

The February 2024 Arizona State Land Department (Department) special audit assessing the Department's agricultural leasing process, groundwater reporting mechanisms, and Fondomonte's leases found that the Department's agricultural leasing process does not fully align with recommended practices; its agricultural leases including with Fondomonte are below market rates and do not require reporting of or payment for groundwater use; and it failed to adjust rental rates for 17 years resulting in more than \$3 million less in potential revenue in calendar year 2023. We made 8 recommendations to the Department, and its status in implementing the recommendations is as follows:

Status of 8 recommendations

Implementation in process	6
Not yet applicable	2

We will conduct an 18-month followup with the Department on the status of the recommendations that have not yet been implemented.

Chapter 1: Department's process for determining agricultural rental rates does not fully align with all recommended practices but includes some components and, although peer state practices vary, is consistent with some peer states

1. The Department should continue to review its agricultural leasing processes, including its 50 percent discount, and consider and identify ways to align its processes to recommended practices, such as providing discounts based on the cost of the improvement.

Implementation in process—As of August 2024, the Department had continued reviewing its agricultural leasing processes, including developing a draft agriculture leasing policy. Pursuant to the draft policy, the Department could annually adjust rental rates based on each lessee's cost of improvements rather than setting rental rates 50 percent below the market rental rate. If implemented, this policy would more closely align the Department's agricultural leasing process to recommended practices we identified during our special audit. The Department reported that it expects to finalize its draft agriculture leasing policy in calendar year 2025. We will assess the Department's alignment of its processes to recommended practices, including its completion and implementation of its draft agriculture leasing policy, during our 18-month followup.

Chapter 2: Department failed to conduct mass appraisals or adjust rental rates over 17-year period and incorrectly charged some lessees, resulting in more than \$3.4 million less in potential revenue for trust beneficiaries in calendar year 2023

2. The Department should conduct a mass appraisal of agricultural State trust land that complies with statutory requirements and update its agricultural rental rates accordingly.

Implementation in process—As of August 2024, the Department had worked with internal subject matter experts to identify methodologies for conducting a mass appraisal of agricultural State trust land, including identifying and analyzing 2 potential approaches for conducting the mass appraisal. The Department identified 1 approach that would involve conducting an overall market lease rate study of agricultural State trust land that determines annual

lease rates, which the Department has historically conducted to determine annual lease rates for each of its farm areas. The other approach the Department identified would involve performing an appraisal of each parcel of agricultural State trust land to determine a specific land value for each parcel and an applicable percentage of the land value to charge to lessees as the annual lease rate. After considering complexity and cost, the Department determined that it would conduct the statutorily required mass appraisal through a market lease rate study and reported it intends to contract with a third party to begin this process by January 2025. We will continue to assess the Department's efforts to conduct a mass appraisal during our 18-month followup.

3. The Department should ensure its agricultural leases are assigned to and charged rental rates for correct farm areas by:

- a. Redeveloping its farm areas map and associated documentation to ensure that it has clear, specific, and accurate boundaries for all Department farm areas, such as by using Geographic Information Systems to clearly delineate the farm areas.

Implementation in process—The Department has developed an interim farm areas map based on the boundaries of its existing agricultural leases that includes clear and specific boundaries. According to the Department, it will use the interim map to delineate the farm areas in its geospatial software. The Department reported that it may also adjust its farm areas as it finalizes its policies related to agricultural leasing (see explanation for Recommendation 1 for more information about the Department's development of an agriculture leasing policy). As such, the Department reported that it anticipates finalizing its farm areas map in calendar year 2025. We will continue to assess the Department's redevelopment of its farm areas map and associated documentation during our 18-month followup.

- b. Developing and implementing policies and procedures for assigning agricultural leases to farm areas.

Not yet applicable—Because the Department is still in the process of redeveloping its farm areas map (see explanation for Recommendation 3a), this recommendation is not yet applicable. Specifically, as discussed in our February 2024 performance audit, the Department's farm areas map lacked detailed and specific farm area boundaries, which likely contributed to the Department incorrectly assigning some leases to farm areas inconsistent with their geographic location. As a result, redeveloping its farm areas map would be necessary for the Department to fully implement policies and procedures for assigning agricultural leases to farm areas. In addition, a farm areas map that includes any changes to farm area boundaries could also help facilitate the Department's development of policies and procedures to help ensure it assigns agricultural leases to the correct farm areas; however, the Department reported that it may adjust its farm areas as it finalizes its policies related to agricultural leasing, which it anticipates completing in calendar year 2025. Therefore, we will assess the Department's development and implementation of policies and procedures for assigning agricultural leases to farm areas during our 18-month followup.

- c. After redeveloping its farm area maps, review lease documentation to ensure that all Department agricultural lessees are assigned to the appropriate farm area, and correct any erroneously assigned lessees, as applicable.

Not yet applicable—The Department has not yet completed redeveloping its farm area maps (see explanation for Recommendation 3a). Therefore, this recommendation is not yet applicable.

4. The Department should develop and implement policies and procedures that outline steps that Department staff must take when lessees fail to submit annual agricultural questionnaires required by the Department's agricultural leases, such as reaching out to lessees to request the questionnaire or take action consistent with its agricultural lease terms if lessees refuse to respond to Department requests and/or provide questionnaires.

Implementation in process—The Department developed a draft agriculture leasing policy that, consistent with its agricultural lease terms, requires Department staff to bill lessees for the maximum farmable acreage on a lease if the lessee fails to submit or submits an incomplete annual agricultural questionnaire. The Department reported it expects to finalize its agriculture leasing policy in calendar year 2025. We will assess the Department's continued development and implementation of its draft agriculture leasing policy, including requirements related to its annual agricultural questionnaires, during our 18-month followup.

5. The Department should develop and implement policies and procedures to apply the subleasing charge to agricultural lessees that sublease land.

Implementation in process—The Department developed a draft agriculture leasing policy that requires lessees that intend to sublease all or portions of their leased land to submit a subleasing application for the Department’s review and approval prior to entering into a sublease. The draft policy also requires Department staff to bill lessees that sublease land an annual subleasing charge in all circumstances. The Department reported it expects to finalize its draft agriculture leasing policy in calendar year 2025. We will assess the Department’s continued development and implementation of its draft agriculture leasing policy, including requirements related to applying subleasing charges to lessees, during our 18-month followup.

Chapter 3: Our review of peer state and recommended practices did not identify relevant groundwater-pumping-reporting mechanisms, but Department requires groundwater reporting from some nonagricultural lessees

This chapter did not include any recommendations.

Chapter 4: Department’s agricultural leases, including those with Fondomonte, provide lease costs for land below market rates and do not require payment for water use

This chapter did not include any recommendations.

Chapter 5: Department’s agricultural leases, including with Fondomonte, do not include provisions to protect water basin levels, and although they require agricultural lessees to use water in the most efficient manner possible, Department does not monitor or ensure efficient water use

6. The Department should develop and implement policies and procedures for determining, measuring, and enforcing compliance with its lease term that lessees use water in the most efficient manner possible.

Implementation in process—The Department developed a draft agriculture leasing policy that includes a mechanism for lessees to potentially receive annual rent adjustments if they provide proof of using water-conserving irrigation methods. Further, the draft policy indicates that agricultural lessees that fail to comply with its lease term that lessees use water in the most efficient manner possible may be in default of the lease terms. However, the draft policy does not include procedures for the Department to measure whether lessees are using water in the most efficient manner possible. We will assess the Department’s continued development and implementation of its policies and procedures related to efficient water use during our 18-month followup.