

AUDITOR GENERAL'S REPORT

**Appraisal Services Unit
Opportunities for Improving Economy,
Efficiency and Effectiveness**

January 16, 2013

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EXECUTIVE SUMMARY

The Auditor General's 2011 Audit Work Plan included an operational review of Real Estate Services Division, Appraisal Services Unit (Appraisal Services). The audit covered the period from January 1, 2011 to September 30, 2012.

Appraisal Services provides land valuation services to City Divisions, Agencies and Corporations

Appraisal Services provides valuation and consulting services to City Divisions, Agencies and Corporations for a variety of real estate matters. Appraisal Services completed 893 appraisals in the period covered by the audit, of which 649 appraisals, or 73 per cent, were in relation to parks levy fees under Section 42 of the Planning Act.

Staff costs and other direct expenses are incurred when the City undertakes appraisal services. Some of those costs may be recovered through appraisal fees charged for appraisals required under Section 42.

The volume and nature of appraisal work varies from year to year due to external factors, such as market-demand for development, current City priorities, or individual Divisional real estate requirements.

Objective of the audit

The objective of this review was to assess the extent to which Appraisal Services' operations are efficient, effective and economical, and to identify improvement opportunities.

Cost recovery structure has not changed since 1998

In July 1998, City Council approved a standardized fee structure to improve the City's cost recovery for appraisals performed to assist in determining parks levy payments required under Section 42. This fee structure has not been revised since it was set in 1998.

Other fee recoveries should be considered

Furthermore, the current fee structure also limits the City from recovering other reasonable costs, including external appraisal costs in excess of \$6,000 and costs for second appraisals required as a result of delays on the part of applicants.

Review of the fee structure is required

To ensure that the City continues to reasonably recover its costs, the parks levy appraisal fee structure should be reviewed and updated. Consideration should be given to enhancing cost recoveries while ensuring that appraisal fees remain fair and reasonable for applicants.

Reconciliation and monitoring are key management controls

We also noted potential improvements in ensuring parks levies and appraisal fees are accurately recorded in the City's financial system. Since Appraisal Services' workload is variable from year to year, regular reconciliation and monitoring controls are critical to ensure the accuracy of financial results and that variances are reasonably explained.

\$0.9 million of parks levy payments deferred prior to 2009

Parks levy payments and the related appraisal fees are recorded into a deferred revenue account when received and subsequently allocated to the appropriate accounts. However, the deferred revenue balance as at September 30, 2012 included approximately \$0.9 million of parks levy payments originating between 2004 and 2009. These balances need to be reviewed and cleared from the deferred revenue account on a more timely basis.

Operational policies and procedures should be documented

In terms of documentation, Appraisal Services does not have documented policies and procedures in place. Although staff are generally familiar with procedures and practices, having formal policies and procedures will help enhance effectiveness and efficiency in operations, minimize potential conflicts of interest, and ensure internal standards are achieved.

Improved use of information technology

Finally, there are opportunities to improve the functionality of existing information technology systems to reduce manual tracking, reconciliation and reporting requirements. The time and costs of any system enhancements should be carefully assessed to ensure they result in a net benefit to the City.

Conclusion

This report contains eight recommendations. Implementation of the recommendations contained in this report have the potential to increase the City's cost recovery for the provision of appraisal services and further improve overall management effectiveness and efficiency of Appraisal Services.

BACKGROUND

Appraisal Services provides property valuation services to City Divisions, Agencies and Corporations

The Real Estate Services Division, Appraisals Services Unit provides valuation and consulting services when requested by City Divisions, Agencies and Corporations. Valuations are completed for real estate matters involving:

- Section 42 parks levy
- disposal/sale
- acquisition/expropriation
- Section 37 community benefits
- leasing activities
- capital budgeting

Appraisals performed by both in-house and external appraisers

Appraisals are performed by a team comprised of six in-house appraisers, a supervisor, and a manager. Appraisal Services also has contracts with a roster of 10 external appraisal firms. External appraisers provide additional capacity and subject-matter expertise on a variety of appraisal types.

Section 42 appraisals represent the largest proportion of appraisal work

The largest driver of requests for appraisals is to determine payments required under Section 42 of the Planning Act, Cash-In-Lieu of Parkland Dedication.

Table 1 summarizes the number of appraisals by type completed between January 1, 2011 and September 30, 2012.

Table 1: Appraisals completed between January 1, 2011 and September 30, 2012

Appraisal Type	# Appraisals Completed	%
Section 42	649	73%
Disposal	67	8%
Acquisition	65	7%
Section 37	64	7%
Other	48	5%
Total	893	100%

City by-laws allow for charging applicants a fee when an appraisal is required under Section 42. Table 2 compares the appraisal fees recorded in 2011 and 2012 against plan.

Table 2: Comparison of actual appraisal fees, 2011 and 2012

	2011	2012
Appraisal Fees	\$434,374	\$438,464
Plan	\$402,955	\$407,223
% of Plan	108%	108%
Total Expenditures	\$1,548,178	\$1,544,993
% of Total Expenditures	28%	28%

Appraisal Services' activity is variable

Appraisal Services' workload is dependent on external factors, such as market-demand for development, current City priorities, individual Divisional real estate requirements, as well as the complexity levels of each real estate transaction itself. Therefore, the volume and nature of appraisal work may vary from year to year.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

Audit was included in the Auditor General's 2011 Work Plan

The Auditor General's 2011 Audit Work Plan included an operational review of Real Estate Services Division, Appraisal Services Unit. The audit covered the period from January 1, 2011 to September 30, 2012 and was limited to the City's real property portfolio.

Separate review of Build Toronto in Auditor General's 2013 Work Plan

Properties transferred from the City to Build Toronto Inc. were excluded from this review. Build Toronto Inc. operates (by statute) independently from the Real Estate Services Division. The Auditor General's 2013 Audit Work Plan includes an operational review of Build Toronto.

Audit objectives

The objective of this review was to assess the extent to which Appraisal Services operates with stewardship for economy, efficiency, and effectiveness, and to identify improvement opportunities.

Audit methodology

Our audit methodology included the following:

- review of relevant legislative and policy requirements
- review and analysis of Appraisal Services financial and operational data
- review of selected appraisal files and related documentation
- interviews with Manager, Policy & Appraisal Services
- interviews with Appraisal Services staff
- discussions with other City staff as required
- evaluation of management controls and practices

Compliance with generally accepted government auditing standards

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

A. OPPORTUNITIES FOR ADDITIONAL COST RECOVERY

A.1. Timely Review of the Appraisal Fee Structure is Required

Appraisal fees are charged for Section 42 appraisals

In July 1998, City Council approved a standardized fee structure for recovering the costs for appraisals performed to assist in determining parks levy payments required under Section 42 of the Planning Act.

The fee structure has not been revised since 1998

The approved fee structure also required that the fee schedule be reviewed periodically to ensure reasonable cost recovery for the services provided. However, the fee structure has not been revised since it was set in 1998, while staff costs and direct expenses have increased significantly.

Formula-based appraisal fee limited to a maximum of \$6,000

Based on the formula established in the 1998 report, the amount of the appraisal fee charged is determined as the lesser of \$250 plus \$1 per square meter of building area, or 20 per cent of the amount charged for the parks levy, but is limited to a maximum of \$6,000. Appraisal fees are recorded in revenue as payments are received.

In 2011, the City recovered \$434,374 through appraisal fees, with an average recovery of approximately \$2,000 per appraisal.

Review of appraisal fee recoveries

We reviewed a sample of appraisal fee charges and determined that they were accurately calculated in accordance with the established fee structure.

Additional costs may be recovered by increasing the fee limit

During our review, we also considered the financial implications of the current fee structure on the overall amount recovered. Our analysis showed that \$264,000 out of the \$434,374 recovered was generated through appraisal fees assessed at the maximum amount. The current maximum, set in 1998, is not allowing for full cost recovery. Increasing the maximum limit on appraisal fees would assist in ensuring a reasonable cost recovery for the services provided.

Based on 2011 data, table 3 shows the potential additional appraisal fees that could be generated by several scenarios for increasing the maximum appraisal fee limit.

Table 3: Potential additional appraisal fees from increasing the appraisal fee limit

	2011 Actual	Example 1	Example 2	Example 3
Appraisal fee limit	\$6,000	\$6,500	\$6,600	\$7,200
Increase in limit	n/a	\$500	10%	20% ¹
Number of appraisals assessed at maximum fee ²	44	44	44	44
Total appraisal fees	\$264,000	\$286,000	\$290,400	\$316,800
Potential additional fees	-	\$22,000	\$26,400	\$52,800

1 - 20% is the approximate percentage increase in Consumer Price Index from 2002 to 2011 for Toronto.

2 - The total number of appraisals on which appraisal fees were collected in 2011 was 205.

Recommendation:

- 1. City Council request the Chief Corporate Officer to review the Parks Levy Appraisal Fee structure to ensure that costs are being reasonably recovered and that fees are revised annually to account for inflationary impacts on costs.**

A.2. External Appraisal Fees Are Not Fully Recovered

Some external appraisal costs are recovered

External appraisers are engaged to provide Section 42 appraisals for complex cases where specific expertise or comprehensive appraisal reports may be required. Approximately 10 per cent of all Section 42 appraisal work is contracted out to external appraisers. Some of those costs may be recovered through the appraisal fees.

Costs in excess of \$6,000 are not recovered

However, as the complexity of the appraisal increases, so do costs. In some cases, costs may exceed \$6,000, which may not be recovered.

Estimate of \$112,000 of external appraisers costs not recovered

We compared the costs incurred for external appraisals to the amount of appraisal fees recovered. For external appraisals on 13 properties, actual costs exceeded \$6,000 and totaled \$190,003. Due to the maximum specified in the by-law, only \$6,000 could be recovered from each applicant.

Based on the external appraisals each costing greater than \$6,000, approximately \$112,000 was not recovered through appraisal fees charged to applicants.

Opportunity for increasing recovery of external appraisal fees

Although costs for external appraisals are not fully recovered in all cases, management should consider the feasibility of increasing recovery rates while balancing the need for ensuring fair and reasonable appraisal fees.

Recommendation:

- 2. City Council request the Chief Corporate Officer, in the review of the appraisal fee structure, to explore opportunities for enhancing recoveries from applicants in instances where external appraisal costs exceed \$6,000.**

A.3. Appraisal Costs for Subsequent Section 42 Appraisals Are Not Recovered

Appraisals have a validity period of six months, after which a revised appraisal is required

When a Section 42 appraisal is completed, Appraisal Services advises the applicant of the resulting amounts due for the parks levy and related appraisal fees. Additionally, the applicant is advised that the amounts are valid for a period of six months from the date of the appraisal.

On limited occasions, the applicant may not proceed with a project on a timely basis and the appraisal expires. In those cases, a subsequent appraisal is required to determine the updated value, resulting in additional costs incurred by Appraisal Services.

No cost recovery on subsequent appraisals

As the appraisal fee is a one-time charge, Appraisal Services does not recover any additional costs associated with subsequent Section 42 appraisals even though the need for the appraisal could have been a result of delays by the applicant.

Consideration should be given to charging for subsequent appraisal fees where the need for the appraisal was due to action/inaction on the part of the applicant.

Recommendation:

- 3. City Council request the Chief Corporate Officer, in the review of the appraisal fee structure, to consider the recovery of additional appraisal fees from applicants when additional costs are incurred as a result of applicant action/inaction.**

B. MONITORING CONTROLS OVER APPRAISAL FEE RECOVERIES CAN BE STRENGTHENED

B.1. Appraisal Fee Recoveries Should Be Reconciled

Reconciliation of appraisal fee recoveries is not performed

The annual budget for appraisal fee recoveries is largely based on prior year actual results. Since appraisal workload is variable from year to year, it is important that financial reporting is accurate. Regular reconciliation and monitoring are critical controls in ensuring the accuracy of financial results.

Appraisal Services does not perform a reconciliation of its appraisal fee recoveries. Rather, a budget analyst within the Real Estate Services Division periodically performs a high-level review of the appraisal fees balance to assess the reasonability against the annual budget.

This high level review was insufficient to notice the processing of an entry for \$65,000 correcting an error in recording of revenue in the prior year. While \$65,000 is not significant to the City as a whole, it is significant in the context of annual appraisal fee revenue in the range of \$430,000.

Recommendation:

- 4. City Council request the Chief Corporate Officer to review the adequacy of the reconciliation and monitoring processes over appraisal fee recoveries to ensure that amounts are accurate and that variances are reasonably explained.**

B.2. Outstanding Amounts in Parks Levy Deferred Revenue Account Need to Be Resolved

Parks levy and appraisal fee payments are deferred upon receipt

Parks levy payments and the related appraisal fee is recorded into a deferred revenue account when received by Toronto Building. These amounts are subsequently cleared from the deferred revenue account and allocated to the appropriate accounts, including the appraisal fee revenue account.

Short delays in clearing the account may sometimes arise, due to outstanding issues with the parks levy amount. Based on our review, the amounts are generally cleared within a reasonable timeframe.

\$0.9 million of parks levy payments prior to 2009 are still deferred

However, we noted that the deferred revenue balance as at September 30, 2012 included approximately \$0.9 million of parks levy payments originating between 2004 and 2009. Amounts should generally not be held in deferred accounts for extended periods of time.

Recommendation:

- 5. City Council request the Deputy City Manager and Chief Financial Officer to ensure that the accounting for the \$0.9 million of parks levy payments originating prior to 2009 be resolved as soon as possible.**

C. OPPORTUNITIES TO IMPROVE MANAGEMENT EFFECTIVENESS

C.1. Operational Policies and Procedures Should Be Documented

Benefits of documented policies and procedures

Documented policies and procedures enhance consistency in operations, support effective decision-making, and provide guidance on staff roles and responsibilities.

Appraisal Services does not have documented policies and procedures in place.

Despite the absence of formal documented policies, Appraisal Services staff consulted during this review had a consistent understanding of practices and procedures in most key operational areas, including:

- Appraisal assignment process
- Supervisory review process
- Manager sign-off threshold requirements
- Section 42 parks levy and appraisal fees calculation
- Validity period applicable for all appraisal types
- Client memos and other communications requirements
- Minimum documentation requirements
- Administrative procedures, including file completion and detailed appraisal tracking
- Internal standards for completion
- Independence requirements
- The use of external appraisers

No formal protocol for the use of external appraisers

Although staff are generally familiar with procedures and practices, there are still benefits to formally documenting these. In particular, we note that there is no formal protocol for the usage or selection of external appraisers. Currently, approximately 15 per cent of all appraisal work is performed by a roster of 10 approved external appraisers.

The manager and the supervisor decide when an external appraisal is required and which external appraiser is appropriate for the assignment, mainly based on the following consideration factors:

- Nature and complexity of the work
- Potential for litigation and/or challenge by applicant
- Staff resource capacity

External appraisers are also selected on a rotational basis within the scope of their respective contracts and Purchasing and Materials Management Division staff perform a quarterly review of expenditures under the contracts.

Conflict of interest risk can be mitigated

Having a formal policy on the use of external appraisers would help ensure that they are used in an effective and efficient manner, while minimizing any perceived or potential conflicts of interest.

Recommendation:

- 6. City Council request the Chief Corporate Officer to document Appraisal Services' operational policies and procedures, and ensure that any policies regarding the usage of external appraisers is aligned with the City's Conflict of Interest Policy.**

C.2. Internal Standard for File Completion Time is Not Always Achieved

Average completion time was nine weeks

Appraisal Services' internal standard for completing an appraisal is five to six weeks from the date of request. We found that the average elapsed completion time for an appraisal was closer to nine weeks.

We were advised that the targeted completion dates serve as a general guideline. Staff are assigned to undertake multiple appraisals at any given time, including the review of work done by external appraisers. The volume of appraisal work has increased steadily, while resource capacity constraints and other external factors beyond staff's control have contributed to delays in achieving the targeted completion date.

Completion dates should be monitored

While there is an internal standard for completing appraisals in a timely manner, regular monitoring of the targeted completion dates is necessary to ensure that internal standards are achieved to the extent possible.

Recommendation:

- 7. City Council request the Chief Corporate Officer to regularly monitor the targeted completion dates for appraisal requests to ensure that appraisal results are provided in a timely manner consistent with internally established guidelines.**

D. MORE EFFICIENT USE OF INFORMATION TECHNOLOGY

D.1. Cost-Benefit of SAP Enhancements Should Be Assessed

The use of SAP is currently limited

The City uses SAP for financial reporting purposes. The Real Estate Module within SAP is currently used by Appraisal Services to create electronic work orders for each appraisal request received, but it has limited functionality for management reporting and detailed tracking purposes.

Opportunities for increased functionality of available technology

There are opportunities to improve the functionality of the Real Estate Module to facilitate the tracking, reconciliation and reporting requirements of Appraisal Services, reducing the need for manual tracking currently done by staff.

Time and costs of future system enhancements should be assessed to ensure any change would result in a net benefit to the City.

Recommendation:

- 8. City Council request the Chief Corporate Officer to assess the merits and feasibility of implementing system enhancements to improve the functionality in SAP to better serve management's needs.**

CONCLUSION

This report presents the results of our operational review of Appraisal Services.

The report contains eight recommendations. In our view, implementation of the recommendations have the potential to increase the City's cost-recovery for the provision of appraisal services and further improve overall management effectiveness and efficiency of Appraisal Services.