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Lance D. Gaebe, Commissioner

TESTIMONY OF

Lance D. Gaebe, Commissioner
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.

I am here to provide comments and respond to questions that the Committee may have regarding the presentation of the State Auditor's Office (SAO) Performance Report relating to the "effectiveness and efficiency of the Department of Trust Lands in obtaining, accounting for, and use of resources".

The Department of Trust Lands is the common reference to the *Office of the Commissioner of University and School Lands*, which serves as the administrative arm of the Board of University and School Lands. The Board was established in the state constitution and statutes to manage the Common Schools Trust Fund and other permanent trusts for the benefit of education and certain state institutions. It and the Department also manage several state funds including the Strategic Investment and Improvements Fund (SIIF), the Coal Development Fund and the Capitol Building Fund.

This testimony is specifically in relation to the audit objective regarding the performance audit relating to mineral and surface resources, expenditures, human resources, and various accounting functions.

The Department manages 708,000 surface acres, which are leased to ranchers and farmers across the state. On behalf of the permanent trusts, it also oversees 1.7 million mineral acres which are offered for oil, gas, coal, gravel and subsurface mineral leasing and production.

Notwithstanding some of the characterizations presented here today, I want to verify that all trust balances and funds overseen by the Board remain healthy and continue to grow, many at a remarkable pace. The combination of market based rents paid by farmers and ranchers, consistent investment returns, and robust production of trust minerals resulted in the value of the Common Schools Trust and other permanent funds nearly quadrupling in size over three biennia, collectively growing from \$900 million to \$3.6 billion since 2009.

Permanent trust distributions are constitutionally based upon the average value of the trusts' financial assets, thus with this growth, allocations to beneficiaries have increased markedly. Collectively, the trusts disbursed \$138.7 million during 2013-2015, which is a part of the support for education and institutions that the Legislature appropriates each year. The amounts approved for distribution by the 2015 Legislature increased 58% to \$219.1 million during the current biennium.

On behalf of the Board, the Department also operates the Energy Infrastructure and Impact Office and the State's Unclaimed Property Division, which I will discuss in separate presentations. I want to emphasize that the administration of these programs is with careful and conscientious consideration of the best interest of the clients and beneficiaries.

As stated, the Board oversees the SIIF, which was the source for the popular “surge” funding and several programs including the School Construction Loan Program, Critical Access Hospital Loan Program, and several one-time State construction and infrastructure expenditures. The SIIF earns revenue from production of 700,000 sovereign mineral acres managed by the Department and a portion of oil and gas production and extraction taxes. During the time-frame of the audit, the Department implemented \$1.7 billion of transfers and \$218 million of programs related to improving State infrastructure including highways, cities, schools and hospitals.

With respect to management of sovereign minerals, the Department and the Attorney General have vigorously defended the State’s ownership of these assets. Just during the audit period the Board has been involved in nine lawsuits related to minerals beneath navigable waters and several others pertaining to acquired minerals. This litigation takes tremendous time and resources.

The Department staff, the Board, and I take pride in the important role and responsibility that we collectively have in managing natural resources and assets to provide substantial educational and institutional funding, to support energy impacted communities and to serve unclaimed property owners. These dedicated employees handle hundreds of requests for information and grants; they process thousands of transactions, manage tens of thousands of property tracts, oversee millions of mineral acres and administer billions of dollars of financial assets.

During this 16-month performance audit, nearly all Department personnel have participated in interviews, desk audits, responses to requests for information relating to policies, processes, and practices, assisting the SAO staff in understanding the Department’s data and systems, and providing responses to recommendations. This effort has resulted in expending thousands of hours of staff time that we had anticipated would culminate in recognition of achievements with concrete recommendations and suggestions for further enhancing controls, increasing efficiencies, and boosting productivity.

The Department acknowledges that mistakes have been made that do not reflect the high standards that the staff embraces. We had hopes that the audit could lead to constructive suggestions for solutions and ideas, however at the end of a long costly process we received generalized, subjective recommendations, and a collection of highlighted unintentional errors and oversights assembled to present a characterization that the Department lacks accountability and that its staff does not recognize its responsibilities.

The Department recently initiated the process to hire a private firm to undertake a business systems analysis and to prepare specific improvement options.

During the 2011-2015 period reviewed by the audit, the Department and the trusts it manages experienced unprecedented growth in both dollars and responsibilities.

MINERALS RELATED

	6/30/11	6/30/15	% Increase
Producing Wells	1,197	5,080	324%
	09/11 bi.	13/15 bi.	% Increase
Royalty Records Processed	88,481	562,683	536%
Royalty Revenues	\$213.3 million	\$688.8 million	223%

SURFACE RELATED

	6/30/11	6/30/15	% Increase
Rights of Way Issued	399	677	70%
	09/11 bi.	13/15 bi.	% Increase
Aggregate Royalties Received	\$48,027	\$1.7 million	3,400%

FINANCIAL RELATED

	6/30/11	6/30/15	% Increase
Permanent Trust Assets	\$1.73 billion	\$3.64 billion	108%
SIIF Assets	\$249.1 million	\$793.7 million	219%
	09/11 bi.	13/15 bi.	% Increase
Permanent Trust Distributions	\$82.3 million	\$138.7 million	536%
	(estimated \$300 million in 17-19 bi.)		
SIIF Transfers	\$35.8 million	\$1.43 billion	398%

The compilation of this third audit draft report, related to the effectiveness and efficiency of the Department in obtaining, accounting for, and use of resources, was delivered to the Department on March 24, 2016; and the SAO directed that it receive responses three weeks later on April 14, 2016.

Procedurally, if the SAO staff determines that Department responses are too lengthy or contain extra information, responses can be summarized or removed and placed into an appendix by the auditors. Thus for the Committee's record, I am submitting the detailed Management Responses as originally presented to the performance auditors.

In closing, I want to highlight the cooperation and openness that the employees of the Department of Trust Lands extended to the performance audit staff during the 16-month audit process. The Department is proud of the work it does on behalf of all of beneficiaries and the State of North Dakota. Even during challenging periods, it has never lost sight of its responsibility to sensibly oversee the permanent trusts, and the other funds and programs that have been entrusted to it. Staff professionalism and dedication in serving the trust beneficiaries and the State is exemplary and deserves acknowledgment.

I have provided a copy of the Department and Board's most recent biennial report for your review. The Department has experienced rapid changes and dramatic growth – particularly during the audit period. Nonetheless, the State's students, impacted communities and abandoned property owners continue to be served well by the Department's committed and talented professionals. These details are presented in this comprehensive report.

We appreciate the auditors' preparation of a thorough "to do" list, which includes many projects that are well underway. The Department staff recognizes some shortcomings, many of which were communicated to the auditors during the extended review, and which are presented herein. It will certainly implement improvements and corrections, but the Department definitively rejects the assertion that fiduciary responsibilities are not being fulfilled, public funds are being used inappropriately, and that the organization lacks accountability.

**PERFORMANCE AUDIT
DRAFT REPORT RESPONSES
REPORT 3 – CHAPTER 1 (SURFACE AND MINERALS)**

ENSURING TRUSTS ASSIGNED TO TRACTS ARE CORRECT

Recommendation 1-1

We recommend the Department of Trust Lands:

- a) Ensure tracts of land managed by the Department are assigned to the correct trust.
- b) Obtain guidance from legal counsel on correcting net assets and past distributions when trusts were incorrectly assigned to tracts.

The Department agrees with these recommendations.

Files and all properties pertaining to assets inappropriately assigned to the Youth Correctional Center Trust in the 1940s will be reviewed and corrected. Additionally, the Department will review all mineral tracts in the YCC Trust for other potential errors.

The audit finding correctly states that the asset balance of the YCC Trust is inflated by \$2.8 million due to the error and recent mineral revenue produced by the seven tracts. Additionally, this amount generated investment income of approximately \$523,000. The collective impact of the error on distributions over the past five years is that the YCC received approximately \$177,000 more and the seven beneficiaries of the Ellendale Trust received that much less. The authority to correct these mistaken appropriations will likely need to be requested from the legislature.

The Department will obtain guidance from the Attorney General's Office on appropriate methods to correct net assets, trust transactions and distributions in which tracts and resulting revenues were incorrectly assigned to trusts.

ENSURING CORRECT INTEREST IN WELLS

Recommendation 1-2

We recommend the Department of Trust Lands:

- a) Conduct a formal review of oil and gas royalty payments to ensure royalty payments received have used the correct decimal interest.
- b) Establish a periodic review to ensure operators are using the correct decimal interest.

The Department agrees with these recommendations.

The Department has begun to implement the suggested changes. In the fall of 2015, the Department adjusted system requirements so mineral ownership is calculated to eight decimal places. The Department has initiated a formal review of oil and gas interests to compare the trusts' documented decimal interest to the interest paid by operators and verify that operators are using the correct decimal interest.

ENSURING ROYALTY PAYMENTS ARE PROPERTY ALLOCATED

Recommendation 1-3

We recommend the Department of Trust Lands:

- a) Ensure oil and gas royalty payments are correctly allocated to the proper trust.
- b) Obtain guidance from legal counsel on correcting net assets and past distributions when royalty payment allocation errors occur.

The Department agrees with these recommendations.

The Department will continue to work to ensure that royalty payments are allocated to the proper trust and make adjustments as needed.

The Department will request guidance from the Attorney General's Office on appropriate methods to correct net assets, trust transactions and distributions where tracts and resulting revenues were incorrectly assigned to trusts.

CAPTURING OF DATA AND AUDITING PRODUCERS

Recommendation 1-4

We recommend the Department of Trust Lands:

- a) Ensure information submitted with oil and gas royalty payments if consistently obtained in an electronic format and includes all necessary information to adequately monitor payment amounts.
- b) Conduct audits of oil and gas producers submitting royalty payments to the Department.

The Department agrees with these recommendations.

Since October 1, 2015, the Department has required that oil and gas operators submit royalty information electronically via the Department's standard form which includes all necessary information for adequate monitoring.

During the 64th Legislative assembly, an FTE was authorized for additional compliance audit efforts. The Department commenced a comprehensive oil and gas audit of a major oil and gas producer starting in September 2015 and has developed an audit schedule to review more operators for compliance with the Board's lease and rules. In addition, in February 2016 the Department began procurement efforts for contracted royalty audit firms to assist with verification and collection efforts.

ASSESSING INTEREST ON LATE PAYMENTS

Recommendation 1-5

We recommend the Department of Trust Lands establish:

- a) An interest rate to be assessed on late oil and gas royalty payments.
- b) A policy identifying the circumstances under which interest will be assessed.

The Department disagrees with these recommendations.

The Department considers the collection of royalties on behalf of the trusts and the State as its primary objective in the management of oil and gas assets and it believes that the application of interest should be when lack of royalty payment is obstinate. The majority of royalties received past 150 days were a result of title issues or adjustments.

The audit finding cites NDCC § 47-16-39.1 as requiring the Commissioner to establish or negotiate an interest rate used by the operator related to late payments. The law is actually permissive in reference to the adjustment of interest for unpaid royalties upon Board managed minerals. The statute reads in part: *“without the requirement that the mineral owner or the mineral owner's assignee request the payment of interest, at the rate of eighteen percent per annum until paid, except that the commissioner of university and school lands may negotiate a rate to be no less than the prime rate as established by the Bank of North Dakota plus four percent per annum with a maximum of eighteen percent per annum, for unpaid royalties on minerals owned or managed by the board of university and school lands.”* (emphasis added).

Similarly, the Board’s rules, which govern its leasing of oil and gas minerals in chapter 85-06-06, state that the Commissioner may collect penalties, interest, or both upon the late payment of royalties. This rule provides discretion so that complexities due to timing, title and legal issues can be considered in application of interest. This adaptability is intentional and has proven useful in the negotiation and collection of royalties.

More rigid policies could prompt litigation, thus the Department will consult with legal counsel before recommending revisions to the Board’s rules.

ASSESSING PENALTIES CONSISTENTLY

Recommendation 1-6

We recommend the Department of Trust Lands ensure penalties are consistently assessed on late oil and gas royalty payments and calculations are accurate.

The Department disagrees with this recommendation.

Board Rule 85-06-06-10 states that the Commissioner may collect penalties, interest, or both upon delinquent royalty payments. This rule provides discretion of the application of penalties due to payment complexities including title disputes, lease assignments, and timing issues. This flexibility is useful in the negotiation and collection of royalties - which is the objective. It is conceivable that unyielding policies would encourage litigation, thus the Department will consult with its legal counsel regarding the appropriateness of adjusting the Board's oil and gas royalty rules to require penalties.

Consistent with the recommendation, the Department will work to ensure that calculations are accurate and improve consistency on application of penalties.

CHANGING ACREAGES AND LEASE CORRECTIONS

Recommendation 1-7

We recommend the Department of Trust Lands:

- a) Monitor changes made to information in the minerals database to ensure changes are appropriate and adequately documented.
- b) Ensure lease agreements are appropriately updated when changes occur.

The Department agrees with the recommendations.

The Department will work to ensure that existing procedures are followed and will implement reconciliation procedures and training related to data changes.

The Department will take measures to appropriately update lease agreements when changes occur.

ENSURING A FAIR MARKET RETURN

Recommendation 1-8

We recommend the Department of Trust Lands ensure the minimum opening bids for pastureland result in a “fair market” return.

The Department agrees with this recommendation.

The Fair Market Value Method of calculating the minimum opening bids at public auction was adopted by the Board in 1989 and subsequently often revised. The FMV Method calculates the opening bids on a tract-by-tract basis based upon a local rent survey and land productivity data.

Because the productivity data is based on vegetation zones and the rent data is county based surveys, the FMV Method blends two data sets into a coherent methodology.

The Department now has extensive cash rent survey data available and since the vegetation zones have been refined by the USDA NRCS into Major Land Resource Areas, this information could be used along with more precise ecological and economic information, to review and possibly update the FMV Method.

This FMV review will be balanced with the risk of raising minimum opening bids to a level that tracts will not be leased resulting in decreased revenue and increased management costs.

REVIEWING THE USE OF ONLINE AUCTIONS

Recommendation 1-9

We recommend the Department of Trust Lands:

- a) Analyze the use of additional online auctions including costs associated with online versus live auctions.
- b) Use the auction process determined to be more beneficial to the trust.

The Department agrees with these recommendations.

The Department has used an online mineral auction service provider since 2011, most often when leases needed to be offered between quarterly scheduled live auctions. In August 2015 and February 2016, the Department conducted a comparison of live and online oil and gas lease auctions with inconclusive results. The Department will continue this analysis and determine the auction method most beneficial for the trusts.

MONITORING OF SURFACE TRACTS

Recommendation 1-10

We recommend the Department of Trust Lands ensure:

- a) Agreements are entered into and/or information is obtained for inspections not conducted by the Department on state owned tracts.
- b) Appropriate action is taken when violations or other concerns are identified on surface tracts.

The Department agrees with these recommendations.

The Department has a cooperative management relationship with grazing associations and the US Forest Service. Trust land within grazing units in the National Grasslands is annually inspected by the grazing associations and livestock use is adjusted based upon weather and guidelines established by the Forest Service. There is not a written agreement between the grazing associations and the Department, so one will be developed to document the relationship and reporting requirements.

Land improvement programs, including a major cooperative trash clean-up effort, were instituted in 1992. Regular five-year inspections are conducted by experienced Department field staff to identify trash, safety, or management issues that need to be addressed. When requested to resolve a problem, the vast majority of lessees make the adjustments or implement changes without enticement or penalty. The trusts are fortunate to partner with good agriculture managers who share similar values in protecting and improving trust lands.

The Department will review inspection agreements and will implement appropriate action in response to repeated or uncorrected abuses of trust surface lands.

CLASSIFYING OF STATE LAND

Recommendation 1-11

We recommend the Department of Trust Lands either:

- a) Comply with state law requirements related to classifying all land owned by the State or its instrumentalities according to its highest and best use; or
- b) Take appropriate action to modify the requirement of classifying all land owned by the State or its instrumentalities.

The Department disagrees with recommendation “a)”, as it has complied with state law.

The Department agrees with recommendation “b)” and will request that the legislature modify the law to minimize confusion or to remove the little used statute entirely.

In context with NDCC § 54-01-05.5, NDCC § 15-02-05.1 requires the Commissioner’s review when the sale of state land is contemplated by the legislature. Legislative proposals to sell land have historically exempted the application of NDCC § 15-02-05.1.

The Department does not have, nor has it ever conducted a classification of all land owned by the State or its instrumentalities. These statutes require an assessment of a tract’s highest and best use only when the legislature is considering a measure that involves the sale or exchange of state land and do not require that an assessment be done on ALL state land.

Recognizing that the phrasing within NDCC § 15-02-05.1 can be construed in more than one way; the Department will seek affirmation from legal counsel that it has correctly interpreted this law.

**PERFORMANCE AUDIT
DRAFT REPORT RESPONSES
REPORT 3 – CHAPTER 2 (FINANCIAL AREAS)**

IMPROVING ACCOUNTABILITY

Recommendation 2-1

We recommend the Department of Trust Lands:

- a) Ensure fiduciary responsibilities are fulfilled
- b) Ensure public funds are used in an appropriate manner.
- c) Enhance the organizational culture of accountability

The Department agrees with the recommendations as provided. The Department staff are keenly aware of their responsibilities as fiduciaries for beneficiaries of the permanent trusts, the state and unclaimed property owners, but recognize that there is always room to improve. The Department takes its role and responsibility of managing natural resources and assets to provide educational and institutional funding, supporting energy impacted communities and serving unclaimed property owners seriously.

Responses to the examples of issues:

Trusts Assigned to tracts:

This example was previously identified and a Management Response provided in recommendation 1-1 of Chapter 1. The Department agrees that there were errors and that it will take steps to correct them.

Royalty Payments:

A response to these details was provided in an earlier chapter of the audit, specifically in recommendations 1-2 and 1-3. The Department agrees that mistakes occurred and it will work to improve processes.

Interaction with vendors:

On behalf of the trusts, the Department staff undertake careful reviews and make recommendations regarding sizeable investment decisions. Part of the review involves understanding an investment firm's style, culture, and fiduciary approach towards managing money for others.

As described in its response to auditors' recommendation 2-6, the Department believes that all interactions have followed its Code of Ethics policy. The Department will review meeting documentation, and if meals or other items of value were improperly accepted by employees, reimbursement will be required.

Reimbursement for meals:

The Department will review the identified instances when employee meals were provided by a contractor or vendor; if per diem was also provided, repayment from the employee will be required.

Use of funds

The Department will review the selected transactions and address the specific concerns as needed.

- The Department will require reimbursement from the two employees who apparently received a per diem meal reimbursement when a meal was included in conference registration. If the employees are no longer employed with the State, the Commissioner will reimburse the Department.
- Due diligence is an industry standard and an essential component of the investment process; it involves confirming that information provided by an investment firm accurately portrays the firm and the product in which an entity is considering investing. Whenever possible, the Department works to minimize the cost of due diligence trips, or any travel.
- Department policy encourages part-time employees to use personal a UTV or ATV to conduct field inspections; because it saves the Department the cost of providing and maintaining these machines that improve employee productivity. In the instance noted, this policy resulted in nominal added expense. The policy is being reviewed to ensure allowable reimbursement is more closely aligned with usage.
- Regarding procurement, a response to this example is provided to recommendation 2-2 in the succeeding section. The Department will enhance compliance with procurement laws and policies.
- The Common Schools Trust Fund owns the office building occupied by the Department. As the landlord it provides the space, utilities, and all other fixtures related to office occupancy; including the parking lot, bathrooms, conference rooms, and a breakroom. Since there is no cafeteria or dining option within near proximity, a provided coffee maker and kitchen appliances allow employees the option of onsite meals. The Department does not purchase food or coffee for employees or guests.
- The Department has provided responses to salary management recommendations in Chapter 3 within recommendations 3-5 and 3-6. The Department believes that its salary increases were in compliance with session law and administrative rules.

During the period reviewed by the audit, the Department and the trusts it manages experienced unprecedented growth in both dollars and responsibilities. The Department acknowledges that mistakes have been made that do not reflect the high standards that the staff embraces.

However, the Department rejects the assertion made herein, through the assemblage of unrelated issues, that fiduciary responsibilities are not being fulfilled, public funds are being used inappropriately, and that the organization lacks accountability.

The Department is proud of the work it does on behalf of all of its beneficiaries. Even during challenging periods, it has never lost sight of its responsibility to sensibly oversee the permanent trusts, and the other funds and programs that have been entrusted to it. The Department welcomes the opportunity to continuously improve its management of these assets and programs.

MAKING IMPROVEMENTS WITH PURCHASING AND CONTRACTING

Complying with Procurement Requirements

Recommendation 2-2

We recommend the Department of Trust Lands ensure compliance with state procurement laws, rules, and policies.

The Department agrees with this recommendation.

The Department has implemented improvements to its procurement procedures by centralizing procurement oversight to one staff person and establishing a purchasing approval policy. Many of identified examples of noncompliance occurred prior to these improvements.

The Department will continue to improve on these processes by reviewing procurement processes for all contracts and purchases.

Improving Contracting

Recommendation 2-3

We recommend the Department of Trust Lands:

- a) Ensure payments for services are made pursuant to a written contract or agreement.
- b) Perform a risk analysis for all contracts and agreements to ensure appropriate insurance provisions are included.
- c) Include applicable terms and conditions within contracts and agreements as recommended by the Office of the Attorney General.
- d) Ensure appropriate reviews are performed by legal counsel.

The Department agrees with these recommendations.

The Department will take steps to improve contract management processes as outlined in the recommendations. A review of existing written agreements and templates will be undertaken to verify that they have been reviewed by legal counsel and include appropriate risk management provisions.

With respect to recommendation that payments for services are made pursuant to written contracts or agreements, the auditors cite an example of a payment of \$18,000 for legal services not included within a written agreement.

According to NDCC §54-12-08 the Department is barred from contracting for legal services. Rather, the authority to appoint a Special Assistant Attorney General lies solely with the Attorney General. The Department's role in the appointment of a SAAG is consultative. The appointment of a SAAG must be in writing, thus the agreement for legal services is retained by the Attorney General's office.

MAKING IMPROVEMENTS WITH ACCOUNTING

Recommendation 2-4

We recommend the Department of Trust Lands:

- a) Ensure direct costs are properly accounted for with the associated trust, program, and/or activity.
- b) Ensure non-direct costs are allocated in an appropriate manner to trusts, programs, and activities.

The Department agrees with these recommendations.

The State Lands Maintenance fund is created under authority of NDCC § 15-03-01.1 to fund Department operations. It consists of fees charged for services, plus a portion of the trusts' financial assets.

Due to the multi-functional nature of the Department, a review of the allocation of direct and indirect costs will be completed to identify appropriate changes.

CONDUCTING A FRAUD RISK ASSESSMENT

Recommendation 2-5

We recommend the Department of Trust Lands conduct a formal fraud risk assessment as required by the Office of Management and Budget policy.

The Department agrees with this recommendation.

The Department will work to complete a fraud risk assessment each biennium as outlined in OMB Fiscal Policies.

COMPLYING WITH THE CODE OF ETHICS

Recommendation 2-6

We recommend the Department of Trust Lands avoid actions resulting in or creating the appearance of:

- a) Losing independence or impartiality.
- b) Creating an adverse effect on the integrity of the Land Board or Department.

The Department agrees with these recommendations.

The Department staff follow the Board adopted Code of Ethics policy regarding employee interaction with members of the public. All dealings with existing and prospective contractors follow this policy, which precludes acceptance of “anything of value” in excess of \$100 annually.

As fiduciaries, the Department oversees investment responsibilities and recommended Board decisions that are in the best interests of the trust funds under its control. The Board will be asked to review its Code of Ethics policy.

**PERFORMANCE AUDIT
DRAFT REPORT RESPONSES
REPORT 3 – CHAPTER 3 (HUMAN RESOURCES)**

MAKING IMPROVEMENTS WITH THE HIRING PROCESS

Hiring Applicants Who Meet Minimum Qualifications

Recommendation 3-1

- We recommend the Department of Trust Lands ensure individuals hired into classified, non-temporary positions meet the minimum qualifications for the job class as required by North Dakota Administrative Code.

The Department agrees with this recommendation.

The Department will continue to work with the State's Human Resource Management Services Division to ensure compliance with system classification descriptions and grades.

Improving the Hiring Process

Recommendation 3-2

- We recommend the Department of Trust Lands should ensure:
 - a) Follow Human Resource Management Services' hiring process best practices.
 - b) Provide proper training to employees involved in the hiring process.

The Department agrees with these recommendations.

The Department will work with HRMS to ensure legal requirements of HRMS recruitment and hiring best practices are met. The Department's human resources manager will continue to participate in training appropriate to oversee hiring processes.

Ensuring Compliance with Veterans' Preference Requirements

Recommendation 3-3

- We recommend the Department of Trust Lands comply with veterans' preference hiring requirements pursuant to North Dakota Century Code.

The Department agrees with this recommendation.

Since 2014 the Department has required job applicants to submit application materials through the State's Recruiting Solutions online program which helps ensure preference points are awarded to eligible candidates.

Starting in 2015, the Department implemented the practice of predetermining the number of candidates to be interviewed prior to the ranking of applications.

COMPLYING WITH LEGISLATIVE INTENT FOR AUTHORIZED FTES

Recommendation 3-4

- We recommend the Department of Trust Lands comply with legislative intent for use of authorized full-time equivalent positions.

The Department agrees with this recommendation.

The Department will utilize FTEs as requested in budget preparation and testimony and according to legislative appropriation, however there are circumstances that require management to reevaluate and adjust staffing to align with changing needs and fiduciary responsibility to the trusts.

The Department has not exceeded the number of FTEs nor the total appropriated salaries authorized in law.

ENSURING COMPLIANCE WITH SALARY ADMINISTRATION REQUIREMENTS

Recommendation 3-5

- We recommend the Department of Trust Lands comply with salary administration requirements pursuant to North Dakota Administrative Code.

The Department agrees with this recommendation but believes that clarification of the auditors' examples is necessary to put them into context.

The Department and Board manage the largest surface and mineral asset holding in the state. During the 2011-2015 timeframe of the audit, it managed exponential increases in easement requests, mineral lease applications, approved drilling permits, producing wells, and numbers of financial transactions. Workload and responsibility increases were evident throughout all areas of the Department, and it attempted to document them in budget requests, legislative presentations, biennial reports, and in the Commissioner's compensation letters to employees.

The 10% "probationary" increase was for the FTE solely assigned to the Energy Impact program. Perhaps the 10% probationary increase would have been more clearly stated as a 5% probationary increase and a 5% workload/responsibility increase. During this employee's 6-month probation, legislative changes significantly increased the workload for this position by appropriating an additional \$35 million for oil impacts; creating a new \$30 million flood impact program, and creating responsibility for supervision of temporary staff.

The Department will take steps to provide additional documentation of future salary increases.

MAKING IMPROVEMENTS WITH PERFORMANCE EVALUATIONS

Complying with Requirements for Performance Evaluations

Recommendation 3-6

- We recommend the Department of Trust Lands comply with:
 - a. Session law requirements related to general legislative salary increases.
 - b. North Dakota Administrative Code requirements related to annual employee performance evaluations.

The Department agrees with these recommendations.

The Department will adhere to legislative guidelines on salary increases and follow administrative code related to annual employee performance evaluations. In 2015 all classified employees participated in a formal evaluation process.

Establishing an Effective Evaluation Process

Recommendation 3-7

- We recommend the Department of Trust Lands establish an effective process for evaluating employees' performance.

The Department agrees with this recommendation.

The Department will improve processes for evaluating employees' performance and will coordinate with state Human Resource Management Services to transition to PeopleSoft's online Talent Management module. This tool will provide more consistency and standardization in review processes.

All Department supervisors attended HRMS-sponsored employee evaluation training in 2015.

**PERFORMANCE AUDIT
DRAFT REPORT RESPONSES
REPORT 3 – CHAPTER 4 (ADDITIONAL AREAS NEEDING IMPROVEMENT)**

IMPROVING THE INFORMATION TECHNOLOGY SYSTEMS

Recommendation 4-1

We recommend the Department of Trust Lands ensure:

- a) Appropriate information technology systems exist.
- b) User manuals are established.
- c) Systems are used to the fullest extent possible

The Department agrees with these recommendations.

With assistance from the State Procurement Office and the State Information Technology Department, the Department began procuring business analysis services in early 2016.

The project will identify areas of process improvement and recommend methods for leveraging technology updates to better utilize shared data, integrate stand-alone applications, and automate processes that are currently being managed using separate spreadsheets.

The completion of the business analysis is expected to lead to a request for an appropriation to upgrade all Department IT systems, which will require the completion of user manuals. In the interim, the Department will work to better document current processes relating to existing applications.

MAKING IMPROVEMENTS WITH POLICIES AND PROCEDURES

Recommendation 4-2

We recommend the Department of Trust Lands:

- a) Establish formal policies and procedures.
- b) Use a standardized format for policies and procedures.
- c) Review policies and procedures periodically to ensure information is current and relevant.

Recommendation 4-3

We recommend the Department of Trust Lands:

- a) Ensure policies and procedures are available to all employees in a centralized location.
- b) Require all employees to periodically review Department policies and procedures and signify acknowledgement in writing.

The Department agrees with these recommendations.

The Department will work to establish an improved methodology for adoption, updating, implementation and administration of formal policies and procedures. It will centralize the responsibility of policy and procedures maintenance to ensure information is easily accessible and relevant.

The Department will implement a system that distinguishes between policies adopted by the Board and are implemented by rule; those approved by the Commissioner for documentation of Department level guidance; and those that detail procedures and division operations.

In 2012 and 2015 all employees signed policy acknowledgement statements. All new employees sign acknowledgements as part of orientation.

IMPROVING MONITORING

Recommendation 4-4

We recommend the Department of Trust Lands perform ongoing monitoring of the design and operation effectiveness of the Department's internal control procedures.

The Department agrees with this recommendation.

The Department plans to develop a program similar to its oil and gas royalty system to better manage other revenues. It will work to improve its internal control policies and monitor compliance with the policies with periodic testing of both revenue and expenditure management.

UTILIZING STATE ARCHIVES

Recommendation 4-5

We recommend the Department of Trust Lands, in conjunction with representatives of State Archives, review records and:

- a) Identify permanently retained records and/or records with archival value.
- b) Transfer applicable records to State Archives.

The Department agrees with these recommendations.

The Department recognizes that it is the custodian of records of unique historic value. A review of agency retention terms and possible disposal and transfer options is scheduled for summer of 2016 and will be done in conjunction with a State ITD initiative to move FileNet records of archival value from agency object stores to a State Historical Society's object store.