

August 2007

## LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2007-08 INTERIM - RECOMMENDATIONS AND REQUESTS MADE DURING PREVIOUS INTERIMS

The Legislative Council by statute appoints a Legislative Audit and Fiscal Review Committee as a division of its Budget Section. Pursuant to North Dakota Century Code (NDCC) 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 2007-09 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association pursuant to NDCC 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 NDCC 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 Developmental Center at Westwood Park, Grafton, pursuant to NDCC 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. North Dakota Century Code Section

26.1-50-05 provides for the audit report to be submitted to the Legislative Council, which has assigned the responsibility to this committee.

5. **Stockmen's Association** - Receive a biennial audit report from the North Dakota Stockmen's Association. North Dakota Century Code Section 36-22-09 provides for the audit report to be submitted to the Legislative Council. The Legislative Council 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 NDCC 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 NDCC Section 54-10-01.
8. **Frequency of audits** - Determine the frequency of audits or reviews of state agencies pursuant to NDCC 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 NDCC 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 NDCC 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. **Workforce Safety and Insurance** - Receive annual reports from the director of Workforce Safety and Insurance and the chairman of the Workforce Safety and Insurance Board of Directors, pursuant to NDCC Section

65-02-03.3, and receive reports from the director of the Workforce Safety and Insurance Board of Directors, the chairman of the Workforce Safety and Insurance Board of Directors, and the auditor regarding the biennial performance review of Workforce Safety and Insurance pursuant to Section 65-02-30.

## 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 accept 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 NDCC 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 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 House and Senate Appropriations Committees at the start of the 60<sup>th</sup> Legislative Assembly.

### **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, Certified Public Accountants, 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.

### **NEW 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

North Dakota Century Code 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, 2005 and 2004 was completed by Eide Bailly LLP, Certified Public Accountants. This audit report was reviewed and approved by the Legislative Audit and Fiscal Review Committee during the January 10, 2006, 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, 2004, to March 31, 2005, is attached as [Appendix A](#). The review identified the following findings:

- The State Auditor's office should fully implement the requirements of Statements on Auditing Standards Number 99 requiring the auditor to conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity, and the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.
- The State Auditor's office did not properly implement all report language changes pursuant to the latest guidance from the American Institute of Certified Public Accountants.
- The State Auditor's office did not clearly state the conclusions for each audit objective in the audit reports.

## PERFORMANCE AUDITS

During the 2005-06 interim, the committee received performance audit reports on the Department of Emergency Services, including a review of fees collected for 911 services and the utilization of fees, and Workforce Safety and Insurance. During the 2005 Legislative Assembly, the Legislative Audit and Fiscal Review Committee received and accepted the performance audit of the Department of Corrections and Rehabilitation.

In addition to the performance audits required by law, the Legislative Audit and Fiscal Review Committee has requested the State Auditor's office to conduct:

- A performance audit of the University of North Dakota School of Medicine and Health Sciences.

- A performance audit on state agency cell phone usage, including a review of the propriety of state cell phone usage, the types of cell phone plans purchased, the number of minimally used cell phones, and various alternative methods to reimburse state employees for cell phone usage.
- A performance audit of the Department of Transportation's Fleet Services.

The 2007 Legislative Assembly provided in Section 16 of Senate Bill No. 2009 ([Appendix B](#)) that the State Auditor's office conduct a performance audit of the services provided pursuant to the cooperative agreement between the Agriculture Commissioner and the United States Department of Agriculture Wildlife Services during the 2007-09 biennium. The performance audit is to include a review of all funding sources, including grants from the Agriculture Commissioner, game and fish funds, and federal funds, for the wildlife damage management program in North Dakota for the 2003-05, 2005-07, and 2007-09 bienniums. The State Auditor's office estimates the performance audit of Wildlife Services will be completed in the spring of 2008.

The following table lists the status of performance audits presented to the Legislative Audit and Fiscal Review Committee during the 1997-99, 1999-2001, 2001-03, 2003-05, and 2005-07 bienniums:

Performance Audit	Status
<b>1997-99 biennium</b>	
State procurement practices	Presented October 7, 1997, and January 21, 1998
State employee classification system	Presented October 6, 1998, and January 27, 1999
Workers Compensation Bureau (performance review)	Presented October 6, 1998
Job Service North Dakota	Presented October 6, 1998
<b>1999-2001 biennium</b>	
Contracts for services	Presented May 22-23, 2000
Child support enforcement program (Department of Human Services)	Presented October 16-17, 2000
Workers Compensation Bureau (performance review)	Presented October 16-17, 2000
Job Service North Dakota	Presented 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)	Presented November 26, 2001
Veterans Home	Presented October 2, 2002, and January 22, 2003

Performance Audit	Status
Workers Compensation Bureau (performance review)	Presented October 2, 2002
Job Service North Dakota	Presented October 2, 2002
<b>2003-05 biennium</b>	
Driver and Vehicle Services (Department of Transportation)	Presented September 3-4, 2003
Administrative Committee on Veterans Affairs and the Department of Veterans Affairs	Presented August 10, 2004
Workforce Safety and Insurance (performance review)	Presented October 27, 2004
Job Service North Dakota	Presented October 27, 2004
Department of Corrections and Rehabilitation	Presented January 24, 2005
<b>2005-07 biennium</b>	
Division of Emergency Management	Presented January 10, 2006
Collection and use of 911 fees (Division of Emergency Management)	Presented January 10, 2006, and June 19, 2006
Workforce Safety and Insurance (performance audit)	Presented November 29, 2006
Workforce Safety and Insurance (performance review)	Presented November 29, 2006

## WORKFORCE SAFETY AND INSURANCE PERFORMANCE AUDIT

In November 2006 the Legislative Audit and Fiscal Review Committee received the performance audit report of Workforce Safety and Insurance. The goals of the performance audit report were:

1. Has Workforce Safety and Insurance established an adequate procurement system?
2. Has Workforce Safety and Insurance established an adequate human resource management system?
3. Are adequate policies and procedures established to provide appropriate leadership and accountability for Workforce Safety and Insurance?

The performance audit report contained 60 recommendations. Findings included in the performance audit include:

- The State Auditor's office noted a significant lack of adequate procurement policies and implementation of policies that have been established.
- The State Auditor's office noted a number of areas of concern related to aspects of human resources, including hiring of employees, evaluating employees, conducting investigations involving employees, using a

pay-for-performance system, making payments to employees, and establishing adequate policies. Due to the lack of an adequate system, the State Auditor's office noted inconsistencies, inappropriate actions being taken, and apparent preferential treatment taking place.

- The State Auditor's office noted a number of areas of concern relating to the organization's personnel system, procurement system, strategic planning, and actions, or lack of actions, taken by the executive director.
- The State Auditor's office noted a number of areas where improvement could be made relating to the Workforce Safety and Insurance Board's governance of the organization as well as compliance with its adopted governance model.

Section 5 of 2007 Senate Bill No. 2021 ([Appendix C](#)) provides that Workforce Safety and Insurance report quarterly to the Budget Section during the 2007-08 interim on the agency's status of implementing the performance audit recommendations of the State Auditor.

## CONTINUING APPROPRIATION STUDY

During the 2005-06 interim, the Legislative Audit and Fiscal Review Committee studied state agency and institution continuing appropriation authority. A continuing appropriation is not specifically defined in the North Dakota Century Code. In general, a continuing appropriation can be defined as an appropriation of funds which is not specific in time or amount. Continuing appropriations are provided by a statutory authorization that remains in force or can be carried on from biennium to biennium, permitting state agencies, boards, or institutions to incur obligations and make payment for specified purposes or uses. These are typically accomplished by using phrases such as "standing appropriation," "continuing appropriation," or "revolving fund."

The Legislative Audit and Fiscal Review Committee requested selected agencies and institutions to present information to the committee regarding statutory authority for continuing appropriation authority within the agencies or institutions; justification for continuing the authority; and related revenues, expenditures, and fund balances for previous bienniums and projections for the 2005-07 biennium. The committee made no recommendation regarding the study of continuing appropriations.

The Office of Management and Budget also directed executive branch agencies to include as part of their 2007-09 biennium budget requests summaries of their continuing appropriations. This continuing appropriations summary report was made available to the 2007 Legislative Assembly.

## AUDITS OF COMPUTER SYSTEMS

North Dakota Century Code 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 2007 Legislative Assembly approved \$100,000 from the general fund, the same amount as the 2005-07 biennium, for an information technology consultant to test state agency and political subdivision information technology system security.

## PROPOSED ACTION PLAN

The following is a proposed action plan the committee may want 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. Request a performance audit be conducted, as deemed necessary by this committee, for Job Service North Dakota.
4. Receive the biennial performance review of Workforce Safety and Insurance.
5. 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.
6. Receive annual reports on the status of accounts receivable for the Department of Human Services and Developmental Center at Westwood Park, Grafton.
7. 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.
8. Develop recommendations and related bill drafts.
9. Prepare the final report for submission to the Legislative Council.

ATTACH:3