Appendix E. Audit of the Lesser Prairie Chicken Mitigation Framework

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Audit of the Lesser Prairie Chicken Mitigation Framework

Prepared for The Western Association of Fish and Wildlife Agencies

By Dr. Ben Guillon, CFA

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This audit was ordered by WAFWA. WAFWA and Lesser Prairie Chicken Conservation, LLC, a subsidiary of Common Group Capital paid equally for the cost associated with the audit.

All opinions expressed are my own.

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1 Acronyms

CCAA	Candidate Conservation Agreement with Assurance
CFA	Chartered Financial Analyst
CGC	Common Ground Capital
CIM	Conservation Investment Management
ENGO	Environmental Non-governmental Organizations
GAAP	Generally Accepted Accounting Principles
KU	Kansas University
LPC	Lesser Prairie Chicken
LPCC	LPC Conservation, LLC
RBC	Royal Bank of Canada
SRF	WAFWA Species Restoration Foundation Inc., an Idaho nonprofit corporation granted 501(c)(4) status by the Internal Revenue Service
U.S. FWS	United States Fish and Wildlife Service
WAFWA	Western Association of Fish and Wildlife Agencies, Inc., an Idaho nonprofit corporation granted 501(c)(4) status by the Internal Revenue Service

2 Qualification of the Auditor and Contact Information

The audit was conducted by Dr. Ben Guillon, CFA. Dr. Guillon is a recognized expert on mitigation markets with over 15 years of experience. He has worked for some of the most sophisticated investors in the space including the World Bank and New Forests. He also served as expert witness for the U.S. Department of Justice on a case related to mitigation banking and in-lieu-fee programs in Alaska. Dr. Guillon has been teaching on the business of mitigation and conservation banking at the mitigation banking conference for many years and has published several articles on the subjects. Among other degrees and certifications, Dr. Guillon holds a Doctorate Degree in Veterinary Medicine with a specialization in wildlife management and a master's degree in environmental economics. Dr. Guillon also holds the CFA designation from the Chartered Financial Analyst Institute. A full resume is available in Appendix B

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3 Scope of the Audit, Approach, Methodology and Timeline

3.1 Scope

The audit conducted by Conservation Investment Management (CIM) has been focused on the implementation of the Range-Wide Oil and Gas Candidate Conservation Agreement with Assurances for the Lesser Prairie-Chicken (***Tympanuchus pallidicinctus***) in Colorado, Kansas, New Mexico, Oklahoma and Texas between the U.S. Fish and Wildlife Service and the Western Association of Fish and Wildlife Agencies / Foundation for Western Fish and Wildlife dated February 28, 2014 ("CCAA", also referred to as the "Mitigation Framework") (Appendix C). The implementation of the CCAA is referred to in this audit report as the "Program". I have limited my analysis of The Lesser Prairie-Chicken Range-wide Conservation Plan dated October 2013 ("Range-wide Plan") and of WAFWA as an organization to the points relevant to the Audit of the implementation of the CCAA.

Based on the audit engagement agreement, I focused my analysis of the following points:

- Financial situation of the Species Restoration Foundation ("SRF")
- Conservation performance of the Program
- Compliance of the Program with the CCAA
- Future market for Lesser Prairie-Chicken ("LPC") mitigation
- Stakeholder support of the Program

In addition, I presented a list of options for the future of the Program.

3.2 Approach

The Program is a complex system that is influenced by a large number of decision makers, staff members and external organizations. For the ease of the reader of this report, I organized the audit using the framework depicted in Figure 1. The Program lies at the intersection of three key functions: financial management, conservation delivery and regulatory compliance. The three functions are coordinated through the management provided by WAFWA to the Program. The State Agencies, as well as some external stakeholders are providing the governance of the Program. Finally, other stakeholders have an interest in the Program, including Program participants, landowners providing mitigation, the U.S. Fish and Wildlife Service as well as different environmental non-governmental organizations ("ENGO").

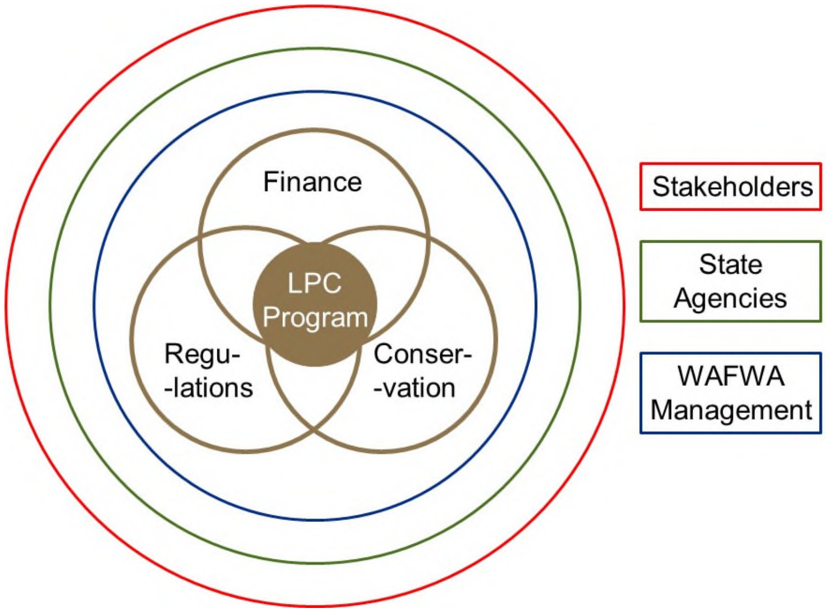

Figure 1: Audit framework

3.3 Methodology

I started with an extensive review of the existing documentation, followed by interviews with WAFWA's current staff as well as interviews of representatives of the different stakeholder groups. I requested additional information from WAFWA to better understand the performance of the Program. However, in most cases, the information was not readily available and required that I worked with WAFWA's staff to generate it.

3.4 Confidentiality

During the course of this engagement, in this audit report and in any presentation relative to this audit, I have respected the confidentiality provisions of the CCAA, of the certificate of inclusion and of the landowner agreements. All information provided was anonymized to maintain confidentiality of names and locations of industry parties and landowners.

3.5 Combination with Due Diligence

In parallel to the audit process, LPC Conservation, LLC ('LPCC'), a subsidiary of Common Ground Capital ('CGC') has been conducting a due diligence process in order to present a proposal to WAFWA on the future of the Program by July 11th.

3.6 Timeline

April 3	Execution of audit engagement agreement
April 4-5	Interviews in Lawrence with WAFWA's program management
April 7-8	Interviews in Boise with WAFWA's CFO
April 10 – May 3	Document review and conservation effectiveness analysis

April 26	Initial results briefings to WAFWA's Directors and to Chris Moore, WAFWA's Executive Director
May 4 – June 30	Interviews with participants and FWS – Finalization of the report

3.7 Audit Limitations

As indicated in the engagement agreement the success of this audit relies on the full cooperation of WAFWA's staff and management, in particular with regard to access to important program information such as financial and conservation performance. Most WAFWA's employees and contractors has considered this audit as "friendly" and have been proactive in sharing information. However, a limited number of WAFWA's employees may have considered the audit as being "adversarial" and have been significantly less forthcoming with information. In addition, as presented in this audit, WAFWA does not maintain customary business analytics related to financial and operational (conservation) performances. WAFWA also used three different accounting programs and charts of accounts for the 5-year period covered by the audit. The different systems and charts of accounts do not match one another rendering any longitudinal analysis almost impossible. Because of the limited time and resources of the audit, I was only able to do a more limited analysis than anticipated.

[redacted]

The highly divided culture between the conservation program staff and the accounting staff has also limited the ability to easily capture a comprehensive picture of the Program. Although WAFWA's Executive Director has been very cooperative and has tried to make himself available as needed, the fact that he was only available on a part time basis and had only a few months of history with the Program has been an added limitation to the audit. Finally, combining an audit with a third-party due diligence created a level of confusion, and sometime suspicion, that may have limited the transparency of the information provided by WAFWA's staff to the auditor.

Despite these limitations, I believe that this report provides a fair overview of the Program.

4 Results of the Audit

4.1 Finances

4.1.1 Although accounting systems and procedures are in place, WAFWA does not properly administer the Program from a financial standpoint

WAFWA has retained a well-trained staff of accountants as well as a Chief Financial Officer. WAFWA has had 4 CFOs over the 5-year period and has used three different accounting software, which is highly unusual. However, financial operations are implemented in a customary manner and WAFWA has successfully passed its annual accounting audits with limited questions or restatements. However, WAFWA's financial management is deficient for the following reasons:

- Financial controls are deficient

Because of the lack of communication between the accounting staff and the management of the program staff, it is unclear how WAFWA ensures that reimbursement to staff are properly approved. In addition, in part due to the lack of funding, WAFWA's accounting team does not maintain the customary checks and balances when approving and making payments to contractors and other third parties. Although I did not identify specific issues, the lack of proper controls could lead to improper practices by staff members and management.

- The financial reporting is inadequate because of multiple software migrations

Over the 5 years covered by the audit, WAFWA used three different accounting software. The charts of accounts for each of the three software are different and expenses cannot be easily compared between years. In addition, WAFWA's CFO is not familiar enough with the three software to easily create meaningful reports.

- The financial reporting gives a distorted view of financial position

The Program's financial statements have been developed using Generally Accepted Accounting Principles, which is the standard used in the industry. However, these financial statements do not give a fair picture of the financial position of the Program. WAFWA's CFO should either add footnotes to the financials or produce a different set of financials for WAFWA's Directors to understand the actual financial position of the Program. For example, WAFWA does not record the liabilities created by the pre-paid mitigation by Program participants. In addition, the Program's fixed assets are overvalued (see 4.1.3).

- The budgeting process is disconnected from Program operations

After discussion with both WAFWA's CFO and the management of the conservation program, it appears clearly that the lack of communication does not allow an effective budgeting process. WAFWA's CFO reported that Program operations would authorize purchase orders without regard for the budget while the Program management complained that the budget was prepared with limited input from them. The result is that WAFWA has only a limited understanding of the Program budget and of how it could be effectively reduced.

- WAFWA does not properly supervise SRF's financial advisor

Based on interviews with WAFWA's CFO and with Royal Bank of Canada ("RBC"), the investment adviser for SRF's endowments, RBC's performance is only reviewed by WAFWA on an annual basis as part of the general accounting report. My recommendation is to assess fund performance quarterly and to review the investment policy, as well as the performance of the investment manager, annually. The agreement between WAFWA and RBC was not available when requested and WAFWA's CFO indicated that she had not reviewed it since she had taken her position. The investment policy statement has not been reviewed in the past 5 years. Reports provided by RBC are particularly confusing and do not give a good overview of the investment performance. Since all endowments have the same goals, they should be maintained as in the same pool and tracked separately, and not through separate accounts as it is currently the case for SRF. Maintaining separate accounts with different asset mixes significantly increases the fees paid by WAFWA to RBC and increases the complexity of the monitoring investment performance. Some of the investment strategies included in SRF's portfolios are not customary and it is not clear why they were chosen. Specifically, most strategies for smaller endowments are focused on index funds and mutual funds. RBC instead opted to create a portfolio composed of individual stocks. This does not ensure the appropriate level of diversification and tends to significantly raise the overall costs of the portfolio. Finally, RBC has been providing erroneous advice to WAFWA's CFO on how to manage SRF's endowments when those questions should have been directed to WAFWA's legal counsel instead. Based on the findings above, my recommendation is for WAFWA to select a new investment adviser and terminate its relationship with RBC as soon as possible. In addition, WAFWA may consider sending a complaint to RBC's management and request that they review their employees' practices and refund any amount of fee that was improperly charged to SRF.

4.1.2 WAFWA's finance team does not provide the strategic overlay that is required to run the Program

[redacted] This translates in a quasi-absence of business analytics beyond the financial statements, the absence of medium- and long-term financial planning and of financial risk management. WAFWA's CFO is disconnected from the conservation operations and has a limited understanding of the implementation of the Program. This would limit any attempt to provide strategic guidance on the Program. [redacted]

One of the direct consequences of the lack of strategic thinking at the financial level is the fact that WAFWA does not conduct proper financial analysis before accepting new initiatives leading to unprofitable arrangements (Such a grant administration). One of the main reasons for the low administrative overhead that can be charged on federal grants stems from the aftermath of the situation related to Steve Barton. However, similar low administrative fees are also charged on state-provided grants. The level of administrative expenses levied on those grants does not cover the administrative costs incurred by WAFWA. [redacted]

4.1.3 WAFWA's financial reporting overvalues its assets

At the end of the fiscal year 2018, SRF is reporting the following assets

Table 1: SRF Fixed Asset (As reported at the end of FY2018)

Land	$	9,250,000
Conservation Easement Asset	$	1,552,597
Software	$	730,744
Furniture and Equipment	$	149,652

The land category refers to the Tate Ranch. However, this value is incorrect for two reasons. First the total purchase price was $10 million. SRF paid $9.25 million at closing because it received a $750,000 credit associated with a 5-year grazing and hunting granted to the previous owners. The $750,000 should have been recorded as a liability and the full $10 million should have been recorded as the value of the asset. Second, WAFWA placed a conservation easement onto the Tate Ranch limiting the development opportunities. WAFWA should have at least inserted a footnote in the financials to disclose the fact that the Tate Ranch's value may be 30% to 50% lower than the initial value. A better approach would have been to do a new appraisal of the ranch to arrive at the current value. Finally, the ranch has been titled in the name of WAFWA and not SRF and is not therefore an SRF asset (WAFWA's CFO disputes this later point).

Conservation easement assets refers to the conservation easements that have been placed on third-party ranches for permanent mitigation. Although it is correct from an accounting standpoint that the conservation easements would be considered as assets, they have no market value (those easements could be considered a net liability to WAFWA because their management by WAFWA creates a perpetual annual cost that is not matched by any proceed). The same is true for the software system that was purchased by SRF. It is highly customized, and it is unlikely the system could be resold to another entity.

We highly recommend that SRF maintains at least 2 sets of financials. One set would be GAAP compliant while the second set of financials would be designed for management and reflect the real value of the assets and of the liabilities.

Finally, the list of fixed assets of SRF reflects neither the Boise building nor the loan to WAFWA for its share of the purchase of the building (see more details in the next section).

After full restatement, I estimated the value of SRF's fixed assets at between $5.8 and $7.8 million, or between 47% and 63% of the value reported in SRF's balance sheet. If the Tate Ranch is removed from SRF's assets, then the value of SRF's fixed assets is close to null.

4.1.4 The purchase of the Boise building using SRF's administrative funds and the associated loan of SRF's funds to WAFWA were not appropriate uses of funds. WAFWA took 100% ownership of the building paid using SRF funds.

In 2016, WAFWA purchased for $650,000 a building in Boise to house WAFWA's and SRF's operations. SRF was responsible for 75% of the funding and WAFWA used funds from SRF's administrative account. WAFWA was responsible for 25% of the purchase price but did have neither the available cash nor the ability to contract a loan. WAFWA decided a take a $162,500 loan from SRF to cover its side of the transaction. I requested the documentation for this loan but was told by WAFWA's CFO that it was never prepared, and only a repayment schedule was prepared and approved by the executive committee.

WAFWA did not request a review by its legal counsel before deciding to purchase a building for WAFWA and SRF using SRF's funds. WAFWA also did not request a review by legal counsel before extending itself a loan from SRF. Neither the CCAA nor the Lesser Prairie Chicken Conservation Delivery Business Plan (Appendix D) clearly describe the expenses that are appropriate under the administrative account. However, the business plan includes a budget that does not contemplate the purchase of a building. In addition, purchasing the building required invading the principal of the endowment, which goes against the business plan. For those reasons, it is my opinion that both the purchase of the building using SRF funds and the loan from SRF to WAFWA were inappropriate use of SRF's funds.

WAFWA decided to use SRF's funds to purchase a building that is titled entirely to WAFWA. No compensation was paid from WAFWA to SRF. Again, legal counsel was not consulted on the appropriateness of these decisions. In addition, WAFWA started charging rent to SRF for its use of the building. When asked about this situation, WAFWA's CFO indicated that "WAFWA had to charge SRF rent because one non-profit cannot benefit from the assets of another non-profit without appropriate compensation". WAFWA's CFO could not explain why the same reasoning did not apply when the SRF's funds were used to purchase the building on behalf of WAFWA. [redacted]

4.1.5 The Program does not track its liabilities properly and may not have enough assets to cover its future potential liabilities

The Program raised around $65 million from participants. Although SRF is a not-for-profit, these contributions were not philanthropic donations but instead a pre-payment for future mitigation. SRF’s balance sheet does not reflect that pre-payment in its liability leading SRF to undervalue its actual liabilities by between $30 and $45 million. In addition, when SRF enters into a contract with a landowner, whether into a 10-year contract, or a permanent contract, these contracts lead to a long-term liability for SRF in the form of an obligation to pay the landowners over the period of the contract. Again, none of these liabilities are actually reflected in SRF's balance sheet. Although we may discuss whether such liabilities should be included under GAPP, it is clear that the net present value of these liabilities should be included in any report to the directors to ensure that they are provided with a clear picture of the financial position of the Program. Further analysis would be required beyond what was possible during the audit to determine the actual financial position of the Program. Based on the limited information available for the audit, it appears possible that the Program does not have enough assets to cover its potential liabilities.

4.1.6 WAFWA did not manage its administrative endowment to ensure that it remains permanent

Based on the CCAA and on the business plan, WAFWA was expected to deposit administrative fees into an endowment fund from which only the proceeds should be used to cover expenses. This would have guaranteed that the endowment fund would remain permanently available. Instead, WAFWA decided to staff-up as soon as funds started coming in and immediately started using the endowment principal. According to WAFWA’s CFO, the rational was that future fees could be used to make up for the money that had already been spent. Consequently, the administrative endowment was converted in a checking account in 2017 because of its low balance and will be exhausted by the end of July 2019. It could be argued that the concept of an administrative endowment was doomed from the beginning. Based on the business plan's assumptions, the endowment required to cover this level of expenses would need to amount to $75 million, way beyond what SRF and WAFWA could generate based on the business plan. In addition, the business plan did not make any arrangement to cover SRF's administrative expenses while the endowment was being progressively funded over the initial three-year period. Because of the lower balance in the endowments, interests would be not have been enough to cover administrative expenses and WAFWA would have had to invade the principal.

4.1.7 The Program does not generate the financial resources needed to support its administrative costs and will run out of administrative funds by the end of the July 2019

For the fiscal year 2017, total expenses charged to the administrative account were around $3 million. Details are provided in Table 2.

WAFWA has been steadily reducing this budget by not replacing leaving staff members, by reducing the budget allocated to Kansas University ("KU") and by shifting a large portion of the cost of the aerial surveys onto some of the WAFWA States. WAFWA's CFO estimated the bare minimum level of expenses to run the program at $900,000 in addition to staffing costs. Based on my experience with similar programs, WAFWA could modify the Program to greatly reduce the need for biology staff and reduce its costs, including staffing to around $1 million a year. Regardless of the level of expenses, the Program has only generated around $40,000 in administrative fees this fiscal year, only 4% of the most conservative budget estimate. As of February 2019, SRF had a balance of $225,000 on its admin account, counting both cash and account receivable. We estimated that by the end of July, the administrative account will be fully depleted.

Table 2: SRF Admin budget for FY 2017

Staffing	$920,209
IT costs (including KU contract)	$611,143
Aerial surveys	$479,020
Accounting Services	$129,787
Legal Services	$65,333
Investment advisory fees	$287,671
Payment to landonwers	$156,736
Bad Debt	$158,325
Misc	$203,536
Office Rent	$57,073
TOTAL	$3,068,833

4.1.8 The Program does have appropriate resources to support its permanent conservation. However, the Tate Ranch endowment needs to be fully funded immediately.

WAFWA anticipated that payments to landowners for permanent conservation should amount to around $450,000 in 2019. The status of the different permanent conservation endowment accounts is presented in Table 3 below.

Table 3: Status of the permanent conservation endowments

	As of 06/2018	With Tate Ranch Endowment fully funded
Tate Ranch	$5,037,699	$ 9,537,699
TNH Easement	$1,250,989	$ 1,250,989
Endowment 3	$1,180,534	$ 1,180,534
Endowment 4	$1,364,612	$ 1,364,612
TOTAL	**$8,833,834**	**$ 13,333,834**
4% distribution	$ 353,353	$ 533,353

Conservation endowments related to permanent mitigation amounted to close to $9 million at the end of fiscal year 2018. Based on the 4% distribution anticipated in the business plan, these endowments could sustainably generate only $350,000 leaving a $100,000 annual deficit. However, WAFWA made the decision to only partially fund the endowment for the Tate Ranch (discussed in more details in section 4.1.10). At the end of fiscal year 2018, $4.5 million the remained to be deposited in the Tate Ranch endowment. If this amount is included in the total endowment amount for permanent conservation, over $530,000 could be generated annually.

4.1.9 The Program spending on temporary mitigation is unsustainable

SRF's balance sheet shows that $28,096,180 was available in the general conservation endowment used to pay for temporary mitigation at the end of fiscal year 2018. However, this amount includes the $4,5 million discussed in the previous section and that should be deposited into the Tate Ranch endowment. The actual amount available in the general conservation endowment is $23,596,180. Assuming a 4% distribution rate, the endowment can generate $943,847 annually, well short of the $1.6 million that WAFWA has anticipated paying to landowners in 2019. At the current spending rate, I estimated that the general conservation endowment could be depleted by 2041. The level of temporary mitigation provided by SRF is clearly unsustainable in the long run. In addition, the principal in the general conservation endowment should be used in the future to purchase additional permanent conservation further reducing the total amount available to pay for temporary mitigation.

4.1.10 Adaptive management cannot effectively solve the financial issues outlined in this audit

The CCAA provides an adaptive management plan that was designed to help in alleviating some of the shortfalls listed in this report but is ineffective. The total annual increase in mitigation fees that is allowable is limited to 7%: 3% to match inflation and 4% to increase conservation practices, well short of the amounts discussed in this report. The adaptive management plan also provides for the administrative fees to be increased if the endowment is at risk of depletion. However, no clear process is laid out for this purpose. In 2018, WAFWA increased the fees from 12.5% to 16.5% and it remains unclear if this is allowable by the CCAA. Because the administrative fees are levied on new impacts, and those have been scarce, raising the level of fees has been unable to raise any significant funds for the administrative account.

4.1.11 WAFWA improperly transferred money from the conservation endowment to fund the administrative costs of the Program, including salaries of WAFWA's staff

After reviewing SRF's financials and interviewing WAFWA's CFO, my opinion is that WAFWA misallocated resources from RSF on multiple occasions. The decisions to reallocate resources were made by the Executive Committee and implemented by WAFWA accounting team:

- Endowment and conservation payments related to the Tate Ranch

The concerns related to the endowment of the Tate Ranch are twofold. First, WAFWA decided not to fund 100% of the endowment after a conservation easement was placed on the property, in contradiction with the CCAA. Despite having the money available in the general conservation endowment, WAFWA, after consulting with its investment adviser but not with its legal counsel, decided to fund the Tate Ranch endowment over 4 years. The stated goal according to WAFWA's CFO was to keep as much capital in the general conservation endowment because the proceeds of those investments were then diverted to the SRF's administrative account and used to pay salaries and administrative operation costs. On the other hand, WAFWA paid off amounts from the endowment that were calculated for a full endowment. Because the interests on the partial endowment were not enough to cover these payments, it resulted in an invasion of the principal of the endowment. The effect is that the Tate Ranch endowment is expected to reach around $9.1 million by the end of the payment plan in 2020 when, based on WAFWA own assumptions, this amount should be at least $11 million. The second concern has to do with the use of the conservation payments drawn from the Tate Ranch endowment. Based on the CCAA, these payments should be used exclusively to reimburse the landowner for the conservation activities that have taken place on the land. However, in the case of the Tate Ranch, WAFWA's CFO indicated that these payments were used not solely for conservation activities on the Ranch but instead reincorporated into the administrative account.

The annual conservation payments amounted to around $680,000. In addition, SRF paid itself a $180,000 incentive payment (similar to third-party landowners) to join the Program.

- Use of proceeds from the conservation account for administrative costs

As stated before, WAFWA withdrew the proceeds from investments from the general conservation account to deposit them into the administrative account. In the meantime, SRF also paid in full landowners who signed a temporary contract. Without any investment proceeds left, WAFWA's CFO had to use the endowment principal to pay landowners. This is a direct violation of the CCAA since these endowments are expected to be perpetual. I estimated the improper transfers to around $3 million over the period. [redacted]

- Transfer of $1,000,000 from the general conservation endowment to the administrative endowment

WAFWA's CFO indicated that based on a decision of the Executive Committee, she transferred on two occasions $500,000 from the SRF's conservation account to SRF's administrative account to ensure that SRF would be able to meet its administrative obligations.

Based on the above analysis, I estimated that between $5 and $7 million are been diverted from the conservation endowment accounts and have been improperly used to cover administrative costs.

4.1.12 [redacted]

[redacted] I would like to highlight the following points:

- [redacted]
- WAFWA extended itself a loan from SRF without discussion with the USFWS and the participants and without properly documenting the loan
- WAFWA assumed ownership of a building paid for with at least 75% of SRF's funds to WAFWA's sole ownership
- WAFWA charged SRF rent on the same building, when it could easily be argued that WAFWA should have paid SRF rent for its use of the building
- Finally, the Tate Ranch was purchased entirely with SRF's funds but WAFWA took ownership of it. [redacted]

[redacted]

4.1.13 [redacted]

[redacted]

4.2 Conservation

4.2.1 The Program is supported by dedicated staff with deep subject matter expertise. However, the staffing structure of the conservation team may not be the most efficient

WAFWA has been able to hire and retain a staff with the expertise, experience and local contact necessary for the Program to operate. However, it may have been more efficient for WAFWA to rely more on contractors and state agency staff for the implementation of the Program. For example, it is unclear that SRF needs the same level of staffing during the survey seasons and during the winter months where no surveys are necessary.

4.2.2 The goals of the Program do not match the criteria that USFWS is using to judge the effectiveness of LPC conservation

Based on a series of interviews and a meeting with USFWS, it is clear that USFWS' main criteria for the effectiveness of LPC conservation activities is the presence of large unbroken tracts of adequate LPC habitat that are protected in the long term. In addition, USFWS indicated that population surveys are not reliable on a short timeframe and only trends greater than 20 years should really be considered to assess the effectiveness of conservation activities. Based on the criteria, the Program should focus on securing long term conservation (probably through permanent conservation easements or conservation bank credits) of properties located in or near potential population strongholds. In addition, these properties either should already have adequate habitat but are at risk of development or they could be restored to provide habitat. The goal pursued by the Program was mainly to increase habitat quality on properties with existing habitat through temporary conservation (10-year contracts). Limited restoration activities took place to convert non habitat to habitat and little attention was paid to fragmentation.

4.2.3 WAFWA does not have a well-articulated conservation strategy and does not properly track its progress against the needs and payments of participants

Based on interviews with the Program staff, it appears clearly that they were focused on applying the framework of the CCAA and the business plan in a formulaic way and did not have a well-articulated strategy to achieve goals such as maximizing restoration opportunities, securing strongholds, limiting fragmentation or minimizing costs. WAFWA also did not conduct regular analysis of the liabilities created by the mitigation that had been pre-paid by participants. For example, as described in Section 4.1.9, the amount of temporary mitigation provided is in excess of what can be supported by the endowment account.

4.2.4 WAFWA has developed a sophisticated database to manage the Program. However, the database is expensive and was not included in the original budget.

WAFWA developed through a contract with KU and Timmons a comprehensive on-line database that allows companies to quickly assess their potential impacts and to track their mitigation requirements. The database rebalances on a daily basis the impacts and the mitigation that was provided to ensures that there is enough mitigation available. This is the most advanced system that I have observed for any environmental markets and has been highly praised by participants. The cost of developing the database, the interfaces and the development modules was in excess of $1 million without counting WAFWA's and KU's staff costs. This cost had not been budgeted in the business plan and WAFWA did not issue a "special assessment" to the Program participants to pay for this unbudgeted cost.

4.2.5 The design of the Program is overly complicated leading to a lack of understanding of the relationship between impacts and mitigation

The conservation delivery system that WAFWA developed to connect acres of impacts to acres conserved is very complex. For example, calculating the fee paid by a company for one acre of impact involves: i) a lengthy calculation involving the cost of implementation of various USDA practices (this calculation changes for each eco-region) ii) the use of a modifier based on the Critical Habitat Assessment Tool (CHAT) iii) a modifier for the quality of the habitat based on the Habitat Evaluation Guide, itself composed of 6 different variables and iv) different impact buffers associated with the Activities. Once the money has been collected by SRF, a similar process is used to determine payments to landowners and the acres that will be conserved. This system is potentially grounded in good science. However, it is not transparent and does not allow WAFWA to clearly make the connection between an impact and the mitigation that was provided. I recommend that this system be deeply modified to make it easier for WAFWA to demonstrate the number of acres of mitigation that are provided for each acres of impact.

4.2.6 The mitigation fee collected by WAFWA does not reflect the actual cost of conservation activities being implemented

The fee collected by SRF reflects a number of assumptions regarding the type and quantity of activities that would be performed by the Program. Although the Program did deviate significantly from the assumptions, WAFWA never sought to analyze the deviation from the initial plan and to reconcile the fee with the conservation activities that were actually implemented. In addition, a careful review of the calculation of the fee revealed some probable errors that significantly underestimated the fee to be paid by Participants.

4.2.7 Although the Program provided valuable mitigation in excess of its initial target, it is unclear if the effort was effective at reducing the threats to the LPC

Based on an analysis conducted with WAFWA's staff, and assuming that the mitigation units provided by WAFWA are valid, my opinion is that the Program is currently offering more mitigation than would be required if all participants were to use their entire prepaid balance. (see Appendix F). However, it is unclear whether the conservation provided is effective:

- WAFWA's staff has not requested a review, formal or informal, by USFWS of the mitigation it provided to ensure that it would comply with the CCAA. This is particularly concerning that this consultation did not happen when WAFWA committed $20 million to the purchase of the Tate Ranch and to fund the associated endowment.
- SRF has not maintained a 75/25 ratio between temporary and permanent conservation as required by the CCAA. The mitigation is generally skewed toward temporary mitigation that is cheaper. Temporary mitigation is used to offset permanent impact and need to be renewed every 10 years. However, as discussed in Section 4.1.9, SRF does not have the resources to maintain this level of temporary mitigation. In the future, SRF may not be in a position to renew the temporary contract and the mitigation provided may fall well short of the impacts.
- SRF has not made significant progress towards creating strongholds and restoring former habitat in part due to the lack of an adequate acquisition strategy.
- In most cases, the landowners that are under contact with SRF are receiving credits for habitat that was already adequate for LPC and was not at risk of being converted. It is questionable in these conditions whether SRF's payments made any positive impact on the conservation of the LPC.

4.2.8 WAFWA should have triggered the adaptive management plan because of the lack of progress on the conservation objectives

The CCAA includes an adaptive management plan that details actions that need to be taken if some of the initial assumptions in the business plan prove not to be correct. However, one of the weaknesses of this plan is that it does not specify timelines for the review of the assumptions and of the Program's performance. Since WAFWA has already identified that several of those metrics cannot be met, it should have triggered the adaptive management plan and communicated with USFWS on the ways it was planning on addressing the shortcomings. The upcoming 5-year review of the performance of the RWP should be used by WAFWA to analyze its performance and use the adaptive management plan to modify the Program.

4.2.9 The Program as currently structured and operated does not provide a net gain in conservation

WAFWA and SRF have not clearly defined how a net gain in conservation could be measured and achieved. If we use one simple measure of success which is the number of acres of adequate habitat for the LPC, it appears quickly that the Program cannot yield a conservation benefit. The Program calls for 20% of the mitigation to be provided through restoration and 80% through the enhancement of existing habitat. In Chat 1 habitat, the most important habitat, the system may result in twice the amount of mitigation compared to the impacts. The Program therefore would result in 40% of the acres impacted being replaced by restored acres of habitat. The current structure of the Program guaranties a net loss of habitat. Since quantity of habitat is the main parameter used by the USFWS to determine conservation effectiveness, my conclusion is that the Program does not provide effective conservation for the LPC and does not ensure a net gain in conservation.

4.3 Regulatory

4.3.1 The Program does not offer any regulatory benefit to electric utility companies or any other industry beyond oil and gas, thereby limiting their potential participation in the Program

Over the course of this audit, I have heard several interviewees complain that the electric utility companies active in the area covered by the CCAA did not enroll in the Program. A review of the CCAA shows that there is no incentive for them to do so. Indeed, they are not in a position to enroll land in advance of impacts, as the oil and gas industry does, as they usually don't know in advance where a new corridor will be located. In addition, they do not own the land or the mineral resources but usually get an easement under eminent domain law. For that reason, they could not benefit from an enhancement-of-survival permit. If WAFWA wanted to increase the enrollment of electric utility companies, I recommend that a new CCAA be designed that would include tangible benefits for this industry.

4.3.2 [redacted]

[redacted]

4.3.3 The Program is out of compliance with the CCAA. However, FWS is currently unlikely to either terminate the CCAA or to deny the issuance of the associated enhancement-of-survival permit

The CCAA includes 27 points of compliance (A summary list can be found in Appendix G). Out of 27 compliance points in the CCAA, WAFWA failed 6 points including:

- all points related to financial management
- all points related to reporting to the FWS

The CCAA does not specifically spell out SRF's compliance obligations with regard to conservation. However, it is clear that SRF also failed to meet expectation regarding the effectiveness of its conservation activities.

The CCAA is currently out of compliance. However, none of the points of non-compliance are currently fatal flaws and all could be corrected within 12 to 24 months, if the necessary financial resources are available. Conversations with USFWS' management indicated a lack of willingness in the current administration to terminate the CCAA over this non-compliance and over the lack of conservation effectiveness. Similarly, it is likely that, under this administration, if the LPC were to become listed, the USFWS would issue the enhancement-of-survival permit associated with the permit. A word of caution is necessary, a different administration may have an entirely different perspective on these two points.

4.3.4 The Program may not be providing enough certainty of the effectiveness of the conservation effort to guaranty that the associated enhancement-of-survival permit will not be successfully challenged by environmental groups

The compliance with the CCAA is not the final goal of the participants in the Program. The participants are looking to limit their future regulatory obligations in case of a listing of the LPC by obtaining an enhancement-of-survival permit from the USFWS. Based on my review of the federal CCAA policy (Appendix H) and of the federal Policy for Evaluation of Conservation Efforts when Making Listing Decisions (PECE) (Appendix I) as well as numerous interviews with current and retired USFWS staff, my opinion is that a permit associated with the current CCAA may be successfully challenged by environmental groups. If that were the case, the permit could be canceled by a judge and the investments by the participants in pre-listing conservation activities would be lost. Given the recent history of lawsuits by environmental groups related to the LPC, it is likely that any permit issued under this CCAA would be challenged. I recommend that WAFWA conveys this information to the participants and discuss with them the need to either increase the effectiveness of conservation activities of the current CCAA or to negotiate a new, more robust CCAA with USFWS.

4.4 Management

4.4.1 WAFWA's management does not have the resources to properly oversee and manage the Program which create a lack of accountability across the entire organization

WAFWA's management is experienced and dedicated to the organization's mission and to its staff. Historically, the executive secretary had a very ambiguous role neither fully an executive director nor just a corporate secretary. Recently, WAFWA hired an executive director delegated by his east coast organization on a pro-bono basis up to five days a month. While in practice, the new executive director has dedicated to WAFWA a greater amount of time than planned, he remains on a part time basis. This situation limits both his availability and his authority internally and externally. In effect, WAFWA operated without a leader, executive director or CEO since its inception. This is particularly detrimental when the organization needs to reinvent itself to go from a coordinating structure and social club to a full scale $65 million program. Someone needs to have the authority, and the associated accountability, to define a strategy and make decisions for the benefit of WAFWA. In addition to its executive director, WAFWA employs a CFO as well as a contractor from a state agency to run its main program. The manager for SRF's conservation program recently resigned and has not been replaced yet.

Based on my observations, WAFWA management has not been empowered to make decisions for WAFWA and they need to rely on multiple committees of directors and stakeholders in order to get the job done. This situation created a lack of accountability through the entire organization, including at the staff level.

4.4.2 WAFWA does not have a business plan in place to manage the Program

A business plan was initially prepared as part of the RWP (see appendix). However, after review, it is clear that the document is not a customary business plan and could not be used to run the Program. For example, the body of the document is less than 40 pages long. However, 14 pages are focused on WAFWA's evolution and history. In addition, some of the assumptions are widely unrealistic or just wrong (such as the assumptions associated with the administrative endowment). During one of the interviews, WAFWA's CFO mentioned that the business plan was found inadequate as soon as the Program started and that when she was hired, she also recognized that it could not reflect the reality of the Program. However, nobody felt they had the responsibility to update the business plan and to present it to the WAFWA's directors for approval. Instead tactics and processes developed organically without any clear strategy. A corollary of the lack of a business plan is that WAFWA's management has not provided a strategic approach to the Program and has not sought to monitor it results from a conservation and finance standpoint.

4.4.3 WAFWA has a [redacted] organizational culture that prevents an effective management of the Program

[redacted] culture at WAFWA where conservation, finance and management staff don't communicate with each other in a proactive and efficient way. A culture of [redacted] has been established and is preventing the organization to operate as a single entity. One of the symptoms of this culture is the dislocation between the finance and conservation functions leading to an ineffective budgeting process. The fact that SRF's program management and staff work in different states than WAFWA's entire accounting team made communication even more difficult.

One of the key issues that were noted are that nobody is formally in charge of human resources at WAFWA. [redacted]

4.4.4 WAFWA use of staff and contractors is inefficient and creates undue costs on the Program

Associated is the lack of a formal human resources function, is the lack of proper supervision and efficient use of employees and contractors. Reviews of employees and raise recommendations are conducted by direct supervisors only without clear guidance or transparency. This lack of information did not allow WAFWA to have discussions critical to containing costs. [redacted]

[redacted]

4.5 Governance

4.5.1 WAFWA strategic priorities are not clear and may not be supportive of the Program

During my interviews with WAFWA's directors, it appeared clearly that there is not a common agreement on the goals of WAFWA as an organization. Some of the directors feel that WAFWA's role should be limited to a platform that allows for coordination among agencies, in particular for the purpose of lobbying, as well as for receiving federal grants. Other directors would like to see an organization with its own voice and direction and the ability to create and manage large cross boundary programs such as the Program. There is an urgent need for WAFWA's directors to be generally aligned on the role of WAFWA. This is where a strong executive director would have the capacity to make a difference for the organization by proposing a vision that the directors could rally around. Based on the options for the future of the Program presented in the next sections, it will be critical for WAFWA's directors to engage and decide, in the coming months, on the mission of WAFWA and on its strategic priorities.

4.5.2 The Program's current committee structure, and WAFWA's decision making process and culture are inadequate to provide proper governance to the Program

During the interview process, it appeared clearly that the governance of the Program is a key issue. Both WAFWA's CFO and the Program manager described a Kafkian process of committees and sub-committees for any decisions, including those who should be left to management. I won't speculate on the reasons for which this system was created. However, it prevents initiatives, limits authority and foster a feeling of unaccountability among WAFWA's management and needs to be changed as soon as possible.

WAFWA's leadership, by the organization's nature, is transient and the tenure of its directors is, on average, much shorter than for a regular non-profit. In addition, WAFWA's directors need to manage their own agencies and are much busier than the average non-profit director. It is critical for WAFWA's directors to define to what extent they are willing to stay informed, involved in discussions and make decisions. Anything else should be left to management who should be held accountable for any shortcoming.

Finally, WAFWA's directors recognize the political nature of the organization. It is uncomfortable to call another director out or to ask for additional information, especially when the decision does not involve the specific state of the director asking the question. However, if WAFWA is to pursue this Program and other similar projects, it is critical for the WAFWA's directors to function more as the board of a well-run company where hard questions and robust discussions are welcome.

4.6 Stakeholder Involvement

4.6.1 WAFWA failed to fully disclose transparent information on the conservation and financial performance of the Program to stakeholders, including to USFWS

WAFWA published an annual report for each year of operation of the Program. The report is well detailed and covers the full range operations such as participation, conservation, and financial management. However, WAFWA's reporting of the program faces several shortcomings:

- WAFWA includes SRF's financials in its own reporting and accounting. Given the size of the Program, it would be more appropriate for the Program to have its ow separate accounting audit and audit report so WAFWA's directors, and other stakeholders, can have access to more detailed information. In addition, any annual report on the financials should include a written management discussion of the results.
- The annual report of the Program is neither prepared nor reviewed by an independent third-party before it is released. This is a best management practice and a requirement of the CCAA.
- More generally, the information in the annual report is presented in a way that makes it confusing to the reader and not user-friendly. Information is often incomplete and does not allow the reader to fully grasp the operation and finances of the Program

4.6.2 USFWS did not ensure that the CCAA was written in a way that ensured the success of the conservation goals

The CCAA as written does not allow USFWS to properly assess the effectiveness of the conservation provided by the Program against a pre-established benchmark. In particular, the CCAA does not include performance criteria or a monitoring plan as can be found in most species conservation banks approved by USFWS. Consequently, it is difficult to objectively assess the compliance or non-compliance of WAFWA with the conservation requirements of the CCAA.

4.6.3 USFWS is supportive of the Program but failed to properly supervise it

USFWS initially approved the RWP and Program, despite opposition at the staff level. During a meeting in Denver in June 2019, USFWS' management met with several WAFWA's directors and indicated that the USFWS remains supportive of the effort. However, they also indicated that changes to the Program would be needed in the near future in order to keep this support. They indicated a willingness for USFWS to engage with WAFWA on an assessment and a restructuring of the Program.

Based on the CCAA, FWS failed to properly supervise the program. In particular, it should have raised concerns to WAFWA's directors when it knew the Program was out of compliance with the CCAA

4.6.4 Participants are supportive of the Program but failed to properly supervise it

Based on a limited number of interviews with Program participants, my opinion is that they remain supportive of the goals of the Program, especially the potential issuance of the permit. It is still unclear how many participants would be willing to increase the conservation requirements in order to reduce the risk of a successful challenge to the permit once it is potentially issued.

Participants have secured several seats on the Program governing committees but failed to properly monitor the progress of the Program.

4.6.5 Environmental Non-governmental Organizations range from openly adverse to engaging in a constructive dialogue

ENGOs are not a homogeneous group. Several organizations are involved in the Program and supportive of its overall goal. Other groups are opposed to further development in LPC habitat and should be expected to pursue legal action against a potential permit.

4.7 Future Market for LPC Mitigation

4.7.1 Although participants are expecting that exploration and production will remain strong, the Program created a strong incentive for avoiding and minimizing impact leading to a much lower need for mitigation than anticipated.

Interviewed participants and experts indicated that they believe that oil and gas production will continue to grow, especially in the Permian Basin. However, this may not translate in a growth of similar scale for the Program because industry has learned to change well location to reduce impacts.

There is limited incentive for non-participants to join the Program and enroll land. This has led to over 200,000 acres of impacts not being mitigated according to a report by Defenders of Wildlife. This could change when we get closer to the presidential election, if the Program is seen as more reliable and if Participants accept to exercise peer-pressure on oil and gas companies that are either not members or have only enrolled a portion of their landholdings.

5 Options for the Future of the Program

5.1 Key Considerations when considering options

When assessing the different options presented for the future of the Program, WAFWA's directors should keep in mind the following criteria

- Fit with WAFWA's mission, vision and strategies
- WAFWA's financial and management capacity to take on a program of this scale
- WAFWA's interest in building a specialized staff
- The potential risk for WAFWA's public relations and credibility
- [redacted]

5.2 Option 1 - Terminate the Program without replacement

The process for this option is simple. WAFWA first notifies USFWS that it will terminate the Program. WAFWA then notifies the landowners that it plans on terminating its short-term contracts at the end of the year. WAFWA also transfers any properties and easements to partners, such as state agencies with their endowment. Finally, because the purpose of the CCAA has been frustrated, WAFWA, USFWS and the participants could agree to amend the CCAA to allow any remaining funds to be returned to participants. An alternative could be for the funds to be distributed to other non-profit organizations with a mission similar to SRF.

The positive sides of this options are that the decision can be made immediately, the process is simple and does not require additional resources or negotiations with stakeholders. However, the negative consequences of this option may be high. Most stakeholders would probably feel that WAFWA did not stand by its word. This would create bad public relations for both WAFWA and the members states. USFWS is less likely to want to engage on pre-listing mitigation with states. Landowner relationships may be strained. More importantly, participants' investment would be lost since USFWS would not issue a permit if the species is listed. [redacted]

5.3 Option 2 - "Freeze" the current Program

WAFWA would not terminate the CCAA but participants could only use up their pre-paid balance and would not be allowed to contribute additional funds. The process would unfold as follows: WAFWA notifies FWS that it will freeze the CCAA. WAFWA notifies participants that they will not be allowed to enroll additional land or contribute more money to the program. Participants would be allowed to use their existing balance for the coming two years after which any remaining money is forfeited. WAFWA would then convert all short-term contracts to permanent mitigation, as allowed by the status of the general conservation endowment.

The positive aspects of this option are that a decision can be made immediately with limited additional resources and negotiation needed. Because the temporary conservation is converted to permanent, administrative expenses are kept low. It is also possible that some regulatory benefit may be preserved for the participants, such as an issuance of an enhancement-of - survival permit. [redacted]

On the negative side, it is unlikely that the Program would still have enough funds available to cover all its mitigation needs with permanent mitigation, leaving some impacts unmitigated. Because of this situation and because future impacts would not be mitigated it is unlikely that USFWS would issue a permit and if they do, the permit is unlikely to survive a legal challenge. The Program would require some level of administration for which no money is currently available so WAFWA would need to negotiate some form of special contribution by the participants. [redacted]

5.4 Option 3 - Transfer the Program to a third-party immediately

WAFWA notifies the FWS, participants and landowners that it plans to transfer the Program to a third-party. WAFWA then defines the criteria needed to select the third-party and conduct a public bidding process. WAFWA would then have two different sub-options. It could either - option 3.a - remain the permit holder and contract with the third-party for the administration of the Program, or – option 3b - WAFWA could request an amendment to the CCAA to transfer its entire responsibility to the third-party.

The positive aspects of option 3a are that this could be a quick process from start to finish since it does not require amending the CCAA. It would also allow WAFWA to keep some control over the Program since only the day-to-day management is transferred to the third-party. As long as the contract with the third-party is not too onerous for WAFWA, it can be maintained with limited WAFWA resources. Finally, it is likely that the participants may be able to maintain some regulatory benefits for the participation in the program. On the negative side, WAFWA is not in a position to hire a third-party administrator until the funding issues are resolved. In this model, WAFWA would also retain some level of liability as a party to the CCAA.

The positive aspects of option 3b is that it could be started quickly if third parties are willing to take over and it requires limited resources from WAFWA. In addition, participants may maintain their benefits from participating in the Program. The negative aspects are that it is unlikely that a third-party would accept to take over the Program without WAFWA accepting very onerous provisions such as indemnification and limitation of liabilities and losses. In addition, it is likely that the third-party would try to amend the CCAA outside of the control of WAFWA. This option also requires amending the CCAA which would require the support of the participants and around 12 months for the USFWS to approve. Finally, if the third-party managing the Program is also in the business of providing mitigation, this would likely result in a conflict of interest.

5.5 Option 4: Restructure the Program

The goal of this option would be to restore financial sustainability, compliance with the CCAA, ecological integrity, and professional execution. This restructuring would be conducted while the Program is still housed at WAFWA and after restructuring the Directors would be able to decide whether the Program should be administered by WAFWA or by a third-party (Option 3a or 3b). This restructuring could take between 6 and 18 months based on the model that WAFWA decides to pursue. Below are some ideas for consideration for the restructuring:

- Adapt WAFWA management structure to the demand of a program of that scale – Need for a full time Executive Director and a business analytics position
- Modify the decision-making structure so it is more straightforward, empowers WAFWA management, creates accountability, limits political pressure and is more inclusive of other important stakeholders (FWS)
- Move to a leaner structure where third parties are in charge of most field assessments
- Redesign the conservation strategy to ensure the integrity of the permit in case of legal challenge. This may include modifying the HEG, the crediting methodology and/or the ratio of temporary to permanent mitigation
- Formalize loan/grant from conservation account to administrative account to allow for a runway of 12 to 24 months
- Define what costs should be borne by the Program vs. by the states through the Range Wide Plan
- Restructure contract with key vendors (KU)
- Require an application fee for each action, regardless of the impact, to be paid to the administrative account
- Require a “membership fee” from each participant, equal in aggregate to the administrative costs of the Program. Each company would pay a prorated share based on either their activity in the past year or the amount of land enrolled
- Open the provision of mitigation to third-party through a transparent RFP process. This would allow the establishment of a clear market price.