



Audit of Capital Projects Administration: Property Acquisition

Follow-Up Review

The Real Estate Division has implemented effective procedures for acquisition of real estate assets and their reporting to Accounting; however, document retention processes need improvement.

A request for qualifications process was completed to ensure qualified appraisers are available for valuation of real estate assets prior to their acquisition. In addition, training requirements for all staff have been established.

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Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Capital Projects Administration: Property Acquisition issued in May 2020. The original audit evaluated the Real Estate Division's property acquisition process for capital projects. This follow-up review was included in the City's fiscal year 2021-22 Annual Internal Audit Plan as approved by the City Council.

What we Found:

The Real Estate Division has implemented effective standard operating procedures that outline the negotiation process for acquiring real estate assets and reporting these to the Accounting Division; however, some critical documentation was not easily found. In addition, Real Estate has adopted a standard operating procedure that requires all staff to receive training and has established qualifications for hired appraisers. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process	Concurred	In Progress
2. Adopt a formalized negotiation process incorporating the following key requirements: <ul style="list-style-type: none"> a. Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property; b. Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and c. Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit. 	Concurred	Implemented
3. Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.	Concurred	Implemented
4. Define qualification criteria in policies and procedures for hiring and engaging appraisers	Concurred	Implemented
5. Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.	Concurred	Implemented

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal¹ of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Audit of Capital Projects Administration: Property Acquisition issued in May 2020. We conducted this performance 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the [Audit of Capital Projects Administration: Property Acquisition \(May 2020\)](#), which evaluated the Real Estate Division's property acquisition process for capital projects.

Audit fieldwork was conducted during February and March 2022. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;
- Interviewed Real Estate Division and Finance Department Staff;

¹ The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

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- Reviewed a judgement sample of 30 right of way acquisitions completed from June 2020 through February 2022;
- Reviewed standard operating procedures implemented by the Real Estate Division since the issuance of the original audit covering the real estate asset negotiation, acquired property reporting, and licensed staff training requirements;
- Reviewed Real Estate staff's training requirements and documentation; and
- Reviewed request for qualifications documentation for evaluation of qualified appraisers.

Recommendation Status Update

This report summarizes the Audit of Capital Projects Administration: Property Acquisition recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report in May 2020.

Acquisition Process Documentation Needs to be Improved

1. **Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process.**

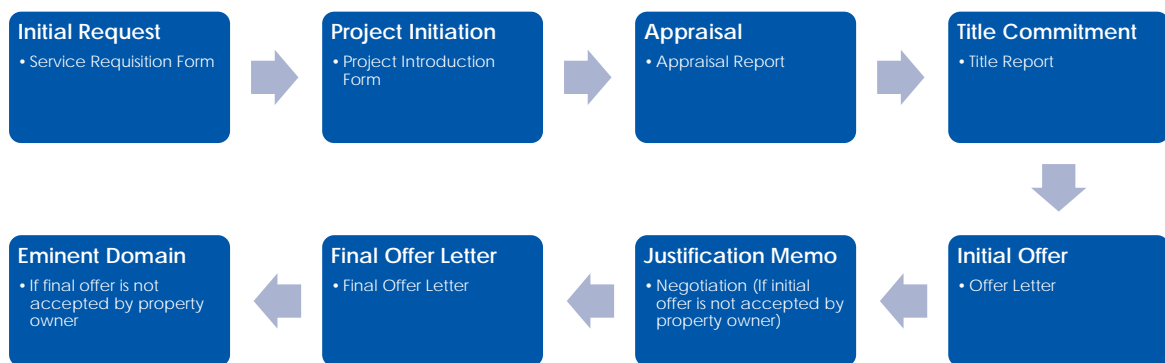
Management Response: Concur

Direction to execute and maintain documents had previously been given prior to audit. Steps have been implemented to check/confirm compliance monthly.

Audit Follow-Up Finding: In Progress

According to the real estate asset acquisition process established in February 2019, which was formally implemented in March 2020, the following steps and associated documents are broadly involved in real estate asset acquisition, as presented in Figure 1 below:

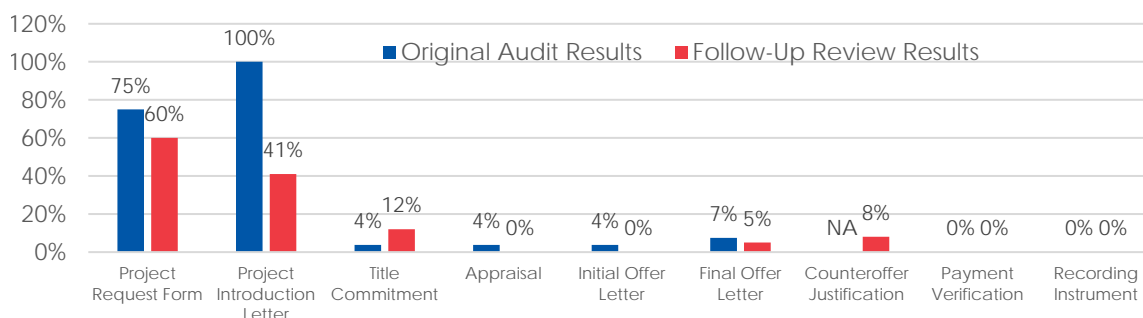
Figure 1: Real Estate Acquisition Process



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Based on review of a judgement sample of 30 parcels, the Real Estate Division's documentation recording procedures have slightly improved compared to missing document percentages observed for reviewed sample properties² in the original audit, as presented in Figure 2.

Figure 2: Missing Documents Comparison



As presented in Figure 2, project request forms and project Introduction letters continue to be missing at high levels for the sample parcels reviewed. That being said, compared to the other documents these present the least risk if they are not executed as it is unlikely this will lead to fraud or financial error. Furthermore, the Real Estate Division has implemented a process to receive real estate acquisition initiation requests from departments through a cloud-based work flow system, enhancing recording keeping and tracking effectiveness.

While other documents, including title commitment, final offer letter, and counteroffer justification memo, are available for most of the reviewed parcels, they must be executed and maintained without fail for each acquisition. If they are missing for any acquisition, the acquisition transaction can not be fully verified, increasing the risk of fraud or error.

Therefore, it can be concluded that there is still room for improvement in executing or maintaining complete transaction documentation following the established real estate acquisition process. Based on discussion with Real Estate Division staff, it is possible that these documents, which are generally maintained physically, are currently in storage due to the Division moving locations. Staff have stated that they are working to locate the missing documents.

² In the original audit, parcels were reviewed in two categories: the prior administration (acquired before February 2017) and the current administration (acquired after). Figure 2 compares the results of parcels reviewed under this follow-up review with the parcels acquired since February 2017.

Negotiation Process is not Formalized

2. Adopt a formalized negotiation process incorporating the following key requirements:
 - a) Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property;
 - b) Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and
 - c) Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.

Management Response: Concur

Processes for each recommendation were in place at time of audit.

Formal adoption has been completed through the department's SOP process.

Audit Follow-Up Finding: Implemented

The Real Estate Division implemented a standard operating procedure in March 2020, which contains the following steps and provisions for negotiation, requirements management approval, and Real Estate Division staff authority limits for acquisition of real estate assets:

- a. Negotiation Process: Real Estate Specialists are authorized to negotiate and finalize the price and terms of the proposed real estate asset acquisitions with property owners, including:
 - Request documentation to support negotiated settlements, including appraisal or newer comparative sales data, or confirmation of an executed contract at a higher per square foot or per acre value;
 - Act as liaison with the engineers and consultants; and
 - Prepare a memo for City management providing justification for accepting a negotiated price for a property beyond its appraised value.
- b. Management Approval and Limitation on Powers:

- Offers under \$50,000 must be approved by the Deputy Director of Real Estate and offers above \$50,000 are required to be approved by the City Manager after the approval of the City Attorney's Office.
- Real Estate Specialists are required to get approval from the Deputy Director of Real Estate or City Manager³ or City Council for any negotiated terms beyond a property's appraised value.

Information about Donated Properties is not Communicated to Accounting

3. **Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.**

Management Response: Concur

Process has been implemented and monthly reporting has been established.

Audit Follow-Up Finding: Implemented

The Real Estate Division has developed a reporting system to report acquired real estate assets to Accounting. Based on the last two years' reports, the Real Estate Division reports acquisitions to Accounting staff at least every six months, allowing them to record acquired assets in the City's books appropriately.

According to the Real Estate Department staff, real estate assets donated to the City are recorded based on the acquired assets' appraised value or Denton Central Appraisal District's appraised value. However, based on review, three assets acquired through donation and reported to Accounting in May 2020 had not been recorded in the City's financial system as of March 2022. In order to verify the effectiveness of the City's fixed assets recording procedures, Internal Audit will consider conducting an audit of fixed assets in the future.

³ In accordance with City Ordinance 013-094, the City Manager is authorized to:

- Make offers at the appraised value;
- Settle at a purchase price up to \$100,000 over the appraised value;
- Settle at a purchase price up to 20 percent above the appraised amount if it is between \$100,000 and \$500,000 for capital project; and
- Settle at a purchase price up to 20 percent above the appraised amount if it is between \$500,000 and \$1 million for properties needed for electric projects.

Real Estate Policy Changes Should be Made to Align with Best Practices

4. Define qualification criteria in policies and procedures for hiring and engaging appraisers

Management Response: Concur
Currently advertising RFQ to define and establish criteria.

Audit Follow-Up Finding: Implemented

The Real Estate Division completed a request for qualifications – or RFQ – process in 2020, which defined qualification criteria for hiring licensed appraisers for real estate acquisition projects. The goal of conducting the RFQ process was to identify a list of qualified real estate firms and pre-approve them as eligible to be hired as appraisers by the Real Estate Division for specific projects.

Based on review, the RFQ process was appropriately conducted, and applicants were evaluated using a scoring system based on their qualifications and other criteria. In July 2020, Denton's City Council approved six appraisers via Ordinance based on this established criteria.

5. Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.

Management Response: Concur
Licensed Real Estate Specialists have required continuing education to maintain licensure. Additionally, industry training is offered, recommended, and required as appropriate, when applicable to legal updates impacting eminent domain acquisition processes invoices.

Audit Follow-Up Finding: Implemented

The Real Estate Division implemented a standard operating procedure – or SOP – in February 2022, that requires licensed staff to complete and report their training needed to maintain their licenses. Additionally, the SOP has been recently updated to establish training requirements for non-licensed Division staff to ensure that unlicensed staff receive adequate training. The updated SOP is in the process of being implemented.

In addition, based on our review of training documentation, there was evidence that four of five Division staff members had attended training in the last two years and the remaining staff member had only recently transferred into the Division, indicating that all staff are receiving training.

Glossary of Property Acquisition Steps

- **Project Request Form** – is submitted by Project Manager to the Real Estate Division to request real estate asset acquisition for specific projects.
- **Project Introduction Letter** - is required to be sent by Real Estate Division to the owners of properties in the project vicinity informing them in advance about the upcoming project and potential acquisitions.
- **Title Commitment** – is obtained from title companies to ensure that the title of the properties to be acquired is free from any defect or encumbrances.
- **Appraisal Report** – is obtained from qualified appraisers to know the actual worth of the property to be acquired based on the prevailing market price.
- **Initial Offer Letter** – is sent to property owners representing the City's terms of acquisition of the property including the purchase price, i.e., appraised value.
- **Final Offer Letter** – is issued by the Real Estate staff when property owners do not accept the initial offer and final price is determined after negotiation.
- **Counteroffer Justification Memo** – is submitted by the Real Estate Specialist to management stating the justification of price to be offered to property owners beyond the properties' appraisal value.