Report No. 2004-09

March 3, 2004

Oregon State Land Board Rangeland Revenue for the Common School Fund Fiscal Years 1998 to 2002

Summary

PURPOSE

The purpose of this audit was to determine if the State Land Board (board), through the Department of State Lands (department), is maximizing the long-term income generated by its rangeland assets.

BACKGROUND

State-owned rangelands are a part of the original land grant received when the state was admitted to the Union. The state is required to use the land and any proceeds from the sale of the land to support public schools. As a trust asset, Oregon's rangelands are to be managed with undivided loyalty to the trust recipient, Oregon's schools. The board must also manage the rangelands to maximize long-term income for schools.

RESULTS IN BRIEF

We found that the board could better fulfill its duty to maximize revenue for Oregon's K-12 public schools.

We found that in fiscal years 1998 through 2002, rangelands lost money for schools. The financial loss for this time period was at least $13,115 for state rangelands. Actual losses were more than that because rangeland fire suppression costs were not available prior to 2001. State-owned rangelands have lost money as far back as 1987.

If all rangelands had been sold and the proceeds invested, we conservatively estimate that the Common School Fund would have received at least $3.0 million to $4.2 million more income for fiscal years 1998 through 2002. Alternatively, if market lease rates had been charged for state rangeland leases for the five fiscal years from 1998 to 2002, we estimate that the Common School Fund would have earned $1.45 million more.

RECOMMENDATIONS

We recommend that the State Land Board use a systematic approach to maximizing long-term income from rangelands. The Department of State Lands should evaluate each parcel for sale or alternate use, and determine how best to maximize long-term revenue. Options to maximize returns for rangelands include the following actions:

- Sell all or part of the land through an open competitive bidding process;
- Exchange all or part of the land for a better performing asset; and
- Obtain market rates for leases either by reinstating competitive bidding for rangeland leases or increasing grazing fees to market rates.

We further recommend to the State Land Board that:

- If rangelands are leased using the grazing fee, review the grazing fee formula and factors at least once every three years as required by Oregon Administrative Rules; and
- If rangelands are retained, determine the resources needed to properly protect the asset and maximize its value.

AGENCY'S RESPONSE

The Department of State Lands generally agrees with most of the recommendations, but has reservations about some of the recommendations.

Cathy Pollino, State Auditor, Audits Division

Bradbury, Secretary of State

Secretary of State Audit Report

Introduction

The Common School Fund was established under the Oregon Constitution as a trust fund for the benefit of public schools. The State Land Board—composed of the Governor, the Secretary of State and the State Treasurer—is responsible for managing the assets of the Common School Fund. The board is required to manage the assets to maximize long-term income for public schools.

Both financial assets and real property benefit the Common School Fund. Financial assets are invested in stocks, bonds and short-term investments. The Common School Fund real property assets include forestland, agricultural land and rangeland, as well as some industrial, commercial, and residential properties.

The State Treasurer and Oregon Investment Council manage the financial assets of the Common School Fund.

With the exception of forestlands, the Department of State Lands manages the real property assets of the Common School Fund at the direction of the board. As of June 30, 2003, the Common School Fund Balance was approximately $702 million. Twice a year, the department distributes fund earnings to counties for support of K-12 public schools. Distributions are made in proportion to the number of individuals between the ages of four and twenty residing within each county.

Background

In 1859, the United States Congress passed the Admission Act, granting Oregon admission to the Union. Section 4 of the Admission Act granted the state approximately six percent of the land, which was sections 16 and 36 of each township to the state, "for the use of schools."[1] The Oregon legislature accepted congress' land offer, creating a binding agreement whereby the state is required to use the land and any proceeds from sales of the land for public schools. As a result, the state created the Common School Fund to hold the proceeds of all lands granted to the state for education purposes. This land is often called 'Trust Land' to signify that the State Land Board holds it in trust for the schools, and acts as trustee in administering the land to benefit Oregon's current and future school children.

As a trust asset, Oregon's rangelands are to be managed with undivided loyalty to the trust recipient, and may not be used to benefit others at the expense of the trust beneficiaries without compensation. In addition, trust assets must be preserved for future beneficiaries. Rangeland soil, water, and growing capacity must be maintained to sustain the land's grazing capacity.

In 1992, the Oregon Attorney General concluded that the board's duty is to manage Trust Lands for the long-term benefit of schools. In 1977 and 1978 opinions, the Attorney General characterized the board's obligation as a duty to maximize the value of, and revenue from, these lands over the long-term. The board is required to obtain full market value from the sale or rental of Trust Lands.

As the administrative arm of the board, the department manages an estimated 638,000 acres of rangeland. Most of this land is located in central and eastern Oregon. Rangelands are used primarily for the grazing of domestic livestock. Of approximately 638,000 acres of rangeland administered by the department, about 613,000 acres (96 percent) are Trust Land. The board therefore must manage rangelands to maximize long-term income for schools.

The department currently manages 144 rangeland leases, of which 54 involve 1,000 acres or more, including 11 in excess of 10,000 acres. It also manages leases of smaller "isolated" parcels. Together, the leases provide for about 65,000 animal unit months (AUMs).[2] One staff member in the department's Bend office is responsible for managing the rangeland, as well as working with the leaseholders to improve the condition of this asset.

[1] A township is a defined as a six-mile by six-mile square area, which includes 36 sections. Each section is one square mile.

[1] An AUM is the amount of forage necessary to feed one animal unit for one month. An animal unit includes one cow, or one cow and one calf (of less than six months in age).

Audit Results

Income From Rangelands Has Not Been Maximized

We found that rangelands with a conservative value between $22.7 and $32.5 million actually lost money, at least $13,115 over the five-year period of our review. Further, we found that because of limited resources available to the program, the department was not able to verify the condition of most of the land or properly monitor leaseholder compliance with lease provisions.

As a comparison, our analysis determined that the board would have generated significantly more income per year over this period, had it used alternative strategies such as selling the land and investing the proceeds in alternative investments (at least $3.0 million), or charging market rates for leases ($1.45 million).

Net Income From Rangelands Has Been Negative

When we reviewed revenues and costs attributed to rangeland operations by the Department of State Lands for fiscal years 1998 through 2002, we found that rangelands lost money over the five-year period reviewed.

The department provided us with an Asset Management Plan Update that shows revenues and costs allocated to rangelands and other programs benefiting the Common School Fund.[3] The costs allocated to rangelands were incomplete, however, because they did not include fire suppression and rehabilitation costs directly attributable to rangelands. Information on fire suppression and rehabilitation costs is not available for years prior to 2001.

After adding fire costs for just two of the five fiscal years, we found that expenses exceeded revenues for this five-year period. For the five fiscal years, total rangeland revenue was $1,454,203 and total estimated costs were $1,467,318. As shown in Table 1, costs exceeded revenues by $13,115 for the five fiscal years.

Table 1: Rangeland Revenues and Costs

Fiscal Year	Total Revenues From Leases	Total Costs
1998	$245,106	$240,961*
1999	287,135**	252,481*
2000	282,599	215,673*
2001	316,843	380,493
2002	322,520	377,710
Total	$1,454,203	$1,467,318

* Information for fire suppression/rehabilitation costs not available/included.

** Revenue does not include a one-time transfer of $3.5 million from General Fund to Common School Fund. See discussion on page 5 of this report.

Further, it appears that the rangelands have a history of negative net income. In 1995, a consultant's report concluded that the rangelands program had operated in the red during fiscal years 1988 through 1994. The report noted that during the reported period the program lost $988,000. The consultant recommended that rangelands be actively marketed for sale or exchange.

Revenues Could Be Increased If Rangelands Were Sold

One option available to the board to improve revenues generated by rangeland assets is to sell the rangelands. Selling the rangelands would reduce management costs while providing proceeds that could be invested in alternate assets.

Most rangeland leases allow the land to be sold with two years' notice to the leaseholder. A wholesale disposal of state owned rangeland could potentially depress rangeland prices. Thus, if the board decides to sell the rangeland, it should proceed over several years to maximize the value for the Common School Fund.

To assess whether the board was maximizing income from its rangeland assets, we analyzed what the asset would have produced using an alternative investment, also known as opportunity cost. Since the board can sell rangelands, it has the ability to invest rangeland assets in an alternate asset. Revenue maximization requires selling the rangelands and investing in another asset if more revenue can be achieved with the same or lower level of risk.

Estimated Average Selling Price Per Acre

Based on our interviews with department, federal and local officials, the average market value of rangeland in Eastern Oregon is hard to determine. In 1993, a committee reviewing grazing fees charged by the board used $35 per acre as a minimum value for rangelands. Previous audit work that we conducted showed that Admission Act lands would likely sell, on average, for about $50 per acre, based on sales of comparable properties, average assessed land values of comparable properties, and estimates of department staff. Another source cited $50 as a minimum per acre value for rangeland. Therefore, to facilitate a comparison with alternate investments, we estimate that a conservative range of value for rangeland assets is between $35 and $50 per acre.

We believe this estimate to be conservative, since in December 1999 the board authorized the department to offer nine isolated unleased parcels of rangeland in Lake and Klamath Counties for sale through a sealed bid process. A total of 23 bids were received for seven of the nine unleased parcels, resulting in the sale of 514.72 acres. The sale value totaled $119,919.09, including a 40-acre parcel containing timber that sold for $62,000. Excluding the parcel containing timber, the average per acre selling price was $122.01.

[1] The Asset Management Plan can be seen at the Department of State Lands website: http://statelands.dsl.state.or.us/.

$22.7 to $32.5 Million Could Be Invested in Other Assets

If rangelands could be sold for net proceeds between $35 and $50 per acre, then the rangeland assets held by the board could conservatively provide an estimated $22.7 to $32.5 million to be invested in other assets.

The income from rangelands could be increased, with less risk, if an alternate investment with less risk provides a higher average return.[4] For example, investment in U.S. Treasury Bills is often thought to be risk-free. Therefore, the average income from rangeland assets must surpass the average income from U.S. Treasury Bills, or an opportunity exits to increase income with essentially no risk by converting rangeland assets to three-month Treasury Bills.

$3.0 to $4.2 Million More Would Have Been Earned

If the board had sold the rangelands and achieved the average rates of return earned by an alternate investment, we estimate that at least $3.0 to $4.2 million would have been earned for the Common School Fund in fiscal years 1998 through 2002.[5] If the average costs remain the same, this range is an estimate of future income lost due to holding rangeland assets rather than converting them into more profitable assets.

In addition, there is currently no property tax revenue being generated for schools by the rangelands. If state-owned rangelands were converted to private ownership then they would generate property taxes, some of which would increase funding for Oregon's public schools. When making decisions about selling rangeland, the board, acting with undivided loyalty to Oregon's public schools, should consider the additional revenue that would support public schools.

Table 2 shows the returns that could be expected annually if rangelands continue to earn 2.6%, which is the average annual rate of return for three month U.S. Treasury Bills.[6]

Table 2: Expected Annual Rangeland Return

		Rate of Return
		2.6%
Net Price per Acre	$35.00	$590,986
	$50.00	$844,266

Other Reports Have Suggested that Rangelands Be Evaluated for Disposal

The suggestion that rangelands be evaluated for sale was previously made to the board in a 1970 report by Charles E. Poulton, Professor of Range Ecology at Oregon State University. The report noted that the previous policy of the state was to sell rangeland and lease the land that was not sold. The earlier state policies resulted in selling the best quality land. The report suggested incorporating an aggressive program of exchange and/or sale of rangeland assets based on consideration of individual parcels.

Another recommendation to sell the rangelands was made by the department in 1995 when it released the Proposed Asset Management Plan. The plan was developed to guide the care and management of land, waterways, and minerals entrusted to the land board. In the plan, the department recommended that, "Rangelands will be actively marketed for sale or exchange. Existing lessees may be offered the first right of refusal on the purchase of Rangelands."

Legal Requirements Regarding the Sale of State-Owned Land

In reviewing the state's legal requirements for land sales, we noted several requirements, such as preference to other government entities that might reduce the potential sales price of rangelands. Because the board has a duty to maximize the value of rangelands for schools and obtain market rates for any rangeland sold, it should consider requesting that the sale of rangelands be exempt from the requirement to offer the land to other government entities before selling the land through an open, competitive bidding process. The most administratively effective way of ensuring that the Common School Fund receives the best price for any sale of rangeland assets is to use open, competitive bidding.

Revenues Could Be Increased Through Grazing Fees

Another option available to the board to improve revenues generated by rangeland assets and comply with trust responsibilities is to increase grazing fees.

The Rangeland Grazing Fee is Below Market Rates

A 1975 opinion of the Oregon Attorney General states that the state must, "… receive full market value for the sale, rental or other use of its trust lands."[7] The Attorney General characterizes charging less than full market value as a subsidy.

In 1996, the board approved the current formula for determining the annual grazing fee to be paid for using state-owned grazing land.[8] For the five years reviewed, the grazing fee formula has con-

[4] Note that asset appreciation for rangeland is not being explicitly considered because department and BLM staff have stated that rangeland appreciation is generally at or below the rate of inflation.

[5] This amount equals the expected return shown in Table 2 corresponding to a net price per acre of $35 and $50, and a 2.6 percent rate of return multiplied by five and rounded to the nearest $100,000.

[6] Calculated by subtracting inflation from the average constant maturity yield of 3-month t-bills for calendar years 1983 through 2002.

[7] C37 Op Atty Gen 569, 574 (1975)

sistently produced rates below estimated market rates for privately owned non-irrigated grazing land.

In 2002, the grazing fee for state-owned grazing land in Oregon was $4.52 per Animal Unit Month (AUM), while the U.S. Department of Agriculture (USDA) National Agricultural Statistics Service (NASS) reported the 2002 average grazing fee for privately owned, non-irrigated grazing land in Oregon to be $12.60 per AUM.[9]

Department management stated that USDA indexes for private grazing fees might include land with amenities that make it more valuable than the rangeland that the department leases. Research suggests that public rangeland leases are worth roughly 30 percent less than private lease rates because fewer services are provided.[10] On this basis, we estimate that the market value of the grazing fee for state-owned rangeland in 2002 was $8.82 per AUM, or $4.30 per AUM more than the rate set by the department. Table 3 presents private grazing fees, estimated market fees for public rangeland grazing, and the fees paid by leaseholders for grazing on state-owned rangeland in Oregon. If the board had charged market rates for leases, we estimate that $1.45 million more would have been earned for the Common School Fund in fiscal years 1998 through 2002.

Table 3: Private Grazing Fee, Estimated Value of Public Grazing, and Grazing Fee Set by Oregon State Land Board (Per AUM)

	Average Private Grazing Fee*	Est. Market Value of Public Land Grazing**	Oregon State Land Board Grazing Fee
1998	$12.80	$8.96	$3.21
1999	$12.30	$8.61	$3.72
2000	$12.90	$9.03	$3.64
2001	$12.80	$8.96	$4.36
2002	$12.60	$8.82	$4.52

* Source USDA, National Agricultural Statistics Service. The average rates are estimates based on survey indications of monthly lease rates for private, non-irrigated grazing land from the January Agricultural Survey.

** Calculated as 70 percent of private fee.

Another way to analyze grazing fees is to determine how much the board would need to charge in order to produce the same income as it would if it were to sell the asset. If rangelands can be sold for net proceeds of $35 per acre, then at 2.6 percent return, rangelands would be expected to provide annual income of at least $0.91 per acre. We found average costs per acre to be at least $0.47 per acre from fiscal years 1998 through 2002. If the average costs remain the same, then the board will need to charge at least $1.38 per acre to justify holding rangeland versus converting to an asset with an expected annual real return of 2.6 percent. Income of $1.38 per acre converts to a grazing fee of about $13.13 per AUM.

Formula Factors Not Reviewed

In accordance with OAR 141-110-0080, the department is to review the grazing fee formula and factors at least once every three years to ensure that they reflect at least a fair market rental rate. However, a review of the formula and factors has not been conducted since 1996.

Decisions Regarding Leaseholders

In reviewing board actions related to rangelands since 1995, we found that the board made decisions favoring grazing leaseholders at the expense of the Common School Fund.

On June 13, 1995, the board voted to repeal competitive bidding for grazing leases, which had been in place for less than a year. By repealing competitive bidding, the board limited demand for grazing leases and effectively reduced the potential revenue from grazing fees.

In 1999 the Legislative Assembly authorized a transfer of $3.5 million from the General Fund to the Common School Fund, as compensation to the trust for implementation of a lease renewal preference that gives current leaseholders an automatic 15-year renewal at the end of their 15-year lease. The $3.5 million was compensation set at $50 per Animal Unit Month (AUM) for 70,000 AUMs. The automatic renewal eliminates demand for grazing leases and potentially reduces revenue from grazing fees for 30 years or more. The $3.5 million transfer was insufficient to compensate for not maximizing revenue, as it only covers the difference between actual and potential revenue for less than three years.[11] Because the $3.5 million did not come from grazing fees, we did not consider it to be lease revenue for 1999.

[8] The AUM Rental Rate is G x CC x S x P. In the formula: G = Animal gain per month (fixed at 30 pounds), CC = Marketable calf crop (fixed at 80%), S = state share of calf gain (fixed at 20%), and P = average weighted calf price based on USDA Oregon agriculture price data indicating the average statewide sales price of calves for the preceding one-year period.)

[9] According to the USDA, the final NASS published grazing fees are derived through an analysis of annual survey indications, state historical trends, and regional and national differences.

[10] Bartlett, E.T., L.A. Torrell, N.R. Rimbley, L.W. Van Tassell, and D.W. McCollum. 2001. Valuing Public Land Forage. *Journal of Range Management* 56. cited in O'Laughlin, J. and P.S. Cook. 2001. Endowment Fund Reform and Idaho's State Lands: Evaluating Financial Performance of Forest and Rangeland Assets. Report no. 21, Idaho Forest, Wildlife and Range Policy Analysis Group, University of Idaho, Moscow.

[11] This assumes a 2.6 percent return on a net sales price of $35 per acre.

Evaluate Resources Needed to Preserve the Asset

If the decision is made to retain all or a portion of the rangelands, the board should determine the resources needed to properly protect rangeland soil, water, and growing capacity.

We found that the department's efforts to manage and protect rangeland quality by monitoring lease compliance and leaseholder adherence to rangeland management plans were insufficient to detect or prevent overgrazing and improper use of the land by leaseholders.

We also found that the department dedicates 12.5 percent of lease receipts to rangeland improvements. According to the department, this is not enough to complete needed improvements. As a result, land maintenance, such as noxious weed control, has been put off. Rangeland improvements are currently aimed primarily at dispersing cattle and improving leaseholder's access to rangelands.

According to department's Asset Management Plan, a rangeland management plan should be developed for each leasehold in cooperation with the leaseholder, and should be made part of the grazing lease. The plan describes scheduled animal grazing by pasture or leasehold, establishes initial grazing capacity of the land, and describes any other special provisions. The plan should be reviewed annually by the department, to determine leaseholders' compliance with the plan's terms and conditions, and to establish the effectiveness of the plan. The plan should be updated as necessary based on annual reviews.

Leaseholders are required to report annual land use. However, the department is only comparing reported use to allowable use, and does so without physical verification of actual land use. The department has only one Range Manager responsible for monitoring leases. In 2002, the Range Manager was able to visit only approximately 40-45 percent of all state-owned rangeland.

A report prepared by an agriculture management consultant stated that the quantities, composition, and quality of vegetation for livestock consumption are important indicators for sustainable forage production and range management.[12] The last full review of rangeland condition was completed in 1970. In 2002, the department began conducting a rangeland health assessment of all rangelands, and has assessed approximately 85,000 acres. At the planned rate of review, a complete assessment will not be finished until 2019.

We recommend that the State Land Board use a systematic approach to maximizing long-term income from rangelands. The Department of State Lands should evaluate each parcel for sale or alternate use, and determine how best to maximize long-term revenue. Options to maximize returns for rangelands include the following actions:

- Sell all or part of the land through an open competitive bidding process;
- Exchange all or part of the land for a better performing asset; and
- Obtain market rates for leases either by reinstating competitive bidding for rangeland leases or increasing grazing fees to market rates.

Agency's Response

This report summarizes the department's response to the audit recommendations. The full text of the department's response is available for review at the Audits Division.

We generally agree that it is appropriate to sell selected isolated rangeland parcels and/or exchange selected parcels of rangeland for better performing assets. However, we do not believe it is necessarily in the best interests of the Common School Fund or the beneficiaries of this trust to sell all rangeland managed by DSL.

For some time, DSL has endorsed the selling of parcels that either do not meet the agency performance criteria, and/or show limited potential to do so in the future. In adherence to the agency's Asset Management Plan, DSL has conducted both sales and exchanges of rangeland parcels.

During the past two years, DSL did not offer any isolated tracts of rangeland for sale. The principal reason it did not do so was, until recently, the lack of administrative rules guiding the sale and exchange of state-owned land and understaffing. However, with the adoption of such rules, DSL can now proceed, staff availability and budget permitting. DSL may also now consider the sale or exchange of additional rangeland identified in earlier studies as non-performing, and the 38 requests it has received since 1995 from persons wanting to purchase or exchange land for 11,323 acres of state-owned rangeland.

DSL concurs that competitive bidding is one, if not the most suitable way to ensure that market rates are realized. However, the agency is not able to use competitive bidding for nearly all the forage leases currently in place. This prohibition resulted from an agreement reached by the agency at the direction of the Land Board with a group of lessees who were in litigation with the Board and DSL, and from legislation enacted which allocated $3.5 million to the Common School Fund.

The auditor's analysis of the effect of the $3.5 million compensation payment to provide assured grazing rights to lessees for the term of the lease is flawed. The auditors conclude that the lessees benefited at the expense of the fund. However, our analysis reveals

[12] Agland Investment Services, Inc. 2000. *Trust Performance Measurement: A Report to Western States Land Commissioners Association.*

that the action was of great benefit to the Common School Fund. The fund received a one-time payment of $3.5 million in 1999 based on the market value rate of $50 per AUM times 70,000 AUMs. This payment compensated the Common School Fund for assured grazing rights for current lessees only for the term of their lease. Most terms are 30 years.

(Auditor Comment: As we state on page 5, the compensation payment was derived from a transfer of General Funds to the Common School Fund. If the compensation payment had been paid by the leaseholders, we would have then viewed the payment as earned income.)

With regard to the average annual fee reported by the U.S. Department of Agriculture (USDA) for grazing on privately-owned, non-irrigated land in Oregon, a comparison of the rental received from leasing a tract of publicly-owned land to one that is privately-owned is subject to criticism unless the parcels have similar vegetative characteristics and the services offered by the lessor are identical. The use of USDA annual data purposes may be indicative, but is not a reliable measure of what private landowners are receiving for rent due to the weaknesses of the USDA data.

We further recommend to the State Land Board that:

- If rangelands are leased using the grazing fee, review the grazing fee formula and factors at least once every three years as required by *Oregon Administrative Rules*; and

Agency's Response: *DSL agrees with this recommendation. Although DSL has closely monitored the fee that results after inputting the variables each year to determine if it is paralleling market conditions, it has not undertaken a formal review of the formula every three years as required. To ensure that DSL is in compliance with the provisions of the administrative rules, the agency will conduct a formal review of the formula within the next 12 months, and every three years thereafter.*

- If rangelands are retained, the board should determine the resources needed to properly protect the asset and maximize its value.

Agency's Response: *DSL agrees with this recommendation. For some time, agency staff has been engaged in identifying improvements needed to our rangeland holdings. Although a number of these improvements have already been made, many more improvements are needed. During the past several years, DSL:*

- *Began an aggressive program to control, for example, medusahead, pepperweed, skeleton weed and yellow star thistle, four noxious weeds that are invading large tracts of state-owned rangeland in eastern Oregon. During the 2003-2005 biennium, $40,000 is identified for additional weed control.*

- *Undertook a rangeland health assessment of 38,000 acres in 2002 and 50,000 acres in 2003. During 2004 and 2005, DSL will continue assessing rangeland health for an additional 30,000 acres each of those years.*

- *Reseeded nearly 2,400 acres to rehabilitate rangeland damaged by wildfires.*

- *Constructed various water delivery facilities and fences.*

Through the process of the rangeland health assessment process, we will be able to identify resource improvements such as noxious weed treatment, water developments, prescribed burning, fencing, and shrub and juniper treatment. These improvements will result in increasing the value of these parcels.

Follow Up on Prior Audit Recommendations

This section is an update on the department's efforts to implement prior audit recommendations communicated in our audit report number 94-01, titled *Division of State Lands*, issued in 1994, and in our report number 2001-13, titled *Division of State Lands: Change of Director Audit*, issued in 2001. This update discusses only recommendations we had not previously reported as fully implemented.

Division of State Lands (Report No. 94-01)

Recommendation: Department management should establish specific performance standards that the department can use to measure its success in identifying and placing under lease uses of state-owned submerged and submersible lands.

Status-Implemented

Agency's Response*: The department has made significant progress in addressing this recommendation. At its October 2003 meeting, the Land Board adopted the Department of State Land's Strategic Plan. This plan, which has been under development for the past two years, contains a number of goals and actions relating to land and waterway management. Associated with these goals are specific performance measures. For example, the department has established the following performance measures relating to the management of the state-owned submerged and submersible land as well as upland under its jurisdiction. By 2005:*

- *75% of all users of this land will be "paying appropriate user fees."*

- *A resource inventory will have been completed for 60% of this land.*
- *Area management plans will have been completed for 80% of this land.*

The department will report its progress on the implementation of the plan goals to the Land Board, legislators, and key constituents every six months. The plan will be updated every two years at the end of odd-numbered years to incorporate items resulting from legislative actions and new information. Now that this plan has been adopted, the department will begin implementing the goals and performance measures contained in it.

Recommendation: Department management should compile information on the cost and benefit of identifying and placing under lease uses of submerged and submersible lands. Department management can use this information to determine the cost-effectiveness of and an appropriate level of resources for identifying and placing under lease submerged and submersible lands.

Status-Implemented

Agency's Response: *With the change in state law in 1995 the universe of state owned waterways and therefore the number of uses subject to lease or other authorization is now limited. Therefore, to compile a cost-effective review seems now moot. In addition, the audit team was responding to our reports of the large number of structures in need of lease. The lease process at that time was lengthy with low rates and application fees. Since that time the Land Board has increased the rental rates and the application fee as well as relieved small personal dock-owners of the need to obtain a lease and substituted a low effort registration process. In addition, the Land Board's rules call for an annual increase in the rental rates for most uses of 3%. In general, we have found that putting uses under lease, once identified, pays off in the long run since they continue to generate revenue to the Common School Fund (at a minimum of additional cost to administer the lease) as long as the use remains.*

During 1999 the department did an extensive inventory of the most developed reaches of state-owned waterways. The department did both on-the-water and aerial photo interpretation to locate leaseable structures/uses. The department mapped all these sites as well as tabulated the data in the department's Geographic Information System. The department also researched the upland property owner information at the local tax assessor and identified the most likely owner of the structures. All of this information is used by the department's property managers as 'leads' to follow up as potential leases and registrations.

Recommendation: The department should establish specific procedures and time frames for identifying and placing under lease uses of state-owned submerged and submersible lands. This includes exerting ownership rights to submerged and submersible lands to which the state is entitled.

Status-Partially Implemented

Agency's Response: *The department has made significant progress in addressing the first part of this recommendation. As discussed above, the Land Board adopted the Department of State Land's Strategic Plan at its October 2003 meeting. This plan contains a number of goals and actions relating to the management of state-owned submerged and submersible land – several of which have already been discussed above. The department also requested and received approval during the 2001 and 2003 sessions of the Legislature for a limited duration position dedicated to bringing users of state-owned submerged and submersible land without proper authorization into compliance.*

Recommendation: The department should work with Business Registry Section staff to create mailing labels from the Business Registry database for businesses within industry classifications that are likely to hold unclaimed property. Using the labels, the department should mail information, forms, and instructions to likely holders of unclaimed property.

Status-Implemented

Agency's Response: *Department staff have worked with the Secretary of State's Business Registry database and extracted from it the names of businesses within various SICs that are likely to hold unclaimed property. These names have been added to the department's mailing list. Periodically, department staff reviews the Business Registry list to identify the names of new businesses to incorporate within the agency's mailing list. The department does mail information to these holders as well as periodically conduct seminars to inform them and other businesses of the state's unclaimed property reporting requirements.*

Recommendation: The department should work with staff from the Employment Department to obtain legislative approval to use otherwise confidential payroll data to identify likely holders of unclaimed property.

Status-Implemented

Agency's Response: *To satisfy the intent of this recommendation, the department was closely involved in the development and subsequent enactment of HB 2129 (introduced in the 2001 session). A provision of the bill (codified as ORS 98.353), directs the Department of Revenue and the Corporation Department of the Office of the Secretary of State to assist the department in determining which persons are required to file a report under ORS 98.352. The department believed that this approach is a better way to identify*

"likely holders of unclaimed property" than by utilizing Employment Department staff and resources.

Recommendation: The department should establish and monitor financial performance measures to provide a means to evaluate programs, make decisions, and demonstrate how successfully it is achieving its objective of generating revenue for the Common School Fund.

Status-Partially Implemented

Agency's Response: *The department has made significant progress in addressing this recommendation. The State Land Board adopted the Department of State Land's Strategic Plan at its October 2003 meeting. This plan contains a number of goals and actions relating to land and waterway management. Associated with, or incorporated within these goals are specific performance measures that the department will now use to "evaluate (its) programs, make decisions, and demonstrate how successfully it is achieving its objective* of generating revenue for the Common School Fund." Additionally, this plan also establishes as Agency Measure #1 "Percent annual increase in revenues from all sources; 2005 goal is 4.5% increase over 2002 amount." Now that this plan has been adopted, the department will begin implementing the goals and performance measures contained in it.

Recommendation: When developing its Asset Management Plan, the department should incorporate minimum required rates of return for real property assets that are consistent with financial theory and that meet the department's trust obligations.

Status-Not Implemented

Agency's Response: *The department will begin updating its Asset Management Plan within the next several months. As a part of the process of updating this plan, the department will recommend the board adopt appropriate rates of return for the real assets managed by the department.*

Recommendation: The department should periodically monitor the actual rate of return against the established minimums and take appropriate action when necessary.

Status-Not Implemented

Agency's Response: *Once the department completes its update of the Asset Management Plan, it will have the requisite target rates of return against which to measure the performance of its real assets.*

Division of State Lands: Change of Director Audit (Report No. 2001-13)

Recommendation: The department should take additional measures to ensure that leave and payroll policies are clearly understood by department management, personnel, and payroll officers.

Status-Implemented

Agency's Response: *The department has taken a number of measures to ensure that leave and payroll policies are clearly understood by all agency staff. Among the action taken have included the development and circulation to all staff of policy statements concerning leave and payroll policies. Additionally, department policies on a wide variety of topics including leave and payroll policies are posted on the agency's internal Internet website. Because non-managerial/non-exempt staff formed a union bargaining unit in 2001, many of the policies concerning leave and payroll are clearly spelled out in the contract agreement.*

Recommendation: The department should work with the Department of Administrative Services State Controller's Division to develop written policies and procedures to implement the forthcoming state policy regarding agency head travel and timesheet review and approval.

Status-Implemented

Agency's Response: *The department contacted the Department of Administrative Services (DAS) and agreed to defer to that agency's policies concerning all policies and procedures regarding agency director travel and timesheet review and approval. However, after consulting with DAS and staff from the Secretary of State's office, it was decided that the most practical and expedient way for the department's director to have his/her travel and timesheets reviewed and approved was to have them signed by a designated Department of State Lands Assistant Director. To have such documents signed by the Governor (as chair of the Land Board) or a person at DAS was determined to be impractical.*

Objectives, Scope and Methodology

The objective of this audit was to determine if the State Land Board, through the Department of State Lands, is maximizing the long-term income generated by its rangeland assets.

We reviewed background information available on the Department of State Lands (department) website to gain an understanding of the rangeland program. We reviewed the department's Asset Management Plan, and the 2000 and 2003 progress updates for the Asset Management Plan.

We reviewed *Oregon Revised Statutes*, Oregon Administrative Rules and Oregon Attorney General Opinions relevant to the rangeland program.

We conducted an initial review of revenue generation by state-owned rangelands, mineral rights, and submerged and submersible lands. Based on our review, we found that rangelands were the most likely land classification to be underperforming, and decided to pursue a detailed review of rangelands.

We interviewed key staff at the department office in Salem, as well as the Eastern Region Manager and Range Manager in the Bend office.

We reviewed reports related to range management, trust fund management, and the financial performance of rangelands.

We obtained a list of active grazing leases including parcel size, AUM capacity and annual fee. We reviewed sample leases to identify important lease provisions.

We contacted the United States Department of Agriculture to obtain information on private grazing fees in Oregon and fees charged by other states with similar publicly owned rangelands.

We contacted county tax assessment officials to obtain an understanding of rangeland value and tax implications of converting rangeland to private ownership.

We contacted officials with the federal Bureau of Land Management to gain an understanding of their range management practices, and to confirm that rangeland value appreciation does not exceed the rate of inflation.

We contacted officials in other states responsible for range or natural resource management in order to determine how their grazing fees were set, what other fees were charged for grazing, and if they had found alternate uses for rangeland.

We reviewed the report of the 1993 Grazing Fee Advisory Committee to the Director of the Department of State Lands, to gain an understanding of the basis for the grazing fee formula and each of its components.

We reviewed accounting data used by the department in their cost allocations. To compare the results from the rangeland program to results of alternate investments, we also reviewed returns from U.S. Treasury securities compared to inflation.

We reviewed minutes of State Land Board (board) meetings available on the department website, which included minutes starting in 1995. The minutes were reviewed to identify decisions of the board affecting rangeland management. In addition, we obtained detailed information on some board meeting agenda items.

This audit was conducted in accordance with generally accepted government auditing standards.

Auditing standards require auditors to be independent of the audited organization to avoid the possibility or perception of a relationship that could impair the audit work done or the findings reported. The Secretary of State serves as the constitutional Auditor of Public Accounts, and also serves as a member of the State Land Board, the subject of this report.

This audit was performed by staff members of the Oregon Audits Division, a branch of the office of Secretary of State. All staff members working on this audit have declared personal independence from the State Land Board and Department of State Lands.

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The courtesies and cooperation extended by the officials and staff of the Division of State Lands were commendable and much appreciated.

This report, which is a public record, is intended to promote the best possible management of public resources. Copies may be obtained by mail at:

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