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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

October 13, 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 update the Committee on progress made in implementing and addressing recommendations for the Department of Trust Lands contained within three performance reports released by the Office of the State Auditor earlier this year.

The performance audit recommendations and Department responses are contained in three sections issued within the State Auditor's Report No. 3036:

Section (a): Energy Infrastructure and Impact Office (publicly released February 25, 2016)

Section (b): Unclaimed Property (publicly released February 25, 2016)

Section (c): Trust Assets and Department Resources (publicly released April 19, 2016)

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 state statutes to manage the Common Schools Trust Fund and other permanent trusts for the benefit of education and certain state institutions. The Board and Department also manage several state funds including the Strategic Investment and Improvements Fund (SIIF), the Coal Development Fund and the Capitol Building Fund.

On behalf of the permanent trusts, the Board and Department manage 708,000 surface acres, which are leased to ranchers and farmers and also oversee 1.7 million mineral acres which are offered for oil, gas, coal, gravel and subsurface mineral leasing and production.

Permanent trust distributions are constitutionally based upon the average value of the trusts' financial assets, which have grown substantially. As a part of the State's support for education and institutions that the Legislature appropriates each year, collectively the trusts disbursed \$138.7 million during 2013-2015, which increased by 58% to \$219.1 million in 2015; and in the next session, the legislature will be asked to authorize distributions of approximately \$304.1 million.

The Board and Department also manage the Energy Infrastructure and Impact Office, which consists of 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.

The Department has also operated the State Unclaimed Property Division since 1975. In this role, it serves as a centralized custodial repository for unclaimed property, and works to make individuals and businesses aware of unclaimed property requirements and assists owners with the process of claiming their forgotten assets.

The Board also oversees the SIIF which is the source of “surge” funding and several programs including the school construction and critical access hospital loan programs, a biofuels loan guarantee, and many infrastructure expenditures. The SIIF earns revenue from production of 800,000 sovereign mineral acres and a portion of oil and gas production and extraction taxes.

Trust Mineral Assignment

One of the critical findings identified during the performance audit was the mistaken assignment of multiple mineral tracts to the wrong trust.

When documents were transcribed in the 1940s, numerous mineral acre properties and files were incorrectly assigned to the Youth Correctional Center Trust (YCC Trust), when instead these tracts should have been identified as being owned by the Ellendale Normal and Industrial School Trust (Ellendale Trust). These errors were ultimately incorporated into mineral tract databases and carried forward as inaccurate records. Subsequently, mineral revenues generated by those mineral tracts were incorrectly attributed to the wrong trust.

As a result of the finding, the Department initiated a detailed review of the historical records of all mineral tracts identified as being owned by the YCC Trust. Efforts focused on tracts which are currently or which have recently been leased for oil and gas production. Of the 121 active YCC Trust tracts that have been critically examined, 37 tracts were incorrectly assigned to this trust. There are approximately 450 tracts that are identified in the database as being owned by the YCC Trust and all will ultimately be reviewed as a part of a county-by-county assessment of mineral tracts.

The Department evaluated 26 years of revenue records for each of the 37 mistakenly assigned mineral tracts. It determined that the collective bonus, rent and royalty revenue mistakenly attributed to the YCC Trust since 1989 is \$6.1 million. The Department also reviewed historical investment income associated with the misapplied financial assets and reimbursed the Ellendale Trust \$1.1 million for the net income that the Ellendale Trust had not received.

Tract corrections have been made and documented in the Department’s paper and electronic records. In addition, accounting adjustments have been made with the transfer of \$7.2 million from the YCC Trust to the Ellendale Trust.

The collective impact of this error on distributions is that over the past 20 years, the Youth Correction Center has received approximately \$610,000 more in distributions than it would have if mineral revenues had been deposited into the correct trust, and the seven beneficiaries of the Ellendale Trust received that much less.

Since the 2015 Legislature made the appropriations from each trust according to the distribution formula outlined in the state Constitution and according to financial statements at the time, distributions continue as appropriated in the current biennium. A one-time adjustment to correct the mistaken over/under appropriations from these trusts will be requested during the 2017 legislative session.

Business Process Modeling

Software weaknesses were emphasized throughout the audit recommendations. The Department has long recognized a need to update processes and systems to ensure data accuracy, enhance security and internal controls, and provide greater online functionality.

The Department has many disconnected manual and paper processes, along with multiple customized computer systems to handle its asset management, leasing processes, royalty and rent compliancy, unclaimed property management, and grant and loan management. Many core systems were developed decades ago using design and tools that are no longer supported by vendors. There have been some supplemental system improvements and purchases over time, but the current database structure has restricted many potential improvements.

Earlier this year the Department hired a consulting firm, Major Oak, to undertake a process and systems analysis and to prepare specific process improvement options. Through the business process modeling effort, Major Oak is making recommendations on solutions to further enhance controls, increase efficiencies, and boost productivity. Major Oak has documented over 100 business processes in an effort to document core business requirements for a future information management system and to provide recommendations regarding build-versus-buy software options.

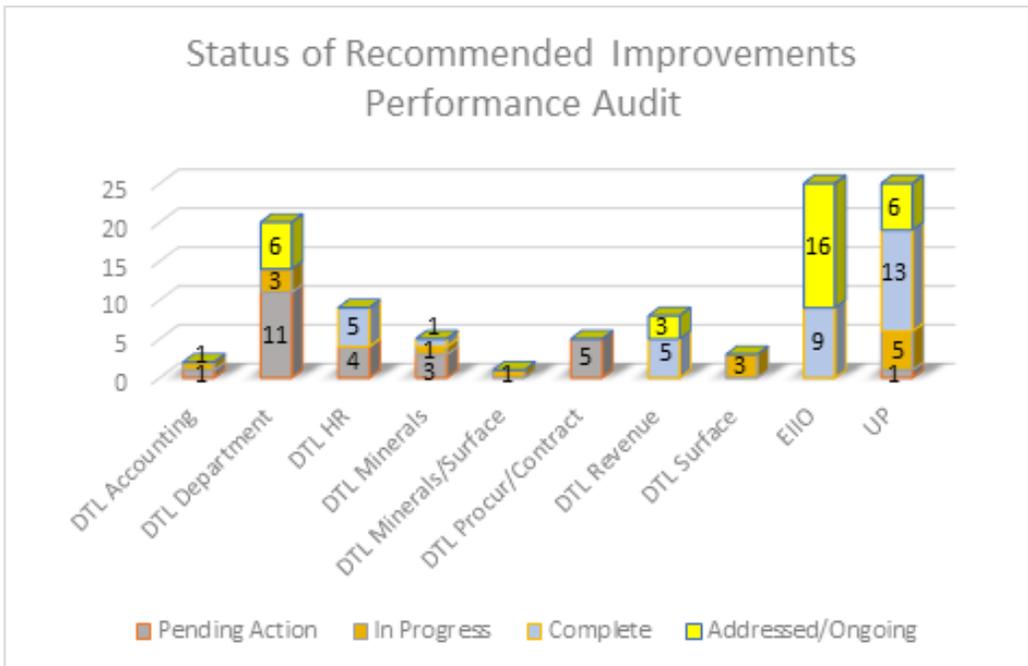
Major Oak has been onsite since July engaging all Department employees to analyze and document current processes and discuss improvement opportunities. It has also contacted peer organizations, software vendors, and various industry professionals. The information gathered will be used in completing recommendations on system replacement options and estimated costs. The project is on schedule to be completed at the end of October 2016.

Improvements Tracking

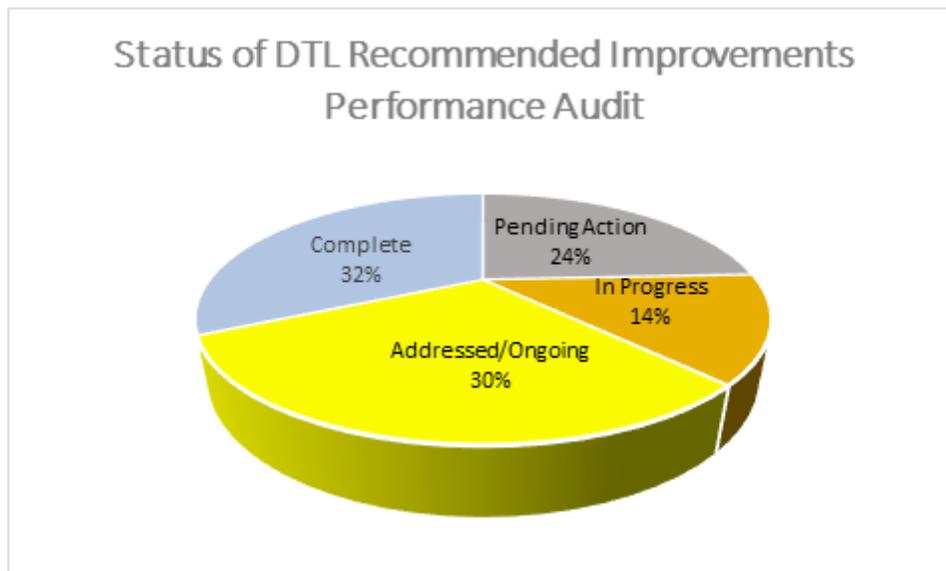
We appreciate the auditors' preparation of a thorough "to do" list, including many projects that are well underway. The Department staff recognizes some shortcomings, many communicated to the auditors during the extended review and presented in recommendations. The Department is working diligently to implement improvements and corrections.

The Department has built an improvement tracking tool to record and gauge progress on each of the audit findings. This database details the finding, the Department response, a time stamped improvement tracking log, policy summaries or plans, and the location of any related documents or files. The Department has already implemented and addressed many of the recommendations.

The following graphs depict various stages of progress on the accumulated recommendations, many of the changes are completed or underway.



- In Progress – Work is underway to address or implement the recommendation but has not yet been completed.
- Complete – Efforts to accomplish the recommendation have been finalized.
- Addressed/Ongoing – Policy or procedure modifications have been initiated to address the recommendation, and monitoring is ongoing without an expected end or conclusion.
- Pending Action – Efforts to address the recommendation have not yet started.



Attached in the following pages are examples of data entry and tracking forms used in the internal improvements tracking system. Also provided for reference is an abbreviated list of the recommendations.

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. The Department's dedicated employees handle hundreds of requests for information and grants; they process thousands of transactions, manage tens of thousands of real estate tracts and financial properties, oversee millions of mineral acres and administer billions of dollars of financial assets.

We appreciate the opportunity presented by the performance audit to implement improvements in processes, policies and operations.

Attachment 1: Abbreviated Description of Audit Recommendations By Functional Area

Attachment 2: DTL Improvement Tracking Portal

Attachment 3: Sample DTL Improvement Tracking Index

ATTACHMENT 1

Abbreviated Description of Audit Recommendations By Functional Area

DTL ACCOUNTING	
DTL 2-04.a	Direct Cost Allocation
DTL 2-04.b	Non-direct Cost Allocation
DTL DEPARTMENT	
DTL 1-11.a	Highest and Best Use
DTL 1-11.b	Highest and Best Use
DTL 2-01.a	Fiduciary Responsibility
DTL 2-01.b	Expenditure of Public Funds
DTL 2-01.c	Culture of Accountability
DTL 2-05	OMB Fraud Risk Assessment
DTL 2-06.a	Losing Impartiality
DTL 2-06.b	Adverse Effect on integrity
DTL 4-01.a	IT Systems
DTL 4-01.b	IT User Manuals
DTL 4-01.c	Effective Use of IT
DTL 4-02.a	Formal Policies and Procedures
DTL 4-02.b	Standardized Policies and Procedures
DTL 4-02.c	Periodic Review of Policies and Procedures
DTL 4-03.a	Centralized Policies and Procedures
DTL 4-03.b	Periodic Policy Acknowledgement
DTL 4-04	Internal Controls
DTL 4-05.a	Records Retention
DTL 4-05.b	Records Retention
ENERGY IMPACT	
EIIO 1-01.a	Emergency/Contingency Funds Procedures
EIIO 1-01.b	Communicate Emergency/Contingency Procedures
EIIO 1-02.a	Identify complete application in screening
EIIO 1-02.b	Score only complete applications
EIIO 1-02.c	Scoring-Priority points & compound criteria
EIIO 1-02.d	Define scoring point scale
EIIO 1-02.e	Document screening process
EIIO 1-03	Recommendations meet eligibility requirements
EIIO 1-04	Eligible applications given consideration
EIIO 1-05	Projects recommended are achievable
EIIO 1-06	Ensure priority in law followed
EIIO 1-07	Include contingencies in recommendations on estimates vs bids
EIIO 1-08	Ensure awards do not exceed state law maximum
EIIO 1-09.a	Land Board provide authority on minor scope changes
EIIO 1-09.b	Required scope changes approved by Land Board
EIIO 1-10.a	Limit grant payments to projects/items
EIIO 1-10.b	Local match & special conditions met

EIIO 1-10.c	Reimbursement adequately supported
EIIO 1-10.d	Expenditures claimed not reimbursed twice
EIIO 1-11.a	Status updates via status reports or phone
EIIO 1-11.b	Risk-based site visits
EIIO 1-11.c	Document site visits status & intent
EIIO 1-12.a	Other counties eligible for distribution?
EIIO 1-12.b	County provided distribution eligible?
EIIO 1-13	Advisory committees/subcommittees comply open meetings
DTL HR	
DTL 3-01	Ensuring Minimum Qualifications
DTL 3-02.a	Hiring Best Practices
DTL 3-02.b	Hiring Practice Training
DTL 3-03	Veteran's Preference
DTL 3-04	FTE Legislative Intent
DTL 3-05	Salary Administration
DTL 3-06.a	Legislative Salary Increases
DTL 3-06.b	Frequency of Performance Reviews
DTL 3-07	Performance Review Forms
DTL MINERALS	
DTL 1-01.b	Correcting Net Assets
DTL 1-07.a	Data Change Documentation
DTL 1-07.b	Lease Agreement Corrections
DTL 1-09.a	On-line Mineral Auctions
DTL 1-09.b	On-line Mineral Auctions
DTL MINERALS/SURFACE	
DTL 1-01.a	Trust Assignments
DTL PROC/CONTRACT	
DTL 2-02	Procurement Laws
DTL 2-03.a	Written Service Contracts
DTL 2-03.b	Contract Insurance Provisions
DTL 2-03.c	AG Contract Terms
DTL 2-03.d	Legal Review of Contracts
DTL REVENUE COMPLIANCE	
DTL 1-02.a	Decimal Interest/Internal
DTL 1-02.b	Decimal Interest/External
DTL 1-03.a	Trust Allocation/Royalty
DTL 1-04.a	Royalty Electronic Reporting
DTL 1-04.b	Royalty Audits
DTL 1-05.a	Royalty Interest Rate
DTL 1-05.b	Interest Assessment Policy
DTL 1-06	Royalty Penalty
DTL 1-03.b	Correcting Net Assets

DTL SURFACE	
DTL 1-08	Fair Market Value
DTL 1-10.a	Grazing Association Agreement
DTL 1-10.b	Act on Lease Violations
UNCLAIMED PROPERTY	
UP 1-01	Complete and Accurate Search Utilities
UP 1-02.a	Increase efforts to locate owners
UP 1-02.b	Efforts to locate owners is fair
UP 1-03.a	Monitor Reporting Compliance
UP 1-03.b	Audit ND entities
UP 1-04	Holder compliance training
UP 1-05	Negative Reporting
UP 1-06.a	Written Authorization to Report Early
UP 1-06.b	Property not abandoned until requirements met
UP 1-07	Complete, Accurate, and Consistent Data
UP 1-08	Accurate Inventory of Tangible Property
UP 1-09	Timely Inventory of Tangible Property
UP 1-10.a	Entering "Aggregate" Properties
UP 1-10.b	Lower Aggregate Amount
UP 1-11	Safeguard Unclaimed Property
UP 1-12	Safeguard Confidential/Sensitive Information
UP 1-13	Claim Processing Consistency
UP 1-14	Stock Transfer Fees
UP 1-15.a	State Agency Property/Budget Section
UP 1-15.b	State Agency "Donation" Option
UP 1-15.c	Publication of State Agency Property
UP 1-16	Tangible Property Management/Disposition
UP 1-17	Establish Administrative Code
UP 1-18	Records Retention and Disposition
UP 1-19	Effective Program Administration

Attachment 2: DTL Improvement Tracking Portal



Dept. of Trust Lands
Investing For Education

gcfisher

Private Web ~ EIO ~ Office ~ Minerals ~ Surface ~ Unclaimed Property ~ Revenue Compliance ~

Improvement Tracking Create

Recommendation #
DTL 1-01.a Trust Assignments

Short Update Notes

Update Notes

Search Notes

Status
Started

[Back to List](#)

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Attachment 3: Sample DTL Improvement Tracking Index

 Dept. of Trust Lands Investing For Education		gcfisher					
Private Web EIIO Office Minerals Surface Unclaimed Property Revenue Compliance							
Improvement Tracking Index							
Create New							
Search: <input type="text"/>							
Recommendation#	DateModified	UserId	ShortUpdateNotes	UpdateNotes	Status	SearchNotes	
DTL 1-03.a	5/18/2016 3:35:09 PM	tklee	Researching	Adam is reviewing those items noted in this recommendation. Monica will incorporate a review of participation factors as she works through the trust net reviews. This item is expected to be automated in our new system. 5/18/2016	Started	participation factors, trust net, decimal interest.	Edit Details
DTL 1-04.a	5/18/2016 3:32:20 PM	tklee	Electronic Reporting Form	The Department implemented an electronic reporting form Oct 1, 2015. As of 5/18/2016, all but one operator are using the form. The one nonuser is working with their IT department on utilizing the new form.	Started	Electronic Reporting form	Edit Details
DTL 1-04.b	5/18/2016 3:34:53 PM	tklee	Royalty Audits	The Department started to conduct comprehensive oil and gas audits in September 2015. In December of 2015, the Department added another FTE to the revenue compliance division to solely conduct oil and gas audits. The division has 6 oil and gas audits that are currently open. And will be sending audit notices out the to the next three shortly. 5/18/2016	Done	Oil and gas royalty audits	Edit Details
DTL 1-05.a	5/25/2016 12:53:06 PM	tklee	Legal Review	Met with Dave G AAG on 5/24/2016 to discuss drafting of policy items.	Started	legal	Edit Details
DTL 1-05.b	5/25/2016 12:54:37 PM	tklee	Legal Review	Met with Dave G AAG on 5/24/2016 to discuss drafting of policy items.	Started	Legal	Edit Details
EIIO 1-02.b	5/19/2016 11:08:38 AM	gcfisher	Processes controls modified regarding complete applications	On 5/19/2016, EIIO Process Controls were modified providing for notification to applicants of missing information or supporting documentation on their application. A deadline (3 to 5 days following the application deadline) will also be provided for them to submit that missing information and if the missing information is not received their application will not be scored or considered during the grant round.	Done		Edit Details
EIIO 1-02.c	5/9/2016 1:05:44 PM	gcfisher	Priority points documented under Objective criteria	3/15/2016 - Documentation was added to the Grant Guidelines under the Objective criteria providing that any priority point assignments should be provided in this category. G:\EIIO\Forms\form - Grant Guidelines.docx	Done		Edit Details
EIIO 1-02.d	5/18/2016 2:44:11 PM	gcfisher	Objective score values are defined	All objective scores are defined in the guidelines. For subjective scores each scorer is allowed to use their own discretion on any point assignments they provide and the averaging of these across multiple scorers in addition to the objective scores provides for a balanced score process.	Done		Edit Details