

**CITY OF HAMILTON**

**CITY MANAGER’S OFFICE**  
**Audit Services Division**

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<th>TO: Chair and Members Audit, Finance and Administration Committee</th>
<th>WARD(S) AFFECTED: CITY WIDE</th>
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**COMMITTEE DATE:** November 23, 2011

**SUBJECT/REPORT NO:**  
Follow Up of Audit Report 2010-01 - Real Estate Asset Management (AUD11031) (City Wide)

**SUBMITTED BY:**  
Ann Pekaruk  
Director, Audit Services  
City Manager’s Office

**PREPARED BY:**  
Ann Pekaruk 905-546-2424 x4469

**SIGNATURE:**

**RECOMMENDATION**

That Report AUD11031, respecting the follow up of Audit Report 2010-01, Real Estate Asset Management, be received.

**EXECUTIVE SUMMARY**

Audit Report 2010-01, Real Estate Asset Management, was originally issued in June, 2010 and management action plans with implementation timelines were included in the Report. In October, 2011, Internal Audit conducted a follow up exercise to determine that appropriate and timely actions had been taken. Of the 12 recommendations that management agreed to in the original Report and Addendum, five have been completed, five are in progress and two have not been completed. Staff originally disagreed with two of the recommendations and no further follow up work was carried out.

**Alternatives for Consideration – Not Applicable**

**FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)**

| Financial: None. | Staffing: None. | Legal: None. |
HISTORICAL BACKGROUND (Chronology of events)

Audit Report 2010-01, Real Estate Asset Management, was originally issued in June, 2010. The Report provided 14 recommendations identifying areas for improvement with respect to the leasing, acquisitions and disposals of the City’s real estate assets.

It is normal practice for Internal Audit to conduct follow up reviews within a 12-18 month period following issuance of the original report in order to determine whether action plans committed to by department management have been implemented.

POLICY IMPLICATIONS

None.

RELEVANT CONSULTATION

The results of the follow up were provided to management responsible for the administration of the City’s real estate holdings and transactions (leasing, acquisitions and disposals) – Real Estate, Economic Development and Real Estate, Planning and Economic Development Department; Facility Services, Transportation, Energy and Facilities, Public Works Department; and Accounting Services & Accounts Receivable, Financial Services, both in the Corporate Services Department.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

The report attached as Appendix “A” to Report AUD11031 contains the first three columns as originally reported in Report 2010-01 along with an added fourth column indicating Internal Audit’s comments as a result of the follow up work. The original Addendum section containing five recommendations also contains follow up comments.

Five of the 14 recommendations have been fully implemented. These are: allocating administrative costs to specific property purchases; endorsing sales deposit cheques upon receipt; collecting proof of liability insurance from all lessees; informing the responsible division of its role in properly administering the terms of the lease; and including supporting documentation for the lease rates charged.

The five in progress recommendations include: providing a single source of accurate and complete property inventory data and lease agreement information; updating the real estate portfolio in the database as changes occur; enabling the calculation of gains/losses on dispositions from information in the database; and implementing a more proactive approach to lease renewals before their expiration date.
The two recommendations whose status are not completed concern invoicing leases through the City’s Accounts Receivable section and recovering the outstanding amount of GST (now HST) from a particular lessee.

There was no follow up pertaining to the two recommendations with which management disagreed.

**ALTERNATIVES FOR CONSIDERATION**
*(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)*

Not applicable.

**CORPORATE STRATEGIC PLAN** *(Linkage to Desired End Results)*


**Financial Sustainability**

- Delivery of municipal services and management of capital assets/liabilities in a sustainable, innovative and cost effective manner

**APPENDICES / SCHEDULES**

Appendix “A” to Report AUD11031: Audit Report 2010-01

ap:tk
# OBSERVATIONS OF EXISTING SYSTEM

1. **Property Inventory**

   Despite the City tracking its real estate holdings in a number of different ways, there is no single database that is complete, up-to-date and can be relied upon to manage the inventory of City-owned properties.

   A manually prepared set of binders kept in the Real Estate section is supposed to catalogue property details by ward. However, this system does not provide an ongoing count of properties owned nor their historic cost. In addition, it was learned that the information in the binders has not been updated for purchases and sales since the summer, 2009.

# RECOMMENDATION FOR STRENGTHENING SYSTEM

That the Real Estate section either implement a new system or modify one of the existing systems in order to provide accurate and up-to-date property inventory data (including identification of purchases and sales) to facilitate real estate asset management from a single source.

That the system implemented above be updated to reflect changes in the real estate portfolio as they occur.

# MANAGEMENT ACTION PLAN

(RE: Real Estate / AS: Accounting Services / AR: Accounts Receivable)

**RE - Agreed.** The Real Estate database is currently being integrated into the Real Estate module within the Archibus program administered by Transportation, Energy and Facilities, Public Works, for sales and acquisitions. Discussion will ensue with the administrator to seek input on the capabilities of expanding the Archibus program to catalogue property assets as a single database within the control of the Real Estate Section. Expected completion – Q1, 2011.

**RE – Agreed.** All current working files are being integrated into the Archibus database.

**In Progress.** As noted above, the new property inventory database described is being updated regularly. Work continues on the RE database helping to augment Archibus. Expected completion – Q1 2012.

**FOLLOW UP (OCTOBER 2011)**

- In Progress. RE has developed a database that works together with Archibus to provide accurate and up-to-date property inventory data. This system is used to verify City owned properties. However, some Archibus records must still be updated to reflect current data for the new database. Expected completion – Q1 2012.
### Observations of Existing System

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<td>1</td>
<td><strong>Property Inventory (Cont’d)</strong></td>
<td>The Archibus system, used extensively for building maintenance management, is another source of information. Even though it captures the cost of the property itself, it does not include other purchase related costs (e.g. land transfer tax, legal fees, environmental assessment fees, etc.) to its capital base. Therefore, it cannot be used in the gain/loss calculations for sales of properties. Properties must be identified by a unique property roll number which may not always be possible. The property database maintained by the Tangible Capital Asset Accounting (TCAA) Specialist was developed to track the City’s capital assets as a financial statement requirement. Once again, various identification and valuation methodologies particular to this data (e.g. exclusion of land parcels less than .15 Ac., updates of purchases and sales only at the end of the fiscal year) result in differences from other databases.</td>
<td>That the system implemented have the data required and the capability of calculating the gain or loss on each property sold.</td>
<td>AS – Agreed. A system would be beneficial for ongoing tangible capital asset accounting and asset management. A more accurate and up-to-date system would reduce the likelihood of a material error occurring from the omission of a major acquisition, sale or disposal. Staff from Accounting Services will be assigned to ensure that the system captures data required from a tangible capital asset accounting perspective and processes for timely updates are implemented.</td>
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### Observations of Existing System

#### Property Inventory (Cont’d)

Several other applications (e.g. Vailtech, ReCapp, GIS) all contain information regarding the City’s real estate holdings but the data is specific to the particular use of the application.

An attempt to compare totals across the various databases resulted in many differences as no single record was considered complete and up to date.

Without a single, complete record of all real estate holdings, asset management and administration are less efficient.

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## OBSERVATIONS OF EXISTING SYSTEM

### Property Purchases

With any property purchase, there are administrative costs incurred. These include appraisal fees, environmental assessment fees, legal fees and land transfer taxes. Even though these costs are available for each property purchase, they are accumulated in an account for the year and then equally distributed to the properties purchased in the time period. Even though the costs are accounted for as a whole, they are unfairly allocated as small properties (which would generally be expected to incur less administrative costs than larger property purchases) are allocated the same expense as larger properties. For example, in 2008, average administrative costs of $9,600 were equally added to properties which cost $10,000 and $1,000,000. This, in turn, would affect the calculation of the gain or loss on the sale of the property.

### RECOMMENDATION FOR STRENGTHENING SYSTEM

That the actual administrative costs incurred for each specific property acquired be accounted for in the cost of the applicable purchase.

### MANAGEMENT ACTION PLAN

(RE: Real Estate / AS: Accounting Services / AR: Accounts Receivable)

AS – Agreed, in principle. From an accounting perspective, this recommendation would increase the accuracy of our financial statements since actual costs would be identified by specific properties, where available. However, it would not make a material difference overall as all costs are accounted for. Some group costs, such as staffing costs of the Real Estate section, would still have to be allocated in the current manner for each real estate holding.

Specific details of expenditures for each property acquisition through regular analysis and categorization of transactions would also require more Real Estate section staff time which may not be cost beneficial.

### FOLLOW UP (OCTOBER 2011)

Completed. Approximately 80% of the administrative costs associated with individual property purchases are now more accurately distributed in Archibus. The remaining 20% of administrative costs are not allocated to a specific property as these charges relate to the general monthly fees incurred for using title search software.
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<td>3.</td>
<td><strong>Property Sales</strong>&lt;br&gt;A purchaser wanting to acquire a City-owned property that is for sale must submit a deposit (in the form of a cheque) equal to 10% of the agreed upon purchase price. Currently, the cheque is not restrictively endorsed when it is accepted by the Real Estate staff. It is stored in a petty cash box until Legal Services acknowledges the acceptance of the purchaser’s offer. This may take from a few days to a few weeks.&lt;br&gt;Cheques that are not restrictively endorsed upon receipt may be more susceptible to misappropriation.</td>
<td>That all cheques be restrictively endorsed immediately upon receipt by the Real Estate section.</td>
<td>RE - Agreed. Upon receipt, the cheques will be endorsed through the stamping of the back of the cheque with “For deposit only to the City of Hamilton”.</td>
<td>Completed. An endorsement stamp has been issued to the Real Estate staff responsible for accepting the deposit cheques. These cheques are now restrictively endorsed immediately upon their receipt by the Real Estate section.</td>
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<td>4.</td>
<td>Leases - General</td>
<td>That the Real Estate section of Planning and Economic Development be assigned accountability for the administration and management of all City leases.</td>
<td>RE - Disagreed. The Real Estate Section provides realty services to the various client departments. Upon completion of lease negotiations, administration of the terms and conditions for premises, wherein the City is a tenant, is currently being administered by Transportation, Energy and Facilities, Public Works and for all other leases administered by the respective client departments/divisions. Real Estate does not become involved in the lease arrangements/negotiations for users groups within Parks, Parking and Recreational facilities, nor to the administration of same.</td>
<td>In Progress. Corporate Facilities Management (CFM) and Real Estate (RE) have been working on a Lease Management Agreement as it relates to the interaction, roles and responsibilities of each section in lease management for corporate facilities. The agreement will establish and define roles and responsibilities with respect to lease transactions; create greater synergy between CFM and RE; create standardized procedures, practices, policies and business processes; and achieve efficiency in the delivery of lease management services by both units utilizing best practices. This agreement is in draft form and is expected to be completed by the end of the 1st quarter 2012.</td>
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### Observations of Existing System

**Leases – General (Cont’d)**

With such separation of information, roles and responsibilities may be unclear in terms of the management of such leases.

### Recommendation for Strengthening System

The assignment and accountability is more of a corporate issue - having all client departments maintain and input data into one centralized corporate database, such as the Archibus program, and assigning accountability for the accuracy of information and continued implementation to a lead department. The tasks to consolidate, input, and effectively maintain a leasing portfolio for the entire organization would have an extensive impact on the section’s resources. Implementation to centralize this program will have a budget and staffing impact conservatively estimated at $200,000 and 2 new FTE’s.

### Management Action Plan

(RE: Real Estate / AS: Accounting Services / AR: Accounts Receivable)

### Follow Up (October 2011)
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<td>4.</td>
<td>Leases – General (Cont’d)</td>
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<td>In addition, the section’s focus is more on strategic real estate planning and portfolio management as set out in Council's approved plan. The recommendation is beyond the scope of the service provided by Real Estate and will be referred to the Portfolio Management Committee with its recommendations to be forwarded to Senior Management Team for discussion and direction. The Portfolio Management Committee, chaired by the Director of Economic Development and Real Estate, meet on a monthly basis. RE – Agreed. See the Management Action Plan for recommendation #1.</td>
<td>In Progress. As noted in the follow up to recommendation #1, work continues on the RE database. Also, RE is working with Corporate Facilities in updating lease information in Archibus (on CFM leases only). Expected completion – Q4 2012.</td>
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<td>5.</td>
<td>Leases - Expiring Agreements</td>
<td>That management consider a process that will alert staff well in advance of the expiration of a lease in order that a more proactive approach to re-negotiating the lease can be taken.</td>
<td>RE - Agreed. Implementation of the Archibus program will alert staff well in advance of the expiration date of leases within the current year to assist staff to act upon renewals in a timely manner. However, on occasion, negotiations may extend beyond the lease term (due to the complexity of the lease conditions thereby requiring further instructions from the client department) and create a gap before the new lease takes effect.</td>
<td>In Progress. A process has been implemented to alert management and staff prior to lease expiration. However, since all lease agreements are not reflected in Archibus at this time, it is difficult to ensure that all leases are being re-negotiated proactively. This will only occur when point #4b above has been completed.</td>
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Even though the Archibus system sends expiry notices to staff six months in advance, Accounts Receivable sends e-mail reminders one month before a lease expires and the Real Estate section’s work plan lists leases up for renewal, it was noted that, in several files reviewed, new lease agreements had not been completed and were not ready to take effect as the existing leases expired. The gaps between the time the existing leases expired and the time that the new leases took effect ranged from four months to as long as thirteen months.
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<td>6.</td>
<td>Leases - Liability Insurance</td>
<td>That the existing provision requiring the lessee to provide proof of liability insurance annually be enforced.</td>
<td>RE - Agreed. Steps have already been undertaken with the appropriate client department administering the terms and conditions of City leases for ensuring that the City is protected by proof of insurance coverage from the lessee(s). As noted above, staff will be alerted through the Archibus program in advance for subsequent follow ups.</td>
<td>Completed. Proof of annual liability insurance is now being obtained from lessees.</td>
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All lease agreements include a provision in which the lessees agree to obtain and maintain liability insurance that names the lessor (the City) as an additional insured. The lessees are obligated to deliver certificates of insurance once a year to the lessor as proof of such insurance. A review of a sample of the current lease agreements revealed that such certificates are not collected. This could place the City at risk in the event of third party liability issues at one of the City’s leased properties.
ADDENDUM

The following items were noted during the course of the audit. Although they do not present internal control deficiencies, they are indicated in this Addendum so management is aware of the issues, risks and inefficiencies and can address them appropriately.

(RE: Real Estate / AS: Accounting Services / AR: Accounts Receivable)

Existing Lease – Billing and GST

1. During the review of rent billings, it was noted that an existing lessee had not been invoiced for rent from the time the lease came into effect on July 1, 2005. Instead, the lessee simply deposited a cheque with the Municipal Service Centre (MSC) every month in accordance with the lease terms as he understood them. There is the risk that staff at the MSC processing the payments would not know whether the amount paid was accurate or complete. For example, it was found that this lessee had not been paying GST on the lease even though the lease agreement expressly stated that this was required. The oversight has totalled approximately $1,500 in unpaid GST to the end of January, 2010.

It is recommended:
That all leases be invoiced through the City’s Accounts Receivable section.

Management Response:
RE - Agreed. All leases will be invoiced through the City’s Accounts Receivable section.
AR - Agreed. Accounts Receivable is prepared to process any invoices for leased premises requested from Facilities or the Real Estate section.

Follow Up Comment:
In Progress. This lease is not invoiced through the City’s Accounts Receivable section although several others are (see Follow Up Comment directly below).

That the outstanding amount of GST due be recovered from the lessee and that it be remitted to the Canada Revenue Agency (CRA).

Management Response:
AR - Agreed. The required information will be obtained immediately and be invoiced.

Follow Up Comment:
Not Completed. The lessee referred to above is still not paying HST on the lease and GST/HST amounts owing have not been recovered. The invoicing and collection is not handled by Real Estate but is to be administered by the client section and/or Facilities. In this particular case, the oversight of this particular lease has been impacted by a staff vacancy in Facilities.
Existing Lease – Lease Terms - Adjustment for Inflation

2. A particular lease agreement reviewed provided for a lease rate adjustment for inflation every year on the anniversary date of the lease. Despite the fact that this lease had been in effect since June 1, 2007, the responsible division was not aware that the operating costs should be reviewed and the rate charged the lessee should be adjusted for the impact of inflation on these costs. A review, in this particular case, indicates that, due to the low level of inflation, no change in the rate was necessary.

It is recommended:
That, once a lease agreement has been finalized, the Real Estate section inform the responsible division of its role in properly administering the terms of the lease.

Management Response:
RE - Agreed. Effectively immediately, once a lease agreement has been finalized/executed, the Real Estate section will forward all supporting documentation and inform the respective client division of its role in properly administering the terms and conditions of the lease.

Follow Up Comment:
Completed. A review of sampled leases indicates that the Real Estate section provides the client department a copy of the leases and an e-mail outlining the highlights and particulars of the lease for administration purposes.

Existing Lease – Lease Terms - Rate Setting

3. Per Council directive, lease rates, where the City is the landlord, are to be set at or above the fair market rate with the fair market rate determined by an appraisal. In some cases, it may not be possible to perform such an appraisal because the property is unique or not readily comparable due to location. Therefore, in such cases, management has decided that the rate should cover the operating costs of the property being leased. In two cases reviewed, it was found that the lease rate was either set below the operating costs or no documentation for the operating costs existed in the files to support the rate. Therefore, these properties may be generating less revenue than directed. Without adequate cost information for each property, it is difficult to evaluate the financial performance of individual properties as well as make effective leasing decisions.

It is recommended:
That the lease rates charged for all properties be supported by the appropriate documentation.

Management Response:
RE - Agreed. Effective immediately, lease rates charged for all properties will be supported by the appropriate documentation.

Follow Up Comment:
Completed. Lease rates charged for properties are supported by the appropriate documentation.
Gain/Loss Calculations

4. The Tangible Capital Asset Accounting (TCAA) Specialist does not have access to Real Estate files and generally does not know the amount paid for a property or when it was acquired (if pre 2007). Therefore, in calculating the gain/loss on the sale of a property in cases where such information is not known, an acquisition price calculated using inflation figures and a backtracking method, pushes values back to 1959. In Internal Audit’s testing of six gain/loss on disposal calculations, two sizeable errors resulted from this methodology – one for a difference of approximately $729,000 and another for a difference of $197,000.

As there are not a significant number of sales in a year, the TCAA Specialist needs to confirm original acquisition data and transactions against records maintained in the Real Estate section.

It is recommended:

That the TCAA Specialist confirm acquisition costs with the Real Estate section’s records prior to the calculation of the gain/loss on disposal of City-owned property.

Management Response:

AS - Disagreed. A property inventory was obtained from the Real Estate section in the form of an Access database but no cost information was included. In the interest of cost and time, an estimated historical cost was assigned based on assessment values for vacant land. Estimating techniques were recommended by the CICA’s Public Sector Accounting Board for tangible capital asset accounting and audited by our external auditors. Furthermore, much of the City’s land holdings were acquired for no monetary consideration (i.e. airport lands transferred from the Federal government, Housing lands downloaded from the Province, developer contributions related to parklands and Water and Wastewater facility lands). Although these lands were acquired by the City for no consideration, a fair value cost is still needed and Real Estate records would not provide the required cost information.

Follow Up Comment:

Management originally disagreed. No follow up was performed.