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A Follow-Up Audit of the School and Institutional Trust Land Administration (SITLA)

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We recommended that the Legislature revisit the constitutional issue of the distribution policy to make sure that it was still fulfilling education's needs. The Legislature has not taken action on this recommendation. Such a review is appropriate because of the rapidly increasing size of the fund and increasing education needs.

Recommendation to Provide Comprehensive Information Was Implemented. In our 2006 review we found that, although not required, SITLA publishes an annual report. This report contained little financial information, did not discuss the earnings on the permanent fund or the distributions to schools, and was not as extensive as reports from other states. Consequently, we recommended that the Legislature require SITLA to publish a comprehensive annual report. This recommendation was implemented by SITLA.

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Advancements Made In Development Project Tracking. The 2006 audit found that there was no central computer report containing all of the information necessary to properly evaluate a project's performance. Review of the new computer program has demonstrated that the computer module has the ability to track projects and report the vital information necessary for the board and outside interested parties to evaluate project performance.

Standardized Processes for More Board Involvement Are Being Developed. A pro forma process is being developed by the development group that provides uniformity and controls to the development business process. The new pro forma process will set criteria for board involvement based on price and the amount of land in the transaction; as the price or investment increases, the amount and regularity of board involvement increases. Continued board involvement is necessary as SITLA's development group continues to employ a variety of methods in order to obtain revenue from the various development projects.

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SITLA and Government Organizations Are Proper Comparisons. There is a difference of opinion between the Office of the Legislative Auditor General (OLAG) and the SITLA board regarding what type of market comparison should be used in setting SITLA's management compensation. SITLA's board believes that SITLA was legislatively mandated to consider salaries in private enterprise and other public employment when setting salary ranges. Although we agree that the Legislature directed the board to consider salaries for similar positions in private enterprise and other public employment when setting salary ranges, we found that there are no similar positions in the private sector. OLAG believes that other state trust land organizations that do the same work as SITLA are most comparable and, therefore, the most appropriate comparison market.

Consultant's Report Favors Private Sector Comparisons. SITLA's consultant reviewed management positions and compared SITLA's compensation program to public and private sector organizations. The consultant blended averages to create a 50 percent public and 50 percent private average. However, choices made by the consultant favor the private sector and increase the compensation amounts. We disagree with a number of the consultant's methods, such as:

- Including non-profit organizations in the public sector calculation
- Comparing SITLA, with 65 employees, with for-profit companies with up to 1,000 employees
- Averaging results from selected studies rather than averaging incumbents
- Not including businesses that do not pay bonuses when calculating bonus averages

Fiscal Year 2007 Bonus Program Modified. In response to the audit, SITLA's director changed the employee bonus program to make it more merit based, and SITLA's board altered the management bonus program. The board amended the percentages awarded and the goals themselves, and updated the revenue thresholds used to determine bonus levels. However, they have not changed the amounts for the management bonuses, totaling $150,000, and it is unclear how the bonus program will be awarded at the end of fiscal year 2007.

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Chapter I
Introduction

There is a continuing, underlying disagreement with the public/private aspect of the organization.

Many of the recommendations made in the January 2006 audit report titled **A Performance Audit of the School & Institutional Trust Land Administration (SITLA)** (Report 2006-01) have been addressed. The Legislature requested a review of SITLA's actions on the audit recommendations as well as SITLA's future direction. There is, however, a continuing, underlying disagreement with the public/private aspect of the organization that prevents full implementation of some of the 2006 report's recommendations. The request for this follow-up report is in large part recognition of legislative concern with the basic disagreement of public versus private.

A total of 10 recommendations were made in the 2006 report to improve the efficiency and effectiveness of SITLA. This follow-up report summarizes the current status of those recommendations. Overall, many of the audit recommendations have been implemented. The audit recommendations were in three distinct areas:

- Investment policies and distribution issues
- Land development issues
- Executive compensation issues

Three recommendations made to the Legislature to provide direction to SITLA have not been completely implemented by statute. Instead, the Natural Resources Committee provided only a cursory review and deferred to SITLA's board for oversight.

Investment Policies and Distribution Issues

Three entities are involved in the process of earning and distributing the revenues earned from trust lands to the public schools in the state. SITLA earns revenue on trust lands given to the state at statehood. Revenues are primarily earned from oil and natural gas generated from lands, real estate development, and leasing. The second entity is the State Treasurer, who invests the revenues that are earned by SITLA. Finally, the School (Learning And Nurturing Development) LAND Trust

Program, housed within the Utah State Office of Education, distributes the interest and dividends earned by the State Treasurer to the school districts. In order to make the process more efficient and effective, we made the following three recommendations:

We recommend that the Legislature revisit the distribution policy of trust lands to see if it is still meeting the needs of public education—particularly the distribution of renewable resources.	Not implemented
We recommend that the Legislature require SITLA to publish a comprehensive annual report.	Implemented
We recommend that the Legislature consider changing the Money Management Act to allow the Treasurer more flexibility in investing the permanent trust funds.	Implemented

Two of the three recommendations made to the Legislature have been implemented, one has not. The Legislature may wish to revisit the distribution policy of trust lands in the future as the fund continues to grow.

Land Development Issues

SITLA develops and sells trust lands throughout the state, particularly in Southern Utah.

As a source of revenue for the trust, SITLA develops and sells trust lands throughout the state, particularly in Southern Utah. In order to create revenue, SITLA participates in auctioned land sales, joint ventures, and self-development projects. We believed that SITLA's process could be more efficient and was lacking the controls necessary to maintain a higher level of accountability. To address this concern, we made five recommendations to SITLA.

We recommend that SITLA establish a uniform method of selling land requiring appraisals and market competition for all properties.	In process
We recommend that the Legislature consider providing direction to SITLA regarding land sales and development including the level of risk appropriate for SITLA's development opportunities.	Not implemented
We recommend that if the Legislature elects to allow development past basic planning and infrastructure, the Legislature consider funding staff with sufficient experience in real estate planning.	Implemented
We recommend that the Development Group use the system in place to track their work on a project-by-project basis to adequately establish true cost calculations and net revenues of projects and that SITLA use this information to adjust the overhead allocation accordingly.	In process
We recommend that the Legislature consider allocating funds for the purpose of hiring additional audit staff for the monitoring of development projects.	Implemented

Two of the five recommendations have been implemented, two are in process, and one has not yet been addressed. The Legislature has not provided direction, through either legislation or policy, regarding SITLA's selling of land.

Management Compensation Issues

Some SITLA bonuses exceed the amount allowed under DHRM rules.

Some SITLA bonuses exceed the amount allowed under DHRM rules. SITLA is, however, exempt from the DHRM rules regarding bonus amounts and therefore needs its own policies for both salaries and bonuses. A primary step in developing policies is identification of comparable organizations. We surveyed other state trust land organizations, state agencies, and quasi state agencies for salary and bonus comparisons. We were unable to identify comparable organizations in the private sector. After analyzing the data, we made two recommendations.

We recommend that if bonuses continue, they be based on appropriate and measurable goals.	In process
We recommend that the Legislature provide SITLA with guidelines for salaries and bonuses.	Not implemented

One of the recommendations is in process and the other has not been implemented, as the Legislature has not provided direction regarding salaries and bonuses. The call for review and a follow-up audit demonstrates some legislative concern and direction regarding SITLA's compensation.

Audit Scope and Objectives

Subsequent to the original report, the Natural Resources Subcommittee asked the Legislative Auditor General to conduct a follow-up audit and verify whether SITLA's Board of Trustees had developed appropriate controls to govern SITLA's development group and report on the implementation of the audit recommendations.

The following areas are addressed within the chapters of this report:

1. Distribution policies
2. Development group recommendations
3. Compensation issues

Chapter II
Distribution and Investment Policies Should Be Reviewed Periodically

SITLA continues to earn record revenues in the year since the original audit. Over the past year, many of the 10 audit recommendations to improve SITLA's efficiency and effectiveness have been implemented. The success of the implementation is due to willing and able staff.

The distribution policy is a balancing act between distributing to current beneficiaries and growing the trust fund for future generations.

The original audit recommended that the Legislature revisit the distribution policy of the funds generated from trust lands. Although the Legislature has not taken action on this recommendation, we believe that as revenues grow, the appropriateness of revisiting the distribution policy will also increase. The distribution policy is a balancing act between distributing to current beneficiaries and growing the trust fund for future generations. The recommendation was made because other states distribute revenues from renewable resources annually, and distributing revenue received from renewables could provide additional funding for education. As the fund increases, so do the distributions and the responsibilities of the School LAND Trust Program; therefore, we recommend a review of the School LAND Trust Program should also be done periodically.

The original audit also recommended that SITLA provide consolidated annual financial reports, financial information regarding investment returns, and the distribution of revenues to schools. This recommendation was made so that a complete picture of revenues earned, investment returns, and revenues distributed to education were provided to the public. This recommendation was implemented by SITLA.

Another recommendation made in the original audit was that the Legislature change the Money Management Act to allow the State Treasurer more flexibility in investing the permanent fund. This recommendation was implemented.

Distribution Policy Recommendation Has Not Been Implemented

During the 2006 audit, we found that the trust land revenues distribution policy differed from that of most other states in that all net revenue was deposited into the permanent trust fund. Other states were distributing revenues from renewable resources (sales interest, grazing, site leasing, telecommunications, and development leases) annually. From fiscal years 1995 to 2005, SITLA earned $47.3 million from renewable resources, and in compliance with the current statute, deposited the funds into the permanent school fund. If SITLA's operation mirrored that of other states, the permanent fund would be less, but public education would have received an additional $47.3 million the last 11 years. Annual revenues from renewable resources in recent years have been in the $6 to $7 million range.

We recommended that the Legislature revisit SITLA's distribution policy. We understand that the proper balance between distributing to current beneficiaries and growing the trust fund for future generations of school children through investing is a policy decision. We believe the distribution policy should be periodically reviewed.

We believe the mission of the School LAND Trust Program should be revisited periodically.

The Legislature has not taken action on the recommendation. Such a review would be appropriate because of the rapidly increasing size of the fund and increasing education needs. We believe that given the increase in funding and the responsibility of the School LAND Trust Program, the School LAND Trust Program's mission should also be revisited periodically to ensure it continues to effectively fulfill its legislative charge.

Policy Has Not Been Reviewed Since 1993

When SITLA was created, the ***Utah Constitution*** was changed to require all net revenue earned by SITLA go into the permanent school fund and not be distributed to the Uniform School Fund. This changed the distribution to the current system and is a factor in the growth of the fund.

The policy of retaining renewable resource income in the fund, rather than distributing it annually, was established by constitutional amendment as a response to past diversions of funds that depleted Utah's permanent fund to almost zero. This change has contributed to the permanent fund's growth to over $870 million.

Periodic Review of Distribution Policy Is Important

The proportion of funds generated from state school trust lands and distributed to public education annually is a policy decision for the Utah Legislature because the Legislature is ultimately responsible for funding public education. There can be legitimate debate as to the proper balance between distributing to current beneficiaries and growing the fund for future generations of schoolchildren. Since the Utah Legislature has the responsibility to fund public education, and since funds generated from state school trust lands are part of funding for public education, this issue is appropriate for both the Legislature and the voters to decide.

Distributing the revenue from renewable resources, rather than retaining it in the fund, would provide more money for education.

Distributing the revenue from renewable resources, rather than retaining it in the fund, would provide more money for education. However, the school beneficiaries believe that the new distribution system is consistent with Utah's Enabling Act and the ***Utah Constitution***. The education beneficiaries were instrumental in getting the ***Utah Constitution*** changed to deposit all operating revenue into the permanent fund, thereby growing the fund and paying out only the interest and dividends to the schools.

School LAND Trust Program Administers Distribution

The School LAND Trust Program distributes the interest and dividends earned to the districts who in turn distribute the funds to individual schools. Staff from the School LAND Trust Program then visit 10 percent of the schools annually to verify that the money was spent according to the School Land Trust Plan on academic programs to improve student performance.

Thus far, the status quo has been maintained, whereby only the interest and dividends are distributed by the School LAND Trust Program. The education beneficiaries, who also run the School LAND Trust Program, feel that they are bound by the ***Utah Constitution*** to not distribute more money and that the renewable resource revenue be deposited into the permanent trust fund for the purposes of growing the fund.

We believe that as the amount of money at the disposal of the School LAND Trust Program increases, oversight of the program should also increase.

We believe that as the amount of money at the disposal of the School LAND Trust Program increases, oversight of the program should also increase. The Legislature should review the mission of the School LAND Trust Program to determine if the program is still meeting the needs of the Legislature and if 2 percent of the weighted pupil unit (WPU) is an appropriate cap for funds distributed to community councils through the School LAND Trust Program.

Recommendation to Provide Comprehensive Information Was Implemented

In our 2006 review we found that, although not required, SITLA published an annual report. This report contained little financial information, did not discuss the earnings on the permanent fund or the distributions to schools, and was not as extensive as reports from other states. Consequently, we made a recommendation to the Legislature to require SITLA to publish a comprehensive annual report. The recommendation has been implemented. However, we suggest that the School LAND Trust Program provide aggregate historical information showing the total funds available each year and the distributions to schools.

The purpose of this recommendation was to give the public a complete understanding of the process of what was earned from managing trust lands and how much was distributed to schools. The three players in the process are SITLA, that earns revenue by managing trust lands; the State Treasurer, that earns revenue by investing the permanent fund; and the School LAND Trust Program, an organization that distributes the earnings to districts.

School LAND Trust Program Reporting Can Be Improved

Distributions to individual schools are reported on the School LAND Trust Program's website, and there is a link to this information on SITLA's website. The School LAND Trust Program's website provides data on the distributions to individual schools. However, there is no aggregate data for the total annual distributions from the School LAND Trust Program. Aggregate historical information showing the total funds available to distribute and the distributions to all schools would make the

School LAND Trust Program's website even more informative and complete the distribution cycle of information.

Investment Recommendation Has Been Implemented

The 2006 audit found that investing SITLA's permanent funds using passive investment practices and following Utah's Money Management Act (MMA) might have been too restrictive for the State Treasurer to maximize the permanent fund's earnings. While the MMA had been modified in prior years, further changes in the MMA might provide higher returns to the beneficiaries within acceptable levels of risk.

The ***Utah Constitution*** and state statute provides that the State Treasurer is the custodian of all permanent and public funds, including the permanent fund of SITLA, and is also given the authority for setting investment policy for the permanent fund. At the time of the 2006 audit, oversight was provided, at least quarterly, by the State Money Management Council. In addition, an investment advisory committee met at least quarterly to give suggestions, advice, and opinions to the State Treasurer in regard to how the fund was invested within the parameters of the Money Management Act.

The Legislature implemented a recommendation giving the State Treasurer more flexibility in investing for the trust.

Our previous audit recommended that the Legislature consider changing the Money Management Act to allow the State Treasurer more flexibility in investing the permanent trust funds. The Legislature implemented this recommendation and it has given the State Treasurer more flexibility in investing the trust funds.

Legislation Passed Provides More Flexibility

During the 2006 General Session, the Legislature passed House Bill 78, which exempted trust land funds from the specific investment limitations of the Money Management Act and directed the State Treasurer to invest trust fund monies using the "prudent investor" rule and other standards established by the bill. It also changed the composition of the investment advisory committee. The bill provided more flexibility for the treasurer to use when investing the permanent trust fund.

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Chapter III
Development Group Is Implementing Recommendations

SITLA's development group earned $36.1 million in revenue for FY 2006.

SITLA's development group continues to increase its annual revenues from a variety of sources. SITLA has instituted process changes within the development group and increased transparency and the timeliness of information. These process changes have not harmed the development group's earning potential as it generated $36.1 million in fiscal year 2006. Through March of 2007, the SITLA development group continues to do well, as it has already generated $29 million in revenue.

The development group has implemented audit recommendations concerning additional staff and better tracking of development projects as well as standardizing processes.

Improvements Made by Development Group

In the 2006 audit, recommendations were made for additional staff and for SITLA to better track costs associated with development projects. It was also recommended that SITLA standardize the sale process ensuring that the market is utilized in obtaining the best price possible for land. Recommendations were also made to the Legislature to provide some direction on the amount of risk appropriate for SITLA's development endeavors.

Legislature Funded Additional Development Staff

Beginning in Fiscal Year 2006, the Legislature appropriated funding for three additional staff.

The 2006 audit recommended that if SITLA continues to work in land development, they hire additional staff with the necessary expertise to carry out the various projects successfully. In 2006, the Legislature provided one-time funding for a construction manager with ongoing funding beginning in fiscal year 2007. The position was filled in May 2006 and is located in St. George where the majority of construction for SITLA projects is currently occurring.

The Legislature also provided for ongoing funding for a land planner in fiscal year 2007. That position has yet to be filled. Additionally, the 2006 audit recommended an auditor position for the development group. The Legislature has allowed funding in fiscal year 2008 for an auditor position. That position, however, will focus on minerals and oil and gas royalties, not development projects, since the majority of revenue comes from oil and gas. According to SITLA's director, future auditing emphasis will vary as SITLA's needs change.

Advancements Made in Development Project Tracking

A new development tracking system is currently being built to track many aspects of development projects.

Funding was allocated from the Legislature in fiscal year 2006 for the development group's computer system upgrade. The new upgrade is currently being built to integrate revenues with the costs found in the state's financial system (FINET). These data are then used to evaluate a project's merits. This new module houses development project information, including:

- The scanned appraisal or board memo that is used to value the property
- Initial projected costs and revenues matching them with actual costs and revenues
- The Net Present Value (NPV) of the properties
- The projected Internal Rate of Return (IRR), including the discount rate used to calculate these numbers
- The difference between initial timelines and the current completion estimation
- A summary and comments section that can be used to explain better-than-expected or poor project performance

The 2006 audit found that there was no central report that housed all the information necessary to properly evaluate a project's performance. Review of the computer program has demonstrated that the new computer module has the ability to track projects and report the vital information necessary for the board and outside interested parties to evaluate project performance.

SITLA's Future Project Tracking Needs

The development project module is a work in progress. It still lacks the ability to account for the direct costs of employee time spent on the project. However, the development group has already developed a way in which, through FINET, they account for their time on a project basis. This system has been online since October 2006. The next element of the development module, which should come online shortly, will import information from the State Finance System (FINET) to produce direct cost calculations on the project summaries.

The development computer program will also soon have the ability to calculate the IRR and NPVs in a standardized manner. In past projects, the agency admits that each employee calculated those returns differently. Therefore, due to a lack of documentation and a standardized process, there was no way that we could duplicate their initial calculations for verification purposes.

As it currently stands, the data are entered into the computer system and are stagnate until a manual update of the information. It would appear that as long as these updates are entered in a timely manner, this program, once completed, will have all the necessary and requested elements to properly evaluate the success of the development projects.

Development Group Standardizing Processes

A pro forma process is being developed by the development group that provides uniformity and controls to the development business process. The pro forma process will set criteria for board involvement based on price and the amount of land in the transaction. As the price or investment increases, the amount and regularity of board involvement increases. Continued board involvement is necessary as SITLA's development group continues to employ a variety of methods to obtain revenue from the various development projects. In fact, the board has asked other groups within SITLA, such as oil and gas, to look for other ways that they can be involved in revenue creation.

Auctioning property is one way to ensure market competition takes place, thus achieving the best possible price. Currently, the greatest part of development revenue comes from long-term projects originated in prior years, which are providing longer revenue streams. In the past year, SITLA has auctioned one property and sold other portions of development properties as part of larger development transactions.

The 2006 audit concluded that sometimes the board did not have timely information to make needed decisions on projects. The new pro forma process sets criteria for board involvement based on the price and the amount of land. The variety of transactions requires close board supervision. The increased standardization and additional board oversight over transactions is essential in managing SITLA's land transactions. The new process provides a mechanism for accurate and timely information to the board, an element that the audit found was lacking previously. The board will now receive the information in order to make the best decisions possible on how to proceed on development projects.

Chapter IV
Management Compensation Continues to Be an Issue

The 2006 audit found that SITLA's management compensation program allowed higher salary and bonus compensation than other states' trust land offices or similarly sized counterparts in Utah state government. The audit addressed SITLA's compensation program by questioning both the high salaries and bonuses it allowed and the use of revenue goals for bonuses. We recommended that SITLA's board review the bonus program to ensure that bonuses were based on appropriate and measurable goals and that the Legislature provide the board with guidelines for future salaries and bonuses.

The SITLA board believes that the consultant's report justifies SITLA's existing total compensation.

In response to the audit recommendations, and in response to the private-versus-public debate surrounding SITLA, the SITLA board engaged a consultant to conduct a compensation study that included private sector comparisons because of the lack of private enterprise comparisons in the 2006 audit. The consultant's December 2006 review compared SITLA to public, non-profit, and private sector organizations. The consultant concluded that the current base salaries for the top two positions at SITLA were both significantly less than the competitive market rate, while one position was significantly above the market competitive rate. The remaining positions were slightly above the market average. Interestingly, the consultant concluded that with the exception of one position, all bonus amounts were significantly above (more than 15 percent) the market competitive rate.

The board believes that the consultant's report validates SITLA's existing total compensation to more closely reflect that in the private sector. The board will use the survey for informational purposes but plans to rely upon their own business knowledge in establishing compensation levels.

The Legislature delayed action on the audit recommendation to allow SITLA to address the recommendations internally. Now that the board has conducted their review, the underlying disagreement regarding whether SITLA's management should be compensated as public sector or private sector employees is even more pronounced. We believe that because of the public nature of SITLA's assets and their negligible level of risk, they should be considered a public entity. This disagreement may only be resolved by legislative clarification of some ***Utah Code*** terminology.

SITLA and Government Organizations Are Proper Comparisons

There is a difference of opinion between the Utah Legislative Auditor General's Office (OLAG) and the SITLA board regarding what type of market comparison should be used in setting SITLA's management compensation. SITLA's board believes that SITLA was legislatively mandated to consider salaries in private enterprise and other public employment when setting salary ranges and believes their compensation program should be compared to private sector organizations that earn $100 million per year.

Although we agree that ***Utah Code*** 53C-1-201(3)(d)(iv) directs the board to consider salaries for similar positions in private enterprise and other public employment when setting salary ranges, we found that there are no similar positions in private enterprise. OLAG believes that other state trust land organizations in other states that do the same work as SITLA are most comparable and, therefore, the most appropriate comparison market. While SITLA's governance has been removed somewhat from governmental controls, the state is still ultimately responsible for SITLA and answerable for its actions.

Public Land Agencies Appear to Be Most Comparable to SITLA

We believe that SITLA positions do not match up well with those in the private sector.

The 2006 audit did not compare SITLA's management positions with those in the private sector because SITLA positions do not match up well with those in the private sector. SITLA is not a private sector organization operating with private assets that is answerable to shareholders. SITLA does not bear the operating and financial risks associated in the private sector market. We could not identify any private sector organizations with similar market risk protection. To us, SITLA more closely resembles a state agency with operations and assets that are part of a pubic trust answerable to public officers.

SITLA's assets are public trust assets that have no taxation or holding costs and were given to the state at statehood. Only other state trusts operate under similar circumstances. Additionally, SITLA's director and some of its employees are former state employees who joined the organization when it was a state agency. Other SITLA employees left private industry to join SITLA because they liked the pace, environment, stability, benefits, or type of work done by the state.

Board Is Involved in Setting Management Compensation

SITLA does not believe the state's pay philosophy can attract the talent needed to increase SITLA's overall performance.

Board members use their experience and knowledge of private industry compensation programs to guide their pay base. The board's performance-based pay philosophy is to pay salaries and bonuses they believe will attract and retain qualified staff in competition with the private sector. They do not believe that the State's service-based pay philosophy that conserves public monies can attract the talent they believe will increase SITLA's overall performance.

The SITLA board believes that compensation is an important part of retaining productive individuals. The board has discussed alternative means to attract and retain employees, such as long-term or deferred bonus plans. In our analysis, SITLA's turnover rate was about half the state average in 2006, even though it was very close to the state average in 2005. In 2007, two development group employees, based in St. George, have been hired away from SITLA by private developers. SITLA as a whole shows no increased turnover compared to their peers in state government, whom we believe provide their best comparison.

The board is more concerned with total compensation than with the individual components of compensation (salary and bonus). The board believes that combining the consultant's reported low salaries and high bonuses shows that SITLA's existing management total compensation is comparable to market averages.

Consultant's Report Favors Private Business Comparisons

The board's consultant reviewed management positions and compared SITLA's compensation program to public and private sector organizations. The consultant used a simple average method to calculate the public sector surveys and the private sector surveys, then blended the simple averages to create a 50 percent public and 50 percent private average. Concerns with the methodology used by the consultant hired by SITLA's board lead us to consult with the Department of Human Resource Management (DHRM), a Human Resources professor from Brigham Young University, and a Management professor from the University of Utah for a more thorough review of the consultant's methodology and conclusions. Letters from OLAG's consultants are found in the appendix beginning on page 31. As a point of clarification, DHRM does not have jurisdiction over SITLA's compensation practices, it was used because its staff has considerable expertise in compensation survey methodologies.

The consultant's results are heavily skewed toward the limited number of private sector organizations whose positions matched SITLA positions.

We and our consultants find the way the consultant averaged salaries and bonuses to be questionable. The consultant averaged national surveys and disregarded the number of incumbents in the surveys. This simple average method does not represent the number of incumbent matches found in other organizations, it weighs each survey the same regardless of the number of incumbent matches. We believe an incumbent-weighted average more appropriately reflects the number of positions that matched SITLA positions. By using a simple average, the consultant heavily skewed the results toward the limited number of private sector organizations whose jobs matched SITLA positions. We also question a number of other decisions made in developing the consultant's findings that heavily sway the findings toward private sector salaries. These decisions include:

- Including non-profit organizations in the public sector calculation
- Comparing SITLA, with 65 employees, with for-profit companies with up to 1,000 employees
- Averaging results from selected studies rather than averaging incumbents
- Identifying bonus averages only for those businesses paying bonuses and not including non-bonus paying organizations

Government and non-profit information was averaged into a single public organization value.

Expanding Public Sector with Inclusion Of Non-Profits Is Questionable

In performing his work on the public sector side, the consultant conducted a survey of trust land organizations in other states, similar to the study done by OLAG. However, he received limited response to his survey. This initial work was augmented by including national compensation survey information of non-profit organizations. Together, government and non-profit results were averaged into a single public calculation that was higher than that of a government-only value.

This grouping affects the outcome of the consultant's work because it changes the values used for both the private and public sectors. Separating for-profit and non-profits on the private side increases the private side value. Adding non-profit on the public side also increases values. The end effect is a 50/50 averaging of two higher values and a higher stated market value. Figure 1 demonstrates the effect of moving non-profits to the public side.

The consultant included non-profit organizations in calculating the average market rate for public organizations.

Figure 1. Comparison of OLAG Survey Results to Consultant's Results of Government and Non-Profit Organizations. OLAG's survey results are similar to the consultant's survey results. However, differences exist between OLAG results and the consultant's reported public average because the consultant included non-profit organizations in the calculation.

Title	OLAG's Survey of Market*	Consultant's Survey of Government Market	Consultant's Results Including Surveys of Non-Profit Organizations	Difference Between OLAG's Results and Consultant's Results Including Non-Profit Organizations
Director	$109,071	$115,959	$152,142	39%
Chief Legal Counsel	97,896	n/a	107,341	10
Assistant Director	79,186	77,050**	82,889**	5
Public Relations Mgr.	66,011	n/a	79,893	21
Admin. Asst.	48,681	44,660	45,379	-7

** OLAG results trended forward to January 2007 using an annual 5% increase from the 2004 data reported in the audit.*
*** Average of all assistant directors*

OLAG's survey results were similar to the consultant's survey results of governmental organizations. However, the consultant included non-profit organizations in calculating the average market rate for public organizations, making the difference with OLAG's survey much larger.

Columns two and three of Figure 1 show that the consultant's survey results are very similar to the survey results reported in the audit report. The consultant's survey received responses from seven trust land and other governmental organizations. OLAG's survey received responses from 12 trust land organizations and other Utah governmental organizations. Two of the states used by OLAG were used by the consultant; another two organizations used by OLAG did not participate in the consultant's survey. The consultant's survey has a slightly higher average salary than OLAG's survey for the director position because, in part, it includes salaries from Utah Retirement Systems, which has five times more employees and a trust fund 20 times larger than what SITLA has.

The consultant included national compensation survey results of non-profit organizations to calculate the average market compensation in column four. The difference between OLAG's survey results and the consultant's survey results are shown in the final column. Figure 2 shows that adding non-profit organizations into the average substantially raises the average compensation for what the consultant defines as public organizations.

Consultant Used Large For-Profit Companies with up to 1000 Employees

We believe a more accurate comparison would have been to compare SITLA to agencies with fewer than 100 employees.

The consultant comparison used some national market surveys that reported the compensation results of private sector organizations with up to 1,000 employees. We and the state's DHRM believe a more accurate comparison, given SITLA's 65 employees, would have been to only include agencies with fewer than 100 employees. However, according to the consultant, national surveys do not report information below a certain threshold.

By using this data, the consultant compares SITLA with some substantially larger private sector organizations. Figure 2 illustrates the consultant's reported public and private sector total compensation for selected positions and then averages the two together to create a market average.

Figure 2. Consultant's Reported Market Average Total Compensation Compared to Current Compensation of Select SITLA Positions. A comparison of current SITLA total compensation to the public/private market average calculated by the consultant shows that two positions are paid lower than market, and others are higher than the market average (50th percentile).

Title	Public Average	Private Average	Average 50% Public/ 50% Private*	SITLA's Total Current Compensation	Difference Between SITLA's Total Compensation and Market Average Reported by Consultant
Director	$152,142	$232,565	$189,785	$155,000	-22.4%
Chief Legal Counsel	107,341	177,037	144,639	129,921	-11.3
Asst. Dir. Oil & Gas	81,186	129,906	109,004	120,030	9.2
Asst. Dir. Surface	83,132	127,436	105,284	117,996	10.8
Asst. Dir. Planning/Dev.	82,411	141,276	111,960	129,521	13.6
Public Relations Mgr.	79,893	73,864	77,654	80,234	3.2
Admin. Assistant	45,379	92,363	70,041	82,314	14.9

** The average is not exactly 50% public and 50% private because of the way the consultant handled the bonuses in the calculations.*

The consultant used a simple average of public and private sector compensation surveys to calculate a market median average. Figure 2 shows that there is a sizeable difference between the reported public sector total compensation averages and private sector total compensation averages. To arrive at the averages, the consultant used information from surveys of both non-profit and for-profit organizations with up to 1,000 employees, as well as surveys of all U.S. firms.

Figure 2 shows the method the consultant used to arrive at a market average total compensation (salary and bonus) for SITLA's management. It also shows the amounts currently earned by management and whether the compensation level is above or below market. The consultant concluded that the compensation of the top two managers was significantly less than the market average, the administrative assistant's compensation was significantly above the market, the compensation of the public relations manager was market competitive, and the compensation of the assistant directors was slightly above the market. The consultant notes that base compensation is considered market competitive when it is within +/-5% of the average pay practices of the market; differences in excess of +/-15% should be considered significant.

Averaging of Unequally Sized Surveys Is Questionable

The consultant relied heavily on published national surveys of non-profit and for-profit organizations to create comparable averages.

A major difference between OLAG's and the consultant's results can be explained by the different comparison methodologies used. While the methodology and results were similar in the survey of comparable government jobs, the consultant's private sector methodology was substantially different. The consultant was only able to get compensation information from a few private businesses, and therefore relied heavily on published national surveys of for-profit organizations to create comparable market averages.

The consultant relied heavily on simple averaging of published national surveys to present a market average for both salary and bonus for a number of SITLA positions. The way in which the data are averaged leads to misleading results. For our review, we could not validate the raw data used by the consultant; however, inferences can by made as to its questionable use from large variances in incumbents, salaries and bonuses from one survey to another. The variances indicate a possible problem with proper matching of candidates between surveys and indicate possible missing data. Figure 3 shows how the consultant averaged national surveys to calculate an average salary and bonus for the director's position.

Figure 3. Consultant's Results of Director's Base Salary, Bonus and Total Compensation. The Consultant averaged three national non-profit surveys and three national private sector surveys to calculate a market average salary and bonus for the director's position.

Survey	Number of Incumbents	Survey Position	Scope Information	50th Percentile Base Salary	50th Percentile Bonus	Total Compensation
Consultant's Survey **	5		Government	$115,959	**	**
A	5,442	CEO/ Executive Director	Non-profit budget $5 - $10M	119,351	0	$119,351
B	13	Top Program Executive	Non-profit all orgs	148,976	$ 6,500	155,476
C	10	Executive Director	Non-profit (100-200 Employees) U.S.	141,200	40,400	181,600
Public Average	**5,470**			**$131,371**	**$15,633**	**$152,142**
B	19	Chief Administrative Officer	For-profit < 1000 employees	184,475	153,000	337,475
C	72	Chief Operating Officer	For-profit (100-200 employees) U.S.	165,566	26,500	192,066
D	345	Chief Operating Officer	For-profit, all firms	136,753	31,400	168,153
Private Average	**436**			**$162,265**	**$70,300**	**$232,565**
50%Private/ 50%Public Average				**$146,818**	**$42,967**	**$189,785****

*** Consultant's custom survey results were only included in the base salary average; they were not included in the bonus or total compensation average calculations. This creates mathematical errors in the reported averages.*

Figure 3 shows the results of the consultant's work using simple averaging to calculate market averages for the director's position using various surveys. The consultant calculated a simple average of results from three surveys of non-profit organizations and took a simple average of results from three surveys of for-profit organizations. He then did a simple average of those two results. The results are reported by the consultant as the market median for this position.

The concern is that using simple averages skews the final results to be higher than the prevailing practice in the market. Using simple averages does not take into account the number of incumbents in each survey that matched SITLA's position and, therefore, may not reflect the prevailing practice in the market for this position. Since the goal of this exercise was to aid in setting salaries and bonuses for SITLA incumbents by identifying market averages, the survey's information should be interpreted on the number of incumbents not the number of surveys.

Although the consultant reports that the average public salary is $131,371, the weighted average of all the surveyed positions yields a weighted average salary of $119,458.

Since there is such a large difference in the number of incumbents in each survey matching the position at SITLA, using simple averages skews the results. For example, in order to reach the public average, the consultant averaged three separate national surveys with position matches of 5442, 13, and 10 respectively. Each of these national surveys was given a one-third weighting in the creation of the final average. So, even though one data source had 500 times more matching positions, it was given the same weight as surveys with fewer matches. Although the consultant reports that the public market average is $131,371, the weighted average of all the surveyed positions yields a weighted average salary of $119,458. DHRM and our two consultants found the board consultant's use of simple averages questionable. According to DHRM, a weighted average using the number of incumbents would show the prevailing practice—what is common in the market.

The same problem with skewed results occurs when the private average is calculated because the consultant calculated a simple average. If the weighted average had been used based on the number of incumbents that matched the director's position, the market median salary would be $143,591, not $162,265 as reported by the consultant. We did not validate the data presented by the consultant. We simply used the data as presented by the consultant. However, the use of this data are questionable since the variances are so great—bonuses range from 0 to $40,400 for the public sector surveys and bonuses range from $26,500 to $153,000 for the private sector surveys and total compensation ranges from $115,959 to $337,475.

DHRM questioned the 50/50 split between public and private, and thought that the averaging should be done based on the number of matched positions (incumbents). If the average was done based on the number of incumbents, the average market salary would be $121,240, not $146,618 as reported by the consultant.

A minor issue is that the consultant's custom survey results were not used in the total compensation calculations. The public average only represents an average of non-profit organizations. It does not include government organizations, which we believe are the most comparable. If the consultant had included his own custom survey, the public average would have been $143,097, not $152,142, and the public/private average would have been $187,831, not $189,785.

Stated Bonus Averages May Be Misleading

Only 23 out of 5,470 position matches received bonuses.

The consultant's stated market bonus averages do not represent the entire market. The bonus averages were created through a process that first, significantly minimizes the effect on the average of any company that did not pay a bonus, and second, minimizes the effect of a bonus-paying business if their incumbent did not receive a bonus. The result for the director's position in the public average was that only 23 out of the possible 5,470 position matches were included in the calculation of average bonus. Equal weighting of all surveyed non-profit organizations yields an average incumbent bonus of $89.31 not $15,633 as reported by the consultant.

The average bonus data in the public section of Figure 3 shows that the majority of the matched positions did not receive a bonus. However, the bonus amount is simply averaged as if all received bonuses. More specifically, in the public section of Figure 3, 5,442 incumbents did not receive a bonus, and only 10 incumbents received an average bonus of $40,400. However, the overall reported public average shows a $15,633 bonus. We believe that the businesses that did not pay bonuses are also an important part of determining the bonus environment for this position. When the majority of incumbents did not receive a bonus, this reported average bonus is artificially high and may be misleading.

Another possibly misleading factor is that the consultant reports the data as if all the companies pay bonuses. When we reviewed one of the surveys, we found that only some of the reporting companies offered bonuses. Specifically, a review of Survey B in the public average showed that only 30.8 percent of the organizations paid bonuses. Of those paying bonuses, the average paid was $6,500. The way the information is presented artificially inflates the averages.

Only 19 of 436 position matches reported large bonuses which artificially increases the average bonus for the private sector section.

The average bonus calculation in the private section of Figure 3 may also be misleading. The comparatively high bonuses paid to 19 incumbents reported in Survey B affect the entire average. Survey B in the private average column shows that the average bonus paid to chief administrative officers of for-profit companies with 1,000 and fewer employees was $153,000. Since the consultant used a simple average of all the surveys and did not do a weighted average, the bonuses averaged $70,300. If a weighted average had been used, the average bonus for the private group would have been $35,890, not $70,300 as reported by the consultant.

We believe that inclusion of all companies not paying bonuses gives a clearer picture of the bonus environment.

We believe that inclusion of all companies not paying bonuses gives a clearer picture of the bonus environment. Since these companies were absent from the calculation, we believe that the reported market average bonus amounts are artificially high. The consultant concludes that the director's current $40,000 bonus appears to be at market level, and his current salary appears below market. However, we believe that if the averages of the bonuses paid by the comparable organizations were calculated differently, the director's bonus would appear higher than market.

Compensation in Government, Non-Profit, and Private Industry Are Very Different

Private industry, non-profit, and government compensate employees very differently. The consultant's choice to combine non-profit and government into a public average favors private business and higher compensation levels. This is indicative of the public-versus-private debate surrounding SITLA. The SITLA board, which is made of businessmen, would like SITLA compensation to be similar to that of private industry. OLAG believes that other states' trust land organizations and other government agencies are most comparable and, therefore, a public-focused market is the appropriate comparison. We believe SITLA compensation should favor governmental standards, as SITLA's existence is tied to the state of Utah's resources.

In response to the audit, the board and SITLA's director made changes to the 2007 bonus program as we will describe in the next section.

In response to the audit, SITLA's board altered the fiscal year 2007 management bonus program.

Fiscal Year 2007 Bonus Program Modified

In response to the audit, SITLA's director changed the employee bonus program to make it more merit based, and the board altered the management bonus program. The board amended the percentages awarded and the goals themselves, and updated the revenue thresholds used to determine bonus levels. However, they have not changed the amounts, totaling $150,000, and it is unclear how the bonus program will be awarded at the end of fiscal year 2007.

During our 2006 audit, we found that 50 percent of the bonus amount was awarded upon reaching a revenue goal; the other 50 percent was awarded based on non-monetary performance objectives. For the fiscal year 2007 bonus, the board decreased the amount associated with reaching the revenue goal to 35 percent and attempted to adjust revenue goals based on a sliding table of average natural gas prices. Another 35 percent of the bonus program was based on reaching non-monetary performance objectives. The final 30 percent of the bonus program was based on specific monetary or percentage increase amounts.

Bonus Reliance on Revenue Has Been Reduced

The bonus methodology currently takes into account the average natural gas price in a given year when rewarding bonuses based on revenue.

The 2006 audit found that SITLA's revenue growth was due to market factors that created high oil and natural gas prices and rapidly appreciating land values. SITLA's bonus methodology was focused on revenue; thus, bonuses were paid based on revenue gains that were beyond SITLA's control. In response to the audit recommendations, SITLA's board has modified the bonus program. It currently takes into account the average natural gas price in a given year when rewarding bonuses based on revenue. As the average natural gas price increases, the revenue goal also increases. The updated revenue portion makes up 35 percent of the total management bonus.

Bonus Now Emphasizes Other Elements

The SITLA board has addressed the audit's criticism of basing a large portion of the bonus on revenue by adding a short-term production component to bonus calculations. In fiscal year 2007, there are three production components. The first focuses on the development group committing(spending) $5 million of capital in recurring revenue projects, such as leases and joint ventures. A concern in the previous audit was that all revenue from land sales was counted as development group gains so the revenue goal was being reached based on "money coming in the door" through land appreciation. Second, in a further effort to mitigate market-driven land appreciation and the fact that SITLA has no holding costs for the land, the surface group is asked to sell property at an average of 35 percent above appraised value to reach their production goal. The last production goal is for the minerals group to increase coal revenue by 90 percent to $9 million. The production component makes up 35 percent of the total management bonus.

The remaining 30 percent of the management bonus is focused on long-term goals for SITLA's managers to accomplish in the current fiscal year that will help to generate revenues in future years. SITLA's long-term goals in fiscal year 2007 are programmatic reviews of the segments within the different groups and exploratory studies in alternate forms of revenue creation within SITLA. The production of a new public relations video and work on specific land transactions are also included in the long-term goals.

SITLA's director has addressed the audit recommendation by adding another component besides revenue to the employee bonus program for fiscal year 2007. Prior to the audit, each employee was awarded $2,000 if the organization reached its revenue goal. In the new bonus program, the employee is eligible for a bonus up to $1,800 if the organization reaches the revenue goal and the employee receives an acceptable performance evaluation. If the employee receives a superior evaluation and the organization has reached its bonus goal, an employee will receive $2,250.

Program Changes May Not Be Enough

The consultant stated that true long-term goals should focus on reaching a multi-year goal.

Even after changes were made regarding the bonus program, the consultant had concerns with the revised bonus program. The consultant noted that these long-term goals do not appear to have a genuine long-term focus but resolving the issues may serve the organization in the long run. He stated that true long-term goals should focus on reaching a multi-year goal. SITLA's board has made some changes to the bonus program. However, we do not address the debate regarding whether SITLA, an organization that operates without risk and with state-granted assets, should be rewarding employees at a level, according to their own consultant's data, above market bonuses. We believe that SITLA's performance rewards should be more in line with rewards given by public agencies, with which we believe they are most comparable. They have more elements in common with public agencies than with private agencies, and their compensation levels should reflect that relationship.

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Appendix

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June 22, 2007

Mr. John M. Schaff
Auditor General
Office of the Legislative Auditor General
W315 State Capitol Complex
Salt Lake City, UT 84114-0151

Dear Mr. Schaff:

I have completed my review of the materials that you provided to me related to your report (#2007-2008), “A Follow-up Audit of the School & Institutional Trust Land Administration (SITLA).” I have limited my analysis to the portion of the report that deals with the computation of average benchmark salaries. I have concluded that from a statistical standpoint, the computations (simple averages) performed by the consultant are flawed, and that your office’s subsequent weighted average calculations are consistent with sound statistical practice. The attached report provides more details of my analysis and results.

Please let me know if you have any questions or concerns related to my findings.

Sincerely,

Don G. Wardell, PhD
Professor and Chair
Department of Management
University of Utah

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Mr. John M. Schaff
Legislative Auditor General
W315 State Captiol Complex
Salt Lake City, UT 84114

RE: Evaluation of the Follow-Up Audit of the School and Institutional Trust Land Administration, Report to the Utah Legislature, May 2007, and related documents

Thank you for this opportunity to evaluate the Follow-Up Audit of the School and Institutional Trust Land Administration (SITLA), May 2007 report. I have examined the following materials that were provided to me:

A Performance Audit of the School and Institutional Trust land Administration, January 2006
Request for Proposals: Management Team Compensation Analysis, due 23 June 2006
Proposal to Conduct an Executive Compensation Study, by Fox Lawson & Associates, 23 June 2006
Consulting Agreement, 1 August 2006
Final Report, Compensation Review, School and Institutional Trust Lands Administration, December 2006
A Follow-Up Audit of the School and Institutional Trust Land Administration (SITLA), Report to the Utah Legislature, Number 2007-08

Sincerely,

David J. Cherrington, DBA, SPHR
780 Tanner Building
Brigham Young University
Provo, UT, 84602

Evaluation of *A Follow-Up Audit of the School and Institutional Trust Land Administration (SITLA), Report to the Utah Legislature, Number 2007-08*

I have been asked to evaluate the methodology and conclusions contained in the Final Report of Fox Lawson & Associates. Four major disagreements have been identified and I will comment first on them, as requested. Then I will discuss these issues in a broader context, since my evaluation is influenced by my opinions regarding other significant considerations.

#1: When collecting wage information, does the relative size of comparison organizations matter? The answer is **yes**, and it would be ideal to find comparison data from organizations with fewer than 100 employees, similar to SITLA. When using wage surveys, however, it is often difficult to find exact matches in size and other relevant considerations. Consequently, the results usually have to be interpreted accordingly. Wage surveys conducted by public agencies, professional associations, and private companies have repeatedly demonstrated that compensation and benefits tend to increase as the number of employees in the organization increase. The effects of size are perhaps best illustrated by data from the National Compensation Survey published annually by the Bureau of Labor Statistics. The following data shows the average hourly earnings for establishments of different sizes.

	Hourly Earnings		
Establishment Characteristics	Total	Private	State and Local Government
1-99 employees	$15.73	$15.69	$18.86
100 – 499 employees	$18.13	$17.72	$21.79
500 – 999 employees	$20.79	$19.94	$23.83
1000 – 2499 employees	$21.66	$21.07	$23.37
2500 or more	$25.44	$27.05	$24.06
Source: www.bls.gov (as of 31May07), *National Compensation Survey*, June 2005, p. 2.			

These data do not support the Consultant's criticism of the Auditor: "The second false assumption made by the Auditor is that organizations with larger numbers of employees will always pay more. The reality of this is often the opposite" (p. 3 of the letter and p. 37 of the report). The Consultant goes on to say that the average salary for directors of organizations with 50-200 employee is $237k rather than the average of $184k for organizations with less than 1000 employees. These averages do not seem reasonable given the normal relationship between size and salaries, which makes one question their reliability and validity.

#2: Did the Consultant use the proper method for calculating average pay? The answer is no. Statistically, the correct procedure for calculating overall means when aggregating data from groups of unequal size, is to weight the means according to the size of each group. For example, if there are two wage surveys, one with100 incumbents and another with 10 incumbents, the data should be combined as if the second survey provided additional data, and the average should be an average of all 110 incumbents, each observation counting equally.

The aggregating procedure used by the Consultants produced distorted conclusions. The wage surveys purported to provide salary and bonus information on jobs that were exact job matches and the data were supposedly blended through a consistent averaging procedure to produce recommended amounts. This process was seriously impacted by the decisions regarding which surveys to include and which job titles constituted job matches. Since the differences in average pay were sometimes as much as 40 to 50 percent, one has to question whether the jobs were really the same. Consequently, ignoring the number of incumbents when aggregating the data is a trivial mistake when compared with the potential bias that arises when improper data are included.

Occasionally, it is appropriate to disregard sample sizes when calculating the average of averages, but the results must then be interpreted differently. For example, if one measures the job satisfaction of employees in twenty companies of different sizes and wants to report the average level of satisfaction in an average company, then averaging the company averages would be appropriate. But the data would then need to be interpreted differently; the unit of analysis is now the company, not the individual.

When using wage surveys, there are occasions when it would be appropriate to disregard sample sizes when calculating the average of averages. For example, when setting the pay of a new job, suppose there were no exact job matches with the job in question, but there were ten other jobs that each possessed some equivalent job requirements. It might make sense to average the average pay for these ten jobs, ignoring the sample sizes from which they came, and use this average as an approximation for setting the pay of the job in question. Here it is appropriate to ignore the sample sizes because it is the average pay of each job that is of interest rather than the average pay of the job incumbents, and one would not want the average to be skewed by the jobs with the most incumbents.

#3: Did the Auditors misinterpret the bonus information? The answer to this question is both yes and no. When the Consultants report a $0 bonus, something that appears to occur six times, that number was included in the calculations (regardless of how many incumbents it applied to). When the bonus information is not reported, something that appears to occur seven times, the data are treated as missing data and the averages are calculated without them, which statistically is the right way to handle missing data. But, missing data has to be carefully interpreted. The Auditor interpreted the missing data as if none of the incumbents received a bonus, which is probably not true. The Consultant, on the other hand, interpreted missing data as if it wasn't reported, but if it had been reported it would have been equal to the average of other similar organizations. This interpretation is probably even more erroneous, and the Auditor is justified in challenging this interpretation. Missing bonus data probably suggests that bonuses were minimal or nonexistent, as was assumed by the Auditor. When bonuses are a significant part on compensation, it is unlikely that they would be overlooked in a reputable wage survey.

The bonus data reported by the consultants is confusing and their efforts to clarify them in their follow-up letter seem wrong. This confusion is best illustrated when examining the bonuses of Directors. The Guidestar survey of 5,442 CEOs/ Executive Directors indicates than **none** of them receive a bonus (or bonuses were not reported); nor did any of the five directors in the Consultant's custom survey receive a bonus. On the other hand, the Watson Wyatt survey of 13 Top Program Executives indicates that they receive average bonuses of $6,500, and the Compudata survey of 10 executive Directors indicates that they receive average bonuses of $40,400. The disparity in these numbers –$0, $6,500, and $40,400 – is very puzzling and needs to be explained. Are these really comparable jobs? Is this a reporting problem? Is the disparity due to inconsistent coding of the data, or what?

The bonuses reported for Chief Administrative Officers and Chief Operating Officers in the three surveys of private companies are even more incredible: $153,000, $26,500, and $31,400. Differences this great have to suggest that the jobs under consideration are not similar; the sample sizes (19, 72, and 345) are too large to attribute the differences to chance factors. Before this information can be used, much more needs to be done to examine the job descriptions, the participating companies, the way the data were collected, and how the terms were defined. But, even if these inconsistencies were resolved, I do not think the size or frequency of bonuses in other organizations should be the determining factor in the design of SITLA's bonus program.

#4: Should non-profit organizations be combined with government agencies to calculate the average salaries and bonuses of public employees? The answer to this question is also both yes and no; but I consider it a moot question and will explain why.

The Consultant rightly claims that government agencies, including SITLA, are non-profit organizations. Since the Consultant has a goal of combining private enterprise and public employment on a 50:50 basis to arrive at a single salary and bonus recommendation, it is reasonable for them to combine non-profit organizations with government agencies for this purpose; they are certainly more like public agencies than private companies. They could have used a ⅓:⅓:⅓ combination, but the Utah Code doesn't say that compensation should be based on private enterprise, public employment, and non-profit groups. Therefore, combining non-profits with government agencies served a broader purpose for them.

Conversely, the Auditor raises a reasonable objection. Non-profit organizations are sufficiently different from government agencies that they should be treated separately when analyzing salaries and bonuses. The fact that they are different is confirmed by the wage surveys that quite consistently indicated that positions in non-profit organizations have significantly higher wages and bonuses than similar positions in government agencies.

I consider this a moot question because the most meaningful way to use wage survey data is not to calculate a composite from multiple surveys, as was done by the Consultants, but by showing summary data from each survey separately along with relevant information about the survey methodology, job descriptions, incumbents, bonuses, and benefits.

Decision makers then have a broader perspective and they can then use the data however they find most helpful to make rational judgments. Data from non-profit organizations would certainly be relevant and useful information to help SITLA's Board make good compensation decisions.

Next, I want to address four additional questions that relate to my evaluation of the above recommendations and conclusions. These questions provide a broader context for examining these issues.

1. Is SITLA a public agency?

The primary issue that arises throughout this audit and impacts almost every question that is asked is whether SITLA is a public agency or some sort of a non-profit or quasi-private organization. Since my conclusions are influenced by my opinion on this issue, I will explain why I think *SITLA is a public agency* that should be managed and compensated accordingly.

SITLA does not produce a profit and it is not subject to the normal market discipline of an entrepreneurial business. It does not compete openly in procuring resources, efficiently producing a product or service, and selling its outputs to the consuming public. SITLA exists in an environment that contains minimal risk; it does not face the likelihood of incurring losses or going bankrupt. SITLA's resources come from public resources, which it sells or manages, and does not replenish. The normal organizational effectiveness criteria of survival and growth that come from producing a product or service and recycling it in the environment to obtain renewable resources does not apply to SITLA. SITLA's survival depends not on economic efficiency and effectiveness, but on satisfying the expectations of a state legislature. Clearly, it is an agency of the state government.

I strongly agree with the statements by the Utah Legislative Auditor General's Office regarding this issue: "…because of the public nature of SITLA's assets and their negligible level of risk, they should be considered a public entity" (p. 16, first paragraph). … "SITLA is not a private sector organization operating with private assets that is answerable to shareholders. SITLA does not bear the operating and financial risks associated in the private sector market" (p. 16 last paragraph).

2. How should the Utah State Legislature's compensation directive be interpreted?

Considerable disagreement exists regarding the mandated criteria that salaries be determined by comparisons with *private enterprise and public employment*. Utah Code 53C-1-201(3)(d)(iv) provides that: "Salaries for exempted positions, except for the director, shall be set by the director, after consultation with the Director of the Department of Human Resource Management, within ranges approved by the board. The board and director shall consider salaries for similar positions in private enterprise and other public employment when setting salary ranges."

Fair pay is not based on fixed formulas; rather, it is determined by relative comparisons. A useful compensation maxim is that employees should be compensated first according to the requirements of the jobs they perform and how well they perform them, and second by labor market conditions (supply and demand) and the organization's ability to pay. When analyzing the requirements of the job in a job evaluation study, we examine *compensable factors* and assign pay ranges commensurate with these factors. When compensation analysts identify compensable factors, they typically list the knowledge, skills, and abilities (KSAs) required to perform the job, or sometimes, the skills, effort, and responsibility (SER).

I believe the legislature was right in mandating that the compensation of SITLA's leaders be compared with private enterprise *and* public employment because the jobs of these leaders are a combination of public agency KSAs and private business enterprise KSAs. I suspect, for example, that these positions are at least somewhat involved in negotiating contracts, developing resources, and making other business decisions that align with private enterprise jobs.

This is not to say, however, that private jobs are an equivalent match for SITLA's positions. The absence of a market discipline is an important missing compensable factor for all SITLA positions. Indeed, one of the most important compensable factors that justify large salaries to business executives is responsibility for producing a profit. The absence of this compensable factor is reflected in all of the salary surveys reported by the consultants, Fox Lawson & Associates, which shows that public positions receive significantly lower salaries than private positions.

It should be theoretically possible to use a common job evaluation system to evaluate both public and private positions. A good job evaluation system that identified the relevant compensable factors and weighted them appropriately could be applied to both public and private jobs, and one of the relevant compensable factors would be responsibility for producing a profit. The Consultant's proposal (23 June 2006) indicated that they intended to do a "job leveling" study using the Decision Band method. I was skeptical about how well this method would work after reviewing its description in the appendix. Nevertheless, it does not appear that they attempted to do this part of the study.

3. How should the Board make compensations decisions?

The Board of Directors says it plans to use its own business judgment to make compensation decisions rather than adopting the averages contained in the consultant's report from wage surveys. I believe this is appropriate since it is the Board's responsibility to know the specific requirements of each job, how well people are performing, and what special behaviors justify being remunerated.

I am impressed with SITLA's Board of Directors. The information I reviewed indicated that they have been open and cooperative and they have responded in a timely way to most of the Auditor's recommendations. Letters from the Board seem to indicate that Board members have an accurate understanding of their responsibility to manage compensation and I believe they will make good decisions if they have good data that are properly explained.

The letter from Michael P. Morris states: “Moreover, we believe that, on the scale of the public and private pay continuum, SITLA executives should be and are paid closer to the public end and not the private end of the pay scale” (p. 34). This sentence seems to agree with the above arguments that SITLA is a government agency and it should have corresponding compensation practices. Therefore, I believe the Board should continue to manage compensation by examining comparative data from public, non-profit, and private organizations and using it to make wise decisions according to the criteria they have established.

My biggest concerns with the Board are twofold: (1) SITLA’s Board consists of highly successful business executives who probably earn significant salaries and bonuses, and their personal incomes will likely bias what they think others deserve. (2) The Board wants “to create a conservative, yet incentive-based, business culture” for SITLA. Both of these concerns are explained further below.

Boards of Directors in U.S. corporations have a very poor record of making good compensation decisions when it comes to executive salaries and bonuses. It would be a shame if SITLA’s Board made similar mistakes by patterning their decisions after corporate boards that have granted enormous salaries, outrageous bonuses, and unreasonable stock options. Since SITLA is a state agency, why should its Director ever be paid as much as the governor of the state?

Corporate boards often make the mistake of assuming that high salaries and bonuses are essential to attracting and retaining good talent. They also make the mistake of assuming that talent is in short supply and only certain people can do the job. Clearly, outstanding leaders make an enormous difference in the success of any organization. But, the role of compensation in attracting and retaining talent is grossly over-rated. SITLA should expect to lose good people because there will always be greater challenges and opportunities for them that SITLA cannot ever hope to provide. Trying to buy their loyalty would be a vain and foolish effort.

Another serious mistake is the tendency to assume that “our executives are performing above average and they deserve to be paid above average.” Probably seventy to eighty percent of boards think their executives are performing above average, which is a statistical impossibility, and this misperception contributes to the spiraling increases in executive compensation that seems to be out of control.

4. Should SITLA have a bonus program?

The wage survey by Fox Lawson & Associates indicates that bonus programs are very rare in public agencies and they are considerably smaller in non-profit companies than in private companies. If the decision about bonuses was based strictly on market considerations, SITLA should not have a bonus program. However, I think the issue of bonuses should be based more on sound compensation objectives than on market comparisons, as explained below.

At the present time, SITLA has a very generous bonus program that exceeds the market averages. Whether this is good or bad depends on the agency's compensation philosophy and how well it matches the situation. Large bonuses (and smaller salaries) create higher levels of motivation when they are tied to measurable performance goals. Small bonuses (and larger base), on the other hand, creates more security at the sacrifice of motivation. In any event, bonuses should be considered as part of overall compensation and when bonuses increase, base pay should be reduced proportionately. Employees who have access to large bonuses should receive lower salaries and know that their base pay is reduced and they are expected to be highly productive.

SITLA's Board says it intends to pursue an incentive-based culture, meaning large bonuses, which I think is wrong for the following reasons. Incentive systems need to match relevant factors in an organization. For example, companies that have repetitive production jobs are ideal for piece-rate incentive systems, and companies that produce a profit are ideally suited for profit sharing programs. Bonus programs should be limited to companies where meaningful performance goals can be established, the employees work independently, the employees can control the pace of performance, and increased performance is always desirable. I doubt that these conditions match SITLA's circumstances. As a government agency, I do not think there are measurable performance goals that qualify for large incentives. Tying bonuses to revenues seems completely wrong since the assets SITLA sells are public assets – gas, oil, and land. These are non-renewable resources and their sales should not be motivated or encouraged by financial incentives for SITLA's employees. It seems equally wrong to tie bonuses to how much money is committed to development projects, to selling land for thirty-five percent above the appraised value, or to increasing coal revenues. Are these really appropriate goals?

Bonuses should normally be tied to value-added activities and only used if meaningful benchmark metrics can be found. And, even then, the bonuses should probably be very small to prevent distortions in reporting, manipulations of information (such as appraisals), and excessive stress. The 2007 bonus program is mentioned in the Follow-Up Report, but it is not explained in sufficient detail for me to understand. Apparently 35% is still tied to revenue goals, which seems entirely wrong; 35% is tied to non-monetary goals that involve three production components, which appears equally questionable, and 30% focuses on long-term goals that are unclear.

Whatever incentives SITLA offers should match its organizational characteristics. SITLA is a government agency. Merit pay programs are ideally suited for motivating and rewarding employees in government agencies and non-profit companies. Asian and South American companies have a custom of giving a thirteenth month salary as a year-end bonus when things go well. These bonuses amount to only 8.3% of pay. The United States does not have this custom; very few American workers receive any kind of bonus.

In summary, I believe SITLA is a government agency whose employees should be compensated fairly relative to the employees in other government agencies who perform similar functions. Compensation data from non-profit and private enterprise organizations should also be used to make compensation decisions, but the important differences between public and private employment should be treated as significant compensable factors and not ignored. The Board and the Director should have access to wage survey data from many sources and use it subjectively to make compensation decisions based partially on what people in other companies receive for performing the same job, partially on what other jobs within the organization pay, and how well each employee is performing relative to others. Finally SITLA should have either a very small bonus program or none at all because it lacks the factors that are conducive to having a significant bonus program.

While I think my recommendations are consistent with the Legislature's current thinking, I may be wrong and I am only one taxpayer. It is the Legislatures responsibility to decide whether SITLA is a government agency and whether they expect it to operate as such, or whether it is an independent quasi-business organization charged with maximizing returns. Does the Legislature want SITLA to operate as an incentive-driven entrepreneurial company that is focused on maximizing its revenues and compensating its employees with high wages and lavish bonuses? The Legislature needs to decide how quickly it is willing to allow public assets to be sold and whether it is willing to allow SITLA to develop public assets and compete with private business. What activities does the Legislature want to reward, and what level of incentives does it want to have driving them? How much should state government be involved in real estate development and the production of energy? Clearly, SITLA could develop a section of state land – plot the subdivision, install utilities and roads, and even construct and sell the homes. But, is this the role of state government? Clearly, SITLA could build a windmill farm on state lands and sell energy to consumers or other power companies, but is this what the Legislature intends for SITLA to do?

in Figure 3 (p. 23) of Report No. 2007-2008 (hereafter referred to as "the Report"). The copy of the report that I received included an appendix with the "Agency Response," which consisted of letters from Kevin S. Carter and Michael P. Morris, together with a report from James C. Fox. As reference material, I also received a copy of a final report entitled, "School and Institutional Trust Lands Administration: Compensation Review" and a memo/report from David J. Cherrington. I did not read all of the supplemental material, and will base the majority of my comments on the criticism of the averages provided in Figure 3 of the Report and Dr. Fox's subsequent response to those criticisms. I will not comment on the appropriateness of the comparison base (public vs. private and non-profit vs. for profit), as I am not qualified to do so.

General Comments on Combining Survey Results to Obtain Averages

In general, when averages from various sources are combined to create an overall average, the sample size from each source must be considered. Information is lost when the sample size is ignored because the average appears to be a single number rather than a value derived from several other numbers. A weighted average essentially disaggregates the summary value by (re)computing a total value. A simple average of averages does not re-create the total. Instead, it assumes that the individual averages are single points, hence losing the information that was originally contained in the sample. A familiar example of weighted averages is in the computation of a student's grade point average (GPA). If a student gets an A in a 4-credit hour course and a C in a 1-credit hour course, it would not make sense to say that the student has a B average (i.e., compute his GPA as 3.0). Instead, we weight the grades by their respective number of credit hours to compute the GPA as (4*4+2*1)/(4+1)=3.6, well above a B average.

There is one caveat with the data in the report under question. The results reported in Figure 3 are not averages, but instead medians ("50th percentile Base Salary"). I am not familiar with the best method to create a combined median, although I am quite sure that there have been papers written on the subject. Instead of making a concerted effort to search for those papers, I did a few small simulations to understand what the impact of combining medians rather than averages might be. Not surprisingly, I found that a weighted average of the median gives a biased estimate of the true median. Nevertheless, the weighted average was always a better estimator than the simple average, in that the bias was less and it was more precise.

In summary, I believe that to use a simple average of results that came from surveys with different sample sizes is inappropriate and gives misleading results. A weighted average is preferred. Hence I believe that the method used by the Office of the Legislative Auditor General (OLAG) more accurately estimates the "typical" or central value of the salary distribution than does the method used by Dr. Fox.

Comments on Dr. Fox's Response

In his response, Dr. Fox noted that using a weighted average method biases individual data sources. I suppose I agree, except that I believe that the word "biases" gives the wrong connotation. Indeed, OLAG's method gives more weight to surveys with more incumbents. As described above, doing otherwise causes information from the original surveys to be lost and results in a poor estimate of a typical salary. Rather than using the word “biases,” I would say that it (appropriately) gives more weight to one survey over another. In contrast, I could use the same verbiage as Dr. Fox to say that *not* weighting by the number of incumbents biases the results towards the surveys with a small number of incumbents. If there is reason to believe that the survey with a very large number of incumbents is not representative, then perhaps that survey should not be included. As mentioned, I cannot comment on the relative merits of the surveys, as I am not an expert in compensation methods or surveys. If there is confidence in the surveys, then the number of incumbents should be taken into account when combining the results.

Dr. Fox also claims that the weighted average method gives results that “violate both professional practice and common sense.” The basis for his argument is that the weighted average method results in a (weighted) average chief legal counsel salary that is higher than that of the (weighted) average director salary. I would agree that such a result probably does violate common sense, but it appears to be a criticism of the surveys used rather than the weighted-average method. In other words, the same “common-sense violation” occurs in the Compdata and EAG surveys themselves, as shown below. If bonuses are included, the same violation is seen. Hence unless the Compdata and EAG surveys are flawed, it appears that in the private sector chief legal counselors are (on average) paid more than directors.

Survey	Director 50th Percentile	Chief Legal Counsel 50th Percentile
Compdata	$165,556	$187,433
EAG	$136,753	$152,622

<u>The Issue of Bonuses</u>

Finally, I thought it would be appropriate for me to comment on bonuses. OLAG criticized Dr. Fox’s report for not including incumbents who did not receive a bonus in the average. Dr. Fox countered that it was not accurate to assume that if a bonus was not reported, then it was not paid. He also stated that the relevant comparison group is organizations that do pay bonuses. In my opinion, if a large number of incumbents in the survey did not report bonuses, it is unwise to draw any kind of conclusion about the typical bonus. Taking an average of only those organizations that reported bonuses is as dangerous as assuming that the non-reporters had no bonus. In other words, I would conclude that there is a large non-response bias and would be leery of any summary statistics computed from the limited number of respondents who reported a bonus.

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Agency Response

State of Utah
School & Institutional
Trust Lands Administration

Jon M. Huntsman, Jr.
Governor

Kevin S. Carter
Director

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9 July 2007

John M. Schaff, CIA
Auditor General
W315 Utah State Capitol Complex
Salt Lake City, Utah 84114

Dear Mr. Schaff:

On behalf of the School and Institutional Trust Lands Administration please accept my appreciation for this opportunity to respond to the Follow-up Audit of the School and Institutional Trust Land Administration (Report No. 2007-08). Your staff members were professional and courteous in their interrelations with agency personnel and made every effort to conduct their duties so as to cause no undue interference with our day-to-day operations.

We recognized the importance and value of the issues which were raised in the original audit (Report Number 2006-01) and made conscientious efforts to address your concerns. I believe that the Follow-up Audit accurately reflects the progress that we have made in implementing your suggestions, and we are pleased that your staff has recognized this progress.

The one outstanding issue is executive compensation. Since this matter is solely in the purview of the Board of Trustees, it is not appropriate for the agency to address this ongoing difference in perspective. The Board of Trustees intends to address the compensation issue under separate cover.

Again, thank you for your suggestions to improve trust land management and oversight. We look forward to the greater accountability and transparency that their full implementation will accomplish.

Sincerely,

KEVIN S CARTER
DIRECTOR

State of Utah
School & Institutional
Trust Lands Administration

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July 13, 2007

Mr. John M. Schaff, CIA
Utah Auditor General
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Salt Lake City, Utah 84114

Re: Follow-Up Audit of the School & Institutional Trust Lands Administration (Report No. 2007-08)

Dear Mr. Schaff:

On behalf of the Board of Trustees of the School and Institutional Trust Lands Administration ("SITLA"), thank you for the opportunity to comment on the recent Follow-up Audit of the School and Institutional Trust Land Administration (Report No. 2007-08) conducted by the Office of Legislative Auditor General ("OLAG").

The Audit Report continues to express concern about executive compensation levels at SITLA. In particular, OLAG recognizes the statutory direction to establish a compensation framework using both public and private industry comparables, but concludes that no private organization exists which can provide valid comparable salary data. Consequently, they have concluded that the correct market comparable for determining SITLA compensation is other state land-management agencies throughout the west and that SITLA executive compensation is above that level.

The Board of Trustees respectfully disagrees with this conclusion. Notably, SITLA does not <u>lose</u> employees to other state land-management agencies, but instead competes for <u>new</u> employees in the private sector marketplace. The Board is directed by statute to set compensation for the director and senior management within the Administration. The Utah legislature has specifically directed the Board to consider <u>private</u> as well as public compensation comparables in developing and setting SITLA's compensation structure. We take seriously our duty to comply with the legislature's directive in this regard.

When the executive compensation issue arose, the Board committed to the legislature's Natural Resources Appropriation Subcommittee that we would engage a qualified independent compensation consultant to provide guidance and recommendations regarding executive compensation. The consultant confirmed that total executive compensation for SITLA management was in the range of comparable government and private industry positions.

The Board recognizes that executive compensation is a difficult topic that is subject to reasonable differences in opinion, and we do not wish to engage in point-counterpoint exercises on the compensation issue. We believe that we have faithfully discharged the duties which the legislature has delegated to us in this regard. Our Board is composed of senior managers from a variety of industries, with leadership experience in both the private and public sector. We have been given specific responsibility for attracting and keeping the quality of staff necessary to fulfill the fiduciary duty imposed by the State Constitution and the legislature to prudently and profitably manage the assets of the state's school and institutional land trusts. We believe that current compensation levels for SITLA management – who have been responsible for building trust financial assets from $83.5 million in 1994, to over $1 billion at the current time (a 21% compounded annual growth rate) – are reasonable based upon our collective business judgment, as confirmed by our independent consultant.

Thank you again for the opportunity to comment. We will be available at the Audit Sub-committee meeting to provide any appropriate comments and to address any specific questions that you or committee members may have.

Sincerely,

Michael P. Morris

Michael P. Morris
Chairman

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May 15, 2007

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Subject: Response to OLAG Audit of SITLA Compensation Practices

Dear Mr. Carter:

As requested, we have reviewed the Office of the Utah Legislative Auditor General's follow-up audit of SITLA's compensation practices and the results of the December 2006 compensation study.

This letter outlines our response to the auditor's report and provides additional perspectives and professional opinion regarding the analysis and interpretation of all related compensation findings.

We appreciate having the opportunity to assist you with this audit review. Should you have any questions of need additional information, please call me at 651-635-0976, extension 12.

Sincerely;

James C. Fox, Ph.D

<u>Audit Response Summary</u> – Auditor's conclusions disregard professional practice and common sense.

The Office of the Utah Legislative Auditor General's (Auditor) 2007 follow-up audit of SITLA provides specific criticisms of the data and methodology utilized for the December 2006 compensation study. Specifically, the auditor discusses concerns with respect to the following aspects of the study and provides selected illustrations of how the study's findings would differ had alternative methodologies been applied. The Auditor's issues relate to:

- The relative size (as defined by the number of employees) of the comparison organizations in comparison to SITLA.
- The method by which collected data were aggregated for the purpose of providing comparisons.
- The interpretation of available bonus data and the application of these data for providing compensation recommendations.
- The inclusion of relevant data from similar non-profit organizations.

On review of the Auditor's report, we have determined that the criticisms offered are generally without merit as they were derived from inaccurate interpretations of provided data and reflect a general lack of understanding of professional compensation practices.

Furthermore, the alternative methodologies implied in the Auditor's report further demonstrate a minimal understanding of modern, appropriate, and correct compensation principals. As it will be demonstrated in this response, the application of the Auditor's suggested methodologies would result in compensation recommendations that threaten both professional and ethical standards, and provide numerical findings which are not consistent with standard practices of organizations, both public and private, in the United States.

Auditor Falsely Interprets Size of Comparisons from Published Salary Surveys

To provide an accurate representation of market data for SITLA's positions, the decision was made to include salary data from a variety of reputable national market surveys. In accordance with professional compensation standards, these data were carefully selected to provide the most appropriate match with SITLA's organizational structure, budget size, and number of employees. Among these data were some comparisons that included organizations with less than 1000 employees, which was the smallest reliable data cut available from that source.

Although the Auditor acknowledged that published data were not always available below a certain threshold, they expressed direct criticism of the inclusion of these data stating that "...a more accurate comparison would have been to compare SITLA with agencies with fewer than 100 employees."

In providing this criticism, the Auditor falsely assumes two aspects of professional compensation work.

- First, the Auditor suggests that the inclusion of an "under 1000 employees" data cut means that SITLA is being compared to organizations with 1000 employees. What the Auditor fails to realize is that this is simply a generic grouping of organizations, not an exact description of the typical organization size. For example, the "under 1000 employees" survey data used for the Director position indicated that the actual median number of employees for the grouping was 222, not 1000 (barely 20% of what the Auditor suggests). Although there were smaller data cuts available, the "under 1000 employees" grouping provided for the most representative cut with the greatest number of incumbents to ensure the best in data reliability and validity.

- The second false assumption made by the Auditor is that organizations with larger numbers of employees will always pay more. The reality of this is often the opposite. Using the Director position as an example, there was a data cut available for organizations with less than 75 employees (which fits perfectly with the Auditor's recommendation of using comparisons with under 100 employees). The reported salary is the same as the larger organizations, but the bonus amount is more than double that of the larger organizations ($335k vs. $153k). There was also a "50-200 employees" data grouping available, but this provides a much higher salary than the data grouping used for the study ($237 vs. $184k) and the same bonus amount. We did not use either of these data cuts because of reliability questions.

Had we used the data cuts from the survey sources that the Auditor suggests, the results would have revealed that SITLA's salaries, especially that of the Director, would have been further below the market than the data we used. Further, these conclusions would lack sufficient reliability and validity for this comparison.

Auditor's Emphasis on Statistical Equality when Aggregating Data Violates Professional Practice, Skews Data, and Results in Internal Inequity

To eliminate the skewing effect of any individual salary data source, whether public or private, the decision was made to calculate an equal weighting for each in accordance with professional compensation practices. By doing so, we are able to provide compensation recommendations that are free of any bias, and therefore most accurately reflect the true competitive market. In addition, since Utah Code provides that the compensation for SITLA incumbents should be based on "...private enterprise and other public employment," public and private data were given an equal weighting. The law does not specifically weight one source of data as more or less important, or relevant than the other. Thus, equal weighting is the only professionally responsible weighting scheme to apply.

The Auditor raised concern with these commonly applied compensation practices and instead suggested the use of an incumbent-weighted averaging. Such an approach would heavily bias individual data sources and result in recommendations that would actually place certain subordinate employees at a higher salary level than the Director.

To illustrate this approach, the Auditor provided a series of tables based on selective and incomplete analyses that ultimately resulted in lower salary recommendations for the Director position. In addition, since the Auditor does not provide an actual solution to the incorporation of private and public salary data as defined by Utah Code, their proposed methodology results in an 8% private, 92% public data weighting for the Director. We found no justification in the law for this weighting scheme.

Had the Auditor performed his preferred methodology in a more complete manner, they would find the approach results in findings that violate both professional practice and common sense. Specifically, by following the incumbent-weighted approach exactly, and weighting all data (including private comparisons) based on the number of incumbents for the Director and Chief Legal Counsel positions, they would find the following (these figures provide average salaries that are based on the incumbent-weighted average of all government, non-profit, and private organizations):

- **Director salary - $120,678**
- **Chief Legal Counsel salary - $126,679**

Clearly, recommending that the Director be compensated at a level that is lower than one of his/her direct reports presents a significant organizational problem that cannot be supported or sustained. In addition, since the incumbent-weighted approach avoids setting an appropriate balance between private and public organization data, the following mix would have resulted. We believe the Auditor would likely object to these results, even through they flow directly from his recommended process.

- **Director data mix – 8% private, 92% public**
- **Chief Legal Counsel data mix – 50% private, 50% public**

Providing a private/public data mix that varies for each position is not supported by any professional compensation practice, and would likely be viewed as biasing the data to achieve a predisposed outcome.

Auditor's Assessment of Bonuses Not Made on the Basis of Fact

The Auditor's assessment of the market bonus averages does not reflect a correct understanding of the provided data or a sufficient knowledge of professional incentive compensation practices. Instead, the Auditor falsely interprets the utilized methodology and follows a path of specious reasoning to provide alternative recommendations.

Most notable among the false interpretations by the Auditor was the statement finding that "only 23 jobs out of the possible 5,470 matches were included in the calculation of average bonus." The Auditor arrived at this opinion by incorrectly recreating the methodology utilized to calculate the average bonus amount. Specifically, it was believed that the "...bonus averages were created through a process of elimination that first, eliminated any company that did not pay a bonus and second, eliminated a bonus-paying business if the incumbent did not receive a bonus." Then, applying the same incumbent-weighted methodology discussed for the salary averages above, the Auditor provided an average public bonus amount of only $89.31 for the Director position (compared to $15,633 reported for the public average).

The Auditor's calculated bonus average of $89.31 is inaccurate because the report did, in fact, use non-reported bonus data as $0 bonus data for 5442 out of 5470 possible data points. As a result, the Auditor's preferred methodology resulted in a recommended bonus that was based on 99.48% inaccurate data. We believe even the Auditor would find that unacceptable.

In addition, the Auditor falsely accused us of eliminating "...a bonus paying business if the incumbent did not receive a bonus." This is incorrect. The average bonus figures included $0 bonuses.

The Auditor also provided a specific criticism regarding the inclusion of average bonus amounts from published salary surveys that were only given at certain organizations. Specifically, when reviewing the Director's compensation, the Auditor noted that "...the public average showed that only 30.8% of the organizations paid bonuses." As a result, the Auditor suggests that this factor should somehow be weighted in the average. We believe this opinion further demonstrates the Auditor's limited understanding of incentive compensation principals. Specifically, SITLA is a bonus paying organizations. Therefore, it is important that it be compared to organizations that also pay bonuses. Weighting the average bonus amount of organizations that pay a bonus against those that do not would result in an intentional manipulation of data.

Auditor's Exclusion of Non-Profit Data from Public Average Improperly Defines Competitive Market

Professional compensation practices provide that data must be collected from an organization's relevant recruiting market when determining competitive compensation, not just those organizations that are operationally identical. The Auditor criticizes this practice suggesting that it is inappropriate to blend non-profit data with government agency data. Instead, they provide the opinion that the public average should only include other government organizations.

What the Auditor fails to realize is that government organizations, including SITLA, are in fact non-profit organizations. More importantly, their organizational structure, budget size, and recruiting pool are generally similar. As a result, to exclude non-profit data from the public average would mean that SITLA's primary recruiting market is ignored when determining compensation. This process would intentionally ignore the places where SITLA's current incumbents came from. Specifically, when examining SITLA's current management group, we find that only one incumbent is from a government organization. The remainder came from non-profit organizations and the same private sector organizations where we collected comparable salary data. Not one of the current incumbents came from another state land management organization. The fact that the majority of SITLA's current management has been recruited from outside of the government market demonstrates that they must look at a recruiting market that includes private sector, non-profit, and government sector organizations, when determining competitive compensation.

In addition, the Auditor should realize that when the competitive market is narrowly defined, it becomes increasingly difficult to find comparable market matches. If the Auditor prefers to survey only similar state-based land management organizations, he will find that even the other land management organizations are not appropriate matches. SITLA is, in fact, unique when compared to the other state-based land management organizations in terms of its quasi-governmental status, organizational structure, resource allocation, activities and dominant source of revenues.

Audit Review Conclusion

Our analysis of the Auditor's follow-up audit finds that:

- The Auditor has placed an inappropriate emphasis on the relative size of comparison organizations, the results of which would be average salaries that place SITLA's current salaries further below the competitive market.
- The alternative data analysis methodologies preferred by the Auditor would result in compensation recommendations that bias individual survey results and ignore general compensation practices and common sense. Use of this

methodology results in a salary that is higher for a direct report of the Director than the Director himself.

- The Auditor's assessment of the market average bonuses was not made on the basis of fact. The preferred methodology results in inaccurate bonus amounts.
- The Auditor's preferred approach of using a narrowly defined competitive market disregards the actual recruiting market used by SITLA.

The compensation study and the recommendations arising from those data were conducted according to commonly accepted professional compensation practices as outlined by *WorldatWork*, the professional compensation association. We found no evidence in the Auditor's follow-up audit which would weaken or call into question the application of those standards.