

August 2011

## LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2010-11 INTERIM

The Legislative Management by statute appoints a Legislative Audit and Fiscal Review Committee as a division of its Budget Section. Pursuant to North Dakota Century Code Section 54-35-02.1, the committee is created:

- For the purpose of studying and reviewing the financial transactions of the state.
- To assure the collection of revenues and the expenditure of money is in compliance with law, legislative intent, and sound financial practices.
- To provide the Legislative Assembly with formal, objective information on revenue collections and expenditures as a basis for legislative action to improve the fiscal structure and transactions of the state.

### STATUTORY DUTIES AND RESPONSIBILITIES

The committee is charged by statute with the following duties and responsibilities for the 2011-13 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association pursuant to Section 4-02.1-18.
2. **Ethyl alcohol and methanol producers** - Receive annual audit reports from any corporation that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-19.1-152, receive annual audit reports from any limited liability company that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-32-156, and receive annual audit reports from any limited partnership that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 45-10.2-115.
3. **Department of Human Services' accounts receivable** - Receive annual reports on the status of accounts receivable for the Department of Human Services and the Developmental Center at Westwood Park, Grafton pursuant to Sections 25-04-17 and 50-06.3-08.
4. **Low-risk incentive fund** - Receive annual audit reports and economic impact reports from the North Dakota low-risk incentive fund. Section 26.1-50-05 provides for the audit report to be submitted to the Legislative Council. The

Legislative Management has assigned the responsibility to this committee.

5. **North Dakota Stockmen's Association** - Receive a biennial audit report from the North Dakota Stockmen's Association. Section 36-22-09 provides for the audit report to be submitted to the Legislative Council. The Legislative Management assigned the responsibility to this committee.
6. **Job Service North Dakota** - Receive a performance audit report, upon the request of the committee, for Job Service North Dakota pursuant to Section 52-02-18.
7. **Performance audits** - The State Auditor is to conduct or provide for performance audits of state agencies as determined necessary by the State Auditor or this committee, and the State Auditor must obtain approval from this committee prior to hiring a consultant to assist with conducting a performance audit pursuant to Section 54-10-01.
8. **Frequency of audits** - Determine the frequency of audits or reviews of state agencies pursuant to Section 54-10-01.
9. **Political subdivisions** - Determine if the State Auditor is to perform audits of political subdivisions on a more frequent basis than once every two years pursuant to Section 54-10-13 and direct the State Auditor to audit or review the accounts of any political subdivision pursuant to Section 54-10-15.
10. **Study and review audit reports** - Pursuant to Section 54-35-02.2, the committee is charged with the following responsibilities:
  - a. To study and review audit reports selected by the committee from those submitted by the State Auditor.
  - b. To confer with the State Auditor regarding the audit reports reviewed by the committee.
  - c. As necessary, to confer with representatives of state departments, agencies, and institutions audited in order to obtain information regarding fiscal transactions and governmental operations.
11. **Family Health Division performance audit** - Receive the results of the performance audit of the Family Health Division of the State Department of Health during the 2011-13 biennium pursuant to Section 9 of 2011 House Bill No. 1004.

## REQUESTS AND RECOMMENDATIONS DURING PREVIOUS INTERIMS

The committee has made various recommendations and requests during past interims, including:

1. **Discussion of audit findings prior to presentation of the report** - The State Auditor should consider discussing audit findings with appropriate boards or commissions prior to the audit report being presented to the committee.
2. **Actions taken by audited agency** - Audited agencies, boards, and commissions should report to the committee at the time the audit report is presented regarding actions taken as a result of audit findings contained in the report.
3. **Responses to recommendations** - Each audit report prepared by the State Auditor should include a summary of audit recommendations along with the audited agency's written response to the recommendations. The summary is to be in recommendation-response format.
4. **Acceptance of audit reports** - The Legislative Audit and Fiscal Review Committee receives audit reports as presented by the State Auditor's office and other independent auditors and by motion accepts the reports. The motion is not a directive for the adoption of the audit recommendations. A representative of the State Auditor's office will follow up on any previous audit findings and recommendations at the time of the next audit. If the agency has not taken steps to address the recommendation or cannot document a justifiable reason for not implementing the recommendation at the time of the next audit, it will be again included as an audit finding and recommendation.
5. **Implementation of recommendations** - Each state agency and institution should comply with and implement, within the limits of the law, recommendations contained in audit reports prepared by the State Auditor's office. Such compliance and implementation should be viewed toward improvement of government operations, including fiscal operations and to full execution of the law.
6. **Six-month review** - The State Auditor's office should determine whether agencies have complied with the auditor's recommendations within six months after a report has been accepted by this committee. The State Auditor should report to this committee, or another appropriate legislative committee, regarding any recommendations not implemented.
7. **Copies of management letters** - The State Auditor should provide copies of management letters to committee members.
8. **Use of salaries and wages funding** - The State Auditor should consider including in audit reports information on the amount of salaries and wages funding spent on filled full-time

equivalent (FTE) positions and the amount relating to vacant FTE positions which is spent for other purposes.

9. **Committee followup with agencies that have not complied with audit recommendations** - The Legislative Audit and Fiscal Review Committee, by motion, may direct the Legislative Council staff to send correspondence to an agency that has not complied with previous audit recommendations requesting the agency to appear before the Legislative Audit and Fiscal Review Committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
10. **Presentation of evidence to the Attorney General** - Pursuant to Section 54-35-02.2, whenever the Legislative Audit and Fiscal Review Committee determines or has reason to believe there may have been a violation of law relating to the receipt, custody, or expenditure of public funds by any state officer or employee, the committee is to present such evidence or information to the Attorney General. Upon receipt of the information, the Attorney General is to immediately commence an investigation. If the evidence supplied by the committee and through the investigation indicates the probability of a violation of law by any state official or employee, the Attorney General is to prosecute the state official or employee as provided by law.
11. **Report on significant findings and recommendations** - The State Auditor should consider providing a report to the House and Senate Appropriations Committees and each member of the Legislative Audit and Fiscal Review Committee at the beginning of each legislative session regarding significant audit findings and recommendations contained in the financial and performance audit reports presented to the Legislative Audit and Fiscal Review Committee during the previous interim. The State Auditor's office presented a summary of significant audit findings and recommendations from audit reports presented to the Legislative Audit and Fiscal Review Committee during the 2005-06 interim to the Appropriations Committees at the start of the 60<sup>th</sup> Legislative Assembly. A similar report was presented by the State Auditor's office at the start of the 61<sup>st</sup> Legislative Assembly for audit reports presented to the Legislative Audit and Fiscal Review Committee during the 2007-08 interim. The State Auditor's office prepared a similar report for audits presented to the Legislative Audit and Fiscal Review Committee during the 2009-10 interim.

## AUDIT GUIDELINES

During the 2005-06 interim, the Legislative Audit and Fiscal Review Committee received suggested changes from the State Auditor's office to revise the 12 audit guidelines as some of the guidelines were no longer applicable to state agencies. The six new questions as proposed by the State Auditor's office to be addressed would highlight key areas and issues that are of interest to committee members and provide similar information to those made by auditors to an "audit committee." The committee also received input and approval from representatives of Eide Bailly LLP and Brady, Martz & Associates PC regarding the six new questions.

The committee also considered other areas the auditors could address before the Legislative Audit and Fiscal Review Committee, such as significant changes in accounting policies, accounting estimates, audit adjustments, disagreements with management, consultation with other independent auditors, major issues discussed with management prior to the auditors' retention, difficulties encountered in performing the audits, and high-risk information technology systems critical to an agency's operations.

The Legislative Audit and Fiscal Review Committee approved replacement of the 12 audit guidelines with six audit questions and eight other issues to be communicated by the auditors to the Legislative Audit and Fiscal Review Committee. For audit periods covering fiscal years ending June 30, 2006, and thereafter, auditors of state agencies and institutions are requested to address the following six audit questions:

1. What type of opinion was issued on the financial statements?
2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?
3. Was internal control adequate and functioning effectively?
4. Were there any indications of lack of efficiency in financial operations and management of the agency?
5. Has action been taken on findings and recommendations included in prior audit reports?
6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

The eight issues to be communicated to the Legislative Audit and Fiscal Review Committee identify:

1. Significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.
2. Significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the

auditor's conclusions regarding the reasonableness of those estimates.

3. Significant audit adjustments.
4. Disagreements with management, whether resolved to the auditor's satisfaction, relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.
5. Serious difficulties encountered in performing the audit.
6. Major issues discussed with management prior to retention.
7. Management consultations with other accountants about auditing and accounting matters.
8. High-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by auditors are directly related to the operations of an information technology system.

## AUDIT APPROACH

During the 1999-2000 interim, the committee received testimony from a representative of the State Auditor's office regarding the agency's plan to change the audit approach used in conducting audits of state agencies and institutions. For audits of state agencies and institutions conducted by the State Auditor's office, governmental auditing standards for performance audits are more applicable than governmental auditing standards for financial audits. A report on an audit conducted using performance auditing standards includes audited financial statements but does not include an opinion on those financial statements because the audit will not determine if the financial statements are prepared in accordance with generally accepted accounting principles. The committee supported the proposal presented by the State Auditor's office to begin conducting audits of state agencies and institutions using governmental auditing standards for performance audits.

The State Auditor's office began to use the new audit approach during the 2001-02 interim. Financial audits conducted by public accounting firms continue to utilize governmental auditing standards for financial audits.

## AUDIT REQUIREMENTS FOR THE STATE AUDITOR'S OFFICE

Section 54-10-04 requires the Legislative Assembly to provide for a financial statement audit of the State Auditor's office. A copy of the audit report must be filed with the Governor and with each house of the Legislative Assembly. The State Auditor's office audit report for the fiscal years ended June 30, 2009 and 2008 was completed by Eide Bailly LLP. This

audit report was reviewed and approved by the Legislative Audit and Fiscal Review Committee during the February 10, 2010, meeting.

The National State Auditors Association requires state auditor's offices to be subject to an external quality control review every three years. The system of quality control encompasses the office's organizational structure and policies adopted and procedures established to provide reasonable assurance of conforming to governmental auditing standards. The most recent quality control review of the State Auditor's office for the period April 1, 2010, to March 31, 2011, is attached as an [appendix](#). The review identified the following findings:

- The State Auditor's office should document its consideration of nonaudit services, including the effect of any reportable deficiencies in internal control over financial reporting, and conclusions about the impact on independence.
- The State Auditor's office should ensure controls for all direct and material compliance requirements are tested sufficiently in order to support a low assessed level of control risk.
- The State Auditor's office should ensure that auditors determine whether relevant controls have been implemented.
- The State Auditor's office should ensure that audit reports are dated and evidence obtained in accordance with generally accepted government auditing standards and American Institute of Certified Public Accountants standards.

## PERFORMANCE AUDITS

During the 2009-10 interim, the committee received performance audit reports on the Department of Commerce, North Dakota University System capital projects, and Medicaid provider and recipient fraud and abuse.

The following table lists the status of performance audits presented to the Legislative Audit and Fiscal Review Committee during the 1997-99 through 2009-11 bienniums:

Performance Audit	Status
<b>1997-99 biennium</b>	
State procurement practices	October 7, 1997, and January 21, 1998
State employee classification system	October 6, 1998, and January 27, 1999
Workers Compensation Bureau (performance review)	October 6, 1998
Job Service North Dakota	October 6, 1998
<b>1999-2001 biennium</b>	
Contracts for services	May 22-23, 2000
Child support enforcement program (Department of Human Services)	October 16-17, 2000
Workers Compensation Bureau (performance review)	October 16-17, 2000
Job Service North Dakota	October 16-17, 2000

Performance Audit	Status
<b>2001-03 biennium</b>	
Aging Services, service payments for elderly and disabled, and expanded service payments for elderly and disabled programs (Department of Human Services)	November 26, 2001
Veterans' Home	October 2, 2002, and January 22, 2003
Workers Compensation Bureau (performance review)	October 2, 2002
Job Service North Dakota	October 2, 2002
<b>2003-05 biennium</b>	
Driver and Vehicle Services (Department of Transportation)	September 3-4, 2003
Administrative Committee on Veterans' Affairs and the Department of Veterans' Affairs	August 10, 2004
Workforce Safety and Insurance (performance review)	October 27, 2004
Job Service North Dakota	October 27, 2004
Department of Corrections and Rehabilitation	January 24, 2005
<b>2005-07 biennium</b>	
Division of Emergency Management	January 10, 2006
Collection and use of 911 fees (Division of Emergency Management)	January 10, 2006, and June 19, 2006
Workforce Safety and Insurance (performance audit)	November 29, 2006
Workforce Safety and Insurance (performance review)	November 29, 2006
<b>2007-09 biennium</b>	
University of North Dakota (UND) School of Medicine and Health Sciences	November 19, 2007
Wildlife Services program	July 8, 2008
Workforce Safety and Insurance (performance review)	October 20, 2008
<b>2009-11 biennium</b>	
Department of Commerce	September 30, 2009
University System capital projects	May 12, 2010
Medicaid provider and recipient fraud and abuse	October 21, 2010

## DEPARTMENT OF COMMERCE

In September 2009 the Legislative Audit and Fiscal Review Committee received the performance audit report of the Department of Commerce. The goals of the performance audit were to determine if the application process and monitoring of centers of excellence provide adequate accountability for the use of state funds and if an adequate system for monitoring operations of the Department of Commerce has been established. Areas reviewed during the audit were:

1. Centers of excellence accountability;
2. Department of Commerce operations;
3. North Dakota Development Fund, Inc; and
4. Agricultural Products Utilization Commission.

The performance audit report contained 50 recommendations. Based on the performance audit, the State Auditor's office determined:

- The application process and monitoring of centers of excellence have not provided adequate accountability for the use of state funds. No determination has been made regarding the centers of excellence having the desired economic impact as required by state law.
- The Department of Commerce has not established an adequate system for monitoring department operations. Improvements are needed to have an effective departmentwide monitoring function.
- Improvements are needed to ensure policies relating to the Development Fund, Inc., are reviewed, updated, and complied with.
- Improvements are needed to ensure policies relating to the Agricultural Products Utilization Commission are reviewed, updated, and complied with.

### **UNIVERSITY SYSTEM CAPITAL PROJECTS**

In May 2010 the Legislative Audit and Fiscal Review Committee received the performance audit report of the University System capital projects. The goal of the performance audit was to determine if University System capital projects are adequately monitored.

The performance audit report contained 18 recommendations. Based on the performance audit, the State Auditor's office determined:

- Capital projects within the University System are not adequately monitored.
- The University System does not have a unified system for capital projects.
- Monitoring of compliance with State Board of Higher Education policies relating to capital projects is minimal.
- North Dakota State University and UND have not complied with capital project requirements in state law and State Board of Higher Education policies.
- Dickinson State University is not in compliance with capital project requirements in State Board of Higher Education policies.

### **MEDICAID PROVIDER AND RECIPIENT FRAUD AND ABUSE**

In October 2010 the Legislative Audit and Fiscal Review Committee received the performance audit report of Medicaid provider and recipient fraud and abuse. The goal of the performance audit was to determine if the Department of Human Services adequately identifies and pursues indications of potential Medicaid provider or recipient fraud and/or abuse.

The performance audit report contained 21 recommendations. Based on the performance audit, the State Auditor's office determined:

- Improvements are needed to ensure an effective surveillance and review process is established to protect the integrity of the Medicaid program. The Surveillance and Utilization Review System Unit should be organized outside the control of other Medicaid operations. A review is necessary to ensure adequate resources exist to perform required functions.
- Potential Medicaid provider fraud and abuse is not adequately identified and pursued by the Department of Human Services. Improvements are needed to ensure appropriate action is taken when a provider is suspected of fraud or abuse. Improvements are needed with denied claims information received by the department from outside vendors. Changes are needed with the audits/reviews conducted on qualified service providers.
- Potential Medicaid recipient fraud and abuse is not adequately identified and pursued by the Department of Human Services. Changes are needed to ensure appropriate action is taken when a recipient is suspected of fraud or abuse. Improvements are needed within the department to communicate indications of fraud or abuse identified with program recipients.

### **INFORMATION TECHNOLOGY AUDITS**

Section 54-10-29 provides that the State Auditor's office may conduct a review and assessment of computer systems and related security systems. Tests conducted in connection with this review and assessment may include an assessment of system vulnerability, network penetration, potential security breach, and susceptibility to cyber attack or cyber fraud. The State Auditor's office may procure the services of a specialist in information security systems or other contractors deemed necessary for the assessment. The Legislative Assembly in 2011 approved \$150,000 from the general fund, the same as the 2009-11 biennium, for an information technology consultant to test state agency and political subdivision information technology system security.

#### **North Dakota Network and Security Audit**

In February 2010 a representative of ManTech Security and Mission Assurance presented the North Dakota network and security audit report. The audit focused on five tasks--external vulnerability assessment, internal vulnerability assessment, penetration testing, wireless security assessment, and application security assessment.

The external vulnerability assessment identified 109 systems at state agencies or organizations with at least one vulnerability that would provide an external

attacker with a possible attack vector that could lead to compromise of the state's network from the Internet. The external vulnerability assessment identified nine unique high-risk vulnerabilities on multiple systems, three unique medium-risk vulnerabilities on multiple systems, and two unique low-risk vulnerabilities on multiple systems. The external vulnerability assessment resulted in the recommendation to filter inbound access to all state systems.

The internal vulnerability assessment identified 440 systems at state agencies or organizations with at least one vulnerability that would provide an attacker with a possible attack vector that could lead to compromise of the state's network and sensitive information. The internal vulnerability assessment identified 23 unique high-risk vulnerabilities on multiple systems, 19 unique medium-risk vulnerabilities on multiple systems, and 4 unique low-risk vulnerabilities on multiple systems. The internal vulnerability assessment resulted in the following general recommendations:

- Segment public-facing servers from internal network.
- Segregate critical internal servers and development systems.
- Implement outbound access control.
- Require use of encrypted protocols for remote management.

The penetration test team was successful in gaining full administrative control of 14 systems and was successful in its attempts to gain user account credentials and showed the susceptibility of users to execute malicious content download from the Internet or access unknown media on their local systems. The penetration test resulted in no recommendations.

An application security assessment was performed on the Game and Fish Department online services, Department of Transportation driver's license online services, the criminal justice information sharing system, and the Job Service North Dakota unemployment insurance Internet claim entry. The application security assessment identified eight unique findings with the applications--four high-risk, two medium-risk, and two low-risk vulnerabilities. The application security assessment resulted in no recommendations.

A wireless security assessment was performed at the State Capitol, the Department of Transportation building, the State Water Commission building, and

the Bank of North Dakota. No high-risk, medium-risk, or low-risk vulnerabilities were identified.

The committee accepted the North Dakota network and security audit report.

### **PROPOSED ACTION PLAN**

The following is a proposed action plan the committee may wish to consider in fulfilling its statutory duties:

1. Receive audit reports prepared by the State Auditor's office and independent auditors.
2. Receive performance audit reports as determined necessary by the State Auditor or this committee.
3. Receive followup reports for the Wildlife Services, UND School of Medicine and Health Services, Department of Commerce, University System capital projects, and Medicaid provider and recipient fraud and abuse performance audits.
4. Receive information technology audit reports, including an Information Technology Department system audit report and a North Dakota network and security audit report.
5. Request a performance audit be conducted, as deemed necessary by this committee, for Job Service North Dakota pursuant to Section 52-02-18.
6. Direct the Legislative Council staff to send correspondence, as deemed necessary, to each agency that has not complied with previous audit recommendations requesting the agency to appear before the Legislative Audit and Fiscal Review Committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
7. Receive annual reports on the status of accounts receivable for the Department of Human Services and the Developmental Center at Westwood Park, Grafton.
8. Receive annual audit reports from any corporation, limited partnership, or limited liability company that produces ethyl alcohol or methanol in this state and which receives a production subsidy from the state.
9. Develop recommendations and related bill drafts.
10. Prepare the final report for submission to the Legislative Management.

ATTACH:1