

INFORMATIONAL
88

**THE COMMISSION STAFF'S UPDATE REPORT
ON ITS AUDIT ACTION PLAN IN RESPONSE
TO THE COMMISSION'S DIRECTION**

PARTY:

California State Lands Commission

BACKGROUND:

At its meeting on September 1, 2011, the Commission directed staff to prepare an action plan to address the findings of the Bureau of State Audits August 2011 Report 2010-125 regarding the Commission's management of leases of state property. At its meeting on October 27, 2011, staff presented its action plan in response to Commission direction. The enclosed report is an update detailing progress made to date.

EXHIBIT:

A: 2011 Audit Action Plan - "January 26, 2012 Progress Report by the Staff of the California State Lands Commission"

EXHIBIT A

2011 Audit Action Plan: January 26, 2012 Progress Report by the Staff of the California State Lands Commission

At the Commission's direction, staff has prepared this progress report to update the Commission on the progress staff has made in its implementation of its 2011 Audit Action Plan. Staff's 2011 Audit Action Plan was prepared, at the direction of the Commission, to address the various deficiencies and recommendations included in the Bureau of State Audits (Bureau) August 2011 Report 2010-125. Commission staff presented its 2011 Audit Action Plan to the Commission, as Calendar Item 54, at its October 27, 2011 meeting.

Commission staff submitted its 60-day response to the Bureau on October 24, 2011. The Bureau's report assessing staff's 60-day response in implementing the Bureau's recommendations will not be released until mid-February. Staff's six month response to the Bureau is due February 23, 2012.

Staffing

Commission staff was successful in securing Administration approval of staffing augmentations in the Governor's Budget for fiscal year 2012-13. A total of 9 positions have been included for further consideration by the Legislature. These include 4 auditors and 5 lease compliance positions. Increase to revenues as a result of these new positions is estimated at \$6.6 million.

Audit Report Recommendations

- Delinquent Leases and General Lease Compliance
- Holdovers
- Missed Rent Reviews
- Audit Cycles for Leases
- Statutory Trust Grant Oversight
- Lease Database

Delinquent Leases/General Lease Compliance

Commission staff continues to conduct its comprehensive review of the aged Accounts Receivable. The management group created to identify and prioritize these delinquent and non-compliant leases has been meeting to address these leases. In fact, the Commission's January 26, 2012 agenda includes three items where staff is requesting authorization to pursue enforcement actions against delinquent leases and/or trespassers. Staff has also finalized procedures for timing and coordination between the Commission's different divisions and the Attorney General's Office in addressing future delinquent and non-compliant leases.

Holdovers

As reported in staff's 2011 Audit Action Plan, as of October 2011, 24 of the 32 holdover leases identified in the Bureau's report had been eliminated from holdover status. As mentioned before, of the remaining 8 leases, one lease (Selby Slag) involves an ongoing environmental clean-up obligation and will remain in its holdover status indefinitely. Another lease (Chevron Estero) is in non-operational caretaker status and should be taken off the holdover list once a determination is made as to its final disposition. Staff is waiting for an abandonment plan to be submitted.

Since October 2011, one lease (GP Gypsum) was approved by the Commission on October 27, 2011. The PG&E pipeline master lease is being split into six separate leases and is scheduled for consideration by the Commission at the January 26, 2012 meeting. The Final EIR for the Nustar marine oil terminal was finalized in mid-January 2012 and staff anticipates bringing the lease and EIR to the Commission for consideration at the next scheduled Commission meeting. The Kinder Morgan pipeline master lease is expected to be considered by the Commission in mid-2012. The two remaining holdovers are the Tesoro marine oil terminals (Avon and Amorco). We have received applications for these terminals and staff is initiating the environmental review. Staff anticipates this environmental review will take anywhere from one to two years. Once the environmental review is complete, staff will take the lease and environmental document to the Commission for consideration. Rent reviews for these two leases were conducted in June 2011 and rent rates and payments have been brought up to date.

Rent Reviews

Staff continues to develop and refine its rent review process. As previously reported, in late 2010, leases due for rent reviews began being pulled one year in advance as opposed to 9 months in advance. In April 2011, the rent review checklist, which identifies steps and timeframes for staff to adhere to, was updated. These changes have been effective in helping staff complete rent reviews in a timely fashion. This directive actually resulted in staff being too efficient with rent reviews and numerous items being prepared for Commission consideration prematurely. If rent reviews are conducted too early in the process, the Commission may not be able to take advantage of land valuation changes or CPI adjustments. In November 2011, staff was directed to only bring rent reviews forward for the Commission's consideration within a 4-month period prior to the effective date of the rent review.

Staff continues to move forward with a more expanded use of the consumer price index (CPI) in calculating annual rent revisions. Staff will continue to recommend to the Commission the expanded use of the CPI in most high-value commercial use, industrial use, and right-of-way use leases on a going-forward basis. Staff is also exploring the use of the CPI in lower value leases to assist in streamlining the rent review process. In November 2011, staff consolidated and simplified the CPI process by using the California CPI (a weighted-index of the Los Angeles and Bay Area CPI indices) as the sole index where feasible on a going-forward basis.

Staff has also made significant progress in updating its benchmarks. The Wingo benchmark was eliminated as it was no longer applicable. The San Francisco and Marin County benchmarks were consolidated and updated in August 2011. The Southern

California benchmark and the Huntington Harbour residential benchmark were updated in December 2011. A new Colorado River recreational benchmark was established in January 2012 and we will work toward establishing a Lake Tahoe residential benchmark. The Black Point residential benchmark is in the process of being finalized and the Lake Tahoe recreational benchmark will be updated in the first half of 2012. The term residential in this context refers to non-water dependent private use of state property.

Audit Cycles for Leases

Staff continues to make significant progress on conducting audits that have been planned for this year. As of January 2012, staff completed the audit of Long Beach Unit revenues for the fiscal periods of 2007-2008 and 2008-2009 as well as the audit for DCOR's royalty payments for 2005 through 2009. Moreover, staff has started its work with the selected consulting firm to audit the royalty payments from Rosetta Resources for the 2006 through 2011 time frame.

Statutory Trust Grant Oversight

As previously reported, staff requested additional positions to implement the Commission's statutory trust grant compliance program, however, staff's request was not approved. Staff is continuing to work with the state's trustees to submit their annual financial reports, as required by Public Resources Code §6306, in a format that readily identifies the trustee's trust fund and details its income and expenditures. Staff, with its limited resources, is also making every effort to assist local trustees with their waterfront revitalization programs.

Lease Database (ALID)

Staff continues to strive to complete entry of all Commission actions into the system within 30 days of the meetings. Further, all income-producing leases are being verified for data elements relating to rent amounts, rent review dates, lease term and lease expiration dates.

Investigations into the availability of off-the-shelf lease/asset management software packages that could provide more extensive and flexible reporting and inquiry capabilities are continuing.

Legislation/Regulation Changes

As previously reported, staff is continuing to explore and analyze potential legislative and regulation changes to give the Commission and its staff authority to implement some of the Bureau's recommendations, including the imposition of lease management fees for surface leasing, participation in the State Intercept Program and use of private collection agencies.

More specifically, Commission staff is actively working on a regulation package to update § 2003 (rent) of the Commission's regulations (Title 2, California Code of Regulations). Staff hopes to submit this package to the Office of Administrative Law within the next couple of months.

Commission staff is also recommending that the Commission direct staff to develop and sponsor legislation for introduction this year that would give the Commission the authority to assess a monetary penalty against lessees who are out of compliance with surety bond and liability insurance requirements. Additionally, staff is recommending that the Commission direct staff to develop legislation, sponsored by the Commission that would allow the Commission to impose a monetary fine on a person who has committed a trespass on state lands. Both of these legislative proposals are described in more detail in Item 91 of the Commission's January 26, 2012 agenda.

Conclusion

Commission staff continues to make progress on implementing the Bureau's recommendations as outlined in staff's 2011 Audit Action Plan.