



# OFFICE OF THE STATE AUDITOR



July 5, 2017

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STATE AUDITOR

## CONSERVATION EASEMENT TAX CREDIT PROGRAM (DECEMBER 2016) STATUS REPORT

Members of the Legislative Audit Committee:

Attached is the status report from the Department of Regulatory Agencies' Division of Real Estate (Division), on the implementation of recommendations in the Office of the State Auditor's (OSA) *Conservation Easement Tax Credit Program, After Changes in 2014* performance audit.

We reviewed supporting documentation from the Division for each recommendation that it reported as having implemented, as follows:

- Documentation of recent application reviews, tracking, and review times
- Documentation and correspondence used to project new applications
- The fee-setting methodology and fee-payment tracking spreadsheets
- Materials for the revised conservation easement update course for appraisers and agendas from roundtables held with appraisers
- Program Annual Reports for 2015 and 2016

Based on our review, the supporting documentation substantiates most of the Division's reported implementation status. However, we identified the following issues that we would like to bring to the Committee's attention:

- Recommendation 1E asked the Division to implement mechanisms to encourage landowners to submit applications throughout the year, such as by setting deadlines for landowners who want to receive application

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decisions by a certain date, to reduce the influx in applications at the end of the year. The Division reports that 1E is “Not Implemented” and has indicated that mechanisms will not be implemented because the Division does not feel it can commit to processing applications within a certain deadline. However, in its update for Recommendation 3C the Division reports that it recommended to the Department’s Office of Policy, Research, and Regulatory Reform (which is conducting the sunset review) that statute should be revised to set application fees throughout the year to respond to the fluctuation in applications. This step may encourage landowners to submit applications earlier in the year or throughout the year, as the audit recommended in 1E.

- Although the Division reported Recommendations 3C, 5A, and 5B as “Implemented”, these recommendations are actually still in process because statutory change has not yet been sought; the Division has made recommendations to the Office of Policy, Research, and Regulatory Reform to revise statutes in these areas.

We have communicated these issues to the Division so that its management and staff are prepared to discuss them and answer any questions from the Committee during the July 24 hearing.



**COLORADO**

**Department of  
Regulatory Agencies**

Division of Real Estate

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June 21, 2017

Dianne E. Ray, CPA  
State Auditor  
Colorado Office of the State Auditor  
1525 Sherman St., 7th Floor  
Denver, CO 80203

Dear Auditor Ray:

In response to your request, we have prepared an updated status report regarding the implementation of audit recommendations contained in the Conservation Easement Tax Credit Program, after changes in 2014. The attached report provides a brief explanation of the actions taken by the Department of Regulatory Agencies and the Division of Real Estate to implement each recommendation.

I understand that the Legislative Audit Committee is seeking an update about the Sunset Review of the Division of Real Estate's Conservation Easement Program. The review is being conducted by the Office of Policy, Research and Regulatory Reform. Sunset reviews are performed independently of the agencies being reviewed. The Sunset Review is ongoing and the report will be released on or before October 15, 2017.

If you have any questions, please do not hesitate to contact me at (303) 894-2422 or by email at [marcia.waters@state.co.us](mailto:marcia.waters@state.co.us).

Sincerely,

Marcia Waters  
Division Director



# AUDIT RECOMMENDATION STATUS REPORT

**AUDIT NAME: Conservation Easement Tax Credit Program, After Changes in 2014,  
Performance Audit**

**AUDIT NUMBER: 1561P**

**DEPARTMENT: Department of Regulatory Agencies, Division of Real Estate**

**DATE OF STATUS REPORT: June 21, 2017**

## SUMMARY INFORMATION

Rec. Number	Agency's Response	Original Implementation Date	Implementation Status	Revised Implementation Date (If applicable)
1a	Agree	July 2017 and ongoing	Implemented and Ongoing	
1b	Agree	July 2017	Implemented	
1c	Agree	July 2017	Implemented	
1d	Agree	July 2017	Implemented	
1e	Agree	July 2017	Not Implemented	
2a	Agree	September 2016	Implemented	
2b	Agree	July 2017	Implemented	
3a	Agree	January 2017	Implemented and Ongoing	
3b	Agree	July 2017	Implemented	
3c	Agree	July 2017	Implemented	
3d	Agree	January 2017	Implemented and Ongoing	
3e	Agree	October 2016 and ongoing	Implemented	
4a	Agree	July 2017	Implemented	
4b	Agree	December 2017	Implemented	
4c	Agree	July 2017	Implemented	
5a	Agree	July 2017	Implemented	
5b	Agree	July 2017	Implemented	
5c	Agree	July 2017	Implemented and Ongoing	

## DETAIL OF IMPLEMENTATION STATUS

**Note: The Department agreed with all of the audit recommendations.**

### **Recommendation No. 1:**

The Division of Real Estate (Division) should implement strategies to reduce the length of time it takes to review applications for conservation easement tax credits and preliminary advisory opinions and to issue its decisions by:

- A. Implementing an ongoing process for analyzing the number of applications that have been processed and are in a queue, and using this information to evaluate the sufficiency of available staffing resources. The Division should then use the results of this evaluation to seek additional staff resources, if needed.

**Current Implementation Status for Rec. 1, part A:** Implemented and Ongoing.

#### **Department's Update:**

*Program staff has been using an access database to track the amount of time each employee spends conducting application reviews. A Google-based system is used to track the progress of the applications through the conservation purpose and appraisal examination processes. The Division also tracks the applications that are in the queue, but that staff has not yet begun reviewing. It takes staff, on average, approximately 23 hours to examine an appraisal that is submitted with a preliminary advisory opinion application. It takes approximately 20 hours, on average, to examine an appraisal submitted with a tax credit certificate application. Staff averages approximately eleven hours completing a conservation purpose review. Following the elimination of the application backlog, the Division believes that the current staffing levels are sufficient to process the declining number of applications. Additionally, the Division has transitioned certified holder applications, renewals, investigations and audits to the Licensing and Investigations Sections of the Division. There are currently four full-time employees dedicated solely to processing the tax credit certificate applications.*

- B. Setting goals for the timeliness of application reviews and for reducing the backlog of applications waiting in queue, and monitoring performance toward such goals and statutory timelines.

**Current Implementation Status for Rec. 1, part B:** Implemented.

**Department's Update:**

*As previously noted, the division is using a Google-based system to track the progress of the applications through the conservation purpose and appraisal examination processes, as well as establish internal timelines for Division staff. This software solution monitors the process and deadlines to better manage staff. Ultimately, the timeliness deadline that the Division continues to identify and track is the 120-day average established by the law. In addition to tracking the time staff spends on reviewing the different components of the tax credit certificate applications and preliminary advisory opinions, the Division hired one independent appraiser and an appraisal firm, with four independent reviewers, to assist the Division with reviewing applications. The contractors assisted with nine appraisal reviews. Between the staff examiners and the contractors, the Division eliminated the "backlogged" applications. Currently the average time to review a tax credit certificate application is 132 days.*

- C. Continuing to identify and implement strategies for improving the efficiency of application reviews.

**Current Implementation Status for Rec. 1, part C:** Implemented.

**Department's Update:**

*As indicated in our initial response, the Division initiated a LEAN project for the Conservation Easement Program in June 2016. As a result of implementing changes from the project, the Division is recognizing positive outcomes from streamlining its review of title exceptions, solely using checklists on reviews of applications without deficiencies, and implementing the use of supplemental narratives to reports documenting deficiencies. The Division has regular, ongoing meetings to discuss the current status of the LEAN project and further potential enhancements.*

- D. Increasing the use of the settlement option for deficiencies in appraisals when the Division has sufficient information to support a negotiated settlement or when such deficiencies are unlikely to affect the value of the tax credit claimed or the credibility of the appraisal.

**Current Implementation Status for Rec. 1, part D:** Implemented.

**Department's Update:**

*To date, the Division has settled nine tax credit applications with appraisal deficiencies. One application was settled in FY2016 and eight were resolved with negotiated settlements in FY2017. The increase in settlements is largely due to the Division no longer requiring that the appraisals be revised so that they are credible prior to reaching a negotiated tax credit certificate issuance amount.*

- E. Implementing mechanisms to encourage landowners to submit applications throughout the year, such as setting deadlines for landowners who want to receive decisions on their applications by a certain date.

**Current Implementation Status for Rec. 1, part E:** Not Implemented.

**Department's Update:**

*The Division has spent a considerable amount of time trying to identify a way to incentivize landowners to participate in a program that already provides a significant monetary reward to landowners who make charitable donations. Due to the uncertainty of the quality of the application materials, the Division does not feel that it would be able to commit to a processing deadline other than the one defined in law. Poor quality application materials that require significant revision causes the applications to take longer to process. Also, revision of the materials is contingent on the schedule of the professional who was engaged to perform the work. The deadlines established by the professionals completing the work is generally separate and distinct from the Division's processing times and causes additional delays.*

*Any further monetary incentive provided to a landowner for an early submission of an application could place the Division in the same predicament it was in with the placeholder certificates. Based on discussions with the Division's legal counsel, this is a position the Division must avoid. The Division ultimately believes that the impetus to submit applications to the Division earlier rather than later lies in the funding mechanism for the program. Delaying applications and an insufficient program fund balance drives up the cost of the program. Active and ongoing participation in the program, as long as there is land to conserve, will stabilize program costs and provide continuity of operations. Based on discussions with the Division's legal counsel, a statutory modification is necessary to allow the Division to set fees throughout the year. If such a change were made to the law, the Division would evaluate fund balances and set fees as necessary to maintain a positive fund balance.*

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**Recommendation No. 2:**

The Division of Real Estate (Division) should address the problems created by the placeholder certificate processes within the Conservation Easement Tax Credit Program (Program) by:

- A. Ensuring that Division administrative staff and Department of Regulatory Agencies budgeting staff understand the purpose of the Program's fees, and the services provided in exchange for the fees.

**Current Implementation Status for Rec. 2, part A:** Implemented.

**Department's Update:**

*As indicated in our original response, the Department has made the necessary adjustment to account for the outstanding liabilities. Division and Department staff engaged in extensive discussions regarding fees, services and liabilities while the audit was occurring and the concerns regarding the placeholder certificates were initially raised. Staff understands the purpose of program fees and services provided.*

- B. Either issuing refunds, as appropriate, to all current holders of placeholder certificates who are not landowners or continuing to track the usage of placeholder certificates for particular applications, depending on the opinion the Division receives from the Attorney General regarding the legality of the placeholder certificates.

**Current Implementation Status for Rec. 2, part B:** Implemented.

**Department's Update:**

*Based on communications with the Office of the Attorney General, the Division completed its reviews of preliminary advisory opinions that were pending in the Division's queue and had stemmed from the issuance of a placeholder certificate. Additionally, the tax credit certificate applications associated with the placeholders and pending in the queue were completed. As of July 1, 2017, the Division has completed processing 60 applications that were generated from the placeholder certificate process. The Division issued refunds for 24 placeholder certificates, totaling \$55,200.00. The Division has tracked the fees and refunds associated with the placeholder certificates until our work with these applications concluded. There are no outstanding placeholder certificates.*

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**Recommendation No. 3:**

The Division of Real Estate (Division) should work with the Department of Regulatory Agencies (Department) to improve the fee-setting process to ensure revenue is sufficient to cover the costs of administering the application review process for conservation easement tax credit certificates by:

- A. Ensuring its fee-setting methodology correctly incorporates the revenue, expenses, and application volume that the Division expects for a single time period and properly accounts for discounted fees.

**Current Implementation Status for Rec. 3, part A: Implemented and Ongoing.**

**Department's Update:**

*As indicated in our initial response, the Department immediately modified its fee documentation for this particular program so that calendar year fee and revenue assumptions and projections are clearly projected on the schedule at the times the fees are actually set. The number of units (applications) are now broken down between actual units received (for the period of the fiscal year that has passed) and the projected units, which for FY17 were estimations from the certified holders, that the Division will receive for the remainder of the fiscal year. In future fiscal years, the Division will no longer need to calculate the impact of the placeholder fees in the fee setting methodology since those have been resolved.*

- B. Improving the accuracy of the projections used to set fees by expanding efforts to work with certified land trusts to obtain accurate information on upcoming conservation easement donations.

**Current Implementation Status for Rec. 3, part B: Implemented.**

**Department's Update:**

*In December 2016, pursuant to the audit recommendation, Division staff conducted a canvas of the 39 certified land trusts and government entities to obtain the number of tax credit certificate applications anticipated would be received by June 30, 2017. The projections supplied by the certified holders was that the Division would receive 119 applications by the end of the fiscal year. The Division used this projection for purposes of fee setting. The Division received 61 applications (22 preliminary advisory opinions and 39 tax credit applications) by June 21, 2017. In future years, the Division may elect to set fees based on prior year application trends or by canvassing the appraisers to gauge how many conservation easement appraisals they estimate completing within the upcoming year.*

- C. Evaluating the most appropriate date to make new fees effective, such as July 1 to correspond with the fiscal year. If the Department and Division determine that a date other than January 1 is more appropriate, they should take steps to change the date, including seeking legislative change if needed.

**Current Implementation Status for Rec. 3, part C: Implemented.**

**Department's Update:**

*The Division has determined that the most appropriate date to adjust fees is throughout the year to respond to the fluctuation in applications and revenue. Based on the current statutory language, legislative changes would be necessary to do so. As the Division indicated in its*

*original response, and based on conversations with legal counsel, the Division has recommended to the Office of Policy, Research and Regulatory Reform that the statute be revised to allow the Division to adjust fees, as necessary to fund the program, throughout the year.*

- D. Setting fees to cover the costs of administering the application review process based on a targeted year-end cash fund balance that is high enough to provide a buffer in the event fee revenue fails to meet expectations, as allowed by statute.

**Current Implementation Status for Rec. 3, part D:** Implemented and Ongoing.

**Department's Update:**

*When fees were set in late December 2016, the Division utilized projections supplied by the certified holders to set fees that would cover the costs of administering the program and provide a higher targeted year-end cash fund balance. As of the close of the fiscal year, the program has a positive fund balance.*

- E. Implementing a process for reconciling its records of fee payments received for each application with the State's accounting system.

**Current Implementation Status for Rec. 3, part E:** Implemented.

**Department's Update:**

*As indicated in our initial response, the Division tracks fee payments on an electronic spreadsheet which is reconciled with CORE. The spreadsheet is updated in real time as applications are received.*

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**Recommendation No. 4:**

The Division of Real Estate (Division) should work to reduce the incidence of rejected conservation easement appraisals submitted with tax credit applications by:

- A. Developing materials, or improving existing materials, to communicate the Division's expectations and appraisal review standards to appraisers. Such materials could include, but need not be limited to, a guidebook on how the Division interprets appraisal standards for documenting analyses.

**Current Implementation Status for Rec. 4, part A:** Implemented.

**Department's Update:**

*On May 5, 2016, the Board of Real Estate Appraisers adopted a permanent rule to require those appraisers who prepare and sign an appraisal for a conservation easement in which a state tax credit may be claimed to complete the "Conservation Easement Update Course". The course, which is offered by an educator independent of the Division, was made available in early November, 2016. The course content covers examples of credible and not credible appraisals, the Uniform Standards for Professional Appraisal Practice and the U.S. Treasury Regulations. Course participants are provided with instructional materials. The Division Director adopted a rule to define "contiguous" to further clarify the Division's expectations of appraisers when they are valuing parcels of land that are physically touching, sharing an edge, boundary or corner. The rule was adopted on April 12, 2017 and became effective on June 14, 2017.*

- B. Improving modes of communicating appraisal review standards to conservation easement appraisers. Improvements could include, but need not be limited to, providing examples of good appraisals in course materials and developing a regular forum for appraisers and Division staff to discuss interpretations of appraisal standards and how to meet the Division's requirements.

**Current Implementation Status for Rec. 4, part B:** Implemented.

**Department's Update:**

*The Division has sponsored quarterly meetings with the conservation easement appraisers to provide an open forum to discuss issues and concerns. The meetings occurred on December 14, 2016, March 14, 2017, and June 14, 2017. There is no requirement of the appraiser to participate in the roundtable discussions. The Division had invited 28 practitioners, who may be interested in performing or currently do conservation easement appraisals, to participate in the meetings, there was approximately eleven attendees at each meeting.*

- C. Pursuing means of providing more information to landowners to help them assess the competency and expertise of conservation easement appraisers.

**Current Implementation Status for Rec. 4, part C:** Implemented.

**Department's Update:**

*On December 8, 2016, the Division published information on its website to assist landowners with questions to ask an appraiser when trying to select one to perform a conservation easement appraisal.*

## **Recommendation No. 5:**

The Division of Real Estate (Division) should improve and expand its public reporting on the benefits the State receives from the Conservation Easement Tax Credit Program (Program) by:

- A. Collecting and reporting on the extent to which the Program helps achieve statewide conservation priorities, such as those articulated in the *State Wildlife Action Plan* and the *Crucial Habitat Assessment Tool*, and on the species and habitats being protected by conservation easements that have been issued state tax credit certificates. If needed, the Division should seek legal guidance and/or statutory change to clarify its authority and responsibility for such reporting.

**Current Implementation Status for Rec. 5, part A:** Implemented.

### **Department's Update:**

*The Division made a recommendation to the Office of Policy, Research, and Regulatory Reform to modify the statutes to “expand the (Division’s) reporting requirements to include information regarding how the program helps achieve statewide conservation priorities, such as those articulated in the State Wildlife Action Plan and the Crucial Habitat Assessment Tool, and on species and habitats being protected by the easements.”*

- B. Seeking a legal opinion from the Office of the Attorney General on whether statute allows the Division to share specific geographic information on conservation easements for which state tax credit certificates have been issued with the maintainers of the Colorado Ownership, Management, and Protection (COMaP) service for the purpose of mapping such easements. If the Attorney General determines that statute does not allow the Division to share such information, the Division should work with the General Assembly to seek legislative change, as appropriate, to allow it to share the information needed by COMaP for mapping the locations of conservation easements for which state tax credit certificates have been issued.

**Current Implementation Status for Rec. 5, part B:** Implemented.

### **Department's Update:**

*The Division sought a legal opinion as to whether it was legally permissible for the Division to share specific geographic information on conservation easements, for which a state tax credit certificate has been issued, with the maintainers of the Colorado Ownership, Management, and Protection (COMaP) service. As a result of that legal opinion, the Division recommended to the Office of Policy, Research, and Regulatory Reform that the law be modified to “allow the Division (if allowable under federal law) to share specific geographic data with the maintainers of COMaP.”*

- C. Issuing statutorily required annual reports earlier, such as by March for the prior calendar year, to include information on the applications received during the previous calendar year regardless of whether a decision has been issued on them

**Current Implementation Status for Rec. 5, part C:** Implemented and Ongoing.

**Department's Update:**

*The 2016 Annual Report was released and posted on the Division's website on April 17, 2017.*

*The 2015 Annual Report was released and posted on the Division's website on May 9, 2017.*

*On a go forward basis, the Division does plan on releasing the annual reports no later April of each year.*