



TESTIMONY OF

Lance D. Gaebe
North Dakota Department of Trust Lands

To The Legislative Audit and Fiscal Review Committee

April 21, 2016

Chairman Klein, and members of the Legislative Audit and Fiscal Review Committee, I am Lance Gaebe. I serve as the Commissioner for the Department of Trust Lands. The Department operates under the direction and authority of the Board of University and School Lands (Land Board) comprised of the Governor, Secretary of State, Attorney General, State Treasurer and Superintendent of Public Instruction.

I appear before you today regarding the submittal and presentation of the State Auditor's Performance Report.

As directed by this Committee in 2014, the State Auditor's Office has been conducting a performance examination of the Department. The identified audit objectives include:

- the effectiveness of Unclaimed Property administration,
- the effectiveness of Energy Infrastructure and Impact Office grants administration, and
- the effectiveness and efficiency of the Department of Trust Lands in obtaining, accounting for, and use of resources.

This testimony is specifically in relation to the audit objective regarding the Energy Infrastructure and Impact Office, for which I serve as the Director. This office within administers assistance programs for oil and gas development and coal impacted political subdivisions, as well as a one-time flood grant program which provided assistance to communities impacted by flood events in 2011.

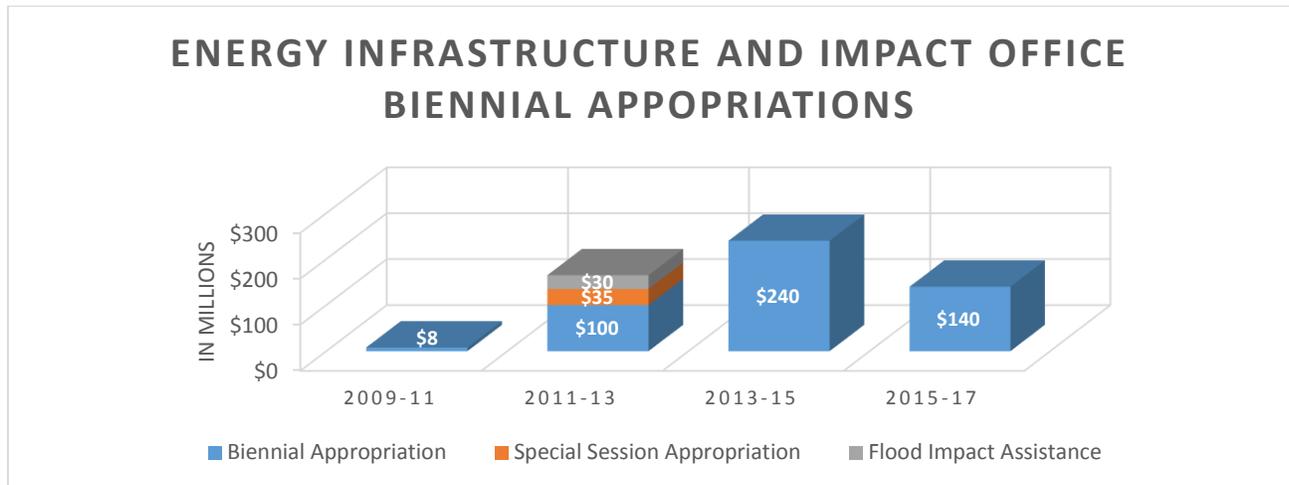
The statutory mission is to assist local political subdivisions in response to the needs directly as a result of actual or anticipated extraordinary expenditures caused by energy development and associated growth.

The program involves a grant program for oil and gas impacted political subdivisions (cities, counties, school districts, other taxing districts) and a low interest loan program for coal impacted political subdivisions.

Under the authorizing legislation the energy infrastructure and impact office director:

- Develop a plan for assistance through grants to counties, cities, school districts, and other political subdivisions in oil and gas development areas.
- Establish procedures and forms for political subdivisions to apply for impact grants.
- Consider the amount of revenue that the entities receive from taxes on oil and gas plants and from tax or fund distribution formulas, when determining grants
- Make reimbursements for costs to counties, cities, school districts, and other taxing districts of grants awarded by the Land Board.

The Governor and Legislature have dramatically expanded the responsibility and the appropriation to the Energy Impact Office, increasing it from \$8 million to \$165 million in the 2011 biennium. The Program is funded from 1% of the 5% of Gross Production Tax on oil and gas. Annual total grants are limited to 60% of the biennial appropriation. In 2011 the supplemental \$35 million and the Flood Impacted Political Subdivision \$30 million were appropriated from the State's general fund.



During the timeframe of the performance audit, from 2011 through 2015, the small and dedicated staff of the Energy Infrastructure and Impact Office:

- Evaluated and distributed several community coal loans
- Considered over 2,350 energy impact and flood assistance grant applications from over 575 applicants requesting \$1.8 billion
- Managed over 1,265 oil and gas, and flood assistance grants from 436 political subdivisions totaling \$392.4 million
- Verified and processed 2,426 reimbursement payments for \$274.6 million

The Land Board makes the grant decisions, but is assisted in its review with guidelines and award recommendations made by a number of advisory groups made up of local county officials, emergency managers, fire and EMS providers and law enforcement, depending upon the sector under grant consideration.

Grants approved by the Land Board largely focused on assisting with infrastructure to provide for permanent housing and public safety improvements. Some funds were also provided for rural transportation projects as well as critical education construction and safety projects. The Legislature has focused the appropriated funds in several specific areas.

During the 2011-2013 biennium, this was undertaken with one FTE plus a portion of the Commissioner's and supplementary service professionals' time and two part-time temporary employees. During the 2013-2015 biennium a second FTE was approved and limited temporary staff was dedicated to the Energy Impact Office efforts.

Since the audit commenced in January 2015, EIO personnel have been interviewed and extensively tapped for information. Virtually all processes and policies, and numerous communications, notes and e-mails have been examined. Thousands of pages of documents and electronic files have been reviewed and in the Energy Impact area alone, hundreds of hours have been dedicated to providing the requested documentation, explanation and background

On January 15, 2016 the State Auditor's Performance Audit Division presented draft reports of its audit findings for the Energy Infrastructure and Impact Office. The Department was directed to respond to the findings by February 16, 2016.

For the Committee's record, I am submitting the detailed Management Responses prepared in reaction to the findings as originally prepared for the auditors. In advance of the final deadline, on February 10, the performance audit staff advised us to substantially remove, edit and condense responses, or it would do so.

These more detailed responses, originally offered, contain more detail and context to the topics addressed in the audit findings.

**PERFORMANCE AUDIT
DRAFT REPORT RESPONSES
ENERGY INFRASTRUCTURE AND IMPACT OFFICE**

ENSURING APPLICANTS ARE AWARE OF FUNDING

Recommendation 1-1

- We recommend the Department of Trust Lands:
 - a) Establish procedures for political subdivisions to use in making applications for funds set aside for emergencies/contingencies; and
 - b) Ensure the procedures are effectively communicated.

The Department agrees that it should have application procedures in place that are effectively communicated; but disagrees that procedures were not communicated in regard to emergency grant requests. The intent of the overall program is not only to meet the known impacts from oil and gas development, but also the significant unexpected impacts during a frenzied period of energy development activity. The Land Board has used the contingency funds as a source for previously unplanned grant rounds when unanticipated needs were identified during the biennium. In these cases, standard application processes and criteria were used and public notification was provided. The contingency funds were also the source for some individual awards to address emergency needs brought to the Board's attention. In all cases, flexibility has been the intent of the Land Board for these contingency funds.

Grant application forms are always available on the Department website for impacted political subdivisions to apply for emergency funds.

IMPROVING THE SCREENING OF APPLICATIONS

Recommendation 1-2

- We recommend the Department of Trust Lands ensure the pre-award process for energy infrastructure and impact office grants is transparent and provides for fair and equitable treatment of all applications. At a minimum, The Department of Trust Lands should:
 - a) Establish a grant application screening process to identify which applications meet the eligibility requirements and are complete.
 - b) Score only those applications that meet the eligibility requirements and are complete.
 - c) Reevaluate the grant application scoring criteria to ensure criteria are reasonable, provide a method for awarding priority points, and separate compound criteria.
 - d) Define the point scale.
 - e) Ensure the pre-award process for energy infrastructure and impact office grants is documented.

The Department agrees that screening processes should be documented and will continue to retain these records. However the Department disagrees that incomplete applications or

requests that fall outside of the focus of a given grant round should be summarily dismissed. Applicants are provided the opportunity to supply missing information when applications are incomplete in order for the Department to be aware of all potential impacts, as well as to ensure equitable attention to all applicants. In cases where an applicant does not supply missing documentation by the application deadline, those applications receive a lower score under the "COMPLETE APPLICATION" criteria.

The Department will reevaluate the grant application scoring criteria to ensure criteria are reasonable, and it will investigate ways to highlight objective and subjective criteria. The Department intends to continue to provide a method for awarding priority or bonus points for unique needs or values presented in applications.

A weighted point scale for scoring applications is defined at the beginning of each grant round.

It needs to be emphasized that the scoring process is only a tool to help prioritize or rank multiple applications for further consideration and evaluation by advisory committees and Department staff for the purpose of providing recommendations. Ultimately, the Land Board has statutory decision making authority in awarding grants and it is satisfied with the pre-award grant processes being utilized.

IMPROVING AWARD RECOMMENDATIONS TO THE LAND BOARD

Ensuring Eligibility Requirements are Met

Recommendation 1-3

- We recommend the Department of Trust Lands ensure recommendations of energy infrastructure and impact office grants to the Land Board comply with eligibility requirements.

The Department agrees with this recommendation and will continue to work to ensure recommendations for grants comply with eligibility requirements outlined in Century Code. During face-to-face meetings with applicants, additional information is often obtained that can result in an applicant achieving eligibility.

Guidelines of priorities and focus are established for each grant round, but the Land Board has full discretion to fund the needs and the projects that it determines meet the justification and requirements outlined in law. Parameters are approved by advisory committees, but the ultimate funding decision rests with the Land Board's judgment, not in pre-established criteria.

Ensuring All Applications are Given Consideration

Recommendation 1-4

- We recommend the Department of Trust Lands ensure all applications for a grant round are given consideration before making recommendations to the Land Board.

The Department agrees and seeks to give fair and impartial consideration to all applicants during each grant round. A summary of all eligible applications is always presented for review by the Land Board as they exercise their statutory authority in providing awards.

Ensuring Recommended Projects are Achievable

Recommendation 1-5

- We recommend the Department of Trust Lands ensure projects recommended to the Board of University and School Lands are achievable at the proposed funding levels.

The Department agrees with this recommendation. Funding achievability can vary significantly from applicant to applicant. For example, two different applicants may be taking on a similar project in which one applicant may need 100% funding while the other applicant may only need 70%. The Department seeks to capture this detail, but will work to improve current practices. Grant recipients are consistently asked to confirm, in writing, that the proposed grant amount will contribute to overall funding necessary for completing the project or to decline the grant if project completion is not achievable.

Ensuring Priorities are Adequately Addressed

Recommendation 1-6

- We recommend the Department of Trust Lands ensure the needs of entities provided priority in law are adequately addressed before consideration is given to other eligible political subdivisions.

The Department agrees that priority specifically stated in law should receive greater consideration than other project categories. However, the Department disagrees that all other impact categories should be disregarded and it disagrees with the implicit assumption of the recommendation that all applications in a certain category are worthy of a grant.

The Department increased the funds allocated to emergency services category threefold due to the public safety priority adopted by the the 2011 special legislative session. The result was a greater funding ratio for public safety than any other type of project for the biennium even though the vast majority of applications received were from cities for infrastructure. The Department is confident that priority was given as intended. The Department will continue to exercise careful judgement in interpreting legislative direction when making grant recommendations to the Land Board.

Establishing Contingencies for Large Projects

Recommendation 1-7

- We recommend the Department of Trust Lands include contingencies in the recommendations made to the Land Board when grant application project costs for large projects are based on estimates rather than actual bids.

The Department has made use of contingent awards for projects in the past; however these have been for emergency applications outside of a normal grant rounds. The Department disagrees with the recommendation which assumes an inaccuracy exists in applicants' estimated project costs.

Project budgets are given serious consideration by Department staff, industry professionals and focused advisory committees during review of applications. Accordingly this professional review is incorporated into the recommended award amounts. This examination of project estimates helps to avoid the significant costs of monitoring and administering numerous contingency conditions. These funds are better spent on remediation of oil and gas impacts than on overhead for administrative tracking.

COMPLYING WITH MAXIMUM AMOUNTS

Recommendation 1-8

- We recommend the Department of Trust Lands ensure energy infrastructure and impact grants awarded annually do not exceed the state law maximum.

The Department agrees with the recommendation, but disagrees with the description of the circumstance provided and the assertion that the law was not followed. The Department recognizes that North Dakota statute limits the grants awarded annually to 60% of the biennial appropriation and has complied with those limits.

2011 Appropriation (HB 1013) for grants	\$99,888,100
2011 Special Session Appropriation (SB 2371)	<u>\$30,000,000</u>
Total for Grants	\$129,888,100
	<u> x 0.6</u>
60% FY Grant Limit=	\$77,932,860

The \$76,804,652 million awarded during FY 2012 is less than the 60% limit.

Recipients of pledged funds were specifically informed they were not receiving grant awards. The pledging of future awards was done specifically so that project planning could commence and future project applications could be submitted with actual estimates and bids, rather than approximations.

APPROVING SCOPE CHANGES

Recommendation 1-9

- We recommend the Department of Trust Lands:

- a) Request the Land Board to pass a motion outlining the authority grant to the Energy Infrastructure and Impact Office related to scope changes of Land Board awards.
- b) Ensure all scope changes are taken to the Land Board for approval

The Department agrees and obtained authorization by the Land Board in December 2015 for the Department to approve grant scope changes within projects which do not change the overall project goals.

MAKING IMPROVEMENTS WITH GRANT PAYMENTS

Recommendation 1-10

- We recommend the Department of Trust Lands ensure:
 - a) Grant payments are limited to the reimbursement of expenditures for projects/items outlined in the grant application.
 - b) Local match requirements and special conditions of the grant award are met.
 - c) Requests for reimbursement are adequately supported.
 - d) Expenditures claimed for reimbursement are not reimbursed twice.

The Department agrees and has implemented additional processes to assist with ensuring local match requirements are met, if they exist. Also if duplicate invoices are submitted as part of reimbursement requests, the matching copy will be rejected. Additional steps have been implemented to help verify that grant payments are limited to awarded items and are satisfactorily documented.

Recommendation 1-11

- We recommend the Department of Trust Lands:
 - a) Obtain status updates for grants with outstanding balances in a more cost effective manner by requiring status reports or via phone discussions.
 - b) Conduct site visits of Energy Infrastructure and Impact Office grants as warranted based on risk of political subdivision or project.
 - c) Ensure site visit documentation clearly identifies the grant award being monitored and the status of the project in relation to the intent of the grant application.

The Department agrees and will consider process improvement in light of the recommendations. Verification visits and personal interaction with applicants and grantees are appropriate in validating grant documentation that has been received.

The Department has utilized status updates captured by other State agencies such as the Aeronautics Commission, the Department of Health, and the Bureau of Criminal Investigation which also monitor the projects. Efforts by these agencies reduce duplicate efforts and save resources in tracking projects.

Visits for projects not yet started were undertaken in conjunction with reviews on active and completed projects to seek information on timelines for completion. High dollar grants are more complex and have greater risk of success, thus more comprehensive reviews are undertaken.

The Department will work to capture and document additional detail during project status visits.

IDENTIFYING DISTRIBUTION ELIGIBILITY

Recommendation 1-12

- We recommend the Department of Trust Lands obtain a legal interpretation of the 2013 Session Law relating to distributions to counties experiencing new oil and gas development activities to determine whether:
 - a) Other counties were eligible for a distribution; and
 - b) The county provided a distribution was eligible.

As required by law, the distribution of awards by the Department was based on the determination of the Director of the Department of Mineral Resources. Guidance of legal counsel has been requested.

COMPLYING WITH OPEN MEETING LAWS

Recommendation 1-13

- We recommend the Department of Trust Lands ensure advisory committees/subcommittees assisting the Land Board with grant determinations comply with open meeting laws.

The Department agrees with this recommendation and posts notices of advisory committee meetings in advance of the meeting on the Department website and also on doors of the meeting site. In the future, advisory board meeting notices will also be posted on the Secretary of State's public meeting notification website. Documentation of advisory committee meeting minutes will be enhanced