

INTERNAL AUDIT REPORT OF THE PURCHASE AND SALE OF LANDS

(Referred from Council Meeting of May 12, 2008, Item 2, Report No. 2)

Council, at its meeting of May 12, 2008, adopted the following:

Recommendation of the Audit and Operational Review Committee, May 6, 2008:

"The Audit and Operational Review Committee recommends that this matter be referred to the next Audit and Operational Review Committee meeting."

Report of the City Auditor dated May 6, 2008.

Recommendation

The City Auditor recommends:

That the Internal Audit Report of the Purchase and Sale of Lands be received.

Economic Impact

The recommendations suggested by the auditor and the implementation of corrective actions in the audit report, will improve the effectiveness of risk management, control and governance processes of the department. Some impact will be economic and will be measurable in dollar terms, while others will provide intangible benefits which may not be measurable. Other benefits will be an improvement in the efficiency and effectiveness in the operations of the department. Internal Audit adds value to all areas of City activity which are audited.

Communications Plan

This is to be addressed by the Corporate Communications department.

Purpose

To present to the Audit Committee, the Internal Audit Report of the Purchase and Sale of Lands .

Background - Analysis and Options

The audit was part of the Internal Audit Work Plan which was approved by the Audit Committee.

The internal audit report is provided as an attachment. The report explains the definition and objective of internal auditing as well as the scope of internal audit work. The report includes, for all deficient items, (1) the observations of the auditor, (2) the implications, (3) the auditor's recommendations, (4) the commissioner's response for corrective actions and (5) the auditor's response to the corrective actions.

Relationship to Vaughan Vision 2020

This report is consistent with the priorities previously set by Council and the necessary resources have been allocated and approved.

Regional Implications

Not applicable

Conclusion

1. Based on the scope of audit work mentioned in the beginning of the audit report, areas reviewed were considered to be operating effectively, except for the noted observations for which the auditor made recommendations for improvement.
2. The commissioner and director of the department/operation audited, have responded favourably to all observations and recommendations in the Internal Audit Report.
3. When all corrective actions are implemented, (1) internal controls will be improved, (2) the quality of performance in carrying out assigned responsibilities will be enhanced, (3) the department/operation will operate more effectively and efficiently and (4) the Internal Audit department will have added value to the organization and assisted members of the organization in the effective discharge of their responsibilities.

Attachments

Internal Audit Report of the Purchase and Sale of Lands .

Report prepared by:

Michael Tupchong, CA, CIA, CPA, CFE
City Auditor

Respectfully submitted,

Michael Tupchong, CA, CIA, CPA, CFE
City Auditor



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Michael DeAngelis
City Manager
City Of Vaughan
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Canada L6A 1T1

Dear Michael De Angelis,

Re: Audit of the Purchase and Sale of Lands

I have completed the audit of the Purchase and Sale of Lands. This audit was conducted in accordance with the three year 2005-2007 Audit Plan.

A follow-up letter will be sent to the auditee, 30 days from the date of this audit report, requesting the status of corrective actions on deficiency items noted in this audit report. Subsequent follow-up letters may be sent until all corrective actions have been satisfactorily implemented.

I would like to thank the commissioner, the director and their staff for accommodating me and providing me with unrestricted access to all staff and information during my audit.

I have exercised independence, objectivity and due professional care in accordance with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors.

The Internal Audit department is committed to adding value, providing continuous improvement recommendations, and professional service to the whole organization.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Tupchong".

Michael Tupchong CA, CIA, CPA, CFE
City Auditor

cc: J. Atwood-Petkovski C. Harris H. Wilson L. Haughton

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INTERNAL AUDIT REPORT
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DEFINITION, OBJECTIVE AND SCOPE

1. **Definition:** Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
2. The **objective** of Auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, Auditing furnishes them with analyses, recommendations, counsel, and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost. In the end, Audit is focussed on continuous improvement of the organization.
3. The **scope** of Auditing encompasses the examination and evaluation of the adequacy and effectiveness of the organization's system of control and the quality of performance in carrying out assigned responsibilities. The Auditors are concerned with any phase of City activity. The scope of Auditing includes:
 - Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
 - Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations, which could have a significant impact on operations and reports, and should determine whether the organization is in compliance.
 - Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
 - Appraising the economy and efficiency with which resources are employed.
 - Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
 - Reviewing the identification of risk exposures and the use of effective strategies to control them.
 - Reviewing specific operations at the request of the Audit Committee or City Manager, as appropriate.

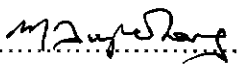
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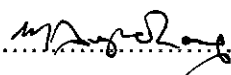
FOLLOW-UP ON CORRECTIVE ACTIONS

1. It is extremely important that all Corrective Actions as stated in this Internal Audit Report are implemented as soon as possible.
2. The Internal Audit Department will perform regular follow-ups, the first being 30 days after the issue date of the Internal Audit Report, followed by subsequent 30 days until all Corrective Actions have been satisfactorily implemented. Follow-up audits may be done to verify the reported implementation.
3. The Corrective Actions will ensure that the deficiencies as raised by the Auditor will be addressed. After all Corrective Actions have been implemented, there will be improvement in the effectiveness of risk management, control, and governance processes. The department will operate more efficiently and effectively. Members of the organization will also have discharged their responsibilities.
4. At the discretion of the Commissioner/Director, this report may be distributed to the appropriate staff members under their jurisdiction. Deficient items which could be common across the organization should be globally addressed. Further consideration should be given to revise/update current policies and procedures, as deemed necessary.

INTENDED PURPOSE OF THE REPORT

This report is presented purely to add value and to improve the operation in terms of the scope of the audit for effectiveness, efficiency and continuous improvement. Areas reviewed were considered to be operating effectively, except where specifically noted as observations for which the auditor has made recommendations for improvement. The report is not intended to criticize/discredit any individual, or the management of the operation. The recommendations are suggestions of the auditor to achieve the objective of the audit.

Auditor(s): Michael Tupchong.....**Signature:**.....

Approved:

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Sale of Land - Agreement of Purchase and Sale wording

Observations:

It was observed that the Agreement of Purchase and Sale used for sale of lands are for the most part one of two varieties, although other variations have been seen. One type (longer version) is used for properties offered for sale "under tender"(usually property with a higher market value), and a shorter version is used for "other properties offered for sale" (usually property with a lower market value), as recommended by the department and approved by Council.

- 1) For these two versions, there is no "as is, where is" clause subject to certain provisions.
- 2) For the longer version, the clause for the Purchaser to opt out of the contract is considered somewhat "grey". The wording "In the event that the Purchaser is not satisfied with the results of any inspection" "or response to inquiries" "which materially impact", is considered not watertight and allows the buyer to rescind the Agreement or use it as a bargaining ploy for a further price reduction or some other benefit.
- 3) For the shorter version of the Agreement of Purchase and Sale, the wording for GST i.e., "the Purchaser agrees to pay GST if applicable", is considered somewhat short and may be improved upon as seen in other agreements.

Implications

1. The "as is, where is" clause may provide the City with additional safeguards against claims in respect of work that may be required in order to bring the land or any part thereof into compliance or against a purchaser trying to rescind the agreement without a justifiable reason.
2. The Purchaser may try to opt out of the Agreement without legitimate reasons as long as he is "not satisfied with the results of any inspection" "or response to inquiries" "which materially impact". This could be used as a "excuse" to re-negotiate a lower purchase price or request some other benefit, or cancel the deal.
3. The explanation on the GST process in the shorter version, could be improved upon to ensure both parties understand their obligations.

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Recommendations:

It is recommended that all versions of the Agreement of Purchase and Sale should be reviewed, whether it is appropriate to include or make revisions for the three observations noted above.

Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

1. "As is, where is" may result in lower or fewer bids on lands, or lower amounts offered in negotiations. Tenders are subject to a confidential reserve bid of market value, which results in the cancellation of the tender should all bids received be below the amount. "As is, where is" may elicit bids at lower than market value.
2. The clause used was a standard clause. Council has directed the clause be limited in future tenders.
3. The wording of the G.S.T. clause is legally satisfactory, and the City has never encountered a problem. Closing checklists provide for receipt of either a G.S.T. Registration number and undertaking, or the funds. Closings are not completed without one or the other.
4. A review of Standard Agreements has been ongoing.

Auditor's Response to Corrective Action:

The auditor accepts the response given and that a review of Standard Agreements is ongoing.

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One Appraisal may be inadequate

Observations:

There is a By-law for the Disposal of Property which states that an appraisal is required before property is disposed of. There is however no guidance on the number of appraisals required should the property exceed "X" dollars.

Purchase:

It was observed that only one independent appraisal is obtained by the City, for lands which are purchased irrespective of the value of the land.

Sale:

For sale of land, only one independent appraisal is obtained by the City, irrespective of the value of the land.

Implication:

For higher priced properties, having only one appraisal may not give the City adequate comfort level on the "true" market value of the land. This may hamper the City in its negotiation process and the City may not receive the "best" price for the land.

Recommendation:

1. It is recommended that should the value of the land be between \$ 1 million and \$5 million dollars, then possibly two independent appraisals should be obtained. Should the value exceed \$5 million dollars, then possibly 3 independent appraisals should be obtained. The additional cost of the appraisal should be more than offset by the additional information obtained from the appraisals which will better prepare the City in their negotiations to purchase or sell lands at the most favourable competitive price.

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Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

The Old Municipal Act require that one appraisal be obtained for disposition of lands, except for those lands listed by regulation (very small parcels). The New Municipal Act does not contain this requirement, however the City's Disposal of Property by-law requires at least one appraisal. The City is complying with the statutory requirements.

The Manager of Real Estate reviews each appraisal, which represents a second opinion. Should the Manager have questions, she forwards the appraisal to a second independent appraiser for review. Review is less costly and time consuming than requesting a second appraisal.

Should Council wish staff to obtain more than one appraisal when lands are anticipated to be of a value for a certain amount, direction can be given, however there is a cost involved which would have to be paid by the City for purchases, and paid out of proceeds obtained on a sale, for sales.

Auditor's Response to Corrective Action:

The auditor accepts the response given and that the Manager of Real Estate reviews each appraisal, which represents a second opinion and uses her discretion whether to seek an additional appraisal.

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“Reasonable survey, legal and other costs” without limits

Observations

1. The City purchased Part of Lot 18, Concession 7, City of Vaughan and being Part1 on Plan 65R-27455(the “Property”) subject to an easement over Part1, Plan65R-26872 for Bell Telephone facilities. The Purchase Price in the agreement reads as follows: “seven hundred and eighteen thousand eight hundred and sixty-seven dollars and ten cents(Cdn\$) \$718,867.10, plus the Seller’s reasonable survey, legal and other costs related to the sale of the Property to the Buyer.”
2. In the opinion of the auditor, “the Seller’s reasonable survey, legal and other costs related to the sale of the Property to the Buyer.” is somewhat loose and open to abuse by the seller. What the City may consider reasonable costs may differ largely from what the seller may consider reasonable. For example, an \$8,000 charge by the seller who considers this reasonable, might be considered excessive by the City which might consider \$5,000 to be reasonable.

Implications:

1. The City could be charged costs which it deems to be excessive, yet which the seller deems as “reasonable.”
2. Disputes over “excessive” survey, legal and other costs could result in “poor” relations with the seller over future purchases.

Recommendations:

It is recommended that the wording “the Seller’s reasonable survey, legal and other costs related to the sale of the Property to the Buyer.” should be reviewed and re-worded to be more specific. There should be a cap for the dollar amount charged so that the seller’s charges are not open to interpretation of what is considered “reasonable”.

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Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

This is a standard condition in TRCA agreements, but is not contained in other agreements except through negotiations, at which time costs are limited. Staff could request a limitation on this clause when negotiating with TRCA in the future, however staff expect TRCA to refuse to amend the clause.

In any event, for those negotiated transactions in which the City agrees to pay "survey, legal and other costs", although a cap is a reasonable suggestion, it must be considered in the context of the purpose of this clause, which is utilized when the City acquires a property, and the Vendor agrees to sell provided that the Vendor receives the sale price in full without any additional expenses. Since expenses to the Vendor are not known at the time the Agreement is executed, it is specified as "reasonable" survey, legal and other costs related to the sale of the Property to the Buyer. The difficulty in utilizing a cap will be determining the amount of the cap. The cap would likely have to be very high in order to accomplish the Vendor's objective, which is to receive a net amount (i.e. the sale price) without any additional expenses. Accordingly, as a practical matter, this "high" cap provides limited protection to the City, because the cap amount would be set by the Vendor at an amount well in excess of what would be considered "reasonable" because the Vendor would not be prepared to take the risk of unanticipated expenses arising.

Auditor's Response to Corrective Action:

The auditor accepts the response that the staff "could request a limitation on this clause when negotiating with TRCA in the future".

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Interest not earned on Deposit Paid

Observation

On a review of deposits paid in three Purchase of land transactions by the City, there was no mention in the Agreement of Purchase and Sale to the effect that the deposits would accrue interest which would belong to the City and be used to offset the Purchase Price. Two deposits were \$50,000 each and one was \$100.

Implication:

The City is not receiving interest on deposits paid. This "loss" is increased by the fact that the City is also paying interest on money borrowed to pay the deposit.

Recommendation:

The Agreement for the Purchase of Lands should have such wording that the deposit paid by the City would bear interest up to the time of closure of the agreement and such accumulated interest would belong to the City. For small deposits, the interest could be small and immaterial, but for large deposits the interest could be a reasonable amount, especially if there was some length of time, between agreement date and closure date, due to unforeseen circumstances.

Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

This is generally not an issue, as the City rarely pays a deposit, as acquisition is usually from other government bodies and closing times are very short. Such a provision may also form part of the negotiations; however the clause can be included in a standard agreement.

Auditor's Response to Corrective Action:

The auditor is satisfied that the clause regarding interest earned on deposits, will be included in a standard agreement.

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Land Purchase-Agreement of Purchase and Sale not corrected

Observations:

1. Council approved the purchase of lots 8, 9, and 10, Concession 2 City of Vaughan on December 9, 1998.
2. The signed copy of the Agreement of Purchase and Sale showed "Lands" as "those parts of Lots 8, 9 and 10, Concession 2, "and comprising 58 acres more or less".
3. In April 1999, the City of Vaughan purchased and paid for Parts of Lots 9 & 10, Concession 2, shown as Parts 28,29,30,31,35,36 & 40 on Reference Plan 65R-21129 City of Vaughan from the Ontario Realty Corporation for \$4,586,090. (53.954 acres @ \$85,000 per acre). This is reflected on (1) Transfer/Deed of Land (2) Charge/Mortgage of Land.
4. However, there was no amendment to the Agreement of Purchase and Sale to exclude Lot 8. The auditor was informed that the information on the (1) Transfer/Deed of Land and (2) Charge/Mortgage of Land, supercedes the information on the Agreement of Purchase and Sale which no longer becomes "relevant" once the (1) Transfer/Deed of Land and (2) Charge/Mortgage of Land have been prepared and registered. Lot 8 was deleted from the legal description through finalization of the reference plan.

Implications:

The Agreement of Purchase and Sale as it reads, does not agree with 1) Transfer/Deed of Land and 2) Charge/Mortgage of Land..

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Recommendation:

It is recommended that:

1. The Agreement of Purchase and Sale should in itself or with an Amendment, accurately reflect the exact details of the land purchased.
2. It would be good housekeeping that the Agreement of Purchase and Sale with or without an Amendment, agree with 1) Transfer/Deed of Land and 2) Charge/Mortgage of Land.

Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

In many instances, such as purchases from O.R.C. or purchases of small slivers of City property, lands acquired or sold are part of a larger parcel, with a corresponding legal description. Reference plans are prepared for the exact land to be purchased, often after the execution of the Agreement of Purchase and Sale. Legal description of the property are clarified through title searches, reference plans, and correspondence between solicitors and it is not legally necessary to amend the Agreement of Purchase and Sale. This is an extra paperwork step that is not common practice in the real estate field.

Auditor's Response to Corrective Action:

The auditor accepts the response given, and the explanation of "not common practice in the real estate field".

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Real Estate Department Staff Level concern

Observations:

1. It was observed that the Real Estate Department currently consists of two people, namely, the Manager of Real Estate and a secretary. In the past, there was one additional temporary part-time position which was filled by a number of individuals who stayed for a number of months each.
2. The Manager handles all the Real Estate activities of the City excluding the legal work. When she is away, there is no one to continue her work or start new projects...the department is somewhat in a standstill until she gets back.

Implications:

1. There is some risk to the City in that there is no one else in the department who is able to (1) effectively continue the work of the Real Estate Manager should she not be available or (2) start new projects.
2. There is also a question of succession planning in the event she retires or resigns.

Recommendations:

1. Due to priority and workload, it may be appropriate to hire an additional qualified person who has knowledge and experience in real estate to perform some of the Real Estate activities and continue the work should the Manager not be available, or even to assist her in pursuing the real estate activities in the interest of the City.
2. The City should also give consideration to succession planning in the department.

Corrective Actions (Commissioner Janice Atwood-Petkovski's Response)

We are currently recruiting for an Appraiser/Negotiator, however if we cannot successfully fill the position, we will reassess and potentially re-define the function or split the job.

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Auditor's Response to Corrective Action:

The auditor is satisfied that the recruitment for an Appraiser/Negotiator will address the concerns raised.

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CONCLUSION

1. Based on the scope of audit work mentioned in the beginning of the audit report, areas reviewed were considered to be operating effectively, except for the noted observations for which the auditor made recommendations for improvement.
2. The commissioner and director of the department/operation audited, have responded favourably to all observations and recommendations in the Internal Audit Report.
3. When all corrective actions are implemented, (1) internal controls will be improved, (2) the quality of performance in carrying out assigned responsibilities will be enhanced, (3) the department/operation will operate more effectively and efficiently and (4) the Internal Audit department will have added value to the organization and assisted members of the organization in the effective discharge of their responsibilities.