
MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

Project to Automate the Land Registration System (POLARIS)

BACKGROUND

In 1980, the Ministry established POLARIS (Province of Ontario Land Registration System), a project to automate the province's land registration system. Documents and plans affecting land in Ontario had been maintained under either the Registry System or the Land Titles System. Until the implementation of the POLARIS project, both of these systems were exclusively maintained in paper and microfilm form at land registry offices operated by the province. The POLARIS project involves the gradual conversion of all properties in the Registry System to the Land Titles System and the automation of records to permit the searching and registration of real property documents through the use of computers. Prior to the commencement of this project, approximately 70% of properties in Ontario were registered under the Registry System.

In 1991, Teranet Land Information Services Inc. (Teranet)—a corporation owned jointly between the province and a private sector company—assumed from the Ministry financial and contractual responsibility for the implementation and operation of POLARIS. At the time, the Ministry had converted approximately 250,000 properties to the POLARIS electronic format. Teranet's services also include providing users with online remote access to the POLARIS database and allowing users to electronically register documents that affect land title.

As part of the new venture, the Ministry provided Teranet with a Licence Agreement, which transferred ownership of POLARIS to Teranet, including all software, hardware, licences and trademarks associated with POLARIS. This transfer did not include original land registration documents, the information contained in these documents, and survey and parcel mapping data.

Teranet, which holds a conditional exclusive licence for providing automated land registration services, receives fees collected by the Ministry for registration and ancillary transactions that the Ministry processes using POLARIS. The Ministry receives from Teranet a royalty of 25% for registration-related revenue and 5% for ancillary non-search services and certain other services.

The Ministry owns 40% of voting shares in the corporation, plus other special shares that entitle the Ministry to 50% of dividends and distributions declared by Teranet. The province and the private sector partner were required to provide \$29 million each to Teranet for their equity in

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the corporation. In addition, when the corporation was established, the Ministry received preferred shares (non-voting, non-participating), redeemable for \$30 million, for its contribution of work already completed on the project and for POLARIS.

The Shareholder Agreement provides that the Ministry and the private sector partner are each entitled to nominate four of Teranet's 11 directors and jointly nominate another three. In addition, the Shareholder Agreement requires that certain matters be approved by 75% of the directors present at a meeting and restricts the distribution of profits. As well, Ministry approval is generally required should the private sector partner change ownership.

As of March 31, 2000, approximately 2.5 million of the estimated 4.3 million properties in the province had been fully converted to electronic format. Since 1991, the Ministry has, out of the Consolidated Revenue Fund, paid Teranet \$235 million from revenue obtained for automated land registration and ancillary services, of which Teranet has paid back \$45 million in royalties to the Ministry. The majority of Teranet's revenues, along with funds obtained through financing, have been used for ongoing project costs incurred to date and the operation and maintenance of the automated system.

REVIEW OBJECTIVE AND SCOPE

In the course of conducting a financial controls review of the Ministry, we identified significant issues and concerns regarding the status of the POLARIS project and the Ministry's arrangement with Teranet. Our objective was to determine whether the Ministry had adequately assessed the impact of its arrangement with Teranet on the continued operation of the land registration system and on the province's investment in the project.

The scope of our review, which was substantially completed in April 2000, included interviews with appropriate staff and an examination and analysis of documentation available to the Ministry. Our review was conducted primarily at the Ministry's Registration Division. We did not rely on the work of the Ministry's Internal Audit Services because they had not conducted any recent work that was relevant to our review.

Our review was conducted in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

OVERALL REVIEW CONCLUSIONS

We identified a number of significant concerns with the Ministry's arrangements with Teranet and the status of its project to automate the province's land registration system. In 1991, the POLARIS project had an original cost estimate of \$275 million and an anticipated 1999 completion date. In April 1999, Teranet provided the Ministry with an estimate of over \$700 million to complete the project and a projected completion date of 2010. According to a consultant hired by the Ministry, due to significant uncertainties in the assumptions used by

Teranet, the project could cost over \$1 billion. Consequently, the Ministry's risk, costs and benefits with respect to the project have changed considerably.

In September 1999, Teranet pledged most of its significant assets as security for a \$280-million bond offering, primarily to repay debts and to fund further implementation of the project. This financial restructuring by Teranet could increase the cost to the Ministry in the event that the Ministry chooses to terminate its agreement with Teranet and assume operation and control of the POLARIS project.

We plan to follow up on the project to automate the province's land registration system in future, since the Ministry had not yet decided on an appropriate course of action.

DETAILED REVIEW OBSERVATIONS

PROJECT COMPLETION DATE AND COSTS

In 1991, an Implementation and Operation Agreement was established that required Teranet to achieve certain benchmarks in connection with the automation of the land registration system. Specifically, Teranet was required to perform all work necessary to automate and convert properties in Ontario in accordance with the progress schedule and timetable stated in the agreement.

The original Implementation and Operation Agreement called for automating all properties by November 1999. In December 1993, the agreement was amended to require fulfillment by November 2000. In January 1998, the Ministry agreed to a contractual extension and a further revision of the project's completion date to March 2004. At the time of our review, the Ministry was evaluating a forecast from Teranet, dated April 1999, that indicated a further extension to 2010 was required. The Ministry advised us that they had not agreed to further changes to the contractual obligations of Teranet for completing the project.

In December 1999, Teranet terminated its contract with its principal subcontractor, who had been converting land registration information to electronic format. This resulted in a reduction in the number of properties being automated from about 23,000 per month during 1999 to about 12,000 for February 2000. Although ministry staff informed us that they believe Teranet will meet its existing contractual benchmarks for the year ending March 31, 2001, the information we obtained indicated that Teranet will not be able to automate a sufficient number of properties to meet such benchmarks for the year ending March 31, 2002, or for future years.

In addition, we noted that cost estimates to complete the project had substantially increased. In 1991, the initial estimate to complete the project was \$275 million. However, in June 1998, in a report to the company's bankers, Teranet's auditors stated that projected costs were expected to be \$560 million. As of April 1999, Teranet estimated that the total costs for the project would be more than \$700 million, and this was based on Teranet's assumption that certain cost-saving methods could be implemented.

In September 1999, the Ministry engaged a consultant to review Teranet's POLARIS project, which included providing advice on the Ministry's financial risk with respect to the project. In its November 1999 report, the consultant noted the following:

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- Teranet's estimate of over \$700 million in total project costs is one of many scenarios. There are significant uncertainties in the assumptions that were utilized to develop the estimate. Other, less favourable scenarios estimate total project costs in excess of \$1 billion.
- The cost to convert the remaining 1.8 million properties using existing workflows and processes exceeds the anticipated revenues from conversions.
- Teranet should reassess its estimation procedures for determining project conversion costs and timetables, and the Ministry should independently review Teranet's procedures and cost estimates.

The consultant also made several recommendations for improving Teranet's accountability process to ensure that relevant operational and financial matters are brought to the attention of key ministry officials on a timely basis.

We found evidence that corroborated the risks identified by the consultant.

In addition, we noted that the Ministry had initially anticipated that transferring the POLARIS project to Teranet would maintain government revenue. However, for fiscal 1994/95, the Ministry's revenues, net of expenditures, from land registration transactions were \$38 million; by fiscal 1999/2000, the Ministry's net revenues, including royalties received from Teranet, had declined to about \$13 million. In addition, Teranet had not declared any dividends to its shareholders since its inception, and, as of March 31, 2000, it had an accumulated deficit of \$44 million.

OTHER COSTS

In the event that Teranet does not perform in accordance with the terms of its Implementation and Operation Agreement, such as inadequate progress made on automating land registration information, the Ministry has the option of issuing a notice of termination of the agreement to Teranet. In this event, the matter is referred to an arbitrator to determine if termination is appropriate under the circumstances. If the arbitrator decides it is appropriate, the arbitrator can then determine fair and equitable compensation for either party in the circumstances.

We noted that unless an adequate contingency plan is in place, termination of the agreement could result in increased risk for the ongoing, uninterrupted operation of the province's land registration system. However, the Ministry asserted that should its agreement with Teranet be terminated, there were adequate safeguards in place to ensure the continued operation of the province's land registration system. For instance, upon termination, the agreement permits the Ministry to assume operation and control of POLARIS in an orderly manner.

We also noted that a recent financing restructuring by Teranet could increase costs to the Ministry should it choose to assume operation and control of the POLARIS system. In September 1999, Teranet issued \$280 million in bonds, which mature September 8, 2009. Teranet used the net proceeds from the sale of the bonds primarily to repay existing bank loans and to finance its future implementation costs for automating land registration information. The province acquired \$30 million of these bonds in exchange for the preferred shares of equal value that it acquired when Teranet was established.

As security for the bonds it issued, Teranet pledged most of its significant assets, including monetary assets held by the company, revenues and receivables, computer software, equipment and agreements. This includes the Licence and the Implementation and Operation agreements between Teranet and the province. As a result, if the Ministry were required to terminate its agreement with Teranet and assume operation and control of the project, it would have to address Teranet's obligation to the bondholders. In addition, the Ministry may have to compensate Teranet for all or part of the costs it has incurred. For instance, since 1991, Teranet has substantially invested in automating land registration documents and further developing the POLARIS system. As of March 31, 2000, Teranet reported these costs to be over \$300 million.

FUTURE FOLLOW-UP

As indicated earlier, the Ministry advised us that they had not agreed to further changes to the contractual obligations of Teranet for completing the POLARIS project. The Ministry also advised us that it was in the process of assessing its options for automating the land registration system, implementing improvements to its accountability process with Teranet and deciding on an appropriate course of action. We plan to follow up on the Ministry's progress in due course.