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DEPARTMENT OF NATURAL RESOURCES

STATE LAND BOARD



OCTOBER 2017

PERFORMANCE AUDIT

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October 11, 2017

DIANNE E. RAY, CPA
—
STATE AUDITOR

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Colorado State Board of Land Commissioners (State Land Board) within the Department of Natural Resources. 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, and Section 2-7-204(5), C.R.S., which requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments for purposes of the SMART Government Act. The report presents our findings, conclusions, and recommendations, and the responses of the State Land Board.

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REPORT HIGHLIGHTS



STATE LAND BOARD
PERFORMANCE AUDIT, OCTOBER 2017

COLORADO STATE BOARD OF LAND COMMISSIONERS
DEPARTMENT OF NATURAL RESOURCES

CONCERN

The Colorado State Board of Land Commissioners (State Land Board) did not consistently follow requirements to conduct appraisals when buying and selling land, determine the fiscal impact when selling land for development, and create management plans for land in the Stewardship Trust. In addition, the State Land Board needs to strengthen its policies and procedures for handling conflicts of interest.

KEY FINDINGS

- The State Land Board did not follow the board's appraisal policy for 12 of 23 real estate transactions in Calendar Year 2016. The State Land Board did not conduct required appraisals for 10 properties it bought or sold. For an additional two transactions, the State Land Board did not conduct required review appraisals. Policy requires review appraisals to verify the initial appraisal for property valued at \$5 million or more. In addition, we could not verify that the State Land Board followed its policy for soliciting and selecting appraisers for any of the 15 appraisals it commissioned in Calendar Year 2016. The combined total value of the land in these transactions was about \$27 million.
- In Calendar Year 2016, the State Land Board sold 10 properties for development without making a determination of fiscal impact as required by the Colorado Constitution. Additionally, it did not have documentation on the intended use of 11 other properties it sold, so we could not verify that a fiscal impact study was not required.
- The State Land Board does not have management plans for any of the 104 properties in the Stewardship Trust or stewardship-specific lease terms for any of the 113 grazing leases within the Stewardship Trust, as required by policy. The purpose of these plans and lease terms are to provide tools and measures for protecting and enhancing the natural values of the properties.
- The State Land Board does not have adequate and consistent processes to detect, review, and mitigate staff conflicts or potential conflicts of interest. For example, the disclosure form is incomplete, completed forms are not collected and reviewed in a timely manner, and the State Land Board did not develop a written plan to mitigate one employee's conflict.
- In Calendar Years 2014 through 2016, the State Land Board did not always meet the board governance manual's expectations for how commissioners disclose conflicts and potential conflicts of interest, and how those disclosures are resolved and recorded.

BACKGROUND

- The State Land Board is the trustee of the land granted to the State by the United States Federal Government at the time of statehood and is the second largest landholder in Colorado, after the federal government.
- The State Land Board manages approximately 2.8 million surface acres and 4 million underlying mineral-only acres to generate reasonable and consistent income for Colorado's kindergarten through 12th grade public schools, and other beneficiaries, and provide for the long-term stewardship of the land. About 11 percent of the land is placed in the Stewardship Trust, which the Colorado Constitution sets apart for extra protections due to its natural values.
- The State Land Board generates income for trust beneficiaries primarily by leasing land for natural resource extraction, grazing, and agriculture. In Fiscal Year 2017, revenue was about \$119 million in total.
- In Calendar Year 2016, the State Land Board bought, sold, and exchanged land in 25 transactions of land valued at \$29 million in total.

KEY RECOMMENDATIONS

- Improve controls over appraisals for valuing land that is purchased, sold, or exchanged.
 - Seek legal or statutory guidance and implement policies on determining the fiscal impact of land sales.
 - Develop and follow a timeline for creating Stewardship Trust management plans and add the plans to leases.
 - Develop policies for disclosing and resolving employee conflicts of interest and revise the disclosure form.
 - Clarify conflicts of interest policy for commissioners, including annual disclosures and review of disclosures.
- The State Land Board agreed with all the recommendations.



CHAPTER 1

OVERVIEW

As part of Colorado’s Enabling Act, which allowed Colorado to join the Union in 1876, the federal government granted the State land to be used for specific purposes, in particular, the support of the “common schools.” The land granted to Colorado included both surface land and its underlying mineral assets (e.g., oil and gas). Colorado has an obligation, enforceable under the Supremacy Clause of the United States Constitution, to act as trustee of these lands. The Colorado Constitution established the Colorado State Board of Land Commissioners (State Land Board) as the trustee of the land grant. The State Land Board, a division of the Colorado Department of Natural Resources, is charged

with managing these trust lands to generate income for trust beneficiaries; most significantly, the State’s kindergarten through 12th grade public school system.

Today the State Land Board manages approximately 2.8 million surface acres and 4 million underlying mineral-only acres to generate revenue for beneficiaries. The State Land Board is the second largest landholder in Colorado, after the federal government.

LAND MANAGEMENT

The State Land Board generates income primarily by leasing land for various uses, including grazing; crop production; rights-of-way; commercial development; recreation activities; oil, natural gas, coal, and other solid mineral extraction; and renewable energy uses. The State Land Board’s trust lands are not “public” in the same way as are lands owned by the United States Forest Service or the United States Bureau of Land Management. Because the State Land Board’s first responsibility is to its beneficiaries, its lands are considered private property and, generally, are off-limits to the public.

From Fiscal Years 2010 to 2015, State Land Board revenue increased significantly, reaching approximately \$191 million in Fiscal Year 2015, largely due to oil and gas development. However, due to the recent fall in energy prices, revenue declined in Fiscal Year 2016, with staff predicting it will fall to \$98 million for Fiscal Year 2018.

EXHIBIT 1.1. TOTAL TRUST REVENUE BY REVENUE SOURCE FISCAL YEARS 2014 THROUGH 2017				
REVENUE SOURCE	2014	2015	2016	2017
Minerals Including oil and gas, coal, copper, gravel, uranium, and other minerals	\$ 155,207,000	\$ 167,152,000	\$ 108,382,000	\$ 95,158,000
Surface Including rental payments for grazing, cropland, rights-of-way, recreation, surface use agreements, timber sales, and ecosystem services	13,367,000	15,759,000	18,158,000	17,243,000
Commercial Including rental payments from office buildings, ground leases, communication towers, and renewable energy	4,815,000	3,797,000	4,462,000	5,303,000
Revenue from Land Sales Not Reinvested in New Properties	0	3,751,000	5,303,000	1,355,000
Interest Income	215,000	896,000	972,000	343,000
TOTAL	\$ 173,604,000	\$ 191,355,000	\$ 137,277,000	\$ 119,402,000

SOURCE: Office of the State Auditor analysis of the State Land Board's Fiscal Year 2016 Income and Inventory Report, and Fiscal Year 2017 data provided by the State Land Board.

In general, each parcel of land is tied to one of the nine trusts, and revenue generated by the land is deposited in that particular trust's fund. The federal government transferred land for each trust to the State at statehood through the Enabling Act, and later through other federal legislation. These transfers of land were designed to benefit specific public institutions and interests.

Of the approximately 2.8 million surface acres managed by the State Land Board, 94 percent of the land is held in trust by the State Land Board for Colorado's kindergarten through 12th grade public schools (School Trust). Revenues from the remaining 160,000 surface acres benefit eight smaller trusts as outlined in EXHIBIT 1.2.

EXHIBIT 1.2. ACREAGE, FISCAL YEAR 2017 TRUST DISTRIBUTIONS, AND ASSOCIATED BENEFICIARIES OF TRUST LANDS MANAGED BY THE STATE LAND BOARD			
TRUST	BENEFICIARY/PURPOSE	SURFACE ACRES ¹	FISCAL YEAR 2017 TRUST DISTRIBUTION
School Trust	Congress granted land through the Enabling Act for the support of common schools. Colorado's kindergarten through 12th grade public school system is the beneficiary of the trust.	2,640,000	\$108,044,000
CSU Trust	Congress granted land for endowment, support, and maintenance of an agricultural college. Colorado State University is the beneficiary of the trust.	19,000	\$680,000
Internal Improvements Trust	Congress granted land for the purpose of "internal improvement." Colorado Parks and Wildlife is the beneficiary, as directed by the General Assembly.	46,000	\$138,000
CU Trust	Congress granted land through the Enabling Act for use by and support of a state university. The University of Colorado is the beneficiary of the trust.	3,500	\$45,000
Public Buildings Trust	Congress granted land through the Enabling Act for erecting public buildings for legislative and judicial purposes, as prescribed by the General Assembly. The General Assembly is the beneficiary of the trust.	48	\$36,000
Saline Trust	Congress granted salt spring land through the Enabling Act. Colorado Parks and Wildlife is the beneficiary of the trust, as directed by the General Assembly.	11,000	\$37,000
Forest Trust	Congress exchanged federal land located in northern Colorado for State-owned land that was within United States Forest Service boundaries. The School Trust, Internal Improvements Trust, CSU Trust, CU Trust, and Jackson and Larimer County School Districts are the beneficiaries of the trust.	70,000	\$32,000
Penitentiary Trust	Congress granted land through the Enabling Act for erecting a penitentiary or state prison. The Colorado Department of Corrections is the beneficiary of the trust.	6,800	\$17,000
Hesperus Trust	Congress granted land for an institution of learning where Indian pupils are admitted free of charge. Income from the property is appropriated by the General Assembly for tuition waivers for qualified Indian pupils at Fort Lewis College.	6,300	\$1,900

SOURCE: Office of the State Auditor analysis of the Enabling Act and information provided by the State Land Board.
¹ As of June 2017.

In 1996, Colorado voters passed a constitutional amendment that changed various aspects of the State Land Board's structure and duties. One of the more significant changes resulting from Amendment 16 was the shift in focus away from the State Land Board securing the "maximum possible amount" of revenue from state lands for the beneficiary trusts. Amendment 16 modified the State Land Board's mission to be "providing for the prudent management" of state trust lands "to produce reasonable and consistent income over time" [Colorado Constitution, Article IX, Section 10(1)]. In addition,

Amendment 16 placed focus on stewardship of the lands to protect and enhance the productivity of lands over the long-term by, among other things, the creation of a Stewardship Trust of between 295,000 to 300,000 acres of state trust land (about 11 percent of state trust surface acres). The acres in the Stewardship Trust are to be protected from sale or development unless four of the five board members vote to remove them from the Stewardship Trust and designate an equal or greater amount of land as a replacement. Stewardship Trust lands continue to generate revenue from grazing, crop production, oil and gas production, and mining, as long as such uses are compatible with the conservation of natural resource values. The State Land Board has the duty to ensure that sound stewardship of the natural values of lands placed into the Stewardship Trust will provide long-term economic benefits to trust beneficiaries.

The State Land Board is authorized to acquire land, through purchases or exchanges, when it is beneficial to the trust. The State Land Board reports that it uses land transactions to meet its constitutional duty of prudently managing trust lands by disposing of isolated inholdings and heavily encumbered properties (such as lands with privately-held home sites), purchasing lands for consolidation purposes, and exchanging and purchasing parcels for others with greater income potential.

PROGRAM ADMINISTRATION

The State Land Board is governed by a board of five commissioners that are appointed by the Governor and approved by the Senate with no more than three members from one political party. Article IX, Section 9 of the Colorado Constitution requires that four of the five commissioners have substantial experience in four separate areas: production agriculture, public education, local government and land use planning, and natural resource conservation. The fifth commissioner serves as a citizen-at-large. The Colorado Constitution states that the Governor shall endeavor to appoint commissioners who reside in different geographic regions of the state. Commissioners serve 4-year terms and shall serve no more than two consecutive terms. The Colorado Constitution tasks these commissioners with the following:

“It shall be the duty of the state board of land commissioners to provide for the prudent management, location, protection, sale, exchange, or other disposition of all the lands heretofore, or which may hereafter be, held by the board as trustee pursuant to section 9(6) of this article IX, in order to produce reasonable and consistent income over time” [Colorado Constitution, Article IX, Section 10(1)].

To fulfill their constitutional duties, the commissioners hire a director who employs support staff and is responsible for the day-to-day administrative operations of the State Land Board [Colorado Constitution, Article IX, Section 9(4)]. In this report we refer to the board of commissioners as the “board” and the organization as whole, including the director and staff, as the “State Land Board.”

The State Land Board currently consists of about 40 staff—most of whom are based in Denver—who are responsible for managing properties, mineral assets, commercial buildings, and other trust assets. The State Land Board divides the state into six geographical districts which are each staffed with a district manager and have offices located in Steamboat, Eaton, Sterling, Alamosa, Pueblo, and Lamar. State Land Board staff are responsible for the business, process management, data, and financial operations of the agency’s lines of business, which include: Asset Management (e.g., grazing leases), Surface and Sustainability (e.g., stewardship and recreation), Resource Extraction (e.g., oil and gas), Commercial/Real Estate (e.g., land acquisitions and dispositions), Transactions and Records Services (e.g., processing lease transactions), Data Services and IT, and Finance. In order to manage its various lines of business, State Land Board staff use an Automated Trust Land Accounting System (ATLAS) for the majority of financial operations, processes, and documentation. Examples of this include payment of open invoices, lease applications, inspections, and lessee records.

The State Land Board’s operations are funded through income it generates for trusts; the State Land Board receives no general funds. As

shown in EXHIBIT 1.3, the State Land Board's operating expenses are typically about 4 percent of its total revenue.

EXHIBIT 1.3. OPERATING EXPENSES AS PERCENT OF TOTAL REVENUE FISCAL YEARS 2014 THROUGH 2017 (IN THOUSANDS)				
	2014	2015	2016	2017
Revenue	\$173,604	\$191,355	\$137,277	\$119,402
Operating Expenses	\$7,065	\$6,449	\$6,661	\$6,395
Operating Expenses as a percentage of Revenue	4%	3%	5%	5%

SOURCE: Office of State Auditor analysis of the State Land Board's Fiscal Year 2016 Income and Inventory Report, revised 2016 operating expenses provided by State Land Board, and Fiscal Year 2017 data provided by the State Land Board.

AUDIT PURPOSE, SCOPE, AND METHODOLOGY

We conducted this performance audit 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, and Section 2-7-204(5), C.R.S., the State Measurement for Accountable, Responsive, and Transparent (SMART) Government Act. The audit was prompted by a legislative audit request related to concerns over the processes for handling land acquisitions and leases. Audit work was performed from December 2016 to September 2017. We appreciate the assistance provided by management and staff at the State Land Board.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The key objectives of this audit were to evaluate the controls to (1) ensure the prudent management of the acquisition and disposal of land to benefit the trusts/beneficiaries; (2) ensure that the State Land Board produces reasonable and consistent revenue from grazing leases while

also ensuring that the lands meet stewardship expectations; and (3) prevent, detect, and address conflicts of interest in the State Land Board's execution of responsibilities.

To accomplish our audit objectives, we performed the following audit work:

- Reviewed the relevant requirements in the Colorado Constitution, statutes, policies, and guidance related to the management of state trust lands and conflicts of interest.
- Interviewed State Land Board staff.
- Reviewed documentation for all Calendar Year 2016 land acquisitions, dispositions, and exchanges.
- Reviewed the State Land Board's processes for awarding grazing leases through competitive bidding when the existing lessee had rights outlined in statute [Section 36-1-118, C.R.S] and for establishing grazing rates applicable in Calendar Year 2016.
- Reviewed documentation of public notice for grazing leases expiring in Calendar Year 2016.
- Reviewed all staff conflicts of interest disclosure forms and outside employment requests for Calendar Year 2016.
- Reviewed documentation and listened to relevant board proceedings for all reported instances of commissioners or staff verbally disclosing conflicts or potential conflicts of interest in Calendar Years 2014 through 2016.
- Gathered best practices on conflicts of interest policies from other state boards.

We relied on the following non-statistical samples to support our audit work:

- A random sample of 20 grazing leases that began in Calendar Year 2016 to test the State Land Board's controls over identifying lands suitable for grazing, executing complete and accurate contracts, collecting payments, and monitoring the stewardship of the land.
- A random sample of three Calendar Year 2016 grazing leases on land designated as part of the Stewardship Trust to test whether the leases had management plans and lease addenda as required by policy.
- A random sample of seven leases with subleases authorized during Calendar Year 2016 and a random sample of five leases that were assigned, in full or in part, to a different party during Calendar Year 2016 to test whether the State Land Board followed applicable policies and processes.

The results of our testing using these samples were not intended to be projected to the entire population. Rather, the samples were selected to provide sufficient coverage to test controls of those areas that were significant to the audit objective relating to the management of grazing leases.

We planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Our conclusions on the effectiveness of those controls, as well as specific details about the audit work supporting our findings, conclusions, and recommendations, are described in CHAPTER 2 of this report



CHAPTER 2

LAND TRANSACTIONS, GRAZING LEASE MANAGEMENT, AND CONFLICTS OF INTEREST

The State Land Board manages state trust lands to generate income for trust beneficiaries, which it does through buying, selling, and exchanging lands, and leasing existing trust lands to others. For example, the State Land Board will conduct land transactions to dispose of isolated in holdings and heavily

encumbered properties (such as lands with privately-held home sites), or to acquire lands with greater income potential. In Calendar Year 2016, the State Land Board conducted a total of 25 land transactions.

The State Land Board has about 2,000 active grazing leases, which covered approximately 2.4 million of the State Land Board's 2.8 million surface acres (86 percent) and generated \$7.9 million in revenue during Fiscal Year 2016.

Our audit work did not identify any findings or recommendations related to a number of aspects of the State Land Board's operations, including identifying lands suitable for grazing, collecting payments, or stewardship on non-Stewardship-Trust land; the process to establish grazing rates; sub-leasing and assignment of grazing leases; or the process of assessing competitive lease bids. However, we did identify findings related to conducting appraisals in land transactions; fiscal impact studies when selling or exchanging land for development; managing grazing leases that are part of the Stewardship Trust; posting all expiring grazing leases; and the need to strengthen conflict of interest processes.

LAND APPRAISALS

The State Land Board periodically buys, sells, or exchanges land to meet its constitutional duty of prudently managing state trust lands. The State Land Board's strategic plan calls for strategic disposal of assets, such as land, to allow for acquiring assets that provide greater return and diversify the portfolio. For example, the State Land Board explained that it is trying to acquire properties in western Colorado as one of its methods to diversify its portfolio since a large percentage of its current properties are in eastern Colorado. In Calendar Year 2016, the State Land Board conducted a total of 25 land transactions, including 20 sales of land sold for a combined total of about \$2.9 million, four exchanges involving properties State Land Board valued at a combined total of about \$19.9 million, and one acquisition purchased for \$6.2 million.

As part of carrying out a land transaction, the State Land Board considers

the value of the land that it is buying, selling, or exchanging. An appraisal is commonly used to estimate the property's market value. To estimate the market value of lands prior to sale, purchase, or exchange, the State Land Board either contracts for the services of an independent, third-party appraiser, or has staff conduct a market analysis.

WHAT AUDIT WORK WAS PERFORMED AND HOW WERE THE RESULTS MEASURED?

We reviewed documentation from the State Land Board for all 25 land transactions that occurred in Calendar Year 2016, of which 23 required an appraisal, and the associated 15 appraisals that the State Land Board commissioned. The purpose of this work was to evaluate whether the transactions complied with State Land Board policy for conducting appraisals and whether the State Land Board has adequate internal controls for to documenting processes related to appraisals.

STATE LAND BOARD POLICY FOR APPRAISALS. In order to “find and select the best qualified appraisers, and to accurately determine asset value across diverse geography and in changing market conditions,” State Land Board policy [Policy 600-001] establishes criteria for commissioning appraisals, as described below:

- **PROPERTIES WITH AN ESTIMATED VALUE OF AT LEAST \$10,000 MUST BE APPRAISED PRIOR TO A TRANSACTION.** In addition, for properties valued at \$5 million or more, State Land Board policy requires a review appraisal conducted by a different licensed appraiser. According to the *Uniform Standards of Professional Appraisal Practice*, review appraisals are typically conducted to verify that the initial appraisal credibly estimates the value, such as market value, of the property and follows appraisal standards.
- **APPRAISERS NEED TO BE APPROPRIATELY SELECTED.** State Land Board policy outlines the following requirements to ensure that it selects qualified appraisers.

- ▶ Staff must conduct a public solicitation process that includes soliciting a minimum of three bids for each transaction.
- ▶ Staff must conduct a review of the appraiser’s past work, which includes contacting work references and the Division of Real Estate in the Department of Regulatory Agencies.
- ▶ Staff must verify comparable sales used in the appraisals against pertinent sales in the Ranchland Sales Database, which contains listings and sales data on ranch lands, or other sales information. The State Land Board reports that the purpose of this verification is to provide an overall quality assurance review of the appraisal to verify the credibility of the estimate.

GOVERNMENT INTERNAL CONTROL STANDARDS. As of February 2016, the Colorado State Controller directed all state agencies to adhere to *Standards for Internal Control in the Federal Government*. According to these standards, documentation is a necessary part of an effective internal control system and is required to demonstrate the design, implementation, and operating effectiveness of an agency’s internal control system [Section OV4.08, GAO-14-704G]. This allows for management to communicate internal controls to personnel and provides a means to retain organizational knowledge, mitigate the risk of having knowledge limited to a few personnel, and communicate that knowledge to external parties as needed [Section 3.10, GAO-14-704G].

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY AND WHY DID THEY OCCUR?

We found that 12 of the 23 Calendar Year 2016 transactions that required an appraisal did not follow the State Land Board’s policy for appraisals and the appraisal processes were not documented for any of the 15 appraisals commissioned. The combined value of the land in these transactions was approximately \$27 million. We outline these problems as follows:

LACK OF APPRAISALS. Of the 23 transactions that involved properties that met the \$10,000 estimated value threshold, the State Land Board did not have appraisals done for 11 of them. In one instance staff requested the board waive the appraisal requirement; the board approved the transaction to continue without an appraisal. For the other 10 transactions, staff did not seek board approval to waive the appraisal requirement. Specifically:

- In nine cases, the State Land Board sold two-and-half acre lots for residential development. The sale price of the lots was between \$180,000 and \$220,000 each, for a total of \$1.8 million for the nine lots. Staff reported two reasons for why they had not conducted appraisals for these properties. First, staff reported that appraisals for these lots would not provide any new information because comparable sales in the area consisted primarily of lots that the State Land Board had already sold for development. Second, the contract for the sale of these properties was originally initiated in 1992, which was prior to the development of the appraisal policy, and required the board come to an agreement on the prices with the developer. However, the current contract also requires annual review of the sales prices and the State Land Board reported that it has annually reviewed the values of the unsold lots by taking into consideration assessor data, comparable sales, and market demand, as well as input from the developer. State Land Board policy does not provide any exceptions to the requirement for an appraisal when a transaction involves property worth at least \$10,000.

- In one case, the State Land Board traded state trust land appraised at \$72,000 for \$50,800 in cash plus a new property which the owner estimated was worth \$21,200. State Land Board staff did not commission an appraisal for the acquired property because they had estimated its value at under \$10,000. Staff reported that this estimate did not take into account the intended use of the property to obtain access to a separate state trust property, but the owner's estimate did account for the intended use. State Land Board policy does not provide staff with any guidance in estimating the value of land to determine if an appraisal is needed, such as the extent to

which the estimate should include the value of the intended use.

LACK OF REVIEW APPRAISALS. In two cases, State Land Board staff did not commission review appraisals for land transactions in excess of \$5 million each. One was a property the State Land Board purchased for \$6.2 million and another was a land exchange in which the State Land Board acquired a \$9.9 million property in exchange for cash and an \$8.4 million property. The State Land Board reported that it was not sure why staff did not commission review appraisals for these transactions.

LACK OF BROAD PUBLIC SOLICITATION PROCESS. The State Land Board did not use a wide-reaching public solicitation process when selecting any appraisers in Calendar Year 2016. Instead, staff told us that they contacted appraisers by phone or email and considered this approach to constitute public solicitation; they reported that it is not the intent of the policy to require a public notice, such as in newspapers or on the board’s website. Board policy does not provide any guidance on how a “public solicitation” should be achieved. However, making individual phone calls and emails to an unknown number of appraisers appears to provide limited opportunities for the public to respond.

LACK OF EVIDENCE THAT APPRAISAL SOLICITATION, REVIEW, AND VERIFICATION POLICY WAS FOLLOWED. We could not verify that State Land Board staff followed board policy related to soliciting, selecting, and reviewing the appraisers for any of the 15 appraisals commissioned for Calendar Year 2016 transactions, as outlined below.

- The State Land Board did not have documentation to show that it had solicited a minimum of three bids for two of the 15 appraisals. The State Land Board told us it did solicit a minimum of three bids for all appraisals but had no documentation for these two bids because they were solicited by phone.
- The State Land Board did not have documentation showing that it had conducted a review of references and confirmed appraiser licenses for all appraisers who conducted appraisals in Calendar Year 2016. The State Land Board told us that all reviews and

confirmations had been completed.

- The State Land Board did not have documentation that it had reviewed each appraisal in Calendar Year 2016 and verified comparable sales using its database. The State Land Board told us that all appraisals had been verified.

The State Land Board does not require staff to document that they are adhering to policies. Staff told us that documenting all of their actions would be time consuming and would not add value to their operations.

WHY DO THESE PROBLEMS MATTER?

One of the State Land Board's constitutional duties and core responsibilities as trustee is to make sound and balanced land use decisions that generate reasonable and consistent income for both current and future trust beneficiaries. When the State Land Board buys or sells property without first having appraisals performed in accordance with its policy, the State Land Board risks not having the information it needs to ensure that it does not pay more than necessary or obtains the best prices. For example:

- The State Land Board sold nine lots for residential development (described above) and accepted prices established in 2011 ranging from \$180,000 to \$220,000 per lot without having had appraisals performed in either 2011 or 2016. Although the State Land Board's annual review of the lot values along with the contractual requirement to agree to the prices with the developer may have resulted in appropriate pricing, obtaining appraisals could have provided the State Land Board with additional information for negotiating the best prices. According to the El Paso County Assessor's Office, the county in which the lots are located, the average price of comparably sized vacant residential lots in El Paso County increased by roughly 29 percent between 2011 and 2016.
- The State Land Board paid \$21,200 in an exchange (noted above) which was more than twice the \$10,000 value staff had estimated for the land. When the lack of an appraisal occurs due to an

inaccurate estimate of a property's value (i.e., by not accounting for the intended use of the land), the risk of paying too much is compounded because the State Land Board does not have appraisal information to help it determine an appropriate price.

- Failing to obtain review appraisals for land transactions in excess of \$5 million prevents the board from receiving the intended assurance that the initial appraisal is a credible estimate of a property's value. As a result, there is a risk that the State Land Board will pay too much to acquire a property or accept too little in disposing of a property.

Often, public solicitation to obtain a specified minimum number of bids for services is used to ensure competition and identify the best provider of the service for the best price. When State Land Board staff do not use a broad-reaching process to solicit appraisals, and if they do not routinely solicit at least three appraisals, they may not be meeting the board's expectations and may not hire the most qualified appraiser at the best price. However, since the State Land Board paid an average of \$1,400 for each appraisal, or a total of approximately \$21,000, for Calendar Year 2016 transactions, it may not be cost-beneficial to seek competition for appraisal bids through an expanded public solicitation effort. As such, it may be appropriate for the board to revise its requirements for public solicitation of a minimum number of appraisal bids.

Finally, the State Land Board's policies are designed to promote transparent and effective trust management practices. When staff do not document that they follow policy for hiring appraisers, they are not operating in a transparent manner that is consistent with expectations for good internal controls and the commissioners do not have assurance that staff are actually following the policies that the board has established.

RECOMMENDATION 1

The State Land Board should improve its internal controls over the valuation of land transactions by:

- A Establishing a written policy requiring that any estimate of land value used to determine the need for an appraisal take into account the value of the intended use of the land.
- B Enforcing the requirement to obtain appraisals as specified in policy, or modifying the policy as appropriate.
- C Enforcing the requirement to obtain review appraisals for transactions involving land valued at \$5 million or more.
- D Providing direction through written policy or procedures, about how staff should conduct a “public” solicitation for appraisers, and ensuring that the direction is consistent with a common understanding of public solicitation, or modifying the requirements for public solicitation from at least three appraisers if the board determines that the policy is not cost effective.
- E Providing direction through written policy or procedures, requiring staff to document their solicitation of appraisers, review of appraisers’ past work, and verification of appraisals.

RESPONSE

STATE LAND BOARD

AGREE. IMPLEMENTATION DATE: MARCH 2018.

The State Land Board will review, modify, adopt, and enforce policies and procedures to address RECOMMENDATIONS 1A through 1E.

FISCAL IMPACT STUDIES

The lands granted by the federal government at statehood were scattered across the state in a mostly checkerboard pattern. Because the majority of the land is still located in rural, agricultural areas, most of the State Land Board’s properties have not been developed, and the Land Board has served as a major source of open land in Colorado. In fact, the State Land Board owns 4 percent of the State’s surface acreage, and about 2.7 million of its 2.8 million acres are leased for agriculture, rather than for mining, oil and gas development, or other commercial or industrial uses. According to our review of a number of sources, in the early 1990s, the State Land Board was involved in several real estate transactions that would have developed some of its undeveloped lands that many community members viewed as particularly picturesque. These plans were ultimately canceled due to public criticism by individuals and groups who wanted to keep many state trust lands as “open space,” some of which spurred the successful passage of Amendment 16 of the Colorado Constitution.

Amendment 16 specified that the “economic productivity of all lands held in public trust is dependent on sound stewardship, including protecting and enhancing the beauty, natural values, open space, and wildlife habitat thereof for this and future generations.” Amendment 16 required the State Land Board to provide for the “prudent management” of the lands, including through the sale and exchange of lands, “in order to produce reasonable and consistent income over time” [Colorado Constitution, Article IX, Section 10(1)]. In Calendar Year 2016, the State Land Board engaged in a total of 25 land transactions. Of these, 24 were disposals of trust properties through either sales or exchanges that involved approximately 4,300 acres of property valued at about \$23 million combined.

WHAT AUDIT WORK WAS PERFORMED, WHAT WAS THE PURPOSE, AND HOW WERE THE RESULTS MEASURED?

We reviewed the 24 land sales and exchanges that closed in Calendar Year 2016 to determine whether the State Land Board completed fiscal

impact studies as required by the following constitutional, statutory, and policy provisions:

- Amendment 16, established in Article IX, Section 10 of the Colorado Constitution, requires the State Land Board to determine the fiscal impact of lands leased, sold, or exchanged for development as a component of the broader stewardship expectations that the State Land Board is obligated to fulfill. Specifically, the Constitution requires that prior to the lease, sale, or exchange of any lands for commercial, residential, or industrial development, the State Land Board must “determine that the income from the lease, sale, or exchange can reasonably be anticipated to exceed the fiscal impact of such development on local school districts and state funding of education from increased enrollment associated with such development” [Colorado Constitution, Article IX, Section 10(1)(a)]. This requirement is echoed in Section 36-1-112.5, C.R.S., regarding fiscal impact studies.
- State Land Board policy issued in May 2016 [Policy 200-006] states that these provisions of the Constitution and statute “require the Board to conduct a fiscal impact study prior to the lease, sale, or exchange of any lands for commercial, residential, or industrial development...” The policy also states that a fiscal impact study should be timely, cost-effective, and based on reasonable cost assumptions and may require consultation with appraisers and industry experts.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

LACK OF REQUIRED FISCAL IMPACT STUDIES. Ten of the State Land Board’s Calendar Year 2016 sales or exchanges involved properties that were intended to be used for development, but the State Land Board did not comply with requirements to conduct fiscal impact studies.

- The State Land Board sold nine parcels that were part of a contract to sell a total of 52 parcels for residential development in El Paso County. These nine parcels were sold for a combined total of \$1.8 million in Calendar Year 2016. The State Land Board reports that

it had previously sold 34 lots and nine remained unsold at the end of 2016. The State Land Board reported two reasons they had not conducted fiscal impact studies for these transactions. First, they believe fiscal impact studies would not be useful for these transactions; we discuss the State Land Board’s reasoning on the nine residential lots below, under “Why Did These Problems Occur and Why Do They Matter?”. Second, they did not believe that fiscal impact studies were required since the contract with the developer was originally initiated in 1992, before the passage of Amendment 16 in 1996. However, it is not clear that the sale of these residential lots in Calendar Year 2016 was clearly excluded from the fiscal impact study requirement because the formula used to determine the State Land Board’s proceeds from the Calendar Year 2016 sales had been renegotiated in 2011, after the fiscal impact requirement was in place.

- The State Land Board exchanged two downtown Denver properties, obtaining one parcel valued at approximately \$9.9 million and relinquishing a parcel valued at about \$8.4 million. Documentation provided to the board in June 2015, when staff outlined the proposed exchange for the board’s consideration, indicated that the new owner intended to establish a charter school and create housing and other retail resources on, or adjacent to, the property the State Land Board was disposing of. The State Land Board agrees, in retrospect, that it should have commissioned a fiscal impact study on the exchange.

LACK OF DOCUMENTATION OF INTENDED USE OF LAND SOLD OR EXCHANGED. Eleven of the State Land Board’s disposals through either sales or exchanges in Calendar Year 2016 involved properties that the State Land Board reported did not need fiscal impact studies because they would not be used for commercial, residential, or industrial development. The State Land Board reported that most of the properties were sold to the existing grazing lessees who said that they intended to keep using the land for agricultural and grazing purposes. The State Land Board also noted that the properties were zoned for either agricultural use or natural resource preservation and are miles away

from the nearest town, which reinforced their conclusion that there would be no fiscal impact on the schools. However, the State Land Board had no documentation of the intended use of these properties by the buyers and does not have a process to ask buyers how the land will be used. As a result, we were unable to verify that these properties would not be used for development and that the requirement for a fiscal impact study was therefore not applicable. In contrast, for three of the 24 Calendar Year 2016 properties disposed of through either sales or exchanges, the State Land Board did have documentation demonstrating that the buyers did not intend to use the property for commercial, residential, or industrial development, and therefore no fiscal impact study was required.

The State Land Board also had no documentation outlining the factors it considered when determining whether a fiscal impact study was needed or how it arrived at its conclusions on whether or not to conduct a fiscal impact study.

WHY DID THESE PROBLEMS OCCUR AND WHY DO THEY MATTER?

LACK OF CLARITY REGARDING THE VALUE OF FISCAL IMPACT STUDIES. The main reason the State Land Board did not conduct fiscal impact studies for some land disposals appears to be that it believes such studies would not be useful. For example, for the sale of nine lots discussed above, the State Land Board told us that there was no value in conducting a fiscal impact study because the contract that guides the sale of the lots, which was initiated in 1992 before Amendment 16 required a fiscal impact study, does not allow the State Land Board to unilaterally set lot prices—the State Land Board and the developer must agree on the prices. However, since the contract requires sales prices to be reviewed annually, a fiscal impact study could have helped the State Land Board to determine whether the lot sales in 2016 would reasonably have been anticipated to generate income that exceeded the fiscal impact to schools, and if not, to work with the developer to revise the pricing.

Another example the State Land Board provided regarding the lack of value in conducting fiscal impact studies is that it is the role of local jurisdictions to weigh any resulting impacts on local school districts and ensure that school districts receive any necessary extractions, which is a form of compensation from developers. As a result, the State Land Board believes that there is a mechanism already in place to help offset the costs of development for local school district. However, the Colorado Constitution gives the State Land Board no latitude in leaving fiscal impact studies to local jurisdictions.

THE STATE LAND BOARD NEEDS TO ASSESS ITS FISCAL IMPACT MODEL. In addition to questioning the value of conducting fiscal impact studies, the State Land Board reports that it does not know how it could obtain accurate data for fiscal impact studies. However, the State Land Board developed a fiscal impact model as a result of our 2005 performance audit, which includes components such as estimates of the number of students to be added, property taxes to be generated, and the overall impact of capital construction. State Land Board staff reported that the model has not been used in almost 10 years and they have not assessed its effectiveness in fulfilling the constitutional, statutory, and policy requirements.

THE STATE LAND BOARD MAY BE INTERPRETING THE FISCAL IMPACT STUDY REQUIREMENT TOO NARROWLY. The citizens and the General Assembly may have intended the requirement for fiscal impact studies to have a broader purpose than that identified by the State Land Board. The requirement to assess the fiscal impact before selling, exchanging, or leasing land for development was part of a larger new directive in Amendment 16 for the State Land Board to carry out a dual mandate of both ensuring consistent revenue for the trusts (rather than maximizing revenue, as had previously been required), while also ensuring the stewardship of lands. Historically, the State Land Board's properties have served as a major source of open land in Colorado. The Blue Book characterized Amendment 16 as "requiring the board to manage lands held by the board in order...to recognize that economic productivity and sound stewardship of such lands includes protecting and enhancing the beauty, natural values, open space, and wildlife habitats thereof..." and embedded the fiscal impact study requirement

within a broader obligation that the board take “actions to protect the long-term productivity and sound stewardship of the lands held by the board.” The first item listed in the Arguments For section of the Blue Book also emphasizes the new focus on balancing natural values with revenue, stating:

“It is time for the board to help meet the challenge of preserving open space in Colorado. The increasing population of Colorado and the pressures for land development that this growth causes make maintaining the natural beauty and attractiveness of the state a priority. The trust lands will be managed in a way that balances the importance of natural values, open space, wildlife habitat with traditional uses, such as farming and ranching, and raising revenue for public schools and other beneficiaries. Land is one of the most precious resources of Colorado, and the state should preserve as much of it as possible for the benefit of future generations.”

Therefore, although the requirement is narrowly stated as weighing the fiscal impact of a land transaction on local schools against the income to be gained, the intent may have been that the State Land Board not approve the sale of open space or natural habitats for residential, commercial, or industrial development without first ensuring that reducing the state’s open and natural spaces would result in added financial benefits to schools. This interpretation would mean that the State Land Board should also consider whether the loss of open space and natural habitats is offset by increased school support. The State Land Board has not sought legal guidance on interpreting this requirement, such as through a formal or informal opinion from the Attorney General, in relation to the overall context of the amendment nor has it sought legislative changes to clarify the intent.

When the State Land Board does not determine the fiscal impact of a lease, sale, or exchange of land for development without first having analyzed the potential fiscal impact on local schools, not only is it out of compliance with the Colorado Constitution, statutes, and its own

policy, there is a risk that the board will approve a transaction in which the impact to schools outweighs the income generated for the trust. When the State Land Board does not document its decision making about when a fiscal impact study is needed and its resulting conclusions, it is not operating as transparently as it could and there is a risk that the process and decisions are not fully communicated to the commissioners.

RECOMMENDATION 2

The State Land Board should ensure that it complies with the requirement to determine the fiscal impact of a lease, sale, or exchange for development by:

- A Seeking legal or statutory clarification of the intent of the requirement for conducting fiscal impact studies.
- B Implementing policies and procedures to conduct fiscal impact studies when required and document how the need for the study was determined and the results.
- C Reviewing the effectiveness of the existing fiscal impact study model and modifying or replacing it to serve as an effective means to conducting fiscal impact studies as needed.

RESPONSE

STATE LAND BOARD

- A AGREE. IMPLEMENTATION DATE: NOVEMBER 2017.

The State Land Board will request that the Colorado Attorney General's office prepare an analysis of the constitutional and statutory requirements for a determination of fiscal impact.

- B AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will adopt policy modifications consistent with the analysis prepared by the Colorado Attorney General's office (see answer to RECOMMENDATION 2A above).

- C AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will review the existing fiscal impact study model in light of the analysis prepared by the Colorado Attorney General office and modify or replace it as appropriate.

STEWARDSHIP TRUST LANDS

In 1996, Colorado voters passed Amendment 16, which changed the State Land Board’s constitutional mandate from maximizing revenue to producing “reasonable and consistent income over time.” It also added new stewardship-related responsibilities to the State Land Board’s duties, including requiring the State Land Board to designate between 295,000 and 300,000 acres of land as part of a long-term Stewardship Trust. According to the Colorado Constitution, lands in the Stewardship Trust are to be “held and managed to maximize options for continued stewardship, public use, or future disposition, by permitting only those uses...that will protect and enhance the beauty, natural values, open space, and wildlife habitat thereof” [Colorado Const., Art. IX, Sec. 10(1)(b)(l)]. Statute [Section 36-1-107.5(1), C.R.S.] requires that “any such restrictions on use need not necessarily preclude existing uses or management practices including but not limited to mineral resources, agricultural, and grazing uses.” As of September 2017, the State Land Board has designated 130 parcels that cover about 296,000 acres on a total of 104 State Land Board properties as Stewardship Trust lands. This comprises about 11 percent of all state trust lands.

When acreage is designated as a Stewardship Trust property, the State Land Board can still lease the land for grazing, recreation, oil and gas extraction, and other uses. However, if staff wish to introduce a new land use after designation, they need to go through a review process involving input from stakeholders and citizens. A lease involving Stewardship Trust land requires additional stewardship by both the lessee and the State Land Board in order to protect the special resources for which the land was designated, such as rare plants, undeveloped land of statewide significance, or archeological sites. As of March 2017, there were 113 grazing leases on Stewardship Trust properties, 13 of which started in Calendar Year 2016.

WHAT AUDIT WORK WAS PERFORMED, WHAT WAS THE PURPOSE, AND HOW WERE THE RESULTS MEASURED?

We requested the State Land Board’s documentation for three of the 13 grazing leases that started in Calendar Year 2016 on Stewardship Trust properties. The purpose of the audit work was to evaluate whether grazing leases comply with the following requirements:

MANAGEMENT PLANS. The State Land Board’s policy for managing Stewardship Trust properties [Policy 400-001] requires each property to have a baseline inventory of the natural values and general conditions of the property to document the state of the parcel upon designation as a Stewardship Trust property. The policy states that baseline inventories should be used by the State Land Board to help create “science-based management plans...containing clear guidelines, tools, and measures necessary to protect and enhance the natural values identified in the appropriate baseline inventory and any subsequent inventories or inspections.” State Land Board staff are expected to conduct inspections of Stewardship Trust properties at least once every 3 years and use the inspection results to update management plans as needed to help ensure the continued safeguarding of the natural values of the properties.

STEWARDSHIP-SPECIFIC LEASE TERMS. The Colorado Constitution [Colorado Constitution, Article IX, Section 10(1)(b)(II)] requires that agricultural leases include “terms, incentives, and lease rates that will promote sound stewardship and land management practices, long-term agricultural productivity, and community stability.” State Land Board policy [Policy 400-001] additionally requires each lease on Stewardship Trust properties to have an addendum that includes a summary of the identified natural values on the property and recommended management practices for the lessee to follow to preserve those resources.

SIGNED LEASE AGREEMENTS. In addition, State Fiscal Rules [1 CCR 101-1, Rule 3-1, (7)] require agencies to “obtain all required approvals and signatures and retain documentation thereof in its files” for its

contracts, which includes grazing lessees. Therefore, we expected that the State Land Board would have leases that are signed by both parties for all grazing leases.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

NO STEWARDSHIP TRUST PROPERTIES HAD MANAGEMENT PLANS. None of the Stewardship Trust properties associated with the three leases in our sample had management plans. When we asked the State Land Board about this, staff reported that they did not have plans for any of the 104 properties in the Stewardship Trust. Staff reported that some Stewardship Trust lands have assessments and plans from other organizations that include some of the information that a management plan would contain. For example, state parks officials have created plans to monitor and manage specific species and recreation opportunities on some Stewardship Trust properties that fall within state parks, and the Nature Conservancy submits an annual report to the State Land Board that summarizes progress on its habitat protection and stewardship goals on state trust lands. However, the State Land Board reported that only 30 of the 104 total Stewardship Trust properties, totaling just under half of the 296,000 acres, have assessments or plans developed by other agencies. Further, staff indicate that some of these documents might serve in lieu of the management plan but others will be a “starting point” for developing management plans because they are not comprehensive enough to take the place of management plans. For example, these assessments and plans do not necessarily contain clear guidelines, tools, and measures necessary to protect and enhance the natural values identified in the appropriate baseline inventory.

NO LEASES HAD STEWARDSHIP TRUST ADDENDA. None of the three leases in our sample contained Stewardship Trust addenda. When we asked the State Land Board about this, staff reported that they had not attached addenda to any of the 113 grazing leases within the Stewardship Trust. The leases do not include a summary of the natural resources on the property or recommended property-specific management practices for the lessee to follow to preserve those resources.

ONE LEASE WAS NOT SIGNED. For one of the grazing leases on Stewardship Trust lands that went into effect in November 2016, the State Land Board had not obtained a signed copy of the lease from the lessee as of May 2017, about 6 months after the lease became effective. Between May and August 2017, the State Land Board obtained the lessee's signature, but the date of the lessee's signature was missing, so it is not clear when the lease was fully executed. Staff also reported in August 2017 that they had identified another lease for which they had not obtained a signed copy.

WHY DID THESE PROBLEMS OCCUR?

THE STATE LAND BOARD LACKS AN IMPLEMENTATION TIMELINE FOR CREATING MANAGEMENT PLANS. The State Land Board created the policy requiring management plans for Stewardship Trust properties in 2014, but reported that staff have not had enough time to complete management plans for any Stewardship Trust properties. State Land Board staff reported that the board has prioritized other duties, such as creating plans that protect crucial species or habitats across all State Land Board properties and developing best management practices for grazing, oil and gas, renewable energy, and other lines-of-business. According to the State Land Board, because the lease addenda should contain recommended practices based on the management plans, the State Land Board has not had the information it needs to create the lease addenda.

Although the State Land Board reported that it will begin developing management plans and adding addenda to leases in the fall of 2017, this will require significant resources and the State Land Board does not have a timeline for completing the plans. Staff estimate that it would take an average of about 20 hours to complete each of the 104 plans, or roughly 2,100 hours in total. Staff estimate that once management plans have been created for each Stewardship Trust property, it would take 1 to 4 hours per lease to prepare the lease addenda and obtain signatures from the lessees. Therefore, in total, developing the management plans and lease addenda would require roughly 2,200 to 2,500 hours of staff time, more than one FTE.

The State Land Board’s 2017 strategic plan calls for the State Land Board to “develop and implement clear science-based management plans containing guidelines, tools, and measures to guide management of identified natural values on Stewardship Trust lands,” which staff reported are the same management plans as the ones required by policy. However, the strategic plan does not contain an implementation date for this goal, so it is unclear when the State Land Board intends to complete all of the management plans. Establishing an implementation date could help the State Land Board in scheduling the development process and help ensure that the management plans and addenda are implemented as soon as possible.

STATE LAND BOARD LACKS A RELIABLE SYSTEM TO ENSURE THAT IT RECEIVES SIGNED LEASES. Staff track whether they have received a signed lease from the lessee using a paper copy of its expiring lease list, which is a quarterly report that the State Land Board creates of all leases expiring in the next 6 to 9 months. Staff record when they receive a signed lease from the lessee on the list and will contact lessees that have not returned a signed lease prior to the start of the lease. The State Land Board reports that in both instances that it did not have a signed lease, it was because staff overlooked that the signed lease had not been received and management does not review the list to ensure that all leases have been received.

The State Land Board reports that an alternative method to track which leases have been signed and returned is to use the billing status field in ATLAS, its lease management and billing system. Using ATLAS would allow all staff and management to run a search to identify which leases have not been signed or returned. However, staff do not consistently use ATLAS to track leases and the State Land Board has not required staff to use it to track leases, so it is currently not possible to use ATLAS to identify which leases have not been signed.

WHY DO THESE PROBLEMS MATTER?

MANAGEMENT PLANS HELP ENSURE STEWARDSHIP OF THE LAND. The State Land Board’s policies require it to weigh “potential long-term asset value”

with “the impact of near-term leasing” when planning its stewardship practices. Staff indicated that the management plans are partly meant to address which land uses are appropriate for each Stewardship Trust property, such as which types of leases the property can support while protecting the long-term value, and best practices associated with each use. The management plans can identify stewardship practices that balance long-term value and near-term leasing.

Without written plans for managing and protecting the Stewardship Trust lands, there is a risk that the State Land Board might not provide adequate stewardship of their most ecologically-important properties. The management plans are intended to provide clear guidelines to staff, such as identifying the management tools staff should use and laying out how staff should measure progress in implementing the plan. For example, the baseline inventory for one lease we reviewed indicated that the property was an “important winter range and migration rout [sic] for large game” that was at risk of overgrazing. However, there was no management plan to guide staff on actions they should take to prevent overgrazing or how stewardship of this key habitat should be measured.

LEASE ADDENDA HELP DOCUMENT AND COMMUNICATE EXPECTATIONS TO LESSEES. Without lease addenda, lessees may not have the information they need about the resources they are required to protect or sufficient direction to manage the lands. The State Land Board’s standard contract requires lessees to use the property “in accordance with good resource conservation practices” and in a manner that “will protect soil fertility and forage production, will not contribute to soil erosion, over-grazing, noxious weeds or pests, and will ensure the protection and long-term productivity of the land,” but it does not identify the resources that are on the property or the steps the lessee should take to protect them. Therefore, without an addendum outlining the resources and management required that are specific to Stewardship Trust properties, lessees on these properties might not be aware of what specific resources need protection or what steps to take. State Land Board staff reported that a number of Stewardship Trust properties have natural values that are clearly at risk, particularly due to erosion around streams and wetlands. While none of the inspection reports for

the three grazing leases in the Stewardship Trust we examined identified problems with protection of natural values, a 2014 staff memo to the board as well as a discussion with district staff, indicated that at least some Stewardship Trust parcels are not managed according to the higher stewardship standards required for properties in the Stewardship Trust. For example, one grassland parcel in Park County was designated into the Stewardship Trust in 2000 to protect a rare plant, but by late 2014 the plant had “been completely replaced with invasive species” due to overgrazing.

When the State Land Board has not developed management plans and attached Stewardship Trust addenda at the start of a lease, there is a risk that a lessee will not be willing to amend the lease mid-way through a 10-year lease term. While the State Land Board’s grazing leases allow for termination of the lease when a lessee does not agree to implement stewardship practices prescribed by the State Land Board, there is a risk that the State Land Board will either have to wait until a 10-year lease term expires or pursue early termination of a lease if the lessee does not agree to add a Stewardship Trust addendum to a lease that is in progress. Waiting for a 10-year lease to expire before adding a Stewardship Trust addendum could result in a decade’s time before the property is managed to higher stewardship standards. Cancelling a lease midway through its 10-year term is potentially time consuming and could result in lost revenue to the State Land Board.

SIGNED LEASES ALLOW FOR ACCOUNTABILITY. Without a signed lease, the State Land Board does not have a clear legal means to enforce the terms of the lease, including payment and stewardship expectations. Although we found that the lessee had made an on-time and accurate lease payment for the first year of the lease (mid-November 2016 to mid-November 2017), the State Land Board would not have a legal means to enforce payment or collect past due amounts without a signed lease. Furthermore, stewardship expectations might not be communicated to the lessee and the State Land Board will not have legal means to (1) enforce the stewardship provisions in the lease and (2) potentially revoke the lessee’s renewal rights when the lessee has not signed a lease.

RECOMMENDATION 3

The State Land Board should improve its management of leases by:

- A Developing and following an implementation timeline for creating management plans for all properties within the Stewardship Trust to ensure that all agricultural leases on Stewardship Trust property include the management plan as an addendum to the lease.
- B Implementing controls to track lease signatures to better ensure that leases are signed by lessees prior to the start of the lease term.

RESPONSE

STATE LAND BOARD

- A AGREE. IMPLEMENTATION DATE: DECEMBER 2017.

The State Land Board will prepare an implementation time line for creating Stewardship Trust management plans and for ensuring that all agricultural leases on Stewardship Trust property have the management plan attached. The time line will be developed by December 2017. To better support the preparation and implementation of the management plans, the State Land Board will review current staffing levels and determine whether additional resources will be required to complete the estimated 1,700 to 1,900 hours of work in a timely manner. Following our review of current staffing, we will be better positioned to estimate when management plans will be completed and leases updated for all Stewardship Trust properties.

- B AGREE. IMPLEMENTATION DATE: SEPTEMBER 2018.

The State Land Board has implemented additional controls to track lease signatures in response to this recommendation. The results of the additional controls and modifications will be regularly reviewed over the next 12 months to ensure process updates are effective and sustainable. Adjustments throughout this time frame will be made if necessary.

EXPIRING LEASES

State grazing leases typically have a duration of 10 years. Unless the State Land Board decides to terminate the lease at an earlier date, it is only at the end of these 10-year periods that the State Land Board considers competitive bids from interested individuals and companies on leases that are expiring and due for renewal. In Calendar Year 2016, a total of 312 of the State Land Board's approximately 2,000 grazing leases expired. These expiring leases spanned 533,000 acres across 40 counties.

Four times a year, State Land Board staff produce a list of agriculture and recreation leases that are due to expire in the next 6 to 9 months. They identify these leases using ATLAS, the Land Board's asset management and billing database, and include leases even if the current lessees are interested in renewing their leases. This list is published on the State Land Board's website, and interested individuals and companies can also check the location of each expiring lease on the State Land Board's online Geographic Information System property map. The list of expiring leases is a key way in which the State Land Board can encourage interested parties to submit bids.

WHAT AUDIT WORK WAS PERFORMED AND HOW WERE THE RESULTS MEASURED?

We checked to see if 300 grazing leases which expired in Calendar Year 2016 were included in the four expiring lease lists that the State Land Board reported were published on its website and sent to counties between April 2015 and January 2016. These quarterly lists corresponded to those agricultural and recreational leases expiring in Calendar Year 2016. In limited cases, expiring leases would not be expected to be published on a list of leases that are due to expire. For example, there are leases in which only the existing lessee is able to continue holding the grazing lease because the leased land is entirely surrounded by the current lessee's private property. There are also

instances when the State Land Board determines that the land will not be immediately leased again because it plans to sell or rehabilitate the land. In other circumstances, the lease is publicly advertised, such as through a Request for Proposal process, rather than being placed on the expiring lease list. In total, there were 12 such leases of the 312 total grazing leases which expired in Calendar Year 2016, leaving 300 leases which we would expect to be published on the State Land Board's list of expiring leases.

The purpose of this work was to verify that Calendar Year 2016 leases had been publicly posted and sent to counties before the subsequent lease was awarded as required by statute. Section 36-1-118(2), C.R.S., requires the State Land Board to "make a listing of all grazing and other agricultural leases which expire" each quarter and send the expiring lease list to each county containing at least one expiring lease. The county clerk and recorder then posts the list in the county courthouse. State Land Board policy echoes this requirement. In practice, the State Land Board also publishes the list on its website. Moreover, the State Land Board's policy related to asset management [Policy 100-001] calls on staff to subject leases to competitive bidding "whenever possible." Staff reported that the expiring lease list is part of the State Land Board's efforts to encourage competitive bidding.

WHAT PROBLEM DID THE AUDIT WORK IDENTIFY AND WHY DID THIS PROBLEM OCCUR?

Of the 300 Calendar Year 2016 grazing leases that expired between January and December 2016 that we reviewed for, we found that the State Land Board did not publicly post or send to the counties eight leases that spanned 15,500 acres across four counties and generated \$48,000 in annual grazing rent. Instead, the State Land Board renewed the lease with the existing lessee.

- For five of these leases, which were in three counties, district staff did not check the appropriate box in ATLAS to identify them as

expiring. Staff based in the State Land Board's six district offices manually indicate which agriculture and recreation leases should be advertised on the upcoming expiring lease list by checking a box next to each lease record in ATLAS. Denver-based staff then run a search in ATLAS for which leases have been check marked across all districts and generate the expiring lease list. The State Land Board could increase the efficiency and accuracy of this process by eliminating the use of the check boxes and instead creating a list using a system generated report that would automatically export from ATLAS, based on the leases' expiration dates.

- For three of these leases, all of which were in one county, staff accidentally omitted them from the final expiring lease list.

Until we brought these issues to the attention of the State Land Board in May 2017, staff did not have a review process to verify that all expiring leases were checked in ATLAS or that the marked leases were properly transferred to the expiring lease list. In June 2017, the State Land Board informed us that they had begun sending the expiring lease list to district staff before publishing to confirm its accuracy. Continuing this process is a good control to help ensure that all expiring leases are included on the expiring lease list.

WHY DOES THIS PROBLEM MATTER?

When expiring leases are not publicly posted, the State Land Board may be foregoing a higher annual rental rate throughout the 10-year lease terms of the successor lease than it would have received if they were advertised. This is because the expiring lease list is one of the primary means by which the State Land Board notifies the public of available leases so that interested parties who may be willing to pay a higher rate can submit lease bids. The eight grazing leases that expired in Calendar Year 2016 and were not public posted were renewed with the existing lessee and had an average rental rate of the successor lease of about \$3.39 per acre. According to information from the State Land Board, this is about half of the average rental amount competitively bid leases generate.

While there is no guarantee that publicly posting notice of an expiring lease will result in competitive bids and higher rates, those that do receive competitive bids often result in significantly higher rental rates for the State Land Board. For example, an April 2017 staff analysis presented to the board found that since 2014 the average annual grazing rent on leases that had received competitive bids was more than twice that for all state grazing lands. Specifically, those grazing properties which received competitive bids had average rents of \$6.50 per acre while the average rent on all grazing properties was only \$3.11 per acre.

RECOMMENDATION 4

The State Land Board should improve its controls over public posting of available leases by:

- A Using a system-generated report in ATLAS to compile a list of expiring leases.
- B Continuing the review procedure by which district staff review the expiring lease lists before publication to help ensure that the lists are complete.

RESPONSE

STATE LAND BOARD

- A AGREE. IMPLEMENTATION DATE: JANUARY 2018.

The State Land Board will create and use a system-generated report to ensure expiring leases are accurately tracked and published.

- B AGREE. IMPLEMENTATION DATE: JANUARY 2018.

The State Land Board will use the system-generated report described in item 4A to enhance the review of expiring leases by district staff before the quarterly reports are published.

REVIEWING AND RESOLVING STAFF CONFLICTS OF INTEREST

Article XXIX of the Colorado Constitution states that government employees should carry out their duties for the benefit of the people and avoid conduct that violates the public trust. Statutes, rules, and administrative guidance echo this expectation in both broad and specific ethical standards that state employees are to adhere to in conducting state business. Examples of ethical standards for employees in carrying out state business include:

- Avoiding conduct that is in violation of the public trust or that creates a justifiable impression among members of the public that such trust is being violated [Colorado Constitution, Article XXIX, Section 1].
- Prohibitions on using one's professional position for personal gain, including engaging in personal financial business with a person whom the employee inspects, regulates, or supervises in the course of his official duties or performing an official act directly and substantially benefitting a business or other undertaking in which the employee has a financial interest [Section 24-18-108(2), C.R.S.].
- Prohibitions on engaging in outside employment or other activities that create a conflict of interest with their state duties [Section 24-50-117, C.R.S.].

These standards collectively outline the expectation that state employees are to avoid conflicts of interest in conducting state business.

The State Land Board has a process for staff to make a conflicts disclosure statement every year during the annual performance evaluation procedures conducted in the spring. The State Land Board

developed a form for the conflicts disclosure statement that includes an affirmation that the employee understands that the State Land Board is subject to state laws regarding ethical behavior and conflicts of interest. The form instructs employees to amend the form within 30 days if there are any changes so that the disclosure statement is always up to date.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We reviewed employees' Calendar Year 2016 conflict disclosure forms and outside employment requests and related documentation. We collected information and documentation of conflicts or potential conflicts of interest verbally reported to management and also listened to recordings of board proceedings relating to conflicts or potential conflicts of interest verbally reported to the board between Calendar Years 2014 through 2016. The purpose of the audit work was to evaluate the State Land Board's processes for managing conflicts and potential conflicts of interest.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

The Colorado Constitution and statutes collectively outline the expectation that employees avoid conflicts of interest in conducting state business. The State Land Board's board governance manual, which includes conflicts of interest requirements for staff, and State Personnel Rules outline specific processes to ensure compliance with conflict of interest requirements, as outlined below.

EMPLOYEE CONFIRMATION AND DISCLOSURE. The State Land Board's board governance manual states "staff annually disclose...official connections (including connections with family members) with any potential lease applicant, as well as affirm that they have adhered to the agency's conflict of interest policies..." The board governance manual also states staff "disclose whether they have received any financial benefit" from any organization that has applied for or received a lease

in the preceding 3 years or intends to apply for a lease, or know of individuals or organizations trying to influence them favorably toward a lease. The State Land Board uses a single form for staff to both provide these disclosures and affirm compliance with conflict of interest requirements. In addition, State Land Board policy relating to governance practices [Policy 100-001] requires employees to disclose any conflicts of interest prior to a board decision.

REVIEW AND RESOLUTION OF CONFLICTS AND POTENTIAL CONFLICTS OF INTEREST. An organization that asks employees to complete a conflict disclosure form and report potential conflicts of interest needs a process to handle those disclosures, including a process to review them in a timely manner and a process to mitigate conflicts. The State Land Board does not have policies or guidance on how employees' written or verbal disclosures of conflicts or potential conflicts of interest should be handled, so we looked to other available guidance. Office of the State Controller guidance on conflicts of interest, issued in June 2017, recommends agencies implement processes for:

- Reviewing disclosed conflicts and possible conflicts of interest by management, as well as agency procurement or human resource officials as needed.
- Mitigating conflicts, such as by developing a management plan when an employee has a conflict that (1) makes necessary modifications to the employee's duties to avoid the conflict, (2) identifies an individual to monitor the plan, and (3) provides for an annual review of the plan.

While the State Controller's guidance was not applicable to the time period we reviewed, we used it to help determine if there were gaps in the State Land Board's procedures and identify improvements in its handling of conflicts of interest.

PRE-APPROVAL OF OUTSIDE EMPLOYMENT. State Personnel Rules specify that advance written approval by the appointing authority is needed for any outside employment and that "the appointing authority shall base

approval on whether the outside employment interferes with the performance of the state job or is inconsistent with the interests of the state, including raising criticism or appearance of a conflict” [4 CCR 801, Board Rule 1-14]. Department of Natural Resources policy, which applies to State Land Board staff, includes technical guidance from the Department of Personnel & Administration, Division of Human Resources updated April 2014 that “employees who engage in outside employment must get advance written approval from their appointing authority before engaging in the additional employment.” The Department of Natural Resources has an outside employment form for seeking approval from the appointing authority.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY AND WHY DID THEY OCCUR?

The State Land Board does not have adequate and consistent processes to detect, review, and mitigate staff conflicts or potential conflicts of interest, as described below.

EMPLOYEES MAY NOT BE DISCLOSING ALL CONFLICTS OR ETHICAL ISSUES OR BE AWARE OF THE STANDARDS THEY MUST FOLLOW. We found that all State Land Board employees who were employed at the end of Calendar Year 2016 eventually submitted Calendar Year 2016 conflict disclosure forms, and it appears that the State Land Board took action to address the three potential conflicts disclosed. However, there is a risk that employees (1) do not disclose all actual and potential conflicts and (2) are not aware of all of the conflicts of interest and ethical standards they should comply with because of problems with the State Land Board’s conflicts disclosure forms and procedures. We summarize the problems with the conflict disclosure form in the table below.

EXHIBIT 2.1.
LIMITATIONS WITH STATE LAND BOARD’S CONFLICT DISCLOSURE FORM

STATE LAND BOARD’S EXISTING FORM	PROBLEMS/GAPS WITH STATE LAND BOARD’S FORM
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EMPLOYEE CONFIRMATION OF CONFLICT OF INTEREST REQUIREMENTS

RISK: It may not be clear to employees what conflict of interest and ethics standards they are expected to be aware of and adhere to.

Employees affirm by checking a box on the form that they understand that the State Land Board is a public governmental agency subject to state laws regarding ethical behavior and conflicts of interest.	The form does not ask employees to affirm they understand that they, as employees of the State Land Board, are subject to state laws and other requirements regarding ethical behavior and conflicts of interest.
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The form’s affirmation statement references only two standards for employees—Article XXIX of the Colorado Constitution related to Ethics in Government and the Governor’s Executive Order on the Executive Department Code of Ethics.	The form’s affirmation statement does not reference conflict of interest requirements that apply to employees, including: <ul style="list-style-type: none"> ▪ Title 24, Article 18 – Standards of Conduct, which apply to all state employees. ▪ Requirement in the board governance manual that employees “not knowingly take any action, make any statement, take advantage of a vendor relationship or otherwise influence the conduct of the agency’s affairs in such a way as to confer a financial benefit upon him/her or a [family] member...or business interest.”
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The form mistakenly references a requirement that only applies to volunteer board members.

The form does not require employees to affirm that they “have adhered to the agency’s conflict of interest policies,” as the board governance manual requires.

DISCLOSURE GUIDANCE

RISK: It may not be clear to employees what and how much they are expected to disclose.

The form requires employees to disclose any conflicts or potential conflicts of interest, defined as situations in which: <ul style="list-style-type: none"> ▪ The employee’s “official actions could...harm, benefit, or promote” the employee’s private interests or the interests of family, friends, or business associates, or ▪ The employee’s pursuing their own interests is incompatible with or detrimental to the State Land Board or compromises their loyalty to the State or their commitment to their duties. 	The form does not reference requirements in the board governance manual that employees disclose: <ul style="list-style-type: none"> ▪ Official connections (including connections with family members) with any potential lease applicant, ▪ Whether they have received any financial benefit from any organization that has applied for or received a lease in the preceding 3 years or intends to apply for a lease, or ▪ Any individuals or organizations trying to influence them favorably toward a lease. The form does not require disclosure of other situations that may create conflicts, such as anyone trying to influence them <i>against</i> a lease.
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SUPERVISORY REVIEW

RISK: Appropriate levels of management may not be aware of potential conflicts.

The form does not have a section to document supervisory review.

SOURCE: Office of the State Auditor analysis of the State Land Board’s conflict disclosure form and board governance manual, and other conflict of interest requirements applicable to state employees, as referenced.

Further, the board governance manual is not clear with respect to whether it establishes requirements that staff *must* follow or provides guidance that staff *may* follow. Specifically, the board governance

manual states that the conflicts of interest section “provides guidance on conflicts of interest for Commissioners, the Director, and Staff, however this section does not create, alter, increase or lessen any duties, obligations or grounds for civil or criminal liability for the Commissioners, the Director or staff that are provided by Colorado law.” Staff reported that they were unaware that the board governance manual contained any requirements that staff must follow because they had understood the board governance manual to apply only to the board. However, the board governance manual does outline the process for the board and staff to annually disclose conflicts of interest and requires that, “The Board President declares to the full board annually that all annual disclosure statements have been received and that there have been no exceptions to these policies.”

THE STATE LAND BOARD DOES NOT ENSURE THAT ALL DISCLOSURE FORMS ARE COLLECTED AND REVIEWED IN A TIMELY MANNER. As of May 2016, the State Land Board had received Calendar Year 2016 conflict of interest disclosure forms for 31 of 47 employees. The State Land Board did not realize that it was missing 16 disclosure forms until December 2016, or about 7 months later, because it had provided no central review of the forms. The State Land Board also did not realize that nine employees had completed outdated disclosure forms; the form had been updated in March 2015. The State Land Board does not have written policies or procedures to ensure that all staff complete and submit the proper disclosure forms and that all forms are reviewed by management in a timely manner. For example, there are not written policies or procedures outlining who should review the forms, such as the employee’s supervisor, human resources, procurement, or the appointing authority; or who should review senior management’s forms. The State Land Board also does not have written procedures or guidance on what types of disclosures are likely to warrant mitigation.

THE STATE LAND BOARD DID NOT EVALUATE A SENIOR MANAGEMENT EMPLOYEE’S VERBAL DISCLOSURE OF A PERSONAL CONNECTION. During the December 2016 board meeting, an employee in senior management disclosed a longtime friendship with the owner of a company that the State Land Board was considering contracting with to provide some

administrative functions. The employee was involved in recommending approval of a sole-source contract for which the contracting firm would receive a portion of future rents. The employee disclosed the friendship and explained that he felt he had nothing to personally gain if the board approved the contract. According to the audio recordings from the board meeting, the board did not ask any questions of the employee about the relationship or discuss whether the situation presented a conflict of interest that should prevent the employee from making a recommendation. The board approved entering into the contract, but the State Land Board reported that the contract ultimately did not go forward.

The State Land Board has no written policies or procedures to ensure that verbal disclosures are appropriately managed. In this situation, it is not clear that the board understood that it needed to assess the disclosure. However, for a similar situation in August 2014, the board did evaluate a senior management employee's disclosure of a potential conflict of interest and reached the conclusion that there was no conflict.

THE STATE LAND BOARD DID NOT DEVELOP A WRITTEN MITIGATION PLAN. One State Land Board employee is part-owner of a ranch on which his family has held a State Land Board agriculture lease for several generations. The employee had held the ownership interest and disclosed the lease to the State Land Board before he was hired in 2013 for a position that included managing leases in the same district where the lease is located. The State Land Board assigned the management of this lease to another district manager, but did not develop a written plan that documents the modifications made to the employee's duties, provides for periodic review of the modifications, and establishes who is responsible for monitoring the situation. Documentation of job modifications, and review and monitoring of those modifications, are all recommended by the State Controller's June 2017 guidance. The State Land Board does not have written guidance or procedures for documenting how a conflict of interest will be mitigated.

THE STATE LAND BOARD DID NOT PROVIDE WRITTEN, ADVANCE APPROVAL OF ONE EMPLOYEE'S OUTSIDE EMPLOYMENT. The State Land Board had two employees who had disclosed outside employment in

Calendar Year 2016. For one of these employees, who worked part-time at the State Land Board, the State Land Board told us that supervisors had approved the outside employment arrangement, but did not have documentation of advance written approval by the appointing authority. Due to the lack of documentation, we could not verify the approval or that it was based on consideration of whether the outside employment would interfere with the performance of the state job or would be inconsistent with the interests of the State, as required by State Personnel Rules. For the second employee, the State Land Board had a Department of Natural Resources' outside employment form which was approved in writing in advance by the State Land Board director as the appointing authority.

The State Land Board reports that it allows employees to use either the Department of Natural Resources' outside employment form or the State Land Board conflict disclosure form to report outside employment. However, the conflict disclosure form has no place or instructions for the appointing authority to approve the outside employment. The State Land Board should direct employees to use one consistent method for seeking approval of outside employment. If this includes using the employee's conflict disclosure form, it should be amended to include a place for the appointing authority to sign.

WHY DO THESE PROBLEMS MATTER?

Having strong processes to detect, review, and mitigate conflicts and potential conflicts of interest is important for ensuring the public trust in the work of the State Land Board and that the decisions and actions taken by its staff are in the best interest of the State.

- When employees are not provided guidance on what they should disclose, there is a risk that staff will not disclose situations that may present true conflicts of interest and that management will not know that a situation exists that should be mitigated.
- When the State Land Board does not identify who is responsible for reviewing disclosed conflicts and potential conflicts of interest, there

is a risk that conflicts will not be mitigated in a timely manner. Unmitigated conflicts could reduce (1) public confidence in the work of the State Land Board and (2) the commissioners' confidence in staff recommendations and evaluations that commissioners rely on in part to make their decisions.

- When the State Land Board does not have a process to document the resolution of disclosed conflicts and potential conflicts of interest, there is a risk that there could be misunderstandings, lack of buy-in by management, or difficulties holding employees and supervisors accountable for a mitigation plan. For example, in the absence of a written plan, the employee might not have the same understanding as management about the mitigation plan, or future management might not be aware of the steps the organization has taken to mitigate the conflict of the employee who is part-owner of a lease. As a result, future management might assign the employee duties that undermine the controls put in place.

- When the appointing authority has not approved outside employment in writing, there is a risk that the State Land Board has not fully considered whether the outside employment is appropriate and in the best interest of the State. Further, the State Land Board lacks documentation that the approval and review occurred prior to beginning outside employment, as required.

RECOMMENDATION 5

The State Land Board should improve its controls over disclosing and resolving employee conflicts and potential conflicts of interest by:

- A Developing written policies or guidance that (1) clearly instruct employees on what types of situations should be disclosed, including definitions of terminology as needed; (2) clarify who is responsible for reviewing employee disclosures (both written and verbal) and what the reviews entail; (3) clarify the circumstances that may need mitigation and require written mitigation plans that align with the State Controller’s conflict of interest guidance; and (4) implement the use of a single form for employees seeking approval for outside employment that includes documentation of approval.
- B Revising the conflict disclosure form to (1) align with the policies or guidance developed in response to PART A of the recommendation, (2) accurately reference all key conflicts and ethics requirements applicable to State Land Board employees, (3) make clear that employees are affirming that they understand and adhere to applicable requirements, and (4) document supervisory review and any mitigation of disclosed conflicts.
- C Revising the board governance manual to clarify the commissioners’ responsibilities for dealing with senior management disclosures, including assessment and mitigation.

RESPONSE

STATE LAND BOARD

- A AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will work with the Attorney General's office to develop written policy and create an annual training program for State Land Board staff on disclosing and resolving employee conflicts and

potential conflicts of interest. The policy and training will include the recommendations made by the auditors and consideration of the Office of the State Controller's Conflict of Interest Policy, the Colorado Independent Ethics guidance and other State guidance. Administrative protocols will ensure conflict mitigation plans are documented and annual filings are completed and recorded. Further, the State Land Board will work with the Attorney General's office to update the agency's governance manual and forms.

B AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will revise the conflict disclosure form to address each concern identified in RECOMMENDATION 5B

C AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will work with the Attorney General's office to modify the board governance manual to clarify the Commissioners' responsibilities in addressing staff conflicts and will establish protocols to assess and mitigate conflicts and potential conflicts of interest involving members of the senior management team.

DISCLOSING AND RESOLVING COMMISSIONER CONFLICTS OF INTEREST

The State Land Board is a Type 1 board as defined in Article 1, Title 24 of Colorado Revised Statutes, and consists of five commissioners, appointed by the Governor with the consent of the Senate. Article IX, Section 10 of the Colorado Constitution charges the State Land Board with managing state trust lands to produce revenue for the trusts and to preserve the land for future generations. A guiding principle of the board is to make decisions with “consistency” and “transparency” and, per policy, the board is responsible for approving various staff decisions and action plans by a vote. For example, the board approves (1) the awarding of leases when there are competing applicants, (2) legal actions and settlements, (3) lease termination for non-monetary violations, and (4) the organization’s strategic plan.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We reviewed the minutes and listened to archived audio recordings from board meetings in Calendar Years 2014 through 2016 for the 13 instances in which the State Land Board reported that commissioners had disclosed conflicts or potential conflicts of interest related to business before the board. Potential conflicts included situations where the commissioner had outside knowledge of a transaction or a personal connection to a party with business before the board that could give the impression of a conflict of interest, even if one did not exist. We also requested all written disclosure statements for all commissioners for these years. The purpose of the audit work was to determine whether

the State Land Board follows its board governance manual in addressing conflicts and potential conflicts of interest disclosed by commissioners.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Since at least 2013, the State Land Board's board handbook, later referred to as the board governance manual, has included guidance for commissioners on (1) avoiding conflicts of interest by abstaining from decisions in which they would find it difficult to remain impartial and (2) ensuring that the reasoning for the board's decisions is apparent and transparent. Effective March 2015, the State Land Board replaced the board handbook with a board governance manual to serve as a guide for good governance and effective operations, and for clarifying roles and responsibilities of commissioners and staff. The handbook included specific reference to the importance of transparency and ethics, stating, "Because we work for the citizens of Colorado in our role as trustees of the public trusts, we must operate with constant vigilance and commitment to good public process, making decisions and taking actions in open, transparent and accessible ways. Our reasoning should be apparent and our discussions and records should be thorough..." The handbook and later the manual also indicate that commissioners should disclose to the board any knowledge gained from their outside experience and activities that is relevant to a board decision and take care to avoid the actuality and appearance of conflict of interest or bias.

Pursuant to State Land Board policy related to governance practices [Policy 100-001], commissioners are "required to disclose any conflicts of interest prior to a decision." The board governance manual states that "Conflicts of interest arise when a Commissioner takes part in Board decisions in which the Commissioner may be unable to remain impartial, maintain objectivity or fulfill the Commissioner's duty of loyalty in choosing between the interests of the agency and Commissioner's personal interests." This definition is broader than that established in the State's Code of Ethics, which states that volunteer commissioners, such as those that serve on the State Land Board, have

a fiduciary duty and “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.]. The manual provides the following requirements for commissioners regarding conflicts of interest:

- **DISCLOSURE OF CONFLICTS AND POTENTIAL CONFLICTS OF INTEREST.** The board governance manual states that commissioners:
 - ▶ Annually disclose any “official connections” with any potential lease applicants.
 - ▶ Disclose whether they have received any “financial benefit” from any organizations which have applied for or received a lease in the preceding 3 years or intend to apply for a lease.
 - ▶ Disclose knowledge of individuals or organizations trying to influence them favorably toward a lease.
 - ▶ Annually affirm that they have adhered to the State Land Board’s conflict of interest policies.
 - ▶ Annually submit a statement indicating that they understand that the State Land Board is subject to state laws governing conflicts of interests.

The manual requires commissioners to update and amend the form within 30 days of a conflict arising.

- **ABSTENTION FROM PARTICIPATION AND VOTING ON MATTERS IN WHICH COMMISSIONERS HAVE CONFLICTS OF INTEREST.** The board governance manual states “In the event there comes before the Board a matter for consideration that raises a conflict of interest for any Commissioner, the Commissioner discloses the conflict of interest as soon as the Commissioner becomes aware of it and abstains from further participation and voting on the matter.” Prior to the March 2015 board governance manual, the board handbook outlined expectations that commissioners recuse themselves from decisions when they cannot remain impartial.
- **PROPER RECORDING IN MEETING MINUTES.** The board governance manual specifies that commissioners’ disclosure of conflicts of

interest and commissioners' abstention are to be recorded in the meeting minutes. The board governance manual also states that the board's minutes are to include "actions of the Board and sufficient detail to evidence the Board's diligence in the matter". Thus, we would expect the minutes to include information about the nature of any conflict and the actions related to the disclosure, such as whether the commissioner abstained from participation in the discussion and abstained from voting.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

In our review of Calendar Years 2014 through 2016 meeting minutes and audio recordings, we did not identify any instances of a commissioner voting on a matter where that commissioner had a conflict of interest. However, we found that the State Land Board did not always meet the board governance manual's expectations for how commissioners disclose conflicts and potential conflicts of interest, and how those disclosures are resolved and recorded.

LACK OF ANNUAL DISCLOSURES. The State Land Board did not have written disclosure statements from any commissioners from March 2015, when the disclosure form was created, through Calendar Year 2016.

IT IS NOT CLEAR THAT COMMISSIONERS CONSISTENTLY AVOID PARTICIPATING IN DECISIONS WHEN THEY HAVE DISCLOSED POTENTIAL CONFLICTS. In four out of 13 instances in Calendar Years 2014 through 2016, when commissioners disclosed at board hearings that they had personal connections to parties involved in State Land Board matters, they (1) still participated in discussion even though they stated they were unable to be impartial, or (2) participated and voted, without the board discussing the disclosure. In all four cases, the Board did not discuss whether the disclosure constituted an actual conflict or conclude that participation or voting by the disclosing commissioner would result in an impartial decision.

- In a March 2014 land-for-land exchange proposal, a commissioner

disclosed at the board hearing that he had a personal connection with a lessee who leases State Land Board land that would be exchanged in the deal. The commissioner abstained from participating in the public discussion and from voting on the exchange, indicating that he wished to avoid the appearance of a conflict of interest. However, based on our listening to the audio recordings of the board proceedings, the commissioner did not abstain from participating in the discussion of the deal when the matter was discussed in executive session; he communicated his reservations about the exchange to the other commissioners. One commissioner asked if this discussion was appropriate for executive session or if it should happen at the public session and another commissioner said this was helping him with his decision. In the public session, the board voted 3-1 against the exchange.

- At the January 2016 board hearing the board reviewed the staff decision not to approve a sale proposal. At the meeting a commissioner disclosed that he was a 20-year friend and former business partner of a person proposing to purchase the State Land Board land. The commissioner felt that he could be impartial because he had not discussed anything with the individual making the proposal that was not included in the board packet or going to be included in staff presentations. The commissioner made two motions to propose selling land to this party. Neither motion was seconded and the sale did not occur.
- In an April 2016 mining lease proposal, a commissioner disclosed at the hearing that he had discussions about the lease with a friend who lived adjacent to the potential mining site. The commissioner abstained from voting on the matter but did participate in the discussion, offering his concerns about the environmental impact of the lease to a nearby nature conservancy.
- In a December 2016 proposal to enter into a development contract, a commissioner said he had known the developer for many years. The commissioner did not explain the nature of his relationship or whether it impacted his impartiality; he participated in the discussion and voted to approve the developer's proposal.

MINUTES DO NOT ALWAYS INCLUDE SUFFICIENT DETAIL TO DEMONSTRATE THE BOARD’S DILIGENCE ON CONFLICT OF INTEREST MATTERS. From March 2015, when the board governance manual was adopted, through Calendar Year 2016, five of the seven potential conflict of interest disclosures were not fully recorded in the board minutes. In these five instances, the minutes indicated that a commissioner disclosed knowing someone involved in the matter before the board and voted, but the minutes did not provide information about the nature of the commissioner’s relationship with the person or reasons why the commissioner or the board determined that the commissioner could remain objective and vote.

WHY DID THESE PROBLEMS OCCUR?

Although the State Land Board has established expectations for disclosing and avoiding conflicts of interest, it is not clear what is required of commissioners and the State Land Board has not implemented procedures for fulfilling and enforcing these expectations.

THE BOARD GOVERNANCE MANUAL IS NOT CLEAR WITH RESPECT TO WHETHER IT ESTABLISHES REQUIREMENTS THAT COMMISSIONERS MUST FOLLOW OR PROVIDES GUIDANCE THAT COMMISSIONERS MAY FOLLOW. Specifically, the board governance manual states that the conflicts of interest section “provides guidance on conflicts of interest for Commissioners, the Director, and Staff, however this section does not create, alter, increase or lessen any duties, obligations or grounds for civil or criminal liability for the Commissioners, the Director or staff that are provided by Colorado law.” However, the board governance manual does outline the process for the board and staff to annually disclose conflicts of interest and requires, “The Board President declares to the full board annually that all annual disclosures have been received and that there have been no exceptions to these policies.”

THE STATE LAND BOARD HAS NOT CLEARLY ASSIGNED RESPONSIBILITY FOR COLLECTING AND REVIEWING WRITTEN DISCLOSURES FROM COMMISSIONERS. The State Land Board has no written procedures for fulfilling the expectations to disclose and avoid conflicts of interest. In

particular, neither the board governance manual nor any written policies or procedures assign responsibility for collecting or reviewing the completed disclosure forms. The manual documents the responsibilities of the board president, commissioners, director, and staff, and outlines a calendar for several recurring board activities, such as review of leasing policies and approval of board meeting dates. The manual could be expanded to assign responsibility and establish procedures for the disclosure process.

THE STATE LAND BOARD HAS NOT DEVELOPED COMPREHENSIVE PROCESSES FOR MANAGING POTENTIAL AND ACTUAL CONFLICTS. Policy and the board governance manual indicate that commissioners have a broad obligation to disclose information and relationships to fellow board members, and we found a number of instances of commissioners disclosing connections with or knowledge of matters coming before the board. However, the board has not established guidance to help commissioners determine what types of relationships or knowledge of a situation should be disclosed and would be considered actual conflicts. The board has also not developed processes for managing disclosures in a consistent manner to prevent conflicts from affecting the board's decisions. For example, the manual does not describe the process by which the board as a whole will assess personal connections or potential conflicts of interest raised and determine if the situation warrants abstention. We found no indication in any of the minutes we reviewed or any of the hearing recordings we listened to that commissioners routinely discussed the seriousness of the potential conflicts of interest the members raised to determine whether a disclosure should affect the ability to participate.

We identified several other decision-making boards and commissions that have established clear guidelines to instruct members on the disclosure and resolution of potential conflicts such as what should be disclosed, what is likely to create an actual conflict that should prevent a member from participating, and the responsibilities of other board members when a conflict is disclosed.

For example, the Wildlife Commission, which is also within the

Department of Natural Resources, provides commissioners with clear instructions on how potential conflicts should be evaluated. Specifically, if a commissioner discloses an issue that could be a potential conflict but intends to participate in discussion or decision making, the other commissioners can call for a vote on whether the commissioner can participate in the matter. One option could be for the State Land Board to assign more collective responsibility to the entire board for ensuring disclosures are properly handled, including discussion of disclosures among all members and the expectation that the board agree on any member's participation.

In another example, the State Board of Education's guidance states that members with conflicts should leave the room when the matter is discussed. One option for the State Land Board is to adopt guidelines for when commissioners should leave the room when a matter in which they have a conflict is discussed.

THE STATE LAND BOARD HAS NOT ESTABLISHED PROCEDURES FOR ENSURING DISCLOSURES AND THEIR OUTCOMES ARE PROPERLY RECORDED. The State Land Board lacks a mechanism to ensure key elements of conflicts of interest matters are recorded in the minutes. State Land Board staff reported that there has been an effort to make board minutes more streamlined, relying on the archived audio records to serve as the full record of proceedings. However, this effort appears to be creating a conflict with the expectation in the board governance manual that the board's minutes are to include "actions of the Board and sufficient detail to evidence the Board's diligence in the matter." Since it is board policy that conflicts of interest issues should be disclosed before a decision on a matter, we would expect that the minutes would include information to show compliance with the policy, such as the determination if a relationship or outside knowledge is a conflict. Further, there is currently no tool to help the person responsible for preparing the minutes ensure that key items, such as the nature of a disclosure and how the issue was resolved, are consistently recorded. Staff acknowledge that a tool, such as a checklist, could be valuable for this purpose.

WHY DO THESE PROBLEMS MATTER?

The State Land Board has fiduciary responsibilities for acting in the best interests of the trusts in making decisions about how trust lands should be managed. Because State Land Board commissioners are often active professionals in their fields of expertise, it is expected that they may have business or personal connections with parties with business before the board, or have outside knowledge of the matters the board has control over. The State Land Board has outlined processes for commissioners to handle conflicts of interest to maintain public trust in their actions, but when these processes are not followed, there is a risk that the commissioners are not acting with impartiality, consistency, thoroughness, and transparency in making decisions on behalf of the trusts. Further, the lack of guidance on determining what constitutes a conflict and what actions should be taken to avoid conflicts can create inconsistencies in how disclosures are handled. For example, in one instance we reviewed, a commissioner abstained from participating and voting on a lease that involved a neighbor, but in another case, a commissioner did participate and vote on the lease involving a neighbor.

RECOMMENDATION 6

The State Land Board should improve its controls over commissioners' conflicts and potential conflicts of interest by:

- A Clarifying in policy what is required of commissioners, including whether commissioners are required to complete annual conflict of interest disclosure statements and enforcing any requirements.
- B Establishing written guidance to help commissioners determine what types of relationships or knowledge of a situation should be disclosed and would be considered actual conflicts.
- C Establishing written procedures assigning responsibilities for collecting and reviewing commissioners' conflict disclosure statements and outlining how the board will collectively evaluate disclosures and ensure that commissioners do not participate in proceedings related to matters in which they have a conflict.
- D Implementing written procedures to document key information in board minutes to demonstrate the board's diligence, such as the nature of commissioners' disclosures and how potential conflicts are resolved.

RESPONSE

STATE LAND BOARD

- A AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will work with the Attorney General's office to develop a written policy and to create an annual training program for State Land Board Commissioners on disclosing and resolving conflicts and potential conflicts of interests. Further, the State Land Board will work with the Attorney General's office to update the agency's conflict of interest disclosure forms and the Commissioners governance manual.

B AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will work with the Attorney General's office to develop a written policy and to create an annual training program for State Land Board Commissioners on disclosure and resolution of Commissioner conflicts and potential conflicts of interests. The policy and training will include the recommendations made by the auditors and consideration of the Office of the State Controller's Conflict of Interest Policy, the Colorado Independent Ethics guidance and other State guidance.

C AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will establish written procedures assigning responsibilities for collecting and reviewing commissioners' conflict disclosure statements. Further, the State Land Board will work with the Colorado Attorney General's office to create an annual training program for State Land Board Commissioners on disclosure and resolution of Commissioner conflicts and potential conflicts of interests.

D AGREE. IMPLEMENTATION DATE: JUNE 2018.

The State Land Board will work with the Attorney General's office to create written procedures for capturing key conflicts information to be incorporated into the board meeting summary minutes. Staff responsible for recording the summary minutes will be trained on implementation.

