REPORT OF

THE

STATE AUDITOR

State Board of Land Commissioners

Performance Audit
November 2005

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November 22, 2005

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the State Board of Land Commissioners. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the State Board of Land Commissioners.

Joanne Hill

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JOANNE HILL, CPA
State Auditor

State Board of Land Commissioners
Performance Audit, November 2005

Authority, Purpose, and Scope

This performance audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct performance audits of all departments, institutions, and agencies of the state government. The audit work, performed between April 2005 and October 2005, was conducted in accordance with generally accepted governmental auditing standards.

The audit reviewed the overall management of the state's trust lands and the State Board of Land Commissioners' compliance with constitutional provisions and applicable state laws. We evaluated the Board's (1) process for valuing and measuring the performance of trust lands; (2) compliance with constitutional provisions requiring fiscal impact studies; (3) process for auditing mineral royalties owed to the Board; (4) land management activities, including the setting of grazing rental rates and the management of noxious weeds; and (5) management controls for conflicts of interest.

Overview

In 1876 the federal government granted Colorado approximately 4.75 million acres of land to be used for specific purposes, in particular, the support of the "common schools." The Colorado Constitution established the State Board of Land Commissioners (Board) as the trustee of the land grant. The Board currently manages approximately 2.8 million surface acres and 4 million underlying mineral-only acres to generate revenue for trust beneficiaries. Ninety-six percent of this land is held in trust (School Trust) for Colorado's kindergarten through twelfth grade public schoolchildren. The remaining 100,000 surface acres benefit seven smaller trusts. Colorado has an obligation, enforceable under the Supremacy Clause of the United States Constitution, to act as a trustee for these lands. Colorado's Constitution specifies that:

> It shall be the duty of the state board of land commissioners to provide for the prudent management, location, protection, sale, exchange, or other disposition of all the lands heretofore, or which may hereafter be, held by the board as trustee pursuant to section 9(6) of this article IX, in order to produce reasonable and consistent income over time. [Section 10 of Article IX]

For further information on this report, contact the Office of the State Auditor at 303.869.2800.

The Board's five commissioners appoint a director who is responsible for overseeing the day-to-day activities of the Board. The Board has six district offices located in Alamosa, Craig, Denver, Greeley, Pueblo, and Sterling. In Fiscal Year 2005, the Board spent a total of about $4.3 million and employed 34 full-time equivalent (FTE) positions.

The Board generates income primarily by leasing land for various uses, including cattle grazing, crop production, oil and gas extraction, coal mining, and recreation. In Fiscal Year 2005, the Board collected about $59 million for all trusts; revenue generated from School Trust lands was about $54 million of this amount. The single largest source of revenue to the School Trust is mineral royalties and bonuses from nonrenewable mineral sources such as oil, gas, and coal. In Fiscal Year 2005, income from mineral royalties and bonuses was slightly more than $40 million, or about 74 percent of total School Trust revenues. Surface rental income, the second largest source of revenue for the School Trust, was about $9 million in Fiscal Year 2005.

Per statute, the income from School Trust lands is deposited into one of two trust funds: the Public School Permanent Fund (Permanent Fund) and the Public School Income Fund (Income Fund). Money deposited into the Permanent Fund is invested by the State Treasurer and provides interest income to the expendable Income Fund. The maximum amount of distributions to local school districts from Board revenues and interest earned on the Permanent Fund is capped at $31 million. This figure represents about one percent of the total state funds contributed toward K-12 education.

Summary of Audit Comments

Land Management

The Board is authorized to acquire land, through purchases or exchanges, when it is beneficial to the trust. The Board uses land transactions to meet its constitutional duty of prudently managing trust lands by disposing of isolated inholdings and heavily encumbered properties, purchasing lands for consolidation purposes, and exchanging and purchasing parcels for others with greater income potential. We evaluated the Board's practices for valuing trust lands; applying fiscal impact studies; and measuring trust land performance. We found:

- **The Board often relies on outdated appraisals to value trust lands for sell or exchange.** We reviewed the 48 sales and exchanges of trust lands completed by the Board between Fiscal Years 2003 and 2005 and found that roughly half, or 26, of the 48 sales and exchanges closed more than one year after the trust land was appraised. Of those 26 transactions, we found that 12 were based on valuations older than two years. One of those 12 was based on a valuation conducted over five years prior to the closing.

- **Board staff are not adequately trained to ensure outside appraisals are adequate and complete.** We contracted with two Colorado-licensed review appraisers to perform administrative or desk reviews of seven appraisals used by the Board to complete land transactions between Fiscal Years 2003 and 2005. The appraisers found a total of 37 errors that could have either materially impacted the value of the appraisal or are considered important for informing and not misleading clients. Board staff had not previously identified the errors.

- **The Board is not complying with statutes regarding the use of staff or outside appraisers when valuing properties for acquisition.** We identified five instances in which the Board violated statute by relying on internal staff market analyses to acquire properties exceeding $100,000. Section 24-30-202(5)(b), C.R.S., requires the Board to contract with an outside appraiser prior to purchasing real property with a value exceeding $100,000. We also found the Board's commissioners have not adopted a formal policy as to when outside appraisals must be conducted or when in-house valuations may be performed.

- **The Board's policies and procedures regarding fiscal impact studies do not reflect constitutional and statutory mandates.** We found that, until our audit, the Board had never conducted a fiscal impact study on any land transaction or lease; despite the Colorado Constitution requiring one be performed prior to leasing, selling, or exchanging any lands for commercial, residential, or industrial development.

- **The Board lacks the needed data to show its land management policies are prudent and produce reasonable and consistent income over time.** Measuring the performance of trust lands is key to overall asset management and demonstrates whether the Board's land management policies and decisions are more advantageous over time than are other alternatives. We found the Board lacks performance information related to trust lands in three crucial areas: (1) land values, (2) land appreciation, and (3) target rates of return.

Administration

Our audit evaluated the Board's formula for determining grazing rental rates; its process for auditing mineral royalties; its management and program controls for addressing conflicts of interest and potential unethical behavior; and its management of noxious weeds. We found:

- **No sound basis exists for the 35 percent across-the-board reduction included in the Board's grazing rate formula.** To set its grazing rates, the Board determines the fair market rate for leasing private land and then reduces that rate by 35 percent. The 35 percent across-the-board reduction is designed to compensate lessees for the additional costs associated with leasing public rather than private land. We believe the 35 percent may no longer be valid and that the Board needs to reevaluate the practice.

- **The Board should increase the number of mineral lessees and percentage of mineral royalty revenue audited.** Although the Board has developed an effective royalty audit program, more than $26 million, or 38 percent, of mineral royalty revenues remain unaudited for Fiscal Years 2001 through 2004. We reviewed the results of 41 audits performed directly by the Board or on the Board's behalf by the Department of Revenue and found the audits recovered a total of $3.2 million in unpaid royalties. The Board spends about $212,000 per year to conduct mineral royalty audits.

- **The Board does not have necessary safeguards to prevent and deter potential conflicts of interest by commissioners and staff.** We found the Board does not provide commissioners or staff with formal training, either initial or refresher, on the state's codes of ethics and conduct. The Board also does not require staff to routinely sign a code of conduct statement. We found that only 10 of the Board's current 37 staff (27 percent) have a signed code of conduct statement on file. We also found the Board does not have a process for staff to formally report, in writing, conflicts of interest and outside employment. Because of the importance of land transactions overseen by the Board, taking measures to minimize the risk of conflicts of interest is crucial.

- **The Board is not managing and controlling noxious weeds as effectively as possible**. The Board has not placed sufficient emphasis on the control of noxious weeds and, as a result, is not as aggressive as it should be to prudently manage trust lands. We found the Board does not provide lessees or district managers with formal training on noxious weeds, as required by Board policy. Also, lessees are neither required to notify the Board of weed growth nor provide the Board with a weed management plan. We also found the Board does not address noxious weed management in all leases, as required by Board policy.

Our recommendations and the responses of the State Board of Land Commissioners can be found in the Recommendation Locator on pages 5 and 6 and in the body of this report.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	18	Limit the time between land valuation and the close of transactions to no more than one year, unless appropriate updates or adjustments have been made and documented.	State Board of Land Commissioners	Agree	July 2006
2	21	Improve the Board's appraisal review process by ensuring staff reviewers are adequately trained and by developing a standard appraisal review checklist. Document and maintain results of reviews in the Board's real estate transaction files.	State Board of Land Commissioners	Agree	July 2006
3	23	Comply with statutes regarding the use of outside appraisals. Adopt policies and procedures delineating when independent, third-party appraisals or market valuations are required and when staff market analyses are permissible. For staff market analyses, adopt standard factors to be evaluated, ensure staff are trained and qualified, maintain adequate documentation, and periodically review analyses.	State Board of Land Commissioners	Agree	January 2006
4	27	Review and modify policies and procedures for fiscal impact studies to reflect constitutional and statutory mandates.	State Board of Land Commissioners	Agree	July 2006
5	30	Develop a system to evaluate the performance of trust lands including: (1) periodically valuing trust lands; (2) establishing a target rate of return; (3) calculating an average annual rate of return; (4) evaluating and documenting management alternatives for those trust lands not meeting the Board's target rate(s) of return.	State Board of Land Commissioners	Agree	July 2007

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
6	36	Set grazing lease rates at an amount representative of fair market value by evaluating the practice of across-the-board reductions. Determine private lessee cost burdens; collect additional information from Board lessees; study the difference in maintenance burden between private and Board lessees; and base reduction on actual difference in costs between Board and private lessees.	State Board of Land Commissioners	Agree	July 2007
7	40	Increase audit coverage of mineral royalties by hiring additional auditors, contracting for third-party audits, or compensating the Department of Revenue for additional audit work. Request severance tax returns from operators as part of the royalty audit process.	State Board of Land Commissioners	Agree	Shifting Resources-Immediately Tax Returns-July 2006
8	44	Strengthen safeguards for preventing and deterring conflicts of interest. Train new commissioners and staff on all applicable codes of ethics and conduct. Require staff to annually sign a code of conduct statement and disclose outside employment and conflicts of interest. Maintain documentation in personnel files.	State Board of Land Commissioners	Agree	July 2006
9	47	Require district managers and other Board staff to obtain weed management training. Make more training and education available to lessees and require lessees, at the first sign of noxious weed growth, to notify the district office and submit a weed management plan.	State Board of Land Commissioners	Agree	July 2006

State Board of Land Commissioners

Overview

When Colorado became a state in 1876, the federal government granted it approximately 4.75 million acres of land to be used for specific purposes, in particular, the support of the "common schools." The land granted to Colorado included both surface land and its underlying mineral assets (e.g., oil and gas). Colorado has an obligation, enforceable under the Supremacy Clause of the United States Constitution, to act as trustee for these lands. The Colorado Constitution established the Colorado State Board of Land Commissioners (Board) as the trustee of the land grant. The Board, a division of the Colorado Department of Natural Resources, is charged with managing these trust lands to generate income for trust beneficiaries; most significantly, the State's kindergarten through twelfth grade public school system.

In almost 130 years of statehood, the Board has sold about 40 percent of the original surface trust lands. Today the Board manages approximately 2.8 million surface acres and 4 million underlying mineral-only acres to generate revenue for beneficiaries. The Board is the second largest landholder in Colorado, after the federal government.

Board Duties

Colorado's Constitution specifies that:

> It shall be the duty of the state board of land commissioners to provide for the prudent management, location, protection, sale, exchange, or other disposition of all the lands heretofore, or which may hereafter be, held by the board as trustee pursuant to section 9(6) of this article IX, in order to produce reasonable and consistent income over time. [Section 10 of Article IX]

The Board generates income primarily by leasing land for various uses, including cattle grazing, crop production, oil and gas extraction, coal mining, and recreation. The Board may also acquire, exchange, and dispose of (sell) the real estate it manages. The Board's trust lands are not "public" in the same way as are lands owned by the United States Forest Service or the United States Bureau of Land Management. Because the Board's first responsibility is to its beneficiaries, its lands are considered private property and, generally, are off-limits to the public.

Ninety-six percent of the land managed by the Board (approximately 2.7 million surface acres) is held in trust (School Trust) by the State for Colorado's kindergarten through twelfth grade public schoolchildren. The remaining 100,000 surface acres benefit seven smaller trusts including:

- University of Colorado Trust
- Colorado State University Trust
- Penitentiary Trust
- Public Buildings Trust
- Hesperus Trust (Fort Lewis College)
- Saline Trust (state parks)
- Internal Improvements Trust (state parks)

In 1996 Colorado voters passed a constitutional amendment that changed various aspects of the Board's structure and duties. One of the more significant changes resulting from Amendment 16 was the creation of a perpetual Stewardship Trust of nearly 300,000 acres of state land (about 11 percent of state trust surface acres). The acres in the Stewardship Trust are to be protected from sale or development unless four of the five board members vote to remove them from the Trust and designate an equal or greater amount of land as a replacement. Stewardship Trust lands continue to generate revenue from grazing, crop production, oil and gas production, and mining, as long as such uses are compatible with the conservation of natural resource values. The Board has the duty to ensure that sound stewardship of the natural values of lands placed into the Stewardship Trust will provide long-term economic benefits to trust beneficiaries.

Appointed by the Governor, the Board's five commissioners function as constitutional officers and trustees of state lands. To fulfill their constitutional duties, the commissioners hire a director who is responsible for carrying out the day-to-day activities of the Board. The Board is administratively organized into four primary sections: field operations, mineral, real estate, and financial. To manage its trust assets, the Board has divided Colorado into six geographical districts. Each district is staffed by one district manager and one half-time assistant who are organizationally located within the Board's Field Operations Section. The six district offices are located in Alamosa, Craig, Denver, Greeley, Pueblo, and Sterling.

Revenue

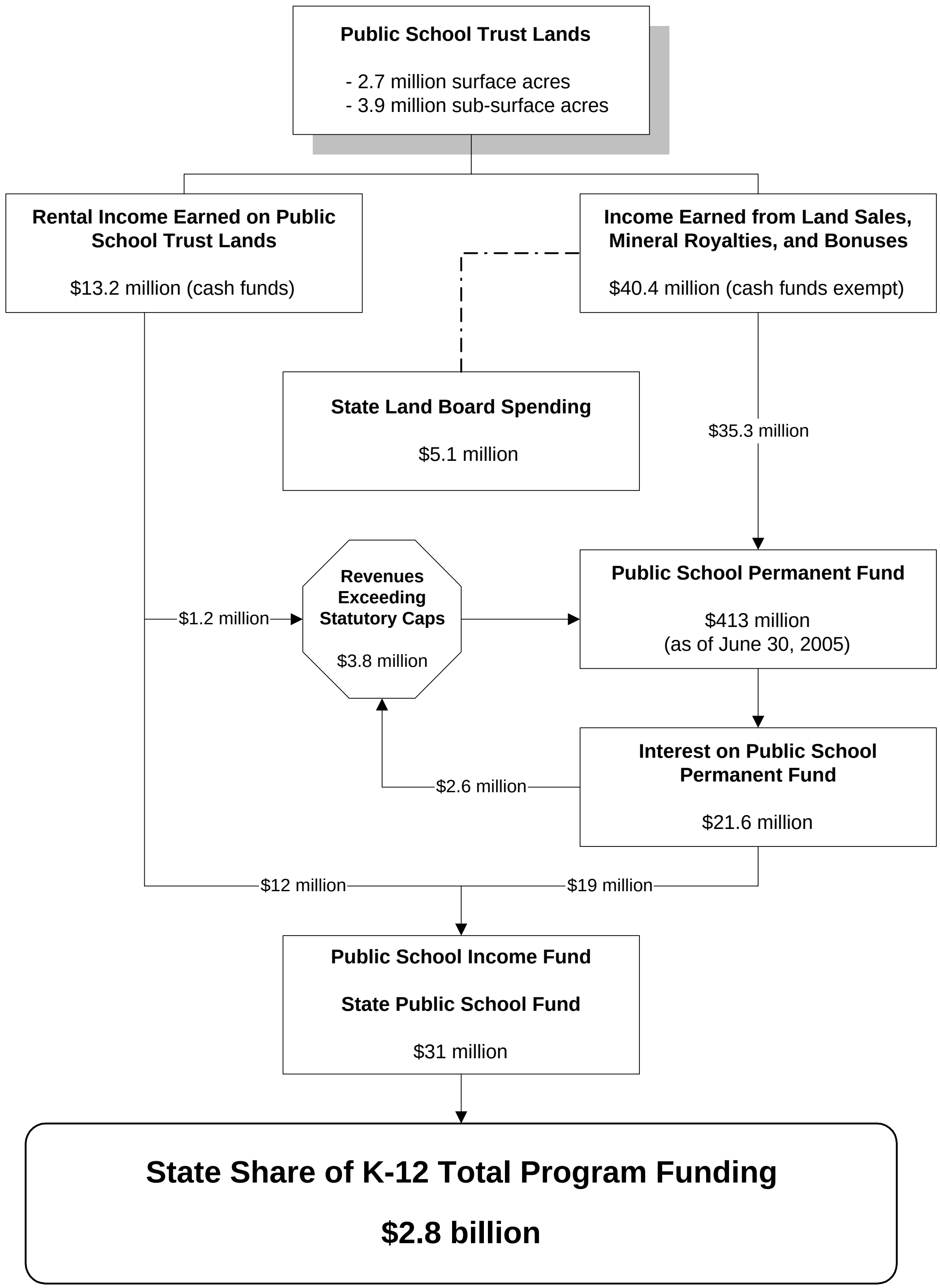
The Board is the only entity in Colorado with responsibility for managing lands to earn revenue for public schools. Income from trust lands is combined with other state and local revenue to fund public education in accordance with the School Finance Act. The School Trust is the largest of the eight trust beneficiaries for which the Board manages trust lands. In Fiscal Year 2005, revenue generated from School Trust lands through leases, royalties, sales, and interest was about $54 million. Per statute, the income from the School Trust lands is deposited into one of two funds:

- **Public School Permanent Fund (Permanent Fund)** - The Permanent Fund is nonexpendable and, as required by Article IX of the Colorado Constitution, is to "remain inviolate and intact." Income earned by the Board from three sources—land sales, mineral royalties, and bonuses—is deposited into the Permanent Fund. Because income earned from property sales (i.e., real property and mineral assets) is exempt from the Taxpayer's Bill of Rights (TABOR), the income earned from these sources is designated cash funds exempt. Money deposited into the Permanent Fund is invested by the State Treasurer and provides interest income to the expendable Public School Income Fund. As a result of Senate Bill 03-248, beginning in Fiscal Year 2004, only $19 million in interest from the Permanent Fund per year will go to the Public School Income Fund for distribution to the local school districts. The remainder of interest will be reinvested in the Permanent Fund where it will compound and produce additional interest earnings for the Permanent Fund over time. According to the State Treasurer's Office, as of June 30, 2005, the Permanent Fund was valued at approximately $413 million.

- **Public School Income Fund** - Income earned by the Board from grazing, agricultural, mineral, recreational, and other special purpose leases goes directly to the Public School Income Fund. Income from these sources is considered TABOR revenue and is subject to constitutional spending limits. As required by the School Finance Act, monthly distributions are made to the local school districts from the Public School Income Fund, through the State Public School Fund. With passage of Senate Bill 05-196, the total distribution to the local school districts from the Public School Income Fund is limited to $12 million per year. The remainder of the income is to be invested in the Permanent Fund where it will compound and produce additional interest earnings over time.

Beginning in Fiscal Year 2006, the total distribution to local school districts from Board revenues and interest earned on the Permanent Fund is capped at $31 million ($19 million + $12 million). This figure represents about 1 percent of total state funds contributed toward K-12 education. The following chart shows the projected flow of School Trust revenues for Fiscal Year 2006:

State Board of Land Commissioners
Fiscal Year 2006 Projected Cash Flow



The single largest source of revenue to the School Trust is mineral royalties and bonuses from nonrenewable mineral sources such as oil, gas, and coal. In Fiscal Year 2005, income from mineral royalties and bonuses was slightly more than $40 million, or about 75 percent of total School Trust revenues. As the table below shows, income from mineral royalties and bonuses increased by more than 160 percent between Fiscal Years 2002 and 2005. Surface rental income, the second largest source of revenue for the School Trust, was about $9 million in Fiscal Year 2005, or about 17 percent of total School Trust revenues.

State Board of Land Commissioners
Revenues for the School Trust by Source (In Millions)
Fiscal Years 2002 Through 2005

	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005	Percent Change FY 2002 - 2005
Mineral Royalties & Bonuses	$15.3	$15.9	$24.5	$40.1	162
Surface Rental Income[1]	8.3	6.2	7.8	9.2	11
Commercial Rental Income[2]	4.3	4.4	3.9	4.0	(7)
Land Sales, Timber, Interest, Penalties, Fees	0.3	0.2	0.2	0.4	33
Total Revenue	**$28.2**	**$26.7**	**$36.4**	**$53.7**	**90**

Source: Colorado Financial Reporting System (COFRS) and the State Board of Land Commissioners Fiscal Year 2004-05 Financial Report.
[1]Includes both surface and mineral rental income.
[2]Includes commercial and industrial ground lease, property management, and commercial development lease income.

As previously stated, in addition to the School Trust, there are seven smaller trusts for which the Board generates revenues. According to Board financial documents, the lands managed for these smaller trusts produced approximately $4.8 million in revenue in Fiscal Year 2005, or slightly more than 8 percent of all revenues (about $59 million) collected by the Board for all trusts in Fiscal Year 2005. According to Board staff, the comparatively high percentage of revenue attributable to the smaller trusts in Fiscal Year 2005 resulted from one-time land sales totaling $4.1 million.

Operating Budget

The Board receives no general funds for its operations. The single largest source of funding for the Board's operating budget is cash funds exempt ($3.3 million), which derives from mineral royalties and bonus income. Cash funds ($115,000) are generated by lease rental revenue, timber sales, related interest income, and fees. The Land Board Trust Administration Fund is the primary operating fund for the Board and is used to pay employees' salaries and all other Board expenses. The Land and Water Management Fund is the Board's second operating fund and is used to manage and improve state-owned lands and waters. By statute, expenditures from this fund cannot exceed $75,000 in any fiscal year.

A new fund, the State Board of Land Commissioners Investment and Development Fund, was created by the General Assembly during the 2005 Legislative Session. It became effective beginning in Fiscal Year 2006. Each year through Fiscal Year 2010, the first $1 million in mineral royalty and bonus revenue will be deposited into the fund for additional value-added benefits for the State's trust lands. Value-added benefits include rezoning, platting, master planning, or other development activities that increase the value of or rate of return from the State's trust lands. On or before January 31 of each year, the Board must provide information on the portfolio enhancement and additional income generated as a result of expenditures from this fund to the Joint Budget Committee and to the House and Senate Education Committees.

As shown in the following exhibit, in Fiscal Year 2005 the Board spent a total of about $4.3 million and employed 34 full-time equivalent (FTE) positions. Approximately $4.1 million or about 95 percent of all Fiscal Year 2005 expenditures, were attributed to managing School Trust lands.

State Board of Land Commissioners Total Expenditures for All Trusts (In Millions) Fiscal Years 2002 Through 2005					
	Fiscal Year 2002	**Fiscal Year 2003**	**Fiscal Year 2004**	**Fiscal Year 2005**	**Percent Change FY 2002 - 2005**
Personal Services	$2.1	$2.4	$2.2	$2.3	10
Contracted Services, Project Management, & Misc. Expenses[1]	1.3	1.4	1.7	1.8	38
Operating Expenses	0.2	0.2	0.2	0.2	0
Total Expenditures	**$3.6**	**$4.0**	**$4.1**	**$4.3**	**19**
FTE	33.0	33.0	34.0	34.0	3

Source: Colorado Financial Reporting System (COFRS) and Fiscal Years 2002 through 2005 appropriation reports.

[1] Includes expenses for trust land evaluations, Lowry Range project management, and land use planning and engineering contracts.

Audit Scope

Our audit focused on the Board's overall management of the State's trust lands and its compliance with constitutional provisions and applicable state laws. The audit did not include a review of the State Treasurer's investment performance related to the Permanent Fund, which was addressed in our 2000 performance audit of the State Board of Land Commissioners, or the General Assembly's appropriation of trust revenues to the local school districts. As part of the audit, we collected and analyzed data related to the Board's 4,400 leases; 74 real estate transactions that closed between July 2002 and March 2005; and general administrative practices. We also reviewed all real estate transactions involving Stewardship Trust lands since the Trust's creation in 1996. We conducted site visits to three district offices located in Craig, Denver, and Greeley. During our site visits, we toured several parcels of school trust lands, interviewed staff, and reviewed various documents related to each district's operations. We also reviewed the Board's progress in implementing recommendations made in the Office of the State Auditor's 2000 performance audit of the State Board of Land Commissioners. In addition, we contacted federal agencies and other states that manage trust lands and reviewed current research.

Finally, we contracted the services of two certified general appraisers to conduct review appraisal work. The purpose of the review appraisals was to determine whether the appraisals used by the Board for the valuation of state trust lands acquired, exchanged, or disposed of were adequate to support the estimated values established in the appraisals. The appraisers' reviews included a determination of whether the appraisals used by the Board conformed with the Uniform Standards of Professional Appraisal Practice (USPAP) for the type of appraisal conducted. Other factors reviewed included whether the appraisals were prepared by appraisers who were competent to appraise the subject type of property (rural, agricultural, development) and property interest (i.e., full or partial right to ownership and/or use of property), and who were licensed by the Colorado Division of Real Estate to operate in the State. The findings of the review appraisals are discussed in detail in Chapter One.

Land Management

Chapter 1

Background

The State Board of Land Commissioners (Board) has the authority to sell or exchange state trust land pursuant to Article IX, Section 9 of the Colorado Constitution, and Title 36 of the Colorado Revised Statutes. The Board is also authorized to acquire land, through purchases or exchanges, when it is beneficial to the trust. The Board uses land transactions to meet its constitutional duty of prudently managing trust lands by disposing of isolated inholdings and heavily encumbered properties and acquiring lands with greater income potential. Beginning in Fiscal Year 2003 through March 2005, the Board completed a total of 74 land transactions. The transactions included 48 dispositions (sales and exchanges) and 26 acquisitions (purchases) involving about 84,000 acres and valued at more than $53 million. In this chapter we discuss our findings and recommendations related to the Board's overall management of state trust lands. This includes not only transactions and associated activities such as land valuations but also the measures needed to determine the performance of trust lands.

Land Valuation

Real estate appraisals are estimates of the value of property as determined by a professionally trained and licensed appraiser. To determine the value of trust lands prior to sale, purchase, or exchange, the Board either contracts the services of an independent, third-party appraiser or has staff conduct a market analysis. Typically, the Board hires independent appraisers when the value of the subject parcel is believed to be greater than $50,000. Staff market valuation, or analysis, generally occurs on transactions valued at $50,000 or less. Of the 74 land transactions (sales, exchanges, and purchases) completed by the Board from July 2002 through March 2005, 39 (53 percent) were valued using independent, third-party appraisals and 35 (47 percent) were valued by staff conducting market analyses.

We reviewed the Board’s processes for valuing trust lands prior to sale, purchase, or exchange. We identified three areas in which the Board should strengthen its policies and practices. The improvements we recommend will provide greater assurances that the Board is fulfilling its mandate to prudently manage, locate, protect, sell, exchange, or dispose of trust lands. As described in the following three sections, we found areas for improving the quality of land valuations related to the age, comprehensiveness, and appropriateness of third-party appraisals and staff market analyses.

Outdated Valuations

Appreciation is an increase in the value of property over time. If the time between land valuation and transaction close is too lengthy, the value conclusion may no longer represent current, fair market value. As a consequence, either the buyer or the seller may not receive a fair price and realize a fair exchange or profit. For example, the seller of a parcel of land valued at $1,000, appreciating at 5 percent per year, would lose approximately $100 if two years elapsed between the dates of valuation and sale. Over the past four years, Colorado cropland has appreciated at an average rate of 3.8 percent per annum, and during the last 30 years, real estate in the Denver metro area has appreciated at an average annual rate of 6.6 percent. Therefore, to uphold its fiduciary responsibility, the Board must rely upon timely valuations of trust lands to be sold or exchanged.

We reviewed the 48 sales and exchanges of trust lands completed by the Board between July 2002 and March 2005 to determine the length of time between the dates of valuation and transaction close. As the following table shows, we found that 26 (54 percent) of all sales and exchanges during this time closed more than one year after the trust land was valued. Our review included valuations established by both third-party appraisals and staff market analyses.

State Board of Land Commissioners
Age of Land Valuations for All Sales and Exchanges
July 2002 Through March 2005

Method of Valuation	Length of Time Between Valuation and Transaction Close		
	Less Than 1 Year	Total More Than 1 Year	Total
Appraisal	6	19	25
Market Analysis	16	7	23
Totals	**22**	**26**	**48**

Source: Office of the State Auditor's analysis of the State Board of Land Commissioners' closed real estate transaction files.

Of the 26 closed transactions in which the period between valuation and close exceeded one year, we found that almost one-half (12) were based on valuations that were at least two years old. Of these 12, one had been conducted at least five years prior to close of the transaction.

In reviewing the Board's files for these 26 sales and exchanges, we found no documentation indicating that the price of the trust land was adjusted to account for changes in the value, including appreciation. Consequently, it is unclear whether the Board received either fair market value from the sales or an equivalent value of land in exchange for trust lands. As discussed later in this chapter, the Board does not know the rate at which its lands appreciate. Therefore, we were unable to quantify the amount of income lost, if any.

Some transactions are complex or can extend for long periods for many reasons, including public opposition, unforeseen complications with incorporation, or other regulatory requirements. As a result, it is not uncommon for significant time to pass between the initial appraisal and transaction close. However, the Board does not have a policy related to the length of time trust land valuations will remain valid for the purposes of sale, purchase, or exchange. We believe the Board should rely only on valuations, whether from third-party appraisals or staff market analyses, in which the time between the dates of value and close of the sale or exchange of trust land is no more than one year. One year appears to be a standard length of time real estate professionals and others consider valuations to be valid. According to staff at the Colorado Division of Real Estate's Board of Appraisers, appraisals are generally considered valid for a range of 6 to 18 months, depending on the growth of the market where the land is located. The state land boards in Texas, Montana, and Utah generally require appraisals to occur within 12 months prior to the date of close of land transactions.

The Board should adopt a maximum one-year time requirement for valuations in which trust lands are to be bought, sold, or exchanged and should require shorter time frames for land in rapidly appreciating areas. The policy should apply whether the land values are determined by a third-party appraiser or by a staff market analysis. In some cases, updated appraisals and adjusted market analyses may be appropriate. In other instances, new appraisals should be conducted. The Board should determine the circumstances under which updates or new appraisals are called for and incorporate these requirements into its policies and the staff procedures manual.

Recommendation No. 1:

The State Board of Land Commissioners should limit the time between the dates of land valuation and the close of transactions for the sale, purchase, and exchange of trust lands to no more than one year unless appropriate updates or adjustments have been made and documented.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2006.

The State Land Board staff agrees with the recommendation. Staff will develop a policy for the Board's consideration which would require an updated or new appraisal after a year's time except in specific transactions approved by the Board.

The State Land Board's land transactions can be very complex and involve many land owners including the federal government. This complexity has sometimes led to the unintended consequence of a long time lapse between appraisals and the completion of transactions.

The State Land Board staff will have this policy for the Board's consideration by July 2006.

Review Appraisals

As mentioned in the previous section, between Fiscal Year 2003 and March 2005, slightly more than one-half of the land valuations upon which the Board based its sales and exchanges were made by independent, third-party appraisers. The Board paid almost $180,000 for these appraisal services. According to Board staff, they use the services of appraisers who are licensed and regulated by the Department of Regulatory Agencies' Board of Real Estate Appraisers. As a condition of licensure, appraisers must follow the Uniform Standards for Professional Appraisal Practice (USPAP). The purpose of USPAP is to promote and maintain a high level of public trust by establishing requirements for appraisers to develop and communicate their analyses, opinions, and conclusions in a meaningful, non-misleading manner. The USPAP, updated annually, reflects the current standards of the appraisal profession.

As part of our audit, we contracted with two Colorado-licensed, review appraisers to perform an administrative or desk review of a sample of appraisals used by the Board to complete land transactions between Fiscal Year 2003 and March 2005. The use of review appraisers is common in the real estate industry. According to the American Society of Farm Managers and Rural Appraisers (ASFMRA), review appraisers are educated and experienced in appraisal review, and are "called upon when a reliable opinion is needed as to the accuracy, relevance, and reasonableness of an appraisal." We selected a sample of seven appraisals used to complete six transactions and asked the review appraisers to determine whether the appraisals conformed to the terms described in the USPAP for the type of appraisal conducted. Both review appraisers found weaknesses in the appraisals they reviewed. The first appraiser reviewed five appraisal reports used by the Board to complete five separate land transactions. This review appraiser identified a total of 20 errors that could have materially impacted the value conclusions reached in the appraisals. The appraiser also identified 17 errors considered important under USPAP standards for informing and not misleading the client, but not of the type that would materially impact the value conclusions.

Our second appraiser reviewed two appraisals used by the Board for completing a complex land exchange. The appraiser found that the two appraisal reports contained significant reporting errors and omissions. Of greatest concern was the review appraiser's inability "to verify the sales data used in the appraisal reports because of their incompleteness and nonconformance to USPAP standards." The errors found in the two reports could have substantially changed the value conclusions of the subject property and could have required the Board to restructure the exchange. Some of the specific errors and weaknesses found by the two review appraisers included:

- Failure to use accurate, comparable sales.
- Lack of adequate, complete documentation of sales.
- Use of incorrect or inapplicable factors in analysis.
- Land appraised not the same land sold, acquired, or exchanged.
- Flawed methodology used to reach value conclusions.

Board Review Practices

We reviewed the Board's real estate transaction files and interviewed district managers to determine if they had identified any of the problems we found with the seven appraisal reports. We found that the errors noted by our review appraisers were not identified by Board staff. No documentation of the district managers' reviews or critiques of the appraisal reports were contained in the Board's real estate transaction files, and we found no evidence the Board required the original appraisers to redo their reports because of errors identified or a lack of information.

The errors identified by our review appraisers were not detected by Board staff for several reasons. First, although required by the Board's staff procedures to review third-party appraisals, district managers do not necessarily have backgrounds or experience in real estate or in appraisal review. The Board does not require prior real estate experience or education as a condition of employment. We found only three of the six current district managers had any real estate experience at the time of hire. One district manager has an inactive real estate license, another maintains a current broker license, and the third previously managed a real estate company but has never been a licensed broker. Second, the Board does not routinely provide or require district managers to have relevant training. District managers received their first and only review appraisal training in October 2004. The Board contracted with an outside appraisal company to provide this one-half day of training. Finally, the Board does not have a standard form or checklist to assist district managers in reviewing appraisal reports. According to Board procedures, if errors or problems are identified, the district manager is to notify the appraiser and discuss the changes or corrections to be made. This review process, however, is neither standardized nor documented.

Uncorrected errors in appraisal reports can lead to inaccurate value conclusions. As one of our review appraisers noted, "the poor analysis in these appraisals makes the opinions and conclusions of value suspect." The Board, by not identifying and correcting errors, may be relying on inaccurate or unreliable estimates of property value to structure and negotiate its land transactions. The Board needs to improve its process for reviewing appraisal reports and ensure third-party appraisals comply with

USPAP and are free of material errors. One way the Board could do this would be to better utilize its current staff. Each of the six district managers is responsible for reviewing appraisals conducted on trust lands in their districts. However, some district managers have more real estate experience than others. For example, one district manager is a board member of the American Society of Farm Managers and Rural Appraisers. The Board should consider assigning its most qualified staff responsibility for reviewing third-party appraisals. The Board could also consider contracting with licensed professionals for appraisal review services.

If using one or more select staff for this purpose is not feasible, the Board should increase the frequency of training provided to all district managers. The Board should also develop a checklist for use in reviewing appraisals. The checklist should standardize the review process and provide district managers a tool for better ensuring appraisals comply with USPAP and are free of material errors. The checklist and the district managers' decisions to accept or reject appraisals should be documented and included in the Board's real estate transaction files. Possibly, the Board could work in consultation with outside review appraisers to develop the checklist and to periodically review appraisals to ensure the in-house reviews are adequate.

Recommendation No. 2:

The State Board of Land Commissioners should improve its appraisal review process by ensuring staff reviewers are adequately trained and by developing a standard appraisal review checklist and documenting and maintaining the results of the reviews in the Board's real estate transaction files.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2006.

The State Land Board staff agrees that district managers should have more training in reviewing appraisals. This is what prompted the appraisal training in October 2004. However in terms of a formal review process, the State Land Board is considering designating one or two staff to specialize in reviewing appraisals rather than all district managers. The reason is that reviewing appraisals is only one part of a district manager's responsibilities and while familiarity is important, expertise in this area may not be the best use of each district manager's time or experience.

The State Land Board will implement a training and internal review process by July 2006. However, the internal review process may require new FTE or contract dollars which may delay implementation of this part of the recommendation.

Staff Market Analysis

As stated previously, the Board values some of the lands it intends to acquire or dispose of through staff market analysis. Whether by independent appraisal or by staff market analysis, it is incumbent upon the Board to accurately value lands. Section 24-30-202(5)(b), C.R.S., requires that all state departments and agencies, prior to purchasing any real property exceeding $100,000, "...contract with at least one but not more than three independent appraisers for an estimate of the value of such property." The Board also has a legal obligation to its beneficiaries to maintain sufficient documentation supporting its actions to buy and sell trust land. As previously mentioned, 35 of the 74 land transactions closed by the Board between Fiscal Years 2003 and 2005 were valued by staff conducting market analyses.

We reviewed the Board's practices related to staff market analyses and identified several concerns. Most significantly, we found the Board has not complied with statutory provisions. We identified five instances in which staff did not obtain independent appraisals but rather relied solely on market analyses to acquire properties exceeding $100,000. For example, in 2004 the Board acquired 560 acres of land for $420,000 ($750 per acre) based on the analysis of one district manager. We also found the Board's commissioners have not adopted any formal policies delineating when outside appraisals must be conducted or when in-house valuations may be done. Rather, internal administrative procedures, adopted and used by staff, appear to be the basis upon which this determination is made. Currently these procedures (specifically, the Real Estate Procedures Manual) generally allow project managers (either the district manager or Real Estate Section staff) to conduct land valuations when they estimate the value of the subject land parcels to be less than $50,000. For transactions estimated to be greater than $50,000, an outside appraisal is to be conducted, according to staff procedures. The origin of this practice appears to be a 1993 Board decision permitting staff to conduct analyses on land parcels with a value of $25,000 or less. Since that time, staff raised the limit to the current $50,000 figure.

We believe the Board's Commissioners, not staff, should formally determine the conditions under which staff market analysis will be allowed. Furthermore, we found some problems with the current market analyses that need to be addressed. Specifically, we found staff do not use a standard methodology for conducting the analyses, and the factors considered in determining land values are not adequately documented. The primary goal of the analysis is to determine the fair market value of the trust lands in question. Analysis should be based on information such as appraisals of nearby, similar properties; previous appraisals of the subject parcels; and recent comparable sales. Currently staff do not always evaluate the same factors when conducting their analyses. Additionally, we found staff do not document the factors evaluated, such as comparable sales, or support the appreciation rate they assert for individual parcels. Section 36-1-101, C.R.S., requires the Board to keep complete records of all of its proceedings, including “all important papers and documents pertaining to the state lands.” Documentation supporting staff conclusions on the valuation of trust lands clearly meets the definition of important papers and documents to be retained and protected.

We surveyed other states' trust land entities and the Federal Bureau of Land Management (BLM) to determine their policies regarding in-house or external appraisals and land valuations. None of the western states we surveyed permit unlicensed staff to conduct market analyses without also obtaining an appraisal report by either a third-party contractor or a licensed staff appraiser. For example, Utah’s trust land entity requires all land transactions be accompanied by an appraisal completed by a licensed third-party appraiser. Other states, including New Mexico, Texas, Nebraska, and Montana, all employ licensed staff appraisers. Texas, for example, employs 20 such staff. Additionally, unlike Colorado, other states require appraisals, regardless of value of the subject parcel. The BLM also requires outside appraisals for all federal land exchanges, regardless of value.

The Board should comply with state statutes and contract for third-party appraisals on all property purchases exceeding $100,000. The Board should also reassess its current appraisal policies and procedures. The Board may decide it more appropriate to contract with licensed, third-party professionals to value all trust lands involved in transactions. If the Board determines some transactions are appropriate for staff market analyses, then the Board needs to ensure staff are trained and qualified to conduct the valuations. It should also clearly outline the factors to be evaluated in a staff market analysis, and findings and all supporting documentation should be maintained in the Board's real estate transaction files. Finally, the Board should monitor staff compliance with the standards and take corrective action where needed.

Recommendation No. 3:

The State Board of Land Commissioners should ensure that its use of staff market analysis complies with state statutes. The Board should also adopt formal policies and procedures delineating the situations under which independent, third-party appraisals or market valuations are required and when staff market analyses may be conducted for all land transactions. If staff will continue to conduct market analyses, this should also include:

a. Adopting standard factors to be evaluated in staff market analyses.

b. Ensuring staff are trained and qualified to conduct the analyses.

c. Maintaining adequate documentation to support the findings of outside appraisals and staff market analyses.

d. Periodically reviewing staff market analyses.

State Board of Land Commissioners Response:

Agree. Implementation Date: January 2006.

The State Land Board staff agrees with many of the criticisms of the market valuation process. The goal of the process was to introduce cost effectiveness into our transactions. Each appraisal costs several thousand dollars and it does not seem justified to spend this amount on transactions that are valued at less than fifty thousand dollars. However, the State Land Board staff admits that we have not done a good job of documenting the support for the analyses or adopting standards by which a market analysis is undertaken.

The State Land Board staff intends to make a proposal to the Board which would eliminate market analyses except as specifically authorized by the Board. As of January 2006, all transaction-related valuations will be performed by licensed appraisers.

Fiscal Impact Studies

Article IX of the Colorado Constitution requires that prior to leasing, selling, or exchanging any lands for *commercial, residential or industrial development*, the State Land Board is to "determine that the income from the lease, sale, or exchange can reasonably be anticipated to exceed the fiscal impact of such development on local school districts and state funding of education from increased enrollment associated with such development." *(Emphasis added.)* We reviewed Board transactions to determine compliance with fiscal impact study requirements. Our review included mining operation leases and land sales, leases, and exchanges for commercial, residential, or industrial development. All of the transactions we reviewed closed between July 2002 and March 2005 or at least five years after the effective date of the constitutional and legislative mandates. We found that until our audit, the Board had never conducted a fiscal impact study on any land transaction or lease, including those specifically intended for development:

- **Land Sales and Exchanges.** We identified one land exchange for which the Board should have conducted a fiscal impact study. In this transaction, the Board exchanged 41 acres of trust land for about 72 acres of land and about $1.5 million in cash. The United States Air Force (USAF) obtained the trust lands for the development of base housing. The Board entered into this transaction with the knowledge that the land in question was to be developed. Therefore, the transaction clearly met the statutory and constitutional requirements for fiscal impact study.

- **Commercial leases**. We identified one commercial lease for which a fiscal impact study was required but not conducted by the Board. The 50-year lease, awarded in 2003, allows the lessee to capitalize, develop, and implement long-term commercial/mixed-use improvements on a 15-acre parcel of state land near Granby, Colorado.

- **Mining Leases**. Section 36-1-112.5, C.R.S., states that when determining the fiscal impact of the proposed lease, sale, or exchange of any land that is a *part of any mining operation*, the Board shall consider the fiscal and other benefits to the local school districts from the *development of the entire operation*. (*Emphasis added.*) Thirty-seven mining leases were in effect during the period of our review. We found the Board never conducted fiscal impact studies on these or any mining leases, although development clearly occurred on at least several of them. For example, one lease, located on a 640-acre parcel of trust land, will likely develop into a major coal operation employing 100 people with $5 million to $10 million in dedicated equipment. In another case, a lease on 160 acres of trust land has developed into a large quarry operation employing more than 10 employees with over $2 million in equipment.

Board staff acknowledge they did not conduct the requisite impact studies for the land transaction and commercial lease noted above. Board staff also agree that they have not conducted any impact studies on mining operations. As we discuss below, mining leases pose some challenges in determining the need for and the timing of impact studies. However, these challenges are not insurmountable.

Compliance

We found the Board did not conduct the required fiscal impact studies for several reasons. First, Board policy narrowly interprets constitutional and statutory mandates. Consequently, according to Board policy, few transactions would ever require fiscal impact studies. Additionally, for those transactions for which Board policies do require impact studies, the point at which the studies are to be conducted is too late in the development process to be meaningful. Specifically, Board policy states that the Board will conduct fiscal impact studies on residential, commercial, and industrial properties for development when (1) the ground that is leased, sold, or exchanged is *zoned and platted* for residential, commercial or industrial purposes, or (2) the Board is involved in the development of the property directly or through a development agreement. By contrast, Article IX of the Colorado Constitution states that impact studies are to be conducted *prior to* the sale, lease, or exchange of lands for development purposes. (*Emphasis Added*.) In at least one case, the Board's staff avoided conducting the necessary fiscal impact study because, as staff noted in working documents, "this property is zoned for industrial development, however, it is not platted. Pursuant to Policy 99-2, a fiscal impact study is not required." The Board was aware, before close of this transaction, that the property was to be developed for residential purposes. Therefore, a fiscal impact study was required and should have been completed.

Second, prior to our audit, the Board had not developed a model or tool for use in conducting impact studies. After we informed staff of the findings of our review, they developed a fiscal impact study model. The model includes components such as estimates of the number of students to be added, property taxes to be generated, and the overall impact from capital construction. These are critical factors in determining the impact residential, commercial, or industrial development will have on local school districts and state education funding. Board staff recently used the model to evaluate bids for a Request for Proposal (RFP) for a development agreement. Staff found the development would have a negative impact on the local school district. At the time we were completing our audit, the Board was still negotiating the terms of the agreement, and had not yet decided how to proceed.

Finally, according to staff, the timing and structure of the Board's mining leases and development agreements make strict adherence to the constitutional and statutory requirement for fiscal impact studies challenging. For example, the Board issues mining leases to companies exploring for minerals but not yet developing trust lands. Staff report that at the time of lease issuance, they do not know if or when development may occur. According to staff, in most cases, exploration does not result in actual production or development because minerals are not found. Other leases, however, do result in large mining and quarry operations that may attract new residents and their school-age children. Although it is difficult, the Board has an obligation to conduct fiscal impact studies and determine if school districts will be affected by the mining development. The same is true for development agreements in which we believe the Board has a duty to determine the fiscal impact prior to entering into a legally binding agreement, although the sale has not yet occurred.

The Board should adhere to constitutional and statutory mandates and apply its fiscal impact model prior to the sale, lease, or exchange of trust lands for commercial, residential, or industrial development. The Board should periodically review its fiscal impact model to determine whether it is adequate to evaluate the fiscal impacts on local school districts from development activities. Adjustments should be made, where needed. In addition, the Board should establish procedures to ensure lessees' self-reported data are accurate. Finally, Board policies need to be modified to be consistent with statutory and constitutional mandates. Specifically, fiscal impact studies should be required on all properties for sale or exchange in which the Board knows that commercial, residential, or industrial development is planned, regardless of whether the land for sale or exchange is zoned and platted. Furthermore, Board policy should require staff to conduct fiscal impact studies on all mining leases in which exploration turns into actual production and development. The Board can identify these companies through its royalty audit program. If the Board believes the statutory requirements for impact studies are unclear, then it should seek statutory clarification. All fiscal impact studies should be documented and included in the appropriate real estate transaction and lease files.

Recommendation No. 4:

The State Board of Land Commissioners should modify its policies and procedures regarding fiscal impact studies to reflect constitutional and statutory mandates and seek statutory clarification, as needed.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2006.

The State Land Board staff agrees with the recommendation. The goal of State Land Board Policy 99-2 concerning fiscal impact studies is to implement the complex concept required by the Constitution. The policy is admittedly too narrow and importantly does not address mining operations.

The State Land Board staff will propose changes to the Board Order 99-2 which will address mining impacts and will attempt to clarify the issues regarding land disposals and other areas identified in the audit. The policy will be forwarded to the State Auditor's Office staff for comment before it is presented to the Board for their approval.

Strategic Management of Trust Lands

As a fiduciary, the State Land Board must provide assurance to beneficiaries (primarily Colorado's public schools) that trust lands are producing reasonable and consistent income over time. To provide this assurance, the Board must first know how well its trust lands are performing. Measuring the performance of trust lands is key to overall asset management and provides information demonstrating that the Board's land management policies and decisions are more advantageous over time than are other alternatives.

We evaluated information on the performance of trust lands and found the Board lacks data showing its land management policies are prudent and produce reasonable and consistent income as mandated in statute and the State's constitution. Basic questions, such as whether the Board should continue to manage all trust lands or dispose of lands and deposit the proceeds into the Public School Permanent Fund, cannot be answered. The decision to retain and manage lands is appropriate if the Board can show that the net revenue from its management practices exceeds the net revenue earned if the Board sold the land and the Treasurer invested the proceeds. We reviewed interest earnings from the Public School Permanent Fund for the past three years and found that funds have yielded an average of 6.1 percent annually. Similar information on the earnings of lands managed by the Board are not available for comparison. Information on the performance of trust lands is also important for identifying underperforming lands and evaluating land management alternatives. For example, an underperforming parcel of land could be exchanged for a higher-performing parcel. Other alternatives for increasing the return on underperforming lands could include water developments, cross-fencing, brush control, access, and raising rental fees.

Currently the Board lacks performance information related to trust lands in three crucial areas: (1) land values, (2) land appreciation, and (3) target rates of return. With respect to land values, no process exists to value trust lands on a periodic basis. Rather, Board staff typically collect valuation data when land is sold, exchanged, or acquired. Only a small number of land transactions occur annually, and the valuations for these transactions cannot be applied to other parcels. Similarly, with respect to land appreciation, changes in value are only collected when transactions occur. Purchase prices can then be compared to calculate land appreciation rates over time. Finally, with respect to target rates of return (defined as the total income produced by an asset as a percentage of that asset's value), rates can only be calculated if data on land value and appreciation—components of the rate of return calculation—are available. Hence, appreciation data are critical for calculating rates of return, setting targets, and measuring the performance of trust lands over time.

In 1999 the Board attempted to obtain information on its trust land values and appreciation rates by conducting an assessment. In its "rapid assessment," the Board also collected data on annual income, rate of return, mineral activity, and recreation potential for each parcel of trust land. We attempted to use the information contained in the assessment to determine the value and rate of appreciation for trust lands. However, according to Board staff, the assessment information is not accurate and cannot be relied upon to provide a reliable rate of return for trust assets.

The Board needs to consider alternatives to obtaining accurate and meaningful valuation and appreciation data to measure rates of return, set performance targets, and identify lands performing at or above expected levels or, more importantly, lands that are underperforming and require action. As a first step, the Board needs to establish the value of trust lands on a periodic basis either by procuring the services of an independent appraiser or by developing an analytical valuation model. In our 2000 performance audit, we recommended that the Board cooperate with the Legislative Council's annual statewide property assessment request for proposal (RFP) process to identify qualified vendors to independently value trust lands. The Board originally agreed with the recommendation and sought to release the RFP by December 31, 2001. The Board never released the RFP, however, and indicated that the costs for an independent appraiser would have been prohibitive. We contacted local appraisers who estimated that an independent appraisal of the Board's lands would cost approximately $40,000 to $120,000 to complete.

Board staff recently told us that they have decided to develop an analytical model to capture the value and appreciation of trust assets. The model could prove very useful and cost effective. We found other states have successfully used analytical models to estimate the value of trust lands. For example, Nebraska's Board of Educational Lands and Funds annually establishes a value for its trust lands by using information prepared by the University of Nebraska's Department of Agricultural Economics. Other researchers have been successful in estimating the value of trust assets by using regression models formulated on statistical samples of arms-length ranch and farm sales. We provided the Board with the information we found on valuing trust assets to assist them in development of their model. No single model for valuing trust lands is without some weaknesses. However, the Board should develop a model and consistently use it to estimate the value of trust lands if it proves useful.

The Board must also develop formal target rates of return against which the performance of trust lands will be measured. The establishment of target rates of return is an important policy decision that should include formal Board approval. We reviewed the professional literature on real estate and trust land management and found that target rates of return generally range from 4 to 8 percent. For example, the Idaho Citizen's Committee established 6 percent as the real rate of return objective for its state's trust lands. It may also be more appropriate for the Board to develop target rates of return for different classes of trust lands. For example, Washington State established a goal of achieving a 9-10 percent annual return on trust lands with commercial leases.

After the Board has designed a process to measure and evaluate the performance of trust lands, it should calculate the average rate of return for each parcel no less than once every five years. The Board should then work with staff to identify, based on the formalized target rates of return, financially underperforming lands and evaluate the management alternatives that would best achieve Board goals. Evaluation should not be limited to surface land values, but consideration should also be given to the importance of a particular tract to other factors such as access to mineral estate or adjacent lands with better and higher uses. The information generated from this process should be included in the Board's information management system for ease of access and future use.

Recommendation No. 5:

The State Board of Land Commissioners should provide assurance it is managing trust lands to provide reasonable and consistent income over time by developing a system, including the information needed, to evaluate the performance of trust lands. This should include:

a. Establishing the value of trust lands on a periodic basis through either third-party appraisals or development of an analytical valuation model.

b. Establishing a target rate(s) of return for trust lands or classes of trust lands.

c. Calculating the average annual rate of return for each parcel of land at least once every five years.

d. Evaluating and documenting management alternatives for those trust lands not meeting the Board's target rate(s) of return.

State Board of Land Commissioners:

Agree. Implementation Dates: Model Date-July 2006, Targets/property specific strategic plan date-July 2007

The State Land Board staff agrees with the recommendation. The State Land Board staff is developing a valuation model that will be methodically consistent and reproducible. The model will set the value for the entire portfolio which will be used to calculate individual rates of return based on appreciation and income. The model will also include the benefits of the mineral estate.

Based on the model, the State Land Board staff will propose that the Board set rate of return targets and broader strategic plans for each class of trust lands. In the end, the asset management model and target rates will need to be consistent with the constitutional requirement of an intergenerational trust that produces reasonable and consistent income over time.

State Land Board staff intends to have the first generation of the model complete by July 2006 and class specific targets and strategic plans completed by July 2007. Additional funding and/or FTE maybe required which may impact the full implementation of this recommendation.

Administration

Chapter 2

Background

The State Board of Land Commissioners (Board) expended approximately $4.3 million and employed 34 full-time equivalents (FTE) for its operations in Fiscal Year 2005. As discussed in the Overview, the Board is administratively organized into four primary sections: field operations, mineral, real estate, and financial. Staff are assigned to each section by the director, who is ultimately responsible for implementing the policies established by the Board's commissioners. Daily operations include the collection and audit of mineral royalties, inspection of trust lands, issuance of leases, sale and exchange of lands, mitigation of noxious weeds, general land and lessee management, and financial administration of the Board's trust funds.

In this chapter, we discuss several activities related to the Board's administrative or day-to-day operations. Although seemingly routine in nature, these activities have a significant impact on the Board's ability to effectively manage trust lands. As part of the audit, we evaluated the Board's formula for determining grazing rental rates; its process for auditing mineral royalties owed to the Board; its program controls for addressing conflicts of interest and promoting ethical behavior on the part of commissioners and staff; and its management of noxious weeds. We identified several areas in need of improvement and discuss each below.

Grazing Rental Rates

The Board currently leases more than 2.3 million acres, or 82 percent, of total trust land holdings to individuals for grazing purposes. In Fiscal Year 2005, revenue from this source totaled approximately $5.3 million. Grazing income is the Board's second largest source of income after mineral royalties and bonuses. As stated previously, the public does not have unrestricted access to Board lands. Rather, trust lands are managed by the Board for the sole benefit of its beneficiaries. Thus, management of the trust lands includes leasing them to private individuals and entities to generate income for the beneficiaries.

As part of its fiduciary responsibility, the Board needs to ensure it is setting its lease rates at a level sufficient to earn reasonable and consistent income. At a minimum, the rate should be equivalent to fair market value. The Board developed its grazing rental rate formula for trust lands in 1994. In general, the formula is designed to make leasing trust lands competitive with the private market. As such, the formula includes factors such as the fair market grazing rental rate charged by private landholders and the USDA national Beef Parity Index (the ratio of beef prices to the prices cattle producers pay for goods and services). The Board also adjusts (decreases) the rate by 35 percent, across-the-board, from the private sector fair market grazing rental rate. This reduction is designed to compensate lessees for the additional costs, such as fencing and water, associated with leasing trust, rather than private, land. The Board typically adjusts grazing rental rates every three years based on the increase or decrease in private rates as reported in the most recent United States Department of Agriculture (USDA,) Colorado Agricultural Statistics Service (CASS) survey. Based on the 2004 CASS survey results, the Board voted to raise rental rates gradually by 11 percent over the next three fiscal years (no increase in 2005, 5.5 percent increase in 2006, 5.5 percent increase in 2007) to match the increase in private rental rates.

We reviewed the Board's rate setting formula and found the Board does not have a sound basis for the 35 percent adjustment. The 35 percent reduction was based on a Colorado State University (CSU) study conducted in 1991. We found the study is outdated and no longer reflects current levels of service and does not compare lands of similar condition. First, the study compared lessees' maintenance costs between private land and public land in Colorado owned by the Bureau of Land Management (BLM) and the United States Forest Service (USFS). At the time of the study, 68 percent of Colorado private landholders provided some services to their lessees, such as fencing and water. According to the 2004 CASS survey, the percentage of private landholders providing services has declined to 51 percent. Second, it is unclear whether the condition of BLM and USFS lands is comparable with that of Board trust lands. A Government Accountability Office (GAO) report released in 1991, the same year as the CSU study, concluded that 43 percent of BLM rangeland was in Fair or Poor condition. The Board does not have a similar rating system for its lands' conditions; however, district managers we interviewed believe that state trust lands are in better condition than BLM rangeland or other public lands. Consequently, we question whether the study's use of the costs associated with leasing BLM and USFS lands appropriately represents the costs associated with leasing state trust lands.

A blanket reduction, such as the one used by the Board, has the effect of rewarding lessees who are poor stewards of trust lands. The 35 percent reduction is provided to all lessees, regardless of whether they properly maintain the trust lands they are leasing. Conversely, there is no added incentive for lessees to maintain or improve their lease holdings. In addition, by reducing grazing rental rates for all leases by 35 percent, we believe the Board is not earning fair market value for trust beneficiaries. The table below shows the amount of income the Board could expect to gain annually if it were to lower the reduction.

State Board of Land Commissioners Increased Revenues From Changes in Grazing Rate Reduction	
Percent	**Estimated Additional Annual Revenue**
35	—
33	$160,000
20	$1.2 million
10	$2 million
0	$2.8 million
Source: Office of the State Auditor's analysis of State Board of Land Commissioners' information management system data.	

We identified similar concerns with the rate reduction in our 2000 performance audit of the Board and recommended all rate reductions from fair market value be made on a lease-by-lease basis according to each lessees' costs of managing trust lands. The Board agreed that lease rate offsets should reflect the particular characteristics of each parcel. However, the Board reported that it was impossible to eliminate the 35 percent reduction and customize individual rates for each of the 3,000 parcels it managed. We continue to believe the 35 percent reduction is no longer valid. If the Board cannot evaluate parcels on an individual basis, it should consider grouping or prioritizing them for evaluation on a systematic basis or adopt other means of establishing appropriate rates. As such, the Board should determine if there are more appropriate and efficient ways in which to compensate lessees for their individual contributions to maintaining trust lands. Any reduction from market value should be correlated to the amount of actual lessee management burden required by Board lessees. As shown in the table above, this change could result in significant additional annual revenue for trust beneficiaries.

Grazing rates set below fair market value have been considered a subsidy by at least one other western state's attorney general, who found such practices to violate that state's land board's fiduciary duty. Therefore, reductions from fair market value should be well documented, periodically reviewed, and directly correlated to the reason for the reduction. Without evidence that the 35 percent rate reduction is directly correlated to the actual cost burden of Board lessees, the reduction could be viewed as a subsidy. We recommend the Board evaluate the validity of the 35 percent rate reduction currently offered to lessees. As an option, the Board could request the USDA to include questions regarding the costs to private lessees of water, fence maintenance, and livestock transportation in its next CASS survey. According to USDA personnel we spoke with, they could collect and report this information in their upcoming 2007 survey. The survey's findings could then be compared with similar data collected from Board lessees to determine the actual difference in lessee costs between trust lands and the private market. As another option, the Board could either contract for or undertake a new study to determine the difference in lessee costs between state trust and private lands.

Recommendation No. 6:

The State Board of Land Commissioners should ensure its grazing lease rates are set at an amount that represents fair market value by evaluating its practice of across-the-board reductions. This should include:

a. Evaluating private lessee cost burdens in Colorado.

b. Collecting similar information from Board lessees.

c. Studying the difference in maintenance burden between Colorado's private grazing lessees and state trust land grazing lessees.

d. Basing any reduction on the actual difference in costs between Board and private lessees.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2007.

The State Land Board agrees with the recommendation. Prior to the audit, the commissioners had expressed their interest in reevaluating the 35 percent reduction made to the grazing rates. Therefore, staff has begun to evaluate alternatives for the Board's consideration.

The alternative identified in the audit report which relies nearly exclusively on the Colorado Agricultural Statistics Services (CASS) survey may be problematic. While the survey helps provides a basis for setting base grazing rates, it may suffer from a self-reporting bias. Furthermore, the CASS survey receives a response rate of less than ten percent. Therefore, it is unclear whether the survey truly identifies fair market value.

The State Land Board staff will reexamine the use of the CASS survey as well as the 35 percent reduction. The goal is to find a more representative fair market rate methodology and/or verify the CASS survey as accurate. Ultimately a proposal will be made to the Board before the next round of grazing rate increases which is scheduled for 2007.

Mineral Audits

Royalties refer to the fee lessees pay to the Board to extract and later sell minerals for private gain. The Board collects royalties for the depletion of oil, gas, geothermal, coal, gravel, and other mineral resources from state trust lands. In a sense, royalties are the Board's share of the profits derived from the exploration and development of its mineral assets by private individuals and companies. In Fiscal Year 2005 the Board collected $34.4 million in mineral royalties, the single largest source of its income. The Board currently manages about 1,800 active mineral leases on approximately 850,000 acres of trust land.

Royalties are based on the quantity of minerals extracted from trust lands and the market rate at which those minerals are sold. The Board, in its mineral leases, stipulates the percentage of the sale lessees must pay as a royalty. For example, if an operator extracted 1,000 barrels of oil from trust lands (quantity extracted) and sold the oil for $60 per barrel (market rate), the lessee must pay the Board 12.5 percent (the Board's standard oil and gas royalty rate) of the total sale, or $7,500 (1,000 x $60 x 12.5%). Lessees are required to submit monthly royalty payments, along with supporting production and sales data, to the Board. The Board relies on lessees to accurately measure, track, and report the quantity of minerals they extract and the price at which they sold the minerals. The Board, as trustee, has a fiduciary responsibility to ensure that lessees are accurately paying for the minerals extracted from trust lands. Audits of lessees' operations and financial records are the best means for ensuring the Board receives the royalties it is owed.

Statutes give the Board the authority to audit the operations of companies extracting minerals from state trust lands. Specifically, according to Section 36-1-138, C.R.S., the Board has the authority to audit "every mine and oil and gas operation and other works upon the land..." and "...to inspect all works operated under lease from the state for the production of mineral resources upon which rentals are due to the state upon basis of a royalty." To fulfill this responsibility, the Board's Mineral Section established a unit to conduct audits of the companies extracting minerals from trust lands. The Audit Unit performs:

- **Desk audits.** Desk audits are limited in scope and usually examine one month of documentation supporting a company's royalty payments. According to Board staff, desk audits take them between two and five days to complete.

- **Field audits**. Field audits are performed as a result of and as a supplement to desk audits, or as a result of a risk-based selection process. Field audits are full scope and typically require the auditor to examine five years of documentation from the operator. Field audits require auditors to collect and examine the operators' purchase and processing agreements, bills of sale, calibration and production reports, and financial records. Field audits are more comprehensive than desk audits and typically take staff four to eight weeks to complete.

- **Third-party audits.** In the past, the Board also contracted with mineral audit companies to conduct royalty audits.

In addition to the audits mentioned above, the Board contracts with the Colorado Department of Revenue (Department) to audit all coal leases operating on state trust lands and any mineral leases spanning both federal and state lands. Section 24-35-115, C.R.S., states that the Department may perform audits through contracts with other state agencies, including the Board. The Board is required by statute to compensate the Department for the costs of the audits. The Department typically performs three to five audits per year for the Board at an annual cost of $41,000.

We evaluated the Board's process for selecting and conducting mineral royalty audits and found that although the Board has developed an effective royalty audit program, the audit coverage or the amount of royalty revenue audited each year should be increased. For the most recent, completed audit cycle, the Board, together with the Department of Revenue, audited a total of 62 percent of royalties collected between Fiscal Years 2001 and 2004. Although this represents a large portion of royalties collected, more than $26 million, or 38 percent, remain unaudited for this period.

As the following table shows, the combined efforts of the Board and the Department have been successful in identifying and recovering unpaid royalties. The 41 audits completed between Fiscal Years 2003 and 2005 resulted in the collection of $3.2 million in unpaid royalty revenue or $78,000 per audit completed. This amount does not include "forward," the future amount of unpaid royalties that should be collected by the Board as a result of royalty reporting corrections made during the audits. We conservatively estimate that the reporting corrections made by companies as a result of the 41 audits completed between Fiscal Years 2003 and 2005 will provide an additional $140,000 in revenues or "forward" over the next ten years.

State Board of Land Commissioners Field Audits Fiscal Years 2003-2005			
Agency	**Audits Completed**	**Returns From Completed Audits**	**Average Return per Completed Audit**
State Land Board	34	$2,900,000	$85,000
Department of Revenue	7	300,000	43,000
Totals	**41**	**$3,200,000**	**$78,000**
Source: Office of the State Auditor's analysis of data provided by the State Board of Land Commissioners' Audit Unit.			

The Board currently spends about $212,000 per year, or 5 percent of its total expenditures, to audit mineral royalties. The Board has assigned only two full-time equivalents (FTE) to audit royalties generated from the Board's four million sub-surface acres. This equates to one auditor for every two million sub-surface acres. By contrast, other states tend to employ one royalty auditor for every one million sub-surface acres. For example, New Mexico has 13.3 million sub-surface acres and 13 audit staff. Texas manages 12.4 million sub-surface acres and employs 15 audit staff. The last staff addition to the Audit Unit occurred during Fiscal Year 2002.

We also found the Board does not take advantage of all available information when conducting desk audits. An important step in performing desk audits is reconciling the production numbers reported by operators. In the past, the Board's Audit Unit conducted monthly electronic data matches of the production numbers it received from lessees with those reported to the Colorado Oil and Gas Conservation Commission. Audit staff report these data matches were beneficial and quickly identified reporting discrepancies they then could investigate further. Due to database conversions, the electronic match is no longer possible and conducting it manually is too time-intensive for current staff. As part of the audit, we searched for other information that could prove helpful to the Board in reconciling the mineral production information it receives from lessees. We found the Department of Revenue also collects production data from all mineral operations in Colorado, whether operated on public or private land, as part of the collection of severance taxes. We sampled eight severance tax returns from the Department and, with the Board's audit staff, compared the production numbers with those reported directly to the Board. The comparison proved useful in identifying reporting discrepancies. Board staff acknowledged that the severance tax information would be useful in conducting desk audits.

Colorado and other states' land boards have found that companies do not always pay the correct amount of mineral royalties, resulting in lost revenues to trust beneficiaries. The Board should increase its audit coverage to provide greater oversight and to assure beneficiaries the Board is collecting all royalties owed. Furthermore, the Board's Audit Unit has consistently demonstrated that it generates much more income in unpaid mineral royalty returns than it costs the Board administratively. For each dollar spent auditing royalty revenue over the past three fiscal years, the Board recovered $5 that otherwise would have been lost. Expanded audit coverage would likely identify additional unpaid royalty revenue and increase the overall amount of income generated for trust beneficiaries.

We believe the Board should increase the amount of royalty revenue and the number of operations audited each year by exploring several options, including employing additional audit staff, increasing the number of contract audits performed by third-parties, and transferring more funds to the Department of Revenue for audits of trust land operations. The Board has flexible spending authority and will need to either reallocate funds from other areas of its operations or seek additional funding from the General Assembly to increase its audit coverage. The Board should also begin requesting copies of severance tax forms from lessees to better verify the accuracy of self-reported production numbers during desk audits.

Recommendation No. 7:

The State Board of Land Commissioners should increase its audit coverage of mineral royalties by:

a. Shifting existing funds to, or requesting additional funds for, the Audit Unit to hire additional staff auditors, contract for more third-party audits, or compensate the Department of Revenue for additional audit work.

b. Requesting severance tax returns from operators as part of the royalty audit process.

State Board of Land Commissioners Response:

Agree. Implementation Dates: Shifting existing resources-Immediately. Severance tax returns-July 2006.

The State Land Board agrees with the recommendation. In FY 2005-06, State Land Board staff added $25,000 to the annual budget for Department of Revenue audits and received approval from the Board to spend Investment and Development funds on a contract minerals auditor in order increase the total dollars audited and royalty dollars recovered. The State Land Board will evaluate whether to request more FTE and/or contract dollars in the future.

The State Land Board staff will also evaluate requesting severance tax returns from operators as part of the royalty audit process. It is a good suggestion that staff believes would add value to our royalty audit process.

The State Land Board has already shifted additional resources to mineral royalty audits and will look towards adding severance tax returns to the audit process by July 2006.

Conflicts of Interest

Board commissioners and staff are required to comply with the Executive Department Code of Ethics, as issued by an Executive Order of the Governor. The Order specifies that commissioners and state employees, "who serve the people of the State of Colorado as public officials should do so with integrity and honesty, and should discharge their duties in an independent and impartial manner." Furthermore, Board commissioners and staff must comply with the code of ethics and standards of conduct contained in Article 18 of Title 24 of the Colorado Revised Statutes. These statutes reiterate public officials' and employees' duties to act impartially and avoid real or perceived conflicts of interest.

The Board is entrusted with almost 3 million surface acres of trust land with an estimated value in excess of $500 million, and, unlike other state agencies, the Board has the authority and sole discretion to dispose of and develop these trust assets for the good of its beneficiaries. Real estate development, especially involving public lands, is closely scrutinized by outside entities and individuals and is an area particularly susceptible to fraud and abuse. Board commissioners and staff are responsible for making critical decisions involving millions of dollars of property and state resources. These decisions, even if appropriate, may be questioned if a real or perceived conflict of interest existed between staff and those conducting business with the Board. It is paramount that the Board have a robust system of management and program controls in place to help prevent and, if necessary, identify conflicts of interest and promote ethical behavior.

As part of our audit, we assessed the Board's process for addressing potential conflicts of interest and promoting ethical behavior and found the Board lacks some basic program and management controls. Specifically, we found the Board does not provide commissioners or staff with formal training, either initial or refresher, on the

State's codes of ethics and conduct. Although the Board provides newly appointed commissioners a copy of the Executive Department Code of Ethics and new staff a copy of the State Personnel System Employee Handbook, it does not offer any formal training on these standards. The responsibility for reading, understanding, and complying with the codes of ethics and conduct is left entirely to new commissioners and staff.

We also found the Board does not require staff to routinely sign a code of conduct statement. In 2000 the Board's chairman required staff to sign such a statement affirming that neither the employee nor his/her family had a conflict of interest, appearance of a conflict of interest, or potential conflict of interest with respect to any of the Board's business operations. The process of requiring staff to sign a code of conduct statement did not continue after 2000; consequently, we found that only 10 of the Board's current 37 staff (27 percent) have a signed statement on file. Furthermore, four of the six district managers were not employed by the Board in 2000. Thus, only two have a signed statement on file. This lack of current code of conduct statements for district managers is of particular concern. The nature of the district managers' work responsibilities, and the relative autonomy and level of authority with which they operate, increases the opportunity for real or perceived conflicts of interest and unethical behavior without management knowledge.

Finally, the Board does not have a process for staff to formally report, in writing, conflicts of interest and outside employment. We interviewed three of the Board's six district managers concerning potential conflicts of interest and outside employment. From these interviews, we identified areas in which potential or perceived conflicts could exist. For example, we found that a family member of one district manager currently leases trust land in this manager's geographic jurisdiction. The district manager is responsible for inspecting the condition of the trust land and enforcing the lease terms if they are not met. The district manager is also responsible for determining the amount of revenue to be paid to the Board at the time of lease renewal. This particular property is geographically isolated and has not been visited by other Board staff. The Board relies entirely on this district manager's reports to make decisions concerning the property. Another district manager is also employed as a farm manager within his district. Although the farm is not on trust land and does not involve Board assets, state personnel rules require written approval prior to engaging in outside employment. We reviewed these district managers' personnel files and could not verify that the potential conflicts of interest were disclosed or that written approval to engage in outside employment was granted by Board management. Both district managers report that Board management was aware of and approved their specific situations.

Board staff told us they have believed their practice of providing the State's code of ethics/conduct to new commissioners and employees and relying on them to understand and comply with these standards of behavior is sufficient. However, we do not agree. The State's code of ethics and conduct is written broadly to encompass many situations and behaviors. As such, the potential exists for commissioners and employees to misinterpret the ethic/conduct codes and to behave contrary to the expectations of the Board's management. For example, a commissioner submitted an application in 2004 to lease a 1,300-acre parcel of trust land that was opened to the public for competitive bid. The Board's director, questioning the prudence of this action, sought a legal opinion from the Governor's Office of Legal Counsel whether such action was prohibited by statute and the Governor's code of ethics. Staff were directed that awarding the lease in this case, may "provide grounds for accusations of conflict of interest to be leveled at the State Land Board by community members." Thus, the commissioner's application was not considered. It is the Board's responsibility to clearly communicate acceptable behavior and expectations to commissioners and staff to avoid similar situations in the future.

We believe the Board needs to do a better job of addressing potential and perceived conflicts of interest and unethical behavior. The American Institute of Certified Public Accountants (AICPA) provides guidance in this area and recommends that organizations train new staff on the entity's code of conduct, provide refresher training to current employees, and require staff to sign a statement acknowledging compliance with the entity's code of conduct. We believe the Board should implement procedures and practices similar to those recommended by the AICPA, including:

- **Training new commissioners and staff at the time of hire about the entity's values and its code of conduct.** Training should discuss the commissioners' and staff's responsibility to adhere to the State's codes of ethics and conduct, provide examples of unethical behavior and conflicts of interest, and explain the process for commissioners and staff to communicate improper behavior. Periodic refresher training should also be provided to all commissioners and staff.

- **Requiring employees within senior management and finance sections, as well as other employees in areas that the Board deems to have a risk of creating the appearance of impropriety, to annually sign a code of conduct statement.** The Board should begin requiring staff to sign an annual code of conduct statement. Signing such a statement clearly articulates to staff that all employees will be held accountable for complying with the State's codes of ethics and conduct and provides confirmation that staff are aware of the standards by which they will be held accountable.

- **Requiring staff to annually disclose all potential conflicts of interest and outside employment.** As part of the annual code of conduct statement, Board staff should also be required to disclose all potential conflicts of interest and outside employment. This disclosure should include all pertinent details regarding the potential conflict of interest and outside employment, including the nature of the outside employment, date outside employment was approved and by whom, and a statement whether the employer conducts business with the Board. The annual statements of conduct and disclosures of potential conflicts of interest and outside employment should be filed and maintained in each employee's personnel file. Requiring periodic confirmation by employees of their responsibilities and disclosure of outside employment and conflicts of interest has been proven to deter some individuals from acting inappropriately and helps identify problems before they become significant.

Recommendation No. 8:

The State Board of Land Commissioners should strengthen safeguards for preventing and deterring conflicts of interest by:

a. Training new commissioners and staff at the time of appointment/hire on all applicable codes of ethics and conduct.

b. Providing refresher training to commissioners and staff on all applicable codes of ethics and conduct.

c. Requiring staff to annually sign a code of conduct statement and disclose, in writing, all outside employment and potential conflicts of interest. Documentation should be maintained in the staff's personnel files.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2006.

The State Land Board staff agrees with this recommendation The State Land Board will provide training sessions for commissioners and staff on the codes of ethics and standards of conduct as well as develop a standard process for all new employees and new commissioners. This process will include annual documentation on compliance with the codes of conduct and conflicts of interest. If a potential conflict is identified, appropriate action will be required by the policy to respond appropriately. The State Land Board staff intends to complete these processes by July 2006.

Noxious Weeds

Noxious weeds are plant species that are not indigenous to Colorado and negatively impact crops, native plant communities, livestock, and the management of natural agricultural systems. Examples of noxious weeds found in Colorado include African rue, Meadow knapweed, Medusahead, and Camelthorn. Noxious weeds present a serious economic threat to both private and public lands in Colorado. For example, according to a 2001 study prepared by the Colorado Department of Agriculture, in 1989, three species of weeds were responsible for the loss of $24 million to Colorado's wheat producers and an additional $36 million to rural wheat-producing communities. Noxious weeds are one of the Board's greatest land management issues and, if not controlled, could threaten to jeopardize the ecological integrity of the State's trust lands, thereby diminishing agricultural productivity, recreational opportunities, as well as the real value of the land and its ability to generate reasonable and consistent income for trust beneficiaries.

The General Assembly recognized the negative impacts of noxious weeds on the economic and environmental values of Colorado's private and public lands and, in 1996, passed the Colorado Noxious Weed Act. Section 3-5.5-110, C.R.S., requires state agencies, including the Board, to manage noxious weeds on lands under their jurisdictions. To meet this statutory requirement, the Board's commissioners passed a policy in 2000 directing its staff to:

- Train and educate lessees and staff on the importance of the threat of noxious weeds, the identification of noxious weeds, and options for effective prevention and control of noxious weeds.

- Oversee weed control efforts on trust lands.

- Address weed management in all Board leases.

We reviewed the Board's efforts to mitigate the effects from noxious weeds on trust lands and its compliance with applicable statutes and Board policies. Although the Board has taken some actions to implement the applicable statutory provisions and Board policies, we found areas in which the Board could do more.

First, the Board does not provide lessees or district managers with formal training on noxious weeds as required by Board Policy 2000-1. Each year, the Board sends lessees a noxious weed calender and weed reference book. The Board newsletter also briefly addresses noxious weeds. However, no formal, direct education or training programs are offered by the Board for persons leasing trust lands. All three of the district managers we interviewed said noxious weeds are a problem in their districts, and two believe the Board should do more to educate lessees on the identification and prevention and control of noxious weeds. In addition, district managers are not required to and do not always have experience with noxious weeds upon hire by the Board. As such, it is important that all newly hired district managers, especially those with no or little experience, receive formal and recurring training.

Second, the Board does not proactively oversee weed control efforts on state trust lands. The Board's policy is to place the primary responsibility of identifying weeds in the hands of lessees. Although the Board's standard surface lease requires lessees to comply with state laws related to noxious weeds, lessees are not required to notify the Board when they identify noxious weeds on trust land. Furthermore, lessees are not required to provide the Board with a weed management plan when noxious weeds are identified or to provide the Board with periodic updates of weed control efforts. Formal inspections of lands by district managers typically occur about once every 10 years. This increases the likelihood lessees could overlook or ignore weed infestations for some time before the Board learns of the problem, thereby putting valuable trust lands at risk.

Finally, the Board does not address noxious weed management in all of its leases, as required by Board policy. For example, the Board's oil and gas leases do not contain any requirements related to noxious weeds. Although oil and gas operations encompass only a small percentage of the Board's surface acres, mineral extraction activities, such as clearing rangeland and building roads, increase the risk for weed growth. Placing specific language in oil and gas leases more effectively notifies companies of their responsibilities for identification and control.

Overall, we believe the Board has not placed sufficient emphasis on the control of noxious weeds and, as a result, is not as aggressive as it should be to prudently manage trust lands. A 1999 report to the Colorado General Assembly, prepared by the Colorado Department of Agriculture, surveyed 51 Colorado counties regarding the weed management efforts of 14 significant federal and state landholders. The Board was rated 13 of 14 overall, with an average rating of "Poor." Only the Department of Defense received a lower rating. The Board scored the lowest rating of the 14 agencies in the three categories: Awareness, Commitment, and Management Plan. As a result of the study, the Board now spends about $150,000 on its noxious weed efforts annually. Because of the serious economic threat noxious weeds pose to trust lands, the Board must take steps to further enhance its weed management activities.

We recommend that the Board comply with all applicable statutes and policies related to noxious weeds, including making formal weed training available to both lessees and staff. District managers should organize at least one formal training per year for persons leasing trust lands in the Board's six districts. This training should be run in cooperation with local weed districts, the Colorado Department of Agriculture, or local Colorado State University Extension offices. Lessees should be notified of the dates of the training by mail or through distribution of the Board's noxious weed calendar. The training should be free of charge and required for all lessees who have limited experience with noxious weeds and for those lessees who failed to effectively control for noxious weeds on trust lands. The Board should also require that district managers receive a specified amount of formal and ongoing training. The Board should also ensure noxious weeds are specifically addressed in all leases as required by Board Policy 2000-1.

Recommendation No. 9:

The State Board of Land Commissioners should be more proactive in mitigating and controlling noxious weeds on state trust lands, by:

a. Requiring district managers and other applicable Board staff to obtain weed management training.

b. Making more training and education available to lessees.

c. Requiring lessees, at the first sign of noxious weed growth, to notify the district office and submit a weed management plan.

State Board of Land Commissioners Response:

Agree. Implementation Date: July 2006.

The State Land Board staff agrees with the recommendation that district mangers and other appropriate staff should receive formal noxious weed management training but we are concerned about our inability to provide direct training to lessees.

Direct training of all 3,000 surface lessees would require a significant funding commitment which would far exceed the State Land Board's current ability to fund. While the State Land Board provides some documentation to assist lessees in identifying and treating noxious weeds, direct education is not feasible and/or would require significant monetary resources.

Nevertheless, the State Land Board will increase the information to lessees including identifying the noxious weed requirement in their current lease. We will try to provide some educational opportunities for lessees to learn more about noxious weeds. We will also add a new requirement to our standard lease that requires lessees to notify the district offices about noxious weed conditions and to submit a weed management plan when weeds are detected.

The State Land Board staff will complete the weed management program changes by July 2006.

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