

## LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2013-15 BIENNIUM

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 2013-15 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 Life Skills and Transition Center (formerly 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 4.1-72-08 provides for the audit report to be submitted electronically 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.

### **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 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 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 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 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 has prepared summaries of significant audit findings and recommendations from audit reports presented to the

Legislative Audit and Fiscal Review Committee and presented, upon request, these summaries to the Appropriations Committees at the start of legislative sessions.

### 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 Legislative Audit and Fiscal Review 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 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 committee approved replacement of the 12 audit guidelines with 6 audit questions and 8 other issues to be communicated by the auditors to the 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 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, 2011 and 2010 was completed by Eide Bailly LLP. This audit report was reviewed and approved by the committee during the March 27, 2012, 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 quality control review of the State Auditor's office for the period April 1, 2010, to March 31, 2011, was received by the committee in August 2011. 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.

The next quality control review of the State Auditor's office is anticipated to be completed in June 2014.

### PERFORMANCE AUDITS

During the 2011-12 interim, the committee received performance audit reports on Dickinson State University, the use of state-supplied vaccines by a provider, the State Department of Health Family Health Division, and fees charged at North Dakota State University (NDSU) and the University of North Dakota (UND). During the 2013 Legislative Assembly, the committee received performance audit reports on the State Water Commission's regulation of industrial water use in the state and the North Dakota University System office.

The following table lists the status of performance audits presented to the committee during the 1997-99 through 2011-13 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
<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

Performance Audit	Status
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>	
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
<b>2011-13 biennium</b>	
Dickinson State University	March 27, 2012
Use of state-supplied vaccines by a provider (State Department of Health)	March 27, 2012
State Department of Health Family Health Division	June 21, 2012
Fees charged at NDSU and UND	July 26, 2012
State Water Commission's regulation of industrial water use in the state	January 24, 2013
University System office	March 12, 2013

### DICKINSON STATE UNIVERSITY

In March 2012 the committee received the performance audit report of Dickinson State University. The objective of the performance audit was to determine if the university has established an adequate system for monitoring operations. Areas reviewed during the audit were:

1. Tuition and fees;
2. Scholarships and waivers;
3. Fiscal-related areas;
4. The enrollment process;
5. Compliance with academic standards; and
6. Compliance with requirements for international students.

The performance audit report contained 33 recommendations. Based on the performance audit, the State Auditor's office determined Dickinson State University has not established an adequate system for monitoring operations and significant improvements are needed at the university relating to tuition and student fees.

The committee accepted the Dickinson State University audit report.

### USE OF STATE-SUPPLIED VACCINES

In March 2012 the committee received the performance audit report of the use of state-supplied vaccines. The objective of the performance audit was to determine if state-supplied vaccines were used in compliance with agreed-upon terms and conditions by the provider. Areas reviewed during the audit were:

1. Provider's use of state-supplied vaccines;
2. Monitoring process;
3. On-site visits; and
4. Borrowing of state-supplied vaccines.

The performance audit report contained five recommendations. Based on the performance audit, the State Auditor's office determined state-supplied vaccines were not used in compliance with agreed-upon terms and conditions by a certain provider.

The committee accepted the use of state-supplied vaccines audit report.

### **STATE DEPARTMENT OF HEALTH FAMILY HEALTH DIVISION**

In June 2012 representatives of CliftonLarsonAllen LLP, Certified Public Accountants, presented the performance audit report of the State Department of Health Family Health Division. The objective of the performance audit was to review the control environment to address potential fiscal irregularities.

The performance audit report contained three high-risk observations, seven moderate-risk observations, and one low-risk observation. Based on the performance audit, the State Department of Health should:

- Include a "whistleblower" protection policy in its personnel policy manual.
- Identify applicable developmental training for program managers and division directors.
- Implement a procedure for tracking and monitoring transfers of expenditures relating to federal grants.
- Evaluate management's oversight and leadership skills regularly and perform regular surveys of employees in the Family Health Division.
- Evaluate management's approach to handling personnel issues.
- Evaluate how the Community Health Section leadership rotation model affects consistency in day-to-day operations, long-term strategic plans, and independence in the chain of command.
- Implement a process to regularly assess employee morale.
- Include detail when documenting compensatory time.
- Approve annual leave before the employee takes annual leave.
- Consider using a credit card for taxicab fares in certain circumstances.
- Require employees to submit original receipts in order to receive expense reimbursement.

The committee accepted the State Department of Health Family Health Division audit report.

### **FEES CHARGED AT NORTH DAKOTA STATE UNIVERSITY AND UNIVERSITY OF NORTH DAKOTA**

In July 2012 the committee received the performance audit report of fees charged at NDSU and UND. The objective of the performance audit was to determine if fees are appropriately established and used by NDSU and UND. Areas reviewed during the audit were:

1. Fee accountability;
2. Mandatory, program, course, and other fees; and
3. Use of fees and public resources.

The performance audit report contained 24 recommendations. Based on the performance audit, the State Auditor's office determined NDSU and UND have inappropriately used fee money and improvements were needed with the establishment, monitoring, and use of fees.

The committee accepted the audit report on fees charged at NDSU and UND.

### **STATE WATER COMMISSION'S REGULATION OF INDUSTRIAL WATER USE IN THE STATE**

In December 2012 the committee expanded the performance audit of the State Water Commission's regulation of industrial water use to include a review of the water permitting process of the State Water Commission and to authorize costs of up to an additional \$50,000 for hiring a certified public accounting firm to assist with the performance audit.

In January 2013 a representative of KPMG, LLP, presented Part 1 of the performance audit report of the Water Appropriations Division of the North Dakota Office of the State Engineer. The objective of the performance audit was to provide an assessment of the industrial water use monitoring and reporting policies and procedures used by the Water Appropriations Division.

The performance audit report contained 17 recommendations. Based on the performance audit, KPMG determined that the Water Appropriations Division executes reporting and monitoring practices to adhere to laws, regulations, and policies. However, the practices are not formally documented and are primarily manual in nature, which may result in inconsistent application of policies and procedures. KPMG determined improvements are needed with the establishment of standard operating procedures, the development of online reporting tools, and the use of technological enhancements.

The committee accepted the audit report on the State Water Commission's regulation of industrial water use in the state. Part 2 of the performance audit report will be presented at the July 2013 committee meeting.

### **UNIVERSITY SYSTEM OFFICE**

In March 2013 the committee received the performance audit report of the University System office. The objective of the performance audit was to determine if the University System office is adequately staffed to perform its functions.

The performance audit report contained 15 recommendations. Based on the performance audit, the State Auditor's office determined that the University System office does not appear to be adequately staffed. However, resources within the entire university system may be available to adequately staff the University System office. The performance audit identified significant improvements were needed relating to resources, monitoring, planning, and becoming a unified system.

The committee accepted the audit report on the University System office.

### **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 2013 approved \$250,000 from the general fund, an increase of \$100,000 from the 2011-13 biennium, for an information technology consultant to test state agency and University System information technology system security.

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

In October 2012 a representative of ManTech Security and Mission Assurance presented the North Dakota network and security audit report. The audit focused on three tasks--external vulnerability assessment, internal vulnerability assessment, and penetration testing.

The external vulnerability assessment identified six unique high-risk vulnerabilities on multiple systems, four unique medium-risk vulnerabilities on multiple systems, and one unique low-risk vulnerability on multiple systems.

The internal vulnerability assessment identified 22 unique high-risk vulnerabilities on multiple systems, 4 unique medium-risk vulnerabilities on multiple systems, and 2 unique low-risk vulnerabilities on multiple systems.

The penetration test team completed five penetration testing scenarios for further explorations based on the findings in the external vulnerability assessment. Upon a detailed review of each system and publically available exploits for the identified vulnerabilities, the project team determined none of the proposed scenarios were viable for execution. In a "phishing" exercise, the project team sent "phishing" e-mails to 545 state employees and collected 63 sets of valid credentials from employees that did not realize the e-mail was a "phishing" exercise.

The external vulnerability assessment, internal vulnerability assessment, and penetration testing resulted in the following general recommendations:

- Implement a formal patch management program.
- Internal segregation of critical servers and development systems.
- Require use of encrypted protocols for remote management.
- Restrict access to protocols for remote management from the Internet.

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 University System capital projects, Medicaid provider and recipient fraud and abuse, use of state-supplied vaccines by a provider, Dickinson State University, fees charged at NDSU and UND, and University System office 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 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 Life Skills and Transition Center (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.