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December 22, 2003

The Honorable Brad Henry
Governor of Oklahoma
212 State Capitol Building
Oklahoma City, OK 73105

RE: Internal Audit Report
Agricultural Lease Auction Review

Dear Governor Henry:

A review covering the ten annual agricultural lease auctions conducted from October 20, 2003 through November 5, 2003 was completed. The audit covered the effectiveness of the agency's procedures and internal controls used at the lease auctions and in the processing and accounting for the leasing in the general office. The audit also evaluated the agency's compliance with the Enabling Act, Oklahoma Statutes and management prescribed procedures used in leasing land.

The audit revealed the CLO was in compliance with all laws and directives. It was a very "clean audit." The auctions and the processing and recording of the leased land were handled properly and efficiently. And, as the audit report states, the employees conducted themselves in a courteous, respectful and a friendly business manner. The audit report is enclosed.

Should you have questions or comments about the audit, please call me at 604-8118.

Sincerely,

Roy Cooper, CPA
Chief Internal Auditor

Enclosure: Agricultural Lease Auction Review
c: Clifton H. Scott

Commissioners of the Land Office

INTERNAL AUDIT REPORT AGRICULTURAL LEASE AUCTION REVIEW

PURPOSE AND SCOPE

This review covered the Real Estate Management Division's performance and effectiveness of procedures and internal controls used during the 2003 annual lease auctions for recording bids, preparing contracts, receipt and deposit of monies and recording of the transactions in the general office. The audit also evaluated whether the Commissioners of the Land Office (CLO) is in compliance with Oklahoma statutes (Title 64, as amended) and management's prescribed policies and procedures concerning the leasing of land.

The review included the accounting for the ten annual agricultural lease auctions conducted from October 20, 2003 through November 5, 2003.

A field review was conducted at five agricultural lease auction locations; Burns Flat, Stillwater, Shawnee, Lawton and El Reno. The procedures used to conduct these five auctions and to process and record the transactions were observed and examined. Most leases were for the standard five-year period. Each tract was appraised for a minimum amount of yearly rent that would be acceptable.

AGRICULTURAL LEASE AUCTION SUMMARY

The total income from the auctions was \$1,865,250. The leases in this year's auctions were appraised at \$1,521,400. The tracts that were leased were appraised at \$1,513,200. The tracts were leased at a "bonus" of \$352,050 (23%) above the appraised value. On 243 tracts there were competitive bidding of two or more individuals bidding against each other to obtain the lease. This resulted in a 63% increase in income over the appraised value in these competitive bid leases.

Approximately 1/5th of the 2,634 agricultural tracts are auctioned and leased each year due to the 5-year term of agricultural leases required by the Oklahoma Constitution. This year thirty-six Counties containing 576 agricultural tracts (142,184 acres) were offered for lease at the auctions. Two tracts were not leased. The Secretary rejected bids on two other tracts. If these tracts are not leased before January, on first come bases, the appraisal will be reviewed and the leases will be put up again for auction in January.

Of the 576 leases, 53 were special conservation leases, Special conservation leases require the lessee to perform to improve the leasehold. Examples: building and maintaining terraces, removal of cedar trees, grazing restrictions and other needed conservation practices.

Three of the leases were for two years duration, two leases were for three years and nine leases were for four years. This change from the normal five year leases was to get these leases back into their normal five year lease cycle. This was the result of tracts being taken back into inventory due to non-payment before the end of the standard five year lease period, or withheld the previous year because of the poor condition of the leasehold caused by drought.

This was the twentieth year anniversary for the CLO public auctions of agricultural leases.

SUMMARY OF AUDIT FINDINGS

1. Procedures and Duties

The Oklahoma Statutes covering the leasing of surface land and management's prescribed procedures were adhered to during the auctions that were observed. The auctions were well organized. It was observed that the CLO employees were knowledgeable and very efficient in their duties. It was also observed that they treated the bidders with courtesy, respect and in a friendly business manner.

2. Reconciliation Of Land Records.

One of the objectives of reviewing the internal controls was to determine if all of the CLO acreage was leased or offered for lease. The auditor found all acreage in the Real Estate Management (REM) Division's records had been accounted for and was either leased or those not leased had been offered for lease. However, the real estate records may possibly not be accurate, as they have been only partly reconciled to historical records. The REM Division has had a project underway to reconcile their land records. They had completed approximately 3/4ths of the project in January 1994, and stopped due to work priorities.

Comment:

Mr. Keith Kuhlman, Real Estate Management Director, said they would finish the reconciliation when Mr. Jim Holshouser, CLO's Computer Service Administrator, creates a land records history program and the database is built. This will require all transactions in the past to be recorded and will result in reconciling to the present records.

3. Improper Handling of Bidder Report.

When a bidder registers he is assigned a bidders number to use in the auction to identify him. Several "bidder's reports" are prepared showing the bidder's number, name, address, telephone and social security number. During the auction the winning bidder's number and amount of winning annual rent is recorded at the auction table on a "bidder's receipt." It is then taken to the payment desk where the CLO employees record the name, address and social security number on the receipt using the bidder report. When the auction is over the "bidder's reports" are put in a box to be returned to the office to be shredded. At the Stillwater auction one report was accidental tossed in a garbage can. The auditor retrieved the report and it was handled properly.

Correction:

A lease auction computer application program is used at the lease auctions. Mr. Jim Holshouser, using Microsoft's Access database management program created the lease auction program in 1999 and has steadily been improving it. Next year the bidders receipt will be electronically prepared at the auction desk and printed at the payment desk. The "bidder's report" will not be prepared.

4. The Computer Program For Real Estate Land Management Has Not Been Documented.

The Access computer program for real estate land management has not been documented. The auditor had to obtain all operational information on how the program was set-up and operated from Mr. Jim Holshouser. He has developed and managed the real estate land management Access program. He is still in the process of refining the program and debugging it so he can turn it over to REM. This was also reported in the February 21, 2003, Review of Real Estate Accounts Receivable and Land Management Data Program audit report.

Corrective Action and Comments:

Mr. Holshouser said he has started the process of documenting the program. He stated he needs to make minor modifications and adjustments to the program and complete the interface of the program with the Geographic Information System

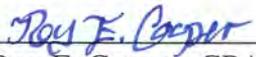
5. One Half Of The Required Rental Was Not Collected For Two Leases At Auction.

Under the Surface Leasing Rules and Regulations and in the terms and conditions of the auction the successful bidder must pay 50 percent of the first year's rent as a deposit. Mathematical errors were manually made by CLO employees in calculating one half of the rental due on two of the 576 leases at the auction. The first lease was in Texas County, Lease No. 102135, leased by Kenny Lunsford for \$25,500 annual rental. Deposit was miscalculated at \$11,250, should have been \$12,750. The second lease was in Stephens County, Lease No. 101208, leased by David Johnson, for \$6,500 annual rent. Deposit was miscalculated at \$3,200.50, should have been \$3,250.

The Lessees were billed for the remaining balance for the first year's annual lease in November, due December 31, 2003.

Corrective Action:

Mr. Jim Holshouser said next year instead of the CLO employee's manually calculating the 50% deposit of annual rent, it will be calculated by the computer when the bidders receipt is prepared at the auction desk. The receipt will be printed at the payment desk.



Roy E. Cooper, CPA
Chief Internal Auditor

December 22, 2003

DISTRIBUTION:

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John C. Rahhal, Business Manager / Assistant Secretary
J. Keith Kuhlman, Real Estate Management Director
Jim Holshouser, Computer Service Administrator
Tom McCreary, Accounting Division Director

