A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit and Sunset Review

Arizona State Land Department

September • 2007
REPORT NO. 07-08

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 17, 2007

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. Mark Winkleman, Commissioner
Arizona State Land Department

Transmitted herewith is a report of the Auditor General, a Performance Audit and Sunset Review of the Arizona State Land Department. This report is in response to a May 22, 2006, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona State Land Department agrees with all of the findings and plans to implement or implement in a different manner all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on September 18, 2007.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

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SUMMARY

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona State Land Department (Department) pursuant to a May 22, 2006, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

The Department manages 9.2 million acres of state trust lands, granted by the federal government when Arizona became a state, for kindergarten through 12th-grade public schools, state universities, and other designated beneficiaries. These lands are located throughout the State, including the expanding urban areas around Phoenix and Tucson. The Department's main focus is maximizing the income from the sale or lease of these lands. In fiscal years 2004 through 2007, the Department held 82 successful state trust land auctions. These auctions generated approximately $1.6 billion in gross sales and nearly $2 billion in lease revenues that the Department expects to collect over the terms of the leases. The Department leases land for grazing, agricultural, mineral, and commercial use. In fiscal year 2007, the Department reported generating approximately $63.4 million through the lease of state trust land. The Department also houses the State Forester, which administers the State's wildland prevention and suppression programs, and coordinates aid activities between rural fire departments and cooperating federal agencies.

Department uses comprehensive selling and leasing process, but should further enhance it (see pages 13 through 26)

Although the Department has developed a comprehensive process to plan for the sale and lease of state trust lands, this process should be further improved. The Department has taken a number of steps to respond to statutory or constitutional requirements, and it has initiated additional steps on its own in an effort to enhance land values, such as conducting various environmental and site studies to provide critical information to potential bidders. However, the Department's process should be improved in the following ways:

- Establishing time frames or ranges to help assess whether the selling and leasing process is taking too long—Preparing parcels for sale or lease can take years, and auditors noted wide variations in how long various projects took. The Department has not established time frames or ranges for completing individual steps in its process. Establishing and monitoring time frames/ranges could help the Department ensure that parcels proceed through the process as quickly as possible.

- Posting site study information on its Web site sooner—During the process of preparing a parcel for sale or lease, the Department often obtains considerable information that can help establish—and sometimes increase—a parcel's value. This information typically includes environmental site assessments, soil studies, and an American Land Title Association (ALTA) survey of the parcel. Although the Department makes this information available to prospective bidders as studies are completed, it typically does not post this information on its Web site until much later. Providing site study information on its Web site facilitates its review, but developers indicated that more time was needed for adequate review. Based on three parcel files that auditors reviewed, this information was available up to 4 to 8 weeks before a request was made to post the site studies on the Department's Web site.

- Improving appraisals by increasing number of qualified, contracted appraisers—According to a department official, the Department does not have access to a sufficient number of qualified appraisers, and fewer than half of the appraisal companies with whom the State has contracted possess the qualifications the Department requires. This has resulted in situations where the Department has spent additional time and resources to remedy problems with appraisals for some parcels. Based on interviews with nine appraisal companies who do not have state contracts, other interested and qualified appraisers are potentially available. To expand the pool, the Department should work with the Department of Administration, which is responsible for state-wide procurement, and the Department of Transportation, which manages the State's appraisal contract, to issue a new or supplemental contract and communicate to potential bidders all of the steps they must take to obtain state contracts. The Department should also establish and implement policies for taking appropriate action when appraisals do not meet department requirements or appraisal standards.

Department should further improve state trust land management (see pages 27 through 39)

The Department should continue to build on steps it has taken to protect the land it leases to ranchers, miners, agricultural users, and others. As of January 2007, the Department administered leases for more than 9 million acres of state trust land. These leases were for agricultural, commercial, grazing, and mining uses, as well as rights of way. Since March 1998, the Department has worked with the Department of Administration's Risk Management Office (Risk Management) to assess financial and environmental risks and improve the State's protection in the language of lease agreements. For example, agricultural and grazing leases now include stronger insurance requirements and provisions addressing lessees' compliance with environmental laws. However, additional improvements are needed:

- Improving existing lease provisions and extending them to permits—As Risk Management staff continue to identify areas where leases can be improved and the State better protected, the Department should implement changes as needed. For example, review by Risk Management staff has shown the need for additional environmental insurance for some leases. The Department should also revise the language of special land use permits and mineral exploration permits to ensure the State is adequately protected. These permits are issued for the same types of land uses as leases, but for shorter time periods. Although these permits are more restrictive, such as not allowing permanent improvements on the land, potential liabilities and environmental risk still exist. The Department should incorporate comprehensive insurance and environmental language into these permits.

- Ensuring that all critical leases are appropriately inspected—On-site field inspections are important to help ensure that the lessee conforms with the lease agreement and to help identify exposures that may pose an environmental hazard or liability to the State. Many leases, particularly canceled mineral leases, have not been checked by the Department. For example, as of January 2007, the Department had not conducted reclamation field visits for more than 380 canceled mineral leases to ensure that the land had been properly reclaimed and does not pose a public health or safety risk. According to the Department, the lack of sufficient staff has affected its ability to conduct inspections.

  To better protect these lands, the Department should make two changes to its process. First, it should prioritize inspections to ensure it inspects the leases that pose the greatest risk. For example, both Risk Management and department management indicated that not all leases have an equivalent risk. Additionally,

according to Risk Management, mineral and agricultural leases have a greater level of risk than grazing leases based on the land use. Second, it should cross-train its staff to conduct different types of inspections. For example, department management has indicated that grazing lease managers could provide assistance in inspecting canceled mineral lease sites by conducting assessments and identifying potential safety concerns regarding mineral leases that are located within the boundaries of grazing leases.

- Strengthening procedures for documenting and tracking all field inspections—Department staff said they sometimes conduct inspections, but do not record having done so. For example, staff in the agricultural section reported failing to document a total of 50 field visits in 2006. Documenting inspections, the problems noted, and the corrective actions required by the Department helps to ensure the Department's leased land is adequately protected. This documentation also provides the Department with historical information to prioritize and guide future inspection efforts and ensure lease compliance issues are addressed and resolved.

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona State Land Department (Department) pursuant to a May 22, 2006, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

State Land Department's history and mission

The Department was established in 1915 to manage state trust lands on behalf of 14 beneficiaries, as established by the 1910 State Enabling Act and State Constitution. Through the Enabling Act and other federal legislation, the State was granted approximately 10.9 million acres of trust lands from the federal government that was to be held in trust for special beneficiaries. As of March 2007, the Department reports that an estimated 9.2 million acres of this endowment remains state trust land. According to the Department, in the 95 years since statehood, the State has disposed of or exchanged about 1.7 million acres of state trust lands. The Department's mission is

> *"to manage state trust lands and resources to enhance value and optimize economic return for the trust beneficiaries, consistent with sound stewardship, conservation, and business management principles supporting socioeconomic goals for citizens here today and generations to come. To manage and provide support for resource conservation programs for the well being of the public and the State's natural environment."*

To accomplish this mission, the Department performs several activities such as working to sustain the trust's long-term value for the beneficiaries by administering, selling, and leasing the State's trust lands, operating the State's wildland fire prevention and suppression programs, and providing state-wide geological information system services.

State Trust Land Beneficiaries

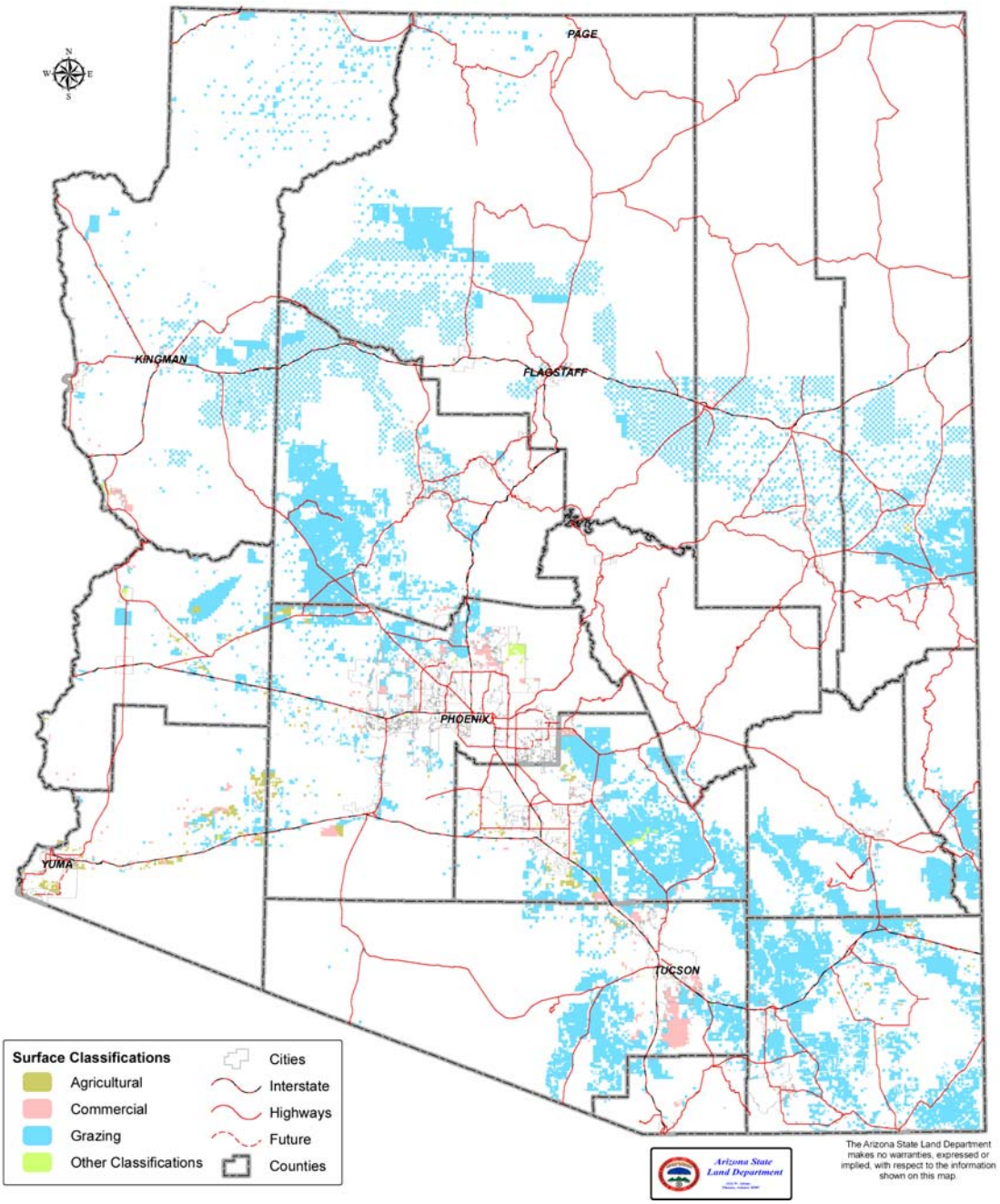
- Common Schools (K-12)
- University of Arizona
- University Land Code
- Normal Schools
- Military Institutes
- Agricultural and Mechanical Colleges
- School of Mines
- State Charitable, Penal, and Reformatory
- School for the Deaf and Blind
- State Hospital
- Miners' Hospital (Two Grants)
- Penitentiary
- Legislative, Executive, and Judicial Buildings

Arizona State University, Northern Arizona University, and the University of Arizona are the beneficiaries of the following grants: the University of Arizona, University Land Code, Normal Schools, Military Institutes, the Agricultural and Mechanical Colleges, and School of Mines grants.

State trust land use

The Department classifies the 9.2 million acres of state trust lands for several uses, including agricultural, commercial, and grazing. Figure 1 illustrates the location and classification of state trust land acres in Arizona. Although most state trust lands, about 8.4 million acres, are used for grazing, over the years, several hundred

Figure 1: State Trust Lands Classifications
As of February 2007

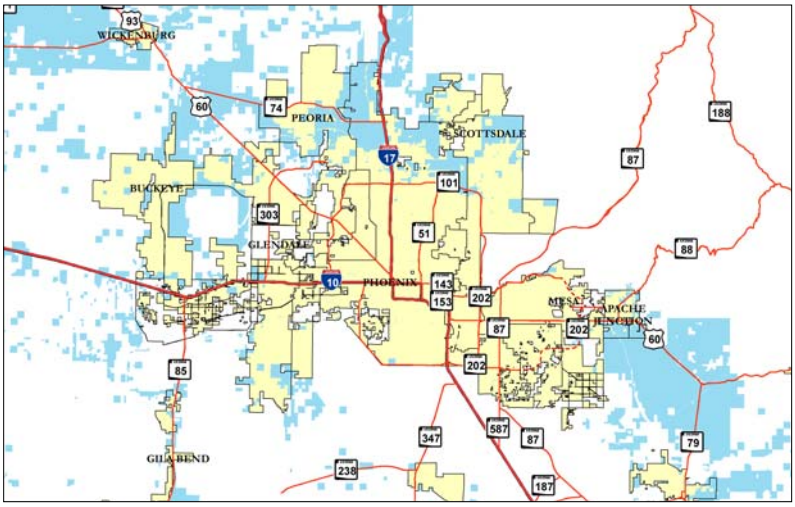


Source: Arizona State Land Department, Geographic Information Systems (GIS) section, GIS data library custom map as of February 1, 2007.

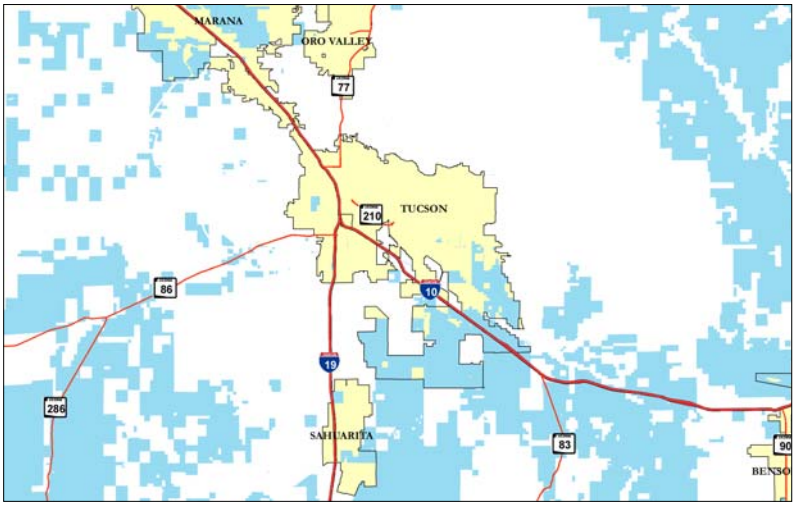
thousand acres of grazing lands have become urban lands as Phoenix, Tucson, and other cities have expanded. Consequently, urban land leases and sales have become the largest revenue producer for the trust beneficiaries. Figure 2 illustrates the location and classification of state trust lands near Phoenix and Tucson.

Figure 2: State Trust Lands in the Phoenix and Tucson Metropolitan Areas As of February 2007

Phoenix Metropolitan Area



Tucson Metropolitan Area



State Trust Lands Incorporated Cities

Source: Arizona State Land Department, Geographic Information Systems (GIS) section, GIS data library custom map as of February 27, 2007.

State trust land revenues

The Department's main focus is its fiduciary responsibility to maximize the income from selling and using state trust lands and their products for the trust beneficiaries. As illustrated in Table 1 (see page 4), the Department held 82 successful state trust land auctions from fiscal years 2004 through 2007. These auctions generated approximately $1.6 billion in gross sales. Some of these parcels were sold for residential development, such as the residential communities of Toscana at Desert Ridge and Camino á Lago. In addition, the Department leases state trust lands for various purposes, including grazing, agriculture, commercial, and minerals. Through the 82 state trust land auctions held in fiscal years 2004 through 2007, the Department also leased various parcels that are expected to generate nearly $2 billion over the terms of the leases. In fiscal year 2007, the Department reported generating approximately $63.4 million from leasing state trust land.

Revenues earned from trust lands are either deposited into the Permanent Fund (Fund) or classified as expendable revenue. Fund revenues come from selling land or royalties from the land's natural products, such as copper, sand, and gravel. These monies are not expendable for any purpose; rather, they are invested by the State Treasurer in stocks, bonds, and other interest-bearing securities. Expendable revenue includes lease revenue from state trust land leases and permits, the interest

The Department generated approximately $1.6 billion in gross land sales from fiscal years 2004 through 2007.

earned from the financing of land sales, and the State Treasurer's distribution of the Fund's monies, which is based on a constitutional formula. Expendable revenue is available to beneficiaries to use for their operations.

Table 1: State Land Auctions, Acres Sold or Leased, and Related Revenue[1]
Fiscal Years 2004 through 2007
(Unaudited)

Fiscal Year	Successful Auctions[2]	Acres Sold	Gross Sales (in millions)	Acres Leased	Minimum Cumulative Lease Revenue[3] (in millions)	Examples of Parcels Auctioned
2004	24	1,874.52	$ 310.6	463.0	$ 110.9	276 acres in the Desert Ridge master-planned community in Phoenix for $100.5 million. 365 acres in Peoria for $56.2 million. 89 acres in the Desert Ridge master-planned community in Phoenix for $49 million.
2005	17	1,816.45	254.5	401.3	23.9	171 acres in Mesa Highlands in Mesa for $75.2 million. 175 acres in Mesa for $42 million.
2006	21	3,426.04	544.3	114.0	595.8	Long-term lease of 55 acres in Peoria that is expected to generate $350 million. Long-term lease of 60 acres in Phoenix that is expected to generate $239 million. 502 acres in the Desert Ridge master-planned community in Phoenix for $135 million.
2007	20	4,262.33	453.7	12,228.4[4]	1,254.8	269 acres in the Desert Ridge master-planned community in Phoenix for $149.5 million. Long-term lease of 124 acres in Scottsdale that is expected to generate more than $875 million.
Total	82	11,379.34	$1,563.1	13,206.7	$1,985.4	

1 According to a department official, most land sales and leases are financed; therefore, the Department does not immediately receive cash at the time of auction.

2 Successful auctions are those at which the Department successfully sold or leased the parcel(s) being auctioned. If potential bidders do not express interest in the parcel(s), A.R.S. §37-236 allows the Land Commissioner to cancel the auction.

3 Lease revenue represents the cumulative lease revenue projected to be collected over the term of the lease.

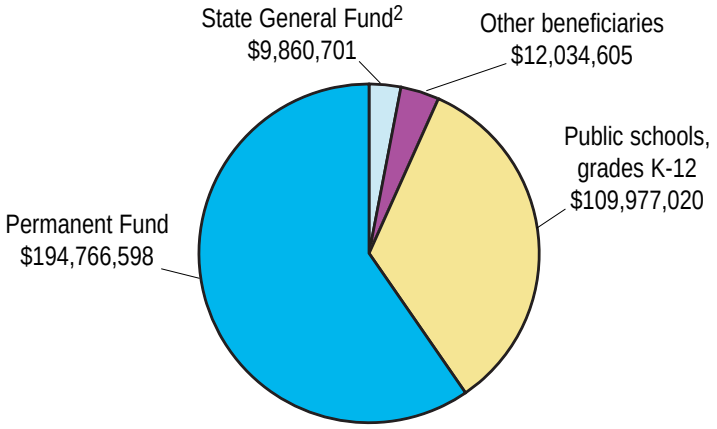
4 According to the Department's Web site, the acres leased in fiscal year 2007 include nearly 12,000 acres that the Department leased to Volkswagen of America, Inc. for the planned development of a new automobile proving ground.

Source: Auditor General staff analysis of the Department's fiscal years 2004 through 2006 annual reports and information obtained from the Department and its Web site.

Kindergarten through 12th-grade public schools are the trust's largest beneficiary, owning approximately 87 percent of the land and receiving close to 90 percent of trust revenues. State trust land was assigned to the beneficiaries, who receive the revenues obtained from the sale or lease of those lands. Figure 3 illustrates the revenues the Department generated for fiscal year 2007 and the revenue distribution to the Fund and trust beneficiaries. These amounts do not include an additional $35.6 million that was distributed to the beneficiaries in fiscal year 2007 by the State Treasurer from the Permanent Fund according to a constitutional formula. Additionally, the State Treasurer reported that as of the end of fiscal year 2007, the Fund had a balance of more than $2.26 billion, which was more than double the Fund's fund balance at the end of fiscal year 2003.

Figure 3: Distribution of Land Sales and Lease Revenue
Fiscal Year 2007
(Unaudited)

Total receipts distributed—$326,638,924[1]



1 According to a department official, the Department did not distribute $5,611,921 in prepayments because these monies were not yet earned. Therefore, receipts totaled $332,250,845 for fiscal year 2007.

2 As required by A.R.S. §37-335(F), costs recovered at the time of sale shall be paid to the State General Fund.

Source: Auditor General staff summary of fiscal year 2007 revenue distribution information from the Department's OASIS business system.

Arizona Preserve Initiative encourages preservation of land for open space

The Arizona Preserve Initiative (API), which was enacted in 1996, is designed to encourage the preservation of select parcels of state trust land in and around urban areas for open space. A.R.S. §37-312 prescribes the process by which state trust land can be petitioned for reclassification for conservation. These lands can then be leased or sold at public auction for that purpose. According to the 1996 legislation, only state trust land within incorporated cities and towns or within specified distances of cities and towns could be reclassified for conservation purposes. In 1997, 1998, and 1999, amendments to the API were enacted, which expanded some of the areas eligible for consideration to be classified for conservation purposes. These revisions expanded areas in Maricopa and Pima Counties up to an additional 10 miles beyond the 1996 boundaries. In addition, the revisions made specific Pinal and Coconino County lands adjacent to the Superstition Mountains and the San Tan Mountains near Metro Phoenix, land within the Tortolita Mountains near Tucson, and land southwest of Flagstaff eligible for consideration.

Public funds are available to help purchase state trust lands for conservation. Specifically, Laws 1998, Ch. 204, established a grant program for acquiring or leasing state trust lands for conservation. The grant program was placed under the Arizona State Parks Board, which can award grants for up to 50 percent of the appraised

Grant monies help purchase state trust lands for conservation purposes.

value of a land parcel. Passage of Proposition 303 authorized funding for the grant program for 11 years beginning in July 2000. This funding comes from the State General Fund, and as of March 2007, the Arizona State Parks Board reported more than $95 million in available funding. Lands eligible for acquisition are those the Department classified for conservation purposes.

According to the Department, since the inception of the API program through the fall of 2005, 33 petitions had been filed requesting approximately 120,032 acres be reclassified as suitable for conservation purposes. As of fall 2005, the Department had reclassified approximately 42,511 acres and denied reclassification petitions for more than 6,000 acres of land because the petitioned land did not meet the criteria the Department established in administrative rule. These include the benefit to the trust, the unique scenic beauty of the land, location of cultural resources, and wildlife and geologic features. The Department reported generating nearly $40 million for the trust through eight land sales (approximately 2,331 acres) for lands classified as suitable for conservation.

Department organization and staffing

The Department is divided into five divisions and the Commissioner's Office. As of March 13, 2007, the Department reported a total of 223 staff positions, with 31 vacancies. Department staff work in the following areas:

- Commissioner's Office (14.5 positions, 2 vacant)—The Commissioner's Office includes the commissioner, deputy commissioner, the Department's legislative liaison, and the Office of Appraisal. The Office of Appraisal supports the Department's revenue-producing functions by assisting it with site analysis, economic analysis, highest and best-use studies of state trust lands, and appeals of appraised values.

- Administration and Resource Analysis (48.5 positions, 5 vacant)—This division is responsible for the Department's administrative functions. According to a department official, this includes overseeing the Department's budget and accounting activities, personnel, purchasing, and risk management. This division is also responsible for managing the Department's computerized business, administrative, and Geographic Information Systems (GIS); and administering the Arizona Land Resources Information System and State Cartographer's Office. Specifically:

    - Arizona Land Resource Information System (ALRIS) program—The ALRIS program provides a GIS service center for government agencies in Arizona. GIS information and data allows public agencies, businesses, and individuals to better accomplish daily tasks that depend on location. This includes managing information about the environment, transportation and utility systems, and emergency response systems. For example, according

to department management, the Department of Transportation may request GIS information to determine land ownership for planning new state highways, while the Arizona Game and Fish Department may request GIS data to aid in wildlife management. The ALRIS program maintains a GIS facility, creates and maintains data, and provides training and technical assistance.

- State Cartographer's Office (SCO)—SCO provides a framework for coordinated development of GIS technology in Arizona by developing standards, facilitating cooperative efforts with other organizations and government agencies, and improving access to GIS information by users in both the public and private sector. For example, SCO coordinated a project to take aerial photographs state-wide and provides these photographs to users on compact disc and through the Department's Web site.

- Natural Resources (30.5 positions, 4 vacant)—This division administers and oversees all natural resource-related leases and permits, such as grazing, agriculture, and minerals. Division staff conduct lease inspections and review applications to place improvements on leased land. The division is also responsible for administrating water sales, mineral materials sales, water rights administration, dam safety on state trust lands, natural resource conservation and recreational permits, and the Department's environmental resource and trespass programs. The Department's trespass section investigates and resolves unauthorized and illegal use of state trust lands, while the environmental resource area handles all environmental issues on state trust land such as dust abatement and environmental contamination.

  Finally, this division maintains a Cultural Resource Management Program to ensure compliance with the State's Historic Preservation Act, which requires the protection of cultural resources from the activities of state agencies.

- Real Estate (51.5 positions, 8 vacant)—This division is responsible for the planning, engineering, and sale of state trust lands. The division includes the commercial lease and sales, planning, right of way, and engineering sections. Division staff perform a variety of functions, such as analyzing and making recommendations concerning the sale or lease of trust land, planning and developing trust land uses, and providing engineering services and support such as infrastructure and environmental assessments. Additionally, this division grants rights of way to facilitate development and accommodate the need for public roads, power, water, and sewers throughout the State. The division also works with communities on land planning and design for urban lands.

- Land Information, Title, and Transfer (22 positions, 2 vacant)—This division is responsible for ensuring the integrity and availability of the State's land ownership title and records. The division also coordinates surface lease, sale, or

use applications and prepares leases, permits, and contracts associated with the surface use of state trust land. Additionally, the division prepares and issues decisions, orders, and notices from the Commissioner's Office, such as notices closing state trust land to recreation, and overseeing the administration of the Department's appeals program wherein interested parties may appeal a final decision of the State Land Commissioner, such as a parcel's appraised value. Specifically, the division coordinates administrative hearings and litigation issues with the Arizona Office of Administrative Hearings and provides administrative support for the Department's Board of Appeals for issues such as appraisal or land classification disputes. Lastly, the division administers the Arizona Preserve Initiative program.

- Forestry (56 positions, 10 vacant)—This division, which houses the State Forester, provides for the prevention and suppression of wildfires on state and private lands located outside incorporated municipalities through the use of various cooperative agreements with local and federal agencies. Additionally, the division mobilizes and manages firefighters and equipment to and from all parts of Arizona and other states, and coordinates firefighting activities between rural fire departments and cooperating federal agencies. The division also maintains in-house firefighting capabilities through its own employees' qualifications and provides technical, educational, and financial assistance through state assistance and other grants to rural communities and private landowners to help manage their forested lands.

The Board of Appeals approves all land sales.

In addition to the Department's divisions, in accordance with A.R.S. §§37-213 and 214, a Board of Appeals is established within the Department that is required to approve all land sales and commercial leases. The Board consists of five members selected by the Governor and confirmed by the Senate for 6-year terms. Three members represent the 15 counties, which are divided into three districts. Two members hold positions-at-large and do not specifically represent any persons or organizations. The Board meets monthly, and during fiscal year 2006, approved 40 commercial leases, 125 right-of-way sale appraisals, and 18 land sale appraisals; and heard 18 appeals.

Operating budget

The Department receives both appropriated and nonappropriated monies. State General Fund appropriations represent the largest source of revenues for the Department. In addition, the Department generates certain fees, such as an administrative fee paid by successful bidders on land sales, which it remits to the General Fund. The Department also receives monies from the sale of environmental special license plates to provide environmental education programs and receives nonappropriated monies from various sources, which, according to a department official, includes federal grants and prepayments from applicants for estimated advertising and appraisal costs.

Table 2 (see page 10), illustrates the Department's actual revenues and expenditures for fiscal years 2005 through 2007. The Department received more than $35.8 million in revenues in fiscal year 2005, more than $52.3 million in fiscal year 2006, and more than $53.5 million in fiscal year 2007. In fiscal year 2006, the Department received an increase of approximately $12 million in General Fund appropriations, which was used to increase staffing and resources for land planning and disposition, to provide additional monies for fire suppression and three additional inmate fire crews, and to retain Central Arizona Project water rights on state trust land. For fiscal year 2005, the Department spent more than $32.2 million, and department expenditures increased to nearly $43.5 million in fiscal year 2006. For fiscal year 2007, the Department spent more than $42.4 million. As of June 30, 2007, the Department had a $5.8 million fund balance.

Audit scope and methodology

This performance audit and sunset review focused on the Department's process for selling and leasing state trust lands and its efforts to manage and protect leased state trust lands. The Department's performance was also analyzed in accordance with the 12 statutory sunset factors. This report includes findings and recommendations in the following areas:

- Although the Department has established a comprehensive process for selling and leasing state trust lands, it should take some additional steps to improve the process; and

- Although the Department has taken steps to better manage leased state trust lands, it should continue to build adequate financial and environmental protections into the terms of lease agreements and permits, and better prioritize inspections of leased lands.

Auditors used various methods to study the issues addressed in this report. These methods included interviewing the Commissioner, department staff, and Board of Appeals members; attending Board of Appeals meetings; and reviewing statutes, rules, and department policies and procedures. In addition, the following specific methods were used:

- To assess the adequacy of the Department's process for selling and leasing urban and rural state trust lands, auditors reviewed the Department's various processes for preparing and selling state trust lands, including processes for creating conceptual land-use plans, selecting parcels that will be placed in the Department's Five-Year Disposition Plan, working with local governments to sell or lease parcels, obtaining various studies for parcels prior to sale or lease, and reviewing the standards and guidelines required for these studies, performing

Table 2: Schedule of Operating Revenues, Expenditures,and Changes in Fund Balance[1]
Fiscal Years 2005 through 2007
(Unaudited)

	2005	2006	2007
Revenues:			
State General Fund appropriations	$17,265,911	$29,263,152	$26,268,946
Reimbursements[2]	6,215,268	4,304,547	10,724,083
Land disposition fees and prepaid fees[3]	3,282,628	11,148,511	10,477,284
Intergovernmental	6,816,876	6,062,086	3,270,871
Cooperative Forestry Fund collections[4]	229,814	197,201	1,389,174
Environmental special plate fees[5]	258,405	256,186	266,705
DOA Risk Management Fund[6]	1,200,000	319,600	230,600
Resale of firefighting supplies and equipment	251,655	256,232	383,994
Other	323,168	507,298	515,699
Total revenues	35,843,725	52,314,813	53,527,356
Expenditures, net operating transfers, and remittances:[7]			
Personal services and employee-related	10,163,586	12,377,437	13,471,968
Professional and outside services	10,841,884	20,017,785	17,061,531
Aid to organizations	4,391,179	3,623,009	2,969,653
Travel and other operating	4,921,875	6,136,528	7,846,541
Equipment	1,924,132	1,321,178	1,055,647
Total expenditures	32,242,656	43,475,937	42,405,340
Net operating transfers out	5,671	54,842	237,444
Remittances to the State General Fund	2,836,800	10,557,639	9,860,701
Total expenditures, net operating transfers out, and remittances	35,085,127	54,088,418	52,503,485
Excess (deficiency) of revenues over expenditures, net operating transfers out, and remittances	758,598	(1,773,605)	1,023,871
Fund balance, beginning of year	5,791,291	6,549,889	4,776,284
Fund balance, end of year	$ 6,549,889	$ 4,776,284	$ 5,800,155

1 The table only includes the Department's revenues and expenditures for operating the Department. Consequently, the table does not include state trust land monies, which are distributed to beneficiaries as prescribed by statute and may not be used to operate the Department. See pages 3 through 5 in the Introduction and Background for information pertaining to the state trust land monies.

2 Consists of monies collected by the Department in accordance with A.R.S. §37-623.02 from cities, other state political subdivisions, and state and federal agencies to reimburse costs incurred in the suppression of wild fires and pre-suppression, and support other unplanned risk activities such as fire, flood, earthquake, wind, and hazardous material responses.

3 Consists of certain fees the Department collects in accordance with A.R.S. §37-108, including a 2 to 3 percent selling and administrative fee paid by successful bidders on land dispositions. Applicants also prepay or reimburse legal advertising, appraisals, due diligence studies, and zoning application costs. As required by statute, the Department remitted approximately $2.8, $10.5, and $9.7 million of these monies to the State General Fund in fiscal year 2005, 2006, and 2007, respectively.

4 Consists of monies restricted to use by the State Forester and are collected by the Department from various sources in accordance with A.R.S. §37-625, including individuals, businesses, cities, towns, and counties. According to the Department, these collections are for various projects such as forest thinning projects conducted by inmate crews.

5 Consists of $17 of the $25 fee charged for environmental special license plates to provide environmental education programs in accordance with A.R.S. §28-2413.

6 Consists of appropriated monies from the Department of Administration (DOA) Risk Management Fund for one-time costs related to the purchase of fire equipment, Wineglass Ranch Dam safety repair costs, and Maricopa County dam repair and maintenance costs in fiscal year 2005, 2006, and 2007, respectively.

7 Administrative adjustments are included in the fiscal year paid.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Revenues and Expenditures by Fund, Program, Organization, and Object* report for fiscal years 2005 and 2006; the AFIS *Trial Balance by Fund* report for fiscal years 2005, 2006, and 2007; and the AFIS *Accounting Event Transaction File* for fiscal year 2007.

appraisals, and selling or leasing parcels through auctions. Auditors also reviewed a sample of five parcel files, appraisal documentation for eight appraisals, the Department's appraisal logs for fiscal year 2006 and July 1, 2006 through May 17, 2007, the State's solicitation issued in August 2005 for appraisal services, and the Department of Administration's February 2007 listing of contracted appraisers.[1] Finally, auditors observed four auctions of state trust lands conducted in June 2006, August 2006, and March 2007, three Board of Appeals meetings, and three department land disposition meetings; conducted a focus group of six land developers; and interviewed an additional two land developers, six city or town officials, five appraisal companies that have contracts with the State, and nine appraisal companies that were not on state contract.

- To assess the Department's management and inspection of leased state trust lands, auditors interviewed Department of Administration Risk Management staff, reviewed various Department of Administration Risk Management reports that addressed state trust land issues, and reviewed the Department's lease and special permit agreements. Auditors also reviewed a sample of 21 well inspections performed in fiscal year 2006 and 16 canceled hard rock mineral lease files in order to verify the Department's reported backlog of inspections, all 8 sand and gravel leases issued between January 2003 and December 2006, and agricultural inspections conducted between October 2006 and March 2007. Finally, auditors interviewed staff from trust land management agencies in Colorado, Montana, New Mexico, Utah, and Wyoming.[2]

- To develop information for the Introduction and Background, auditors gathered and analyzed unaudited financial information about the Department from the Arizona Financial Information System; interviewed agency management; and reviewed unaudited information from the Arizona Master List of State Government Programs for fiscal years 2003 through 2005, the Department's Web site, the Department's organizational chart, the Department's fiscal year 2003 through 2006 annual reports, and other information provided by the Department.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Commissioner and staff of the Arizona State Land Department and members of the Board of Appeals for their cooperation and assistance throughout this audit.

1 Although auditors used the Department's appraisal logs to determine the number of contracted appraisals, this information was limited because auditors could not verify its completeness and accuracy.

2 Auditors contacted Colorado, Montana, New Mexico, Utah, and Wyoming because these states own significant amounts of state trust lands.

FINDING 1

Department uses comprehensive selling and leasing process, but should further enhance it

Although the Department has developed a comprehensive process to sell and lease state trust lands, it should take several steps to further improve this process. The Department has implemented several key steps to improve the return it receives from selling or leasing state trust lands. However, the Department should take some additional steps to further improve the process, including establishing time frames or ranges for the work involved to prepare parcels for sale or lease and making information about parcels available to potential bidders on its Web site as soon as possible. In addition, the Department should improve the appraisals it receives by expanding the pool of contracted appraisers it can use and taking action against appraisers who do not provide quality appraisals to the Department.

Department uses comprehensive planning and selling/leasing process

The Department has developed and implemented a comprehensive process that helps maximize revenues for trust beneficiaries from the sale or lease of state trust lands. Unlike other states, Arizona actively relies on a strategy of selling or leasing these lands to generate revenues for the trust. As such, the Department undertakes a very involved and somewhat complex process to help ensure that the sale or lease of these lands complies with state laws and maximizes revenues for the trust. Although this process was developed for the sale or lease of state trust lands in urban areas, the Department uses many of its steps to evaluate and prepare rural state trust lands for sale or lease.

Sale or lease of state trust lands key strategy for generating revenues—Although some states may periodically sell state trust lands, Arizona is unique in that it actively employs a strategy of selling or leasing state trust lands

to generate revenues for its beneficiaries. Consistent with its mission, the Department sells a small percentage of state trust lands each year to generate revenues for trust beneficiaries. The Department reports that, as of March 15, 2007, it manages approximately 9.2 million acres of state trust land on behalf of various state beneficiaries, including kindergarten through 12th-grade (K-12) public schools. According to a joint Lincoln Institute Land Policy and Sonoran Institute report, which summarizes 2004 information on state trust lands of the Western states that continue to hold some of their originally granted state trust lands, such as Nevada, New Mexico, and California, Arizona possesses the largest holding of these lands.[1] While some of these states have retained a large portion of their original state trust land grants, others have only retained a small fraction of the state trust lands granted to them. For example, while New Mexico still holds approximately 9 million acres and Montana holds approximately 5.1 million acres, Nevada only retains around 3,000 acres of its original 2.7 million acre grant. New Mexico holds nearly the same amount of state trust lands as Arizona, but obtains most of its revenue from oil and gas reserves on its state trust lands and generates practically nothing from commercial and residential uses.

The Department generated $453.7 million from state trust land sales in fiscal year 2007.

As previously illustrated in Table 1 (see page 4), during fiscal years 2004 through 2007, the Department held 82 successful state trust land auctions, which generated approximately $310.6 million, $254.5 million, $544.3 million, and $453.7 million in gross sales, respectively. For fiscal years 2004 through 2007, these auctions also generated nearly $2 billion in lease revenues that the Department will collect over the terms of the leases.

Urban Lands—Enacted in 1981, this act establishes a process for planning urban lands, contains criteria for determining when trust lands are suitable for urban planning, and authorizes the Department to prepare development plans for properties.

Growing Smarter—Enacted in 1998, this act requires comprehensive municipal, county, and department land use planning and zoning reforms, provides for the acquisition and preservation of open spaces, and establishes a program for continuing study and consideration of pertinent issues relating to public land use policies.

Growing Smarter Plus—Enacted in 2000, this act builds on the Growing Smarter Act by establishing nomination and selection procedures for the conservation of select state trust lands through the designation of those lands as Arizona Conservation Reserve lands. It also modifies and expands the planning authority of municipalities and counties and expands citizen participation in the process. It allows for the exchange of state trust land for other public lands, the donation of state trust lands to school districts for use as instruction sites, and the creation of rural planning areas.

Source: A.R.S. §37-331 et seq; Laws 1998, Ch. 204; and Laws 2000, 4th Special Session, Ch.1.

Process helps Department comply with mandates—As illustrated in Figure 4 (see page 15), the Department uses a comprehensive process to sell or lease state trust lands. Not only does this process help the Department to identify, plan for, and prepare state trust lands for sale or lease, it helps the Department to comply with the many state laws governing the sale or lease of these lands and to maximize revenues from the sale or lease of these lands for trust beneficiaries. For example, in planning for the sale or lease of state trust lands, the Department must comply with the Urban Lands, Growing Smarter, and Growing Smarter Plus Acts (see textbox). The process also includes other steps that the Department implemented to improve or properly oversee the process. Specifically:

[1] Culp, Peter W., Diane B. Conradi, and Cynthia C. Tuell. *Trust Land in the America West: A Legal Overview and Policy Assessment.* Cambridge, MA: Lincoln Institute of Land Policy, 2005. According to this report, it primarily includes information from 2004.

Figure 4: Process to Sell or Lease State Trust Lands
As of June 2007

Conceptual planning	The Commission shall create conceptual land use plans for all urban lands and other lands determined to be appropriate. (A.R.S. §37-331.03)	The Commissioner shall prioritize the creation of conceptual plans to correlate with the population growth in urban areas of the State and to coincide with the creation of municipal general plans under A.R.S. §9-461.05 and county plans under A.R.S. §11-821. (A.R.S. §37-331.03)	Urban Land Planning Oversight Committee reviews the plan and makes recommendations for approval of the final plan.[1] (A.R.S. §§37-331.02, 03)	Commissioner approves the final plan. (A.R.S. §37-331.03)
Five-Year Disposition Plan	The Commissioner shall create a *Five-Year Disposition Plan* (Plan).[2] (A.R.S. §37-331.03)	For parcels listed on the Plan, an application to purchase or lease the parcel can be submitted and is reviewed by staff. According to a department official, applications may also be submitted for parcels not listed on the Plan which staff will review and recommend for possible inclusion in the Plan.	Comments are solicited from department divisions and outside agencies on applications for sale or lease.	Issues raised by department divisions and outside agencies are resolved.
Obtain studies and information	Site studies are conducted. These studies can include, but are not limited to: • American Land Title Association (ALTA) Survey • Environmental assessments • Soil studies	Commissioner shall reclassify the parcel if existing classification is not consistent with proposed use. For example, if the parcel is classified for agricultural use, but the proposed use is for commercial development, the parcel would need to be reclassified. (A.R.S. §37-335)	Department staff review and approve site studies.	
Parcel appraisal	All state trust lands, including all improvements made or placed on or connected with state trust lands, are subject to appraisal. (Enabling Act, the Constitution, and A.R.S. §37-231)	Department's Office of Appraisal reviews and approves appraisal.	Board of Appeals reviews and approves or denies the sale or lease of state trust lands. (A.R.S. §37-132)	
Property is sold or leased	Department advertises proposed sale or lease of parcel for 10 consecutive weeks in a newspaper regularly published nearest the location of the parcel and at the State Capitol prior to the auction. (Enabling Act, the Constitution, and A.R.S. §37-237)	Department auctions parcel.[3] (Enabling Act, the Constitution, and A.R.S. §37-236)		

Required by Enabling Act, Constitution, or Statute Department Process

1 The Urban Land Planning Oversight Committee is a Governor-appointed committee that recommends procedures and strategies to efficiently create conceptual land use plans.

2 Parcels are included in the *Five-Year Disposition Plan* if market demand and anticipated transportation and infrastructure, such as roadways, water, sewer, electric, and gas, exist for a parcel. In addition, parcels may be included in the Plan if an application is submitted to purchase or lease a parcel or if the Commissioner determines that a parcel is suitable for sale.

3 Auctions are held at the county seat of the county where the parcel or a major portion of the parcel is located. The successful bidder is the highest and best bidder as determined by the Department.

Source: The Arizona State Constitution, Enabling Act, Arizona Revised Statutes, and Auditor General staff analysis of a sample of five parcels the Department sold between June 2004 and April 2007 and interviews with department staff.

Conceptual Land Use Plan—A plan developed for urban state trust lands and other state trust lands the Commissioner considers to be appropriate and that identifies appropriate land uses, including commercial, industrial, residential, and open space uses; transportation corridors and infrastructure requirements, and all natural and artificial constraints and opportunities associated with the land.

Source: A.R.S. §37-331.03(E)(1).

- **Conceptual planning**—As required by A.R.S. §37-331.03, the Commissioner must initially create conceptual land use plans for all urban state trust lands in Arizona and other state trust lands the Commissioner considers to be appropriate.[1] The Department created the first conceptual plan in May 2000, and as of May 2007, the Department reported creating conceptual land use plans for 6 percent of state trust lands. A department official reported that the majority of conceptual planning in priority areas, including growth areas in Maricopa, Pima, and Pinal Counties, will be completed in the next 2 years. Creating conceptual land use plans for state trust lands is consistent with the Auditor General's recommendation from its 1997 performance audit and sunset review of the Department (Report No. 97-6) that it develop a state-wide asset management plan to guide trust land management and disposition decisions. Conceptual land use planning can help assist the Department in determining appropriate land uses and open space uses, available roads and infrastructure, and natural and artificial constraints and opportunities associated with the land.

  Conceptual land use plans are typically created for large areas of state trust land. For example, the Department developed a conceptual land use plan consisting of 34,742 acres of state trust land in and around the City of Peoria. Once the conceptual land use plan has been created, the planned area is later divided into smaller properties, called parcels, for additional planning and eventual sale or lease. For example, the Department sold 56.77 acres that were located in the City of Peoria for the development of a commercial retail shopping center.

  A.R.S. §37-331.03 requires the Commissioner to work with cities or towns and counties to integrate the conceptual land use plan into each city's or town's general plan or county's plans. According to all six city and town officials interviewed during the audit, the Department works with them on various planning activities, such as determining allowable zoning and the availability of roadways and infrastructure, including water, sewer, and utilities, when planning a parcel for sale or lease. One city official indicated that the Department has a better general planning process than it did 20 years ago, and another official indicated that the Department is doing a great job working with his city. In addition, two other city officials indicated that the Department tries hard and is doing the best job that it can considering the legal requirements that it must meet.

The Department works with cities and towns on various land-planning activities.

- **Five-Year Disposition Plan**—As required by A.R.S. §37-331.03, state trust land parcels that are being planned for sale or lease, reclassified for conservation purposes, master planned, or zoned within the next 5 years are included in the Department's Plan. Parcels must at least have a conceptual plan or a more detailed plan, called a development plan, to be included in the Plan. Parcels

[1] According to A.R.S. §37-331.01, the governing body of a city, town, or county may request that the Commissioner designate as urban lands state trust lands that are located within 1 mile of the corporate boundaries of an incorporated city or town having a population of fewer than 250,000 people or within 3 miles of the corporate boundaries of an incorporated city or town having a population of 250,000 people or more.

may be included in the Plan if the Commissioner determines that a parcel is suitable for sale or if market demand and available infrastructure, such as roadways, water, sewer, gas, and electric, exist for a parcel. In addition, parcels may be included in the Plan if an application has been submitted to purchase or lease a parcel. If individuals or companies are interested in purchasing or leasing a specific parcel, they can submit an application expressing this interest. Once a parcel is included in the Plan, department staff meets regularly to discuss what steps should be taken to prepare the parcel for sale or lease, such as when the parcel will be appraised and which site studies should be obtained for the parcel. The Department also works with local governments to address any concerns regarding the parcel and to establish the appropriate zoning, determine the availability of roads and infrastructure, and sometimes perform additional planning.

Five-Year Disposition Plan—Created by the Commissioner for all state trust land based on market demand and anticipated transportation and infrastructure availability. The Commissioner must review and update the Plan each year as may be necessary; consult with the cities, towns, or counties in which the land is located and with any regional planning organization; and submit the Plan and revision to the Urban Land Planning Oversight Committee. This committee consists of five members appointed by the Governor who provide advice and recommendations to the Department regarding land planning.

Source: A.R.S. §§37-331.02 and .03.

Department efforts to prepare state trust land parcels for sale or lease are also consistent with recommendations from the Auditor General's 1997 performance audit and sunset review (see Report No. 97-6). This report recommended that the Department develop selling and leasing strategies for large urban trust properties as they become ready for development. The report also recommended examining the feasibility of installing core infrastructure to increase the value of parcels. Although the Department does not install infrastructure, it works with local governments to determine the availability of roads and infrastructure on parcels being prepared for sale or lease and in some cases, to determine the cost of installing infrastructure to increase the parcel's value.

- **Various site studies and information obtained for parcels**—As part of its process for preparing state trust lands for sale or lease, the Department may obtain various site studies and information regarding a parcel in order to properly value, and in some cases increase, the value of a parcel. Depending on available funding, either the Department or the applicant contracts with consultants to obtain site studies and gather information. To help pay for the costs of these studies, the Legislature established a due-diligence fund in fiscal year 2006. According to a department official, this fund has made additional monies available to expedite the completion of site studies. The Department has also established standards and guidelines for the performance of site studies and the information provided by consultants. Although different site studies and information may be required for each parcel, the Department typically obtains an environmental site assessment to determine if any environmental issues such

Environmental, soil, ALTA, and other site studies help to properly value a parcel.

as hazardous waste need to be addressed, soil studies to determine the quality and density of the soils on the parcel, and an American Land Title Association (ALTA) survey of the parcel, which is a survey map of the parcel. In addition, as required by A.R.S. §41-861, the chief administrator of each state agency is responsible for the preservation of historic properties that the agency owns or controls. As such, the Department consults with the Arizona State Parks Board, State Historic Preservation Office regarding each parcel to determine whether there are cultural resources on the parcel.

Once the site studies are completed, the Department makes them available to potential bidders and other interested parties. The Department also posts these studies on its Web site. If the successful bidder for the property was not the applicant and therefore did not pay for the site studies, then the successful bidder reimburses the applicant or the Department for the cost of the site studies.

Some developers that auditors interviewed indicated that the site studies have improved greatly over the past 6 years. In addition, these developers indicated that the site studies are needed as they remove some of the risk and uncertainty regarding the parcels. For example, an archaeological survey of a parcel that was auctioned in Peoria in June 2006 indicated that the parcel had several archaeology sites for which the estimated cost of removing the artifacts was approximately $1.9 million. This type of information helps both the Department and potential bidders place a value on a parcel.

- Parcels are appraised—After the site studies have been completed, the Department must appraise the parcel to determine its value. Specifically, A.R.S. §37-231 requires that all state trust lands, including all improvements made or placed on or connected with state trust lands, shall be subject to appraisal. This appraised value then serves as the minimum amount that the Department can accept when the parcel is sold or leased. Either department staff or contracted appraisers perform appraisals of state trust lands. According to a department official, the Department will use contracted appraisers for most of the parcels that are included in the Plan and are being prepared for sale or lease, while department staff typically perform appraisals of more low-profile parcels, such as parcels that will be disposed of to schools because schools are beneficiaries.

  Once the appraisal is completed, the Department submits the parcel to the Board of Appeals for review and approval. The Board, which consists of members with experience in the classification and appraisal of all types of real estate, is required under A.R.S. §37-132 to approve a parcel for sale or lease. The Department cannot move a parcel to auction without this approval.

The Board of Appeals must review and approve a parcel for sale or lease.

- Marketing and selling/leasing property—Prior to holding an auction, A.R.S. §37-237 requires the Department to advertise the auction once each week for at least

10 consecutive weeks in a newspaper of general circulation published regularly at the State Capitol, and in a newspaper of like circulation regularly published nearest the location of the state trust land to be sold. In addition to advertising the auction, the Department attempts to find applicants by contacting potential buyers within the real estate community, such as builders, land developers, and land brokers, to inform them of parcels that are available for purchase or lease. The Department also participates in real estate conferences and provides potential buyers with informational packets and brochures regarding parcels that are available for purchase or lease. These efforts are consistent with the Auditor General's 1997 performance audit and sunset review, which recommended that the Department expand its marketing efforts. However, if the Department does not receive interest in a specific parcel, A.R.S. §37-236 allows the Commissioner to cancel the auction and reschedule it for a later date. Additionally, A.R.S. §37-236 stipulates that the Department shall order the sale of lands to the highest and best bidder.

Process also used to sell or lease rural state trust lands—Although the Department developed the process to identify, plan for, and sell urban state trust lands, it uses many of these same steps to evaluate and prepare rural parcels for sale. In response to legislation in fiscal years 2005 and 2006, the Department reports that it committed resources and staff to sell and lease state trust lands in rural areas. Specifically, Laws 2005, Ch. 286, and Laws 2006, Ch. 344, require the Department to use at least 2 of the 12 newly appropriated Full-Time Equivalent positions for the planning and sale or lease of state trust lands located within 5 miles of the corporate boundaries of incorporated cities and towns having a population of fewer than 100,000 persons.[1] The Department submits quarterly reports to the Joint Legislative Budget Committee identifying the resources, including FTE and monies, used for the planning and sale or lease of urban and rural parcels. Based on the quarterly reports for fiscal year 2006 and the first and second quarters of fiscal year 2007, the Department reports that the equivalent of between 12 and 17.5 staff spent time planning and selling or leasing rural parcels. According to a department official, these staffing resources represent the combined total of time department staff spent on rural parcels converted into FTE positions. As illustrated by Table 3 (see page 20), the Department reported that it has sold 1,763.07 acres of rural parcels between fiscal years 2004 and 2007. The Department is also preparing several other rural parcels for sale or lease, including parcels in Kingman, Lake Havasu City, Flagstaff, and Yuma. The Department reported that the sale of rural parcels generated $73.3 million for trust beneficiaries from fiscal years 2004 through 2007.

1 According to a department official, the intent of this law was to increase planning, sales, and leasing efforts in rural areas. According to this same official, the Department classifies state trust lands as rural based on the definition established by legislation; however, the Department also includes state trust lands that are located in areas where there are no cities or towns nearby and excludes the surrounding areas of cities and towns located within city limits, such as the area surrounding the Town of Paradise Valley. This same official also indicated that the Department's interpretation of the definition classifies state trust lands as rural in areas such as Lake Havasu City, Kingman, and Flagstaff.

Table 3: Urban and Rural Land Sales
Fiscal Years 2004 through 2007
(Unaudited)

	Urban Lands[1]		Rural Lands	
Fiscal Year	Acres Sold	Sales Price (in millions)	Acres Sold	Sales Price (in millions)
2004	1,824.41	$ 309.9	50.11	$ 0.7
2005	1,766.30	253.6	50.15	0.8
2006	2,538.84	484.5	887.20	59.8
2007	3,486.72	441.7	775.61	12.0
Total	9,616.27	$1,489.7	1,763.07	$73.3

1 As defined by A.R.S. §37-101, urban lands are those that adjoin existing commercially or home site-developed lands and that are either within or adjacent to a city or town's corporate boundaries, or are lands requested to be designated as urban lands pursuant to by A.R.S. §37-331.01, which permits cities, towns, and counties to request that the Commissioner designate as urban lands state trust lands that are located within 1 mile of the corporate boundaries of an incorporated city or town having a population of fewer than 250,000 people or within 3 miles of the corporate boundaries of an incorporated city or town having a population of 250,000 people or more. According to a department official, the Department uses this definition to classify lands as urban or rural in its annual reports.

Source: Auditor General staff analysis of the Department's Annual Reports for fiscal years 2004 through 2006 and fiscal year 2007 information provided by department staff.

Department should further enhance selling and leasing process

Although it has established a comprehensive process to sell or lease state trust lands, the Department should take steps to further enhance this process. First, to help determine whether substantial variations in processing times are indications of problems in the process, the Department should establish time frames or ranges for each step within this process, monitor compliance with these time frames, and analyze any discrepancies when time frames or ranges are not met. Additionally, the Department should make information from site studies available on its Web site as soon as possible to ensure that potential bidders have sufficient time to review this information.

The Department may require years to prepare a parcel for sale or lease.

Time frames or ranges can help in analyzing whether some steps take too long—Although the Department meets regularly to assess the progress made in preparing a parcel for sale or lease and to establish target dates to complete the various steps in its process, the Department has not established time frames or ranges for the completion of these steps. Preparing and selling or leasing parcels can take the Department years, and auditors noted wide variations in how much time was required to sell various parcels. According to a department official, it typically takes the Department approximately 2 years to sell or lease a parcel. However, this amount of time varies from parcel to parcel. Based on a review of five parcel files, auditors found that it took the Department between approximately 18 months and 3 years to sell these parcels. In fact, for the two parcels that sold in 18 months and 3 years, the Department performed many of the same activities to plan and prepare these parcels for sale, such as obtaining similar site studies, obtaining two appraisals, and rescheduling the auction. Yet, one parcel required an additional 18 months to sell.

Although the Department establishes target dates to complete some steps in its process, it has not established time frames or ranges to complete the steps in its process, nor does it track how long the various steps within its state trust land selling and leasing process take. Specifically, as the Department proceeds through its land selling and leasing process, it regularly meets to review what steps

have been completed, determine what steps need to be completed next, and establish or revise target dates for completing these steps. However, without established time frames or ranges for completing steps in the process, and by not tracking how long these steps take, the Department does not have a true indication of how long the state trust land selling and leasing process and each step within the process should take, nor can it detect when steps within the process are taking too long. Therefore, the Department should establish time frames or ranges, and then monitor the performance of the various steps within its process against these time frames or ranges and analyze any discrepancies when time frames or ranges are not met. Although this may not dramatically decrease the time it takes to sell or lease parcels, it could help the Department identify steps that could be completed more quickly.

Establishing time frames or ranges can help the Department assess process timeliness.

Department should post site study information on its Web site as soon as possible—Although the Department obtains various site studies regarding parcels planned for sale or lease, it does not post site study information on its Web site when each of the site studies has been completed. As previously mentioned, the Department obtains various site studies and information for a parcel in order to properly value, and in some cases increase, the value of a parcel. For example, soil studies may indicate the number of units that can be developed on a parcel, which informs potential bidders of the parcel's development potential.

Although department officials indicated that interested parties can review site study information at the Department as these studies are completed, in some cases, it takes much longer to make site study information available on the Department's Web site. Based on auditors' review of three parcel files, site studies for two of the parcels were completed between approximately 6 to 8 weeks before a request was submitted to post the studies on the Department's Web site, while most of the site studies for the third parcel were completed 4 weeks before a request was submitted to post the studies on the Department's Web site. However, for this third parcel, one site study was completed 7.5 months before a request was made to post the study on the Web site. Additionally, for the third parcel, the request to post most of the site studies on the Web site was submitted approximately 10 weeks before the auction. This may not provide developers and other interested parties sufficient time to review the site studies on the Department's Web site. According to the developers interviewed during the audit, 10 weeks does not provide a sufficient amount of time for them to adequately evaluate the site studies and the parcel. Developers also indicated that they especially need more time to evaluate larger parcels. Providing insufficient time to review site studies may deter potential bidders from bidding on the parcel. Therefore, the Department should post site studies on its Web site as the studies are completed.

Department should improve appraisals

In addition to enhancing its state trust land sales and lease process, the Department should take steps to improve appraisals. According to a department official, the Department does not have an adequate number of qualified appraisers on contract, and as a result, the quality of some appraisals has not met the Department's needs. As such, the Department should take steps to develop a larger pool of qualified appraisers from which it can contract for appraisals, and when warranted, take appropriate action when appraisals do not meet department requirements or appraisal standards.

Department lacks sufficient number of qualified appraisers on contract—According to a department official, the Department does not have access to a sufficient number of qualified appraisers on contract to perform appraisal work. According to the Department of Administration's (DOA) SPIRIT System Web site and a review of one contract not reflected on this Web site, 35 companies have contracts with the State to provide appraisal services to state agencies, including the Department. The State's appraisal contract is managed by the Arizona Department of Transportation (ADOT), which serves as the State's strategic contracting center for appraisal services. According to an ADOT official, ADOT worked with various state agencies, including the Department, that use appraisal services to develop this contract. According to a department official, the Department typically selects appraisers from the State's approved list based on the type of parcel to be appraised, the complexity of the appraisal assignment, the specific qualifications of the appraiser, the availability of an appraiser, and the Department's prior experience with the appraiser. However, according to this same official, based on these needs and requirements, only 14 of the 35 appraisers on contract possess the qualifications the Department requires.[1] Additionally, this official indicated that, depending on the unique characteristics of a parcel being appraised, many of these 14 contractors may not be qualified to do the appraisal. For example, when the Department needs a complex right-of-way appraisal, only 10 of the 14 contractors possess the necessary expertise to perform these types of appraisals.

SPIRIT System—An automated procurement system administered by the DOA's State Procurement Office that includes state solicitations, state contracts, and state contractors.

Source: DOA SPIRIT Web site available at: http://spirit.az.gov/Applications/SPIRIT/SR.nsf.

A department official indicated that only 14 of 35 appraisal companies on state contract meet Department requirements.

This relatively small pool of qualified appraisers has forced the Department to take various actions to obtain acceptable appraisals from contractors. Based on the Department's appraisal log, from July 2006 through May 17, 2007, the Department contracted for 79 appraisals.[2] Additionally, although the Department could not provide a complete listing, the fiscal year 2006 appraisal log indicated that the Department contracted for 81 appraisals in fiscal year 2006. However, according to a department official, since the state-wide appraisal contract has only 14 contract appraisers who are qualified to do the Department's appraisals, it has

1 Based on the Department's appraisal log, from July 2006 through May 17, 2007, the Department used two additional appraisers. However, according to a department official, the Department will not use one of these appraisers again, and the other appraiser does not usually want to do appraisals for the Department.

2 Although auditors used the Department's appraisal logs to determine the number of contracted appraisals, this information was limited because auditors could not verify its completeness and accuracy.

used some appraisers in areas where they may not possess the requisite expertise. In addition, in a few instances, the Department has continued to use appraisers despite problems with their previous work. Further, the Department has had to use appraisers that are not on the state-wide contract to obtain needed appraisal services. Specifically, based on the Department's appraisal logs from June 2006 through April 2007, the Department contracted with five appraisers who were not on the state-wide contract to provide appraisal services. These five appraisers provided eight appraisals during this time. The Department reported that it entered into these contracts because the appraisers on the state contract either did not possess the desired qualifications or could not perform the requested work. Additionally, according to a department official, the Department has used some of the appraisers on the state-wide contract to conduct appraisals for which they were not the best qualified because the Department lacked options to get the appraisal work done within the required time frame. Finally, the Department has continued using some of the 14 contractors to perform appraisals even though the Department has had concerns with some of their work.

The Department has established and implemented procedures regarding the reporting requirements and minimum standards that contract appraisers must meet. Although department staff review appraisals to ensure compliance with these requirements, according to a department official, some appraisals have not met these requirements as initially submitted. This has resulted in situations where the Department spent additional time and resources to remedy problems with some appraisals. For example:

- Appraisal contained errors—The Department has spent time working with one contracted appraiser to address errors in an appraisal. Specifically, department staff spent approximately 5 months working with this appraiser to address problems in the appraisal report, including noncompliance with the *Uniform Standards of Professional Appraisal Practice and Advisory Opinions* (USPAP) and the appraisal methodology.[1] According to a department official, the Department has continued to use this contracted appraiser because the Department has a limited number of appraisers on contract, and some of the most qualified appraisers on contract do not accept assignments from the Department for various reasons, including being too busy with other clients. However, according to this same official, the Department tries to use this appraiser only for less-complex appraisals and provides more specific instructions and oversight than are normally provided to other appraisers regarding what needs to be done for each appraisal.

Because of the limited number of contracted appraisers it can use, the Department has generally preferred to work with appraisers to ensure appraisals meet department requirements rather than take punitive action. According to a department official, the Department has discontinued using one appraiser because this appraiser did not comply with confidentiality requirements. However,

1 The USPAP is published, interpreted, and amended by the Appraisal Standards Board of the Appraisal Foundation. State and federal regulatory authorities use the content of the applicable edition of the USPAP, which includes rules, standards, and statements on appraisal standards to be used by appraisers and users of appraisal services.

according to this same department official, instead of taking any action against appraisers as authorized by the contract, the Department has opted to work with appraisers to address problems with the appraisals before the Department accepts and approves appraisal reports. According to another department official, by doing so, the Department hopes it is raising the bar regarding the level of work the Department accepts. Additionally, according to a department official, the Department has not reported the USPAP noncompliance to the Arizona Board of Appraisal because errors in appraisals are not fraudulent, but rather are a result of mistakes due to the contract appraiser's lack of knowledge or experience to competently complete the assignment. Appraisers are also usually willing to work with the Department to perform the specific appraisal competently.

Department needs to do more to obtain quality appraisals—To help ensure that the Department consistently obtains quality appraisals, it should take the following steps:

Several appraisers not on state contract expressed interest in conducting the Department's appraisals.

- Expand pool of qualified appraisers—Several appraisers have expressed interest in performing appraisals for the State, and the Department should work with DOA and ADOT to increase the number of qualified appraisal companies on state contract. To obtain a contract with the State, interested parties must complete several steps. Generally, they must register with the State on DOA's SPIRIT System, specifying the various categories of goods and/or services they would be interested in providing, await a solicitation notice from DOA through the SPIRIT system, and then respond with a formal proposal to the solicitation. The proposal would then be evaluated and a contract potentially awarded. According to the Department, it prepared a letter notifying all certified General Real Estate Appraisers licensed in the State regarding the appraisal contract solicitation and procedure for registering with the State on DOA's SPIRIT System. Auditors contacted nine companies that registered to provide appraisal services to the State, but did not submit a proposal in response to DOA's solicitation for services. These nine companies were recommended to auditors by the Department as companies that could provide the types of appraisal services the Department needs. Six of the nine appraisers indicated that they misunderstood the State's contracting process and thought they had submitted all necessary information when they had not, or thought they had a contract with the State simply because they had registered. Additionally, these six appraisers indicated that they would like to do appraisals for the State. Further, according to a department official, some of the appraisers that he spoke to said that they did not even register to provide appraisal services to the State because they did not know the type of appraisals that the State needed and thought that the appraisals were only going to be done for ADOT.

Some appraisers reported misunderstanding the State's contracting process.

The existing state-wide contract expires in November 2007 with 1-year renewable options through November 2010. According to an official with DOA's State Procurement Office, additional contractors cannot be added to a

current contract. However, if a strategic contracting center chooses to, it could let the contract expire and issue a new solicitation and contract, or issue a supplemental solicitation and contract. According to an ADOT official, ADOT would consider pursuing a new or supplemental solicitation and contract to assist the Department if it provides documentation justifying the need for more appraisers on contract. In addition to working with ADOT, the Department should communicate with all potential bidders to ensure that they understand all of the steps of the State's procurement and contracting process and that they understand the types of appraisals that the Department needs.

- Take action against appraisers when warranted—Although the Department has preferred to not take action against appraisers for either poor quality or USPAP-noncompliant appraisals, it should establish and implement policies for taking appropriate action when appraisals do not meet department requirements or USPAP standards. These policies should take into account the seriousness and frequency of problems, as well as the enforcement or penalty actions authorized by the contract, such as termination of the appraiser's contract with the State and/or withholding payment to recover any costs resulting from nonperformance. The policy should also identify circumstances that would require the Department to report appraisers to the Arizona Board of Appraisal.

- Document justification for use of off-contract appraisers—Department procedures require that each off-contract purchase must be justified and approved by department management. Although letters were submitted to department management justifying the use of the five appraisers that are not on the state-wide contract, only one letter was submitted for an appraiser who provided a total of four appraisals. The Department did not document justification for three appraisals that this appraiser performed. According to a department official, the initial letter that was submitted justifying the use of this appraiser was thought to be adequate for any additional use of this appraiser as well. However, the Department should ensure that it documents justification for each appraisal that is obtained from an appraiser who is not on the state-wide contract, as required by department procedures.

Recommendations:

1. The Department should establish time frames or ranges for each step within its state trust land selling and leasing process, monitor the performance of various steps within its process against these time frames or ranges, and analyze any discrepancies when time frames or ranges are not met.

2. Once it establishes time frames or ranges and evaluates the timeliness of the steps within the process, the Department should identify steps that could be completed more quickly and modify its process to complete these steps more quickly.

3. The Department should ensure that site study information is posted on its Web site as soon as studies are completed.

4. The Department should work with the Departments of Administration and Transportation to increase the number of appraisers on state contract that meet the Department's needs by:

    a. Issuing a new or supplemental solicitation and contract, and

    b. Communicating with all potential bidders to ensure that they understand all of the steps of the State's procurement and contracting process and the types of appraisals the Department needs.

5. The Department should establish and implement policies for taking appropriate action when appraisals do not meet department requirements or USPAP standards. These policies should take into account the seriousness and frequency of problems, as well as the enforcement or penalty actions authorized by contract, such as termination of the appraiser's contract with the State and/or withholding payment to recover any costs resulting from nonperformance. The policy should also identify circumstances that would require the Department to report appraisers to the Arizona Board of Appraisal.

6. The Department should ensure that it documents justification for each appraisal that is obtained from an appraiser that is not on the state-wide contract, as required by department procedures.

FINDING 2

Department should further improve state trust land management

Although the Department has improved its management of the approximately 9 million acres of state trust lands that are leased, it should take steps to further improve lease and permit language and better prioritize inspections of these lands. Since 1998, the Department has strengthened the financial and environmental protection terms of its lease agreements, but some additional steps are needed. The Department has also established inspection programs, but should ensure all critical leases receive inspections in a timely manner. Additionally, to ensure it focuses resources on inspecting leases that pose the greatest risk, the Department should prioritize inspections and explore a staffing structure that would potentially allow for better state-wide coverage. Finally, the Department should better document and track the inspections it performs.

Most state trust lands leased

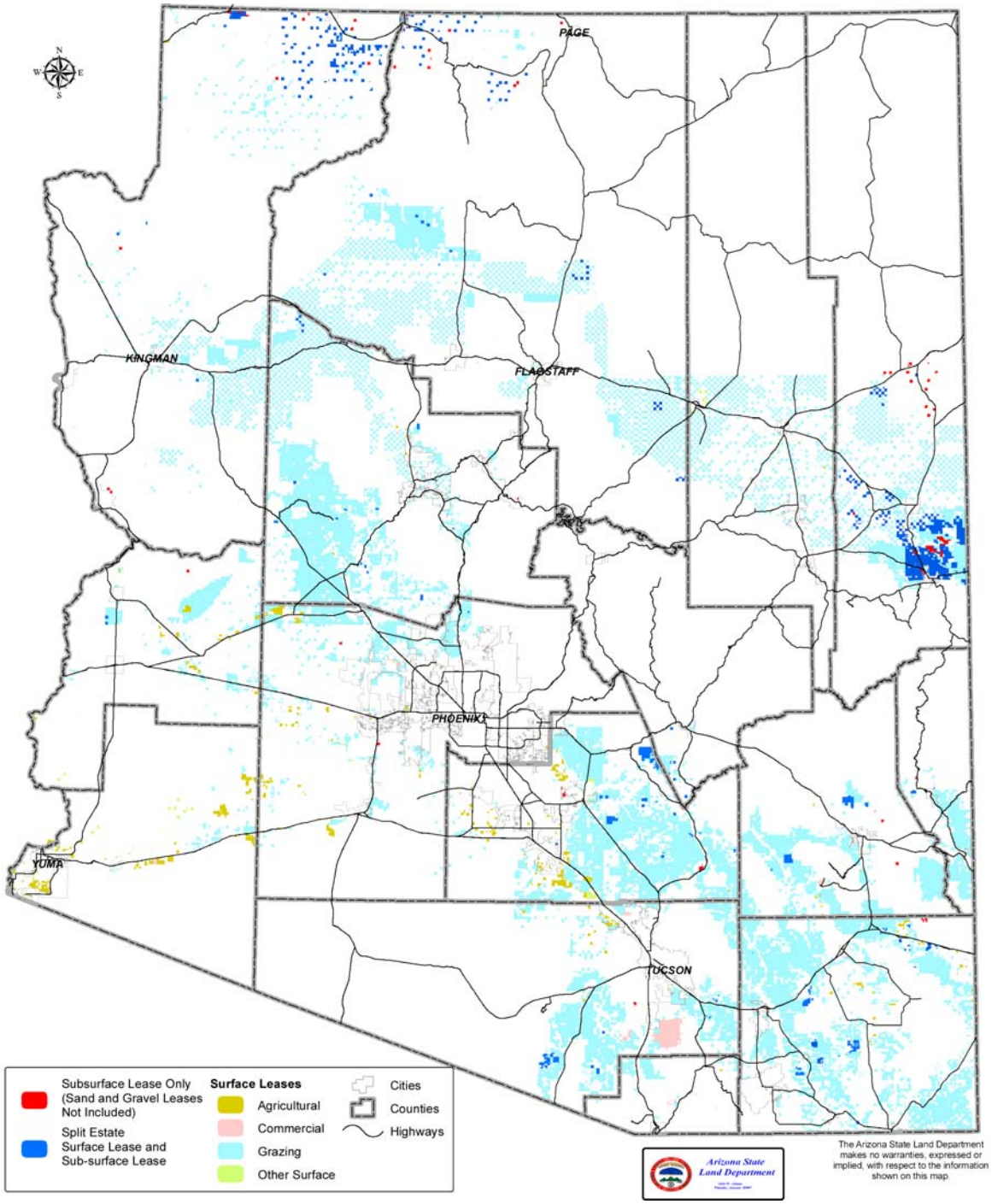
The majority of state trust lands are leased for various uses. As of April 2007, the Department administered leases for more than 9 million acres of state trust lands, including more than 1,200 grazing leases covering close to 8.4 million acres, almost 400 agricultural leases covering more than 173,000 acres, and close to 120 mineral leases throughout the State. The Department also issues leases for other purposes, such as commercial use and rights of way, and issues both short- and long-term leases. Figure 5 (see page 28) shows the distribution of these leases throughout the State. Although the lease lengths vary depending on lease type, the Department typically enters into 10-year grazing and agriculture leases whereas a commercial lease may be issued for up to 99 years. Additionally, with department approval, lessees can place reimbursable improvements on the leased state trust land, such as irrigation systems, and can have a leasehold interest. The Department also issues more restrictive special land use permits (SLUPs) for these same land uses, but generally for a

More than 9 million acres of state trust lands are leased.

Special Land Use Permit (SLUP)—SLUPs are granted for the temporary use of state trust lands, such as grazing, agricultural, and commercial activities. A SLUP does not give the permittee a leasehold interest in the land, and therefore, can be unilaterally revoked by the permittee or the State Land Commissioner. A SLUP does not allow the placement of permanent improvements on state trust lands.

Source: The Department's Web site and a department official.

Figure 5: State Trust Land Leases
As of February 2007



Source: Arizona State Land Department, Geographic Information Systems (GIS) section, GIS data library custom map as of February 1, 2007.

shorter period of time. The Department issues permits for other uses as well, such as mineral exploration, bee-keeping, and advertising. Although commercial leases generate higher revenues for the trust, the majority of the land is leased for natural resource purposes. Additionally, the Department administers more than 560 SLUPs and nearly 370 mineral exploration permits.

Lease language improved, but additional steps needed

Since March 1998, the Department has worked with the Department of Administration's (DOA) Risk Management Office to address concerns with the financial and environmental terms of its lease agreements. Although the Department has made improvements, it should continue to work with Risk Management as Risk Management identifies areas where the Department could improve its leases to better protect the State. Similarly, the Department should revise its SLUP and permit language to ensure the State is adequately protected.

Department has made improvements to leases to better protect State—In March 1998, the Department entered into an agreement with DOA's Risk Management Office to assess and modify as needed the Department's lease terms to better protect the State. According to Risk Management, claims resulting from environmental issues on state lands, such as contamination from pesticides or leaking petroleum, historically ranked as the Department's largest claim expenditure. Risk Management reported that although in some instances a lessee was identified, the State could not recover its costs because the lessee either had insufficient resources to cover the remediation costs and/or had not been required to provide insurance or bonding when the lessee entered into the lease with the Department. From January 1989 through March 2007, the Department's total environmental claims exceeded $14.7 million. Additionally, according to Risk Management, DOA is holding more than $9 million in reserve for open environmental claims on state trust lands. Some claims are a result of the lessee's actions, while others may be out of the Department's control, such as illegal dumping.

The State paid more than $14.7 million for environmental claims on state trust lands between January 1989 and March 2007.

To reduce the number of these claims, the Department began working with Risk Management to revise some of its lease terms. Although the Department's commercial leases already had fairly comprehensive indemnity provisions and environmental language, other lease types provided less protection for the State, but have since been improved. Specifically:

- **Grazing and agricultural lease terms improved**—Grazing and agricultural leases included indemnification language, but neither required the lessee to maintain commercial general liability insurance during the lease term with specified limits. Maintaining insurance coverage ensures that in the event of a

loss, the financial responsibility would not fall to the State. As such, the Department added insurance requirements to both its grazing and agricultural leases in early 2005, as well as a provision addressing the lessee's compliance with environmental laws. Agricultural leases were again revised in February 2006 to include stricter environmental provisions.

- Environmental provisions added to mineral leases—Hard rock mineral leases also included fairly protective indemnity and insurance requirements, but they lacked environmental provisions. As a result, in the late 1990s, the Department added comprehensive environmental protection terms to these leases. For example, the revised lease requirements require the lessee to obtain and provide documentation of appropriate environmental permits and to obtain environmental assessments and/or consultants if requested.

Department should continue to improve lease terms—In August 2006, Risk Management began reviewing lease files to assess the Department's continued implementation of its revised lease terms and to determine whether the State is adequately protected. According to Risk Management staff, commercial leases posing the greatest environmental risk were to be reviewed first, followed by a review of all lease types the Department administered. In March 2007, Risk Management staff completed their review and found that some leases needed additional environmental insurance based on the type of activities the lessee engaged in. According to Risk Management staff, many general commercial insurance policies do not cover environmental losses, and additional environmental insurance coverage is needed to ensure the State is protected in the event of an environmental occurrence. Therefore, as Risk Management identifies areas where leases can be improved and the State better protected, the Department should modify its leases to implement these recommendations.

The Department should continue to improve lease terms.

Similar improvements needed to some SLUP and permit terms—The Department has not included comprehensive insurance and environmental protection terms in all of its SLUPs and permits. Although permits are more restrictive, such as not allowing the lessee to place permanent improvements on the land, and are generally of a shorter duration, according to Risk Management staff, potential liabilities and environmental risk still exist based on the use of the land. Although the Department previously discussed incorporating insurance and environmental protection terms into its grazing and agricultural SLUPs, according to a department official, it simply may be the result of an oversight that this has not been done. As of May 2007, the Department reported more than 200 active commercial SLUPs, 150 grazing SLUPs, and 40 agricultural SLUPs. In addition, as of April 2007, the Department reported nearly 370 mineral exploration permits.

According to department staff, the number of SLUPs is increasing in some areas because SLUPs are being issued rather than leases. For example, the Department reports issuing grazing SLUPs near some developed urban areas instead of long-

term leases because this land may be used for other purposes. Additionally, some 10-year grazing leases are being converted into grazing SLUPs because the lease revenues are not covering the lease administration costs. Department staff reported that some grazing leases bring in less than $25 a year, whereas SLUPs have a minimum rent of $100 a year.

The Department should improve SLUP and mineral exploration permit terms.

Given the growth in the Department's use of SLUPs and the potential liabilities and environmental risks associated with SLUPs and mineral exploration permits, the Department should incorporate terms into the SLUPs and permits that will protect the State. Specifically, the grazing and agricultural SLUPs should be revised to reflect similar terms included in the grazing and agricultural lease agreements regarding insurance and environmental requirements, such as requiring liability insurance and compliance with applicable environmental laws. The Department should also ensure that environmental terms are incorporated into the mineral exploration permits. Lastly, the Department should develop and implement policies and procedures regarding when insurance should be required for mineral exploration permits to ensure that permittees engaging in significant levels of surface disturbance are properly insured.

Department should ensure critical leases are appropriately inspected

The Department has established inspection programs for some lease types, but it should ensure that all critical leases receive inspections in a timely manner to ensure proper treatment of leased state trust lands. Specifically, while the Department has established inspection programs for wells, agricultural leases, and grazing leases, many of these wells and leases have not been inspected. Additionally, the Department faces a significant backlog of mineral leases requiring inspection. To ensure that it devotes its limited resources on inspecting the leases that pose the greatest risk, the Department should prioritize inspections and explore implementing a staffing structure that may allow for more inspections.

Inspections needed to ensure proper treatment of land—Both Risk Management and the Department have identified the need for on-site lease inspections. According to Risk Management staff, on-site field inspections help ensure the lessees' conformance with the lease agreement and help to identify exposures that may pose an environmental hazard or liability to the State. Further, one department official stated that field inspections are beneficial because they help manage the land, improve land quality, and prevent future and continued land abuse. Field inspections, which involve a thorough review of the land's condition, can also help identify potential health and safety issues caused by the lessee, such as improper storage of equipment or chemicals. Further, field inspections

conducted at lease-end can ensure that land condition does not pose health or safety concerns. For example, department management reported that sand and gravel operations pose an increased risk because they are generally located near urban areas and close to people. If the lessee has not properly reclaimed or contoured the land, recreational users of state trust lands could be at risk for injury. Additionally, some leases may have a reclamation bond in place that the State could access if the land has not been appropriately reclaimed.

Department's inspection programs have some gaps—The Department actively inspects wells, established an agricultural inspection program in October 2006, and inspects grazing leases; however, numerous wells and agricultural leases have not been inspected. Specifically:

Nearly 3,000 wells are located on state trust lands.

- Well inspection program—Although the Department has inspected hundreds of wells since fiscal year 2005, more than 200 high-risk wells remained to be inspected as of January 2007. According to the Department and Risk Management, as of January 2007, there are nearly 3,000 wells located on state trust lands of varying ages and uses. These wells are used for various purposes, including livestock, municipal and domestic use, and industrial use. The Department inspects new and existing wells to confirm their location and to assess the condition, function, and potential risk these wells pose. Several hundred wells are more than 50 years old and constructed without regulatory guidelines; therefore, inspections help to verify the safe and appropriate operation of the well. According to the Department, 128 well inspections were performed in fiscal year 2005, 175 in fiscal year 2006, and 37 inspections from July 2006 through November 15, 2006.

Photo 1: Well Site on State Trust Land

Photo courtesy of the Arizona State Land Department.

Based on a review of a random sample of 21 well inspections performed from July 2005 through November 15, 2006, auditors found that these inspections were thorough. For these 21 well inspections, the Department determined that 2 wells were either in disrepair or improperly capped, requiring the lessees' immediate action. As a result, the Department notified and required the lessees to address the identified concerns. An inspection of a third well identified environmental concerns at the well site, including containers of used oil, used equipment, and possible soil contamination. For these three wells, the file documentation indicates that the Department received the necessary follow-up information to verify that the lessee took corrective action to address the identified concerns.

Despite the Department's ongoing inspections of wells, more than 200 high-risk wells still required inspection as of January 2007. Risk Management provided a listing of nearly 650 high-risk wells requiring inspection to the Department in May 2005. This listing included wells that Risk Management

had determined to be at higher risk because of the well's age, depth, and/or proximity to known environmental sites. Although the Department reported that it had previous inspection information on close to 380 of the wells on this list and had conducted inspections on more than 60 high-risk wells since receiving the list, as of January 2007, more than 200 had yet to be inspected. According to the Department's well inspector, the Department will continue to focus on the remaining high-risk wells; however, there is not an estimated time for completion.

- Agricultural lease inspections—Beginning in October 2006, the Department began inspecting expiring agricultural leases. These inspections are part of an overall program to inventory state trust lands that are leased for agricultural purposes and to eventually establish lease rates that reflect the market value of these lands. The Department had previously conducted and continues to conduct other types of inspections involving agricultural leases, including verifying the number of farmed acres and inspecting and approving improvements. However, the focus of these inspections differs from lease-end field inspections as the lease-end field inspections assess the land's condition and the lessee's compliance with lease conditions.

In October 2006, the Department began inspecting agricultural leases.

Between October 11, 2006 and March 6, 2007, department staff conducted 51 inspections of expiring agricultural leases. These inspections consisted of 26 of the 39 leases expiring in February 2007 and 25 of the 32 leases expiring in February 2008. These inspections provide the Department with valuable information pertaining to the land's condition and the lessee's compliance with lease conditions. For example, a field inspection of one lease in October 2006 identified more than 100 drums posing an environmental hazard that the Department has required the lessee to remove. Further, this inspection resulted in the Department 's requiring the lessee to obtain a soil remediation consultant to properly remove and dispose of the contaminated soil. Another inspection required another lessee to remove debris and inoperable equipment. Routinely conducting these types of inspections before lease expiration allows the Department time to require remediation and impose special conditions at renewal, if necessary.

Photo 2: Example of Noncompliance with Agricultural Lease Terms

Photo courtesy of the Arizona State Land Department.

Although the Department plans to continue conducting field inspections of expiring agricultural leases, it did not conduct inspections of 13 agricultural leases before their February 2007 expiration because the Department determined that some inspections were not cost-effective and has yet to inspect the remaining leases that expire in February 2008.

The Department has more than 1,200 grazing leases covering close to 8.4 million acres.

- **Grazing lease inspections**—Both the Department and Risk Management noted that based on land use, it can be assumed that grazing leases pose the least environmental risk and thus should represent the lowest priority for inspections. Although these leases do present a lower level of risk, the Department has more than 1,200 grazing leases covering 8.4 million acres of state trust land. As such, the Department has assigned several staff throughout the State to manage these leases and conduct inspections. Inspections are conducted for various purposes, including reviewing and making recommendations for land treatment applications and range improvements, such as the application of herbicides or the removal of trees or bushes that may interfere with cattle grazing. The Department's archaeologist also trains these staff to conduct the archaeology site review and clearance associated with applications for improvements to leased grazing lands. For example, if the lessee applies to put a fence on the leased land, an archaeology site review would be conducted to ensure that any surface improvement to the land does not disturb cultural resources. Staff also reviews and makes recommendations on nonrange-related applications to determine if they will impact the grazing lessee, such as an application for a right-of-way or commercial lease.

  These staff have performed various inspection activities. Specifically, inspection information was available for four of the six assigned staff or range managers.[1] According to one range manager responsible for the northern part of the State, he conducted 34 field visits in 2006, including archaeological clearances for proposed range improvements, new permits, rangeland monitoring, and pasture inspections. Additionally, this inspector reviewed 27 applications between March 24, 2006 and January 31, 2007, including applications for commercial leases, right-of-way leases, and a right-of-way entry permit, to determine the impact on grazing lessees. The range manager responsible for the south-central portion of the State reported reviewing a total of 16 range improvement projects for improvements such as cattle guards, fences, and pipelines; and 3 rangeland monitoring projects between February 1, 2006 and January 31, 2007. Additionally, he reported reviewing a total of 58 lease/permit and/or sale applications to determine the impact on range land. Similarly, the range manager assigned to the southeast portion of the State reported conducting 18 range improvement inspections and 4 land treatment projects, monitoring 8 ranches, and assessing and reviewing the impact of more than 20 lease/permit or sale applications between January 6, 2006 and January 10, 2007. Lastly, the range manager located in Phoenix, who is responsible for the southwest portion of the State, reported inspection activity, as well as the responsibility for administering the grazing sublease surcharge and billing state-wide, which includes the approval, tracking, and billing of grazing lessees who sublease to other cattle growers.

1 According to division management, workload information is not available for two range managers who left the Department during 2006. Although range managers were required to track and report on their activities, these two managers did not provide this information before leaving the Department.

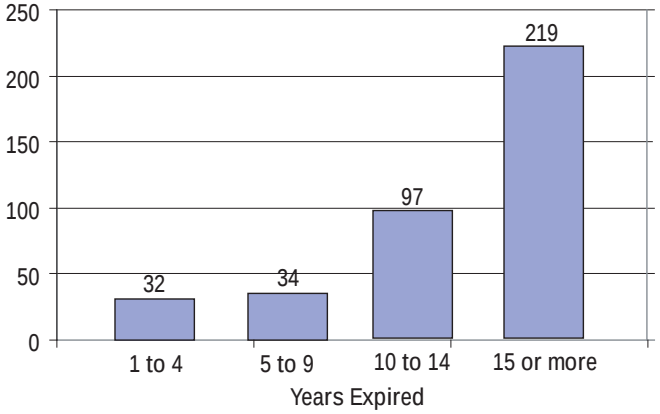
Department faces significant backlog of mineral lease inspections—

Despite ongoing inspections of its wells, agricultural leases, and grazing leases, the Department reported that it has not conducted reclamation field visits on hundreds of canceled mineral leases, some of which may pose potential liability and public health and safety risks. The very nature of mining involves some type of surface disturbance and environmental risk, whether the operation is the removal of sand and gravel or the mining and processing of hard rock minerals such as copper or gold. Environmental risks associated with mining operations include acid drainage; metals contamination of the ground or surface water; erosion; or abandoned equipment, trash, and debris.

As of January 2007, the Department had not inspected more than 380 canceled mineral leases to ensure proper reclamation of state trust lands.

As of January 2007, the Department reported a backlog of 382 canceled hard rock and sand and gravel leases requiring a field examination to ensure that the land has been properly reclaimed and the site does not pose a public health or safety risk. Auditors' review of 16 canceled hard rock mineral leases confirmed that there was no documentation indicating that the Department had conducted a reclamation visit. As illustrated in Figure 6, more than 25 percent of the canceled minerals leases that have not received a field visit have been expired for 10-14 years, while more than 57 percent of these leases have been expired for more than 15 years. Because the Department typically entered into 20-year hard rock leases, more than 85 percent of the canceled hard rock leases were entered into before the Department required reclamation bonds. According to the Department, reclamation bonds were added to mineral lease requirements in 1982 and allow the Department to access the bond money in the event the lessee did not adequately restore the land.

Figure 6: Canceled or Expired Mineral Leases Requiring Inspection
Number of Years Canceled or Expired
As of January 2007



Source: Auditor General staff analysis of the Department's list of canceled mineral leases as of January 2007.

In addition to mineral leases, the Department also issues permits allowing for the exploration of minerals on state trust lands. According to department staff and management, although many permits cause surface disturbance and have a reclamation bond in place, the Department has not conducted reclamation visits. Generally, exploration permits are issued and reissued yearly in order for the permittee to locate minerals on state trust lands and, if successful, apply for a lease in order to mine the minerals. As of April 2007, the Department reported nearly 370 active exploration permits. Department staff reported that exploration permits routinely do not receive reclamation field inspections because department management has not directed staff to do so and bonds are released without ensuring that the land has been adequately restored and free of debris.

Department should implement risk-based inspections and cross-train existing staff—The Department should take steps to improve its inspection of all leases and SLUPs through better prioritizing inspections and using staff. This would allow the Department to focus its limited inspection resources on those leased lands that are at the greatest risk for damage or harm. According to the Department, the lack of sufficient staff has affected its ability to conduct inspections of leased state trust lands, including mineral leases. For example, while the Department has four geologist positions assigned to its minerals leasing program, as of March 2007, two positions were vacant, and two other positions were filled in 2006. According to the fiscal year 2008 *State of Arizona Appropriations Report*, the Department received authorization to hire two additional positions for its mineral program in fiscal year 2008.

Additionally, the Department has not established policies directing the frequency of inspections, when they should occur, and the priority for inspecting various lease types. For example, one geologist indicated that she would only conduct a reclamation field inspection when management directed. However, when auditors interviewed management, they indicated that the field inspections are left to the geologists' discretion. Additionally, one range manager indicated that although he frequently conducts an inspection of a new grazing lease, he has received no directive to conduct an inspection of an expiring lease. Therefore:

- Department should implement risk-based inspections of all leases, SLUPs, and permits—The Department should adopt a risk-based approach for conducting inspections. Risk Management staff recommended that the Department conduct a formal site assessment at the beginning of a lease to establish a baseline on the condition of the land, and at the end of a lease to ensure the lessee did not cause damage. However, both Risk Management and department management reported that not all leases have equivalent risks associated with them. For example, according to Risk Management, mineral and agricultural leases have a greater level of risk than grazing leases based on the land use. Based on this assessment of risk and availability of resources, the Department should develop and implement policies requiring that at a minimum, it inspect all mineral and agricultural leases, SLUPs, and mineral exploration permits before expiration. This would allow the Department to inspect these leases, SLUPs, and permits at least once during the lease, SLUP, or permit term.

Mineral and agricultural leases present the most risk to state trust lands.

  As part of a risk-based inspection approach, the Department should also ensure that it inspects high-risk wells in a timely manner. As previously mentioned, more than 200 high-risk wells have yet to be inspected as of January 2007, and the Department should focus its efforts on ensuring that these remaining 200 wells are inspected in a timely manner. In addition to inspecting these high-risk wells, the Department's inspection policies should also address the factors that should be considered when determining the number, types, and frequency of well inspections.

- **Department should cross train-staff**—The Department should cross-train staff to ensure that critical inspections are conducted in a timely manner. Department management has indicated that range managers could provide assistance in inspecting canceled mineral lease sites by conducting assessments and identifying potential safety concerns. Range managers are located state-wide and already have received cross-training in other areas, such as performing archaeology site assessments for improvements. Because most state trust lands are leased for grazing and most current mineral leases are located within the boundary of an existing grazing lease, range managers should be further trained to assess the adequacy of mineral lease reclamations. Based on auditors' review of one active mineral lease file, range managers should be able to assess mineral lease reclamations. Specifically, as part of a review of a new minerals application that was within a grazing lease boundary, range section staff identified environmental hazards, such as inoperable equipment, trash, shell casings, and seeping petroleum, that needed to be addressed. Based on these findings, the Department's environmental resource section was notified and required that the environmental issues be addressed as a condition of the mineral application approval.

  Range managers could be trained to assess mineral lease reclamations.

  Cross-training range managers is similar to the organizational structures in Montana, New Mexico, and Colorado. Each of these states has offices state-wide that are staffed by land use specialists that are responsible for a broad range of activities within their particular geographic boundary. The land use specialists inspect and oversee multiple lease types, including grazing and agricultural, and conduct mineral inspections, as well as responding to trespass complaints. In contrast, department staff are assigned to a specific section (such as range or agricultural) and inspect only a single lease type. The Department also has two staff who are responsible solely for trespass complaints state-wide. Further, minerals, agricultural, and trespass staff are located in Phoenix at the main office, but are responsible for lease inspections close to the Arizona-Utah border, which require considerable travel time. Given the amount of time required to travel to some areas, the Division should consider maximizing its resources by cross-training staff to inspect multiple lease types and respond to complaints.

Department should improve documentation and tracking

Finally, the Department should establish and implement policies and procedures for documenting and tracking all field inspections. In some instances, department staff have reported performing inspections, but have not been able to provide documentation evidencing the performance of these inspections. For example, according to minerals staff, although some types of mineral applications received field inspections during the application process, not all inspections were

documented. Auditors reviewed all eight mineral lease files from January 2003 to December 2006 to determine if there was documentation of a field investigation during the application process. Only two of the eight lease files made reference to an on-site initial visit. Additionally, when auditors requested a listing of the mineral lease field visits that were conducted beginning in July 2005, staff were only able to provide a listing beginning in May 2006.

Department staff do not always document agricultural field visits.

Similarly, staff in the agricultural section reported not always documenting field visits that were conducted. In one instance, staff indicated that a lessee was out of compliance with lease terms and was required to remove trash from the leased property. Neither the request for trash removal or the field inspection verifying compliance was documented. Staff reported failing to document a total of 50 field visits in 2006. Although some staff reported not documenting inspections because they were new, others offered no explanation for not documenting field visits. Further, only limited information was available from the Department's grazing staff to document their work.

Documenting inspections, the problems noted, and the corrective actions the Department requires helps to ensure that leased state trust lands are adequately protected. This documentation also provides the Department with historical information to prioritize and guide future inspection efforts and ensure lease compliance issues are addressed and resolved. Therefore, the Department should ensure all field inspections are adequately documented and tracked so that it has the necessary information to guide its inspection efforts and ensure that identified problems or compliance issues are addressed and appropriately resolved.

Recommendations:

1. As Risk Management identifies areas where leases can be improved, the Department should modify its leases to implement these recommendations.

2 The Department should:

   a. Revise the terms in its grazing and agricultural SLUPs to reflect similar insurance and environmental terms included in the Department's leases; and

   b. Incorporate environmental language into the mineral exploration permits, as well as develop and implement policies and procedures for when to require insurance coverage in these permits.

3. The Department should develop and implement policies establishing a risk-based inspection approach that at a minimum:

    a. Requires that all mineral and agricultural leases, SLUPs, and mineral exploration permits receive a field inspection before expiration.

    b. Requires that all identified high-risk wells receive an inspection in a timely manner; and

    c. Specifies the factors that should be considered when determining the number, types, and frequency of well inspections.

4. The Department should cross-train staff to ensure that critical inspections are conducted in a timely manner.

5. The Department should establish and implement policies and procedures requiring all field inspections to be adequately documented and tracked.

SUNSET FACTORS

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona State Land Department (Department) should be continued or terminated.

1. The objective and purpose in establishing the Department.

   The Department was established in 1915 and charged with administering all laws relating to lands owned by, belonging to, and under the control of the State. The federal government granted 10.9 million acres of these state trust lands to Arizona to support specific beneficiaries, such as educational institutions and hospitals. Since the Department's inception, its mission has been to manage these state trust lands to maximize the revenues for the beneficiaries. All uses of state trust lands must benefit the trust's beneficiaries, a fact that distinguishes it from the way public lands, such as parks or national forests, are managed. The Department is responsible for managing the surface land, as well as the subsurface products. The Department generates revenues through the sale and lease of state trust lands for various uses, such as residential and commercial development, minerals, farming, and livestock grazing.

   In addition to state trust lands management responsibilities, the Department is responsible for preventing and suppressing wildland fires on state and unincorporated private lands, which encompass approximately 30 percent of the State. Additionally, the Department has the statutory responsibility to provide Geographic Information System (GIS) development, analysis, and coordination in the State. It also houses the State Cartographer's Office, which is responsible for developing and managing a long-term program for collecting, updating, and disseminating state-wide information about GIS data resources.

2. The effectiveness with which the Department has met its objective and purpose and the efficiency with which it has operated.

   The Department has generally operated effectively and efficiently in performing its functions, but some improvements could be made. The Department's main focus is its fiduciary responsibility to maximize the revenue from the sale, lease,

and use of state trust lands and their products for the trust beneficiaries. While some states may periodically sell state trust lands, Arizona is unique in that it actively employs a strategy of selling or leasing state trust lands to generate revenues for its beneficiaries. Consistent with its mission, the Department sells a small percentage of state trust lands each year to generate revenues for trust beneficiaries. From fiscal years 2004 through 2007, the Department held 82 successful state trust land sale auctions and generated approximately $1.6 billion in gross sales. As a result of this significant sales activity, the State Treasurer reports that the balance in the Permanent Fund (Fund) as of the end of fiscal year 2007 was more than $2.26 billion, more than double the Fund's cash balance at the end of fiscal year 2003. The Arizona Constitution of 1912 required the Fund's establishment to deposit monies from the sale of state trust lands or royalties from the sale of the natural products of state trust lands.

Despite the significant increase in sales, the audit identified some improvements that the Department should make to improve its process for selling and leasing state trust lands. Specifically, the Department has developed and implemented a comprehensive process to identify, plan, and prepare state trust lands for sale or lease, but should take some steps to further improve this process. The Department established this process to help ensure that it complies with the state laws governing the sale or lease of state trust lands and to help maximize the revenues from the sale or lease of these lands. Significant steps in this process include creating conceptual land-use plans, which identify appropriate uses for the land; obtaining various studies and information on the land parcel in order to properly value, and in some cases increase, the value of the parcel; appraising the land parcel to determine its value; and marketing and selling/leasing the land parcel at auction.

However, the Department should take some steps to improve its process for planning and selling or leasing state trust lands. Specifically, the Department should establish time frames or ranges for the steps within its process and monitor compliance with these time frames to determine whether any steps are taking too long. The Department has not established, nor does it track, how long the various steps within its state trust land selling and leasing process take, and auditors noted wide variations in how much time was required to sell various land parcels. The Department should also post site study information on its Web site as soon as these studies are completed.

In addition, the Department reported not having an adequate number of qualified, contracted appraisers it can use. This has forced the Department to take various actions to obtain acceptable appraisals from contractors. Based on information available in the Department's appraisal logs, for fiscal year 2006 and from July 2006 through May 17, 2007, the Department contracted for 160 appraisals. However, since the Department reported that it has only 14 qualified contract appraisers, it has used appraisers who were not on the state-wide

contract to obtain needed appraisal services, used some appraisers in areas where they may not possess the requisite expertise, and in a few instances has continued to use appraisers despite problems with previous work done by these appraisers. This has resulted in situations where the Department has spent additional time and resources to address errors in appraisals. The inadequate pool of qualified, contracted appraisers can be attributed to a misunderstanding of the State's procurement process as several appraisers who do not have state contracts indicated an interest in doing work for the Department, but had not fully completed the procurement and contracting process. Therefore, the Department should take steps to increase the number of qualified contract appraisers it can use by working with the Department of Administration (DOA), which is responsible for state-wide procurement, and the Arizona Department of Transportation, which manages the State's appraisal contract, to issue a new or supplemental contract for appraisal services and communicate to potential bidders all of the steps for obtaining a state contract. (See Finding 1, pages 13 through 26.)

3. The extent to which the Department has operated within the public interest.

Overall, the Department has operated in the public interest by managing state trust lands to sustain the long-term value of these lands for the beneficiaries. As previously mentioned, the Department conducted 82 successful land auctions in fiscal years 2004 through 2007, which generated approximately $1.6 billion in gross sales. As the Department receives these monies, they will be deposited into the Fund for the benefit of the trust's beneficiaries. For example, according to Figure 3 (see page 5), the Department deposited approximately $194.8 million in the Fund in fiscal year 2007, and received more than $122 million in expendable revenue, which was directly distributed to the trust's beneficiaries. Expendable revenue includes lease revenue from trust land leases and special land-use permits (SLUPs) and the interest earned from the financing of land sales. The State Treasurer distributed an additional $35.6 million to the beneficiaries in fiscal year 2007 from the Permanent Fund according to a constitutional formula. The kindergarten through 12th-grade public schools received approximately $142.3 million of these amounts, while more than $15.2 million was distributed to the other beneficiaries, including the State Hospital, Miners' Hospital, and Correctional Institutions. Finally, the Department distributed nearly $9.9 million to the State General Fund. According to the Department, the total annual revenue generated and disbursed to the beneficiaries has increased by about 122 percent since fiscal year 1996.

The Department also operates the State's wildland fire prevention and suppression programs, which provide firefighting coordination, staffing, and equipment state-wide for state and unincorporated private lands. Specifically, the Forestry Division within the Department mobilizes and manages firefighters and equipment to and from all parts of Arizona and other states, and

coordinates firefighting activities between rural fire departments and cooperating federal agencies. In addition, the Division assists private landowners with developing and implementing forest management and hazardous fuel reduction plans that improve forest health and reduce the risk to their homes and property.

However, the audit identified ways in which the Department could better operate in the public interest. Specifically, while the Department has taken steps to better manage and protect leased state trust lands, it should take steps to further improve lease, SLUP, and mineral exploration permit terms and better prioritize inspections of these lands. The Department has worked with DOA's Risk Management Office (Risk Management) to strengthen lease terms to better protect the State from loss. For example, the Department revised both its grazing and agricultural leases to include insurance and environmental provisions and has included more comprehensive environmental protection terms in its minerals leases. Risk Management has continued to review lease files to assess whether lease terms adequately protect the State and found that some leases need additional environmental insurance. Therefore, as Risk Management identifies areas where leases can be improved and the State better protected, the Department should continue to modify its leases. Additionally, the Department has not included comprehensive insurance and environmental protection terms in its SLUPs and mineral exploration permits and should do so.

In addition to improving the terms of its leases, the Department actively inspects wells, established an agricultural inspection program in October 2006, and inspects grazing leases; however, numerous wells and agricultural leases have not been inspected. Additionally, the Department needs to address the significant backlog of mineral leases requiring inspection. The very nature of mining involves some type of surface disturbance and environmental risks, including acid drainage, metals contamination of the ground or surface water, erosion, or abandoned equipment, trash, and debris. As of January 2007, the Department reported a backlog of 382 canceled hard rock and sand and gravel leases requiring a field examination to ensure that the land has been properly reclaimed. More than 57 percent of these have been canceled for more than 15 years.

The Department should take steps to improve its inspection program by better prioritizing inspections and using staff. This would allow the Department to focus its limited inspection resources on those leased lands that are at the greatest risk for damage or harm. For example, mineral and agricultural leases were identified as having the most risk, while few risks were identified with grazing leases based on the land use. Based on this risk assessment, the Department should develop and implement policies requiring that it inspect all mineral and agricultural leases, SLUPs, and mineral exploration permits before expiration.

Additionally, the Department should continue its effort to inspect wells that have been identified at high risk for disrepair. The Department should also cross-train staff to ensure that critical inspections are conducted in a timely manner. (See Finding 2, pages 27 through 39.)

4. **The extent to which rules adopted by the Department are consistent with the legislative mandate.**

Auditors requested that staff of the Governor's Regulatory Review Council review the Department's rules to determine whether they are consistent with the legislative mandate and they reported: "According to the staff of the Governor's Regulatory Review Council (GRRC), it appears that the Department has promulgated some, but not all, of the rules it has statutory authority to establish. GRRC staff have identified instances where the Department has or may have the authority to make rules, but has not done so. For example, A.R.S. §27-273(A) gives discretion to require a bond to guarantee money owed to the State under a lease. According to GRRC staff, the Department has not adopted a rule establishing standards for whether to require a bond. Similarly, A.R.S. §37-321(A) addresses the Department giving approval to make improvements on state land. GRRC staff notes that the rules established by the Department only address improvements under an agricultural lease, but not for other types of leases. GRRC staff have identified a total of 23 statutory references where the Department has or may have the authority to establish rules, and has not made rules."

According to the Department, it has adopted 31 new rules, amended 13 existing rules, and allowed 85 antiquated and obsolete rules to expire since fiscal year 2000. The Department reported that as of March 2007, it was in the process of prioritizing and reviewing an additional 63 rules that may require amendment or elimination. Additionally, in March 2007, the Department submitted a 5-year rules review report to GRRC for its review and approval. This report covered the Department's rules relating to natural resource conservation districts, mineral leases, and prospecting permits. In July 2007, the Department submitted another 5-year rules review report to GRRC for review and approval. This report covers the Department's rules relating to special leasing provisions, rights-of-way, exchanges, and special land-use permits. Finally, as of July 2007, the Department has opened two rule-making documents to amend rules regarding oil and gas leases and state trust land sales.

5. **The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

The Department encourages public input when developing and amending its rules. The Department adheres to the Administrative Procedures Act, which

requires the publication of the Notices of Rulemaking Docket Opening before beginning the formal rule-making process. This notice identifies the subject matter of the proposed rule as well as the times in which the Department will accept oral or written comments from the public. This public notification is filed with the Office of the Secretary of State and located in the Administrative Register. Additionally, the Department reported that, when necessary, it has notified various stakeholders, organizations, and individual groups in an effort to solicit as many comments as possible. For example, the Department reported that, while developing the rules addressing conflicting livestock grazing applications, draft rules were forwarded to the Arizona Livestock Growers Association to be discussed among its membership. The Department also reported initiating public meetings to solicit input regarding proposed agency rules or actions. For example, the Department reported presenting information at a meeting of the Arizona Cattle Grower's Association, which was attended by grazing lessees, to discuss proposed changes to the Department's lease requirements.

The Department has also complied with open meeting laws regarding the Board of Appeals by filing the required meeting notices with the Secretary of State's Office, posting meeting notices in the specified location, and making agendas and meeting minutes available. The Department has also filed the appropriate meeting notices with the Secretary of State's Office for the State Land Conservation Advisory Committee, which meets quarterly, and the Urban Land Planning Oversight Committee, which meets on an as-needed basis. Also, in accordance with A.R.S. §37-623(B), the Department has forwarded notices to the Secretary of State's Office regarding fire restrictions and closures of specified state lands to recreational use because of wildland fire emergencies.

Lastly, the Department uses its Web site, the newspaper, and public meetings to keep the public informed of its actions. The Department's Web site includes links providing information on fire restrictions, available properties for sale or long-term lease, schedules of upcoming auctions, and state trust lands dust abatement closures. The Department also publishes land auctions in local newspapers for 10 weeks before the auction.

6. The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.

The Department has the statutory authority to investigate and resolve complaints regarding agency or state trust lands issues, including trespass complaints. The Department reported that the agency ombudsman responds to approximately 15 to 20 inquiries per year ranging from individuals seeking general information to complaints about the agency and/or trust lands issues. The Department also reported that some complaints are forwarded to the Department's Environmental and Trespass Section. According to department officials, two investigators in this section respond to reports of unauthorized activities on state

trust land state-wide, including trespassing, dumping, target shooting, nonrecreation or extended camping, or collection or removal of any natural products. According to the Department's fiscal year 2006 annual report, the Environmental and Trespass Section conducted 26 clean-up projects using more than 1,700 volunteer hours to remove 80 tons of trash and more than 850 tires from state trust lands. Additionally, nearly $115,000 was collected from trespass and/or unauthorized use penalties in 21 different case actions.

The Department reports that it also receives formal complaints, such as appeals of Commissioner's decisions. These appeals may question a state trust land appraisal or classification. The Department forwards complaints or appeals to either the Board of Appeals or the Office of Administrative Hearings. The Department reported receiving 526 complaints from fiscal years 1996 through 2006.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.

According to A.R.S. §37-102(C), the Department may, in the name of the State, commence, prosecute, and defend all actions and proceedings to protect the interest of state trust lands and the proceeds from those lands. Statute further authorizes the Department to request initiation of such actions through the Attorney General, a county attorney, or a special counsel under the direction of the Attorney General. According to the Department, the statutory authority to prosecute and defend action and proceedings involving the Department appear adequate. The Department also reports using Attorney General representation daily. Specifically, the Attorney General's Office provides legal guidance, assists in contract and settlement negotiations, represents the Department in court hearings, lawsuits, and appeal hearings before the Board of Appeals and Office of Administrative Hearings, and provides legal advice on clarification of the law.

8. The extent to which the Department has addressed deficiencies in its enabling statutes, which prevent it from fulfilling its statutory mandate.

The Department has sought numerous technical and administrative changes to its statutes over the years. Laws 2002, Chapter 336, made numerous changes to department statutes, addressing issues such as planning, public hearings, patents, payments, and appraisals. For example, the conditions under which the Department may issue a partial land title/patent were modified, while forfeited down payments from land sales are now classified as expendable revenue and are distributed to the beneficiaries. Additionally, issues such as bankruptcy were addressed by allowing the Department to issue a lease or certificate of purchase to a priority lien-holder in the event a lessee or purchaser declares bankruptcy. Further Laws 2003, Chapter 69, made other changes involving application fees, contracting for the sale of recreational permits issued by the Department to allow

recreation on state trust lands, and land management. For example, the Department was given the ability to contract with a third party to sell recreational permits, as well as the authority to close urban lands to applications for sale, lease, or recreational permits to reduce a risk from hazardous environmental conditions.

According to the Department, the laws governing trust management are antiquated and in need of substantial reform. The Department reported that it is working with a broad range of interested parties to address these issues, including the education community, developers, conservationists, and others who have worked on reform proposals over the past several years. For example, the Department provided assistance to the various groups proposing state trust lands reform that appeared as Propositions 105 and 106 in the November 2006 general election. Although voters did not approve these measures, they proposed:

- Proposition 105—This referendum proposed various changes to state laws and department processes, such as allowing state trust land in urban areas that was classified or eligible for designation as suitable for conservation prior to 2005 to be conveyed to a county, city, or town without advertisement or auction upon payment of compensation. The referendum would have also required the Legislature to create a method for designating up to 400,000 acres of state trust land for conservation purposes and conveying those lands without advertisement, auction, or compensation to the county in which the state trust land is located; reduced newspaper advertising periods for state trust land auctions from 10 consecutive weeks to 5 consecutive weeks and requiring the Department to post an auction notice on its Web site for at least 35 days prior to the auction; allowed the granting of public rights-of-way on state trust land to governmental entities without advertisement or auction; required that state trust lands designated as conservation land be held in trust by a governmental entity restricted against "development"; and required that commercial land-use planning in urban areas be prepared in consultation with the county, city, or town where the state trust land is located.

- Proposition 106—This initiative included various changes to department processes, including creating a Board of Trustees to plan and dispose of all state trust lands; setting aside approximately 694,000 acres of state trust land for conservation; allowing the Board of Trustees to adopt a method for determining the "highest and best bid" that does not require the highest return; allowing the granting of public rights-of-way without a public auction; requiring that land-use planning be prepared in conjunction with the county, city, or town where the state trust land is located; and allowing a portion of the proceeds generated from state trust lands to be used for the land's administration, management, planning, and disposition.

In addition to enacted legislation and voter initiatives or referendums, there have been efforts to transfer the operations of the State Forester to another state agency. During the 2005 legislative session, the Legislature considered a provision in House Bill 2644 that would have transferred the State Forester to the Department of Fire, Building and Life Safety, which houses the State Fire Marshal. While this bill passed, the provision transferring the State Forester to the Department of Fire, Building and Life Safety was not included in the enacted legislation. According to legislative staff, although there has been mention of moving the State Forester from the Land Department, there was a reluctance to mix the rural firefighting responsibilities of the State Forester with the urban fire responsibilities of the State Fire Marshal within the Department of Fire, Building and Life Safety.

9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors in the sunset law.

Audit work did not identify any areas for legislative change.

10. The extent to which the termination of the Department would significantly harm the public's health, safety, or welfare.

Terminating the Department would harm the public's health, safety, and welfare because the Department performs a vital role in managing and administering state trust lands and preventing and suppressing wildland fires state-wide. Administration of state trust lands for the benefit of K-12 public schools and the other beneficiaries is required by the Arizona Constitution and Enabling Act. If the State Land Department were terminated, another state agency would need to perform these duties in its absence. In addition, unregulated use of state trust lands could result in damage to the land and the loss of valuable resources. Such a loss could reduce the revenues generated from the sale or lease of state trust lands, which in turn would reduce revenues that can be distributed to the beneficiaries of the Trust. For example, in fiscal year 2006, the Arizona Pioneers' Home received all of its appropriated funding through trust revenues. The Arizona Pioneers' Home, which opened for residents in 1911, is presently the home for more than 100 long-time Arizona residents and disabled miners. The home provides direct nursing care and support to these residents.

Additionally, the Forestry Division within the Department is responsible for fire suppression activities on all state trust lands and nearly 12 million acres of unincorporated private lands in the State, and supports more than 250 local fire departments when needed. According to the Department, in fiscal year 2006, the Forestry Division responded to 1,231 wildland fires, including 857 that were the responsibility of the State and 374 in support of federal and tribal agencies. Although 94 percent of these fires were controlled at less than 100 acres, 67,567 acres were burned on state and private lands during this time.

11. **The extent to which the level of regulation exercised by the Department is appropriate and whether less or more stringent levels of regulation would be appropriate.**

    This factor does not apply since the Department does not have regulatory authority.

12. **The extent to which the Department has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.**

    The Department uses private contractors to help it accomplish several duties, including planning, engineering, and obtaining site studies, and appraisal services related to the sale and lease of state trust lands. For example, the Department contracts with appraisers to perform a variety of appraisals related to state trust lands. This includes appraisals in preparation of selling state trust lands, appraisals for various leases, and appraisals for rights-of-way. However, the audit found that the Department should take steps to increase the pool of qualified appraisers it can use. Specifically, the Department does not have an adequate number of qualified, contracted appraisers, which has resulted in situations where the Department had continued to use appraisers despite concerns with the quality of appraisal services received. This has required the Department to spend additional time and resources to address appraisal errors. Therefore, the Department should take steps to increase the available pool of appraisers by communicating to appraisers all of the steps they need to take to obtain contracts with the State to provide appraisal services. (See Finding 1, pages 13 through 26.)

    The Department also reported contracting with private firefighting companies, such as Rural Metro, along with using the services of federal fire-fighting agencies to suppress wildland fires. Lastly, the Department reported using private contractors in GIS development. For example, large data development projects, such as digital elevation data development and aerial photography development, have been performed by contractors.

    The audit did not identify any additional uses for private contractors.

AGENCY RESPONSE

ARIZONA STATE LAND DEPARTMENT

Janet Napolitano
Governor

Mark Winkleman
State Land
Commissioner

September 10, 2007

Ms. Debra K. Davenport
Auditor General
2910 N 44th St. Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The Arizona State Land Department has read the preliminary report draft of the performance audit and sunset review performed by the Auditor General's Office. The audit has two findings and 11 recommendations. The following is the Department's response to those recommendations:

Finding 1 - Department should further improve sales and leasing process

1. **The Department should establish time frames or ranges for each step within its state trust land sales and leasing process, monitor the performance of various steps within its process against these time frames or ranges, and analyze any discrepancies when time frames or ranges are not met.**

   The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

   As mentioned in the report, the process for selling or leasing state trust land is complicated and can vary with each parcel. While there are steps in the process that are required by law, many steps are taken to ensure the highest benefit for the beneficiaries of the land. Additionally, every parcel is unique and presents its own challenges. The time needed for many steps in the process are very parcel specific. Therefore, it would be difficult to set a general time frame for many of the steps.

   To comply with this recommendation, the Department will continue to meet regularly to discuss the progress of the parcels on the disposition plan. As part of the discussion, goals or timetables will be set for the next steps in the process. At subsequent meetings, the project and the timetables will be discussed.

2. **Once it establishes time frames or ranges and evaluates the timeliness of the steps within the process, the Department should identify steps that could be completed more quickly and modify its process to complete these steps more quickly.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The Department has been examining the process and has made several improvements. While speeding up the process, it has also improved its communication with prospective bidders, local governments, the public, and the beneficiaries. These improvements are partly responsible for the record revenues of the previous few years. The Department will continue to look at the process to sell or lease land and make necessary adjustments to improve and shorten the process.

3. **The Department should ensure that site study information is posted on its Web site as soon as studies are completed.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

   For FY 2008, the Department requested and was budgeted for a webmaster. Previously, the network administrator was assigned the duties of updating the Department's website, which was to take a very small portion of their time. Consequently, there was not enough staff time to make constant changes to the website. This new position will greatly enhance the Department's ability to update and keep its website current.

   The Department will try to expedite the posting of completed studies on its website. Before a study can be posted, however, it must be reviewed and accepted by the Department. Procedures will be put into place to ensure that after the study is finalized and accepted by the Department it will be forwarded to the new webmaster to be posted.

4. **The Department should work with the Departments of Administration and Transportation to increase the number of appraisers on state contract that meet the Department's needs by:**
   a. **Issuing a new or supplemental solicitation and contract, and**

   b. **Communicating with all potential bidders to ensure that they understand the State's procurement and contracting process and the types of appraisals the Department needs.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

   The Department's FY 2008 appropriation includes funds for a procurement position that will help implement this recommendation. The new procurement position will help communicate the Department's need for a new or supplemental solicitation with the State Procurement Office and assist with the solicitation. The Department does not have the delegated procurement authority to issue Request for Proposals (RFP), so it is dependent on the State Procurement Office or other agencies with that delegation to conduct solicitations.

5. **The Department should establish and implement policies for taking appropriate action when appraisals do not meet department requirements or USPAP standards. These policies should take into account the seriousness and frequency of problems, as well as the enforcement or penalty actions authorized by contract, such as termination of the appraiser's contract with the State and/or withholding payment to recover any costs resulting from nonperformance. The policy should also identify circumstances that would require the Department to report appraisers to the Arizona Board of Appraisals.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

   As mentioned in the Audit Report, the Department has established and implemented procedures regarding the reporting requirements and minimum standards that contract appraisers must meet. The Department will improve this policy.

6. **The Department should ensure that it documents justification for each appraisal that is obtained from an appraiser that is not on the state-wide contract, as required by department procedures.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

   The new trust management procurement position will help train employees on procurement procedures. Additionally, the Department has already implemented a more rigorous review of purchase requests to ensure that the proper procurement procedures are followed.

Finding 2 – Department should further improve state trust land management.

1. **As Risk Management identifies areas where leases can be improved, the Department should modify its leases to implement these recommendations.**

   The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

   The Department will continue to work with Risk Management to reduce the liability to the state. However, in doing so, the Department must analyze the impact on the Trust.

2. **The Department should:**
   a. **Revise the terms in its grazing and agricultural SLUPs to reflect similar insurance and environmental terms included in the Department's leases; and**

b. **Incorporate environmental language into the mineral exploration permits, as well as develop and implement policies and procedures for when to require insurance coverage in these permits.**

a. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The Department agrees that the insurance and environmental terms in grazing and agricultural SLUPs should be improved.

b. The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The environmental language will be incorporated into the exploration permits. In 2004, the Department implemented an informal policy regarding the insurance requirements in an exploration permit. The Department will strengthen and improve the existing policy and procedure.

3. **The Department should develop and implement policies establishing a risk-based inspection approach that at a minimum:**
   a. **Requires that all mineral and agricultural leases, SLUPs, and mineral exploration permits receive a field inspection before expiration;**
   b. **Requires that all identified high-risk wells receive an inspection in a timely manner; and**
   c. **Specifies the factors that should be considered when determining the number, types, and frequency of well inspections.**

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The inspections of Mineral leases, SLUPs and Exploration Permits will increase as the Minerals Section gains replacement staff and two new Geologist positions that were requested by the Department and appropriated for FY 2008 are filled. The Department will continue to refine and develop inspection frequency and procedure on Agriculture leases. As noted in the audit, Agriculture lease inspections have greatly improved since 2006.

4. **The Department should cross-train staff to ensure that critical inspections are conducted in a timely manner.**

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

5. **The Department should establish and implement policies and procedures requiring all field inspections to be adequately documented and tracked.**

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The Environmental Resources and Trespass Section has already made considerable progress on a process to track trespass cases and field inspections. A training class for lease administrators will be conducted by the environmental specialist to enable the administrators to conduct a basic environmental inspection and complete an inspection form. As time allows, the environmental specialist will accompany commercial lease administrators on inspections of leases suspected of having environmental issues.

I and my staff want to thank you and your staff for the professional manner in which this audit was performed. The Department is constantly looking for ways to improve to better serve the citizens of Arizona and specifically the beneficiaries of the Trust. The implementation of these recommendations will improve our service and performance.

Sincerely,

Mark Winkleman
Arizona State Land Commissioner

Performance Audit Division reports issued within the last 24 months

05-10 Foster Care Review Board
05-11 Department of Administration—Information Services Division and Telecommunications Program Office
05-12 Department of Administration—Human Resources Division
05-13 Department of Administration—Sunset Factors
05-14 Department of Revenue—Collections Division
05-15 Department of Revenue—Business Reengineering/Integrated Tax System
05-16 Department of Revenue Sunset Factors
06-01 Governor's Regulatory Review Council
06-02 Arizona Health Care Cost Containment System—Healthcare Group Program
06-03 Pinal County Transportation Excise Tax
06-04 Arizona Department of Education—Accountability Programs
06-05 Arizona Department of Transportation—Aspects of Construction Management
06-06 Arizona Department of Education—Administration and Allocation of Funds
06-07 Arizona Department of Education—Information Management
06-08 Arizona Supreme Court, Administrative Office of the Courts—Information Technology and FARE Program
06-09 Department of Health Services—Behavioral Health Services for Adults with Serious Mental Illness in Maricopa County
07-01 Arizona Board of Fingerprinting
07-02 Arizona Department of Racing and Arizona Racing Commission
07-03 Arizona Department of Transportation—Highway Maintenance
07-04 Arizona Department of Transportation—Sunset Factors
07-05 Arizona Structural Pest Control Commission
07-06 Arizona School Facilities Board
07-07 Board of Homeopathic Medical Examiners

Future Performance Audit Division reports

Commission for Postsecondary Education