

**Property Tax Appeals and Refund Processing**  
**Revenue Services Division**

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**February 28, 2007**

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 **TORONTO** Auditor General

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**PROPERTY TAX APPEALS AND REFUND PROCESSING  
REVENUE SERVICES DIVISION**

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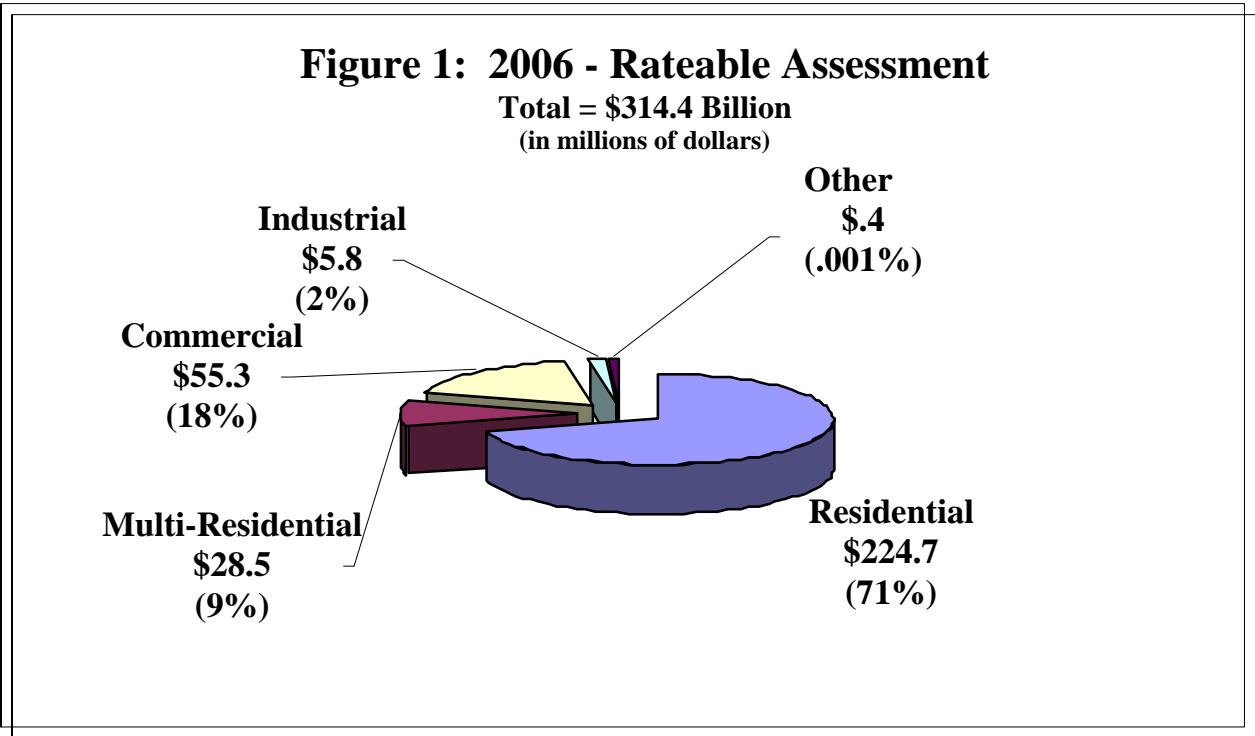
## **BACKGROUND**

The Auditor General's Work Plan included a review of the Revenue Services Division property taxation operations for property assessment and tax appeals and related refund processing. This review was selected based on the potential for risks related to the administration of property tax appeals and accompanying tax adjustment processing.

Appeal processes are provided for under the Assessment Act and the Municipal Act, 2001. Assessment appeals, unlike tax appeals, arise from disputes over the assessed value or classification of the property. Property tax appeals are applications made to the municipality for an in-year reduction in taxes due to changed circumstances dictated by legislation. Examples are buildings destroyed by fire, demolition or a change in property use.

The appeal process is initiated when a taxpayer files a complaint with the Municipal Property Assessment Corporation, Assessment Review Board or City Clerk depending on the type of appeal. When a decision is made, information on the property appeal is provided to the municipality to adjust taxpayer assessment amounts and the amount of property tax due. For property taxpayers in the City of Toronto, appeal decisions are processed by the Revenue Services Division.

For 2006, the rateable assessment for properties in the City of Toronto was \$314.4 billion. Figure 1 provides the 2006 total rateable value by property type.



Revenue Services appeal and refund operations are administered by two separate sections, the Tax and Assessment Section and the Revenue Accounting and Collection Section. The Tax and Assessment Section includes property tax billing and appeals, the tax rebate, deferral and cancellation programs, and the tax assessment and analysis unit. The Revenue Accounting and Collection Section is responsible for revenue collection, accounting and financial reporting, payment processing and refunds.

The Appeals Unit consists of 13 staff members involved in processing property tax appeals. The total 2006 expenditures are \$888,500 of which over 98 per cent is salaries and benefits. The Refund Unit consist of nine staff members and 2006 expenditures total \$599,000. Staff salaries and benefits represent 98 per cent of the total for this unit.

Figure 2 represents the number and value of successful assessment and tax appeals processed in 2005 and 2006 by the Appeals Unit.

**Figure 2: Number and Value of Successful Assessment and Tax Appeals Processed**

Property Classification	2006		2005	
	Number of Appeals	Dollar Amount	Number of Appeals	Dollar Amount
Residential	12,699	6,965,125	12,439	7,002,113
Non-Residential	<u>12,379</u>	<u>63,985,665</u>	<u>13,633</u>	<u>73,349,398</u>
Total	<u>25,078</u>	<u>70,950,790</u>	<u>26,072</u>	<u>80,351,511</u>

Successful assessment and tax appeals may result in a credit on a property tax account which will result in the issuance of a cheque refund or transfer of the credit to reduce outstanding taxes payable.

Revenue Services uses the Tax Management and Collection System (TMACS) for processing tax transactions. TMACS facilitates property database management, billing, collection and payment processing functions.

The 2005–2014 Capital Program for the Finance Department includes approximately \$2.6 million related to reviewing and updating or replacing Tax and Water computer systems.

In an effort to improve customer service and streamline operations a separate refund unit was established in 2004. Improvements were implemented to facilitate tax refund processing where credit balances exist on tax accounts.

The processing of assessment and tax appeals is an important and highly visible part of the Revenue Services Division. The Tax and Assessment Section and the Revenue Accounting and Collection Section handle taxpayer disputes and are vital in ensuring the correct amount of property tax due is billed or refunded on a timely basis.

## **AUDIT OBJECTIVES, SCOPE AND METHODOLOGY**

The objectives of our review were to:

- assess the extent of compliance with applicable laws, regulations and City policies;
- review related internal controls and operating procedures; and
- assess the efficiency and effectiveness of property tax appeal and refund processes.

Our audit scope included the review of transactions and procedures relating to assessment and tax appeals and refunds processed during the period January 2005 to November 2006.

This audit was conducted in accordance with generally accepted government auditing standards. Our audit methodology included the following:

- review of relevant provincial statutes and regulations, City of Toronto By-laws, directives, policies, procedures and current divisional practices;
- interviews with Revenue Services Division staff;
- review of relevant documents, records and management reports maintained by the City's tax and financial systems;
- review of the adequacy of management controls;
- consultation with the City's external auditors;
- review of reports to City Council and Committees;
- review of audit reports and practices in the following cities: Mississauga, Hamilton and Ottawa; and
- review of audit reports in other local governments in Canada and the United States including: Winnipeg, Kansas City, and Los Angeles.

We also reviewed related audit work conducted by the following audit agencies:

- Office of the Auditor General of Canada;
- Office of the Auditor General of Ontario; and
- Australian National Audit Office.

## **EXECUTIVE SUMMARY**

This review focussed on procedures carried out by the Revenue Services Division related to the administration of assessment and tax appeals and refund processing.

Our review found that divisional staff are clearly committed to ensuring taxpayers receive complete and accurate information. While we identified a number of concerns and improvement opportunities in this report, it is important to understand that Revenue Services faces a continuing challenge related to implementing ever-changing and complex property tax legislation. These difficulties are not unique only to the City of Toronto as many other municipalities face similar challenges.

The review identified a number of areas requiring strengthened management controls and better use of technology to improve operations and the efficiency of staff resources. Our review also identified opportunities where the processing of assessment and tax appeals and related refund processing could be delivered more efficiently and effectively. These issues are outlined in detail in the balance of this report and are summarized below.

### **Assessment and Tax Appeal Processing**

- Weaknesses related to the accuracy and completeness of assessment and tax appeal processing result in time consuming manual calculations and manual system interventions.



- TMACS does not presently generate a tax calculation summary. This results in staff having to prepare manual tax appeal calculations in order to verify system calculations. Use of a system generated tax calculation summary would ensure calculations are performed accurately, using a consistent methodology.
- Existing performance measures provide limited management information for evaluating processing efficiency and effectiveness. Useful performance information provides comparisons with pre-determined performance goals. Without appropriate performance measures, management is unable to determine the operational efficiency or effectiveness of services provided by the Appeals Unit.

### **Refund and Tax Credit Processing**

- Taxpayer unclaimed credit balances totalling \$72 million are maintained in the Taxpayer Repayment Account (55 per cent or approximately \$39 million is from pre-amalgamation accounts). Unclaimed credit balances maintained in the Taxpayer Repayment Account should be reviewed and where appropriate transferred to General Revenue. As well, policies and procedures should be developed to ensure taxpayer unclaimed credit balances in the Taxpayer Repayment Account are reviewed and properly administered.
- Management's 2004 review and analysis of current policies, related internal controls and processes for the tax refund process should be periodically reassessed to determine their continued relevance. As part of this process, management should identify information required to better manage resources, improve management practices and establish an effective system of monitoring and evaluating performance.
- Current performance information used to determine the efficiency and effectiveness of Refund Unit operations need to be enhanced. Management should develop performance measures to assist in managing the timeliness of tax refund processing, staff workload and overall Unit performance.

## **Tax Management and Collection System Processing**

- The current Tax Management and Collection System (TMACS) limits the efficient processing of property tax appeals and refunds. Management conducts no formal periodic risk assessment of the TMACS to determine system control weaknesses and risks.
- A significant number of unresolved computer system problems exist. Manual calculations and system interventions are required to support computer processing. This requires significant staff time and increases the risk that incorrect processing goes undetected. A review of controls and the ability of the system to accommodate current and future operational requirements would be helpful in identifying ways to improve staff efficiency.
- A commonly used control not currently used in TMACS is the capability to identify credits prone to error and credit transactions considered unusual or abnormal due to magnitude, frequency or source. The implementation of an exception reporting system in addition to regular supervisory review of refund processing would assist in preventing errors during the refund process.
- Computer access controls for restricting access to data systems should be reviewed. Further refinement of current system security access levels are required to minimize the risk of fraud, susceptibility to unauthorized manipulation of taxpayer records and loss of revenue.

## **AUDIT RESULTS**

Details relating to each of the above are contained in the following sections. The implementation of recommendations contained in this report will improve internal controls in the administration of assessment and tax appeals, the refund process, and will strengthen program efficiency and effectiveness.

### **A. ASSESSMENT AND TAX APPEAL PROCESSING**

Our review focussed on processing appeal decisions related to assessment and tax appeal complaints filed with the:

- Municipal Property Assessment Corporation (MPAC);
- Assessment Review Board (ARB); and
- City Clerk in accordance with the Municipal Act, 2001.

In 2005 and 2006, the Appeals Unit processed \$80 million and \$71 million respectively in successful assessment and tax appeals.

The City has no control over the number of property tax appeals filed by property owners during the tax year. As appeal decisions are rendered by the Municipal Property Assessment Corporation, the Assessment Review Board or Council, the City is required to process the resulting tax adjustment or refund.

#### **A.1. Accuracy and Completeness of Processing of Assessment and Tax Appeals Should Be Strengthened**

Our evaluation of assessment and tax appeal processing included a review of the adequacy of existing internal controls and procedures to ensure the accuracy and completeness of processing. We noted the following issues:

- inaccurate tax adjustment amounts on non-residential accounts due to computer system deficiencies resulting in the need for time consuming manual intervention; and
- use of an interest formula not programmed to re-calculate penalty and interest amounts on unpaid or overdue tax balances following the processing of an appeal. Instead, staff manually calculate adjustments to penalty and interest charges on outstanding balances following an appeal.

Management is aware of computer system problems related to processing tax adjustments and the system's inability to correctly re-calculate interest and penalty charges on outstanding amounts, following an appeal. Manual calculations increase the risk that appeals may not be calculated correctly and input errors may occur. These system deficiencies increase the cost of processing appeals, cause delays in appeal processing and result in inefficient use of staff.

**Recommendation:**

**1. The Director of Revenue Services take steps to:**

- (a) **assess the tax system's ability to accommodate changes to tax adjustment processing on non-residential accounts; and**
- (b) **ensure the tax system is programmed to adjust penalty and interest charges on overdue tax balances resulting from appeal adjustments as part of the planned re-development of the Tax Management and Collection System.**

**A.2. Lack of a System Generated Tax Calculation Summary**

In examining appeal processing, we noted TMACS does not presently generate the detail for system produced tax calculations. This results in staff manually preparing and documenting tax calculations in order to verify system calculations.

According to management, the system was capable of producing the detail for a system generated tax calculation summary prior to 2001, however, the practice was discontinued. Continued changes to provincial legislation governing assessment and taxation for non-residential properties and the growing complexity associated with the increasing rules and regulations impacting the calculations made the programming of the tax calculation summary in TMACS impractical.

Use of a system generated tax calculation summary would improve operational efficiency and reduce reliance on manual preparation of tax calculation summaries. Additional benefits from the use of a system generated tax calculation summary include:

- improved timeliness of appeal processing;
- facilitate independent review of tax calculations;
- eliminate the need for manual calculation; and
- provides information for taxpayers.
- 

**Recommendation:**

- 2. The Director of Revenue Services assess the feasibility and cost of developing an automated tax calculation summary as part of the 2008–2009 Capital Program to review the Tax Management and Collection System.**

**A.3. Meaningful Performance Measures Do Not Exist**

The Appeals Unit has developed limited performance indicators to assist in measuring Unit performance. Existing performance data is based only on output. For instance, the number and dollar value of tax assessment appeals processed, and the number of telephone calls and correspondence received. These indicators do not capture performance in a manner useful to management. Useful performance information involves comparisons with pre-determined performance goals. Without appropriate performance measures, management is unable to determine the operational efficiency or effectiveness of services provided by the Appeals Unit.

In our review of other similar organizations, we noted the use of management performance information such as differences in processing cost per appeal and average appeal processing time. We recognize the difficulty in comparing the operations of one municipality to another due to differences in practices and the nature of appeals handled. However, measuring performance in relation to predetermined in-house performance targets is a useful management tool.

**Recommendation:**

- 3. The Director of Revenue Services develop and implement appropriate performance measures for the Appeals Unit that assist in determining the effectiveness and efficiency of the assessment and tax appeal process.**

**B. REFUND AND TAX CREDIT PROCESSING**

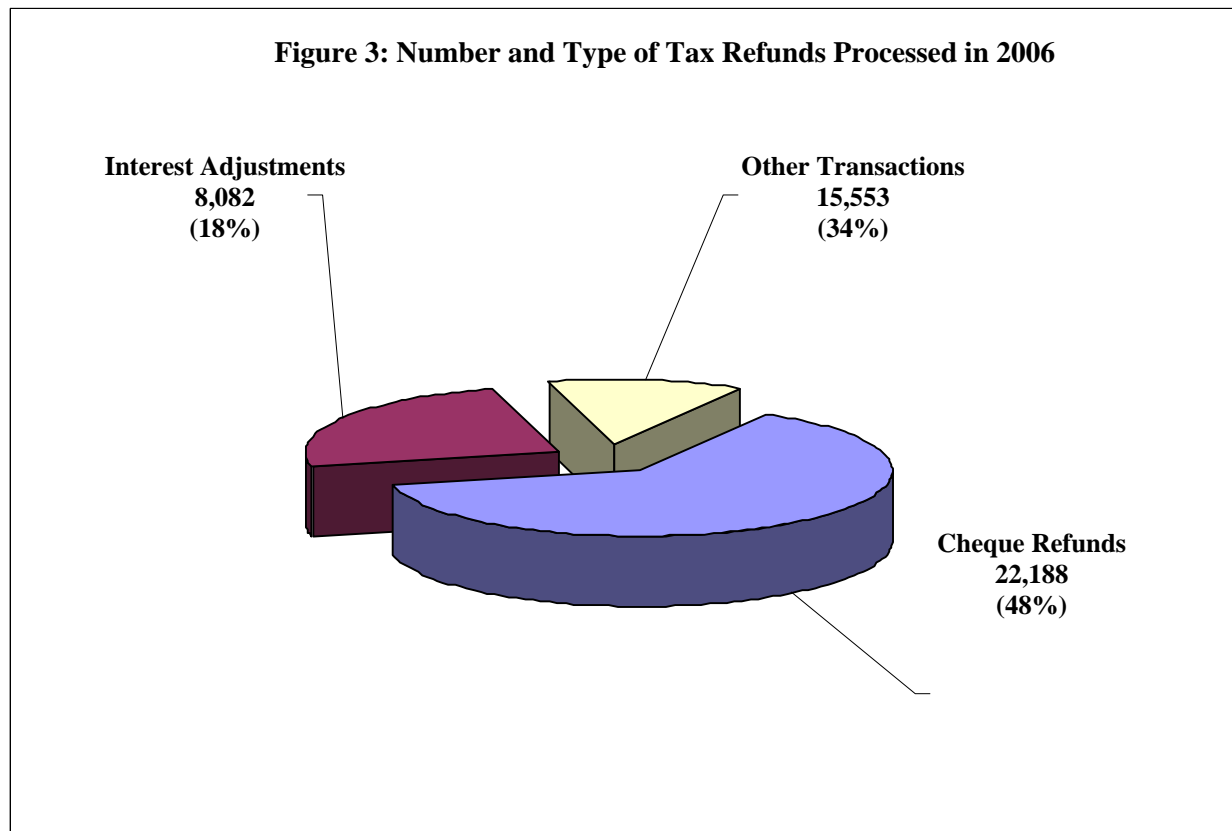
An overpayment of property taxes or a credit balance on a property tax account can arise from any of the following circumstances:

- Assessment and Tax Appeals;
- Rebate, Deferral and Cancellation Programs;
- Payments made by several persons;
- Payments applied to incorrect accounts; and
- Overpayment of taxes (payments in excess of taxes due).

If the processing of an assessment or tax appeal results in a tax credit, it is the responsibility of Refund staff to refund or apply a credit to the taxpayer's account in the property tax system.

The establishment of a separate refund unit in 2004 was part of the Revenue Services Division re-organization and service improvements initiative. Previously the processing of taxpayer credit balances resulting from assessment and tax appeals was done by both Appeals and Revenue Accounting and Collection staff.

In 2006, the nine staff members of the refund unit processed over 45,000 tax refund transactions. Figure 3 depicts the number, percentage and type of tax refund transactions processed.



Recommendations related to the Tax Refund Unit are described below.

#### **B.1. Establish Policies and Procedures Related to Credit Balances Maintained in the Tax Repayment Account**

In 2005 and 2006 the year end balance in the Tax Repayment Account was approximately \$70 million and \$73 million respectively. Taxpayer credit balances are transferred to this account after attempts to notify taxpayers have failed. Our analysis of taxpayer credit balances in the Taxpayer Repayment Account indicated credit balance amounts dating back before pre-amalgamation (1997 and prior years). The balance maintained in the Tax Repayment Account continues to increase as policies and procedures do not provide direction on how and when to transfer amounts from the Tax Repayment Account to General Revenue.

The balance in the Tax Repayment Account also includes misclassified amounts. For example, we noted certain transactions described as “outstanding 1998 tax payments, adjustment for school board payable accounts, and funds for fraudulently cashed cheque recovered.”

The City’s Tax Repayment Account should serve as a temporary holding account. Over time, credit balances comprising the account should either be refunded or transferred to general revenue and include only taxpayer credit balances recently transferred. However, given the age of the amounts currently in the account, it appears that a review of these credit balances is not taking place and the Tax Repayment Account balance continues to increase.

We identified the following issues related to the Tax Repayment Account:

- the account includes amounts other than unclaimed taxpayer credit balances;
- the refund process does not include a staff review of credit balances in the Tax Repayment Account; and
- policies and procedures do not provide direction regarding the management, administration and disposition of credit balances held in the Tax Repayment Account.

**Recommendation:**

**4. The Director of Revenue Services take steps to:**

- (a) ensure staff review amounts included in the Tax Repayment Account and make the necessary adjustments to ensure appropriate amounts are included in the account; and
- (b) establish policies and procedures for the administration, management and disposition of taxpayer credit balances included in the Tax Repayment Account.



## **B.2. Need for Periodic Re-assessment of Refund Process**

In the event taxpayers have an overpayment on their taxes, a credit balance may result and the taxpayer is due a refund. The overpayment amount is maintained in the Tax Credit Balance account until the amount is refunded to the taxpayer or transferred to the Tax Repayment Account. For 2005 and 2006, the year-end credit balances in the Tax Credit Balance account were \$66 million and \$64 million respectively.

In 2004 management conducted a detailed review and analysis of its refund practices and taxpayer credit balances. The purpose of management's 2004 assessment was to identify changes in the tax refund process to improve processing times while managing the financial risk to the City. During 2005 management conducted an update to the 2004 review. Both assessments included an analysis of the number of property tax accounts with a credit balance and the associated dollar amounts for residential and non-residential/mixed-use properties.

As a result of the 2004 assessment, procedures related to processing tax refunds were revised. Management revised documentation requirements and procedures based on the dollar value of the credit balance. Procedures implemented require refunds less than \$100 to be applied as a credit to the property owner's account with minimal review. For refunds over \$100, procedural requirements are more demanding and documented proof of payment is required.

In order to effectively manage the refund process both the 2004 assessment and 2005 update should be formally incorporated into the ongoing operation of the Refund Unit.

### **Recommendation:**

- 5. The Director of Revenue Services ensure tax credit balances and tax refund policies, processes and related internal controls are periodically reassessed to determine continued relevance and effectiveness.**

### **B.3. Improved Performance Measures Would Assist in Managing Staff Efficiency**

Current performance information used to determine the efficiency and effectiveness of operations and procedures in the Refund Unit can be enhanced.

A review of refund processing transactions processed by staff indicated significant variances in staff workload. Differences in workload can be the result of a variety of factors including account complexity, staff expertise and experience, and lack of training in specific refund types. Refund staff also process water, parking tag and other types of refunds.

Currently, the only performance evaluation data collected is the number of work items processed. While this data provides information regarding the output of the Refund Unit, it does not capture other useful management information such as refund processing time or comparisons with other predetermined performance targets or standards such as cost per refund, on-time completion rate or accuracy.

Relevant performance measurement information provides useful target information related to quantity, quality, timeliness, refund cost and results achieved. Performance measurement information is also helpful in predicting future costs and performance, identifying trends and other areas for improvement.

#### **Recommendation:**

- 6. The Director of Revenue Services develop and implement appropriate performance measures to assist in evaluating the efficiency and effectiveness of processing in the Refund Unit.**

## **C. TAX MANAGEMENT AND COLLECTION SYSTEM PROCESSING**

The Tax Management and Collection System supports property database management, billing, collection and payment processing. The system also provides support for property assessment and tax appeals, refunds and other transactions related to the administration of property taxes and taxpayer accounts. On an annual basis, over nine million transactions are processed in TMACS.

Since the development and implementation of the tax management and collection computer system in 1996, the system has required on-going modification, as well as the development of new applications. Changes in provincial tax legislation have been the primary reason for required system modifications.

Among the issues identified related to TMACS are:

- lack of system assessment to address tax system weaknesses and risks;
- weaknesses resulting in processing errors and problems resulting from untimely resolution of tax system problems;
- lack of exception reporting; and
- the need for enhanced system access controls.

Issues related to these areas are discussed below.

### **C.1. Assessment Needed to Address Tax System Weaknesses, Risks and Inefficiencies**

Ongoing assessment of computer system controls, risks and processing inefficiencies is a generally accepted business practice helpful in addressing system problems on a preventive basis. We noted management conducts no formal periodic risk and efficiency assessment on TMACS to determine current system control weaknesses, risks and inefficiencies.

The Finance Department 2005–2014 Capital Program includes approximately \$2.6 million related to reviewing and updating or replacing Tax and Water computer systems. Management

indicated that the initial feasibility study for the tax system is to assess TMACS to ascertain if the existing system can continue to meet user needs and business requirements.

Our review of assessment and tax appeal processing indicates a potential to further automate the TMACS system to improve the processing of assessment and tax appeals.

Examples of controls that can be further developed to improve TMACS system efficiency include checks for missing data involving key data elements, checking the relationship of one data element to another, values outside of a designated range and calculations performed outside a logical progression.

System reporting could also be enhanced to provide reports to staff to reflect errors and processing results and to provide staff query reports.

**Recommendation:**

- 7. The Director of Revenue Services ensure that the 2008-2009 Capital Program assessment of the Tax Management and Collection System include an analysis clearly defining business processes and data and systems requirements necessary to effectively manage the appeals and refund programs.**

**C.2. System Weaknesses Resulting in Processing Errors**

As part of our analysis of processing efficiency we reviewed 2005 and 2006 system user requests for computer system problem resolution. Among the problems identified in the service requests we noted the following common issues:

- incorrect posting of interest on tax appeals and refunds;
- incorrect calculation of tax adjustments; and
- duplicate posting of tax appeal calculations.

Compounding the issues arising from the account and processing issues identified above is the lack of timeliness in resolving system problems.

Unresolved service requests result in manual intervention by staff or suspension of appeal processing until computer problems are resolved. In some instances, when the service request is finally addressed, staff must remember to reverse the previous manual input, as the system repair duplicates the previous manual intervention.

**Recommendation:**

- 8. The Director of Revenue Services review outstanding service requests to assess additional automation features to be incorporated into the next generation of the Tax Management and Collection System.**

**C.3. Strengthening the Process for Monitoring and Processing Taxpayer Credits**

Refund exception reporting provides valuable information related to monitoring and processing taxpayer credits.

Beyond the existing dollar threshold and account classification criteria now used, the ability of TMACS to identify credits prone to error and credit transactions considered unusual or abnormal due to magnitude, frequency or source needs to be developed. Monitoring tax credits would enable timely adjustment and improved efficiency in processing of taxpayer credits. Examples of tax credits to monitor include interest and penalty adjustments over a predetermined value, duplicate or multiple credit transactions posted to the same taxpayer account and credits created from account transfers.

According to management, upon discovery of a refund irregularity, steps are taken to resolve the issue. From a control perspective this is a reactive rather than preventive control. Regular exception reporting as a part of refund processing is useful in preventing incorrect refunds from being processed.

The implementation of an exception reporting system accompanied by the validation process that now occurs with the release of refunds would further assist in ensuring only correct refunds made.

**Recommendation:**

- 9. The Director of Revenue Services assess the feasibility of implementing a refund exception reporting system as part of the 2008-2009 Capital Program to review the Tax Management and Collection System.**

**C.4. Need to Enhance Use of Computer Access Controls**

Computer access controls based on an individual's need to view, change or authorize data in TMACS should be strengthened. Currently some staff within the Appeals Unit can enter data and also make changes to a taxpayer's property tax account. This provides the opportunity for the individual to modify information relating to a tax appeal, amend tax calculations and alter tax due amounts.

Access rights assigned to individuals should reflect individual roles and responsibilities assigned. According to management, proper separation of duties is not fully possible due to high transaction volume, limited resources and related staff responsibilities. Management indicates that in order to compensate for this weakness, dollar limits have been established as to who can verify and authorize changes to taxpayers' accounts.

We noted no such dollar limits set in the Tax Management and Collection System and access controls have not been established to restrict staff from approving their own changes. Further refinement of current system security access levels and development of new access roles within TMACS would minimize the risk of fraud, susceptibility to unauthorized manipulation of taxpayer records and loss of revenue.

**Recommendation:**

- 10. The Director of Revenue Services review computer access controls to provide staff access based on respective roles and responsibilities in the Tax Management and Collection System. Where possible, access to the Tax Management and Collection System should be limited to those functions required by staff to perform related job duties.**

**CONCLUSION**

The objective of this review was to assess whether assessment and tax appeal processing and administration are performed efficiently and effectively, and in compliance with applicable laws, regulations and City policies. We also reviewed related internal controls and operating procedures to determine their adequacy in ensuring the accuracy and completeness of tax related transactions.

Our review identified areas requiring strengthened management controls and improved technology to improve operations and the efficiency of staff resources. Our review also identified opportunities where the processing of assessment and tax appeals and related refund processing could be delivered more efficiently and effectively. Addressing the recommendations in this report will strengthen management controls, improve the efficiency of staff resources and address the capabilities of the existing technology.