REPORT OF

THE

STATE AUDITOR

Energy and Mineral Impact Grants
Department of Local Affairs

Performance Audit
October 2007

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October 12, 2007

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Department of Local Affairs' administration and oversight of energy and mineral impact grants to local governments, which are funded through state severance tax and federal mineral lease revenues. 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 Department of Local Affairs.

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OFFICE OF THE STATE AUDITOR REPORT SUMMARY

SALLY SYMANSKI, CPA
State Auditor

Energy and Mineral Impact Grants
Department of Local Affairs
Performance Audit
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Authority, Purpose, and Scope

This performance 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 audit work was conducted from January through September 2007 in accordance with generally accepted government auditing standards. During our audit we reviewed the Department of Local Affairs' (Department's) administration and oversight of the energy and mineral impact grants. These grants distribute state severance tax revenues from the Local Government Severance Tax Fund and federal mineral lease revenues from the Local Government Mineral Impact Fund to local governments. Our review included examining the Department's activities and processes in several key areas, including awarding grant funds, monitoring grant expenditures, and managing grant data and information. We gratefully acknowledge the cooperation and assistance extended by Department management and staff, as well as by local government grant recipients.

Overview

Since 1978, the State has levied a severance tax on the production and extraction of nonrenewable natural resources. In addition to the state severance tax, energy producers who extract minerals from federally owned lands pay rent and royalties to the federal government, half of which are returned to the State. The General Assembly intended to set aside a portion of state severance tax and federal mineral lease revenues for use by local governments affected by natural resource development. Specifically, state statute requires that 50 percent of all severance tax revenues be credited to the Local Government Severance Tax Fund. Additionally, through a series of allocations and dollar thresholds established in state statute, the State Treasurer distributes federal mineral lease revenues to a number of recipients, including the Local Government Mineral Impact Fund.

The statutes governing the distribution of revenues from both the Local Government Severance Tax and the Local Government Mineral Impact Funds outline similar purposes and allowable uses. In particular, statutes require the Department's Executive Director to allocate funds to political subdivisions that are socially or economically impacted by the development, processing, or energy conversion of minerals and mineral fuels. Funds are to be used for the planning, construction, and maintenance of public facilities, and for the provision of public services. The Department distributes monies through an integrated program known as the Energy and Mineral Impact Assistance Program that includes discretionary grants, loans, and direct payments to local governments. Between Fiscal Years 2003 and 2007 the Department awarded more than 1,400 energy and mineral impact grants totaling approximately $404.2 million.

Key Findings

Grant Awards

We evaluated the Department's processes for awarding energy and mineral impact grant funds and found problems in several areas, including:

- **Lack of sufficient controls over supplemental awards to promote transparency, accountability, and cost containment.** We found that, contrary to its written guidelines, the Department has used supplemental awards to substantially expand the scope of grant projects subsequent to the initial approval of the award. Of the 142 supplemental awards we reviewed, we found that 93 had increased the original grant award amount by 20 percent or more, 46 had increased the original grant award amount by 50 percent or more, and 17 had increased the original grant award amount by 100 percent or more. Additionally, we found that not all energy and mineral impact grant recipients are aware of the existence of supplemental awards or the process for applying for these funds, which suggests potentially unequal access to funding.

- **Lack of substantive compliance with statutory requirements that funds from the Local Government Severance Tax Fund be awarded to political subdivisions.** We identified a series of energy and mineral impact grants totaling $725,000 made to the Town of Limon that appear to have been made only to provide a conduit for funding statewide projects coordinated between the Department and the Colorado Rural Development Council (CRDC), a private nonprofit 501(c)(3) corporation. We found the Town of Limon was not the primary beneficiary of the grant funds, nor was it the manager of these projects. Rather, the Town of Limon acted as a fiscal intermediary to facilitate the draw down of grant funds for the CRDC projects. Additionally, we found that as the granting agency, the Department lacked an arm's length relationship with the CRDC. Throughout the period when these grants were awarded, the Department had representation on the CRDC's Board of Directors and Executive Committee, which gave the Department a direct role in the management and oversight of the CRDC's business affairs. None of these grants went through the standard grant application and review processes used for other grant applications.

- **Inconsistent use of evaluation criteria.** We found the Department's grant evaluation criteria are not understood or applied consistently and uniformly by the Energy Impact Assistance Advisory Committee (Advisory Committee) members. The Advisory Committee is established by state statute and the Department uses it to review grant applications and make funding recommendations. On the basis of our interviews with Advisory Committee members and our observations of the March 2007 Advisory Committee meeting, we found that (1) members tend to place more weight on certain criteria than others, (2) the factor receiving the most weight varies depending on the member, (3) social and economic impacts were not the primary consideration when discussing the merits of grant applications, and

(4) members do not agree on how social and economic impacts should be defined or assessed.

- **Inconsistent treatment of revenue sources when evaluating matching funds.** We reviewed grant applications from the July 2006, October 2006, and March 2007 grant cycles and found that of the 46 applications that had in-kind contributions, the Department included the in-kind contribution in the matching percentage calculation for 23 cases (50 percent) and excluded the in-kind contribution from the matching percentage calculation for 18 cases (39 percent). We could not determine how the Department treated the in-kind contribution for the remaining 5 cases (11 percent). We identified similar inconsistencies in the Department's treatment of funding from outside sources. We found that the Department's current method for calculating the matching percentage does not provide sufficient information to fully evaluate matching funds in accordance with the Department's goals.

- **Lack of formal rules of conduct intended to mitigate actual or perceived conflicts of interest during the review and evaluation of grant applications.** During the March 2007 Advisory Committee meeting we observed one member who actively questioned grant applicants and voiced support for two projects prior to self-identifying a conflict of interest and abstaining from the final vote. Additionally, our analysis of data for the July 2006, October 2006, and March 2007 grant cycles revealed that Advisory Committee members representing municipalities handled grant applications from their county and neighboring municipalities within their county inconsistently. The members abstained during one grant cycle, but then voted on projects from the same applicants during another grant cycle.

Grant Expenditures

We reviewed the Department's processes and procedures for managing and overseeing grant expenditures and identified problems in several areas, including:

- **Lack of sufficient and standardized monitoring to ensure that grant expenditures are for allowable uses and supported by adequate documentation.** We reviewed a sample of 128 payments totaling $17.9 million on 40 grants and found problems with 18 (14 percent) of the transactions. We also identified questioned costs totaling $1.6 million, or about 9 percent of the $17.9 million in payments we reviewed. The questioned costs we identified resulted from overpayments to grantees, payments for project costs that were not allowed under the terms of the grant contract, and grant payments lacking sufficient supporting documentation. We found that the Department's contracts with local governments did not always clearly specify allowable costs for projects and documentation requirements and review practices were not clearly specified and varied widely. We also found that the Department lacked a substantive secondary review of grant expenditure documentation and a formalized structure for conducting on-site monitoring activities.

- **Controls over access to the electronic grant information system need improvement and grant data needs to be reconciled with the State's accounting system.** Out of 315 active system user IDs we reviewed, we identified 16 (5 percent) active IDs for users who no longer required access to the system, including 2 employees terminated for disciplinary reasons. We also found that 299 (95 percent) user IDs lacked strong passwords and 117 (37 percent) user IDs were generic, making it impossible for the Department to track activity to a single user. The Department also lacked routine review processes to ensure that user access is appropriate for the employee's job responsibilities. As of the end of Fiscal Year 2007, the Department's grant database showed that grant budgets and grant expenditures, respectively, totaled about $2.4 million and $3.7 million less than what was reported from the State's accounting system. Prior to our audit, the Department had not attempted any reconciliations of data between the energy and mineral impact grants and the State's accounting system.

Strategic Grantmaking

The Department's energy and mineral impact grants constitute one of the largest state-funded grant programs directed toward local governments, distributing more than $404 million in grant funds between Fiscal Years 2003 and 2007. We found that the Department has not taken advantage of the opportunity to use these grant funds to address the social and economic impacts of energy and mineral resource development in a cohesive manner and maximize the effectiveness of the state severance tax and federal mineral lease revenues allocated to local governments. Additionally, we found that the Department cannot systematically assess whether the distribution of these grant funds has resulted in desired outcomes or has provided funding for those projects that will derive the greatest benefit to the recipients and the State. Currently the Department lacks an overall strategic approach to its grantmaking activities, including (1) methods for identifying and assessing the common impacts and needs created by nonrenewable resource development throughout the State; (2) clearly defined program goals, objectives, and desired outcomes; (3) defined funding initiatives that proactively solicit grant applications and target resources in support of program goals and objectives; (4) and processes for tracking program data to routinely assess outcomes and evaluate program performance.

Our recommendations and the responses from the Department of Local Affairs can be found in the Recommendation Locator and in the body of the report.

RECOMMENDATION LOCATOR
Agency Addressed: Department of Local Affairs

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
1	24	Create written policies and procedures that detail the process for applying for, evaluating, and making supplemental awards and limit the amount of supplemental funding available (1) program-wide in any given year, (2) on an individual per-project basis, (3) or both.	Agree	June 2008
2	30	Comply with statutory requirements and ensure that monies are awarded to political subdivisions both in form and substance, refrain from submitting or participating in grant applications from entities or on projects where the Department has a direct management role or interest, and seek legislative spending authority to fund statewide projects benefiting local governments out of the Local Government Mineral Impact Fund.	Agree	June 2008
3	34	Provide more specific guidance on how to define and evaluate social and economic impact, prioritize and weight established selection criteria, develop a numeric scoring system to rate grant applications, and communicate and provide training on the prioritization and weighting of selection criteria and the numeric scoring process.	Agree	March 2009
4	38	Assess the goals for requiring matching funds on projects, develop one or more methods for calculating matching percentages in accordance with these goals and apply the calculation consistently, and include the goals and the methods for calculating matching percentages in the grant guidelines.	Agree	March 2009

RECOMMENDATION LOCATOR
Agency Addressed: Department of Local Affairs

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
5	41	Establish written procedures to ensure the Energy Impact Assistance Advisory Committee's practices comply with statutory rules of conduct. Specify examples of situations that could create an actual or perceived conflict of interest, require that Advisory Committee members formally disclose any interests and affiliations that could be construed as a conflict of interest, and expand the official record of Advisory Committee funding recommendations to include a breakdown of individual members' votes and a notation of the reasons for abstentions.	Agree	June 2008
6	46	Ensure timely contracting by awarding grant funds only for projects that are ready to move forward in a timely manner, setting performance goals and tracking statistics on grant award to grant contract time frames program-wide, and withdrawing award offers outstanding for more than 12 months.	Agree	June 2008
7	50	Establish a target year-end reserve amount for the uncommitted cash balance for the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund and define and announce the amount of funds available for each grant cycle.	Agree	June 2008
8	52	Obtain and review documentation from regional councils of governments demonstrating that the entity is formed pursuant to Section 29-1-203(1), C.R.S., and assess the need to define "political subdivision" in the severance tax and federal mineral leasing statutes.	Agree	June 2008

RECOMMENDATION LOCATOR
Agency Addressed: Department of Local Affairs

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
9	59	Take a stronger and more standardized approach to monitoring grant expenditures by including sufficient detail in grant contracts on the costs that are allowable or unallowable for reimbursement with grant funds; establishing clear and consistent documentation requirements that are applicable program-wide; ensuring a thorough review of reimbursement requests and supporting documentation before approving payments; developing procedures for conducting a secondary review of expenditure documentation; formalizing policies and procedures for on-site monitoring at grantee locations; and communicating and providing training on new documentation standards, review practices, and other program requirements.	Partially Agree	June 2009
10	65	Ensure the security and integrity of data maintained in the grants database by deactivating user IDs as soon as the user's employment status changes, implementing strong password controls over all user IDs, minimizing the use of generic user IDs, establishing processes to review user access permissions and audit trail reports, and continuing efforts to implement a routine reconciliation of data between the grants database and the State's accounting system.	Agree	November 2007
11	69	Improve management of loans made from the Local Government Severance Tax Fund by formally documenting the assessment of each loan applicant's ability to repay the loan, aligning contract loan terms and internal policies and procedures to clarify when payments are considered late or loans are considered in default, considering use of financial disincentives to encourage timely loan payments, and enhancing routine correspondence with loan recipients.	Agree	June 2008

RECOMMENDATION LOCATOR
Agency Addressed: Department of Local Affairs

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
12	71	Obtain approval from the State Controller's Office, as required by State Fiscal Rules, and develop internal policies if advances of funds on energy and mineral impact grant contracts are offered in the future.	Agree	June 2008
13	84	Develop a more strategic approach to grantmaking activities, including designing a methodology to identify and assess the common impacts and needs; setting clear program goals, objectives, and desired outcomes to guide grantmaking activities; using defined funding initiatives to proactively solicit grant applications and target resources in support of established program goals and objectives; and tracking program data to assess outcomes and evaluate and routinely report on performance.	Partially Agree	March 2009

Overview

Ever since the discovery of gold in 1859, Colorado has prospered from a rich heritage of mining and mineral resource development, which has produced thriving communities throughout the State. Colorado's natural resource industry has enjoyed profitable boom periods, but the State also has endured several devastating busts, which create challenges for communities that rely on natural resource production to provide local jobs and economic sustainability. Despite a long history of boom-and-bust cycles, energy and mineral development continues to be a major contributor to Colorado's economy. Currently the contribution of oil and gas production is substantial. A June 2007 study by the Colorado Energy Research Institute at the Colorado School of Mines estimated that the total economic contribution from all oil- and gas-related activities in 2005 was about $22.9 billion statewide.

As we describe in this chapter, energy and mineral development is responsible for two primary sources of revenue for the State—severance tax revenues and federal mineral lease revenues—which have reached historically high levels in recent years. The distribution of these revenues is complex, and a range of different state and local agencies receive these monies for a variety of uses. In particular, a portion of these revenues is set aside for use by local governments affected by natural resource development. The Department of Local Affairs' (Department's) principal mechanism for allocating severance tax and federal mineral lease revenues to local governments is its energy and mineral impact grants, which are the focus of this audit.

Revenues

Since 1978, the State has levied a severance tax on the production and extraction of nonrenewable natural resources [Sections 39-29-103 through 107, C.R.S.]. The severance tax is intended to capture a portion of the wealth that is lost when these natural resources are removed from the earth and sold for private profit. Five resources are subject to Colorado's severance tax: oil and gas, coal, metallic minerals, molybdenum ore, and oil shale. Metallic minerals include such things as gold, silver, copper, nacholite, uranium, vanadium, and zinc. The severance tax applies regardless of whether the resources are removed from privately or publicly owned lands, and the tax rate is set differently depending on the type of resource being extracted. The severance tax on oil and gas, metallic minerals, and oil shale is based on the gross income derived from the sale of these commodities. The severance tax on coal and molybdenum ore is based on the weight of the mineral that is extracted. The majority of severance tax revenues collected by the State are from oil and gas production. For example, during Fiscal Year 2007, taxes levied on oil and gas production ($116.7 million) accounted for about 92 percent of the total revenues, and taxes levied on coal production ($8.8 million) accounted for about 7 percent of total revenues. The remaining 1 percent of total severance tax revenues ($1.9 million) was from taxes levied on molybdenum ore and metallic minerals. Severance taxes are subject to the limits imposed by the Taxpayer's Bill of Rights (TABOR) in Article X, Section 20 of the State Constitution.

In addition to state severance taxes, energy producers who extract minerals from public lands may pay rent and royalties to the federal or state governments to use the lands for that purpose. Under federal law [30 U.S.C. 191], 50 percent of royalty, rental, and other income generated from mineral and oil and gas leases on federally owned lands is returned to the state where the extraction occurred. Unlike severance taxes, federal mineral lease revenues are not subject to TABOR limits. In addition to federal mineral leases, there are mineral leases on state-owned lands. For example, all royalties and rental income paid for mineral leases on lands owned by the State Land Board are credited to the Public School Trust for the benefit of K-12 public education. Revenues from state mineral leases are subject to TABOR limits.

Increases in mineral and oil and gas production, as well as the increasing sale price of these commodities, have yielded substantial increases in severance tax and federal mineral lease revenues in recent years. The table on the following page shows that the State received more than $1.1 billion in combined severance tax and federal mineral lease revenues between Fiscal Years 2003 and 2007. Combined revenues reached a high of about $364.7 million in Fiscal Year 2006 but then decreased by about 31 percent to $250.4 million in Fiscal Year 2007. Despite this recent decrease, Fiscal Year 2007 revenues were still about 222 percent higher than Fiscal Year 2003 revenues.

State of Colorado
Combined State Severance Tax and Federal Mineral Lease Revenues
Fiscal Years 2003 Through 2007
(Dollars in Millions)

Revenue Source	**Fiscal Year 2003**	**2004**	**2005**	**2006**	**2007**	**Five-Year Total**	**Percent Change 2003-2007**
State Severance Taxes	$26.1	$119.1	$143.4	$221.3	$127.4	$637.3	+388%
Federal Mineral Leases[1]	$51.6	$77.3	$101.0	$143.4	$123.0	$496.3	+138%
Total Revenues	**$77.7**	**$196.4**	**$244.4**	**$364.7**	**$250.4**	**$1,133.6**	**+222%**
Percent Change from Prior Year		+153%	+24%	+49%	-31%		

Source: Office of the State Auditor's analysis of data from the Colorado Financial Reporting System (COFRS).
[1] Includes federal mineral lease revenues, as well as interest income earned on the Mineral Leasing Fund cash balance.

Although revenues have seen dramatic growth recently, it is important to recognize that these revenues are not stable and rise and fall with the industries that generate them.

Distributions

The distribution of severance tax revenues and federal mineral lease revenues is governed by state statute. In Appendices A and B, we provide a graphical representation of how severance tax revenues and federal mineral lease revenues are allocated, respectively. Local governments are a primary recipient of severance tax and federal mineral lease revenues. Specifically, state statute [Section 39-29-108(2), C.R.S.] requires that 50 percent of all severance tax revenues be credited to the Local Government Severance Tax Fund. Through a series of allocations and dollar thresholds established in state statute [Section 34-63-102, C.R.S.], the State Treasurer distributes federal mineral lease revenues to a number of recipients, including the Local Government Mineral Impact Fund.

The General Assembly intended to set aside a portion of state severance tax and federal mineral lease revenues for use by local governments affected by natural resource development. The statutes governing the distribution of revenues from the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund outline similar purposes and allowable uses for each revenue stream as follows:

- **Socially and Economically Impacted Areas.** State statutes require the Department's Executive Director to allocate funds to those political subdivisions that are socially or economically impacted by the development, processing, or energy conversion of minerals and mineral fuels. These funds are to be used for the planning, construction, and maintenance of public facilities, and for the provision of public services [Sections 39-29-110(1)(b) and 34-63-102(1)(a) and (b), C.R.S.]. The statutes are broadly constructed and provide flexibility in the allocation and use of the funds. For example, funds must go to socially and economically impacted areas; however, "socially and economically impacted" is not defined. Additionally, the statutes do not require that funds be used to mitigate these impacts. The Department distributes this portion of severance tax and federal mineral lease revenues to local governments through its energy and mineral impact grants.

- **Counties and Municipalities of Residence.** State statutes require the Department's Executive Director to make payments directly to those counties and municipalities where energy and mineral production employees reside [Sections 39-29-110(1)(c) and 34-63-102(3)(b)(III), C.R.S.]. The Department distributes these funds through two formula allocations known as the "severance tax direct distribution" and the "federal mineral lease direct distribution," respectively. By making payments to jurisdictions where production employees reside, these allocations acknowledge that communities are affected by the additional burdens placed on roads, housing, water and sewer systems, public safety, and other infrastructure and government services resulting from active energy and mineral resource development. There are no statutory restrictions on how local governments receiving direct distribution payments can use the monies.

During the 2007 Legislative Session, Senate Joint Resolution 07-042 created an Interim Committee and Working Group to study the allocation of severance tax and federal mineral lease revenues in Colorado. The Interim Committee consists of 11 members of the House and Senate and, among other things, is charged with proposing legislation or other policy changes regarding how severance tax and federal mineral lease revenues are allocated. The Working Group consists of 11 members, including the executive directors or their designees of the Departments of Local Affairs and Natural Resources, six members appointed by the majority and minority leadership of the House and Senate, and three members appointed by the Governor, one of whom is from a nonprofit corporation or organization that represents the regional interests of energy producing areas of Colorado. The Working Group is charged with making policy recommendations related to issues, as assigned by the Interim Committee, involving the allocation of severance tax and federal mineral lease revenues.

Energy and Mineral Impact Assistance Program

Because the enabling statutes outline similar purposes for both the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund, the Department distributes these monies to local governments through an integrated program known as the Energy and Mineral Impact Assistance Program. This assistance program has several different mechanisms for allocating funds to local governments—discretionary grants, loans, and direct distribution payments.

The following table shows the total combined revenues to the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund for Fiscal Years 2003 through 2007. Not surprisingly, the trends in program revenues generally echo those of the severance tax and federal mineral lease revenues. Between Fiscal Years 2003 and 2007 program revenues totaled approximately $484.6 million, including interest income. In Fiscal Year 2007, total program revenues were about $112.2 million, which was a 337 percent increase over Fiscal Year 2003 revenues.

Department of Local Affairs
Energy and Mineral Impact Assistance Program Revenues[1]
Fiscal Years 2003 Through 2007
(Dollars in Millions)

	Fiscal Year					**Five-Year Total**	**Percent Change 2003-2007**
	2003	**2004**	**2005**	**2006**	**2007**		
Local Government Severance Tax Fund	$16.0	$61.6	$75.2	$116.2	$71.5	$340.5	+347%
Local Government Mineral Impact Fund	$9.7	$18.0	$29.4	$46.3	$40.7	$144.1	+320%
Total Energy and Mineral Impact Assistance Program Revenues	**$25.7**	**$79.6**	**$104.6**	**$162.5**	**$112.2**	**$484.6**	**+337%**
Percent Change from Prior Year		+210%	+31%	+55%	-31%		

Source: Office of the State Auditor's analysis of data from the Colorado Financial Reporting System (COFRS).
[1] Includes interest income earned on the Local Government Severance Tax Fund and Local Government Mineral Impact Fund cash balances, as well as other miscellaneous revenue.

The following table shows the total pooled expenditures from the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund for Fiscal Years 2003 through 2007. In Fiscal Year 2007 expenditures totaled about $119.8 million, an increase of about 224 percent from Fiscal Year 2003. From Fiscal Years 2003 through Fiscal Year 2007, program expenditures totaled approximately $364.8 million. The majority of expenditures were related to the energy and mineral impact grants and, in some cases, loans to counties, municipalities, school districts, and other political subdivisions. Direct distribution payments to counties and municipalities comprised the next largest group of expenditures. Finally, the General Assembly used these two funds to finance a portion of the direct and indirect costs in the Department's four divisions and the Executive Director's Office.

Department of Local Affairs
Energy and Mineral Impact Assistance Program Expenditures[1]
Fiscal Years 2003 Through 2007
(Dollars in Millions)

	Fiscal Year					Five-Year Total	Percent Change 2003-2007
	2003	2004	2005	2006	2007		
Grants and Loans[2]	$32.5	$30.3	$45.2	$72.5	$97.0	$277.5	+198%
Direct Distribution Payments[3]	$2.7	$9.9	$13.5	$23.8	$16.2	$66.1	+500%
Operating Transfers[4]	$1.8	$2.9	$6.9	$3.0	$6.6	$21.2	+267%
Total Energy and Mineral Impact Assistance Program Expenditures	**$37.0**	**$43.1**	**$65.6**	**$99.3**	**$119.8**	**$364.8**	**+224%**
Percent Change from Prior Year		+16%	+52%	+51%	+21%		

Source: Office of the State Auditor's analysis of data from the Colorado Financial Reporting System (COFRS).
1 Expenditures are from the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund.
2 Section 39-29-110(1)(b)(II)(A), C.R.S., permits the Executive Director of the Department of Local Affairs to make loans from the Local Government Severance Tax Fund for domestic wastewater and potable water treatment facilities. New loans totaled approximately $14 million over the five fiscal years shown, while grants totaled approximately $263.5 million.
3 The percentage increase in the direct distributions in Fiscal Year 2006 is due in part to a 2005 Attorney General's Opinion requiring a change in the Department of Local Affairs' methodology for calculating the direct distribution of federal mineral lease revenues from the Local Government Mineral Impact Fund.
4 These transfers are used to cover a portion of direct and indirect costs across the Department of Local Affairs' four divisions and the Executive Director's Office. Figures for Fiscal Year 2005 include a transfer of about $3.8 million to the Kansas v. Colorado Plaintiff's Damages Payment Fund pursuant to Section 39-29-110(4)(a), C.R.S., for use by the Department of Law. Figures for Fiscal Year 2007 include a transfer of $3.25 million to the Wildfire Preparedness Fund pursuant to Section 34-63-102(5)(a)(I), C.R.S., for use by the Colorado State Forest Service.

Energy and Mineral Impact Grants

Although statute does not require it, the Department has allocated the majority of funds to local governments through a grantmaking process since the inception of the Energy and Mineral Impact Assistance Program in 1977. The Department's energy and mineral impact grants constitute one of the largest state-funded grant programs directed toward local governments and, in many ways, these grants have historically been used as a community development program throughout the State. Local governments rely heavily on these grant funds as a source of revenue for capital improvement projects, economic development, community planning, public services, and local infrastructure.

The following table shows that between Fiscal Years 2003 and 2007 the Department awarded more than 1,400 energy and mineral impact grants totaling $404.2 million. The number and the total dollar value of these grant awards have increased in recent years. In any given fiscal year, the dollar amount of grant awards will not necessarily agree with grant expenditures (discussed previously) due to timing differences between when the award is made and when expenditures occur.

Department of Local Affairs
Energy and Mineral Impact Grant Awards
Fiscal Years 2003 Through 2007
(Dollars in Millions)

	Fiscal Year					**Five-Year Total**	**Percent Change 2003-2007**
	2003	**2004**	**2005**	**2006**	**2007**		
Total Grant Awards	143	253	315	391	362	**1,464**	+153%
Total Funds Awarded	$27.8	$49.0	$81.1	$126.5	$119.8	**$404.2**	+331%
Percent Change from Prior Year		+76%	+66%	+56%	-5%		

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.

In accordance with state statute, funded grant projects must relate to planning, construction and maintenance of public facilities, or the provision of public services. The $404.2 million in funds awarded over the last five fiscal years was for the following types of projects:

- $103.7 million (26 percent) for public facilities, including public buildings, school improvement projects, and parks and recreation projects.

- $101.5 million (25 percent) for water and sewer projects.
- $96.7 million (24 percent) for road improvement projects.
- $35.4 million (9 percent) for telecommunications projects, including equipment for local governments to connect to the State's Digital Trunked Radio System.
- $25.7 million (6 percent) for health and human services projects, including hospital improvements and medical equipment purchases.
- $25.4 million (6 percent) for public safety projects, including equipment for fire, law enforcement, and other emergency response agencies.
- $14 million (3 percent) for economic and community development, planning, and other administrative projects.
- $1.8 million (1 percent) for other projects, including emergency disaster assistance and uranium mill tailing cleanup.

Chapter 3 contains additional information and analysis on projects funded with energy and mineral impact grants.

Division of Local Government

The Division of Local Government is the organizational unit within the Department that directly oversees and administers the Energy and Mineral Impact Assistance Program. The Division of Local Government has approximately 60 full-time equivalent (FTE) positions, including eight regional managers located in field offices across the State. The Department's regional managers are central to the administration of the Energy and Mineral Impact Assistance Program and are the primary point of contact between the Department and local governments in each region. There are no FTE assigned full time to the Energy and Mineral Impact Assistance Program. Division staff, including the regional managers, oversee and administer a number of other local government financial assistance programs (e.g., Community Development Block Grants and Gaming Impact Grants) and provide technical assistance to local governments with budgeting and financial management, land use planning, water and wastewater management, and general government administration.

Audit Scope

During this audit we reviewed the Department's of Local Affairs' distribution of severance tax revenues from the Local Government Severance Tax Fund and federal mineral lease revenues from the Local Government Mineral Impact Fund to local governments through the energy and mineral impact discretionary grants. We reviewed the Department's administration and oversight of the grants, including activities and processes related to awarding grant funds, monitoring grant expenditures, and managing grant data and information. We also reviewed payment histories on loans made from the Local Government Severance Tax Fund. We analyzed program and financial data, reviewed grant file documentation, and interviewed Department management and staff. We observed the March 2007 Energy Impact Assistance Advisory Committee meeting and interviewed Advisory Committee members. We interviewed energy industry representatives and conducted site visits to 16 grant project locations—two from each of the Department's eight regions—to interview grantees and observe grant projects. We reviewed supporting documentation for 128 grant payments totaling $17.9 million that the Department disbursed on a sample of 40 grants between March 2005 and March 2007. Finally, we gathered information on grantmaking best practices, as well as on current practices used by three other state-administered grant programs—the Department of Education's Public School Capital Construction Program, the State Historical Fund, and Great Outdoors Colorado—and one private foundation.

Our audit did not include severance tax revenues distributed from the State Severance Tax Trust Fund or federal mineral lease revenues distributed to the Colorado Water Conservation Board Construction Fund, the State School Fund, or payments to counties and municipalities by the State Treasurer's Office. (See Appendices A and B for detail on the allocation of state severance tax and federal mineral lease revenues.) Our audit also did not include the Department's severance tax or federal mineral lease direct distribution payment processes. We focused on the Department's severance tax direct distribution payment process in our August 2007 *Severance Tax Direct Distribution Payments Performance Audit.*

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Grant Awards

Chapter 1

The General Assembly established the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund to set aside a portion of state severance tax and federal mineral lease revenues for use by local governments. Funds are to be distributed to those areas of the State that are socially or economically impacted by energy and mineral resource development for use in the planning, construction, and maintenance of public facilities, and for the provision of public services. The Department of Local Affairs (Department) allocates the majority of these monies to local governments through discretionary grants. Between Fiscal Years 2003 and 2007, the Department awarded more than 1,400 energy and mineral impact grants totaling $404.2 million for projects in 63 counties. The City and County of Denver was the only county that did not receive funds during this five-year period.

The energy and mineral impact grant award process begins at the local level. The Department's regional managers work with counties, municipalities, school districts, and other potential applicants in their regions to identify viable projects and advise the local governments on preparing the grant application. Through this process, the Department prescreens potential energy and mineral impact grant applications. The Department accepts and considers grant applications over the course of three regular funding cycles each year. Upon receipt of an application, a regional manager meets with the applicant, reviews the application and proposed project, and prepares a project summary sheet that describes the scope of the project and the project budget, and provides a summary of the application's strengths and weaknesses in accordance with established evaluation criteria.

State statute [Section 34-63-102(5)(b)(I), C.R.S.] establishes the Energy Impact Assistance Advisory Committee (Advisory Committee) whose statutory duties include making continuing recommendations to the Department regarding those actions deemed reasonably necessary and practicable to assist impacted areas with the problems occasioned by energy and resource development. To this end, the Department uses the Advisory Committee to review applications and make funding recommendations for energy and mineral impact grants to the Department's Executive Director. By statute, the Advisory Committee is composed of nine members, including five citizen members appointed by the Governor for four-year terms; the executive directors or their designees of the Departments of Local Affairs, Natural Resources, and Transportation; and the Commissioner of Education or his or her designee. The Governor's appointees do not undergo Senate confirmation.

The Advisory Committee reviews grant applications in a public meeting, during which applicants discuss their application and answer questions. The Advisory Committee members receive copies of the prepared staff summaries in advance of the meeting. At the public meeting, the Advisory Committee members vote on a funding recommendation for each application. Subsequent to the Advisory Committee meeting, program staff review the recommendations of the Advisory Committee and also prepare a funding recommendation for each application. The final decision to award an energy and mineral impact grant, including determining the award amount, rests solely with the Department's Executive Director. During the July 2006, October 2006, and March 2007 grant cycles, the Department received a total of 214 applications requesting $72.9 million in funding. The Department approved 198 applications (93 percent) for funding and awarded a total of $62.7 million (86 percent).

In addition to the regular grant cycles, the Department may award out-of-cycle grants for such things as preliminary design, planning, engineering, or feasibility studies; supplemental awards; emergency situations; and other special circumstances. In recent years, the Department has held special funding cycles for projects related to specific needs such as water and wastewater infrastructure, interoperable communications equipment, road and bridge improvements, and rural health care. Individual applications for out-of-cycle grants and special funding cycles are not typically reviewed by the Advisory Committee; rather, the applications receive administrative review by Department staff with final approval by the Department's Executive Director. Staff reported that the Department notifies the Advisory Committee on an ongoing basis about grant awards made outside of the regular grant cycles.

During our audit we reviewed the Department's processes for awarding energy and mineral impact grant funds. Overall, we found the Department needs to formalize and adhere to consistent policies and procedures that promote transparency and accountability in the award and allocation of grant funding and ensure equal access to grant funds. We discuss these issues in the remainder of this chapter.

Supplemental Awards

Supplemental awards are additional funds provided to a grantee through an amendment to an existing grant contract. Supplemental awards can be used to assist grantees when they encounter unforeseen cost overruns on a project. We analyzed data on the Department's energy and mineral impact grants and found the Department has allocated a significant amount of funds in supplemental awards on existing grants. As shown in the table on the following page, between Fiscal Years 2003 and 2007, the Department made 224 supplemental awards totaling

$32.3 million on 187 different grants, which is about 13 percent of the more than 1,400 grants awarded during this five-year period. The $32.3 million in supplemental funding represents about 8 percent of the total grant funds awarded during this five-year period. Additionally, our analysis shows that both the number and dollar value of supplemental awards have generally increased in recent years. Overall, we found that the percentage of total funds allocated through supplemental awards has increased from about 3 percent in Fiscal Year 2003 to about 11 percent in Fiscal Year 2007.

Department of Local Affairs
Energy and Mineral Impact Grants
Supplemental Awards
Fiscal Years 2003 Through 2007
(Dollars in Millions)

	Fiscal Year					**Five-Year Total**
	2003	**2004**	**2005**	**2006**	**2007**	
Number of Supplemental Awards[1]	11	24	35	88	66	**224**
Total Supplemental Funds Awarded	$0.9	$1.8	$4.2	$12.3	$13.1	**$32.3**
Total Grant Funds Awarded	$27.8	$49.0	$81.1	$126.5	$119.8	**$404.2**
Supplemental Funds Awarded as a Percentage of Total Funds Awarded	3%	4%	5%	10%	11%	**8%**

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.
[1] These supplemental awards were made on 187 different grants, which is 13 percent of the more than 1,400 grants awarded over the five years shown.

The Department reported that the increase in supplemental awards in recent years is due largely to the increased cost of construction materials and labor in areas with active energy and mineral development, as well as to more general increases in the price of oil, concrete, and other construction materials resulting from Hurricane Katrina and other world events. As we discuss later in this chapter, supplemental awards also appear to be more frequent on grant awards that take longer to get under contract.

Supplemental awards allow granting agencies to respond to grantees' changing circumstances, such as unforeseen cost increases, and ensure project completion. However, the Department's process for making supplemental awards also presents risks because the awards do not go through established review processes intended to ensure transparency and are not subject to any general or project-specific limits intended to contain project costs. During our audit we analyzed award data for the 142 grants with at least one supplemental award between Fiscal Years 2002 and

2006. Complete data for Fiscal Year 2007 were unavailable at the time of our analysis. We identified a number of concerns with the Department's management of supplemental awards.

First, we found that the Department's supplemental award process does not encourage cost containment. Of the 142 grants with at least one supplemental award between Fiscal Years 2002 through 2006, we found that in 93 cases, the supplemental award increased the original grant award amount by 20 percent or more, and in 46 cases, the supplemental award increased the original grant award amount by 50 percent or more. We found that in 17 cases, the supplemental award increased the original grant award amount by 100 percent or more. Additionally, in 22 cases, the supplemental award increased the total amount of grant funds above the suggested maximum amount of $500,000 per project, as specified in the Department's grant guidelines. We identified eight cases in which the supplemental award itself exceeded $500,000.

The Department makes grant awards that exceed the suggested maximum amount in certain circumstances, such as when a project presents a compelling need or is critical to addressing significant impacts. However, the frequency of large supplemental award amounts raises questions about the adequacy of the initial planning, application, and review process and whether supplemental awards are being used to circumvent established controls. For example, recipients could go through the regular grant application and review process to receive an initial award below established thresholds and use the supplemental award process to secure additional funding for the project with potentially less outside review. The Department reports that it requires a dollar-for-dollar match from the grantee on all supplemental funding awarded, which is intended to deter potential abuses of the supplemental award process by grantees. However, even with a matching funds requirement, grantees can use the supplemental award process to secure funding that substantially increases the cost of their project or exceeds the suggested maximum award amount.

Second, we found that contrary to its written grant guidelines, the Department has used supplemental awards to expand the scope of grant projects. According to the Department's grant guidelines, supplemental grants are used on "projects previously reviewed by the Advisory Committee *and where no substantive changes in the project have occurred*" [emphasis added]. However, we identified instances where the supplemental award expanded or changed the scope of the project beyond what was originally proposed and funded. For example:

- In one case, the Department awarded a grant totaling $30,000 to cover salary and travel expenses on a rural development project. However, during the ensuing 30 months, the Department approved four supplemental awards totaling $545,000 and expanded the scope of work considerably to include a number of separate projects. The original grant was an out-of-cycle grant, and the remaining 95 percent of project funds were awarded through supplemental awards. Thus, at no time did either the original award or the expansion in the scope of work go through the standard Advisory Committee review process. (We discuss additional concerns regarding this particular grant award in the next section of this chapter.)

- In another case, a local government received a grant in June 2005 for $490,000 to build a kitchen in its county jail. The original project was reviewed by the Advisory Committee. However, in March 2006 the local government received a supplemental award of $500,000 in additional funding for furnishings and equipment in areas of the jail unrelated to the kitchen. This supplemental award and the expanded project scope were not reviewed by the Advisory Committee.

These two cases illustrate how in some instances supplemental awards bypass established grant review processes intended to provide accountability and transparency.

Third, we found that grant guidelines do not provide applicants with sufficient information on the supplemental award process. Grant guidelines only state that supplemental awards are a type of funding assistance awarded through administrative review by program staff in lieu of the formal Advisory Committee review. The guidelines do not provide grantees with detailed information on how to apply for supplemental awards or the Department's criteria for evaluating such requests. During our site visits, we found that not all energy and mineral impact grant recipients are aware that they can apply for supplemental awards. We spoke with two grantees who were relatively new grant recipients, neither of which had pursued supplemental funding at the time of our site visit. However, each grantee reported being forced to cut back on certain aspects of its project due to increases in the cost of labor and materials. The grantees reported being unaware of any process—even an informal one—for requesting a supplemental award. In contrast, a third grantee we spoke with had managed numerous energy and mineral impact grants and reported that supplemental funds were relatively easy to secure. However, this grantee readily acknowledged that the process for securing supplemental funding is "learned" and not explicit in the grant guidelines. Our discussions with grant recipients raise concerns because they suggest potentially unequal access to grant funding. More experienced grant recipients tend to be more aware of the supplemental award process and, as a result, may be better able to secure additional funding for their projects. In contrast, grantees unaware of the availability of supplemental funds or how to request them must cut back on projects or pay for the additional costs themselves.

The Department needs to improve its management and oversight of supplemental grants. To assist with improving its processes, the Department should consider practices used by other state-administered grant programs. Great Outdoors Colorado does not allow for supplemental awards on its local government grants. The State Historical Fund also does not allow for supplemental awards but encourages grant applicants to include contingencies within the proposed project budgets. Alternatively, the Department of Education's Public School Construction Grant Program uses several approaches. First, each grant award includes a defined contingency amount that can be accessed only through written approval from program staff. Unused contingency funds are reverted for use on other projects. Second, grant recipients can apply for a separate supplemental award. These requests must use a standard request form and are evaluated as part of the next formal review cycle because they draw from funds available for new projects. In all cases, the Department of Education only considers contingency and supplemental requests when emergency or unforseen circumstances arise that create additional costs that would otherwise prevent the approved project from being completed. Contingency and supplemental requests cannot be used to expand the scope of an existing project.

There are legitimate reasons for awarding supplemental funding to grantees. However, the problems we identified, along with the rapid increase in the number and total dollar value of supplemental awards, underscore the need for more stringent and explicit written policies and procedures for supplemental awards. The Department needs to formally define and communicate a process for grant recipients to use to request additional funding for their projects and identify the circumstances when such requests will be considered. A standard supplemental request form could assist with this task. The Department also needs to outline the process and criteria for reviewing supplemental award requests. Finally, the Department needs to control the amount of funds distributed through supplemental awards relative to the total amount of grant funding awarded. This could occur through an overall limit on the amount of supplemental funding available program-wide in any given year, limits that are applied on an individual per-project basis, or both.

Recommendation No. 1:

The Department of Local Affairs should improve its management and oversight of supplemental funding on energy and mineral impact grants by:

a. Creating written policies and procedures that detail the process for applying for, evaluating, and making supplemental awards. This should include specifying those circumstances when grantees may qualify for supplemental funding. These policies and procedures should be included in the grant guidelines and clearly communicated to all grantees.

b. Limiting the amount of supplemental funding available program-wide in any given year, on an individual per-project basis, or both.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

In order to further enhance program transparency and accountability, the Department will develop written policies and procedures that detail the process for applying for, evaluating, and making supplemental awards, including circumstances qualifying applicants for such funding. These will be included in the program guidelines.

The Department will develop written policies and procedures that detail the process used to apply for and evaluate supplemental awards. These guidelines will identify limits on supplemental funding on a per-project basis. Using historic data and supplemental policy guidelines, the Department will attempt to predict the amount of money that will be available on an annual basis for supplemental grants but we expect the prediction to be inexact given the volatility in revenues and number of active grants.

As part of discussions held with the Legislative Interim Committee to study the Allocation of Severance Tax and Federal Mineral Lease Revenues and its attendant Working Group, the Department has outlined a process of extensive consultation with the state Advisory Committee and program stakeholders to revamp the grants program. This process will begin formally in late 2007. The policy framework for supplemental funding practices will be incorporated into the guidelines for a proposed new small grant program, which the Department expects to have in place in June 2008.

Until this broader review of the program can be completed and effective immediately, the Department will not approve supplemental funding in excess of twenty-five percent (25%) of the existing funding amount without prior review by the state Advisory Committee. Also beginning immediately, all smaller supplemental awards and all new awards made without prior review of the Advisory Committee will be reported to the Advisory Committee.

Colorado Rural Development Council

During our audit we identified a series of energy and mineral impact grant awards that raise concerns about the appropriateness of the awards and whether the Department complied substantively with the statutory requirement that funds from the Local Government Severance Tax Fund be awarded to political subdivisions of the State. Specifically, we identified grant awards totaling $725,000 made by the Department to the Town of Limon that appear to have been made only to provide a conduit for funding projects coordinated between the Department and the Colorado Rural Development Council (CRDC), a private nonprofit 501(c)(3) corporation. It is important to note that although we question the Department's methods for awarding these funds, we acknowledge that the overall purpose of these grants, which is to promote the welfare of rural areas of the State, is consistent with the Department's mission.

In summary, the first grant was made in May 2003 for $30,000. By October 2005, supplemental awards had increased the total amount of the grant to $575,000 and the scope of the grant had expanded considerably. A second grant was made in December 2006 for $150,000, increasing the total funds awarded to $725,000. As of the end of our audit, a total of $650,000 in grant funds had been paid to the Town of Limon. We provide the following detail on these grant awards on the basis of our review of the grant file documentation:

- *January 2003.* The Department submits a proposal to the CRDC outlining common areas of interest, including infrastructure, health care, and economic and community development needs in rural areas of the State. The proposal includes an offer of $15,000 in energy and mineral impact grant monies plus $39,000 in in-kind support from the Department (e.g., professional and clerical support, office space, and phones provided out of the Department's operating budget at no charge to the CRDC).

- *May 2003.* The Department awards an out-of-cycle grant totaling $30,000 for a portion of the CRDC's administrative and program expenses, which include the salary and travel expenses of the CRDC Executive Director. The performance period on the grant is 14 months. No matching funds are required.

- *December 2003.* The Department awards an additional $330,000 in supplemental funds. The grant project's scope of work is expanded and the performance period is extended by 18 months. No matching funds are required. The additional grant funding is to be used by the CRDC for ongoing administrative expenses and for salaries and expenses associated with employment of consultants to assist with the Tech Ready Communities Project. According to Department staff, this project was a continuation of efforts started under the State's Beanpole project (established by House Bill 99-1102) to deliver high-speed Internet access to rural areas.

- *July 2004.* The Department awards an additional $85,000 in supplemental funds. The grant project's scope of work is expanded and the performance period is extended by six months. No matching funds are required. The additional grant funding is to be used by the CRDC to contract with Colorado Rural Health Center, another nonprofit organization, to manage two projects on behalf of the CRDC. One project, the Health Care Funding Partnership Project, is to identify rural health projects statewide that, if provided funding, would strengthen health-care infrastructure in the local community. The second project, the Rural Healthcare Success Project, is intended to highlight successful local efforts in improving health care in rural Colorado.

- *March 2005.* The Department awards an additional $75,000 in supplemental funds. The grant project's scope of work is expanded and the performance period is extended by six months. No matching funds are required. The additional grant funding is to be used by the CRDC to conduct various technology and community assessments, hold rural issue forums, and provide technical assistance throughout the State. The contract does not specify what the technology and community assessments are intended to accomplish.

- *October 2005.* The Department awards an additional $55,000 in supplemental funds. No matching funds are required. The additional grant funding is to be used by the CRDC for administrative and program expenses on existing projects. The grant project's scope of work is not expanded and the performance period is not extended. The grant expired in December 2006. As of the end of our audit, all $575,000 in grant funds had been paid to the Town of Limon.

- *December 2006.* The Department awards a new out-of-cycle grant totaling $150,000 for a portion of the CRDC's administrative and program expenses to implement its statewide Colorado Rural Imperative Program, which is intended to raise awareness about the importance of rural Colorado, enhance community economic sustainability, and provide for rural community advocacy with policymakers. A 50 percent match on the total grant amount is required. According to Department staff, this is a grant to cover some of the CRDC's administrative and program expenses while it secures other sources of funding. The grant performance period runs through December 2007. As of the end of our audit, a total of $75,000 in funds had been paid to the Town of Limon.

These grant awards are of concern for several reasons. First, although on paper the funding was awarded to a political subdivision—the Town of Limon—in substance these grants were made to a private non-profit 501(c)(3) corporation, which is in violation of Section 39-29-110(1)(b)(I), C.R.S., stating that only political subdivisions may receive these monies. The Town of Limon acted as a fiscal intermediary to facilitate the drawdown of grant funds from the Department that were awarded for a variety of *statewide* projects coordinated between the Department and the CRDC. Limon was not the primary beneficiary of the grant funds, nor was it the manager of these projects. These projects were for the benefit of all of rural Colorado. As described previously, the Department itself developed the initial grant proposal and submitted it to the CRDC in January 2003. Additionally, each expansion of the scope of work appears to have been at the Department's direction working in concert with the CRDC. The grant contract includes language stating that the CRDC director and consultants will work under the direction of the Department's project monitor and that the Department retains ownership of all work products developed through the CRDC's projects. Department staff reported that the Department provides in-kind support to the CRDC (e.g., clerical support, phones); however, the specifics of this arrangement were not outlined in any of the grant contract documentation we reviewed. According to Department staff, the Town of Limon agreed to act as a fiscal intermediary on the grants because the Town's Administrator was on the CRDC's Board of Directors at the time.

Second, we found that the Department lacked an arm's length relationship with the CRDC when making these awards. As a state funding partner, the Department has had representation on the CRDC's Board of Directors since the CRDC's bylaws were first approved in March 2003, and the Department's representative has served as Secretary/Treasurer on the CRDC's Executive Committee. Thus, throughout the period when these energy and mineral impact grants were being made, the Department—the granting agency—had a direct role in managing and overseeing the business affairs of the CRDC—the recipient agency—and a vested interest in the CRDC's receiving grant funding. As the granting agency, the Department's activities should avoid any involvement with grant recipients that could give rise to a real or perceived conflict of interest. Upon being notified of our audit finding, the Department's representative resigned his position on the CRDC's Board of Directors and Executive Committee.

Finally, we are concerned about the overall lack of transparency of these grant awards. As discussed previously, all of these grant funds were awarded through out-of-cycle grants or supplemental awards. Department staff reported that the Advisory Committee was apprised of these awards; however, at no time did any of these awards go through the standard grant application and Advisory Committee review process used for applications received through the regular grant cycles. Additionally, all of the monies used on these grant projects came from the Local

Government Severance Tax Fund, which according to state statute [Section 39-29-110(1)(b)(I), C.R.S.] may only be awarded to political subdivisions. However, state statute [Section 34-63-102(7), C.R.S.] does allow for state agencies to expend federal mineral lease monies from the Local Government Mineral Impact Fund, provided there is a separate legislative appropriation. As noted previously, these CRDC projects appear to be consistent with the Department's mission. The Department could have sought legislative spending authority to use federal mineral lease revenues to accomplish these statewide projects itself. Instead, the Department chose to funnel grants of severance tax revenues through a local government that had no substantial ownership of, involvement in, or primary benefit from the funded projects. The Department should have followed established review processes, such as seeking a separate legislative appropriation, to ensure transparency in the use of grant funds and compliance with the law.

During our October 2005 *Homeland Security Grant Program Performance Audit* we identified a similar case in which the Department awarded an energy and mineral impact grant to a local government who acted as a fiscal intermediary. Although in that case the grant funds were for a State project, it is nonetheless troubling that these instances of questionable use of energy and mineral impact grant awards have come to light in recent years. During our current audit, we asked the Department to identify any similar arrangements in place for other energy and mineral impact grants. The Department reported there were no other such arrangements or awards.

The General Assembly intended that a portion of state severance tax and federal mineral lease revenues be made available to local governments affected by energy and mineral development. Partnerships between local governments and nonprofit entities can be valuable mechanisms for addressing local communities' needs. However, the Department has a responsibility to ensure that grant funding is awarded to eligible recipients in a transparent and appropriate manner and that the grantee has clear ownership, management responsibility, and direction over the funded project. There may be statewide projects benefiting local governments that the Department chooses to undertake itself using federal mineral lease revenues; however, the Department needs to seek a separate legislative appropriation in accordance with statute. Furthermore, the Department has an obligation to be free from actual or perceived conflicts of interest when awarding grant funds.

Recommendation No. 2:

The Department of Local Affairs should ensure that awards of energy and mineral impact grant funds are appropriate, transparent, and free from actual or perceived conflicts of interest. Specifically, the Department should:

a. Comply with statutory requirements and ensure that monies are awarded to political subdivisions both in form and in substance.

b. Refrain from participating in grant applications from entities or on projects where it has a direct management role or interest. Grantees receiving funds should have clear ownership and management responsibility for funded projects.

c. Seek legislative spending authority to fund statewide projects benefiting local governments out of the Local Government Mineral Impact Fund, rather than using local governments as fiscal intermediaries.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department will ensure that grant awards are appropriate, transparent, and free of actual or perceived conflicts of interest. Specifically, the Department will:

a. Comply with statutory requirements and ensure that monies are awarded to political subdivisions both in form and substance.

b. Refrain from participating in grant applications from entities or on projects where it has a direct management role or interest. Grantees receiving funds will have a direct interest in, and grant management responsibility for, funded projects.

c. Refrain from using local governments as intermediaries to fund statewide projects benefiting local governments. If such statewide projects are considered in the future, legislative spending authority or specific statutory authorization will be sought.

Partly as a result of its work with the Legislative Interim Committee and Working Group, the Department is considering the option of seeking legislative changes to permit funds to be granted to nonprofit organizations that have a statewide mission. Nonprofit organizations play an important role in addressing impacts of mineral production. However, this potential legislation should be thoughtfully developed.

Evaluation Criteria

State statute [Sections 39-29-110(1)(b)(I) and 34-63-102(1)(b), C.R.S.] specifies that funding shall be distributed to those areas socially or economically impacted by energy and mineral resource development. Apart from this general directive, the distribution of funding remains at the discretion of the Department's Executive Director. Since the statutes are broad and the Department's Executive Director has the final funding decision, the Department has a responsibility to further define and communicate the criteria and processes used to evaluate applications and award funds. This responsibility includes providing sufficient structure and guidance to the Advisory Committee and program staff to promote a uniform application of the evaluation criteria during the review of grant applications. Additionally, grant applicants should be afforded the expectation that their proposed projects will be evaluated fairly and consistently.

The Department has specified a number of different criteria in its grant guidelines for evaluating proposed projects. Some of these criteria include (1) the range and extent of social and economic impacts associated with energy and mineral development, (2) the extent to which the proposed project addresses existing or projected community impacts, (3) availability of matching funds, (4) the project's relationship to community goals and needs, (5) the applicant's fiscal and management capacity, and (6) the feasibility of the proposed project. The Department's regional managers prepare a summary of each application's strengths and weaknesses in accordance with established evaluation criteria. As described previously, the Department also uses an Advisory Committee to evaluate and discuss grant applications in a public meeting. The Advisory Committee makes funding recommendations that range from full funding, to high- or low-partial funding, to no funding at all. It is ultimately up to the Department's Executive Director to determine which grantees will receive funding and the specific dollar amount of the award.

Our analysis of funding decisions from the July 2006, October 2006, and March 2007 grant cycles revealed a strong correlation between the recommendations of the Advisory Committee and the final decisions of the Department's Executive Director. A different executive director was in place during each of these grant cycles. We found that when the Advisory Committee gave a high level of support for a grant application (i.e., when more than 80 percent of the Advisory Committee members supported the project), the Executive Director awarded high-partial or full funding (i.e., more than 60 percent of the requested amount) about 98 percent of the time. Similarly, when the Advisory Committee gave mid-level support for a grant application (i.e., more than 50 percent of the Advisory Committee members supported the project), the Executive Director awarded high-partial or full funding about 88 percent of the time. Thus, the recommendations of the Advisory Committee have a strong bearing on the final funding decision.

We found that although the Department's grant evaluation criteria are reasonable and appropriate, these criteria are not understood or applied consistently and uniformly by Advisory Committee members. Our interviews with Advisory Committee members and our observations of the March 2007 Advisory Committee meeting demonstrated that members tend to place more weight on certain criteria than others and that the factor receiving the most weight varies depending on the member. In fact, we found that a member's support or lack of support for an application could be based solely on a single factor. One Advisory Committee member reported focusing more on whether the applicant has contributed matching funds to the project, whereas another Advisory Committee member reported focusing more on the applicant's ability to maintain and sustain the project in the future. Program staff prepare comprehensive summaries analyzing the strengths and weaknesses of proposed projects. These summaries are provided to the Advisory Committee in advance of its meeting; however, it is not clear that Advisory Committee members consider all of the information provided by program staff when evaluating grant applications. One grantee we spoke with during our site visits reported that the Department and the Advisory Committee appear to have an informal hierarchy for evaluating projects, yet the Department's grant guidelines do not provide any guidance on which evaluation criteria are more important or how to weight them, as is common in other grant programs.

The statutes clearly indicate that grant funds are to be prioritized toward areas of the State that are socially and economically impacted by energy and mineral resource development. However, the statutes do not formally define what "socially or economically impacted" means. The Department also has not defined this term. Our observations of the March 2007 Advisory Committee meeting revealed that social and economic impacts were not the primary consideration when discussing the merits of grant applications. Additionally, our interviews with the Advisory Committee members showed that they do not agree on how social and economic impacts should be defined or assessed. For example, some Advisory Committee members reported that only projects specifically related to addressing the direct impacts from active production should be considered for funding. Other Advisory Committee members take a broader approach and consider indirect and historical impacts of energy and mineral development when evaluating applications. These members also understand that the statutes allow for broad uses of the funds and do not require that the proposed project be directly related to or mitigate social and economic impacts, regardless of whether social and economic impact is defined narrowly or broadly.

Ultimately, it is up to the grant applicant to demonstrate that it is in a socially or economically impacted area and to describe the impact. We reviewed the applications for our sample of 40 grants and found that nine of the grantees gave explanations of the direct energy and mineral impacts they were experiencing. For example, one applicant requested funding for road repairs because of damage from heavy truck traffic driving through an oil field area, as well as increased local traffic from a growing population. Another 28 grantees described indirect or historical impacts. For example, a hospital district seeking grant funds for new medical equipment described how an increase in unemployment from the closure of a nearby gold mine had led to increased numbers of uninsured patients seeking medical care, thereby reducing the hospital district's ability to provide for major capital expenses. We found that three grantees in our sample did not clearly demonstrate that they were in a socially or economically impacted area or explain any direct or indirect impacts from energy and mineral production.

Our interviews with grant recipients demonstrated that most applicants support the use of an Advisory Committee to review projects. However, 4 of the 16 grant recipients we interviewed reported that the Advisory Committee sometimes deviated from discussing the merits of the proposed project. Recipients also reported that recently the Advisory Committee had become more polarized over how to assess the direct versus indirect impacts of energy and mineral resource development, which has led the Advisory Committee to apply the evaluation criteria inconsistently. Some grant recipients believe that certain Advisory Committee members do not have an appreciation for the broader impact that energy and mineral development creates statewide.

We reviewed procedures used by the Department of Education's Public School Capital Construction Grant Program, Great Outdoors Colorado, and the State Historical Fund to evaluate grant applications for their respective programs. Similar to the Department's energy and mineral impact grants, these other state-administered grant programs rely on some combination of program staff and outside parties (e.g., an advisory committee) to review grant applications against defined selection criteria and make funding recommendations to the final decisionmakers. However, unlike the Department, each of these other programs uses a numeric scoring system to assess proposed projects, and certain factors count for more points than others in terms of the overall project evaluation. For example, for the State Historical Fund grants, the appropriateness and thoroughness of the proposed project scope and budget weighs more heavily than the applicant's ability to successfully complete the project.

The Department has developed appropriate criteria for evaluating grant applications. However, the Department needs to provide more specific guidance on defining and evaluating social and economic impact. The Department also needs to adopt a system for prioritizing and weighting the evaluation criteria and numerically scoring applications. This would ensure a more consistent and uniform application of the evaluation criteria and ensure that each grant application is evaluated on all dimensions. A weighting system would also allow the Department to more closely match the evaluation criteria with its overall funding priorities and program goals. For example, if the Department weighs social and economic impact more heavily than other criteria, a project that has fewer matching funds in a highly impacted area might be more likely to be approved. The Department could involve the Advisory Committee, regional managers, and grant applicants when designing this weighting and scoring system, which would help to emphasize a common understanding of the grant evaluation criteria among all parties involved.

Currently the Department's regional managers qualitatively evaluate the strengths and weaknesses of grant applications for energy and mineral impact grants prior to the Advisory Committee meetings. A weighted scoring system could be added to this staff review process, thereby providing a quantitative dimension to the information already provided to the Advisory Committee. Advisory Committee members could also score applications. Although neither program staff nor the Advisory Committee makes the final funding decisions, their recommendations have a strong bearing on the final outcome. Ultimately, these steps will allow the Department to provide more guidance and structure to the Advisory Committee and staff review processes and ensure that energy and mineral impact grant applicants are treated fairly and consistently.

Recommendation No. 3:

The Department of Local Affairs should ensure that applications for energy and mineral impact grants are more consistently and uniformly reviewed by:

a. Providing more specific guidance on how to define and evaluate social and economic impact.

b. Prioritizing and weighting established selection criteria. This should include reviewing the selection criteria for continued appropriateness and applicability.

c. Developing a numeric scoring system to rate the extent to which grant applications meet established selection criteria.

d. Communicating with and training members of the Energy Impact Assistance Advisory Committee, regional managers, and grant applicants on the prioritization and weighting of established selection criteria and the numeric scoring process.

Department of Local Affairs Response:

Agree. Implementation Dates: June 30, 2008 (small grant program); March 31, 2009 (standard and large grant programs)

The Department agrees to develop policies and procedures to ensure that grant applications are reviewed more consistently and uniformly by providing more specific guidance on how to define and evaluate social and economic impact, and by using an objective scoring system in which selection criteria will be quantified and in which communities will be classified on an annual basis based on impact metrics. The Department agrees to provide training to stakeholders—local government representatives, Advisory Committee members, and program staff—to ensure reliability. Additionally, the Department is seeking to strengthen the Advisory Committee by placing increased emphasis on the Advisory Committee's policy development role, scheduling periodic reviews of the selection criteria with the Advisory Committee to ensure appropriateness and applicability, adding two local representatives to the Advisory Committee, and requiring Senate confirmation of gubernatorial appointments. Finally, the Department is working on developing a three-tiered grants program to include a small grant option (under $200,000) and a larger, multi-year grant program in addition to the standard grant program currently being used.

It is expected that guidelines for a proposed new small grants program will be implemented by June 30, 2008. Full implementation of all program changes, including stakeholder outreach, is anticipated by March, 31 2009.

Matching Funds

As discussed previously, the Department's guidelines specify a number of different criteria for evaluating grant applications. Our interviews with Department staff, as well as with members of the Advisory Committee, revealed that perhaps the most important criterion is the amount of matching funds an applicant will contribute to the project. Larger matching amounts are considered to be more competitive, and a dollar-for-dollar cash match is encouraged. In other words, if an applicant requests

$100,000, ideally the applicant will dedicate at least $100,000 of its own funds to the project. In addition to the applicant's own cash funds, there are other sources of revenue that could potentially be counted as matching funds. These include in-kind contributions (e.g., donations of land, labor, equipment) and outside funds (e.g., other state or federal grants and loans) that are either committed or pending. Matching funds are generally reported to the Advisory Committee as a percentage of the total project cost, accompanied by a narrative describing the various funding sources for the project.

During our audit we reviewed the staff summaries and data on matching funds for the 214 grant applications considered during the July 2006, October 2006, and March 2007 grant cycles. We found that the Department treats different revenue sources inconsistently when calculating matching percentages. Not every grant application had in-kind contributions or other outside sources of funding. However, for those that did, the following table shows that these revenues were not uniformly included or excluded when calculating the matching percentage. For example, 46 of the 214 applications we reviewed had in-kind contributions to the project. We found that for 23 of these applications (50 percent), the Department counted the in-kind contributions in the matching percentage calculation. However, for 18 of these applications (39 percent), the Department did not include the in-kind contributions in the matching percentage calculation. In the remaining five cases (11 percent), we were unable to determine how the Department treated the in-kind contributions. We identified similar inconsistences in the Department's treatment of funding from outside sources.

Department of Local Affairs
Energy and Mineral Impact Grants
Treatment of Revenue Sources in Matching Fund Calculations
July 2006, October 2006, and March 2007 Grant Cycles

Revenue Source	Included	Excluded	Unclear	Total Applications[1]
In-Kind Contributions	23 (50%)	18 (39%)	5 (11%)	46 (100%)
Outside Funding, Committed	38 (54%)	23 (33%)	9 (13%)	70 (100%)
Outside Funding, Pending	18 (37%)	26 (53%)	5 (10%)	49 (100%)

Source: Office of the State Auditor's analysis of project summaries prepared by the Department of Local Affairs.
[1] Of the 214 total applications reviewed, not all had in-kind or outside sources of funding.

Our discussions with regional managers also confirmed that different methods are used to calculate the matching percentage. For example, one regional manager reported that in-kind contributions should not be included in the match, because it is difficult to value in-kind contributions or ensure the contributions are made. Another regional manager reported that pending funds from outside sources also should not be included in the match, because the applicant cannot guarantee that it will receive the funds. The treatment of pending funds is further complicated by the fact that the Department is often the first entity to commit funds on a project. Nonetheless, by treating revenue sources inconsistently when assessing matching funds, the Department holds applicants to different standards. This is especially troublesome since Department staff and Advisory Committee members reported that the applicant's matching contribution is perhaps the most important factor considered when evaluating grant applications.

In addition to these inconsistencies, we found that the Department's method for calculating the matching percentage does not provide sufficient information to fully evaluate matching funds in accordance with the Department's goals. The Department reported that it has two primary goals for evaluating matching funds on energy and mineral impact grant applications. First, the Department reported that it places a high priority on cash funds contributed by the applicant because this demonstrates a local commitment to the project. Second, the Department reported that applicants should demonstrate that they are leveraging energy and mineral impact grant monies by obtaining additional funding sources for the project. Currently when calculating a grantee's matching percentage, the Department divides the applicant's cash funds by total project costs. While this calculation may demonstrate the applicant's cash commitment, it does not reflect the applicant's ability to leverage multiple funding sources for the project.

Overall, the Department needs a clear and consistent policy for evaluating all matching funds on projects. Since the Department has more than one goal for assessing matching funds on projects, the Department should reevaluate its methodology and consider using more than one matching percentage calculation. We reviewed three other state-administered grant programs that have a required minimum matching percentage. All three generally evaluate matching funds, inclusive of cash and other sources of funding, as a percentage of the total project cost. Neither the Department of Education's Public School Capital Construction Grant Program nor the State Historical Fund factors in-kind contributions into the matching percentage calculation. Great Outdoors Colorado allows in-kind contributions to count as matching funds, but specifies how in-kind contributions will be valued and that at least 10 percent of the total project cost must be a cash match from the applicant. Regardless of how the Department chooses to evaluate in-kind contributions and calculate matching percentages, the Department needs to ensure a consistent application and that the analysis supports a meaningful evaluation of matching funds on projects.

Recommendation No. 4:

The Department of Local Affairs should ensure a meaningful and consistent evaluation of matching funds on energy mineral impact grant applications by:

a. Assessing the goals for requiring matching funds on projects.

b. Developing one or more methods for calculating matching percentages in accordance with these goals and applying the calculation consistently for all applications. This should include establishing a policy for how in-kind contributions and outside sources of funding will be treated and valued.

c. Including the goals for requiring matching funds and the methods for calculating matching percentages in the grant guidelines, and clearly communicating this information to all regional managers, grant applicants, and Energy Impact Assistance Advisory Committee members.

Department of Local Affairs Response:

Agree. Implementation Dates: June 30, 2008 (small grant program); March 31, 2009 (standard and large grant programs)

The previously mentioned comprehensive review of project selection criteria and selection processes will include changes with respect to matching funds requirements and expectations. The Department has specifically committed to the Working Group to the Legislative Interim Committee that matching requirements will be changed to better reflect the reality of local government financial conditions, including the stage in the life cycle of energy development and fund balances. A specific proposal the Department has advanced is to relax or eliminate cash match for immediate, direct needs in heavily impacted areas, such as the need for road improvements in affected communities.

The Department expects to implement guidelines for a new small (up to $200,000) grant program in June 2008 and for the standard ($200,000 to $1,000,000) and new large (more than $1,000,000) grant programs in March 2009. The review of matching requirements will include the rationale for such requirements, the method of calculation of the matching percentage, a policy for treatment of in-kind contributions and contributions from outside sources, and training for staff and Advisory Committee members. The

Department will ensure a meaningful and equitable evaluation of matching funds as one of the selection criteria for application review.

Rules of Conduct

The Colorado Code of Ethics established in state statute provides that "a member of a board, commission, council, or other committee . . . shall not perform an official act which may have a direct economic benefit on a business or other undertaking in which such member has a direct or substantial financial interest" [Section 24-18-108.5(2), C.R.S.]. "Official act" is broadly defined to include any vote, decision, recommendation, approval, disapproval, or other action, including inaction, which involves the use of discretionary authority.

As discussed previously, the Department uses an Advisory Committee established by state statute [Section 34-63-102(5)(b)(I), C.R.S.] to evaluate applications for energy and mineral impact grants and make funding recommendations. Members of the Advisory Committee include five citizen members appointed by the Governor; the executive directors or their designees of the Department of Local Affairs, Natural Resources, and Transportation; and the Commissioner of Education or his or her designee. The current citizen members on the Advisory Committee include a county commissioner, two municipal mayors, a former State Representative, and an energy industry representative. Overall, we found that the Department and Advisory Committee lack written procedures to ensure Advisory Committee members comply with statutory rules of conduct and avoid actual or perceived conflicts of interest during their review and evaluation of grant applications.

We observed the March 2007 Advisory Committee meeting and reviewed data on the Advisory Committee's voting records for the July 2006, October 2006, and March 2007 grant cycles. We also interviewed Advisory Committee members and grant recipients. We identified two primary concerns:

- **Advisory Committee members who abstain from voting still participate in the discussion of proposed projects.** During the March 2007 meeting, we noted two projects where an Advisory Committee member self-identified a conflict of interest and abstained from the final vote. However, these abstentions occurred after the member actively questioned grant applicants and voiced support for the projects. In both cases, the grant application was from the county in which the Advisory Committee member's municipality was located. We question whether members should participate in discussions and actively advocate positions on projects where a self-identified conflict exists.

- **Advisory Committee members inconsistently abstain from voting on projects.** During the March 2007 meeting, an Advisory Committee member recommended funding for a project in the county in which the member's municipality is located. Yet our review of voting records for a prior grant cycle showed that this same member abstained from voting on a proposed project from the same county. In a second and third case, Advisory Committee members representing municipalities handled applications from neighboring municipalities within their county inconsistently. At the March 2007 hearing, the two Advisory Committee members voted in support of projects proposed by neighboring municipalities. However, one of these members had abstained from voting on a project from the same applicant during a prior grant cycle. We were not able to determine from the voting records why members abstained from voting during one grant cycle, and not others, when the circumstances in each case were similar. We did not find any evidence of Advisory Committee members voting on grant applications from their own jurisdiction.

Advisory Committee members who are elected officials pose the greatest risk for potential conflicts of interest because they represent local jurisdictions that may directly benefit from receiving grant funds. However, actual or perceived conflicts of interest can exist for any member. During our interviews with grant recipients, several shared concerns that Advisory Committee members seem to favor projects from areas within the members' geographic region more than projects from other regions.

Department staff reported that Advisory Committee members are expected to abstain from voting on proposals from the jurisdictions they represent, and all other situations that may pose a conflict are handled at the members' discretion. However, our observations and analysis of members' votes from prior grant cycles demonstrate a need for the Department to establish formal written procedures to ensure the Advisory Committee's practices comply with statutory rules of conduct. When developing these procedures, the Department should require that Advisory Committee members formally disclose any personal, business, or organizational interests and affiliations that could be construed as a conflict of interest. Both the State Historical Society and Great Outdoors Colorado have adopted codes of ethics for their respective boards of directors. Finally, program staff need to maintain an official record of each Advisory Committee member's votes on applications and note reasons for abstentions. Taking these steps will help the Department ensure that Advisory Committee members appropriately and consistently abstain from voting on proposals that could present actual or perceived conflicts of interest, thereby promoting greater transparency in the grant award process. This is important because, according to our analysis, the Advisory Committee's recommendations have a strong influence over the Department's final funding decisions for grant awards.

Recommendation No. 5:

The Department of Local Affairs should establish written procedures to ensure the Energy Impact Assistance Advisory Committee's practices comply with statutory rules of conduct. At a minimum, the Department should:

a. Specify examples of situations that could create an actual or perceived conflict of interest and, therefore, warrant a member's abstention from discussion and voting on a proposed grant project.

b. Require that Advisory Committee members formally disclose any personal, business, or organizational interests and affiliations that could be construed as a conflict of interest. Such disclosures should be made at least annually or at the time any conflict or potential conflict of interest becomes apparent.

c. Expand its official record of Advisory Committee funding recommendations to include a breakdown of votes on grant applications by each individual Advisory Committee member and a notation of the reasons for abstentions.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department will establish written policies and procedures concerning rules of conduct for the Energy Impact Assistance Advisory Committee. The Department will establish these rules of conduct in accordance with Section 24-18-108.5, C.R.S., Rules of Conduct for Members of Boards and Commissions. Specifically:

a. As is present practice, committee members will be instructed not to vote on grant applications from jurisdictions for which they serve in an elected or appointed position. Consideration will be given to establishing policies and procedures to avoid situations in which a committee member's vote might create the perception of a conflict of interest.

b. The Department will require Advisory Committee members to self-disclose actual conflicts of interest and sign conflict-of-interest statements annually.

c. The Department will expand its official record of funding recommendations to include a breakdown of votes on grant applications by each individual Advisory Committee member. Notations of reasons for abstentions will be made part of the official record.

Contract Timeliness

After a review of grant applications by program staff and the Advisory Committee, the Department's Executive Director makes the final funding decision and issues a grant award letter. The award letter advises each applicant of the decision to award or deny grant funding and specifies the total amount of the grant award. The award letter is not a formal obligation of funds by the State but rather an offer to enter into a grant contract for the project. The award letter may also specify conditions—such as formation of a taxing district, increased local financing, securing funding from other grant programs, or development of plans—which must be met either prior to or during the project performance period. The project performance period on energy and mineral impact grants averages just under 1.5 years, but this is ultimately driven by the type of project (e.g., one of our sampled grants for a public facility project had a performance period of 2.5 years).

Upon receipt of the award letter, grantees must contact their regional manager to initiate the contracting process. The Department uses a standard contract for all grant projects. Once the grant contract is fully executed by both the grantee and the State, the funds are encumbered and officially obligated for the project in the State's accounting system. According to the Department's grant guidelines, the Department generally holds the offer to contract open for up to 12 months after the award letter is issued.

During our audit we analyzed data on grant award and contract execution dates for the 1,584 energy and mineral impact grant awards extended between July 2001 and March 2007 to determine the timeliness of the Department's contracting process. As of March 22, 2007, 1,447 awards (91 percent) were under contract, 29 awards (2 percent) had been withdrawn, and 108 awards (7 percent) were still pending.

The table on the following page shows data on the length of time it took the Department to place the 1,447 awards under contract. Overall, we found that most grant awards are encumbered by contract in a timely manner. About 69 percent of all grant contracts were executed within three months of the grant award date, and 21 percent of the awards were encumbered by contracts within three to six months of the grant award date. However, we found it took more than six months from the date of the award offer to finalize 148 (10 percent) of the grant contracts, valued at about $42.6 million.

Department of Local Affairs Energy and Mineral Impact Grants Time From Grant Award to Grant Contract *July 2001 Through March 2007*				
Award to Contract Date	**Number of Contracts**	**Percent of Total Contracts**	**Total Amount of Initial Award**	**Percent of Total Amount**
0-3 Months	992	69%	$234.8 million	67%
3-6 Months	307	21%	$70.5 million	20%
6-9 Months	83	6%	$23.6 million	7%
9-12 Months	32	2%	$10.1 million	3%
>12 Months	33	2%	$8.9 million	3%
Total	**1,447**	**100%**	**$347.9 million**	**100%**
Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.				

We also found that some grant awards are outstanding for more than a year before being contracted or withdrawn. Specifically, of the 1,447 awards under contract, 33 (2 percent) were executed more than 12 months from the date of the grant award. Furthermore, of the 108 awards pending a contract in the data we analyzed, 22 (20 percent) were pending for more than 12 months at the time of our analysis. Finally, of the 29 withdrawn awards we analyzed, 3 (10 percent) were not withdrawn by the Department until more than 14 months after the grant award date. Currently the Department's grant guidelines do not require the Department to rescind grant awards that cannot be encumbered by contract within 12 months.

When contracts are not executed in a timely manner the Department cannot maximize the use of grant funds. Since grant awards are offers to contract, the Department does not allocate these funds for use on other projects. Additionally, it is difficult for the Department to obtain accurate information on the amount of funds available for new awards. Finally, the longer it takes to get a project under contract, the more likely it is that the total cost of the project will increase. For example, many projects funded with energy and mineral impact grant funds are construction projects. Data on the Producer Price Index (PPI) for materials and inputs to construction, such as concrete and steel products, show percentage increases of 8 percent and 12 percent, respectively, over the one-year period between January and December 2006. Thus, when it takes upwards of 9 to 12 months to get a grant contract in place, grantees' need for supplemental funding on the project is likely to increase.

We analyzed supplemental awards on the 1,447 grant contracts executed between July 2001 and March 2007 and found that the longer a grant award remains unencumbered by contract, the more likely it is to have a supplemental award. The following table shows that of the 148 awards with contracts that took more than six months to execute, approximately 19 percent had a supplemental award. However, only about 11 percent of the contracts that took less than six months to execute had a supplemental award. Additionally, we found that the total dollar value of the supplemental award as a percentage of the initial award amount is higher for awards that take longer than six months to get under contract. Thus, when grant awards are not encumbered by contract in a timely manner, supplemental awards are more likely and the supplemental award tends to be proportionally larger.

Department of Local Affairs
Energy and Mineral Impact Grants
Supplemental Awards by Original Grant Award-to-Contract Date
July 2001 Through March 2007

Award Date to Contract Date	Number of Contracts	Number of Supplemental Awards	Percentage of Contracts with Supplemental Awards	Total Amount of Initial Awards	Total Amount of Supplemental Awards	Supplemental Award Amount as a Percentage of Initial Award Amount
0-6 Months	1,299	148	11%	$305.3 million	$23.4 million	8%
6+ Months	148	28	19%	$42.6 million	$5.6 million	13%
Total	**1,447**	**176**	**12%**	**$347.9 million**	**$29.0 million**	**8%**

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.

There are a number of reasons why certain grant awards may take longer to get under contract than others. In particular, grantees may not always be ready to proceed with the project at the time funds are awarded. For example, the Department is often the first entity to commit funds to a project and it will not proceed with a grant contract until all other funding for the project (e.g., funds from other grant programs, proceeds from bond issues, local cash matching funds) is secured. In many cases, the Department places a special condition on the award of funds, which may require additional time before a contract can be secured. Of the 40 sampled grants we reviewed during our audit, 4 took longer than six months to place under contract. The award for one of these projects was made contingent upon the grantee's securing, within a nine-month period, the balance of funds needed to pay for the project. In another case, the grant award was originally made from severance tax funds, but because severance tax revenues count against limits established by the Taxpayer's Bill of Rights (TABOR), the local government subsequently requested that the source of funds be changed to federal mineral lease revenues, which are not subject to TABOR limits, to preserve the enterprise status of its sewer fund. In the third case, the funding source was also changed to federal mineral lease revenues due to similar concerns with TABOR limits, as well as due to negotiations between the grantee and its bidders related to cost increases on the project. Finally, the fourth case did not involve any type of special conditions on the award; however, the regional manager reported that the contracting process simply took longer because the grant award was part of a large and complex multiphase project. We did not find that the longer contracting timelines were caused by delays in the execution of the grant contracts.

Although the Department may not be able to control all factors contributing to longer contracting timelines, the Department does control when it awards the funds. Overall, few applications are denied funding. For example, only 7 percent of the applications considered during the July 2006, October 2006, and March 2007 grant cycles did not receive funding. Care should be taken to ensure that grant funds are awarded only when projects are ready to move forward in a timely manner. The Department should consider denying or deferring the award of funds to a subsequent grant cycle when the entity clearly is not ready to contract. If an award is made, the Department should closely monitor those cases when a grant contract is not likely to be in place for several months. Award offers not resulting in contracts within 12 months should be withdrawn.

Additionally, the Department should improve its efforts to monitor the timeliness of grant contracts. Currently regional managers receive a monthly report on grant projects by region. This report includes a list of all awards pending contracts. This monthly report could be modified to include additional data on the number of months elapsed since the grant award date. Outstanding award offers approaching 12 months since the date of award could be flagged for additional review and follow-up with the grantee by the regional manager to ensure that awards are either withdrawn or are placed under contract. Additionally, the Department should set performance goals and regularly track statistics on grant award to grant contract time frames program-wide.

Recommendation No. 6:

The Department of Local Affairs should ensure the timely contracting of energy and mineral impact grant awards by:

a. Awarding grant funds only for projects that are ready to move forward in a timely manner. The Department should consider denying or deferring the award of funds to a later grant cycle when the entity is clearly not ready to contract.

b. Setting performance goals and tracking statistics on grant award to grant contract time frames program-wide. This should include adapting monthly reports to include data on the number of months elapsed since the grant award date and flagging those awards approaching 12 months for follow-up by the regional manager.

c. Withdrawing award offers outstanding for more than 12 months.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department will ensure the timely contracting of grant awards by:

a. Awarding funds only for projects that are ready to move forward in a timely manner, as specified in the project selection criteria. In some cases this may result in the award letter not being issued until such time there is confidence the project can reasonably be expected to go to contract in the 12-month timeline specified in the program guidelines.

b. Setting performance goals and tracking statistics on grant award to grant contract time frames, as recommended.

c. Withdrawing award offers outstanding for more than 12 months unless the extension is adequately justified, documented, and approved in writing.

Uncommitted Funds

The Department distributes revenues to local governments from both the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund. The majority of revenues from these two Funds are distributed through the energy and mineral impact grants. We analyzed fiscal year-end data and found that the Department has maintained a large balance of uncommitted funds at the end of each of the past five fiscal years. As we describe in this section, the Department could strengthen its policies and procedures to ensure that available monies are identified and distributed as quickly as possible through the grantmaking process.

The table on the following page shows the breakdown of the year-end uncommitted cash balances for the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund for Fiscal Years 2003 through 2007. In this table, the “operating cash balance” represents the total amount of operating cash in the respective Fund at the end of each fiscal year. We adjusted this amount to account for funds that are otherwise committed and, therefore, unavailable for new grant awards.

Department of Local Affairs
Local Government Severance Tax Fund and Local Government Mineral Impact Fund
Analysis of Fiscal Year-End Operating Cash Balances
Fiscal Years 2003 Through 2007
(Dollars in Millions)

	As of June 30					Percent Change 2003-2007
	2003	**2004**	**2005**	**2006**	**2007**	
Local Government Severance Tax Fund						
Operating Cash Balance	**$51.1**	**$87.3**	**$120.9**	**$167.8**	**$161.9**	**+217%**
Less:						
Unexpended Balance on Grant Contracts[1]	($19.6)	($29.4)	($41.9)	($78.1)	($92.9)	+374%
Pending Grant Contracts[2]	($1.1)	($3.7)	($14.9)	($10.6)	($13.4)	+1,118%
Accounts Payable[3]	($3.8)	($10.6)	($14.3)	($20.1)	($18.0)	+374%
Plus:						
Short-Term Loans Receivable[4]	$1.3	$1.3	$1.5	$1.6	$1.8	+38%
Uncommitted Cash	**$27.9**	**$44.9**	**$51.3**	**$60.6**	**$39.4**	**+41%**
Uncommitted Cash as a Percentage of the Operating Cash Balance	55%	51%	42%	36%	24%	-56%
Local Government Mineral Impact Fund						
Operating Cash Balance	**$27.2**	**$33.3**	**$45.7**	**$71.1**	**$71.9**	**+164%**
Less:						
Unexpended Balance on Grant Contracts[1]	($12.6)	($13.5)	($15.2)	($34.8)	($47.1)	+274%
Pending Grant Contracts[2]	($0.1)	($3.3)	($6.6)	($11.2)	($7.8)	+7,700%
Accounts Payable[3]	($1.2)	($0.6)	($1.1)	($8.1)	($7.0)	+483%
Uncommitted Cash	**$13.3**	**$15.9**	**$22.8**	**$17.0**	**$10.0**	**-25%**
Uncommitted Cash as a Percentage of the Operating Cash Balance	49%	48%	50%	24%	14%	-71%

Source: Office of the State Auditor's analysis of data from the Colorado Financial Reporting System (COFRS) and grant data provided by the Department of Local Affairs.
[1] Amount of spending authority encumbered by existing grant contracts. This excludes amounts paid out to grantees.
[2] Amount of grant awards approved but not yet under contract.
[3] Amount of accrued liabilities (e.g., direct distribution payments and other amounts) to be paid in the next fiscal year.
[4] Amount of principal and interest payments due from loan recipients in the next fiscal year.

The uncommited cash balance at year-end has fluctuated year to year for both Funds. At the same time, there is evidence of the Department's efforts to reduce the amount of uncommitted cash. For example, the amount of uncommitted cash as a percentage of the operating cash balance in the Local Government Severance Tax Fund has decreased from about 55 percent in Fiscal Year 2003 to about 24 percent in Fiscal Year 2007. Additionally, the dollar value of existing grant encumbrances and the dollar value of pending awards have increased, which suggests more active grant awards. Despite these efforts, however, the uncommitted cash balances remain high. As of the end of Fiscal Year 2007, the amount of uncommitted funds was about $39 million for the Local Government Severance Tax Fund and about $10 million for the Local Government Mineral Impact Fund.

We identified two ways in which the Department could improve cash management practices and help ensure that the use of available resources is maximized. First, the Department has not determined a minimum year-end amount of uncommitted cash that should be maintained in reserve. Department staff reported that the Department had tried to maintain a reserve amount in the past. However, this practice was stopped in 2001 due to concerns that the reserve would be targeted to help with the State's impending budget crisis, and since that time, the focus has been on awarding the monies to local governments as quickly as possible. The uncommitted cash represents the resources available for new grant awards, as well as resources reserved for unexpected costs and contingencies, such as supplemental awards or lower-than-anticipated revenues. To balance the goal of funding as many eligible projects as possible with the need to provide for contingencies, the Department should establish a methodology for determining a reserve amount for both the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund. The Department should use the strategic approach to grantmaking discussed in Chapter 3 to help set reserve amounts at an appropriate level.

Second, although Department staff reported that they monitor revenues and fund balances on a routine basis, the Department does not formally define and announce the amount of funding available prior to each grant cycle. This approach would provide for more robust budgeting of the uncommitted funds available for new grant awards and help determine the amount of funds that should be held in reserve for out-of-cycle awards, supplemental awards, and other contingencies. Announcing the amount of funds available in each grant cycle would also provide useful information to potential grant applicants.

Both the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund have significant inflows and outflows, and a number of factors influence the amount of uncommitted funds available throughout the year. Proper budgeting and monitoring of uncommitted funds, especially as each grant cycle approaches, would help ensure that the Department maximizes the resources available for new projects.

Recommendation No. 7:

The Department of Local Affairs should improve the management of resources available in the Local Government Severance Tax Fund and the Local Government Mineral Impact Fund for energy and mineral impact grants by:

a. Establishing a target year-end reserve amount for the uncommitted cash balance for each Fund. The Department should use the strategic approach to grantmaking discussed in Recommendation No. 13 to help set reserve amounts at an appropriate level.

b. Defining and announcing the amount of funds available for each grant cycle, as well as budgeting for out-of-cycle awards, supplemental awards, and other contingencies.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department has committed to taking a more strategic approach to grant-making activities (see response to Recommendation No. 13). Such an approach will include better management of resources by more systematically analyzing and controlling cash balances. This will be accomplished by:

a. Performing analysis for each Fund to determine an appropriate reserve cash balance. Whether this would be an absolute cash amount, a percentage of average revenue flows over a specified time period, or an amount determined in some other fashion will result from the analysis. Sensitivity to the volatility in revenues to the funds will likely lead to a conservative strategy, to avoid unforeseen drops in revenue that might jeopardize the program's ability to be responsive to local government impacts associated with revenue downturns.

b. Budgeting for supplemental awards and contingencies, such that, combined with cash flow analysis, a targeted amount of funds available for each grant cycle can be determined and announced.

The analysis of the reserve balance options and budgeting for supplemental awards will be completed by June 30, 2008 and implemented for Fiscal Year 2009.

Councils of Governments

As far back as the 1980s, the Department has awarded energy and mineral impact grant funds to regional councils of governments for such things as technical assistance, economic development, and planning studies. More recently, the Department made 11 awards totaling about $385,500 to regional councils of governments in Calendar Year 2006.

According to state statutes [Sections 39-29-110(1)(b)(I) and 34-63-102(1)(b), C.R.S.] governing the distribution of severance tax and federal mineral lease revenues, political subdivisions of the State are generally the only entities eligible to receive distributions of funds. However, these statutes do not specifically define "political subdivision." As a result, this creates questions about whether agencies such as regional councils of governments are eligible to receive energy and mineral impact grants.

Our search of the Colorado Revised Statutes identified at least 22 separate definitions of the term political subdivision. Counties and municipalities are almost always included in the definition, as are school districts and special districts. We found that regional councils of government are only included in the definition of political subdivision for 2 out of the 22 individual statutes we reviewed. Councils of government are specifically included in the statutes pertaining to local government retirement systems [Section 24-54-101(2.7)(c), C.R.S.]. Additionally, statutes pertaining to the Colorado Employment Security Act [Section 8-70-103(23), C.R.S.] specifically include cooperative agencies formed pursuant to Section 29-1-203(1), C.R.S.—of which councils of governments may qualify—in the definition of political subdivision.

Department staff reported that the question of whether councils of governments qualify to receive energy and mineral impact grant funds has been a long-standing issue. In July 2007 the Department obtained an informal opinion from its legal counsel to clarify the issue. According to the informal opinion, councils of governments are considered to be political subdivisions for the purpose of receiving energy and mineral impact grants because Section 29-1-203(1), C.R.S., allows local governments "to cooperate or contract with one another to provide any function, service, or facility lawfully authorized to each of the cooperating or contracting units." In other words, councils of governments are associations of political subdivisions acting as a group and, therefore, are eligible to receive the grants. However, the informal legal opinion stated that the contractual agreements establishing the councils of government need to authorize the acceptance of grant funds and that the monies need to be used in a manner consistent with the statutes governing the Local Government Severance Tax Fund and the Local Government

Mineral Impact Fund (i.e., for planning, maintenance, and construction of public facilities, or for the provision of public services).

In July 2007 the Department issued a letter to all councils of governments confirming its commitment to provide grant funding to regional organizations for community development. In its correspondence, the Department included a request that regional councils of governments provide affirmative evidence that the organization qualifies as a political subdivision as outlined in the informal legal opinion. That is, the councils of government must provide copies of their establishing agreements and show that such agreements authorize the acceptance of grant funds. In the short term, the Department needs to ensure it obtains and reviews such documentation prior to awarding grant funding to councils of governments. In the long-term, the Department should evaluate whether including a specific definition of political subdivision in the severance tax and federal mineral leasing statutes would be a more appropriate solution.

Recommendation No. 8:

The Department of Local Affairs should ensure that regional councils of government are eligible to receive energy and mineral impact grant funds by:

a. Obtaining and reviewing documentation from councils of governments demonstrating that the entity is formed pursuant to Section 29-1-203(1), C.R.S., and that the agreements establishing the councils of governments authorize the acceptance of grant funds.

b. Assessing the need to define "political subdivision" within the severance tax and federal mineral leasing statutes.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department is in the process of obtaining and reviewing documentation from regional councils of governments to determine their eligibility under the statutes to receive program funds. In instances where necessary statutory status is not clear, Department staff will work with local officials, as requested, to create appropriate political subdivisions eligible to receive grant funds. The Department will assess whether changes to the severance tax and federal mineral leasing statutes are necessary or desirable in light of the review of regional councils of governments' eligibility status.

Grant Expenditures

Chapter 2

The Department of Local Affairs' (Department's) energy and mineral impact grants constitute one of the largest state-funded grant programs directed toward local governments. Between Fiscal Years 2003 and 2007, local governments were awarded more than $404 million in energy and mineral impact grant awards and were reimbursed for expenditures totaling more than $263 million. As with any grant program, there are risks that funds will not be used as intended. Thus, strong internal controls over grant expenditures are critical. As the granting agency, the Department has a responsibility for maintaining an effective system of internal controls to ensure that taxpayer dollars are used properly and achieve intended results.

We reviewed the Department's processes for managing and overseeing grant expenditures, including controls over the review and approval of grantees' reimbursement requests. Overall, we found the Department needs to strengthen and standardize its oversight of grant projects to ensure that grant expenditures are for allowable uses and supported by adequate documentation. Additionally, the Department needs to improve controls over its electronic grants database and ensure the timely remittance of payments by loan recipients. We discuss these issues in the remainder of this chapter.

Program Monitoring

Monitoring expenditures is a key component of a granting agency's system of internal controls and is critical for large programs such as the energy and mineral impact grants. Monitoring generally includes some combination of reporting by grantees and review performed by program staff to provide reasonable assurance that grant funds are used for authorized and intended purposes in compliance with state laws, grant contracts, and other program requirements, and to keep grantees on course toward meeting project goals. Additionally, as we discuss later in Chapter 3, monitoring is essential for measuring whether overall program goals, objectives, and desired outcomes are being achieved.

Because statutes specify a broad range of allowable uses, the Department relies on a grant contract executed with the grant recipient to specify each project's scope of work and the types of expenditures that may be reimbursed with grant funds. Once the grant contract is fully executed, grantees may begin requesting reimbursement payments against their energy and mineral impact grant award. The Department's eight regional managers oversee grant payments by reviewing and approving reimbursement requests and related expense documentation submitted by grantees within their region. Once payment requests are approved by the regional manager, accounting staff at the Department's central office in Denver process the request and remit the payment to grantees.

During our audit we examined expenditure documentation for a judgmental sample of 40 energy and mineral impact grants totaling $25 million. At the time we drew our sample in March 2007, the Department had made 128 payments totaling $17.9 million on these grants, which represents about 12 percent of all expenditures under grants contracted during Fiscal Years 2005 and 2006. Our sample included five grants from each of the Department's eight field regions and represented various types of projects, including building construction, road improvements, water and sewer facility upgrades, equipment purchases such as fire trucks and medical equipment, and communications equipment to connect to the State's Digital Trunked Radio System. We also conducted site visits to 16 of the 40 sampled grant project locations to interview grantees and observe the projects.

Questioned Costs

As discussed previously, granting agencies should have sufficient controls to ensure that grantee expenditures are substantiated and that monies are used as intended. We evaluated whether the expenditures in our sample of 128 payments were reasonable and allowable under statutory, contractual, and other program requirements and were supported by adequate documentation. Of the $17.9 million in expenditures we reviewed, about $14.4 million (80 percent) was supported by invoice documentation and about $3.5 million (20 percent) was supported only by summary spreadsheets prepared by the grantee. Overall, we found problems with 18 (14 percent) of the transactions in our sample and identified questioned costs totaling $1.6 million, or about 9 percent of the $17.9 million in payments we reviewed. Specifically we found:

- **Overpayments totaling approximately $34,000 on 6 transactions.** The Department issued one grantee a duplicate payment resulting in an overpayment of $29,200. The Department paid another grantee $1,150 for expenses that were never incurred because the project was completed for less than the contract amount. The Department reimbursed another three grantees a total of $3,700 more than it should have based on invoiced amounts. Although none of the overpayments we identified resulted in the grantee's receiving more than the total amount of the grant contract, these are reimbursement-based grants and the grantees were not entitled to receive these funds at the time the Department approved the reimbursement request.

- **Unallowable costs totaling approximately $257,000 on 7 transactions.** These were reimbursements for grantee expenses that were not allowable under the grant contract provisions. For example, the Department reimbursed one grantee about $189,900 for a land purchase related to a road intersection improvement project whose contract stated that "eligible expenses include construction, paving, striping, and revegetation." Land purchase was not specifically included as an allowable expense, nor did the grant contract define the types of expenses that should be considered as a construction cost. In another example, two grantees were reimbursed a total of about $39,500 for expenses that the grantees incurred between 18 and 33 days prior to the execution date of their respective grant contracts. The grant contract states that grantees cannot be reimbursed for expenses they incur prior to the date the contract is executed by the State Controller or his or her designee.

- **Insufficient supporting documentation for payments totaling approximately $1.3 million on 3 transactions.** Specifically, these were reimbursements for which the grantee had submitted an expense summary, but the summary lacked sufficient detail (e.g., vendor name, invoice numbers and dates, and/or expense description) to determine whether each expenditure was appropriate and allowable under the terms of the grant contract. State Fiscal Rules [Rule 1-8] require the Department to ensure that grant monies are paid only when expenditures are properly substantiated.

In addition to these questioned costs, we identified about $35,000 in reimbursements on two transactions that drew funds from the final retainage amount specified in the grant contract before either project was complete. We provided the Department with complete details on the results of our grant file review and the questioned costs we identified for follow-up with grantees.

The results of our sample testing indicate a need for the Department to improve its oversight of grant expenditures. As we discuss in the following sections, the Department needs to reevaluate its program monitoring procedures and take a stronger and more standardized approach to monitoring energy and mineral impact grant expenditures to balance program flexibility with risks that taxpayer dollars will be spent inappropriately.

Standardized Documentation and Review

One element of effective program monitoring is to establish documentation requirements and review processes that are applied consistently program-wide. Currently the Department's documentation and review practices are not well-specified and vary widely among regions. Other state-administered grant programs that allocate substantially less funding have adopted stronger practices than those currently used for the energy and mineral impact grants. Many of the problems and questioned costs we identified could have been avoided if the Department had a more standardized and thorough review of grantees' expenditures before approving grant payments. Specifically, we identified the following problems:

- **Grant Contracts.** We noted wide variations in the degree of clarity and specificity with which allowable expenses were described in the contracts for our sampled grants. Some contracts listed specific expenses or expense categories eligible for reimbursement, whereas other contracts described the scope of the project and broadly stated that any expenses related to the project were eligible for reimbursement. When allowable uses of grant funds are not clearly specified in the grant contract, misunderstandings may occur and the Department cannot ensure that funds are used as intended. Grant contracts should clearly state the scope of the funded grant project and the project expenses eligible for reimbursement.

- **Documentation Standards.** During our review we noted inconsistencies in the extensiveness and the type of documentation used to substantiate grant expenditures. For example, some grantees submitted copies of actual invoices substantiating their project expenses, whereas other grantees only provided a self-reported summary of project costs containing varying levels of detail about the expenditure. Inconsistencies existed across regions, among grants within the same region, and even among different reimbursement requests from the same grantee. As discussed previously, about 20 percent of the grant expenditures we reviewed were only supported by summary spreadsheets prepared by the grantee. Currently neither the grant contract nor the Department's grant guidelines specifies what constitutes "proper documentation" to support a grantee's reimbursement request. The Department also does not require grantees to use a standard form when requesting reimbursement. In contrast, Great Outdoors Colorado and the Department of Education's Public School Capital Construction Grant Program require grantees to complete a standard reimbursement request form summarizing expenditures and to submit copies of invoices when requesting grant payments. Great Outdoors Colorado also requires grantees to provide copies of cancelled checks or certified accounting statements that tie directly to invoices or purchase orders documenting project expenses. The State

Historical Fund only requires grant recipients to submit standard expense summary forms, but program staff conduct routine desk reviews and request copies of invoices and cancelled checks to verify the documentation supporting grantees' reimbursement requests. The Department needs to establish clear documentation standards and practices, including the use of standardized reporting forms, to ensure that financial data and other project information supporting grant expenditures are complete and reported consistently across all grant awards.

- **Total Project Costs.** Grantees are not currently required to document their total project costs, which increases the risk that grantees funding projects through multiple grant programs may bill more than one grant for the same expense. Although we did not find evidence of double billing on the grants in our sample, the Department should be cognizant of this risk when setting its documentation requirements. Grantees should be required to submit detailed cost allocation information for total project costs—not just those to be paid from the energy and mineral impact grant—when requesting reimbursement. This is a common practice used by the other state-administered grant programs we reviewed.

- **Secondary Review.** Currently regional managers are the only individuals who review and sign off on the documentation submitted by grantees. The Department's accounting staff enter grant payments in the State's accounting system; however, the underlying supporting documentation is not transmitted to the Department's central office with the payment request. Lack of a substantive secondary review by an individual other than the regional manager is a concern, especially since regional managers may only rely on cost summaries when approving payments and do not always review the underlying invoice documentation for every project expense. The Department should implement a secondary review of documentation supporting grant expenditures. Such review could be performed on a risk basis by either program or accounting staff and take place during the grant performance period as reimbursement requests are submitted by grantees, prior to final closeout of the grant, or both.

On-Site Monitoring

In addition to standardizing its documentation requirements and expenditure review procedures, another element of effective program monitoring is to establish a formalized on-site monitoring process. Site visits to grantee locations are an effective way to review financial and programmatic records, observe operations, and offer technical assistance to grantees. Currently the grant contract states that the Department will monitor energy and mineral impact grant projects on an "as-needed basis." Regional managers reported that they routinely conduct site visits, during which they observe grant projects, review supporting expenditure documentation, and offer technical assistance to grantees. However, the grant files we reviewed did not contain details about when site visits were scheduled or took place, the issues or problems discussed with grantees, the supporting documentation reviewed, the problems identified, how the problems were rectified, and any follow-up that was required. In addition, the Department has not developed a standard checklist for regional managers to use during site visits.

Determining the best way to structure on-site monitoring activities will depend to a large extent on the documentation requirements the Department adopts for the energy and mineral impact grants. If the Department requires grantees to submit detailed expenditure documentation with their reimbursement requests, site visits could focus less on reviewing financial documentation and more on providing technical assistance to grantees, such as developing applications, troubleshooting, and assessing project performance and outcomes. If the Department relies solely on self-reported cost summary data when approving payments, the Department should conduct routine desk reviews and supplement these reviews with site visits that include a review of supporting expenditure documentation at the grantee location. Under either option, the Department will need to develop standard monitoring tools and checklists to structure and document the site visits. Additionally, the Department will need to establish follow-up procedures to ensure that any problems identified during site visits are corrected. Considering the large number and dollar value of energy and mineral impact grants awarded each year, it will also be important for the Department to identify and prioritize potential at-risk recipients to target its on-site monitoring activities. Risk factors that may trigger a site visit could include problems identified through desk reviews, the project's complexity, the total grant award amount, the proportion of grant funds to total project costs, and grantee experience with managing grant monies.

Finally, all changes to program requirements should be clearly communicated in the grant guidelines. Regional managers and other staff will need to be trained on the Department's new documentation standards and review practices. Training must also be provided to grantees on changes to documentation and reporting requirements, including how to complete standard reimbursement request forms. Communication and training are essential to successfully implementing changes in program monitoring procedures and provide additional assurance that energy and mineral impact grant funds are used appropriately.

Remaining Challenges

A substantial amount of funds flow through the energy and mineral impact grants. Between Fiscal Years 2003 and 2007, the Department reimbursed grantees for expenditures totaling more than $263 million. Overall, we found that the Department needs to reevaluate its program monitoring procedures and identify the appropriate combination of grantee reporting requirements, the level of documentation to be provided with reimbursement requests, desk reviews, and site visits. According to the Department, resource limitations present a challenge for improving and restructuring its practices for monitoring and overseeing the energy and mineral impact grants. As we discussed in the Overview Chapter, there are no staff in the Division of Local Government, including the regional managers, who are assigned full time to overseeing the energy and mineral impact grants. However, data reported by the Department show that the number of active energy and mineral impact grants it manages each year has increased by 127 percent from 357 active awards at the end of Fiscal Year 2001 to 809 active awards at the end of Fiscal Year 2007. The dollar value of active awards has increased by 312 percent from $65.2 million to $268.8 million during the same period. As it works to strengthen processes for monitoring the energy and mineral impact grants, the Department will need to assess its current allocation of resources and the distribution of tasks among staff to identify opportunities for increased efficiencies or to quantify the need for additional resources.

Recommendation No. 9:

The Department of Local Affairs should take a stronger and more standardized approach to its monitoring of energy and mineral impact grant expenditures by reevaluating its program monitoring procedures. The Department should determine the appropriate combination of grantee reporting requirements, the level of documentation to be provided with reimbursement requests, desk reviews, and site visits needed to provide assurance that funds are used as intended. At a minimum, the Department should:

a. Include sufficient detail in grant contracts to describe the scope of the funded project and clearly identify the costs and cost categories that are allowable or unallowable for reimbursement with grant funds.

b. Establish clear and consistent documentation requirements, including use of a standard reimbursement request form, that are applicable program-wide. This should include a requirement that grantees document total project costs when seeking reimbursement.

c. Ensure that regional managers thoroughly review reimbursement requests and supporting documentation before approving payments. Costs claimed for reimbursement should be allowable and sufficiently documented in accordance with established requirements.

d. Develop and implement procedures for conducting a secondary review of expenditure documentation to take place on a risk basis as reimbursement requests are submitted by grantees, prior to final closeout of the grant, or both.

e. Formalize policies, procedures, and checklists for conducting site visits to grantee locations on a risk basis and following up on any problems identified.

f. Communicate and provide training on new documentation standards, review practices, and other program requirements to grantees, regional managers, and other staff, as appropriate.

Department of Local Affairs Response:

Partially Agree. Implementation Dates: January 31, 2008 (part "a");
June 30, 2009 (parts "b-f").

Contingent on availability of additional resources, the Department agrees to take a stronger and more standardized approach to monitoring grant expenditures. Local needs and program revenues from both state severance taxes and federal mineral lease funds have increased dramatically in recent years. Specifically, the amount of grant and loan awards to local governments has more than quadrupled from Fiscal Year 2003 ($27.8 million) to Fiscal Year 2007 ($119.8 million). Despite reallocation of all other available staff resources to administration of the program, resources have not been adequate to properly administer the program. The Department is seeking additional FTE through a budget amendment for the Fiscal Year 2009 budget. Severance tax and federal mineral lease funds are sought to fund this unforeseen need for additional resources prompted by this audit and internal review.

With increased resources, the Department commits to the following, which will be accomplished as part of its ongoing review and improvement of program policies and procedures:

a. Including sufficient detail in contract scopes of work to more clearly identify project costs and cost categories that are allowable to be reimbursed from grant funds.

b. Establishing clear and consistent documentation requirements, a standardized reimbursement request form, and a requirement that grantees document total project costs when seeking reimbursement.

c. Establishing standardized protocols for thorough and consistent review of reimbursement requests by regional managers before approval of payments. Only costs determined to be allowable and sufficiently documented will be reimbursed.

d. Developing and implementing a process for secondary review of expenditure documentation, to occur as reimbursement requests are submitted or prior to grant closeout.

e. Implementing a risk-based on-site monitoring process, as well as formalizing policies, procedures, and checklists for conducting site visits.

f. All of the above procedures and practices will be incorporated into program guidelines, and training will be provided to grantees, regional managers, and other staff as appropriate.

Grant Data

Grant management information systems can increase the efficiency and effectiveness of the granting agency's oversight activities by allowing managers to capture, track, and report on a wide range of programmatic data. Data typically maintained in and reported by grant management systems include pending grant applications, grant award amounts, contract execution dates, grant payments, budgets and related modifications, grant balances, and performance outcomes. The Department relies on an integrated information system—referred to here as the grants database—to manage data and report on information for several different programs, including the energy and mineral impact grants. No grant payments are issued from this system.

During our audit we identified two issues related to the Department's management of grant data. First, security access controls for the grants database are not sufficient and may present risks to the overall security and integrity of data maintained on the system. Second, the Department should continue its efforts to implement a routine reconciliation of financial data for the energy and mineral impact grants between the grants database and the State's accounting system.

System Access

Access controls are measures put in place by management to ensure the confidentiality, integrity, and availability of information stored in an agency's database. Controls can be either preventive or detective. Preventive controls, such as policies and procedures or system edits, attempt to avoid the occurrence of unwanted events. Detective controls, such as audit trail reports and intrusion detection, identify unwanted events after they have occurred. When adequate access controls are lacking, the reliability of computerized data and, therefore, its usefulness to management for decisionmaking is potentially compromised.

We reviewed the system access controls in place for the grants database. We examined all 315 system user IDs active as of April 25, 2007, and found:

- **16 user IDs (5 percent) were inappropriately maintained in "active" status.** The prompt removal or disabling of accounts belonging to users who no longer require access to the system is a basic security control. We found that 12 user IDs belonging to former employees were still active at the time of our review. Two of these former employees had been terminated for disciplinary reasons. We also identified active user IDs for three employees who had transferred to another agency and one employee who was on an extended leave of absence. At the time of our review, these user IDs had been active for between 4 and 20 months after the change in the user's employment status.

- **299 user IDs (95 percent) lacked strong passwords.** Strong passwords are the first line of defense against unauthorized access. We found that the majority of user IDs did not have strong passwords, which potentially allowed system users to use a password with as few as one character. We also found that 149 user IDs had passwords older than 60 days, and 67 user IDs had passwords older than six months.

- **117 user IDs (37 percent) were generic.** A generic user ID is one that is not specifically assigned to any single person and could potentially be used by multiple individuals, thus making it impossible to track activity to a specific user.

The problems we identified with user IDs and passwords represent weaknesses in access controls and a risk to the overall security of data residing on the system. The Department needs to take several steps to address these issues. First, the Department needs to reassess its notification procedures for changes in users' employment status. Staff in the Department's Office of Information Services (OIS) reported that the Human Resources Office notifies OIS of terminated or separated employees on a monthly basis. An OIS security administrator is then responsible for inactivating the user ID. However, since we identified user IDs for terminated or separated employees that were still active well after one month, the Department needs to review this process and ensure these updates are comprehensive, occur more frequently, and are documented to provide a record of the notification and follow-up by OIS staff. Second, the Department needs to ensure that strong password controls are in place over all user IDs. This should include requiring that (1) the minimum password length be eight characters and contain a combination of letters, numbers, and symbols; (2) ensuring users do not select passwords that are the same as the user ID; and (3) requiring users to change their passwords on a routine basis. Finally, the Department should minimize the use of generic user IDs whenever possible. Generic user IDs provide no single-user accountability for system activity associated with the ID. None of the generic user IDs we identified were specific to the Division of Local Government or the energy and mineral impact grants. However, because all data reside on the same system, a generic user ID in another division could still pose a risk for all users and data on the system.

Our audit also reviewed controls related to segregation of duties. Segregation of duties as it relates to a computer system means that, in general, a single person should not have the ability to electronically create, change, and approve the same data transaction. One effective means of ensuring properly segregated duties is by limiting users' information system access to only those activities required to perform their job duties. For example, some users will have an access level that only allows them to extract data and produce reports (i.e., read-only access). Other users will have an access level that also allows them to enter or change data (i.e., read and write access). At the time of our audit, 16 of the 31 user IDs affiliated with the Division of Local Government's grant programs had permission to add, change, and delete data. Division managers reported that many staff are assigned work responsibilities across different programs, and the current permissions may be appropriate. However, there is no process in place to routinely review user access and confirm that access continues to be appropriate for the employee's job responsibilities. We also found that there is no process for routinely preparing and reviewing audit trail reports, which are chronological logs of access and data modifications by system users. By implementing a routine review of user access and audit trail logs, management can minimize the risk of unauthorized or unintended access, use, or changes to key program data.

Data Reconciliation

The State's accounting system (COFRS) contains the State's official record of all encumbrances, expenditures, and other financial transactions related to the energy and mineral impact grants. As discussed previously, the Department's grants database also contains financial data on the energy and mineral impact grants, including such things as total grant award amounts, grant expenditures, and remaining award balances. During our audit the Department's accounting staff began working with program staff to reconcile financial data stored in the grants database with COFRS. No prior reconciliations had been performed for the energy and mineral impact grants. Reconciling the information stored in these two systems is important because regional managers and other program staff rely on information from both systems to make programmatic decisions regarding individual grants or the grant program as a whole.

The Department conducted a reconciliation between extracts of data from the grants database and COFRS as of June 30, 2007. This reconciliation revealed some substantial differences between the information maintained in the two systems related to grant budgets, expenditures, and balances for the energy and mineral impact grants. For example:

- The Department's grants database showed that grant budgets totaled about $2.4 million less and grant expenditures totaled about $3.7 million less than what was reported from COFRS for Fiscal Year 2007.

- The Department's grants database showed that the balance of unexpended grant funds was about $1.2 million higher than what was reported from COFRS as of June 30, 2007.

Department staff reported that these differences occur because of differences in the timing of when transactions are recorded in the grants database and COFRS.

The data for the energy and mineral impact grants are dynamic, and adjustments to grant awards and expenditures occur for multiple grantees on a daily basis. Routine reconciliations are an important control to ensure that grant data are complete, accurate, and up to date, and that information on the State's accounting system is reliable and complete. The Department's accounting staff report that they intend to continue working with program staff to correct the problems identified during these data reconciliations. The Department should continue its efforts until a routine reconciliation process, including steps to correct identified discrepancies, is fully implemented. Additionally, in the long term, the Department could explore options for a direct data interchange between its grants database and COFRS, thereby reducing the need for double entry of certain information. We made a similar recommendation in our October 2005 *Homeland Security Grant Program Performance Audit.*

Recommendation No. 10:

The Department of Local Affairs should strengthen controls to ensure the overall security and integrity of energy and mineral impact grant data maintained in its grants database. This should include:

a. Reassessing its notification process for changes in employment status to ensure that user IDs are deactivated as soon as a user's employment status changes.

b. Implementing strong password controls over all user IDs.

c. Minimizing the use of generic user IDs wherever possible.

d. Establishing processes to review user access permissions and to prepare and review audit trail reports on a routine basis.

e. Continuing efforts to implement a routine reconciliation of grant data between the grants database and the State's accounting system. This should include exploring options for a direct data interchange between these two systems.

Department of Local Affairs Response:

Agree. Implementation Date: November 30, 2007.

a. The Department has developed and implemented a paper process for departing employees which utilizes a "Departing User Checklist." Human Resources initiates the process; and end user accounts are deactivated with the signature of the system administrator and date/time stamped for each type of system account. The original paper record is maintained by Human Resources. The Office of Information Services maintains a copy of the completed document. Internal accounts are reviewed and necessary changes are made monthly. External inactive accounts are on a 90-day password replacement cycle. The password cycle forces the accounts to be activated or in a locked state, thereby making the inactive account non-accessible.

b. As of September 2007, the Department's grants database now enforces strong password protection.

c. The Department has "generic" user accounts for web access by local jurisdictional officials who are responsible for each of these accounts. The Department is in the process of creating an accountability letter to be signed for each account. The letter will be completed by November 1, 2007.

d. The Department has developed a security matrix for all database applications. This security matrix report will be issued quarterly to the program manager(s). A signature of verification will be required. Audit logs will track actions (inserts, updates, deletes) to data tables for three years. The audit logs will be sampled annually to verify the security changes. Audit logs will be reviewed on demand.

e. Grant program data and COFRS accounting data are now being reconciled on a monthly basis. Enhancements are being implemented in the grants database to expedite this reconciliation. Direct data interchange between COFRS and the database is technically possible and is the ultimate goal.

Loan Payments

For the most part, financial assistance available through the Department's Energy and Mineral Impact Assistance Program is provided through grant awards. However, in 1985 the General Assembly authorized the Department's Executive Director to make loans or loan-grant combinations from the Local Government Severance Tax Fund to political subdivisions for domestic wastewater or potable water treatment facilities. The statute [Section 39-29-110(1)(b)(II), C.R.S.] only allows for loans to be used for the planning, design, construction, erection, building, alteration, modernization, reconstruction, improvement, or expansion of such facilities. Loans cannot be made for projects involving raw water storage or transmission to a treatment facility. Finally, the statute provides that loans shall only be made under such terms as will ensure repayment of the loan with interest assessed and collected at an interest rate of no less than 5 percent.

The Department has specified in its program guidance that it only considers loan requests for up to $1 million, and loan terms typically will not exceed 20 years. Interest accrues monthly, and loan payments are due annually on September 1. In its January 2007 annual report to the General Assembly, the Department reported it has made more than 300 loans, with 161 being fully repaid. As of June 2007, there were 155 active loans with an outstanding loan principal totaling $15.8 million. The Department reports no defaults in the history of the loan program.

During our audit we selected a judgmental sample of 11 loans and reviewed all 45 payments received on these loans between Fiscal Years 2003 and 2007. We identified a total of four late payments (9 percent)—one each on four different loans. These four payments were made between 1 and 23 days after the Department's 15-day grace period. Upon further inquiry, the Department reported that several loan recipients make late payments each year. For example, the Department reported that from January 2002 through December 2006 there were a total of 20 late payments on 20 different loans. Although the number of loan recipients making late payments is relatively low, the occurrence of even one late payment is a concern when considering that loan recipients only have one scheduled payment each year. As discussed previously, the statute states that loans shall only be made under such terms as will ensure repayment. We identified a number of steps the Department could take to minimize the occurrence of late payments and ensure that it makes loans under such terms as will ensure repayment, as intended by statute.

First, the Department needs to strengthen its review and analysis of loan applications. According to program guidelines, before approving a loan application, Department staff perform an analysis to determine the applicant's ability to repay. We found that this fiscal analysis was missing for 9 of our 11 sampled loans and was not maintained in the active loan files for the 2 remaining cases. The fiscal analyses for these two loans appeared to be comprehensive and included information such as a review of population statistics, overall community tax burden, existing debt service, fund balances, and water and sewer tap fees. The analyses also included several different repayment scenarios (e.g., different loan amounts for different lengths of time). However, we found that the analyses did not conclude on the applicant's overall ability to repay the loan. The Department reported that it has never denied a loan application and that it works to negotiate loans that meet applicants' needs. Nonetheless, the Department needs to formally document its considerations and conclusions about whether loan applicants qualify for a loan based on the ability to repay. This could be accomplished by using a standard loan application form and checklist to assess applicants against specified minimum criteria. Potentially risky borrowers should be denied in cases where repayment is questionable. All documentation and information pertinent to the Department's decision to make a loan of severance tax funds should be maintained in the permanent loan files.

Second, we found there is inconsistency between the terms of the loan contract and the Department's internal policies regarding when a loan payment is considered to be late or in default. According to language in the loan contract, "if the full amount of the annual installment payment is not received by the State on or before

September 1 of each year, the Contractor *shall* be considered to be in default on this loan agreement" [emphasis added]. However, in practice, the Department's internal policy does not consider a loan payment late until it is more than 15 days past due, and a loan is not considered to be in default until a payment is more than 60 days past due. As discussed previously, we identified four loan payments in our sample that were received after the Department's 15-day grace period. However, if the Department had adhered to the contract requirements, there were actually 11 late payments. That is, the Department received seven of the loan payments in our sample after September 1 but before September 15. Inconsistent policies and practices create confusion for loan recipients and ultimately do not contribute to timely payments. The Department needs to align the loan contract terms and its internal policies and procedures to clarify when payments are considered late or loans are considered to be in default.

Third, the Department needs sufficient disincentives for making late loan payments. Currently the only disincentive for late payments is that when a loan payment is received after September 15, interest accrues on the past due principal as of September 1. The Department does not impose any additional monetary penalties when loan recipients make late payments. As mentioned previously, the Department has never held a loan recipient in default. Rather, the Department's internal loan procedures state that the Department typically arranges for a renegotiation of the loan payments in case of a loan recipient's inability to pay. For example, this could include extending the term of the loan, or arranging for interest-only payments for a period of time. We found that in some extreme cases, the Department has forgiven the loan obligation by converting the loan to an energy and mineral impact grant. This was the case for four separate loans with outstanding principal totaling $219,000. We were unable to obtain complete details on any of the four loans paid off with grant funds because the Department had purged the loan files. The Department needs to ensure that its practices provide incentives to loan recipients to make payments in a timely manner. Furthermore, lack of appropriate sanctions or actions is unfair to those loan recipients who do make timely payments on their loan obligations.

Finally, the Department needs to improve its communication regarding outstanding loan balances. The letter the Department sends to all loan recipients only includes the payment due (principal and interest). The letter does not include information such as the amount of principal still owed, the payments received to-date, and the new outstanding balance. All of this information is maintained in the Department's database. The Department needs to ensure that its routine correspondence with loan recipients include sufficient detail on outstanding loan balances and payment amounts, thereby promoting effective management and timely payment of loan obligations.

Recommendation No. 11:

The Department of Local Affairs should improve its management of loans made from the Local Government Severance Tax Fund to ensure that all loans are repaid in full with interest. Specifically, the Department should:

a. Formally document its assessment of each loan applicant's ability to repay the loan, including concluding on the specific factors and data supporting the loan decision. Applicants who do not meet specified minimum criteria should be denied. Documentation and information pertinent to the loan decision should be maintained in the permanent loan files.

b. Align loan contract terms and internal policies and procedures to clarify when payments are considered late or loans are considered in default.

c. Consider financial disincentives, such as additional monetary penalties, to encourage timely loan payments. The Department should avoid using awards of energy and mineral impact grants to forgive loan recipients' outstanding loan obligations.

d. Enhance routine correspondence with loan recipients to include sufficient detail on outstanding loan balances and payment amounts.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department will improve management of its loan program to ensure that all loans are repaid in full with interest. Specifically:

a. Each loan applicant's ability to repay the loan will be analyzed according to standard methods of determining recipient credit-worthiness, and such analyses will be maintained in permanent loan files. Those applicants not determined to be credit worthy will be denied loans.

b. Loan contract terms will be aligned with policies and procedures to clarify when payments are considered late or when loans are in default. Loans payments are due September 1 and are considered late if not received by September 15. If late, interest accrues on the delinquent amount from September 1 until paid. Loans are considered in default after 60 days.

c. Use of financial disincentives to encourage timely loan payments will be considered. Grants will be used to forgive outstanding loan obligations only in cases of extreme financial hardship, as is present practice.

d. Routine correspondence with loan recipients will be enhanced to include additional detail on outstanding loan balances and payment amounts.

Advance Payments

Prior to November 2006, the Department automatically paid grant recipients an initial, advance payment equal to 10 percent of the total grant award upon execution of the grant contract. Grantees then received 80 percent of their grant award through interim payments and the final 10 percent upon the project's completion. Since November 2006, the Department stopped making initial payments on new grant awards because staff reported it was difficult to verify how grantees were using those monies. We encountered similar difficulties with verifying grantees' use of initial payments during our review of sampled expenditures. Eliminating automatic initial grant payments as a general practice is an important step for ensuring better accountability for the expenditure of grant funds.

Although making initial payments has been discontinued as a matter of standard practice, it is possible that the Department could choose to authorize initial payments in certain circumstances. For example, during our site visits, grantees from small jurisdictions with limited cash flows reported that they benefit from receiving an initial payment on their grant contracts. State Fiscal Rules [Rule 2-2] prohibit advance payment for goods or services unless it is an established industry standard or unless the advance payment provides a benefit to the State at least equal to the cost and risk of the payment. If the Department decides in the future to offer advances of funds on energy and mineral impact grants, even if only on a case-by-case basis, it needs to obtain written approval from the State Controller's Office, as required by State Fiscal Rules. Additionally, the Department needs to develop a policy defining those circumstances in which grant recipients would be eligible for the initial payment without first incurring an expense. When developing this policy, the Department should consider the costs and benefits of advancing grantees funds that could continue to earn interest in state-administered accounts.

Recommendation No. 12:

The Department of Local Affairs should obtain written approval from the State Controller's Office, as required by State Fiscal Rules, if it decides in the future to advance funds on energy and mineral impact grant contracts. Additionally, the Department should develop a policy defining those circumstances in which grant recipients could be eligible for an advance payment of energy and mineral impact grant funds.

Department of Local Affairs Response:

Agree. Implementation Date: June 30, 2008.

The Department ceased making initial, advance grant payments in November 2006. As part of its overall review of program policies and procedures, the Department will develop a formal policy defining circumstances (such as land and equipment purchases) in which grant recipients may be eligible for initial, advance payment of grant funds prior to incurring an expense. Cases of initial, advance payments are expected to be rare, and in any cases in which such a policy permits an advance payment, the Department will obtain written approval from the State Controller's Office.

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Strategic Grantmaking

Chapter 3

Since its inception, the Energy and Mineral Impact Assistance Program administered by the Department of Local Affairs (Department) has provided financial assistance to communities affected by the growth and decline of energy and mineral industries in the State. The Department's energy and mineral impact grants constitute one of the largest state-funded grant programs directed toward local governments. For example, in Fiscal Year 2007 the Department awarded about $120 million in energy and mineral impact grants. By comparison, the Department of Education's Public School Capital Construction Grant Program awarded about $53 million, the State Historical Fund awarded about $11 million, and Great Outdoors Colorado awarded about $8 million in local government grants in Fiscal Year 2007. Even major philanthropic foundations allocate less money statewide than the Department's energy and mineral impact grants. For example, the Colorado Trust reported awarding about $20 million, and the Boettcher Foundation reported awarding about $11 million for projects in Colorado in 2006.

In many ways, the energy and mineral impact grants have historically been used as a community development program throughout the State. Our site visits and interviews with grant recipients around the State demonstrated that local governments rely heavily on these grant funds as a source of revenue for capital improvement projects, economic development, community planning, public services, and local infrastructure. Attitudes about the Department's administration of the energy and mineral impact grants are largely positive. At the same time, many policymakers and stakeholders question whether the Department's allocation of grant funding effectively addresses needs in highly impacted areas.

As we discuss throughout this report, we identified some key areas where the Department lacks sufficient controls over the award and expenditure of energy and mineral impact grant funds to ensure equal access to and effective use of grant funds. We believe these problems are symptoms of a larger issue that hinders the overall effectiveness of the energy and mineral impact grants—lack of a strategic approach to grantmaking. In this chapter, we present analysis which shows that the Department has distributed a large portion of grant funds to areas of active energy and mineral production for a wide variety of projects. However, we also found that there is no way to systematically assess whether these distributions of grant funds have resulted in desired outcomes or have provided funding for those projects that will provide the greatest benefit to the recipients and the State. We discuss how by shifting its approach to grantmaking, the Department could increase the effectiveness of its energy and mineral impact grants for local communities and for the State as a whole.

Current Grant Allocations

State statutes [Sections 39-29-110(1)(b)(I) and 34-63-102(1)(b), C.R.S.] require the Department to prioritize the distribution of severance tax and federal mineral lease revenues to local governments that are socially and economically impacted by energy and mineral development. Additionally, Section 39-29-101(3), C.R.S., specifies that it is the intent of the General Assembly that a portion of severance tax revenues be made available to local governments "to offset the impact created by nonrenewable resource development." Funding may be used for the planning, construction, and maintenance of public facilities, and for the provision of public services. Both the severance tax and federal mineral lease statutes are broadly constructed, directing funds to socially or economically impacted areas for a wide range of possible uses.

Complete data for Fiscal Year 2007 were unavailable at the time of our analysis. Therefore, we analyzed grant data for Fiscal Years 2002 through 2006 to assess the extent to which the Department allocates energy and mineral impact grant funds to socially and economically impacted areas as specified in statute. During this five-year period, the Department awarded approximately 1,200 grants totaling $318 million.

Grant Awards by Region

First, we analyzed the distribution of energy and mineral impact grant funds by region. (See Appendix C for a map of the regions.) The table on the following page shows that although each region in the State has received a portion of the grant funding, some regions have received more grant funding than others. Specifically, recipients in the Northwest received the most grant funding—$91 million—which was about 29 percent of the total funds awarded during Fiscal Years 2002 through 2006. Recipients in the Southern Mountains received the smallest share of the grant funding—$46 million—which was about 14 percent of the total funds awarded during this five-year period. The remaining grant funds were fairly evenly distributed among the remaining three regions. Recipients in the Front Range, Eastern Plains, and Southwest received between $57 million and $66 million, or approximately 18 to 21 percent of the total funds awarded. The average dollar amount awarded per grant ranged from a low of about $200,300 for awards in the Eastern Plains to a high of about $352,000 for awards in the Northwest. It is important to note that these regional differences reflect, in part, the underlying pool of applications submitted by local governments within each region.

Department of Local Affairs
Distribution of Energy and Mineral Impact Grants by Region
Fiscal Years 2002 Through 2006

Region	Total Number of Grants	Total Amount of Grants	Percent of Total Amount	Average Amount Per Grant
Eastern Plains	293	$58,674,000	18%	$200,300
Front Range	233	$56,894,000	18%	$244,200
Northwest	259	$91,180,000	29%	$352,000
Southern Mountain	214	$46,252,000	14%	$216,100
Southwest	222	$65,555,000	21%	$295,300
Statewide Totals	**1,221**	**$318,555,000**	**100%**	**$260,900**

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.

Grant Awards by Top 20 Impacted Counties

Second, we analyzed the distribution of energy and mineral impact grants to Colorado's top 20 impacted counties. Using Department data over a five-year period, we developed a weighted index of three different measures—the total value of mineral production, the number of new oil and gas well permits, and the number of production employees residing in the county—to rank all counties in the State. We then selected the 20 counties that scored highest on this weighted index. The resulting list included Adams, Cheyenne, Clear Creek, Delta, Garfield, Grand, Gunnison, Jefferson, La Plata, Las Animas, Mesa, Moffat, Montezuma, Rio Blanco, Routt, San Miguel, Teller, Washington, Weld, and Yuma Counties. This list generally corresponds with similar rankings of counties produced by the Department and favors areas of active production.

The table on the following page shows that between Fiscal Year 2002 and Fiscal Year 2006, the top 20 impacted counties received more grants for more money than did the remaining 44 counties in the State. Specifically, we found that of the $318 million awarded over the five-year period we analyzed, approximately $198 million (62 percent) went to the top 20 impacted counties. On average, each of the top 20 impacted counties received six awards per year totaling nearly $2 million, whereas each of the remaining 44 received an average of three awards per year totaling about $547,000. In other words, on average, the top impacted counties received more than three-and-a-half times as much grant funding as other counties received per year.

Department of Local Affairs
Distribution of Energy and Mineral Impact Grants by County Grouping
Fiscal Year 2002 Through 2006

County Grouping	Total Number of Grants	Total Amount of Grants	Percent of Total Amount	Average Amount Per Grant	Average Number of Grants Per County Per Year[1]	Average Total Amount Per County Per Year[1]
Top 20 Impacted Counties[2]	620	$198,286,000	62%	$319,800	6	$1,983,000
Remaining 44 Counties	601	$120,269,000	38%	$200,100	3	$547,000
Statewide	**1,221**	**$318,555,000**	**100%**	**$260,900**	**4**	**$995,000**

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.
[1] Figure was calculated by dividing the total by the number of counties in each category and then dividing by the number of fiscal years included in the analysis. The resulting figure is an average per county per year.
[2] Determined based on a weighted index of the total value of mineral production, the number of new oil and gas well permits, and the total number of production employees residing in the county. Includes Adams, Cheyenne, Clear Creek, Delta, Garfield, Grand, Gunnison, Jefferson, La Plata, Las Animas, Mesa, Moffat, Montezuma, Rio Blanco, Routt, San Miguel, Teller, Washington, Weld, and Yuma Counties.

Grant Awards by Type of Project

Finally, we analyzed data on the types of projects funded with energy and mineral impact grants. The table on the following page shows that nearly three-fourths of the total $318 million in grant funding allocated statewide was for road and bridge improvement, water and sewer, and public facility projects.

Department of Local Affairs
Energy and Mineral Impact Grant Awards by Project Type
Fiscal Years 2002 Through 2006

Project Type	**Funds Awarded to Top 20 Impacted Counties[1]**	**Funds Awarded to Remaining 44 Counties**	**Funds Awarded to All Counties**
Road and Bridge	29%	5%	20%
Water and Sewer	23%	28%	25%
Public Facilities	26%	29%	27%
Economic and Community Development	1%	1%	1%
Health Care	6%	11%	8%
Public Safety	14%	23%	17%
Planning and Administration	1%	3%	2%
Total	**100% $198 million**	**100% $120 million**	**100% $318 million**

Source: Office of the State Auditor's analysis of grant data provided by the Department of Local Affairs.
[1] Determined based on a weighted index of the total value of mineral production, the number of new oil and gas well permits, and the total number of production employees residing in the county. Includes Adams, Cheyenne, Clear Creek, Delta, Garfield, Grand, Gunnison, Jefferson, La Plata, Las Animas, Mesa, Moffat, Montezuma, Rio Blanco, Routt, San Miguel, Teller, Washington, Weld, and Yuma Counties.

Without a detailed review of individual project files, we cannot determine whether certain of these projects are more related to the impacts of energy and mineral production than others. However, in the table we compare the types of projects funded by grants going to the top 20 impacted counties with the types of projects funded by grants going to the remaining 44 counties in the State. Overall, we found the distribution of funds with respect to the types of projects was similar for both county groups. The only major difference is that about 29 percent of the grant funding awarded to the top 20 impacted counties went toward road and bridge projects, whereas only 5 percent of the funding awarded to the remaining counties went toward road and bridge projects. This difference is due, in part, to the fact that in Fiscal Years 2006 and 2007 the Department reserved a portion of grant funds for road and bridge projects and only the top impacted counties were eligible to apply.

The amount of grant funds awarded to local governments over the last five fiscal years has reached historically high levels. Our analysis showed that a large portion of these grant funds have been distributed to areas of active energy and mineral production for a wide variety of projects. However, as mentioned previously, there is no way to assess whether these distributions of grant funds have resulted in desired outcomes or have provided funding for those projects that will derive the greatest benefit to the recipients. This is because the Department lacks an overall strategic approach to its grantmaking activities.

Strategic Grantmaking

Strategic grantmaking, also known as initiative-based grantmaking, is a common best practice used by many private grantmaking foundations. Faced with increased scrutiny from donors and investors, philanthropic foundations have had to become more strategic with how they use their resources and are paying more attention to the impact of their grantmaking activities. In many ways, the expectation that the Department must demonstrate accountability to the taxpayer for the effective allocation and appropriate use of severance tax and federal mineral lease revenues through its own grantmaking activities is no different.

As we describe in the following sections, strategic grantmaking blends together several elements to bring about desired results and demonstrate that grantmaking activities yield the most value out of the investment of funds in a project. Strategic grantmaking is an iterative process used to set goals and objectives for a grant program and design funding initiatives, selection criteria, award allocations, and project monitoring around these desired goals and objectives. An evaluation of outcomes is used to further define program goals and objectives. The Department has taken some initial steps in this direction.

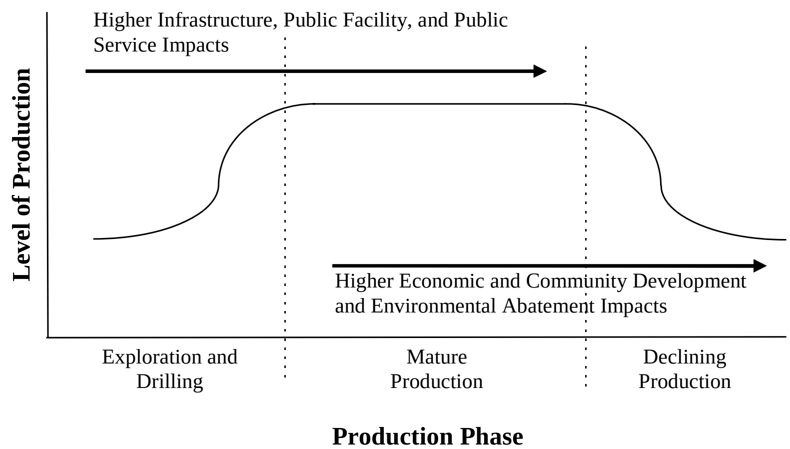
Plan Desired Outcomes

Although considerable resources can be spent evaluating grant applications, awarding funding, and monitoring projects, many granting agencies devote inadequate resources up front to thinking through the impact they would like to have with their grantmaking and how to allocate their resources to achieve their goals. It is difficult to evaluate the impact of grantmaking efforts if the goals and funding strategy are not clearly defined at the outset. For example, Great Outdoors Colorado uses a strategic plan that specifies targeted distribution goals among four different funding priorities established in the Colorado Constitution, the principles by which the program will be administered, and the objectives against which the program can be measured.

The severance tax and federal mineral lease statutes instruct the Department to distribute funds to areas socially and economically impacted by energy and mineral development. However, the statutes do not define what “socially or economically impacted” means, nor do statutes require that funds be allocated for uses that relate in any way to these impacts. Our discussions with Department management and staff, as well as with grant recipients and industry stakeholder groups, demonstrated that there is no consensus on the meaning of social and economic impact or the outcomes the Department's grant distributions should achieve. Some understand impact to mean the direct and tangible effects of energy and mineral production on the local community and its infrastructure. This viewpoint tends to be most common in areas of active production. However, others reported that this perspective ignores longer-term impacts of energy and mineral development. For example, the loss of energy and mineral production, or the aftermath of production, can have as much of a social, economic, and environmental impact on a local community as active production.

The Department has not stressed in its grant guidelines those types of projects that might be most effective at addressing impacts or which needs are most pressing. Thus, it has not taken advantage of the opportunity to use grant funds to address social and economic impacts in a cohesive manner. In order for the Department to allocate energy and mineral impact grant funding more strategically, it needs to specify goals, objectives, and desired outcomes of the program. If the ultimate goal or outcome of the grants is to help local communities offset the social and economic impacts created by nonrenewable resource development, the Department needs to identify impacts experienced by local communities throughout the State and outcomes that can be affected through the awarding of grant funds. This will be a challenging process because communities are likely to experience a different set of impacts and related needs depending on where they are in the cycle of energy and mineral production. As we show in the figure on the following page, communities are likely to experience one set of impacts when energy and mineral development is actively increasing and a different set of impacts when energy and mineral development is declining.

Potential Impacts of Energy and Mineral Production by Production Phase and Level of Production



Source: Office of the State Auditor.

In earlier phases of production, expanding local infrastructure (e.g., roads, water and sewer systems, housing) might have a higher priority. The focus is on accommodating an often rapid growth in population and demands on government services. Industry and local government stakeholders we spoke with indicated that larger grant awards with lower matching requirements would be more appropriate for communities in this phase of development. In later phases of production, maintaining or replacing existing infrastructure, economic and community development, and environmental abatement issues might become more important. The focus shifts to diversifying the economic base and positioning local communities to sustain a loss of production, which can be sudden, and the lasting effects of an absent industry. Industry stakeholders we spoke with felt that revenues from *ad valorem* taxes collected by local governments combined with smaller grants from the State for more targeted needs was a more appropriate source of project funding for communities in the mid- to later phases of production. In either case, the Department has not elaborated a plan for identifying these differing impacts to better focus its allocation of grant funds.

State statute [Section 24-32-104, C.R.S.] specifies that the Division of Local Government within the Department shall serve as a clearinghouse of information relating to the common problems of local government and the state and federal services available to assist in the solution of these problems. Thus, it would appear that the Department is already charged with conducting the research necessary to further define the goals and desired outcomes for the energy and mineral impact grants. Involving community and industry stakeholders in this process increases the likelihood that the energy and mineral impact grants will be directed toward pressing community needs. The Department currently has a number of available resources that could be more fully utilized in these efforts. First, the Department's regional managers work closely with local governments in their region to identify potential uses for energy and mineral impact grant funds. The Department could use these existing relationships to facilitate more systematic data collection efforts to obtain statewide data on the social and economic impacts of energy and mineral development and local community needs. Second, to assist in identifying these common needs and solutions, state statute [Section 34-63-102(5)(b)(I), C.R.S.] empowers the Energy Impact Assistance Advisory Committee (Advisory Committee) to continuously review the existing and potential impact of resource development on various areas of the State, including those areas indirectly affected. The statute also directs the Advisory Committee to make continuing recommendations to the Department including, but not limited to, those actions deemed reasonably necessary and practicable to assist impacted areas with the problems created by resource development.

Although local governments are able to identify their individual needs, these needs will depend on the types of impacts being experienced and are driven by the cycle of energy and mineral production. Additionally, local governments experience their problems on a local level. The Department is in a position to identify common needs and, therefore, common solutions. The Department needs to more systematically analyze local governments' needs to identify areas or strategies whereby the distribution of energy and mineral impact grant funding can realistically be expected to lead to positive outcomes.

Historically, the Department's approach to the energy and mineral impact grants has been based on the premise that local governments are best situated to identify and address their own needs. However, the impacts or needs stemming from energy and mineral resource development are not necessarily unique to each community. Energy and mineral production either is or historically has been present in all regions of the State, and communities across the State experience many of the same impacts and share many of the same needs. The Department's role in allocating grant funding is important for balancing the fact that energy and mineral production affects all regions of the State with the fact that certain areas may be more directly affected than others.

Implement Targeted Funding Initiatives

Currently the Department has an open solicitation for energy and mineral impact grant applications, and applications are considered during the course of three regular funding cycles throughout the year. Grant cycles are open to all applicants for all types of projects. The grant application process is driven entirely by the local requests, which means that the resulting allocation of funds is generally reactive. In contrast, strategic grantmaking requires much more deliberate action on the part of the granting agency when soliciting grant applications and awarding funding. Instead of considering unsolicited proposals for a broad range of projects, the granting agency budgets and allocates its grant funds in accordance with a series of funding initiatives (or requests for proposals) that are more narrowly defined and designed to address a specific need or purpose. Applications are then evaluated according to how well the proposed project fits into the goals and objectives of the particular funding solicitation. The breadth and flexibility of the grantmaking process is maintained by having several different initiatives running concurrently. Each funding initiative must relate to the overall goals and objectives of the grant program. This more targeted and proactive approach to grantmaking increases the likelihood of achieving desired results.

With respect to energy and mineral impact grants, the Department could design a series of funding initiatives—each with a budgeted amount of funds—that are focused on separate, yet complementary, outcomes that address the different social and economic impacts local governments across the State are experiencing from energy and mineral development. Some funds could still be held aside for open applications; however, the allocation of the majority of grant funds needs to be driven by more defined initiatives. We found that the Department has already taken some steps in this direction. In recent years, the Department has worked with local governments, other state agencies, and nonprofit organizations to set aside a portion of energy and mineral impact grant funds for projects related to specific needs, such as water and wastewater infrastructure, interoperable communications equipment, road and bridge improvements, and rural health care. Most of these special funding cycles were open to all applicants statewide; however, the Department restricted grant applications for the road and bridge initiative and the water-wastewater treatment initiative only to counties identified by the Department as experiencing the greatest impacts.

The Department needs to make more use of an initiative-based grantmaking process to ensure a more deliberate and purposeful allocation of energy and mineral impact funds. The funding initiatives must be sufficiently based on systematic analysis of local governments' needs and flow from the overall goals and objectives of the grant program. This process would allow the Department—with input from local governments, industry representatives, and other stakeholders—to identify strategies for addressing impact issues and provide a stronger link between its allocation of grant funds and the desired outcomes. Additionally, defined funding initiatives will help the Department improve many of the issues discussed in Chapter 1 related to the evaluation of grant applications and the budgeting and management of available resources.

Evaluate Outcome-Related Data

The last step in a strategic grantmaking process is to assess and evaluate outcomes, and use the results of this analysis to revise program goals and objectives. Currently the Department maintains a wealth of data on outputs, such as the number and dollar value of grants awarded and the types of projects funded. However, the Department has no data on outcomes, such as what gaps in local governments' needs the grants have addressed or what changes in impacts the grants have brought about. Although the individual grants are undoubtedly beneficial for the communities that receive them, it is unclear what results the energy and mineral impact grants have collectively achieved. As we discussed previously, our inability to assess whether the Department has effectively allocated grant funding stems from the lack of clearly specified goals, objectives, and outcomes for the program. Without any prespecified and commonly understood goals, objectives, and outcomes, there can be no effective measures of achievement.

Typically, the evaluation process requires data collected from individual grantees that is then aggregated and analyzed program-wide. Thus, individual project monitoring and reporting is the primary means by which the Department can gather the data needed to determine the efficacy of its grantmaking activities. The Department will need to rely on more robust project monitoring and grantee reporting (discussed in Chapter 2) to inform this broader strategic planning and evaluation process.

Remaining Challenges

The Department has a legacy of providing grants to local governments in a flexible manner that allows the local government officials to access and expend funds for a variety of self-identified projects. However, the Department needs a more deliberate and controlled grantmaking process that ensures the most effective use of the dollars available. Many of the concerns we identified throughout this report stem from a lack of clarity or agreement regarding the desired goals and outcomes of the program.

Strategic grantmaking can be complex and requires resources. However, we believe that by making a shift in this direction, the Department will greatly enhance the overall effectiveness of its energy and mineral impact grants for individual local governments and for the State as a whole. It can also help the Department better justify difficult funding decisions, especially when revenues decline and there are fewer grant funds available. In many ways, the Department already has the infrastructure in place to facilitate this type of grantmaking process. Moreover, we believe the Department could adopt such an approach without sacrificing flexibility or its ability to adapt the grants to meet local governments' ever-changing needs.

Recommendation No. 13:

The Department of Local Affairs should take a more strategic approach to its grantmaking activities for the energy and mineral impact grants. This should include developing a methodology to identify and assess the common impacts and needs created by nonrenewable resource development throughout the State; setting clear program goals, objectives, and desired outcomes to guide grantmaking activities; using defined funding initiatives to proactively solicit grant applications and target resources in support of established program goals and objectives; and tracking program data to assess outcomes and evaluate and routinely report on performance.

Department of Local Affairs Response:

Partially Agree. Implementation Date: March 31, 2009.

Contingent on additional resources, the Department has committed to improving the overall effectiveness of its grant program by taking a more strategic approach to grantmaking activities. This commitment, as well as preliminary strategies developed to date, have been communicated to the Legislative Interim Committee and Working Group. As noted in the response to Recommendation No. 3, DOLA will be engaging in a process to review all program policies and procedures and to recommend improvements to the grantmaking process. This process will include department management and program staff, regional managers, grant applicants, the Advisory Committee and other stakeholders. Particularly in light of recent revenues, more strategic approaches are a high priority. In consultation with program stakeholders, the Department will develop a methodology to identify and assess the common impacts and needs created by resource development throughout the state. Grantmaking activities will be guided by clear goals, objectives and desired outcomes guided by the impact and needs assessment. The Department will continue to use and refine funding initiatives based upon strategic objectives developed with stakeholders to target resources to support program goals and objectives. Grant applications will be proactively solicited in support of these initiatives. The Department will track program data to assess outcomes and to evaluate and routinely report on performance.

The Department, as part of this process, is proposing to develop a three-tiered grants program consisting of a small grant program (under $200,000) and a larger multi-year grant program in addition to the standard grant program currently being used.

The Department is seeking additional FTE through a budget amendment for the Fiscal Year 2009 budget. Severance tax and federal mineral lease funds are sought to fund this unforeseen need for additional resources prompted by this audit and internal review.

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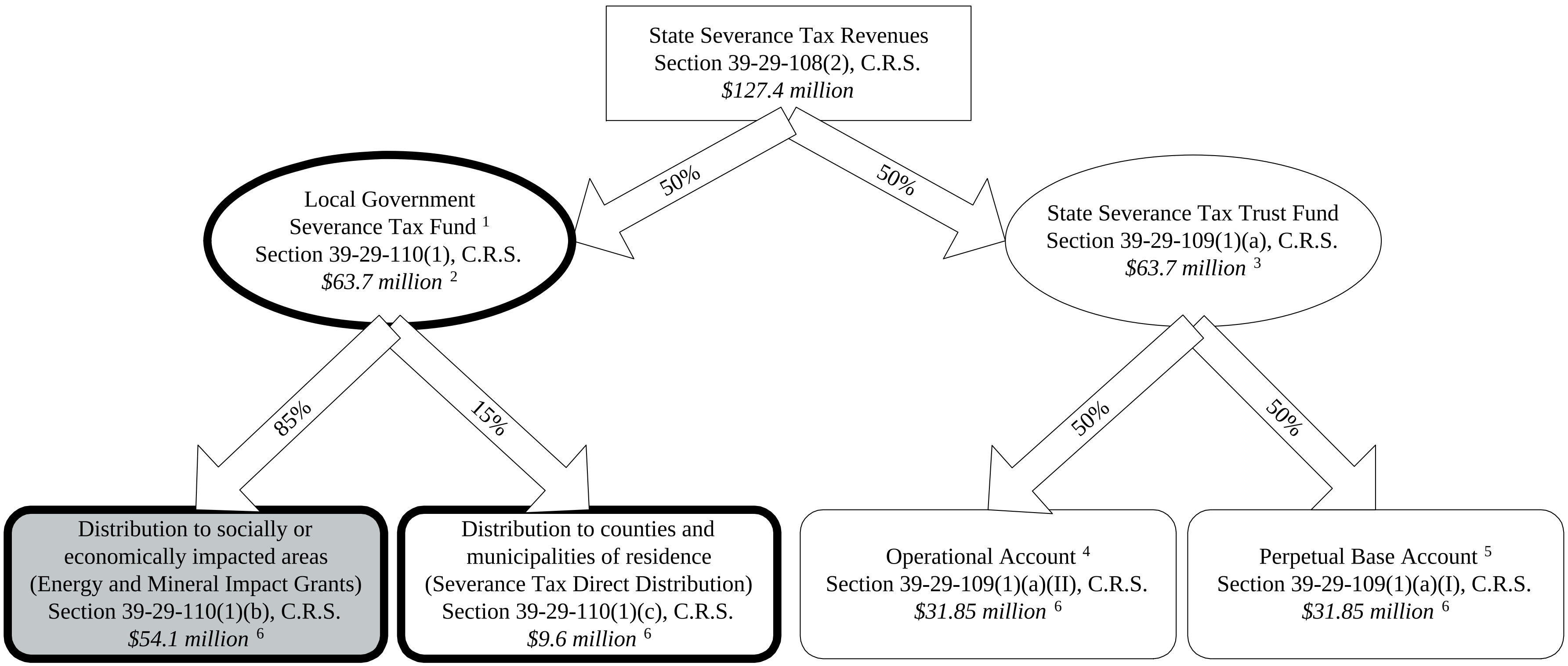
Appendix A
State of Colorado
Distribution of State Severance Tax Revenues
Amounts Are Based on Fiscal Year 2007 Revenue Data



Source: Office of the State Auditor's analysis of the Colorado Revised Statutes and data from the Colorado Financial Reporting System (COFRS).
Note: Boldface outlines represent funds and distribution processes administered by the Department of Local Affairs. Shading represents funds distributed through the energy and mineral impact grants.

[1] Pursuant to House Bill 07-1139, starting with Fiscal Year 2008, the percentage of funds allocated under the energy and mineral impact grants will decrease to 70 percent, and the percentage of funds allocated under the severance tax direct distribution will increase to 30 percent.

[2] Figure does not include about $7.8 million in revenues from interest income, interest from outstanding loan principal, and penalties.

[3] Figure does not include about $10.2 million in revenues from interest income.

[4] The Operational Account is used to fund a portion of core operations within the Colorado Oil and Gas Conservation Commission; the Colorado Geological Survey; the Division of Reclamation, Mining, and Safety; and the Colorado Water Conservation Board. Funds have also been appropriated for a number of other projects and programs.

[5] The Perpetual Base Account is used by the Colorado Water Conservation Board for loans for state water projects (e.g., flood control, water supply/storage, and hydroelectric energy facilities).

[6] Represents the revenues available for distribution based on Fiscal Year 2007 revenue data and percentage splits specified in state statute.

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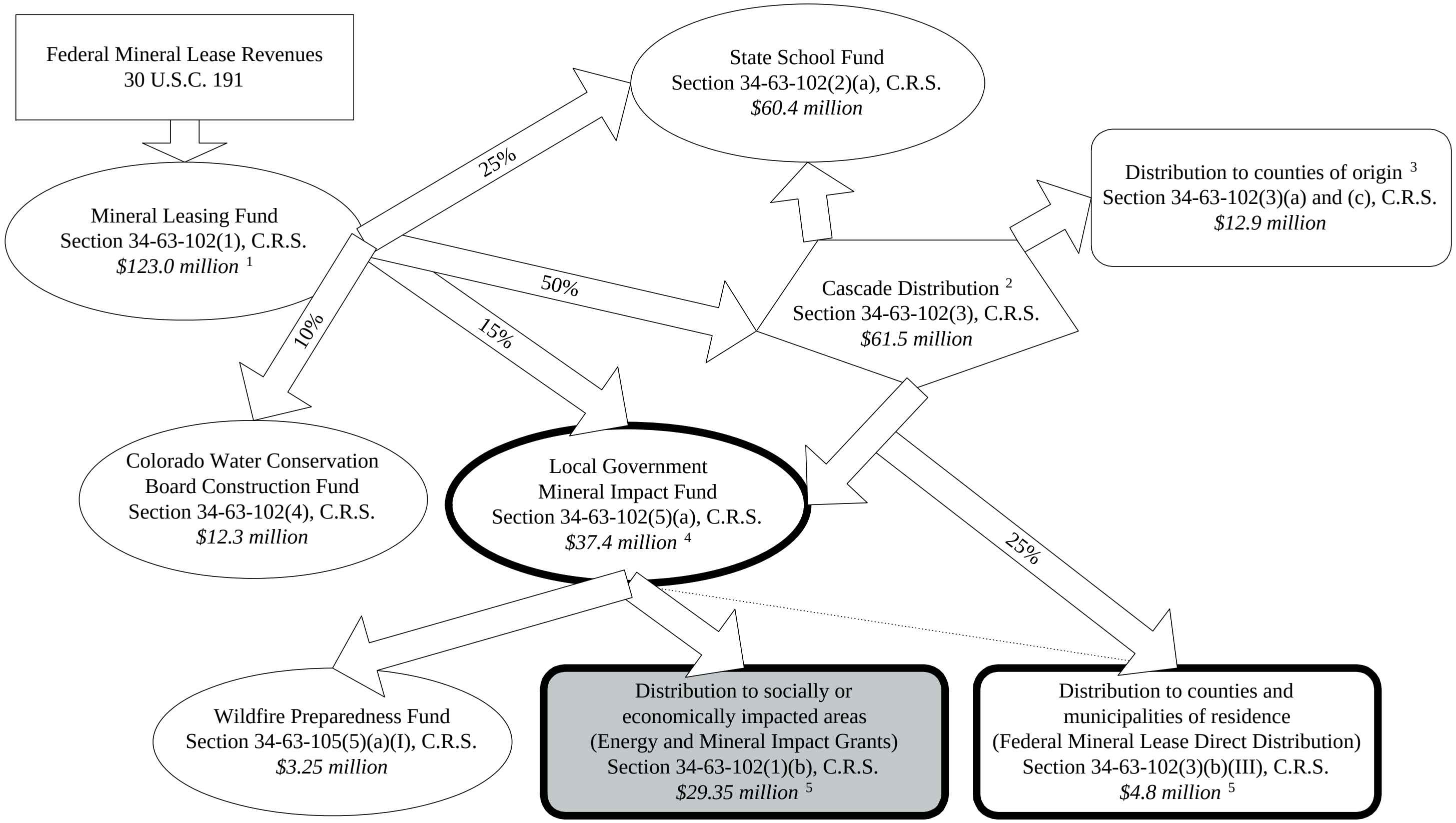
Appendix B
State of Colorado
Distribution of Federal Mineral Lease Revenues
Amounts Are Based on Fiscal Year 2007 Revenue Data



Source: Office of the State Auditor's analysis of the Colorado Revised Statutes and data from the Colorado Financial Reporting System (COFRS).
Note: Boldface outlines represent funds and distribution processes administered by the Department of Local Affairs. Shading represents funds distributed through the energy and mineral impact grants.

1 Figure includes about $768,000 in revenues from interest income.
2 The cascade distribution involves a series of dollar thresholds set in statute whereby the State Treasurer divides funds among several recipients.
3 These are payments of federal mineral lease revenues made by the State Treasurer under the federal Payments in Lieu of Taxes (PILT) Program, which provides payments to local governments to help offset losses in property taxes due to nontaxable federal lands within their boundaries.
4 Figure does not include about $3.3 million in revenues from interest income.
5 Represents the revenues available for distribution based on Fiscal Year 2007 revenue data and percentage splits specified in state statute.

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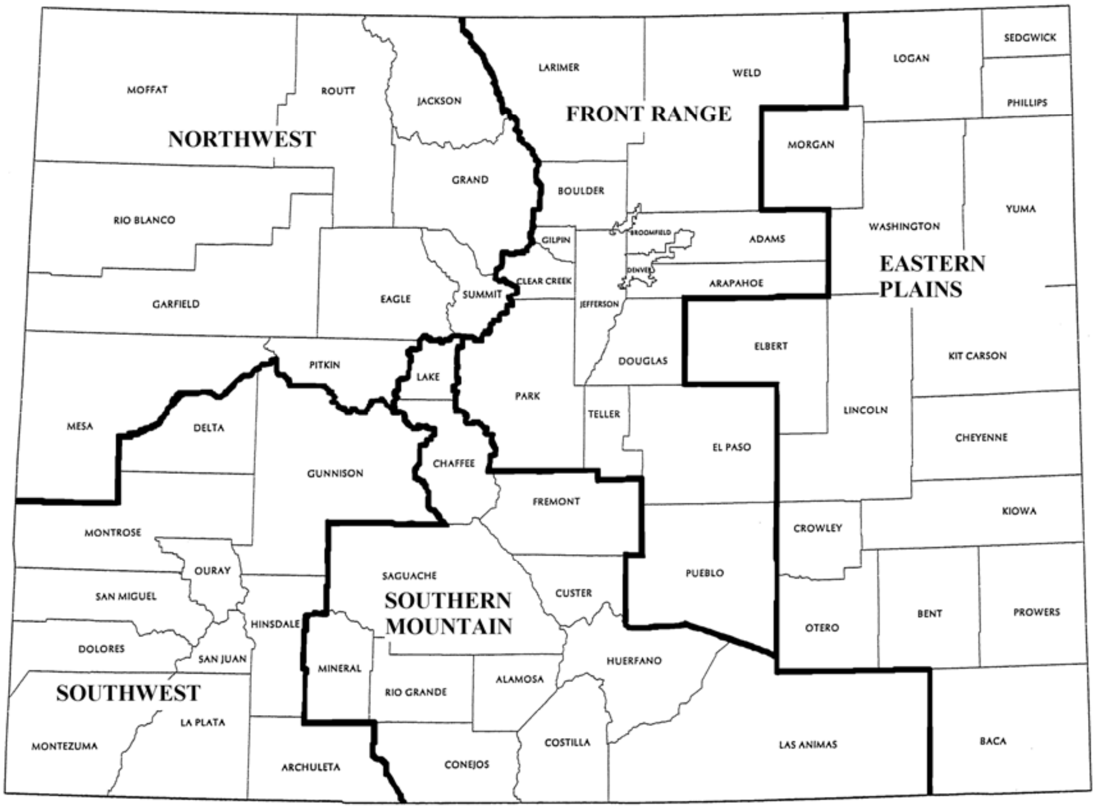
Appendix C
Colorado Counties by Region



Source: Department of Local Affairs.

Eastern Plains: Baca, Bent, Cheyenne, Crowley, Elbert, Kiowa, Kit Carson, Lincoln, Logan, Morgan, Otero, Phillips, Prowers, Sedgwick, Washington, and Yuma Counties.

Front Range: Adams, Arapahoe, Boulder, Broomfield, Clear Creek, Denver, Douglas, El Paso, Gilpin, Jefferson, Larimer, Park, Pueblo, Teller, and Weld Counties.

Northwest: Eagle, Garfield, Grand, Jackson, Mesa, Moffat, Pitkin, Rio Blanco, Routt, and Summit Counties.

Southern Mountain: Alamosa, Chaffee, Conejos, Costilla, Custer, Fremont, Huerfano, Lake, Las Animas, Mineral, Rio Grande, and Saguache Counties.

Southwest: Archuleta, Delta, Dolores, Gunnison, Hinsdale, La Plata, Montezuma, Montrose, Ouray, San Juan, and San Miguel Counties.

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