increased priority given to

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<sup>8</sup> The DFAT Senior Executive comprises the Secretary and four Deputy Secretaries.

<sup>9</sup> These organisations include the Canadian and New Zealand Governments and three State Governments.

security-related upgrades and relocations following the attack on the Jakarta Embassy in 2004 has added to the complexity of the management task.

## The audit

### Audit objective

**1.13** The objective of the audit was to assess the effectiveness of OPO's management of the overseas owned estate. In particular, the audit examined whether:

- sound arrangements are in place to effectively plan and oversight the management of the overseas estate;
- OPO effectively manages owned property on a day-to-day basis;
- the condition of the overseas owned estate is adequately maintained by structured and systematic repair and maintenance arrangements; and
- OPO has appropriate information to facilitate the effective management of the owned estate, and appropriately consults with stakeholders.

**1.14** The audit focused on the owned estate. In addition to occupying owned chanceries and residences, DFAT also leases a range of chanceries and residences overseas. The audit excluded the management of leased property, although some management aspects—such as those relating to strategic planning—are common to both and were examined in this audit.<sup>10</sup>

### Audit methodology

**1.15** Audit fieldwork was largely undertaken in OPO in Canberra. The ANAO interviewed relevant officers and reviewed files and other documentation. It also consulted in Canberra with the head offices of five key Australian Government agency tenants (DFAT, DIAC, Defence, Austrade and the Australian Agency for International Development) that lease space in owned properties at a range of overseas posts. It also consulted with Finance as the agency with oversight responsibility for the Australian Government Property Ownership Framework.

**1.16** The ANAO also visited two large and prestigious posts—the Australian High Commission, London and the Australian Embassy,

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<sup>10</sup> The ANAO commenced an audit of the management of the overseas leased estate in April 2010.

Washington—where it undertook a general inspection of the chancery buildings and some owned residences, including both Head of Mission residences (an outline of the posts is at Appendix 3). It reviewed files and interviewed relevant post and facility management staff, and a range of attached agency tenants at those posts.

**1.17** To help inform the audit, the ANAO also undertook a survey of all posts, seeking their advice and views on property guidance and training, repairs and maintenance, and the suitability and condition of their property. Responses were received from 90 per cent of the posts surveyed.

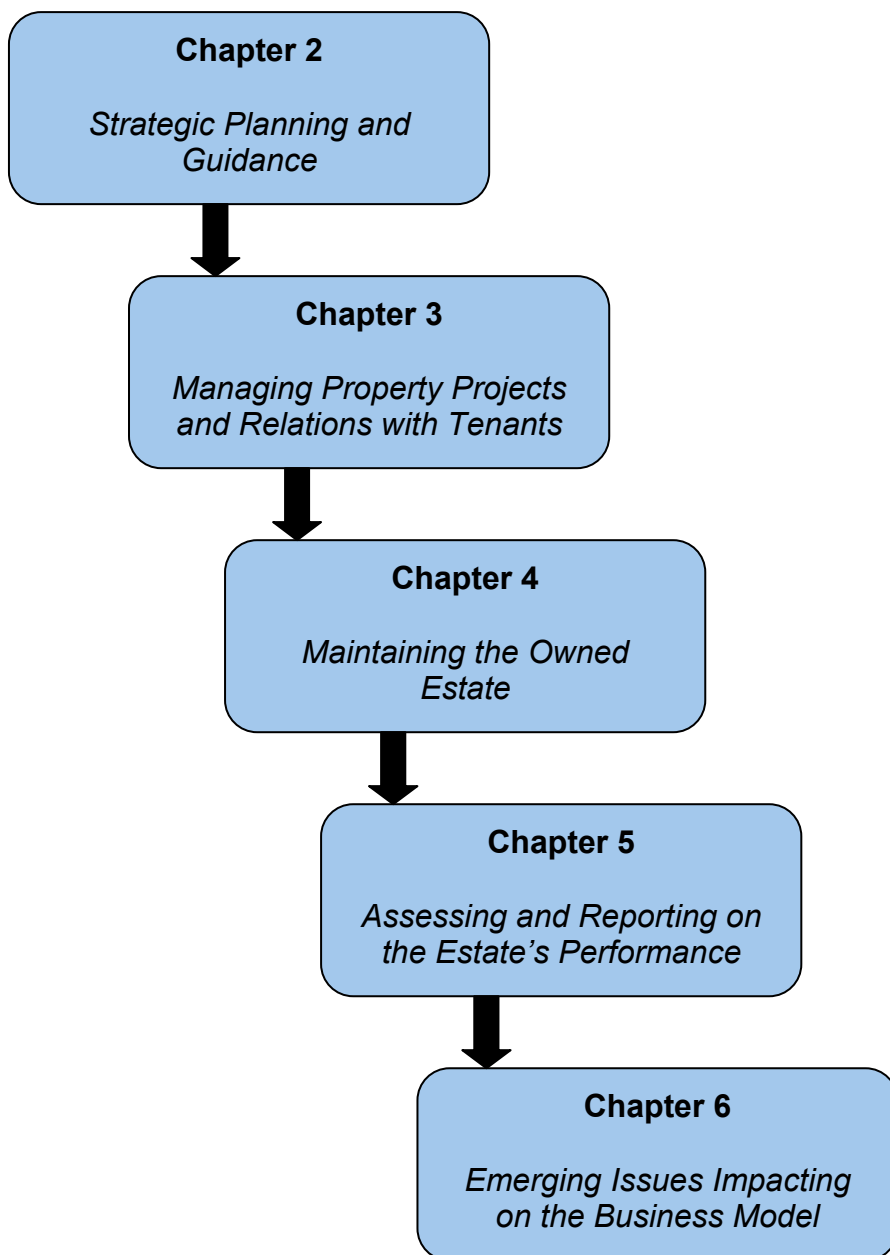
**1.18** The audit was conducted in accordance with ANAO auditing standards. The cost of the audit to report tabling was \$470 000.

## **Report structure**

**1.19** The audit findings are reported in the following five chapters, as illustrated in Figure 1.1.

**Figure 1.1**

**Structure of the remainder of the report**



## 2. Strategic Planning and Guidance

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*This chapter discusses the arrangements for planning and overseeing the management of the overseas owned estate. It also examines the guidance and training arrangements supporting overseas property management.*

### Planning

**2.1** Effective planning is one of the attributes of a well-governed organisation. It reduces the scope for uncertain objectives and facilitates effective monitoring by the Senior Executive.

**2.2** This section examines OPO's strategic and property operational planning, including its approach to identifying and prioritising future projects. It also looks at business continuity planning at posts, and the identification of property-related risks.

#### **OPO's strategic planning approach**

**2.3** OPO established an annual strategic planning approach in 2002 following the transfer of management responsibility for overseas property from Finance. This involves preparing an *Overseas Property Report* and individual *Post Profile Reports* on both the owned and leased estates.

**2.4** These reports incorporate many elements of sound practice. In particular: they are documented and updated annually; they cover the previous year's outcomes and report on key performance indicators; they incorporate a five-year program of activity; and they discuss issues and challenges facing overseas property management. Importantly, the reports make recommendations to the Senior Executive, and a formal record is made of the decisions taken.

**2.5** While these elements provide a sound planning framework, OPO's strategic planning would be strengthened by a more proactive and systematic approach to identifying future projects.

#### ***Developing a more proactive and systematic approach***

**2.6** The Overseas Property Report incorporates a five-year rolling program of activity. This five-year plan is updated each year to include projects identified through various means such as: requests from attached agencies for new fit-outs; requests from the Diplomatic Security and Services Branch for security-strengthening works; requests from the Senior Executive following

Post Liaison Visits (PLVs);<sup>11</sup> OPO's own visits to posts; and requests from post management and facility managers.

**2.7** This approach to planning is largely reactive in nature and tends to result in a focus on projects that predominantly address current needs. This can be seen in the 2009 five-year plan where 44 of the 45 projects are in either the delivery stage or the planning/approval phase in 2009–10. No projects enter the planning phase in the last three years (2011–12 to 2013–14), and only nine are in the delivery phase in the final year (2013–14). A more proactive and systematic approach would show a more even spread of works entering the planning phase over the forward period.

**2.8** The risk with the current approach is that major projects are not built into the plan until they become urgent. For example, the proposed Washington Chancery refurbishment (discussed in Chapter 4) first appeared in the 2008 five-year plan, notwithstanding the fact that the need for major works had been identified in both 2006 and 2007. Ideally, such a large project would have been flagged in the strategic plan some years before the need became urgent and planning commenced.

**2.9** A more active and systematic approach to identifying projects would involve identifying the age and life cycle of all owned buildings and equipment, and identifying their anticipated replacement and/or refurbishment requirements into the future. Given the longevity of buildings, plant and equipment, this would necessitate a focus of 20 to 30 years. Such an approach would not only provide a more comprehensive view of long-term requirements but also inform budget considerations and longer-term funding strategies. The ANAO notes in this regard that a lack of long-term asset replacement planning was identified by a consultant engaged by OPO in 2006.<sup>12</sup>

**2.10** At the time of the audit OPO had commenced work in this area. In particular, it was developing a 20-year forward plan to forecast major capital

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<sup>11</sup> Each year a small team of DFAT staff, usually led by a Deputy Secretary, visits a small number of posts to assess their performance. Property issues are normally examined during the visit.

<sup>12</sup> The consultant's report found that there was a lack of long-term asset replacement planning beyond the five-year planning horizon, and recommended that greater attention be given to long-term asset replacement cycles. The recommendation was agreed to by OPO, with a life-cycle costing model to be developed.

works for the owned estate.<sup>13</sup> It had also initiated some work on life-cycle analysis and advised that further work would be undertaken.

**2.11** The ANAO considers that the 20-year plan, while currently high-level, has the potential to substantially strengthen OPO's strategic planning process by helping, among other things, to identify work for the latter years of the five-year plan. It also has the potential to strengthen OPO's approach to preventative repairs and maintenance by identifying important remedial work in a timely and systematic manner (discussed in Chapter 4). It will be important to integrate the 20-year plan into the current five-year strategic planning process.

**2.12** The ANAO also notes that during the audit OPO was restructured to manage the long-term workload arising from the construction of new chanceries in Jakarta and Bangkok. DFAT expects that the restructure will also provide a stronger focus on forward and strategic planning.

### *Prioritising projects*

**2.13** Prioritising major projects is important to ensure that their relative merits can be compared and objectively assessed, and resources efficiently allocated. The ANAO found, however, that there is no rigorous, documented prioritisation process. The key driver for project selection in recent years has been the need for security-related upgrades and relocations following the attack on the Jakarta Embassy in 2004.

**2.14** The ANAO appreciates the importance of security upgrades and notes that a more structured approach could give appropriate weight to these considerations. The current, largely ad hoc approach means that other important projects are not given sufficient weight and could be overlooked, impacting on the condition and value of the affected properties.

**2.15** Introducing new arrangements to rate the relative merit of projects would add objectivity and rigour to their selection. A new rating system could be designed to give appropriate weight to security and compliance issues, asset replacement considerations and agency space requirements. In response to these findings OPO advised that it will develop a more formal process to prioritise projects as part of a business process review.

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<sup>13</sup> OPO advised that the plan is in the nature of a working document—it has not been formally approved—but it expects that it will form the basis of its long-term strategic planning.

## Property operational planning

**2.16** Better practice suggests that operational plans should be developed to assist in the management of individual properties.<sup>14</sup> Plans should include a range of relevant information such as building condition assessments, maintenance programs and critical dates. These property plans would be an important source of information for strategic planning, and would help identify the need for preventative repairs and maintenance.

**2.17** OPO's contract with its service provider required *Property Operational Plans* to be prepared for each property by May 2009, and combined to form a Consolidated Estate Plan. However, at the time of the audit only one Property Operational Plan had been drafted.

**2.18** OPO advised that it has put in place management arrangements to ensure that plans are now developed in a timely manner and remain current.

## Business continuity planning by posts

**2.19** Business continuity planning involves the development and maintenance of information and procedures to use in the event of business disruptions. Business Continuity Plans (BCPs) generally cover a range of scenarios—ranging from terrorist attacks to burst water pipes—and normally identify procedures to continue essential services where, for example, a building becomes uninhabitable.

**2.20** In 2007, a consultant engaged by DFAT examined a sample of 11 BCPs from overseas posts and found that virtually all failed to adequately address one or more of the key areas required by the relevant standards. To improve the completeness and consistency of BCPs, a new BCP template for posts was developed, and was being rolled out to posts at the time of the audit.

**2.21** In light of the transition to the new templates, the ANAO did not undertake a detailed assessment of existing post BCPs, although it did note similar weaknesses in the BCPs of the two posts visited to those identified by the consultant. The ANAO notes that the new template should help overcome these weaknesses.<sup>15</sup>

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<sup>14</sup> The intention to develop individual asset management plans for all properties was originally identified at the time the property portfolio was commercialised in 1999.

<sup>15</sup> In December 2009 DFAT advised that all post BCPs had been revised to conform to the standard template and that all were reviewed in the second half of 2009 against better practice.

**2.22** The ANAO found that the posts did not observe the requirement to maintain a complete set of all post BCPs in the one location.<sup>16</sup> There would be merit in DFAT reminding posts of this requirement.

## **Planning—risk management aspects**

**2.23** The effective management of risk is important for OPO because it operates in a fluid international environment and oversees property management across an extensive network of posts. In addition to strategic property management issues, it manages projects ranging from relatively minor refurbishments to large construction projects and chancery relocations.

**2.24** Against this background, the ANAO examined OPO's approach to identifying and managing strategic risks, and project-related risks.

### ***Strategic risks***

**2.25** Better practice suggests that strategic planning should be fully informed by formal risk management processes.

**2.26** A small number of high-level, property-related risks are identified in the DFAT-wide risk management register. These include: accommodation needs not matching available space; inadequate property service standards; and inadequate management of the overseas estate.

**2.27** The register and associated framework was under review at the time of the audit. The ANAO considers that this review would provide an opportunity to update the register for newly emerging property-related risks such as agency disputation of lease agreements (discussed in Chapter 3) and OPO's concern that the ongoing financial viability of the Special Account would be undermined by the potential loss of funding for building 'amortisation' payments (discussed in Chapter 3). DFAT agreed that it would be timely to update property risks in the register.

**2.28** OPO does not separately prepare a formal risk management plan covering all of its strategic risks, although it does identify some risks in the Overseas Property Report.

**2.29** The weakness with this approach is that it does not facilitate a regular and systematic review of all strategic risks. There would be merit in OPO

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<sup>16</sup> This requirement is set out in the *Prime Minister's Directive: Guidelines for the Management of the Australian Government Presence Overseas*, 20 February 2007.

revising its approach to ensure that all strategic risks (and their treatments) are systematically identified, recorded, monitored and reviewed. This would facilitate the reporting of strategic risks to the Senior Executive each year as part of the Overseas Property Report and facilitate the inclusion of key risks in the DFAT-wide risk management register.

**2.30** In response, OPO advised that it would review its risk management approach and design a new risk management plan to be incorporated into its strategic plan.

### *Project risks*

**2.31** Better practice is to develop risk management strategies at the time an initiative is being designed and resourcing decisions made. The ANAO examined examples of risk assessments prepared with respect to recently completed projects for London and Harare.

#### *London refurbishment*

**2.32** The risk assessments undertaken for this \$23 million project were generally high-level and generic in nature. Between seven to nine risks were identified and allocated an overall risk rating of either low or medium. However, a likelihood and consequence rating was not identified, nor was it clear whether the overall risk rating reflected the situation before or after the proposed remedial action.

#### *Harare refurbishment/relocation*

**2.33** The business case did not include a risk assessment. This \$4.2 million project encountered a range of significant problems, including a change in building scope, a lack of skilled tradespersons, financial issues associated with the devaluation of the local currency, poor financial reporting and problems in rectifying defects.

**2.34** Overall, the ANAO found that there was significant scope to improve the risk management approach for these two completed projects, and for two other current projects examined. In particular, all four projects would have benefited from: clearer articulation of the risks; the identification of likelihood and consequence ratings (to assist later review of the overall risk rating); clearer identification of remedial action; and clearer allocation of responsibility (and ideally a timetable) for undertaking that action.

**2.35** During the audit OPO was working to improve its risk management approach for projects. In particular, it organised risk management training for

its staff, and completed the development of detailed guidance to assist staff in better managing project risk.

**2.36** The ANAO considers that this guidance has the potential to significantly strengthen OPO's approach to project risk management.

## Guidance and assistance

**2.37** The effective management of the overseas owned estate should be facilitated by providing property staff with clear, up-to-date, relevant and user-friendly guidance, and by providing timely and helpful responses to specific post queries and requests for information.

### Overseas Property Management Guide (OPMG)

**2.38** The OPMG is the key formal guidance material for property management staff. It is electronically available to relevant staff both in Canberra and at DFAT's overseas posts.

**2.39** The OPMG provides useful background information on the operational framework within which overseas property is managed, an overview of the owned and leased estates, and an outline of the roles and responsibilities of the various stakeholders, including OPO, its contracted service provider and posts. The OPMG also provides relevant guidance to posts in their day-to-day management of property.

**2.40** This finding was supported by the ANAO's post survey, which found that all respondents were aware of the OPMG, with 86 per cent reporting it to be a useful resource.

### Occupant Booklet

**2.41** The Occupant Booklet sets out the arrangements for posts to report faults to the service provider and identifies owner and occupant responsibilities for repairs and maintenance (R&M).

**2.42** While a useful reference document, the Booklet was out-of-date at the time of the audit. In addition, non-DFAT tenants at the two posts visited were generally unaware of it and the ANAO's post survey revealed that 43 per cent of A-based<sup>17</sup> (DFAT) property staff surveyed were unaware of the Booklet.

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<sup>17</sup> A-based staff are appointed to the mission from the departmental head office in Canberra.

**2.43** During the audit OPO electronically linked the Occupant Booklet to the OPMG, which will improve its accessibility.

### **OPO assistance to posts**

**2.44** In addition to providing written guidance, OPO also provides ongoing support to posts on property-related issues. The ANAO's post survey found that 86 per cent of staff who had sought advice or assistance from OPO during 2008–09 thought it was useful. The two posts visited by the ANAO generally reported OPO to be helpful and responsive to their needs.

## **Training**

**2.45** Senior Administrative Officers (SAOs) and other DFAT post property staff perform a broad range of day-to-day functions relating to the management of property overseas. Appropriate and timely training should help them perform their roles and responsibilities competently. This is particularly important given that around one-third of DFAT property managers have no prior property management experience.

### **Pre-posting property management course**

**2.46** OPO runs a mandatory property management course for SAOs and other A-based property officers being posted overseas. The ANAO found the course to be well-presented and useful, providing among other things an overview of property officer roles and responsibilities, building compliance and facility management.

**2.47** The ANAO's post survey found that 69 per cent of respondents considered the training to be useful in preparing them for their property roles. However, it also revealed that 34 per cent of respondents had not been able to attend the course.<sup>18</sup> There would be merit in OPO and DFAT reviewing the arrangements to ensure that all relevant staff are being adequately trained or briefed.<sup>19</sup>

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<sup>18</sup> About half of those who had not attended did note that they had been provided with a specific post briefing.

<sup>19</sup> OPO was considering running courses more frequently at the time of the audit.

## **Mobilisation briefings**

**2.48** At the time the new contract with the service provider was put in place (1 July 2008), OPO organised mobilisation briefings for key overseas property management staff to explain the new facility management arrangements. This involved a series of joint OPO/service provider briefings in six overseas and one Australian location over the period June to September 2008.

**2.49** OPO reported that the briefings were well attended, with 86 of the 90 or so posts sending representatives, and that the inclusion of locally engaged property staff was appreciated, as they had not previously received specific property management training. The ANAO visits to Washington and London, and the ANAO's post survey results, supported this conclusion.

### 3. Managing Property Projects and Relations with Tenants

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*This chapter discusses the arrangements for managing and delivering major property projects, and for managing tenant relations, including leasing, rent-setting and agency space requirements.*

#### Project management

**3.1** OPO is responsible for the development and delivery of projects for the owned estate, including the relocation, construction and refurbishment of chanceries and staff residences.

**3.2** The management of these projects across a network of some 90 posts presents significant challenges. Projects can run over several years, cost hundreds of millions of dollars, require the acquisition of suitable land, and involve the design and construction of complex buildings with special security features. The delivery of projects in high-risk environments like Baghdad poses particular challenges. Access to skilled labour and suitable materials can also be limited, and local cultural, political and environmental risks need to be managed.

**3.3** It is common for security works that are the responsibility of DFAT's Diplomatic Security and Services Branch and Post Security Taskforce, and some tenant-related works, to be incorporated into OPO projects to achieve efficiencies in tendering, project management and construction, while reducing tenant disruption.<sup>20</sup>

**3.4** OPO's project management process reflects standard industry practice by following four phases: concept and feasibility, development, implementation and finalisation.

**3.5** In order to assess OPO's approach to managing projects, the ANAO examined OPO's project management guidance; its preparation of project business cases; its compliance with parliamentary committee requirements; and its approach to identifying lessons learned.

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<sup>20</sup> OPO enters into agreements with the relevant agencies for reimbursement of the direct costs incurred in delivering their works.

## Project management guidance

3.6 OPO issued a Project Management Manual (PMM) in March 2009. The PMM provides useful information and guidance to staff on the project management process, including: outlining governance structures; stakeholder consultation arrangements; and procurement processes. It also usefully sets out handover arrangements between the various OPO sections that look after project feasibility, project management and estate management.

3.7 While the PMM focuses on the project development and implementation phases, it does not cover the feasibility phase,<sup>21</sup> notwithstanding that this is complex and involves: multiple steps; consultation with, and sign-off by, attached agencies and DFAT Branches; sign-off by the DFAT Senior Executive; and government approval processes. OPO has recently illustrated the process in a flow chart, but has not documented or provided guidance on the steps and processes involved.

3.8 OPO considers that documenting the feasibility phase is desirable but advised that it had not done so because of resourcing constraints.

3.9 Guidance would assist new staff to understand the various steps and requirements, and would help facilitate consistency within OPO across projects. Given the complexity of this phase there would be merit in OPO giving it priority when resources become available.

## Business cases for acquiring or disposing of property

3.10 OPO develops business cases for projects estimated to be worth over \$50 000. Business cases involving the acquisition of property are subject to assessment against both the Australian Government Property Ownership Framework<sup>22</sup> (AGPOF) and the *Lands Acquisition Act 1989*.<sup>23</sup>

3.11 The ANAO reviewed three recently approved business cases relating to the relocation of two large chanceries (both involving land acquisition), and one relating to the purchase of a HOM residence. Both chancery business cases

<sup>21</sup> The feasibility phase includes identifying and assessing options, liaising with attached agencies to estimate space requirements and developing business cases for the preferred options.

<sup>22</sup> Department of Finance and Deregulation, *The Australian Government Property Ownership Framework*, [Internet], available from <<http://www.finance.gov.au/property/>> [accessed 1 September 2009].

<sup>23</sup> DFAT and OPO have delegations under the *Lands Acquisition Act 1989* for the acquisition of leased property, however Finance retains the delegations for owned property.

identified and analysed only one alternate to that being proposed, that is, the 'do nothing' option.

**3.12** While OPO advised that an assessment of alternate options was undertaken at an earlier stage for one of the chancery projects, this information was not included in the business case. The ANAO considers there would be merit in routinely identifying and analysing alternate options in the business case to provide assurance that the preferred option provides value for money. If only one option is considered viable, then a discussion of the reasons would be desirable.

**3.13** Overall, the process for developing and submitting business cases for consideration and approval by Finance was well understood by both OPO and Finance, and was working well.

### **Public Works Committee approval**

**3.14** Government property projects with an estimated value over \$15 million are required to be reviewed by the Parliamentary Standing Committee on Public Works (PWC). Projects with an estimated value of between \$2 million and \$15 million are considered 'medium works' and must be reported to the PWC.<sup>24</sup> The PWC also requires agencies to advise it of significant departures from the initial concept or cost.<sup>25</sup>

**3.15** The ANAO reviewed 13 OPO projects, seven of which were major capital works and had been submitted to and approved by the PWC. One project was exempted because of its urgency.<sup>26</sup>

**3.16** Of the seven major projects, the ANAO found one—the Australia House, London refurbishment project—that had significantly increased in scope from the initial PWC approval of \$11.9 million. This largely involved the addition of security and tenancy refurbishment works costing \$13.9 million.

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<sup>24</sup> While the requirement for 'medium works' to be notified to the PWC is outlined in the Committee's *Manual of Procedures for Departments and Agencies*, it is not a requirement under the *Public Works Committee Act 1969*. Projects that commenced prior to November 2006 and whose estimated costs were between \$2 million and \$6 million should have been notified to the Committee.

<sup>25</sup> Parliamentary Standing Committee on Public Works, *Manual of Procedures for Departments and Agencies*, Edition 7.3, September 2009, p. 34.

<sup>26</sup> This project involved repairs and an upgrade of chancery security following the September 2004 Jakarta Embassy bombing.

**3.17** While OPO informed the PWC of the additional security works (\$8.9 million), it did not inform it of the additional tenancy refurbishment works (\$5 million). OPO advised that it did not consider these works to be an addition to the project as they originated at a later date and were funded from a separate source.

**3.18** Nevertheless, the ANAO notes that the works were delivered concurrently and considers that it would have been prudent to notify the PWC of the additional work to assist transparency.

*Notification of medium works to the PWC*

**3.19** The requirement to notify ‘medium works’ was established by the PWC in the 1980s to ensure that agencies do not split projects into smaller components to avoid PWC scrutiny. Weaknesses in this area were identified in ANAO Audit Report No.20 2008–09.<sup>27</sup>

**3.20** Of the 13 projects reviewed by the ANAO, four met the ‘medium works’ criteria, costing between \$2 million and \$15 million.<sup>28</sup> These projects had not been notified to the PWC.

**3.21** OPO advised the ANAO that it had not previously notified the PWC of medium works, but had implemented internal controls and procedures to address this matter following the publication of ANAO Audit Report No.20 2008–09. OPO has since advised PWC of the changes it has made to ensure that it is notified of future ‘medium works’ projects.

**3.22** The ANAO notes in this regard that the PMM guidance in this area does not set out the requirements for the notification of medium works. OPO advised that the PMM will be amended to address this.

## **Lessons learned**

**3.23** It is good practice to conduct an evaluation after the completion and occupancy of a project. This involves reviewing the completed project against the design brief and identifying lessons learned to assist future projects.

<sup>27</sup> ANAO Audit Report No.20 2008–09 *Approval of Funding for Public Works*, ANAO, Canberra, reviewed the PWC approval process across a number of agencies. Among other things, it found inconsistencies in agencies’ management of the PWC process, including that some agencies were not notifying the PWC of significant project changes, splitting projects into smaller components to avoid scrutiny and not notifying the PWC of medium works.

<sup>28</sup> The threshold was increased from \$6 to \$15 million in November 2006.

**3.24** OPO has been undertaking lessons learned exercises for completed projects since 2006. The ANAO reviewed four lessons learned reports and found that three of the four exercises brought together the relevant stakeholders, and all usefully identified and recorded lessons learned. Extracts from three of these reports are set out in Table 3.1.

**Table 3.1**

**Extracts from lessons learned reports**

**Bali Chancery**—Future designs are recommended to incorporate a greater local or in the case of Bali, greater Indonesian market content that will result in efficiencies and savings that will be passed on to the Department. Suggest the design consultant investigate thoroughly the availability of local building materials and suppliers in the concept design phase.

**Harare Chancery**—Major difficulties were experienced during the project as a result of the ‘free fall’ of the Zimbabwe currency and associated hyper-inflation conditions. ... It is recommended that all OPO contracts be written in recognised international currencies only.

**London Chancery**—Value Added Tax was successfully obtained back from HM Revenue and Customs. This was a successful process and should be written into future DFAT OPO contracts.

Source: OPO Bali, Harare and London project lessons learned reports.

**3.25** In response to ANAO suggestions, OPO agreed that there may be some benefit in strengthening the lessons learned process and was considering developing a consistent report format and template for inclusion in the PMM, recording results in a database, and including procedures in the PMM for distributing outcomes to stakeholders and when initiating new projects.

## **Lease agreements with tenants**

**3.26** OPO acts as landlord of the overseas owned estate, leasing office and residential accommodation to tenants, and deriving income from the rents charged.

**3.27** Tenants comprise 25 Australian Government agencies and 10 other organisations.<sup>29</sup> In 2008–09, OPO collected \$150.6 million<sup>30</sup> in rent from tenants. As the agency with the largest overseas presence, DFAT paid 65 per cent of the total rent collected, with DIAC being the second largest at eight per cent.

<sup>29</sup> Other organisations include: the Canadian and New Zealand Governments; three State Governments; the Organisation for Economic Co-operation and Development International Energy Agency; and the UN High Commissioner for Refugees.

<sup>30</sup> Includes \$42.5 million of amortisation revenue.

## Renewing lease agreements with tenants

**3.28** The effective management of the overseas estate would be facilitated by up-to-date lease agreements (Memoranda of Understandings—MOUs—for Australian Government agencies, and commercial leases for other tenants) for all tenanted properties, which set out lease terms and conditions. Up-to-date agreements therefore help to protect the interests of both the tenant and the landlord. Sound practice would be to commence renewal negotiations well in advance of the agreement's expiry.

**3.29** At the time of the audit, there were 548 lease agreements across the owned estate. Leases generally cover a five or 10-year period and provide for fixed annual rent increases and periodic market rent reviews.

**3.30** The ANAO found that 167 leases (about 30 per cent) had expired at 30 June 2009 with some having expired as long ago as 30 June 2007. An analysis of 57 leases<sup>31</sup> that had expired on 1 July 2008 showed that it took between seven and 12 months to renew 46 of the leases, while the other 11 leases remained outstanding at the time of this audit. These 57 leases represent \$30.5 million in rent.

**3.31** Some tenants continued to pay rent while the new leases were being negotiated, but others did not. OPO maintains a record of these outstanding debtors and did not consider there was a risk to the revenue of the Special Account from payment default by agencies.

**3.32** OPO's contracted service provider is required to administer all lease agreements as part of the property services it provides to OPO. This involves managing OPO's landlord obligations.<sup>32</sup>

**3.33** The ANAO's discussions with attached agency tenants in Canberra revealed widespread dissatisfaction with the timeliness and accuracy of lease renewals and associated invoices prepared by the service provider in Canberra. For example, two large tenants reported that the majority of proposed leases they receive are incorrect, which delays the renewal process, and another reported instances of invoices being received more than 12 months late.

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<sup>31</sup> The leases related to the Australian Federal Police, DFAT, DIAC and Defence tenancies.

<sup>32</sup> This includes: maintaining records of lease agreements and critical dates; preparing, negotiating and issuing new leases and lease variations (and forwarding the original lease documentation to OPO); and managing rent reviews and rent collection.

**3.34** Discussions with Australia Centre tenants in London<sup>33</sup> also revealed widespread dissatisfaction with the timeliness of lease renewals—with some leases having expired in 2007 and 2008—and both the timeliness and accuracy of invoices provided by the service provider over a number of years.

**3.35** These findings indicate that there are systemic problems with lease renewals that need to be addressed. There is a range of risks involved arising from this situation, including incorrect rents being paid or rents not paid at all, tenants devoting unnecessary resources to checking and correcting inaccuracies, and the Special Account being unnecessarily exposed to outstanding debt.

**3.36** OPO acknowledged the problems with lease renewals. It also noted that tenant agencies can add to delays and, unlike a commercial landlord, OPO does not have any enforcement powers—like interest charges or termination of tenancy—to help resolve issues.

**3.37** The ANAO notes in this regard that agencies contest leases for a variety of reasons including: disputation of shared space costs in new chanceries, lack of access to rent review information, and concerns with increased rents for new chanceries or residences (these three issues are discussed further below).

**3.38** Overall, the ANAO concluded that the number of outstanding leases suggests that this is an area that requires closer management oversight to facilitate the negotiation of lease renewals in a timely manner and enable any disputes to be dealt with promptly.

## Rent—setting, funding and reviewing

**3.39** Finance expects that, in accordance with the AGPOF, properties in the overseas owned estate will be managed on a commercial basis with market-based leases in place and tenants charged market-based rents.<sup>34</sup>

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<sup>33</sup> The Australian High Commission and the Australia Centre London are contiguous buildings, albeit with their own entrances. A number of the Centre tenants are non-Australian Government entities and have standard commercial lease agreements with OPO. Tenants include the Agents-General for South Australia, Victoria (also subleases to CPA Australia) and Western Australia, the Australian Wine Board, Tourism Australia and the Menzies Centre/Kings College.

<sup>34</sup> Finance notes that there may be a gap between income from market rents and that required to make a commercial return on the property.

## Basis for rents

**3.40** Transparency and accountability would be assisted by a consistent rent policy which clearly articulates the approach used in setting rents.

**3.41** The 2003 Overseas Property Report to the DFAT Senior Executive set out the basis of rents as follows: ‘Agencies occupying overseas Commonwealth owned property pay rent to OPO based upon market rates or an economic return where there is no market.’ In brief, rents were to be determined on one of two bases:

- *market rents*—reflecting local property markets (the market rent has been supplemented by the amortisation component as discussed below); or
- *economic rents*—applying in locations where no property market exists, or for new construction and acquisitions where a return on investment is sought in accordance with the AGPOF.<sup>35</sup>

**3.42** While this approach was affirmed in OPO’s 2004, 2005 and 2006 Overseas Property Reports, it has not been discussed in its more recent Reports. In addition, the policy is not clearly articulated in OPO guidance material such as the OPMG.

**3.43** OPO advised in this context that Finance is responsible for the policy framework, and that the rent-setting methodology can only be determined when decisions in respect of budget funding for building amortisation payments (discussed further below) are made.<sup>36</sup> OPO considers that given the long-term nature of its leases, it is not necessary to articulate rent policy to tenants every year. In addition, it noted that the majority of chancery MOUs will expire in 2013, at which time it will have reviewed and adopted a new rent-setting methodology and articulated it to tenants.

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<sup>35</sup> In response to the audit Finance advised that: ‘The AGPOF is primarily used for deciding whether properties should be owned or leased. It does not set return on investment targets; rather, it states that “rate of return would be one factor, among the identified criteria of the Framework, for consideration when assessing property proposals” and that the rate of return should be “commensurate with the exposure to risks associated with the nature of the property.” Once a decision to own property has been made, the AGPOF requires that “a commercial basis for property is to be retained such that: landlords will continue to operate on a commercial basis; and market-based leases continue to be in place.”’

<sup>36</sup> In response to the audit Finance confirmed that the AGPOF includes properties being operated on a commercial basis with market-based leases, and noted that the AGPOF does not specify the basis for charging rents.

### *Impact of the move from market to economic rents*

**3.44** Under the Australian Government Property Ownership Framework, proposals to acquire new property or construct new buildings are assessed by Finance against criteria which, among other things, involve agencies achieving value for money.

**3.45** This consideration, together with the requirement to manage property on a commercial basis, has resulted in OPO changing the basis of rents for new chanceries, from market to economic rents.<sup>37</sup> The ANAO understands that new chanceries provide enhanced facilities for tenants, and that rents are likely to increase to reflect these facilities. However, the change from market to economic rent results in an increase in the rent charged to tenants. Two examples are set out below.

#### **New Phnom Penh chancery**

**3.46** The relocation to the newly constructed chancery in Phnom Penh<sup>38</sup> involved a change from market to economic rent to cover the cost of construction. This resulted in a 67 per cent increase in rent, from \$507 per square metre in 2008–09 to \$850 in 2009–10.

#### **HOM residences in Vienna and Copenhagen**

**3.47** In mid-2008, OPO proposed purchasing new HOM residences in Vienna and Copenhagen, with the rents to be based on economic rates of return. In Vienna, this involved a 106 per cent increase in annual rent for DFAT (from \$106 484 to \$220 000) and between 90 to 140 per cent for Copenhagen, depending upon the property being considered.<sup>39</sup> While the proposed properties would have provided better facilities, correspondence between the tenant (DFAT) and OPO noted that:

While acknowledging the need to find alternative HOM residence locations in both Vienna and Copenhagen, the owned option, as currently modelled, would impose significant costs to DFAT that would not be affordable under the tight budget constraints facing the department. We are concerned that the

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<sup>37</sup> Finance advised that where there is a strong and reliable market, it prefers market-based rents to be used. In many cases when special buildings such as chanceries are involved, there is no reliable market. Finance notes that in these situations an alternative basis for rent is required, and that an economic rent is an alternative that can be considered.

<sup>38</sup> The new chancery was completed in May 2009.

<sup>39</sup> In Vienna, OPO found that market rents for similar, but unsuitable properties varied from as low as \$128 000 to \$338 000 a year.

rents proposed are driven by the IRR [*internal rate of return*] model set down by Finance rather than market rents.<sup>40</sup>

**3.48** The Copenhagen HOM residence proposal did not go ahead on this basis, while Vienna proceeded due to necessity.

**3.49** The ANAO concluded that there is currently a lack of clarity about the circumstances in which market and economic rents should apply. While a market rate could apply in a city such as Copenhagen, an economic rate was used because a new acquisition was involved. In addition, notwithstanding that new acquisitions may provide better facilities that justify higher rents, the use of economic rents also appears to result in increases in rents, with implications for tenants' budgets.<sup>41</sup>

**3.50** There is a risk that a significant increase in rent may create a disincentive for tenants to cooperate with OPO on relocations. This could result in the retention of unsuitable properties for representational purposes, and staff working and living in less secure or lower-standard properties.

**3.51** OPO advised the ANAO that the rent-setting methodology is currently under review, and dependent on the outcome of discussions with Finance on the future of amortisation funding (discussed further below).

## **Supplementary funding for building amortisation payments**

**3.52** Supplementary budget funding was introduced in 1999 for properties that formed part of the owned estate at that time. Tenant agencies received funding to make rental payments to OPO, comprising a component for market based rents and an additional fixed *amortisation* component, which represented

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<sup>40</sup> Finance advised in this regard that while the AGPOF specifies discount rates to be used in evaluating the acquisition and disposal of property, neither the AGPOF nor Finance requires an internal rate of return model.

<sup>41</sup> The ANAO notes that the OPO business cases submitted to Finance seek approval for OPO capital, DFAT security fit-out, tenant fit-out costs and the economic-based rents to be charged. The impact of rent increases on tenants is not discussed. OPO advised in this regard that rent-setting on new projects is negotiated with Finance as part of the New Policy Proposal process and agencies are able to seek rent supplementation funding themselves through the budget processes.

the 'special value' of diplomatic property at that time.<sup>42</sup> An outline of the arrangement is in Table 3.2.

**Table 3.2**

**Outline of building amortisation payments**

- In 1999, amortisation funding was set at \$42.5 million a year for a 10-year period.
- In 2008–09, 17 agencies continued to make payments to OPO for building amortisation, with the largest paid by DFAT (\$29 million), DIAC (\$3.8 million) and Austrade (\$2.5 million).
- The amortisation payments for the 17 agencies represent about half (46 per cent) of the total rent they paid to OPO in 2008–09.
- Amortisation payments were initially calculated on the basis of 421 owned properties.
- At the time of the audit, 198 of these were either no longer occupied by the tenant or had been sold. For example, of the 40 amortised DIAC properties, 29 were no longer used by DIAC.

Source: ANAO analysis.

**3.53** While OPO has long understood that tenants would cease making building amortisation payments from 1 July 2009, in more recent years it has become concerned about the impact of the cessation of these payments on its revenue base. At the same time, some agencies advised that they were expecting the supplementation they received for making the amortisation payments to be rolled into their base funding at the end of the 10-year period, and hence available for more general use.<sup>43</sup>

**3.54** OPO considers that without the building amortisation payments from agencies, or an alternative arrangement, the financial viability of the Special Account would be undermined.<sup>44</sup>

<sup>42</sup> OPO advised that the additional rental payment was calculated as the difference between the Deprival Value of the property and the Market Value amortised over 10 years. The total value was calculated at \$425 million, and is referred to by OPO and tenants as the building amortisation payment. The 'special value' or 'true cost' reflects the additional cost of diplomatic properties, in particular: representational areas, increased security, unique communication systems, additional backup systems and other amenities not available in standard commercial properties.

<sup>43</sup> In response to the audit Finance confirmed that the amortisation payment memorandum of understanding between OPO and tenant agencies expired on 1 July 2009. It further noted that agencies were supplemented for the extra payments, and that this decision was not time limited.

<sup>44</sup> Amortisation funding represents about a quarter of OPO's annual revenue. The impact on the Special Account of the lapsing of amortisation funding could be moderated in the short term by a reduction in the dividend paid to the Government. However, as noted in Chapter 5, the dividend paid in recent years has been declining. The dividend paid for 2008–09 (\$24.7 million) would not be sufficient to fully offset the loss of the amortisation supplementation.

**3.55** The ANAO has discussed this issue with OPO, Finance and attached agencies but there is a general lack of clarity about the intended status of the amortisation funding provided to agencies once the 10-year period ended.<sup>45</sup>

**3.56** Pending resolution of this issue the amortisation funding was to be rolled over for 2009–10 to provide time to develop successor arrangements. However, four key agencies contested this<sup>46</sup> and the amortisation funding was instead quarantined by Finance until such time as the issue can be considered by the Government.

**3.57** At the time of the audit OPO and Finance were continuing discussions on the amortisation funding. Finance advised that it expects that the Government will consider the issue in the 2010–11 Budget context.

## Reviewing rents

**3.58** Leases typically provide for a rent revaluation after five years, in addition to automatic two or three per cent annual rent increases. The rent revaluation is undertaken by an OPO-engaged property consultant and may result in an adjustment up or down in the rent payable.

**3.59** Four (of five) attached agencies consulted by the ANAO had either sought or would like to have access to the rent revaluations for transparency reasons. Two had formally sought access to justify their delegate's approval of increased expenditure under Financial Management and Accountability Regulation 9. One agency had a number of outstanding leases dating from 1 July 2008 that it would not sign, pending access to the rent revaluations.

**3.60** OPO advised the ANAO that it does not provide rent revaluations to tenants as a matter of principle. That is, it operates a commercial model and tenants would not be given such access in the private rental market. OPO noted that tenants could organise their own revaluations to confirm OPO's rent revaluation. The ANAO considers that a more efficient approach would be for OPO to provide information to tenants on the key factors leading to any rent adjustments.

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<sup>45</sup> Other than the original Cabinet documents, DOFD and OPO have been unable to locate papers from 1999 that might clarify the original intention.

<sup>46</sup> A number of agencies were disappointed that OPO had not consulted with them on the amortisation rollover. Consultation is discussed more generally in Chapter 5.

## Managing agency space requirements

**3.61** Given the purpose-built nature of many chanceries, the ability to accommodate tenants when their space requirements change is a difficult but important task for OPO. Similarly, agencies have a responsibility to plan and manage their overseas space requirements.

**3.62** The requirement to charge commercial rents and achieve an economic rate of return sometimes creates tensions between OPO and its tenants in managing space requirements. For example:

- OPO's commercial orientation means that it builds new chanceries to meet identified agency requirements, rather than allowing for surplus space in anticipation of possible future agency demand;<sup>47</sup>
- agencies consider that the long lead times between the identification of their requirements to project completion makes it difficult to predict their final space requirements;<sup>48</sup> and
- agencies are required to respond to changing government policies and priorities, which can impact on their overseas staff numbers, and hence space requirements, at short notice.

**3.63** OPO considers that, consistent with standard commercial practice, it is not viable for it to release agencies from leases unless another tenant can be found. Consequently, this approach can result in agencies paying *dead rent* for space they no longer occupy.

**3.64** A number of agencies were concerned at this lack of flexibility, with some noting that they pay dead rent for reasons beyond their control.<sup>49</sup> The ANAO noted that OPO has been prepared to modify leases where other agencies have been able to take up the space.

**3.65** At other posts, agencies had insufficient space, which resulted in staff working in crowded environments and temporary office accommodation. The ANAO's post survey showed that 44 per cent of posts with owned chanceries

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<sup>47</sup> OPO does require project design briefs for all new chanceries to identify property extension contingencies.

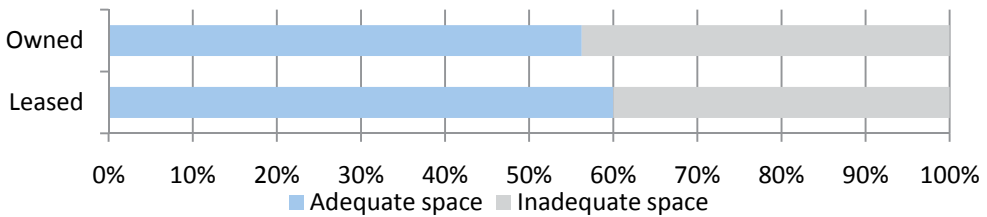
<sup>48</sup> OPO may seek agency space commitments a number of years in advance of project completion. By the time the project is completed, agencies' space requirements may have changed.

<sup>49</sup> One agency noted that it paid *dead rent* at several posts and expected to do so at one of those posts until 2022 when the lease expires.

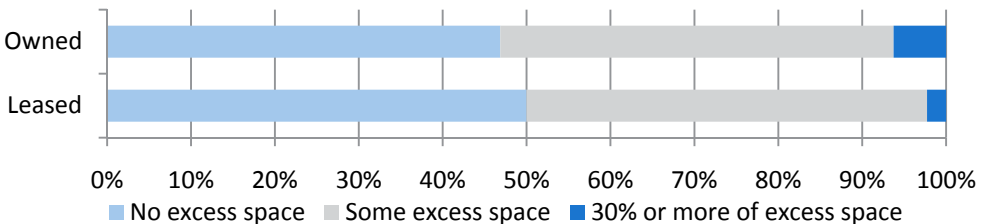
considered that there was inadequate space in the chancery (see Figure 3.1). The survey further indicated that 53 per cent of those posts considered there were varying amounts of excess space.

**Figure 3.1**

### **Adequacy of space in chanceries reported by posts**



### **Amount of excess space in chanceries reported by posts**



Source: ANAO post survey, July 2009.

**3.66** A number of posts considered that the lack of space in their owned chanceries was causing difficulties and impairing the effective operation of the posts. For example, one post reported that the owned chancery is ‘very crowded and post cannot recruit essential new staff because there is nowhere to put them.’

**3.67** While OPO is able to address agencies’ long-term space requirements through chancery refurbishments and relocations, it can be difficult to meet requests for additional space in the short-term where there is limited or no unused space available. Where short-term needs have arisen, OPO and agencies have implemented ad hoc measures, including construction of temporary annexes, conversion of compound apartments into office space and the leasing of commercial office space.

### **Space distribution between agencies**

**3.68** The distribution of space between agencies at chanceries is determined by a variety of factors, including: the overall space available and its historic

use, the specific requirements of agencies, agency funding constraints, and the space available within the controlled and restricted areas of the chancery.<sup>50</sup>

**3.69** About 53 per cent of posts surveyed considered that the distribution of space between agencies was effective, while about 34 per cent disagreed. The ANAO noted examples of posts where some agency staff are crowded, while other staff have excess space.

## **Vacant space**

**3.70** The effective management of the overseas owned estate would be assisted by minimising and monitoring the amount of vacant space in chanceries. However, given that vacant space in chanceries cannot be easily sublet for security reasons,<sup>51</sup> use of this performance indicator for the overseas owned estate would only be meaningful for internal year-on-year comparisons, rather than comparisons with industry benchmarks.<sup>52</sup>

**3.71** OPO monitors vacant space in the estate and, at the time of the audit, advised that 6 800 square metres or 6 per cent of space was vacant across owned chanceries.<sup>53</sup> OPO advised that vacant space can result from the rationalisation of areas following office refurbishments, or when attached agencies reduce their tenancies.

**3.72** The ANAO notes that information on vacant space is not routinely provided to the Senior Executive. There would be merit in OPO formally reporting to the Senior Executive on changes in vacant space and its associated cost, particularly in light of recent lease renewals which have resulted in OPO picking up the cost of vacant space.

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<sup>50</sup> Locally engaged staff are generally unable to work within the restricted area, so the reallocation of spare space in this area may not be possible.

<sup>51</sup> OPO and DFAT sublet vacant space where possible. For example, space is sublet to the International Energy Agency at the Paris Embassy, to the Canadian Government in the Phnom Penh Embassy and to the UN High Commissioner for Refugees in Islamabad.

<sup>52</sup> Vacant space, expressed as a percentage of Net Lettable Area, is a performance indicator used by the property industry to measure the amount of unused space within a property portfolio.

<sup>53</sup> This includes the mothballed floors in the London, Kuala Lumpur, Singapore, Washington and Wellington chanceries.

## Shared space

**3.73** With the devolution of property funding to agencies in 1997, DFAT, as head lessee, received rent supplementation for all existing shared space<sup>54</sup> in existing chanceries. However, since that time a number of chanceries have been relocated or rebuilt, which has resulted in a change in the amount of shared space.

**3.74** OPO and DFAT consider that where chancery relocations result in additional shared space, agencies should bear a proportional share of all rent and fit-out costs relating to that space. DFAT considers that it is unable to subsidise agencies due to its own funding pressures.

**3.75** Some agencies had contested the OPO/DFAT position and had not signed new leases for some new chanceries. At the time of the audit, this issue remained unresolved. This creates a risk that the financial arrangements supporting recent and future relocations will not be settled, with potential financial impacts for both OPO and DFAT.

**3.76** In light of the fact that funding for shared space was devolved to DFAT in 1997, it would be timely for DFAT, in consultation with OPO and relevant stakeholders, to review the funding arrangement to ensure that it is achieving its intended purpose. OPO advised that it was willing to participate in an inter-agency review of the shared space arrangements.

## Consultation with tenants

**3.77** Most public sector organisations have a wide range of stakeholders with an interest in their operations. The interests represented by stakeholders can be disparate, to the point where they can be in conflict with one another. As such, stakeholder management is a key aspect of risk management for public sector organisations.

**3.78** It is particularly important for OPO, as a monopoly provider of property services to Australian Government agencies overseas, to have effective consultative arrangements in place with its tenant stakeholders.

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<sup>54</sup> OPO advised that shared space consists of: corridors and circulation space used for access by multiple tenants; theatres, libraries, entertainment, recreation areas and bars; conference rooms outside a tenancy and considered shared by posts; and man traps/air locks.

## **Consultation at the post—Post Property Committees**

**3.79** The requirement for posts to operate Property Committees derives from a Prime Ministerial directive.<sup>55</sup> Committees advise the HOM on day-to-day property issues at posts. OPO views the committees as a valuable forum to discuss property issues at posts, with DFAT responsible for overseeing the requirement.

**3.80** Neither of the two posts visited by the ANAO—London and Washington—operated a Post Property Committee. While some aspects of property management were discussed in other committees, one post was considering the establishment of a Committee at the time of the ANAO's visit.

**3.81** The risk in not having committees at larger posts is that tenants are not kept up-to-date with property issues such as changes in the provision of services or compliance issues. It would be timely for OPO/DFAT to remind posts of their requirements with regard to the establishment and operation of these committees.

## **Consultation with tenants in Canberra**

**3.82** OPO organises biannual briefings for agencies to provide updates on, and a forum to discuss, overseas property issues.

**3.83** Attached agencies in Canberra generally considered that the forums provided useful updates about current issues and the status of projects. However, a number of agencies commented that the forums did not encourage questions or open discussion, with some feeling outnumbered or intimidated by the number of OPO representatives attending.<sup>56</sup>

**3.84** On the other hand, OPO advised that it does not receive feedback at the forum from attached agencies and noted that senior officers from those agencies often failed to attend. This made it difficult for OPO to engage attached agencies in meaningful discussions on issues.

**3.85** The ANAO notes that agency head offices in Canberra are not covered by OPO's tenant satisfaction survey (discussed in Chapter 5) and that there is no formal process to collect their views on their routine dealings with OPO and

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<sup>55</sup> Prime Minister's Directive: *Guidelines for the Management of the Australian Government Presence Overseas*, DFAT Administrative Circular P0783 of 20 February 2007.

<sup>56</sup> The ANAO notes that about 60 per cent of attendees at the April 2009 forum were from OPO or its contracted service provider.

its service provider. As noted above, there was widespread dissatisfaction with some aspects of service from OPO's service provider. There would be merit in OPO collecting the views of attached agencies in Canberra about their satisfaction with OPO and the service provider.

**3.86** The ANAO considers that the current consultative arrangements, although soundly based, are not fully effective. In response, OPO advised that it has now introduced dedicated one-on-one agency briefings to improve consultation and agency responsiveness.

**3.87** Through the audit, the ANAO identified instances where there was a lack of consultation with attached agency tenants prior to decisions on key issues being made or announced. These key issues included:

- the future of amortisation funding (discussed above); and
- changes to the arrangements for tenant repairs and maintenance work at hub posts (discussed in Chapter 4).

**3.88** Better practice would be to formally consult with affected agencies on such issues and their likely impact, well in advance of new arrangements coming into effect. OPO advised that it has arranged specific issues-based forums, including updates on the capital works program delivery and on the development of new policy proposals which affect agencies.

**3.89** These issues suggest that a more formal expression of service and client expectations would help both OPO and its tenants. This could be achieved through the establishment of a client service charter which formally sets out the standards of service clients can expect from an agency.<sup>57</sup> Importantly, in the case of overseas property services, a charter could formally set out both OPO's and attached agencies' expectations and obligations to each other.<sup>58</sup>

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<sup>57</sup> Australian Public Service Commission, *Client Service Charter Principles*, APSC, Canberra, 2006.

<sup>58</sup> An Overseas Property Client Service Charter could be developed by OPO in consultation with attached agencies and could serve as a performance measurement and accountability tool with a focus on service outcomes. Its scope could include: consultation arrangements, including frequency, and level of attendance at biannual forums; MOUs and invoicing arrangements, including accuracy and timeliness targets; repair and maintenance response times at posts; dispute resolution arrangements; and project development, management and consultation arrangements.

## Conclusion—Managing property projects and relations with tenants

**3.90** The effective management of major projects and tenant relations are difficult but important tasks. They require effective processes to deliver major projects, manage lease arrangements with tenants, facilitate efficient space management and consult with tenants on key issues.

**3.91** OPO has put in place arrangements to manage projects and has indicated its intention to make further improvements in this area. With regard to its relations with tenants, there are a range of pressure points emerging which indicate a need for OPO to better manage these relationships. These would be strengthened by improving the timeliness of lease renewals, reviewing and articulating its rent-setting policy, and developing a client services charter.

### Recommendation No.1

**3.92** The ANAO recommends that, in order to better manage agency tenancy arrangements, OPO:

- improve the timeliness of lease agreement renewals;
- articulate its rent-setting policy and, in conjunction with the Department of Finance and Deregulation, review the impact of the policy on tenant rents;
- review, in conjunction with DFAT and other tenants, the management of space in overseas owned properties to optimise its effective allocation, and review the shared space funding arrangement to determine if it is achieving its intended purpose; and
- develop, in consultation with attached agency tenants, a client service charter covering the provision of property services to agencies.

#### *DFAT response*

**3.93** DFAT agrees with this recommendation, with qualification. The report notes that tenant agencies can add to delays in lease renewals and unlike a commercial landlord OPO does not have any enforcement powers. The introduction of a client service charter could assist to resolve issues of disagreement but adoption of such a charter by all agencies would be necessary.

#### *Finance response*

**3.94** Agreed.

## 4. Maintaining the Owned Estate

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*This chapter discusses the arrangements for monitoring and recording the condition of the overseas owned estate for the purpose of identifying and undertaking repairs and maintenance. It also examines arrangements for reviewing the estate's compliance with building standards.*

### Monitoring and recording property condition

**4.1** Monitoring and recording property condition provides useful management information about changes in condition over time and helps to prioritise repair and maintenance work. OPO does this through its property condition rating system.

#### OPO's property condition rating system

**4.2** OPO rates each property using a six-point scale: *Excellent, Very Good, Good, Fair, Poor* and *Very Poor*. Ratings are recorded in the Overseas Property Management System (OPMS) database, and aggregated to form one of three key performance indicators (KPIs) for the estate (see Chapter 5).

**4.3** Property ratings are generally updated on an ad hoc basis, for example following: an OPO Estate Manager's<sup>59</sup> visit to a post, the receipt of information from posts, or a post refurbishment.

**4.4** The rating system has a number of strengths: in particular, it enables the condition of individual properties to be monitored over time and compared to other properties, and it provides useful information to the Senior Executive on the overall condition of the estate. However, there is considerable scope to strengthen current arrangements, as:

- the rating system is not documented and the rating categories are not defined. Clearly articulating the ratings descriptions would help establish a common understanding among staff and assist review;
- the approach is simplistic—for example, it does not record factors such as representational impression, space and utility; and

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<sup>59</sup> At the time of audit there were four Estate Managers who had responsibility for the 90 overseas posts split between them on a regional basis. Estate Managers generally have a background as an SAO.

- the ratings are not formally linked to the more systematic and sophisticated annual inspection and condition rating model used by the contracted service provider to identify repair and maintenance requirements (discussed at paragraphs 4.13 to 4.18).

**4.5** Appendix 4 sets out potential enhancements that would address these weaknesses.

**4.6** In addition, the ANAO noted instances where ratings reported to the Senior Executive were at odds with available information. For example, while the Dhaka Chancery was rated as *Very Good* in both the 2008 and 2009 Post Profile Reports, internal DFAT correspondence at that time indicated that it was in fact ‘tired and dated’ and ‘in need of a mid-term renovation’. This example, and two other similar examples which are outlined at Appendix 5, suggest that a greater focus on quality assurance is required.<sup>60</sup>

**4.7** Overall, there is significant scope to strengthen OPO’s property condition rating system to make it more robust and reliable, and thereby reduce the risk that the overall condition of the estate will be inaccurately reported. A more systematic, sophisticated and less subjective rating system, formally drawing on the service provider’s annual ratings, and with greater quality assurance, would improve transparency and accountability. This is particularly important given that the ratings are one of the KPIs reported to the Senior Executive (and used in the DFAT Annual Report) for the overseas owned estate.

## Repair and maintenance arrangements

**4.8** Organisations need structured and systematic repair and maintenance (R&M) arrangements to ensure that property continues to support their service delivery and to maintain the condition and value of the property. This section examines a range of issues and processes relating to maintaining the condition of the overseas owned estate, in particular:

- benchmarking expenditure on repairs and maintenance;
- processes for assessing maintenance requirements at posts;
- OPO Estate Managers’ visits to posts;

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<sup>60</sup> OPO advised that some of these examples may be explained by timing differences, or lapses in communication, and may point to a need to review the business process.

- reactive R&M arrangements;
- tenant repairs; and
- preventative R&M.

## **Benchmarking expenditure on repairs and maintenance**

**4.9** There are no firm rules governing the extent of estate maintenance work that should be undertaken each year. However, on assuming responsibility for the owned estate, OPO recognised the importance of adequate maintenance and identified a benchmark of three to four per cent of total estate value.

**4.10** OPO's benchmark included recurrent R&M, and minor and major capital expenditure. OPO reported that it had generally achieved this benchmark in its 2002 to 2006 Overseas Property Reports to the Senior Executive, but from 2007 the benchmark was discontinued.<sup>61</sup> OPO advised that the information provided to the Senior Executive has changed over time in response to the Senior Executive's requirements and requests.

**4.11** While the comparison of expenditure to benchmarks can be complicated by such factors as movements in exchange rates and the capital works program, there would be merit in re-establishing a benchmark and reporting against it to help measure the adequacy of the R&M program over time.

## **Assessing maintenance requirements**

**4.12** Sound practice suggests that a regular program of property inspections is required to inform an organisation's R&M and capital works programs.

**4.13** Reflecting sound practice, OPO proactively identifies R&M requirements by tasking its service provider with an annual program of property inspections. This involves facility managers inspecting each property and rating the condition of its elements (external, bathroom 1, etc) and sub-elements (walls, floors, etc). Each sub-element is weighted and given a rating on a five-point scale (set out at Appendix 6). The annual inspection reports are

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<sup>61</sup> Notwithstanding the discontinuation of benchmark reporting, in 2007 OPO prepared a paper for Finance discussing the long-term annual target required to maintain the estate to an acceptable industry standard. The paper concluded that an expenditure target of four per cent would be appropriate, with an approximate equal spread between maintenance (operating expenditure) and reinvestment (capital expenditure).

reviewed by OPO Estate Managers in conjunction with the service provider to determine the elements that should be included in OPO's R&M program for the following year.

**4.14** This process has a number of strengths: in particular, it involves a regular and systematic approach to identifying emerging R&M issues across posts, and facilitates a comparison of property condition from year to year.

**4.15** The ANAO examined a range of reports and found that some were of a high quality, providing substantial, well thought-out and useful commentary in support of the rating. For example, providing information on the nature and timing of previous repair work ('ceiling repainted in 2008–09') or on the maintenance cycle ('5 yearly testing required. Main switch boards are very old and will need to be replaced in the near future') and good descriptions of proposed work (e.g. 'engage consultant to check on air quality').

**4.16** However, other reports fell short, undermining their usefulness to OPO in prioritising work. In particular:

- condition ratings were often not accompanied by descriptive comments and/or proposed work;
- comments from inspectors were often poor and inconsistent;
- reports often revealed significant unexplained variations in ratings and/or cost estimates from year to year; and
- reports were often incomplete (further examples are at Appendix 7).

**4.17** OPO acknowledged the poor quality of many reports, and advised that it had been working with the service provider during 2008–09 to improve reporting through the introduction of a standard report template.

**4.18** The risk of poor quality reports is that significant R&M requirements may not be identified in a timely manner and OPO Estate Managers waste time following up reports. Therefore, in addition to the introduction of a standard template, there would be merit in OPO improving the consistency and quality of annual inspection reports by:

- providing guidance to facility managers on its minimum requirements, including promulgating better practice report examples;
- requiring facility managers to write descriptions against all sub-element ratings or at least those with a lower rating;

- requiring an explanation of changes to ratings from the previous year; and
- requiring facility managers to outline past work (nature and timing), and the nature and extent of any proposed work.

## **OPO Estate Managers' visits to posts**

**4.19** OPO Estate Managers provide a help desk service for post property managers and liaise with attached agencies in Canberra. They also visit posts to obtain first-hand knowledge of post infrastructure and property issues. Such visits normally involve the preparation of a written report, including recommendations for action.

**4.20** The posts visited by the ANAO thought that these visits were likely to be useful to help familiarise Estate Managers with the properties. However, beyond this they noted that their purpose and outcome was not always clear. There would be merit in OPO routinely advising posts of the specific purpose of its visits and providing them with completed reports.

**4.21** The ANAO examined a sample of recent reports and found that they varied in format, coverage and approach, reflecting, at least in part, individual preferences. Some reports did not set out a purpose, so it was difficult to assess whether the objective of the visits had been achieved.

**4.22** The ANAO considers that a standard template would help ensure that key issues are routinely addressed.<sup>62</sup> There would also be benefit in management overseeing the introduction and use of the template, given that a similar issue was identified by an OPO-engaged consultant in 2006.

**4.23** An Estate Manager's Handbook was developed in 2005, but this was not complete, up-to-date, or in use at the time of the audit. An up-to-date handbook would assist new and existing staff in their day-to-day work and facilitate a more consistent approach to post visits and reporting. OPO advised that the handbook will be updated.

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<sup>62</sup> The template could cover, for example: purpose; previous visit (timing and outcomes); recent PLV visits; meetings held during the current visit; post and attached agency views; compliance follow-ups; further action required; and recommendations.

## **Reactive repairs and maintenance**

**4.24** OPO, through its service provider, operates a Help Desk arrangement whereby posts can report faults 24 hours a day, seven days a week to the service provider's call centre in Melbourne.

**4.25** In practice, however, most faults are reported direct to the facility manager at the post.<sup>63</sup> OPO monitors post satisfaction with fault reporting and this reveals about 90 per cent of posts are generally positive about the arrangements.

**4.26** The ANAO met with a range of staff at the two posts it visited to discuss the R&M arrangements at the post. At one post staff reported that, in the past, there had been a general lack of responsiveness on the part of the service provider. The ANAO noted that this issue had now been addressed through the combined efforts of the service provider and OPO/DFAT.

**4.27** DFAT management at both posts had established good communication arrangements with the facility manager including regular review of reactive maintenance tasks. While the posts generally considered the responsiveness of the facility managers to be good, there were significant concerns about recent OPO restrictions on the work that could be performed by them for tenants. This issue is discussed below.

## **Tenant repairs**

**4.28** Up until July 2008, the service provider delivered a range of services to OPO tenants (DFAT and attached agencies) at hub posts either on a fee-for-service basis or free of charge. Services included managing or undertaking agency fit-outs and minor R&M work, including changing light bulbs in tenant areas.

**4.29** When the new service provider contract was put in place from July 2008, OPO decided that its additional responsibilities with respect to the leased estate would not generally permit the service provider to continue to provide these services to tenants. Instead, tenants would generally need to contract services from local providers.

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<sup>63</sup> The contracted service provider reviewed the Help Desk transactions for the first quarter of 2009 and advised that about 90 per cent of faults were logged by its facility managers and locally engaged staff.

**4.30** Attached agencies in both Canberra and at the posts visited were not consulted prior to the change and considered that the new arrangements had not been well explained.<sup>64</sup> About one-third of hub posts expressed concern about the arrangements in the ANAO's post survey.

**4.31** At the time of the audit, the new arrangements were causing particular difficulties and inconvenience at one of the two posts visited. These included agencies purchasing their own stocks of light bulbs and either arranging for a contractor to install them or doing it themselves.

**4.32** During the audit OPO modified the arrangements (from 1 October 2009) to enable resident facility managers to undertake minor R&M for tenant agencies in certain circumstances and where prior approval is granted by OPO.<sup>65</sup> OPO was considering a number of post requests at the time of the audit.

**4.33** The ANAO concluded that the modifications should provide greater flexibility and overcome at least some of the potential inefficiencies with regard to minor R&M work at some posts.<sup>66</sup> It will be important for OPO to keep the new arrangements under review, in consultation with all tenants, to ensure that the interests of both landlord and tenant are appropriately accommodated.

## **Preventative repairs and maintenance**

**4.34** The ANAO's visits to London and Washington involved a general inspection of the chancery buildings and a number of owned residences, including both HOM residences. The ANAO spoke to post management, facility management staff and a range of attached agency staff about the adequacy of preventative R&M and minor works.

**4.35** There was a general view among staff at both posts that preventative R&M work had been inadequate in the past, resulting in infrastructure that

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<sup>64</sup> Some agencies did not find out about the new arrangements until about a year after their introduction.

<sup>65</sup> In particular, the facility manager must have the capacity to undertake the work and there are no suitable local contractors who can do the work. If approved by OPO, resident facility managers will be able to perform minor repairs and maintenance tasks for tenants in owned chanceries, such as replacing light bulbs (where they are not reasonably accessible or require more than a step ladder to change), fixing squeaky doors and other small tasks.

<sup>66</sup> The new arrangements provide no certainty that services will be provided to tenants. In addition, where outside contractors are able to provide the service, there may be inefficiencies for tenant agencies in having to escort contractors and supervise their work.

was old and overdue for replacement. Because of this it was thought that the facility managers had a difficult job keeping the facilities running pending identified upgrades.

**4.36** In this regard, OPO advised the ANAO that it had accepted and funded all recommended maintenance and minor capital works proposed by the service provider at London and Washington. However, it advised that the agreed works programs had not always been delivered in the timeframe intended. It also advised that it has made some changes to facility management arrangements by, for example, broadly increasing the number of facility managers at overseas posts.

*Australian High Commission, London*

**4.37** A major project was completed in 2008, including restoration of three lightwells within the building and refurbishment of some tenanted areas, at a total cost of \$23 million.



A refurbished lightwell at Australia House, London.

Photo: DFAT

**4.38** During the ANAO's visit, concerns were raised by staff about some aspects of the building, such as the age of the bathrooms and the non-

replacement of aging air conditioning units during the recent refurbishment.<sup>67</sup> OPO advised in this regard, that London has historically suffered from a piecemeal approach to property management due to complex tenant arrangements between Australia House and the Australia Centre, and the frequency of changing tenant requirements.

**4.39** More generally, the ANAO noted that problems with past maintenance at the post had been highlighted by OPO's lessons learned review of the 2008 lightwells project, which found:

The state of the services installations throughout the building were terrible and the standard of workmanship was very poor. ... [that is] plant that had never been serviced, plant not in commission, power supplies incorrectly labelled/altered, urinals discharging directly into the lightwells, etc.

Throughout the duration of the project it became quite clear that if the preventative maintenance had been carried out correctly..., half the major issues for the project team would not have existed.

The Australia House M&E [mechanical and electrical] building services require rationalisation and replacement. The Facilities Management team are merely providing temporary repairs "band aiding" for a system that requires stripout and replacement. Rationalisation of the buildings M&E should be carried out by an external M&E consultant/sub contractor.<sup>68</sup>

**4.40** Action has been taken to address some of the issues, such as those relating to the urinals and the facility management. In particular, changes to the facility management arrangements in 2008 resulted in a stronger preventative maintenance/minor capital program that now provides for bathroom refurbishments, and the progressive replacement of the air conditioning units. While a more substantial refurbishment of the mechanical and electrical building services, including the installation of more efficient air conditioning, was not under active consideration at the time of the audit, OPO advised that it expects to undertake 'full end of life cycle major works' at London in 2020–2022.

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<sup>67</sup> Because of the age and design of the building, about 300 individual air conditioning units are installed in ceiling cavities.

<sup>68</sup> Department of Foreign Affairs and Trade, *The Australian High Commission Refurbishment & Security Projects, London, Lessons Learnt Workshop*—7 March 2008.

## *Australian Embassy, Washington*

**4.41** The chancery underwent a major cosmetic ('front-of-house') refurbishment in 1999–2000. This did not involve an upgrade of the building services ('back-of-house') although various aspects of the heating, ventilation and air conditioning (HVAC) system such as the cooling towers have since been upgraded via a number of ad hoc projects.

**4.42** Notwithstanding these upgrades, in 2007 it became evident that the chancery's HVAC equipment could no longer meet building demand, with building services approaching 40 years in age. In 2008, an OPO report noted that:

[the service provider] had proposed that, over time, major elements in the system would be upgraded. The system is operating very inefficiently and to meet normal office conditions in the summer, must come on very early in the morning. All upgrading work has been undertaken in a "piece meal" fashion with no coordinated plan for the overall upgrade of the HVAC and other building services.<sup>69</sup>

**4.43** The ANAO's visit to the post confirmed these comments. In particular, there was a common view that some plant and equipment—including elements of the HVAC, lifts, bathrooms and electrical equipment—was overdue for replacement.

**4.44** In this regard, the ANAO noted that the air conditioning cannot be zoned for most of the chancery, which results in equipment operating at full capacity when a staff member enters the building after hours. OPO also advised that parts are no longer obtainable for some important equipment, including the 40 year-old main electrical switchboards and the emergency generator automatic transfer switches.

**4.45** In addition, the emergency generators have not been load tested for many years.<sup>70</sup> This creates a risk that they will fail during a power blackout, with the building becoming uninhabitable, which has the potential to undermine the post's business continuity planning. The ANAO notes a similar

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<sup>69</sup> Department of Foreign Affairs and Trade, *Trip Report—New York, Washington and Paris 04/05/08–16/05/08*.

<sup>70</sup> OPO advised that the generators are serviced at three-monthly intervals and are operated without load for 10 minutes every month. It also advised that provision was made in the previous service contract for an additional fee to connect the generators to a load bank, but there is no record of this option having been exercised.

situation at the Australian High Commission, London, with a new generator being installed in the late 1990s, but not fully commissioned and load tested until 2008.



Australian Embassy, Washington. The main electrical switchboards (right of photo) are 40 years old, with parts no longer obtainable. Photo: ANAO

**4.46** At the time of the audit, OPO was developing a proposal for a substantial upgrade of the Washington chancery's M&E services. OPO advised that business continuity planning was one of the primary drivers for the proposed upgrade, and that the air conditioning zoning and the electrical switchboards would be rectified as part of the upgrade. OPO expected to develop a new policy proposal for consideration in the 2011–12 Budget, with project completion in 2013. If approved, this will be at least 10 years after significant problems with the chancery's air conditioning system were identified.

#### *Other posts*

**4.47** While the ANAO did not closely examine the arrangements at other posts, its post survey results and its review of internal DFAT documentation indicates that there are concerns at other posts regarding the adequacy of past maintenance (see Table 4.1).

**Table 4.1**

**Comments re adequacy of maintenance at other posts**

- *always seems a battle to get any pro-active maintenance work done. Always reactive when faults occur*
- *air conditioning units are old, unable to function to full capacity, and are long overdue for replacement*
- *repairs and maintenance program for owned property at post does not appear to adequately address the speed at which buildings, plant, etc, deteriorate*
- *most work appears to be reactive and not proactive*

Source: ANAO's post survey, and DFAT documentation.

**Conclusion—Preventative repairs and maintenance**

**4.48** Preventative maintenance has been inadequate at both the chanceries the ANAO visited. While the ANAO recognises that OPO has identified, or is in the process of identifying, remedial work at those chanceries, there has been a failure to identify this work in a timely and systematic manner. This creates a risk that important remedial work will not be undertaken in time and that significant equipment failure occurs.

**4.49** A more systematic approach would be to identify the expected life cycle of all mechanical and electrical equipment across the owned estate. This would facilitate strategic planning and budgeting and help inform prioritisation of projects across posts. It would also reduce the risk of placing undue reliance on an individual facility manager's skills and knowledge to determine if and when equipment needs replacement or refurbishment.

**4.50** As noted in Chapter 2, OPO was developing a 20-year forward plan to forecast major capital works for the owned estate. It expects that this work will have flow-on effects for repairs and maintenance and minor capital, and advised that it had initiated some work on life-cycle analysis and that further work would be undertaken. This has the potential to strengthen preventative repairs and maintenance by identifying important work in a timely and systematic fashion.

**Residential Undertakings and associated inventories**

**4.51** A-based officers who are allocated residential accommodation at posts are required to complete a *Residential Undertaking* agreeing to certain terms and conditions of their occupancy. These include taking care of and maintaining the premises, grounds, furniture, fittings and equipment (fair wear and tear excepted). An inventory of items and their condition should be attached.

**4.52** The ANAO found that neither of the posts it visited had routinely put agreements in place for all owned residences on changeover of occupant and neither had up-to-date and sufficiently detailed inventories for all owned residences. This creates a risk that it will not be possible to assess fair wear and tear when property is damaged and, where necessary, recover restoration costs from the occupant.

**4.53** There would be merit in DFAT reminding all posts about its requirements in this regard.

## Compliance audits

**4.54** DFAT has a duty of care under Occupational Health and Safety (OH&S) legislation to provide and maintain a safe working environment for its staff, contractors and the general public working, visiting, and living in its owned (and leased) properties.<sup>71</sup>

**4.55** To this end, OPO commenced a program of compliance audits in 2004 to review its owned property portfolio against Australian and overseas building standards and OH&S requirements, to determine the level of compliance and to identify remedial action required.<sup>72</sup> More recently, audits have been contracted out in tranches that have a regional focus. In early 2007, OPO strengthened its compliance audit approach by the appointment of a full-time compliance manager.

**4.56** Compliance audit reports can be extensive and detailed, often identifying a wide range of issues requiring attention, although solutions are often not identified. More complex remedies, such as compliance with fire standards, are generally beyond the competence of facility managers, and require the engagement of experts to investigate further and develop a solution.

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<sup>71</sup> OPO obtained legal advice on this issue a number of times over the period 2002 to 2006. In summary, the advice provided was that DFAT had both statutory and/or common law duties of care towards its employees and third persons in regard to the overseas owned estate and would likely have similar duties of care in relation to the overseas leased estate.

<sup>72</sup> Compliance audits cover both owned and leased chanceries and HOM residences, and owned residential compounds/apartment blocks. Although audits are generally not undertaken of leased residences (this is generally considered a landlord responsibility), OPO does provide guidance to posts on issues to consider when inspecting potential new properties and, as a last resort, will assist with remedial work on OH&S areas such as electrical wiring where safety of officers and their families is clearly at risk and landlords are unwilling to undertake repairs.

**4.57** Remedial action ranges from removing lead paint and raising the height of balustrades, to removing asbestos and ensuring fire separation of areas. Some work cannot be undertaken because of overriding heritage and security considerations.

**4.58** To assess the compliance audit process, the ANAO examined the arrangements for prioritising posts for compliance audits and for reporting on the audit findings.

### **Prioritising posts for compliance audits and reporting on audit findings**

**4.59** Better practice suggests that a risk-based approach should be used to prioritise posts for audits. OPO advised the ANAO that such an approach was used initially to identify the order of regions to be audited, and that this approach was chosen as it is more cost-effective for travel purposes. Notwithstanding this consideration, there is a risk that posts with more significant OH&S risks are not audited in a timely fashion because of their regional location. A better approach would be to rate posts across regions according to likely OH&S risk and to then determine an appropriate travel schedule.

**4.60** Compliance auditors are required to prepare a draft report on their findings. There is no standard template for these reports, although OPO specifies areas that must be covered. In addition, OPO seeks to assure the quality of the process by reviewing the draft report and interacting with the contractor in the development of the final report.

**4.61** Compliance reports are not provided to post management or to attached agencies at the post or their head offices in Canberra because OPO is concerned that the sometimes extensive lists of items for remedial action will be open to misinterpretation. Instead it provides a relatively brief Action Plan identifying action to be taken, urgency and responsibility (OPO or tenant). OPO expects post management to discuss the Action Plan with attached agencies, although this expectation is not brought to the attention of the post when the Action Plan is provided.<sup>73</sup>

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<sup>73</sup> At the two posts visited attached agencies had an understanding of the recent compliance audits but this was generally limited to those issues affecting their tenancies and for which they had responsibility.

**4.62** Two attached agencies in Canberra advised the ANAO that they wanted to be better informed about compliance audit outcomes, with one noting that it had unsuccessfully sought a copy of a report because of its own duty of care. To facilitate a common understanding of audit outcomes and proposed remedial action, there would be merit in OPO:

- providing relevant agencies in Canberra with an executive summary of reports and/or Action Plans; and
- formally instructing post management to brief attached agencies on both owner and tenant issues.

**4.63** During the compliance audit inspection, the compliance auditor must contact OPO immediately when a serious problem is found. Contractors are required to rate other deficiencies on a three-point scale of *High*, *Medium* or *Low*, although these ratings are not formally defined. However, the ANAO found that the Action Plans for London and Washington used a four-point scale of: *Critical*, *Urgent*, *Medium* and *Low*. The ANAO considers that selecting a common rating scale, defining the ratings and providing examples of where they should be used would facilitate a common understanding among contractors and OPO staff. OPO advised in this regard that the priority given by auditors is meant to be a guide for OPO. However, it also advised that it will consider requesting all future ratings be given under the four-point scale for consistency.

### **Examples: Compliance audits of London and Washington**

**4.64** The ANAO examined the compliance audits for the London and Washington posts. An outline of the audits, their findings and the ANAO's comments are set out in Table 4.2.

**Table 4.2**

**Compliance audit findings at London and Washington**

**Australia House/Centre, London**

- A compliance audit of Australia House was conducted in October 2005, with a supplementary audit of the adjoining Australia Centre undertaken in August 2007.<sup>74</sup>
- The audits found a range of significant deficiencies with regard to fire resistance, access and egress, and general environmental and OH&S issues, including: a lack of fire separation of floors and lift shafts; inadequate provision for escape from the building; a lack of internal fire hydrants; incomplete sprinkler systems; and inadequate smoke detection systems.
- These and most of the other deficiencies identified were rated as *Urgent*. The OPO Action Plan (April 2008) also identified all fire compliance issues as *Urgent* and noted that they should be completed within six months.<sup>75</sup> However, while some work had been undertaken, other key elements of the fire rectification work had not commenced at the time of the ANAO's visit in July 2009 and are not expected to be completed until at least 2012–13.
- The ANAO acknowledges that bringing a 90 year-old building up to current standards will pose major problems for the owner, and that OPO must prioritise compliance funding across the network of posts. However, the ANAO notes that major fire rectification work at Australia House/Centre will not be completed until at least seven or eight years after the deficiencies were first identified and noted as *Urgent*.

**Australian Embassy, Washington**

- A compliance audit of the Australian Embassy was also conducted in October 2005. The audit was supplemented by a fire consultant's review in 2007.
- Like the London audit, the Washington audit found a range of deficiencies with regard to fire resistance, access and egress, and general environmental and OH&S issues, including: penetrations between walls and floors requiring fire-stopping measures; a lack of internal fire hydrants/hose reels; and inadequacies in the smoke detection and emergency warning systems.
- While the findings are not as substantial as those for London, the compliance auditor rated most as *Urgent*. The Action Plan in place at the time of the ANAO visit had downgraded many of the items to a *Medium* rating, noting that they should be completed within 12 months. At the time of the ANAO's visit, most rectification work had not commenced although funding for the fire safety compliance work had been provided for in 2009–10.

Source: ANAO analysis.

**4.65** Overall, these two examples suggest that there would be merit in OPO reviewing its approach to prioritising remedial work, and the adequacy of

<sup>74</sup> This audit incorporated a separate fire safety audit of both the Australia Centre and Australia House.

<sup>75</sup> The Action Plan noted that 'The building is a single fire compartment with no fire sealing of floor penetrations, service shafts or lift shafts. The building also has 2 enclosed stairs serving all levels, except the upper level of Victoria house. This essentially provides no fire compartmentalisation for the Chancery hence the extensive scope of works required. The building because it is over 25 metres in effective height, is required to be sprinkled, have a zone smoke control system, stairwell pressurisation and an EWIS [Emergency Warning and Intercommunications System] system.'

funding for that work, to ensure that significant deficiencies are dealt with promptly.

*Management approach to compliance audit findings at the posts*

**4.66** Following the compliance audits of these two posts, letters were sent by OPO to the HOMs drawing their attention to action items that were, respectively, the tenants' and the service provider's responsibility to rectify. The majority of items and in particular, the serious deficiencies, fell to the service provider's facility manager to action on behalf of OPO.<sup>76</sup>

**4.67** Post management generally left owner items to the facility manager to implement. However, there was a lack of clarity as to the role post management should play in supervising or monitoring that work. One post considered it had an inadequate knowledge of requirements and processes.

**4.68** The ANAO noted in this regard that the compliance audit process is not documented in internal guidance or handbooks nor are the roles and responsibilities of post management relating to owned chanceries and residences. A greater involvement and better understanding of the processes would seem appropriate given the post management's duty of care. Therefore there would be merit in developing and promulgating such guidance.

**4.69** More generally at the posts there was a lack of clarity as to who, if anyone, is required to certify that appropriate remedial action has been taken to address a compliance issue, and where a solution has not been identified or is not considered financially viable, who is required to sign off that no action is appropriate. There would be merit in OPO developing formal certification arrangements for remedial work undertaken (and not undertaken) to ensure that there is adequate transparency and accountability for decisions.

## Conclusion—Maintaining the owned estate

**4.70** Adequate and timely maintenance of overseas property is important to support service delivery and preserve the condition and value of the overseas estate. This requires effective systems to monitor property condition, identify maintenance requirements, and ensure that buildings comply with OH&S requirements.

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<sup>76</sup> Remedial action identified in the owned estate, and in relation to the base building, is funded by OPO. Remedial action relating to tenant fit-out is funded by tenants, that is, DFAT and attached agencies.

**4.71** OPO has put in place systems for monitoring and recording property condition and identifying maintenance requirements. It is also undertaking a series of compliance audits to assess property against building standards and OH&S requirements. However, weaknesses in the implementation of these systems are reducing their effectiveness.

## **Recommendation No.2**

**4.72** The ANAO recommends that OPO strengthen the arrangements for maintaining the owned estate by:

- documenting and improving its property condition rating system;
- reporting against benchmarks for repairs and maintenance;
- improving the quality and consistency of annual inspection reports; and
- strengthening its approach to compliance auditing.

### ***DFAT response***

**4.73** DFAT agrees with this recommendation. The ANAO has acknowledged that the current property rating system has a number of strengths and that OPO has adopted sound practice by proactively identifying repair and maintenance requirements. The recommendation identifies opportunities for strengthening current management arrangements.

## 5. Assessing and Reporting on the Estate's Performance

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*This chapter discusses the arrangements for managing information on the overseas estate, and for measuring and reporting on the estate's performance.*

### Managing information on the estate

**5.1** Effective planning, management and decision-making rely on an agency's access to accurate and timely information about its programs and operations.

#### Overseas Property Management System

**5.2** The Overseas Property Management System (OPMS) is the key information management system used by OPO to support estate management and record information on both the owned and leased estates. It records a variety of useful data that supports the day-to-day management of the estate, including information on: post openings; property leases; project status; valuations; tenancies; and rents, including building amortisation payments for relevant properties. It also includes photographs of properties, and electronic copies of MOUs and building/tenancy floor plans.

**5.3** The OPMS also generates a variety of useful reports, including weekly project status reports. Among other things, OPMS data is used for management and annual reporting purposes, including the Overseas Property Report and Post Profile Reports. OPO staff considered the OPMS to be a useful tool.

**5.4** Notwithstanding these strengths, the ANAO identified a number of opportunities to improve the database, including:

- developing and maintaining a comprehensive and up-to-date user manual; and
- improving the accuracy and currency of data to enhance its usefulness as a reliable reporting and monitoring tool. (Further information on these issues is set out at Appendix 8.)

**5.5** OPO advised that resources will be available in 2010 to complete an online help manual for the OPMS. It also advised that out-of-date data reflects delays in receiving information from its contracted service provider, and that it

had reminded its service provider of its obligations to provide documentation in a timely manner.

## Performance information

**5.6** Performance information should provide staff with timely feedback on program performance and assist managers and stakeholders to draw well-informed conclusions on performance.

**5.7** To this end, OPO reported on five key performance indicators (KPIs)<sup>77</sup> in the DFAT Annual Report 2008–09, with four also used in the Overseas Property Report 2009. Table 5.1 sets out these KPIs (financial indicators are shaded blue), together with their targets and outcomes.

**Table 5.1**

### OPO performance indicators 2008–09

Indicator	Identified target	Reported Outcome
<b>Portfolio condition</b>	Maintain building condition to industry standards.	Assessed as 'good'.
<b>Tenant satisfaction</b>	Meet tenant requirements.	Assessed as 'satisfactory'.
<b>Annual dividend</b>	Pay agreed dividend to the Government (agreed with Finance).	Dividend of \$24.731 million paid.
<b>Return on investment</b>	Commensurate with risk factors in the overseas environment and the nature of the property.	8.66 per cent.
<b>Management expense ratio</b>	Achieve a management expense ratio consistent with external industry benchmarks.	Assessed at 1.353 per cent.

Source: OPO Overseas Property Report 2009 and DFAT Annual Report 2008–09.

Note: The Annual Report identifies two further indicators relating to contractor performance that are not examined in this chapter.

**5.8** These five performance indicators are discussed below, along with another potentially useful performance indicator: *space utilisation*.

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<sup>77</sup> The DFAT Annual Report 2008–09 identified one KPI, with five component targets.

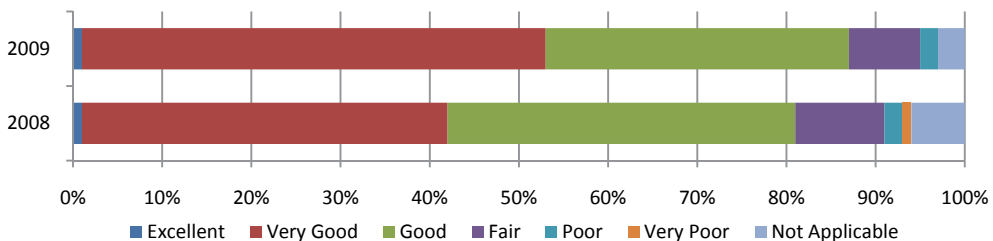
## Portfolio condition

5.9 DFAT's Annual Report 2008–09 noted that the overall condition of the overseas owned estate in 2009 was assessed as 'good', measured against industry-based benchmarks.<sup>78</sup>

5.10 The Post Profile Report identifies owned and leased property by post, and rates the condition of the property.<sup>79</sup> The owned property ratings reported for the last two years are set out in Figure 5.1.

**Figure 5.1**

### Owned property condition ratings, 2008 and 2009



Source: OPO Post Profile Reports, August 2008 and August 2009.

5.11 The ANAO reviewed the ratings reported in the Post Profile Reports since 2004<sup>80</sup> and found that there had been a steady improvement in the reported condition of owned properties since that time (see Figure 5.2), with a substantial improvement identified in 2009. OPO attributed the 2009 change to the number of new and refurbished properties coming on line.

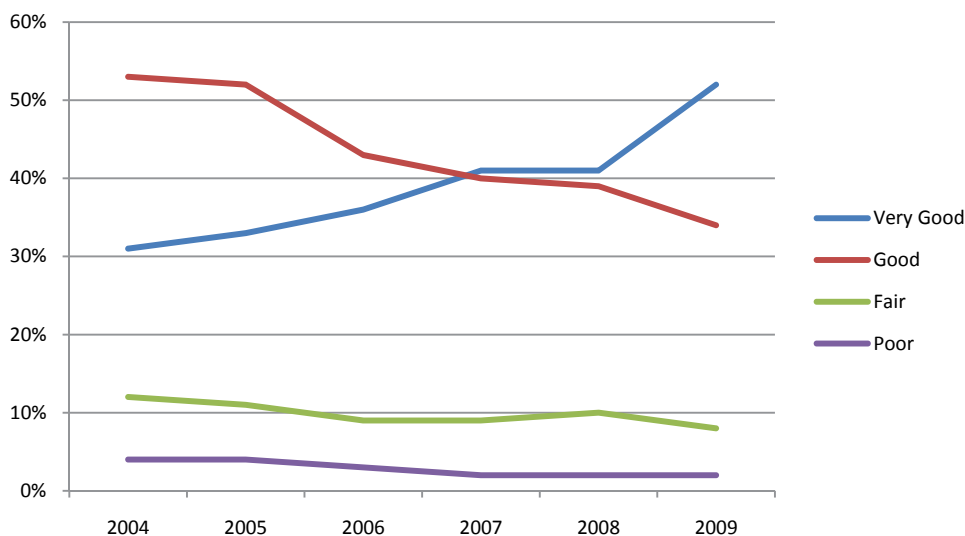
<sup>78</sup> OPO advised that the 'good' rating is subjective, as it is based on the opinions of Estate Managers and comments in property inspection and valuation reports. It also advised that it was considering a more structured business process which would derive the rating from the property inspections undertaken by its service provider (discussed at paragraph 4.13 to 4.18).

<sup>79</sup> The ANAO discusses weaknesses in the operation of the rating system in Chapter 4.

<sup>80</sup> Comparison of data prior to 2004 is difficult, as a different rating system was used. This rating system was more sophisticated than the current system, taking into account a range of factors including: expenditure on repairs and maintenance as a percentage of asset value; age of the properties; functionality and amenity.

**Figure 5.2**

**Key condition ratings for owned properties, 2004 to 2009**



Source: ANAO analysis of OPO Post Profile Reports.

Note: Ratings for *Excellent* and *Very Poor* are not shown as these constitute only about 1 per cent of properties.

**5.12** While the property condition information provided to the Senior Executive would provide comfort that properties are being well-maintained or improved, the indicator is fairly simplistic, as:

- each property is weighted equally. That is, a staff residence in Harare carries the same weight as the Australian High Commission in London;
- ratings therefore do not take account of property value or size; and
- the report does not reveal whether overall property condition is improving or declining from year to year.<sup>81</sup>

**5.13** There would be merit in developing a broader range of performance information on the condition of the estate. Information could be provided on overall property condition, split between chanceries, HOM residences and staff residences. Property could be analysed by age and condition, expenditure on the estate could be expressed as a percentage of capital value, space utilisation

<sup>81</sup> Each of the last four reports noted that there had been a substantial improvement in the condition of the estate since 2001, although this was not quantified.

per employee could be measured, and reactive maintenance expenditure could be expressed as a percentage of total repairs and maintenance (R&M) expenditure.

**5.14** The ANAO notes in this regard that the amount of performance information provided to the Senior Executive in the Overseas Property Reports has declined significantly in recent years. OPO advised that the length and detail of reporting has reduced since 2006 to make the information more accessible and useful and that the Senior Executive is satisfied with the current reporting. Nevertheless, OPO also advised that it will review the format and content of performance information in preparing future reports.

### Tenant satisfaction

**5.15** OPO undertakes an annual survey of all posts to determine their satisfaction with the property services provided by its service provider. The overall survey result is reported in the DFAT Annual Report (see Table 5.1 above), and helps OPO assess and reward its service provider's performance.

**5.16** While the indicator and survey provides reassurance that the services being provided are satisfactory, there is scope to improve the approach used (see Table 5.2).

**Table 5.2**

### Opportunities for improving the measurement and reporting of tenant satisfaction

Issue	Opportunities for improvement
The target ('meet tenant requirements') is vague.	It is recognised better practice to compare performance quantitatively or qualitatively against specific targets, benchmarks or activity levels. A target could be quantified, e.g., x% rate the service as <i>good</i> or better. In addition, the Annual Report provides no indication of whether tenant satisfaction has been improving or declining over time.
Not all agencies at the posts visited by the ANAO have had the opportunity to provide input.	OPO expects post management to collect the views of all tenants at the post. However, of the two posts visited by the ANAO, only one post (London) had involved attached agencies in the most recent survey, and then only Australia House tenants (tenants in the Australia Centre had not been consulted). There would be merit in OPO reminding posts at the time of the 2010 survey of the need to consult with all tenants, and require sign-off that full consultation had occurred.
The survey does not cover OPO assistance to posts.	The survey could include a separate section which seeks post feedback on OPO's performance in assisting posts with property matters. As noted in Chapter 2, this is a good news story for OPO, with 86 per cent of respondents to the ANAO's post survey agreeing that OPO's assistance had been useful.

Source: ANAO analysis.

**5.17** Overall, while the annual survey of tenant satisfaction is an effective method of collecting feedback from posts on the delivery of contracted services, and comparing changes in those services over time, the approach would be strengthened by providing all tenants at posts with the opportunity to provide input, and by establishing a specific target against which performance can be measured.

## **Annual dividend**

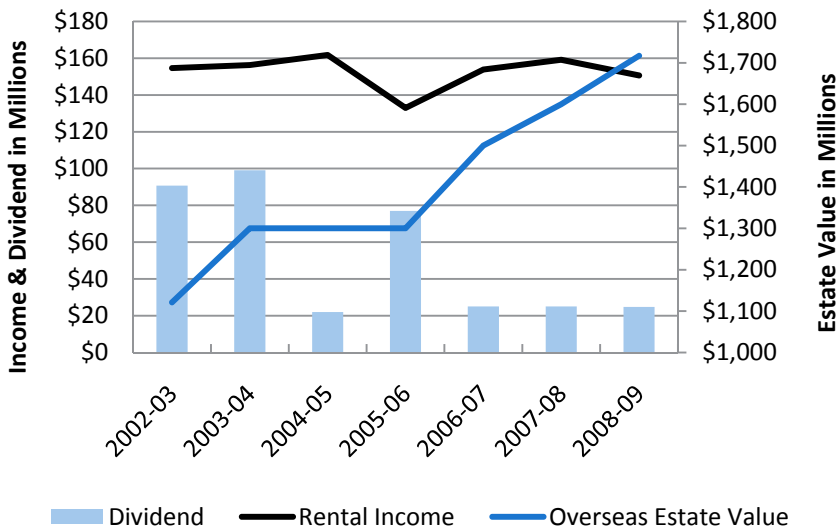
**5.18** In 1999–2000 the Government decided that overseas property would be managed on a ‘fully commercial’ basis, with the full cost of properties charged to tenants, and with the portfolio required to achieve a commercial rate of return on its assets, benchmarked to industry standards. Part of this commercial model subsequently involved OPO paying an annual dividend.

**5.19** A dividend target is not set in advance, with the dividend being negotiated toward the end of the financial year by OPO and Finance, and then formally agreed by the respective ministers.<sup>82</sup> Dividends paid since 2002–03 are shown in Figure 5.3, together with comparators of rental income and estate value.<sup>83</sup>

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<sup>82</sup> The Ministers for Foreign Affairs and Finance and Deregulation.

<sup>83</sup> OPO notes that there is no relationship between the dividend and estate value, other than that retained proceeds from operations are reinvested in the estate. The ANAO has used the comparators to illustrate that the dividend has not decreased due to declining estate values or income.

**Figure 5.3****Dividend payments, compared with rental income and estate value**

Source: DFAT Annual Report data, and ANAO analysis.

**5.20** At the time the commercial model was established dividends were expected to be in the order of \$70 to \$100 million a year. In recent years the dividend has declined to around \$25 million as the Special Account has been used to fund the costs of upgrades and relocations to reflect the current security environment.

**5.21** Finance advised that the level of dividend represents a balance between reinvesting earnings in the overseas estate and paying a return to the budget. OPO confirmed the Government decisions to reinvest recent surpluses in the estate rather than pay a larger dividend.

**5.22** The ANAO notes in this regard that the reduction in the dividend to fund capital works obviates the need for funds to be appropriated and is not transparent in the DFAT Annual Report 2008–09 or Portfolio Budget Statements 2009–10.

**5.23** The performance indicator for the dividend refers to payment of the agreed dividend, and is not really a measure of performance per se. Finance noted that while dividends can be influenced by factors external to the management of property, the trend over time may provide useful information. It noted that the trends identified in Figure 5.3 may also highlight a potential issue with OPO's ability to manage overseas property on a 'fully commercial

basis’ and with the continued appropriateness of the current management framework. It also noted that a review of the ongoing appropriateness of the current framework and the performance indicators may help to support efficiency and value for money in the management of the overseas estate.

**5.24** Finance considered that the appropriate context for any review of performance indicators would be the review of the continuing effectiveness of the commercial model in meeting the Government’s objectives (discussed in Chapter 6).

**Return on investment**

**5.25** OPO reports on the overseas owned estate’s return on investment (ROI) in the DFAT Annual Report. The ROI reported for the last eight years is shown in Table 5.3.

**Table 5.3**

**Reported return on investment**

2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
16.10%	9.74%	21.32%	3.88%	11.73%	12.58%	8.66%

Source: DFAT Annual Reports.

**5.26** Table 5.3 shows that the ROI has varied substantially over the last eight years. However, variations are not usually explained in Annual Reports and the 2008-09 Report does not explain whether the 8.66 per cent return is a good result or not. In addition, the target identified for the ROI is vague: ‘Achieve a rate of return on investment commensurate with risk factors in the overseas environment and the nature of the property’. This does not provide a clear target or benchmark against which the outcome can be compared.

**5.27** Overall, the ANAO considers that the vagueness of the target, and the lack of comparators and interpretation of the outcome, limits the ROI’s usefulness as a performance indicator for the overseas owned estate.

**5.28** OPO advised that it has previously raised its usefulness with Finance but that the matter had not been resolved. It advised that its current discussions with Finance may allow consideration of appropriate performance measures to be used in future.

**Management expense ratio**

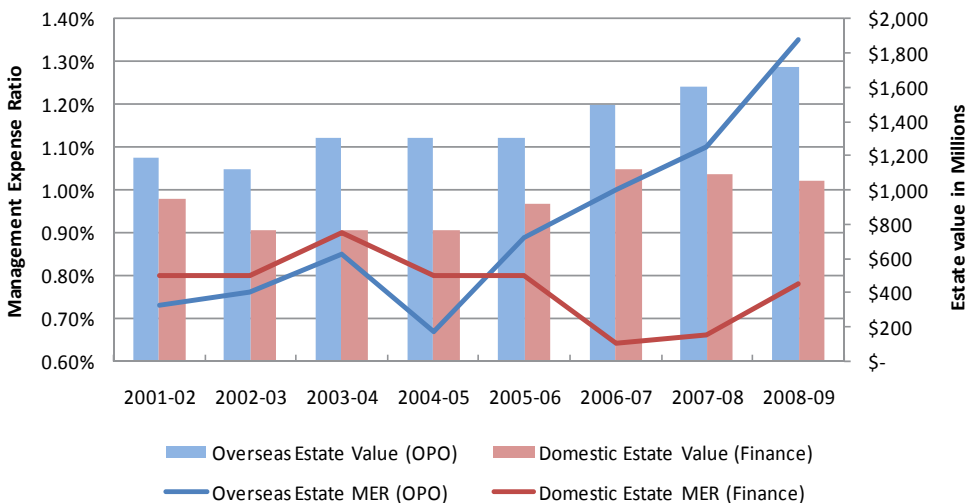
**5.29** A management expense ratio (MER) is commonly used by an organisation to measure its operating costs. It expresses an organisation’s

operating costs (such as employee, contract and office accommodation costs) as a percentage of the total value of its assets. It is sound practice for OPO to set an annual MER target comparable to appropriate benchmarks.

**5.30** OPO reports on the estate's MER in DFAT's Annual Report. The MER for the estate since 2001–02 is set out in Figure 5.4, together with the value of the estate. Also included, as a comparator, is the equivalent information for the Australian Government's domestic (non-Defence) property portfolio, which is managed by Finance.

**Figure 5.4**

**OPO MER compared with Finance's domestic estate**



Note: OPO excludes project management operating costs from the MER.

Source: ANAO analysis of data reported in the DFAT and Finance Annual Reports.

**5.31** Figure 5.4 suggests that there has been a significant increase in OPO's operating expenses over the last five years, compared to the estate's value. Over this period, the overseas estate's MER increased from 0.67 to 1.35 per cent.<sup>84</sup> OPO advised that a range of activities can impact on its MER in any year, for example higher expenditure during service provider contract negotiations. It also noted that travel costs will be greater for the overseas

<sup>84</sup> As the MER is represented as a percentage of the estate's total value, it would be expected to decline if operating expenses remain stable while the estate value increases. An increase in the estate value with a stable MER would indicate that operating expenses are increasing.

estate and that the overseas estate has a different range of properties to the domestic estate.

**5.32** Notwithstanding these factors, the increase in the MER since 2004–05, compared with benchmarks,<sup>85</sup> indicates that this is an area that would benefit from further analysis.

**5.33** While OPO identified a measurable target for the overseas estate's MER for 2008–09—'Achieve a management expense ratio consistent with external industry benchmarks'—it did not disclose these benchmarks, or whether they were actually achieved. Instead, reporting was limited to the following statement: 'For 2008–09 the ratio was assessed at 1.353 per cent'. It is therefore not possible for the reader to determine whether the benchmarks were achieved.

**5.34** In addition, DFAT's Annual Report 2008–09 does not provide the reader with a sense of whether the MER is increasing or decreasing over time.

**5.35** Therefore, the ANAO considers that there is scope to improve transparency by reporting the actual MER benchmark each year as a comparator, and commenting on trends in the MER from year to year. Finance agreed that there is scope to improve the transparency of OPO's MER reporting.

## **Potential indicator—space utilisation**

**5.36** Office space utilisation per employee can be used to measure the efficiency and effectiveness of property management. In October 2009 the Australian Government announced new *Commonwealth Property Management Guidelines*<sup>86</sup> to improve, among other things, property management planning. The Media Release introducing the new Guidelines noted that:

Office accommodation currently varies considerably across agencies, with between 15 to 25 square metres of space allocated per person. For the first

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<sup>85</sup> The ANAO examined two industry funds used as benchmarks by OPO, the ISPT Core Fund and the Commonwealth Property Office Fund, which identified MERs of 0.23 (2007–08) and 0.80 (2008–09) per cent, respectively.

<sup>86</sup> Department of Finance and Deregulation, *Commonwealth Property Management Guidelines*, October 2009.

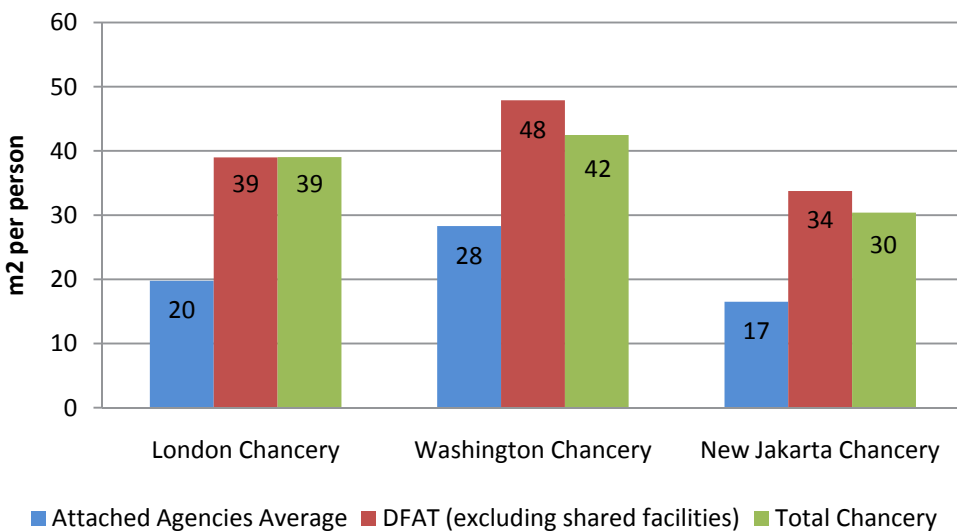
time, the Australian Government will now apply an occupational density target across agencies set at 16 square metres per occupied workpoint.<sup>87</sup>

**5.37** The Guidelines are not directed at owned or leased property overseas. Nevertheless, monitoring space usage at overseas posts, over time, could be a useful performance indicator. Indeed, OPO did some work in this area in 2004–05 for the overseas estate. This work showed that the average for both leased and owned estates was about 40 square metres per person. However, OPO does not currently assess or report space utilisation to the DFAT Senior Executive or other stakeholders.

**5.38** The ANAO undertook an examination of space utilisation at both the posts it visited and for the planned Jakarta chancery (see Figure 5.5).

**Figure 5.5**

**Space usage at the London, Washington and planned Jakarta chanceries**



Source: ANAO analysis.

Note: Total chancery space includes space used by DFAT, attached agencies, and shared facilities. Vacant space at both the London and Washington chanceries has been excluded.

**5.39** Figure 5.5 shows that overall space utilisation at London and Washington is broadly consistent, at about 40 square metres per person, while at the planned Jakarta chancery it is expected to be about 30 square metres.

<sup>87</sup> The Hon Lindsay Tanner MP, Minister for Finance and Deregulation, Media Release 68/2009 of 28 October 2009 entitled *New Property Guidelines*.

Space utilisation by attached agencies varies considerably between agencies at London and Washington, from 46 to 13 square metres per person.

**5.40** Space utilisation at overseas posts is likely to be higher than domestically for a number of reasons.<sup>88</sup> OPO advised that while it responds to agencies' identified space requirements, it does seek opportunities for efficiencies and encourages shared and multi-functional facilities. OPO also advised that it will be pursuing, in conjunction with its largest tenant DFAT, a higher level of open-plan work areas to improve space densities.

**5.41** The ANAO considers there is merit in OPO actively monitoring and analysing space utilisation across overseas posts and reporting this information periodically to the Senior Executive. Among other things, this information could be used to inform its strategic planning by, for example, identifying and comparing posts where accommodation is tight.

## **Conclusion—Assessing and reporting on the estate's performance**

**5.42** OPO reports against a range of performance indicators on the owned estate. However, the reporting of each has significant weaknesses. Some indicators do not have targets set in advance and those that do tend to be too vague. In addition, there is no sense as to whether the estate's performance over time is improving or declining. The current reporting of the three financial indicators, in particular, would not enable stakeholders to form a view on whether the performance of the estate is satisfactory.

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<sup>88</sup> These include the need to meet representational requirements, the need for separate reception arrangements for some agencies, the need to separate some A-based and locally engaged staff, and to meet other security requirements.

## Recommendation No.3

**5.43** The ANAO recommends that OPO strengthen the performance indicators for the overseas owned estate by:

- reviewing, in conjunction with the Department of Finance and Deregulation, their usefulness as measures of the estate's performance;
- specifying targets or benchmarks against all performance indicators;
- reporting on achievements against those targets or benchmarks, including reporting changes and performance trends over time; and
- developing an indicator for space utilisation across overseas posts.

### *DFAT response*

**5.44** DFAT agrees with this recommendation. The existing performance indicators for management of the estate are those established by Finance. DFAT agrees that revised performance measures, including additional or alternative benchmarks aligned to a corporate real estate portfolio may assist managers and stakeholders to draw informed conclusions on performance.

### *Finance response*

**5.45** Agreed.

## 6. Emerging Issues Impacting on the Business Model

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*This chapter brings together the key issues emerging from the audit that are impacting on the business model underpinning the management of overseas property.*

### Background—limitations on the commercial model

**6.1** As noted in Chapter 1, in the late 1990s the then Government decided that property management would be undertaken on a ‘fully commercial’ basis, with the full cost of properties charged to tenants, and with the property portfolios required to achieve a commercial rate of return on their assets, benchmarked to industry standards. However, there are a number of inherent factors limiting this in practice, including:

- an inability to let out vacant space in chanceries to commercial tenants for security reasons;
- a requirement for attached agencies to operate from chanceries, rather than seek commercial space—in effect, OPO is a monopoly provider; and
- an inability of the Special Account to retain the proceeds of disposals, while being required to meet the cost of acquisitions.

**6.2** In addition, there is limited capacity within the private sector to provide the property services required by OPO across the network of overseas posts.

### Issues emerging from the ANAO’s audit

**6.3** The ANAO has noted a number of key areas in previous chapters where the overseas property business model is under pressure. These are briefly outlined below.

#### Security-related relocations and capital works

**6.4** As noted in Chapter 2, following the Jakarta Embassy bombing in September 2004 security considerations became the key driver for relocating chanceries and other capital works. While additional funding has been provided via the Diplomatic Security and Services Branch of DFAT for security upgrades, some security costs are absorbed by the Special Account. For

example, some security ‘hardening’ features need to be incorporated into the base building costs.

**6.5** In addition, there are a number of upcoming chancery relocations, involving the purchase of land and construction of large purpose-built chanceries, which are expected to impact on the reserves of the Special Account in future years.<sup>89</sup>

## **Supplementary funding for building amortisation payments**

**6.6** As noted in Chapter 3, budget funding for building amortisation payments from agencies—which represents about a quarter of OPO’s annual revenue—lapsed from 1 July 2009. Funding has been quarantined pending a review of the financial impact and to develop successor arrangements. OPO considers that without the building amortisation payments from agencies, or an alternative arrangement, the financial viability of the Special Account will be undermined. At the time of the audit OPO and Finance were continuing discussions on the amortisation funding. Finance advised that it expects that the Government will consider the issue in the 2010–11 Budget context.

## **Funding for shared space and other funding pressures**

**6.7** As noted in Chapter 3, at the time of the audit, the shared space funding issue remains unresolved. In addition, there are tensions between OPO and its tenants on a number of other funding issues, including: access to rent revaluations; checking and contesting MOUs; the payment of dead rent; and rent increases arising from the use of economic rents (rather than market rents) in new locations.

## **Payment of dividends to the budget**

**6.8** The increased demand on the Special Account to fund security-related capital works and relocations is impacting on the annual dividend paid. However, the reduction in the dividend to fund capital works is not transparent from DFAT Annual Reports or Portfolio Budget Statements. As

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<sup>89</sup> The total estimated cost of the Jakarta Embassy relocation is \$415.1 million, while Bangkok is \$193.4 million (Kabul is in the planning stage). Finance advised that the Special Account will be required to meet construction costs and land purchase for Jakarta and Bangkok (Kabul is not yet approved). Agency fit-out costs for both projects will be funded through their appropriation funding, in line with normal practice.

noted in Chapter 5, the ANAO concluded that the dividend is not a useful indicator of the estate's performance as it is currently reported.

### **Uneven quality of fit-outs at posts**

**6.9** With the devolution of property funding to agencies in 1997, agencies became responsible for their own tenancy fit-outs. During its visits to the London and Washington chanceries the ANAO noted that the age and quality of tenant fit-outs varied, reflecting, at least in part, the funding capacity of agencies.<sup>90</sup>

**6.10** OPO noted that the same situation could occur in leased premises shared by different tenants with the flexibility to determine their own fit-outs. While accepting these points, the ANAO notes that tenants within owned chanceries are normally seen as representing the one entity—the Australian Government, and that a certain base level of fit-out quality could, therefore, be expected.

**6.11** In addition, there is a risk that the current piecemeal approach to tenant refits may not produce the best outcome: it may not be the most cost-effective outcome for the Australian Government as a whole.

**6.12** Consequently, while there have been clear benefits to agencies arising from devolution of property funding in terms of flexibility of tailoring fit-outs to particular requirements, these need to be balanced against the need to maintain an appropriate whole-of-government image at the post.

### **Conclusion—Issues emerging from the ANAO's audit**

**6.13** There are a number of issues that are impacting on the overseas property business model and causing tensions between and within agencies. These may have consequential impacts on the capacity of the Special Account to fund relocations and refurbishments, maintain property to an appropriate standard, and pay annual commercially based dividends. The pressures that are emerging suggest that the self-funded commercial model, as currently constituted, would benefit from review.

**6.14** Finance advised the ANAO that after 10 years it may be valuable to revisit the overseas property framework to assess its appropriateness,

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<sup>90</sup> Internal OPO documentation and discussions with stakeholders indicates that this is a particular issue at older chanceries.

efficiency and effectiveness. OPO advised that it would be prepared to participate in any general review of the current model.

## Recommendation No.4

**6.15** The ANAO recommends that the Department of Finance and Deregulation review the continuing effectiveness of the commercial model and overseas property framework in meeting the Government's objectives for the overseas owned estate, in conjunction with OPO and relevant stakeholders.

### *Finance response*

**6.16** Agreed.

### *DFAT response*

**6.17** DFAT agrees with this recommendation. In 1996, the Government agreed to commercial management arrangements for its domestic property portfolio and this policy was extended to the overseas estate in 1999. The key principles of this framework included provisions that agencies should reflect the full costs of their overseas representation in their accounts through a user pays policy, and that the overseas estate should operate on a commercial basis. This principle included the application of market rents and an additional fixed payment reflecting the specialist nature of the estate to enable achievement of a commercial return and the return of an annual dividend to government. The original Commonwealth Property Principles were replaced in 2005 by the Australian Government Property Ownership Framework (AGPOF) which retained most of the original principles. An independent review will allow examination of the current overseas estate management model and framework.

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Ian McPhee  
Auditor-General

Canberra ACT  
28 April 2010



# Appendices



## Appendix 1: Letter of Response from DFAT



**Australian Government**  
**Department of Foreign Affairs and Trade**

**Secretary**

Telephone: 02 6261 2472  
Facsimile: 02 6273 2081

File Number: 09/3090

30 March 2010

Mr Peter White  
Group Executive Director  
Performance Audit Services Group  
Australian National Audit Office  
GPO Box 706  
CANBERRA ACT 2601

*Dear Mr White,*

I refer to your letter of 4 March 2010 and the proposed report on the ANAO's performance audit of overseas property management. I note your advice that DFAT's comments will be included in the report.

DFAT welcomes the findings of the report, including that the Overseas Property Office (OPO) has put in place the basic elements needed for effective estate management. In particular, the report recognises that the management of the overseas estate is a challenging task in often difficult environments, and that maintenance of the estate to ensure compliance with current standards can be difficult and expensive. The report also notes that the necessary increased priority given to security related upgrades in recent years, and the requirement to manage the estate on a commercial basis, have added to the complexity of the task.

DFAT also welcomes the ANAO's acknowledgement of good practice in OPO's management of the estate, including implementation of a strategic planning process, monitoring of maintenance requirements, property compliance and indicators to monitor performance. The report also notes the high level of satisfaction of posts with OPO's response to their needs.

R G Casey Building, Barton ACT 0221 [www.dfat.gov.au](http://www.dfat.gov.au)

DFAT considers the report's four recommendations to be constructive in identifying opportunities for strengthening existing processes and procedures. The report's more general comments on the issues impacting on the current overseas estate management model, inherited by DFAT in 2001 from the then Department of Finance and Administration, are both relevant and timely. DFAT welcomes the recommended joint review of the funding model as a means to more fully define the Government's objectives for the overseas owned estate. DFAT also considers the suggested development, in consultation with tenant agencies, of a client service charter to be potentially useful in managing tenant agency expectations and obligations.

#### **Comments on Recommendation 1**

DFAT agrees with this recommendation, with qualification. The report notes that tenant agencies can add to delays in lease renewals and unlike a commercial landlord OPO does not have any enforcement powers. The introduction of a client service charter could assist to resolve issues of disagreement but adoption of such a charter by all agencies would be necessary.

#### **Comments on Recommendation 2**

DFAT agrees with this recommendation. The ANAO has acknowledged that the current property rating system has a number of strengths and that OPO has adopted sound practice by proactively identifying repair and maintenance requirements. The recommendation identifies opportunities for strengthening current management arrangements.

#### **Comments on Recommendation 3**

DFAT agrees with this recommendation. The existing performance indicators for management of the estate are those established by Finance. DFAT agrees that revised performance measures, including additional or alternative benchmarks aligned to a corporate real estate portfolio may assist managers and stakeholders to draw informed conclusions on performance.

#### **Comments on Recommendation 4**

DFAT agrees with this recommendation. In 1996, the Government agreed to commercial management arrangements for its domestic property portfolio and this policy was extended to the overseas estate in 1999. The key principles of this framework included provisions that agencies should reflect the full costs of their overseas representation in their accounts through a user pays policy, and that the overseas estate should operate on a commercial basis. This principle included the application of market rents and an additional fixed payment reflecting the specialist nature of the estate to enable achievement of a commercial return and the return of an annual dividend to government. The original Commonwealth Property Principles were replaced in 2005 by the Australian Government Property Ownership Framework (AGPOF) which retained most of the original principles. An independent review will allow examination of the current overseas estate management model and framework

Finally I would like to express appreciation for the constructive approach taken by the ANAO throughout this audit.

Yours sincerely



Dennis Richardson

## Appendix 2: Letter of Response from Finance



**Australian Government**  
**Department of Finance and Deregulation**

Mr Peter White  
Group Executive Director  
Performance Audit Services Group  
Australian National Audit Office  
GPO Box 707  
CANBERRA ACT 2601

Dear Mr White

### **Performance Audit: Management of the Overseas Owned Estate**

Thank you for your letter of 5 March 2010 seeking the Department of Finance and Deregulation's (Finance) comments on the extract of Australian National Audit Office's (ANAO) audit report titled *Management of the Overseas Owned Estate*. Finance provided detailed comments on 6 April 2010. We appreciate that these comments have already been incorporated into your report. Following discussions between Finance and the ANAO we are providing abbreviated comments for publication.

Finance agrees with recommendations 1, 3 and 4 (that were previously numbered 1, 2 and 3 in the extract that was provided). Finance welcomes the opportunity to work with the Department of Foreign Affairs and Trade to improve the management of the overseas estate.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kathryn Campbell'.

Kathryn Campbell  
Deputy Secretary  
Budget Group  
14 April 2010

John Gorton Building, King Edward Terrace, Parkes ACT 2600 • Telephone 02 6215 2222  
Internet [www.finance.gov.au](http://www.finance.gov.au)

## Appendix 3: Posts visited by the ANAO

### *Australian High Commission, London*



Australia House, London.

Photo: DFAT

Australia House is situated on the Strand in Central London and was built during the First World War and opened in 1917. It was modernised and air conditioned in 1994. Australia House comprises six floors and a mezzanine area of general office accommodation, and two underground levels. It is occupied by some 180 A-based and locally engaged staff who are employed by nine Australian Government tenants including DFAT and the Department of Defence. The building is heritage listed, which means that changes need special approval. The Australia Centre is integrated into the structure, albeit with its own entrance, and houses a number of tenants including the Agents-General for South Australia, Victoria and Western Australia. The property was valued at \$123.5 million at 30 June 2009.

## *Australian Embassy, Washington*



The Australian Embassy, Washington.

Photo: DFAT

The chancery is located at 1601 Massachusetts Avenue in North West Washington. It was built in 1969 and an extension was added in 1977. A major refurbishment of some elements of the chancery was undertaken in 1999–2000. The building comprises seven levels of office space above ground and two underground levels. It is occupied by some 270 A-based and locally engaged staff employed by 12 Australian Government tenants. The property was valued at \$78.7 million at 30 June 2009.

## Appendix 4: Strengthening OPO's property condition rating system

Existing Weakness	Desirable enhancement / ANAO comment
The arrangement is not documented.	Documenting the arrangement would facilitate a common understanding of the action required, by whom, and when.
The rating categories are not defined.	Staff currently rely on the simple meanings. Defining the ratings and providing examples would help make the ratings less subjective.
The rating system is simplistic.	A more sophisticated rating system could record factors such as: representational impression, space and utility, age and condition of fit-out, suitability of location, expansion capacity, OH&S factors. This would help subsequent rating reviews, particularly where there has been a changeover of Estate Managers. Indeed, as noted in Chapter 5, a more sophisticated approach was employed for several years after 2001.
The rating system is not formally linked to the annual inspection and rating model used by the contracted service provider.	While Estate Managers may visit posts only once every three or more years, the service provider formally inspects and rates the condition of each property annually for the purpose of developing a repairs and maintenance program.
The Overseas Property Management System (OPMS) database does not record a date against the condition rating.	Recording a date would be a useful prompt for a rating review. While noting that a date field could be added, OPO considers that it would be preferable to update ratings on the basis of regular service provider and Estate Manager reports. The ANAO agrees, but notes that a date could usefully alert OPO staff to ratings that have not recently been reviewed or updated.
Entering the default rating of 'very good' could result in upward bias.	When a property is entered into the OPMS database it receives a default rating of 'very good'. <sup>91</sup> Calculating an initial rating would provide better baseline data against which future ratings could be compared.

Source: ANAO analysis.

<sup>91</sup> Most properties being entered into the OPMS database are leased residential properties (this is where the turnover of property is highest).

## Appendix 5: Examples of OPO's property condition ratings being at odds with available information

OPO rating	Other information
The HOM residence in Colombo was rated <b>'Very Good'</b> in the August 2008 and 2009 Post Profile Reports.	<ul style="list-style-type: none"> <li>A September 2008 Post Liaison Visit (PLV) to Colombo was 'disappointed with the standard of maintenance and upkeep' at the HOM residence and found it was 'in need of repair and refurbishing' to bring it back to an 'acceptable standard'. It identified a wide range of required work.<sup>92</sup></li> <li>OPO advised that the difference stems from an apparent failure of the Estate Manager to marry the PLV report with the profile update for 2008 and 2009.</li> </ul>
The chancery in Dhaka was rated <b>'Very Good'</b> in the August 2008 and 2009 Post Profile Reports.	<ul style="list-style-type: none"> <li>September 2008 correspondence from the post advised OPO that the chancery was not considered to be 'very good', but in fact 'tired and dated' and 'the building is 25 years old and looks every minute of it.'</li> <li>March 2009 correspondence between OPO and the Senior Executive noted that the chancery was 'rundown and in need of a mid-term renovation.'</li> <li>A refurbishment of the Dhaka chancery was identified as a potential future project in the August 2008 and 2009 five-year plans.</li> </ul>
Three owned staff residences in Vientiane were rated <b>'Good'</b> in the August 2008 and 2009 Post Profile Reports.	<ul style="list-style-type: none"> <li>A June 2008 PLV visit to Vientiane found that 'the three owned residential properties in Vientiane are of a substandard quality for representation and living arrangements.'<sup>93</sup></li> <li>The overall 'Good' rating is also at odds with property descriptions in the 2008 and 2009 Post Profile Reports which noted that each of the properties were in 'fair overall condition' for their age.</li> </ul>

Source: ANAO analysis of DFAT documents.

<sup>92</sup> The work identified was as follows: 'determine the extent of borer damage and make good as necessary, repair the roof, fascia boards, gutters and down pipes as necessary; replace the ceiling in the kitchen storage area and guestroom; replace a number of doors to bedrooms, replaster walls to bring up to an acceptable standard and paint throughout the residence; fix window frames and fly screens as necessary and paint; install exhaust fans in bathrooms; install an appropriate pond fence and mend or replace the property fencing as required. Furniture and fittings in the representational area were tired and in need of refurbishing. Curtains need to be replaced.'

<sup>93</sup> Required work identified was as follows: 'Each requires significant maintenance, including re-painting, furniture replacement and, in some cases, repairs to plumbing, hot water systems and air-conditioners.'

## Appendix 6: Property condition ratings used by the contracted service provider

Condition Rating	Description
5	Sub-element is in excellent or as new condition with regular service and maintenance being carried out.
4	Sub-element is in very good condition with no immediate attention necessary.
3	Sub-element is showing minor signs of wear and should be checked against its life cycle expectancy for the necessary remedial action in the current budget or scheduled into next year.
2	Sub-element is approaching its life cycle expectancy and requires urgent remedial or replacement action in the current budget.
1	Sub-element is considered as an immediate health or life safety risk with critical corrective action being necessary. All efforts should be directed at rectifying the situation immediately.

Source: OPO document.

## Appendix 7: Weaknesses in the contracted service provider's annual inspection report process

Weakness	ANAO comment
Condition ratings often not accompanied by descriptive comments and/or proposed work.	Many reports allocate ratings of 3—which should indicate work will soon be required—but these ratings are often not accompanied by any comment or suggested maintenance work over the five-year period.
Poor and inconsistent comments from inspectors.	<p>Some comments were too brief to provide any real insight into when work might be required, e.g. 'serviceable' and 'good'.</p> <p>The ANAO noted many inconsistencies in the use of ratings and comments. For example:</p> <ul style="list-style-type: none"> <li>• comments of 'fair', 'good', 'serviceable', 'sound', 'adequate', 'reasonable' and 'fine' were found accompanying ratings of 4 (a 4 rating is formally defined as 'very good').</li> <li>• comments of 'fair', 'good' and 'serviceable' were also found accompanying ratings of 2 (which is formally defined as 'requires urgent remedial or replacement action').</li> </ul> <p>This suggests that some inspectors do not have a sound understanding of the rating definitions, and undermines the usefulness of the reports to OPO in prioritising the allocation of resources across properties.</p>
Significant variations in ratings and/or cost estimates between reports.	<p>Ratings can vary significantly over a relatively short space of time. For example:</p> <ul style="list-style-type: none"> <li>• between April 2007 and May 2008, reports on the Washington chancery indicate a substantial deterioration in many elements of the building (from an overall rating of 68 out of 100, to 41); and</li> <li>• the external façade of a HOM residence appeared to have deteriorated substantially over a 14-week period, from a rating of 7.7 out of 10, to one of 4 out of 10. While the condition deteriorated, the estimated cost of repairs halved.</li> </ul> <p>This suggests that different inspectors have different priorities and/or expertise.</p>
Incomplete inspection reports.	<p>Some reports provided summary information only, without the full inspection report detail (and vice versa) and some did not identify the inspector.</p> <p>Summary information by itself does not provide sufficient detail (e.g., it does not identify the condition of various property elements, or estimate expenditure against forward years) to properly inform decisions on a five-year R&amp;M program.</p>

Weakness	ANAO comment
Inspection reports may produce misleading results.	<p>The report splits each property into elements (external, bathroom 1, etc) and further splits these into sub-elements (walls, floors, etc). Each sub-element is weighted and given a rating. Sub-element ratings are totalled to give an overall rating for the element (7.8 out of 10, etc), which are totalled to give an overall rating for the property (83 out of 100). For example: should every sub-element receive a 5 rating, the property would receive an overall rating of 100 out of 100; while a 2 rating for every sub-element would result in an overall rating of 40 out of 100. In practice, sub-elements are variously rated along the scale to produce the total (e.g. 78.81).</p> <p>While this is a systematic approach, elements also contain one or more 'other' sub-elements that are, by default, given a rating of 5. Where these ratings are not applicable (as is often the case) a rating of 5 would remain and result in the property being rated more highly than it should be.</p> <p>The ANAO discussed this issue with OPO which advised that it was a known problem and that it had asked the contracted service provider to fix it. OPO also advised that it does not use the summary rating information.</p>

Source: ANAO analysis of annual inspection reports.

## Appendix 8: Opportunities to improve the OPMS database and its management

Issue	Opportunities for improvement
User manual.	At the time of the audit there was no up-to-date and comprehensive user manual, or system documentation on the operation and management of the database. <sup>94</sup> This creates a risk of over-reliance on one or more individuals' corporate knowledge of the system.
Accuracy and currency of data.	Some of the data in the OPMS database is not accurate or up-to-date. For example, MOU data for July 2008 was not entered into OPMS until June 2009, and some photos and floorplans were out-of-date or not available.
Inconsistencies between OPMS and Post Profile Reports.	Some data in the Post Profile Reports did not match the data in the OPMS database. For example, the list of tenants in the Australia Centre in London was inconsistent at the time of the audit.

Source: ANAO analysis.

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<sup>94</sup> One module of the OPMS, the *Post Openings, Relocations and Major Works* module has a user manual.

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