

## NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

**LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE**

Tuesday, January 21, 2014  
Roughrider Room, State Capitol  
Bismarck, North Dakota

Representative Gary Kreidt, Chairman, called the meeting to order at 10:00 a.m.

**Members present:** Representatives Gary Kreidt, Wesley R. Belter, Jeff Delzer, Ron Guggisberg, Patrick Hatlestad, Keith Kempenich, Andrew G. Maragos, Bob Martinson, Corey Mock, Chet Pollert, Jim Schmidt, Wayne Trottier; Senators Ralph Kilzer, David O'Connell, Terry M. Wanzek

**Members absent:** Representatives Jerry Kelsh, Scot Kelsh, Dan Ruby, Robert J. Skarphol; Senator Judy Lee

**Others present:** Representative Brenda Heller, member of the Legislative Management, was also in attendance.

See [Appendix A](#) for additional persons present.

**AUDITS OF STATE AGENCIES, BOARDS, AND COMMISSIONS**

Chairman Kreidt called on Mr. Ed Nagel, Director, State Auditor's office, who presented the audit report for the North Dakota Barley Council for the years ended June 30, 2012 and 2011. Mr. Nagel reviewed the auditor's responses to the committee guidelines and said the report includes one prior recommendation not implemented for travel voucher reimbursement and three findings relating to fraud risk assessment, entering and coding expenditures, and segregation of duties.

In response to a question from Representative Pollert, Mr. Steven Edwardson, Executive Administrator, North Dakota Barley Council, said the council anticipates using a portion of its reserve funds in 2013, as it did in 2012.

Mr. Nagel presented the audit report for the North Dakota Potato Council for the years ended June 30, 2012 and 2011. He reviewed the auditor's responses to the committee guidelines and said the report does not include any findings or recommendations.

Mr. Nagel presented the audit report for the North Dakota Beef Commission for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report includes one finding relating to segregation of duties.

In response to a question from Representative Schmidt regarding whether the use of North Dakota Beef Commission payments to other organizations is audited, Ms. Nancy Jo Bateman, Executive Director, North Dakota Beef Commission, said payments made to other organizations are based on a contract or a reimbursement process with the use of funding being available only for specified purposes.

Mr. Nagel presented the audit report for the North Dakota State Wheat Commission for the years ended June 30, 2012 and 2011. He reviewed the auditor's responses to the committee guidelines and said the report does not include any findings or recommendations.

Mr. Nagel presented the audit report for the State Historical Society for the years ended June 30, 2012 and 2011. He reviewed the auditor's responses to the committee guidelines and said the report included two noncompliance findings relating to construction in progress not properly reported and improperly capitalizing purchases and projects. He also said the report included two internal control findings relating to weakness in inventory segregation of duties and lack of controls surrounding complimentary admissions at historic sites.

In response to a question from Representative Schmidt, Mr. Merl Paaverud, Executive Director, State Historical Society, said the federal government allows certain federal funding to be continued at the end of each fiscal year.

Mr. Nagel presented the audit report for the Mill and Elevator Association for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report does not include any findings or recommendations.

Mr. Nagel presented the audit report for the Veterans' Home for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report does not include any findings or recommendations.

Mr. Nagel presented the audit report for the North Dakota University System office for the years ended June 30, 2012 and 2011. He reviewed the auditor's responses to the committee guidelines and said the report does not include any findings or recommendations.

### **UNIVERSITY SYSTEM COMMENTS ON AUDIT FINDINGS AND RECOMMENDATIONS**

Dr. Larry Skogen, Interim Chancellor, North Dakota University System, introduced Mr. Timothy Carlson, Chief Auditor, North Dakota University System. Mr. Carlson started in December 2013 as the new Chief Auditor of the University System.

Chairman Kreidt called on Ms. Laura J. Glatt, Vice Chancellor for Administrative Affairs, North Dakota University System, who presented information on the University System's progress in addressing previous audit findings and recommendations ([Appendix B](#)).

Ms. Glatt said actions to date to address the University System audit findings and recommendations include:

- Additional training for controllers and internal control functions;
- Additional meetings with the State Auditor's office;
- Standardizing processes across universities;
- Creating a formal mentoring program;
- Updating accounting manuals;
- Transferring each university's internal audit functions to the University System office; and
- Adding a University System Chief Compliance Officer position and a new Chief Auditor.

Ms. Glatt said ongoing challenges include:

- Staff turnover both at the university campuses and in the University System office;
- Inadequate staffing levels for the financial and audit functions;
- Complex changing standards;
- Condensed timeframes; and
- Many processes that are not standardized across the University System.

Ms. Glatt said the University System office will also be:

- Appointing an interdisciplinary team to develop a multiyear internal control and risk assessment implementation plan;
- Identifying additional staff needs across the campuses and in the University System office;
- Implementing an electronic workflow to review and modify processes for internal control and risk assessment;
- Enforcing a policy requiring 40 hours of continuing professional education annually for all auditors;
- Appropriately budgeting for training; and
- Creating five-year peer reviews of internal audits by external certified public accountants.

Ms. Glatt addressed the ongoing challenges relating to Williston State College financial reporting. She said the college has had difficulties recruiting and retaining high-quality staff. She said limited staff has created challenges for segregation of duties. To address these issues, she said, the college has hired a full-time Director of Finance, a full-time Controller, and a part-time Chief Financial Officer. She said other changes include adding controls for the

segregation of duties, updating all cash reconciliations, and partnering with Bismarck State College for staff mentoring and training.

### **AUDITS OF STATE AGENCIES, BOARDS, AND COMMISSIONS**

Chairman Kreidt called on Ms. Rhonda Mahlum, Mahlum Goodhart, PC, Certified Public Accountants, who presented the audit report for the Education Standards and Practices Board for the year ended June 30, 2011. Ms. Mahlum reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Chairman Kreidt called on Mr. Thomas Rey, CliftonLarsonAllen LLP, Certified Public Accountants, who presented the audit reports for the Retirement and Investment Office for the years ended June 30, 2012 and 2011, and June 30, 2013 and 2012. Mr. Rey reviewed the auditor's responses to the committee guidelines and said the reports contain unqualified opinions and do not include any findings or recommendations.

In response to a question from Representative Delzer regarding management fees, Mr. David Hunter, Executive Director and Chief Executive Officer, Retirement and Investment Office, said North Dakota is paying, on average, management fees of 0.75 percent and performance bonus fees of 15 percent for private debt and private equity strategies. He said these fees are favorable compared to the market rate for management fees of 2 percent and performance bonus fees of 20 percent. He said the office will be conducting an analysis of management fees over the next year.

Representative Maragos asked Mr. Hunter for an analysis explaining changes in the funded ratio of the Teachers' Fund for Retirement since fiscal year 2007. Mr. Hunter said he would prepare the analysis and provide it to the committee.

The committee recessed for lunch at 12:00 noon and reconvened at 1:00 p.m.

Chairman Kreidt called on Mr. Darrell Lingle, Eide Bailly LLP, Certified Public Accountants, who presented the audit report for the student loan trust for the years ended June 30, 2013 and 2012. Mr. Lingle reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for the State Building Authority for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for Workforce Safety and Insurance for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations. He said there was a finding of noncompliance with North Dakota Century Code Section 65-02-35 relating to attorney's fees for legal review in preparation for rehearing of an administrative order.

Mr. Lingle presented the audit report for the rebuilders loan program for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion. He said the report includes a finding relating to a material weakness audit adjustment.

Mr. Lingle presented the audit report for the Development Fund, Inc., for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion. He said the report includes a finding relating to financial statement preparation.

Mr. Lingle presented the audit report for the Board of University and School Lands for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and one finding relating to unclaimed property penalties.

Mr. Lingle presented the audit report for the PACE fund for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for the Ag PACE fund for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for the North Dakota State Fair Association for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for the State Auditor's office for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion. He said the report contains a finding relating to recording of transactions and two significant audit adjustments to reduce work in progress and accounts receivable balances in both the general and operating funds.

Mr. Lingle presented the audit report for the Legislative Council for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and a finding relating to recording of transactions and one significant audit adjustment.

Mr. Lingle presented the audit report for the Legislative Assembly for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Chairman Kreidt called on Ms. Mindy Piatz, Brady, Martz & Associates, PC, Certified Public Accountants, who presented the audit report for Job Service North Dakota for the years ended June 30, 2013 and 2012. Ms. Piatz reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. John Mongeon, Brady, Martz & Associates, PC, Certified Public Accountants, presented the audit report for the Public Employees Retirement System for the years ended June 30, 2013 and 2012. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Ms. Piatz presented the audit report for the housing incentive fund for the years ended June 30, 2013 and 2012. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and does not include any findings or recommendations.

Ms. Piatz presented the audit report for the Housing Finance Agency for the years ended June 30, 2013 and 2012. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and said one significant audit adjustment of \$770,000 relating to valuation of a financial derivative instrument.

## **DEPARTMENT OF HUMAN SERVICES ACCOUNTS RECEIVABLES**

Chairman Kreidt called on Ms. Debra McDermott, Chief Financial Officer, Department of Human Services, who presented the status of accounts receivables pursuant to Sections 25-04-17 and 50-06.3-08 ([Appendix C](#)). Ms. McDermott stated that a large one-time receivable was written off for the State Hospital this period resulting in a larger annual writeoff than usual. She said the total amount written off by the department for fiscal year 2013 was \$6,873,189, of which \$1,003,516 related to human service centers, \$5,843,330 related to the State Hospital, and \$26,343 related to the Life Skills and Transition Center.

Representative Trottier asked whether the federal Affordable Care Act will result in additional third-party collections for the department and decrease the level of writeoffs. Ms. McDermott said the department will provide information for the committee in response to the question.

## **WATER PERMITTING PROCESS - NORTH DAKOTA AND TEXAS**

The Legislative Budget Analyst and Auditor presented a memorandum entitled [Water Permitting Process - North Dakota and Texas](#).

The State Water Commission issues two types of water permits--conditional water permits and temporary water permits.

The conditional water permits allow individuals or entities to gain access to a specific amount of water to be used for a defined beneficial use. The application process for conditional water permits consists of three phases:

- Permit application administration phase;
- Permit application analysis phase; and
- Permit perfection phase.

Two types of temporary water permits are issued--temporary in lieu of irrigation permits and temporary industrial use permits. There are no statutory requirements that govern the temporary permit application process; therefore, the process is not segmented into components like the conditional permit application process.

Texas authorizes the use of state water primarily through a permitting system administered by the Texas Commission on Environmental Quality (TCEQ). Water in the state of Texas consists of water in the rivers, streams, underflow, creeks, tides, lakes, and every bay and arm of the Texas portion of the Gulf of Mexico but does not include ground water. Ground water is not regulated through TCEQ but is regulated by most counties.

The Texas Commission on Environmental Quality grants an applicant a permit if the following three criteria are met:

- The application conforms to the requirements prescribed by law and is accompanied by the prescribed fee;
- Unappropriated water is available in the source of supply; and
- The proposed appropriation is intended for a beneficial use, does not impair existing water rights or vested riparian rights, is not detrimental to the public welfare, and addresses a water supply need in a manner consistent with the state water plan.

Permits may be issued by TCEQ in perpetuity, for a limited number of years, or for a temporary use. Seasonal permits are also issued and in the same manner as regular permits.

### **WATER PERMIT FEE STRUCTURE AND ANY CHANGES TO THE FEE STRUCTURE**

Chairman Kreidt called on Mr. Jon C. Patch, Director, Water Appropriations Division, State Water Commission, who presented the commission's water permit fee structure and any changes to the fee structure pursuant to Section 61-04-06.2 ([Appendix D](#)). Mr. Patch proposed in response to the recommendation by KPMG and the State Auditor that rates for temporary permit fees be adjusted to \$75 for water volume less than 1 acre-foot, \$125 for 1 acre-foot to 10 acre-feet, and \$200 for more than 10 acre-feet.

### **COMMITTEE DISCUSSION AND STAFF DIRECTIVES**

The Legislative Council staff distributed a memorandum entitled [Summary of Audit Reports Not Selected for Presentation](#).

Chairman Kreidt requested the audit report for the North Dakota Soybean Council for the two-year period ended June 30, 2013, and the audit reports for the North Dakota Firefighter's Association and the Private Investigative and Security Board for the two-year period ended December 31, 2012, be heard at the next committee meeting.

**It was moved by Representative Guggisberg, seconded by Representative Mock, and carried on a roll call vote that, pursuant to Section 54-35-02.2, the committee accept the following reports presented to the committee:**

1. North Dakota Barley Council (June 30, 2012 and 2011).
2. North Dakota Potato Council (June 30, 2012 and 2011).
3. North Dakota Beef Commission (June 30, 2013 and 2012).
4. North Dakota State Wheat Commission (June 30, 2012 and 2011).
5. State Historical Society (June 30, 2012 and 2011).
6. Mill and Elevator Association (June 30, 2013 and 2012).
7. Veterans' Home (June 30, 2013 and 2012).
8. North Dakota University System office (June 30, 2012 and 2011).
9. Education Standards and Practices Board (June 30, 2011).
10. Retirement and Investment Office (June 30, 2012 and 2011, and June 30, 2013 and 2012).
11. Student loan trust (June 30, 2013 and 2012).
12. State Building Authority (June 30, 2013 and 2012).
13. Workforce Safety and Insurance (June 30, 2013 and 2012).
14. Rebuilders loan program (June 30, 2013 and 2012).

15. Development Fund, Inc. (June 30, 2013 and 2012).
16. Board of University and School Lands (June 30, 2013 and 2012).
17. PACE fund (June 30, 2013 and 2012).
18. Ag PACE fund (June 30, 2013 and 2012).
19. North Dakota State Fair Association (September 30, 2013 and 2012).
20. State Auditor's office (June 30, 2013 and 2012).
21. Legislative Council (June 30, 2013 and 2012).
22. Legislative Assembly (June 30, 2013 and 2012).
23. Job Service North Dakota (June 30, 2013 and 2012).
24. Public Employees Retirement System (June 30, 2013 and 2012).
25. Housing incentive fund (June 30, 2013 and 2012).
26. Housing Finance Agency (June 30, 2013 and 2012).

Representatives Kreidt, Belter, Delzer, Guggisberg, Hatlestad, Kempenich, Maragos, Martinson, Mock, Pollert, Schmidt, and Trottier and Senators Kilzer, O'Connell, and Wanzek voted "aye." No negative votes were cast.

No further business appearing, Chairman Kreidt adjourned the meeting at 3:30 p.m.

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Michael C. Johnson  
Fiscal Analyst

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Allen H. Knudson  
Legislative Budget Analyst and Auditor

ATTACH:4