NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

Wednesday, February 10, 2010
Harvest Room, State Capitol
Bismarck, North Dakota

Representative RaeAnn G. Kelsch, Vice Chairman, called the meeting to order at 10:00 a.m.

Members present: Senators Randel Christmann, Jerry Klein; Representatives Merle Boucher, Jeff Delzer, Patrick R. Hatlestad, RaeAnn G. Kelsch, Keith Kempenich, Gary Kreidt, Chet Pollert, Bob Skarphol, Blair Thoreson, Benjamin A. Vig

Members absent: Senators Joan Heckaman, Judy Lee; Representatives Rick Berg, Jerry Kelsh, Louis Pinkerton, Lonny Winrich

Others present: Jim W. Smith, Legislative Council, Bismarck

See attached appendix for additional persons present.

It was moved by Representative Skarphol, seconded by Representative Thoreson, and carried on a voice vote that the minutes of the September 30-October 1, 2009, meeting be approved as distributed.

NORTH DAKOTA NETWORK AND SECURITY AUDIT

Mr. Mark Shaw, Technical Manager, Security Operations Branch, ManTech Security and Mission Assurance, Vienna, Virginia, joined the meeting via telephone. He provided information regarding vulnerability assessment and penetration testing of the Information Technology Department. A copy of the information presented is on file in the Legislative Council office. He said during September and October 2009, ManTech Security and Mission Assurance performed a vulnerability assessment and penetration test for the State Auditor's office. He said the assessment and penetration testing consisted of the following five major project tasks:

Project Task	Description
External vulnerability assessment	An external vulnerability assessment is intended to provide an organization with information on the overall security and risk of the network from an external point of view. External assessment procedures focus on performing Internet research, discovering systems connected to the Internet, and probing the system to discover misconfigurations and vulnerabilities.
Internal vulnerability assessment	An internal vulnerability assessment is intended to provide an organization with information on the overall security and risk of the systems and network from an internal point of view. Internal assessment procedures focus on examining systems for vulnerabilities, misconfigurations, and implementation flaws that may expose the system to additional risk.
Application security assessment	An application security assessment gives an organization an opportunity to thoroughly and realistically evaluate the security posture of an application and its associated components.
Wireless security assessment	A wireless security assessment seeks to identify unauthorized wireless devices and access points within an organization. It may also be used to verify proper setup and controls of approved wireless configurations.
Penetration testing	Penetration testing is intended to provide an organization with information on the overall security and risk picture of its network from an external or an internal point of view. Penetration testing focuses on gaining access to systems under an organization's control.

Mr. Shaw said vulnerabilities discovered were assigned a risk identifier that was relative to the network or system under test. He said the three risk levels used are defined as follows:

- High risk - A high likelihood of compromise of system-level access exists. If exploited, this vulnerability may allow total control of the system.
- Medium risk - A vulnerability exists that may provide access to critical data or user-level access to a system. This vulnerability may lead to further exploitation.
- Low risk - A vulnerability exists that may disclose information but does not directly lead to the exploitation of a system.

Mr. Shaw provided the following summary of the findings and recommendations:

Project Task	Findings	Recommendations
External vulnerability assessment	Overall, 109 systems at state agencies or organizations were found to have at least one vulnerability that would provide an external attacker with a possible attack vector that could lead to the compromise of the state's network from the Internet. There were 14 unique vulnerability findings, including 9 high-risk, 3 medium-risk, and 2 low-risk.	Filter inbound access to all state systems

Project Task	Findings	Recommendations
Internal vulnerability assessment	Overall, 440 systems were found to have at least one vulnerability that would provide an attacker with a possible attack vector that could lead to the compromise of the state's network and sensitive information. There were 46 unique vulnerability findings, including 23 high-risk, 19 medium-risk, and 4 low-risk.	Segment public facing servers from internal network Internal segregation of critical servers and development systems Implement outbound access control Require use of encrypted protocols for remote management
Application security assessment	The applications assessed were: Game and Fish Department online services, Department of Transportation driver's license online services, criminal justice information sharing system, and the Job Service North Dakota unemployment insurance Internet claim entry. There were eight unique vulnerability findings, including four high-risk, two medium-risk, and two low-risk.	None
Wireless security assessment	The following locations were assessed: • State Capitol, 600 East Boulevard Avenue • Department of Transportation, 608 East Boulevard Avenue • State Water Commission, 900 East Boulevard Avenue • Bank of North Dakota, 1200 Memorial Highway No high-, medium-, or low-risk vulnerabilities were identified during the assessment of these locations.	None
Penetration testing	The test team was able to gain full administrative control of 14 systems. In addition, using social engineering techniques, the test team was very successful in its attempts to gain user account credentials and showed the susceptibility of users to execute malicious content downloaded from the Internet or access unknown media on their local systems.	None

Mr. Shaw said the findings are typical of organizations with an enterprise the size of the state of North Dakota. He said these results show an improvement over the assessment conducted in 2007.

In response to a question from Representative Delzer, Mr. Dan Sipes, Director, Administrative Services Division, Information Technology Department, said he would provide information to the Legislative Council regarding attempted attacks on information systems and state agency websites.

In response to a question from Representative Delzer, the legislative budget analyst and auditor said the Legislative Council will provide information regarding whether the North Dakota University System has had vulnerability testing completed on its information technology systems.

DEPARTMENT OF COMMERCE

Mr. Shane C. Goettle, Commissioner, Department of Commerce, presented information regarding the status of implementation of the State Auditor's office performance audit recommendations. A copy of the information presented is on file in the Legislative Council office. He said the department has taken action on 49 of the 50 recommendations included in the audit report. He said 41 recommendations have been fully implemented, 8 recommendations have been partially implemented, and the department disagreed with 1 recommendation in the report. He said the department has hired a compliance manager to assist with the implementation of many of the recommendations.

Mr. Goettle presented information on contracts entered by the department during the 2007-09 biennium exceeding $100,000. A copy of the information presented is on file in the Legislative Council office. He said the department entered eight contracts during the 2007-09 biennium which exceeded $100,000. He said these do not include grants and loan agreements relating to programs such as community services block grants, weatherization assistance, low-income home energy assistance programs, or community development block grants.

VEHICLE REGISTRATION AND TITLING SYSTEM AUDIT

Mr. Don LaFleur, Audit Manager, Information Systems Audit Section, State Auditor's office, presented the audit report for the Department of Transportation's vehicle registration and titling system for the fiscal year ended June 30, 2009. He said the audit report identified three findings relating to security roles and three findings relating to distribution of revenues.

In response to a question from Representative Kempenich, Mr. Shannon Sauer, Director, Financial Management Division, Department of Transportation, said the recommendations included in the audit would not require the department to hire additional staff for implementation.

AUDITS OF STATE AGENCIES, BOARDS, AND COMMISSIONS

Mr. Ed Nagel, Director, State Auditor's office, presented the audit report for the Mill and Elevator Association for the years ended June 30, 2009 and 2008. 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.

In response to questions from Representative Pollert and Representative Kreidt, Mr. Vance Taylor, General Manager, Mill and Elevator, Grand Forks, said he would provide information regarding the decrease in administrative salaries expenses for fiscal year 2009.

Mr. Ron Tolstad, Technical Specialist, Division of State Audit, State Auditor's office, presented the audit report for the North Dakota Lottery for the years ended June 30, 2009 and 2008. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one finding of noncompliance relating to confidential information of prize winners.

Mr. Nagel presented the audit report for the Potato Council for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies three internal control findings relating to segregation of duties, expenditures, and fraud risk assessment. He said the report included two prior audit findings relating to noncompliance with contract terms and conditions and timely submission and accuracy of closing packages.

Mr. Nagel presented the audit reports for the Beef Commission for the years ended June 30, 2009 and 2008, and June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the June 30, 2009, report contains an unqualified opinion and identifies one finding of noncompliance relating to unclaimed property relating to beef certificates. He said the recommendation relating to beef certificates is a prior audit finding included in the June 30, 2008, report. He said the June 30, 2008, report contains an unqualified opinion and also identifies one internal control finding relating to establishing fraud risk assessments and controls.

In response to questions from committee members, the legislative budget analyst and auditor said the Legislative Council will provide information on the state's liability if a statutorily authorized board, commission, or commodity group goes into debt and subsequently defaults on the debt.

The committee recessed for lunch at 12:10 p.m. and reconvened at 1:00 p.m.

Mr. Nagel presented the audit report for the Milk Marketing Board for the years ended June 30, 2008 and 2007. 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. Nagel presented the audit report for the Dairy Promotion Commission for the years ended June 30, 2008 and 2007. 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. Nagel presented the audit report for the Dry Bean Council for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one internal control finding relating to segregation of duties.

Mr. Nagel presented the audit report for the Barley Council for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one internal control finding relating to segregation of duties and one area of operational improvement relating to accruals and closing packages.

Mr. Nagel presented the audit report for the Dry Pea and Lentil Council for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies two internal control findings relating to PeopleSoft access controls and establishing fraud risk assessments and controls.

In response to a question from Representative Skarphol, the Legislative Council staff said information would be provided to the committee regarding the Dry Pea and Lentil Council's hiring practices and staffing levels.

Mr. Nagel presented the audit report for the Oilseed Council for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies two internal control findings relating to segregation of duties and establishing fraud risk assessments and controls.

Mr. Nagel presented the audit report for the Wheat Commission for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies two internal control findings relating to reconciliation of deposits and establishing fraud risk assessments and controls.

Mr. Nagel presented the audit report for the Securities Commission for the years ended June 30, 2008 and 2007. He reviewed the auditor's responses to the committee guidelines and said the report identifies three internal control findings relating to establishing fraud risk assessments and controls, lack of employee evaluations, and segregation of duties. He said the report identifies one area for operational improvement relating to securities applications, reporting, and renewal procedures.

Mr. John Mongeon, Brady Martz & Associates PC, Certified Public Accountants, presented the audit report for the partnership in assisting community expansion (PACE) fund for the years ended June 30,

2009 and 2008. 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. Mongeon presented the audit report for the Ag PACE fund for the years ended June 30, 2009 and 2008. 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. Mongeon presented the audit report for the student loan trust fund for the years ended June 30, 2009 and 2008. He reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one area for operational improvement relating to the federal award program.

Mr. Mongeon presented the audit report for the guaranteed student loan program for the years ended September 30, 2009 and 2008. 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. Mongeon presented the audit report for the Public Employees Retirement System for the years ended June 30, 2009 and 2008. 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. Mongeon said the actuary for the Public Employees Retirement System has determined that the fund's unfunded actuarial accrued liability is approximately $284 million and $128 million, as of June 30, 2009 and 2008, respectively. He said the actuary has determined that the current statutory contribution rates are insufficient to meet the actuarially determined requirements, based on the current assumptions.

Mr. Mongeon presented the audit report for Workforce Safety and Insurance for the years ended June 30, 2009 and 2008. 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. Barb Aasen, Eide Bailly LLP, Certified Public Accountants, presented the audit report for the North Dakota Development Fund, Inc., for the years ended June 30, 2009 and 2008. 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. Aasen presented the audit report for the State Fair Association for the years ended September 30, 2009 and 2008. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies three internal control findings relating to segregation of duties, controls over recording of transactions, and controls over preparation of financial statements.

Ms. Aasen presented the audit report for the Board of University and School Lands for the years ended June 30, 2009 and 2008. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies three internal control findings relating to recording of transactions, preparation of financial statements, and prior period adjustments.

Ms. Aasen presented the audit report for the Housing Finance Agency for the years ended June 30, 2009 and 2008. 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. Aasen presented the audit report for Job Service North Dakota for the years ended June 30, 2009 and 2008. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies two internal control findings relating to preparation of schedule of federal awards and audit adjustments.

Ms. Aasen presented the audit report for the Retirement and Investment Office for the years ended June 30, 2009 and 2008. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one internal control finding relating to recording of fair market value adjustments for alternative investments.

Ms. Aasen said the actuary for the Teachers' Fund for Retirement has determined that the fund's unfunded actuarial accrued liability is approximately $546 million and $421 million, as of June 30, 2009 and 2008, respectively. She said the actuary has determined that the current statutory contribution rates are insufficient to amortize the unfunded actuarial liability over any period of time, based on the current actuarial assumptions.

Ms. Aasen presented the audit report for the State Auditor's office for the years ended June 30, 2009 and 2008. 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. Aasen presented the audit report for the Legislative Assembly for the years ended June 30, 2009 and 2008. She reviewed the auditor's responses to the committee guidelines and said the report contains an unqualified opinion and identifies one internal control finding relating to recording of transactions.

Ms. Aasen presented the audit report for the Legislative Council for the years ended June 30, 2009 and 2008. 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.

Mr. Jason Schuh, Jason Schuh PC, Certified Public Accountant, presented the audit reports for the State Board of Cosmetology for the years ended June 30, 2009, and June 30, 2008. He reviewed the auditor's responses to the committee guidelines and said both reports contain an unqualified opinion and identify one internal control finding relating to

segregation of duties and one finding of noncompliance relating to uninsured deposits.

STATE INVESTMENT BOARD

Mr. Steve Cochrane, Executive Director/Investment Director, Retirement and Investment Office, presented information regarding investment returns of funds invested by the State Investment Board, including the status of funds held in receivership. A copy of the information presented is on file in the Legislative Council office. He said the total State Investment Board exposure to the alleged fraud by WG Trading Investors, L. P., was $161.3 million. He said $23.3 million has been recovered and $138 million is in receivership. He said of the $138 million in receivership, $55.2 million, or 40 percent, was written down in May 2009, resulting in $82.8 million awaiting recovery. He said recovery is expected in approximately two years.

Mr. Cochrane said the market value of the budget stabilization fund was $329,356,450 on December 31, 2009.

Representative Boucher asked that information be provided at a future committee meeting regarding the status of investment funds, including funds of the Public Employees Retirement System and Teachers' Fund for Retirement and the entities' plans to address the unfunded liabilities of their retirement funds.

OTHER REPORTS

Mr. Gordy Smith, Audit Manager, Performance Audit Section, State Auditor's office, presented information regarding the State Auditor's authority relating to audits or reviews of entities and component units of the North Dakota University System. A copy of the information presented is on file in the Legislative Council office. He said component units are legally separate organizations for which the elected officials of a primary government are financially responsible. According to governmental accounting standards, he said, a component unit can be an organization for which the nature and significance of the relationship with a primary government are such that exclusion of the component unit would cause the reporting entity's financial statements to be misleading or incomplete. He said component units that are grouped together for inclusion in the primary government's financial statements are referred to as "blended" component units, and component units that are required to be presented separately in the financial statements are referred to as "discretely presented" component units.

Mr. G. Smith said government accounting standards provide that organizations that are legally separate, tax-exempt entities that meet the following requirements should be discretely presented component units:

1. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
2. The primary government or its component units is entitled to or has the ability to otherwise access a majority of the economic resources received or held by the separate organization.
3. The economic resources received or held by the individual organization that the primary government or its component units is entitled to or has the ability to otherwise access are significant to that primary government.

Mr. G. Smith said there are currently 32 component units associated with the North Dakota University System, including the North Dakota State University Technology Park, the University of North Dakota Aerospace Foundation, and various alumni foundations.

Mr. G. Smith said the State Auditor has limited authority to audit or review the records of the component units. He said the authority to examine the books and accounts of component units is only to the extent of their involvement with the state government agencies and institutions.

STUDY OF REQUIREMENTS FOR POLITICAL SUBDIVISION AUDITS

Mr. G. Smith presented information regarding the length of time required to review audits submitted by private firms. A copy of the information presented is on file in the Legislative Council office. He said the State Auditor's office annually reviews approximately 300 political subdivision audit reports submitted by public accounting firms. He said the amount of time required to review the report depends on the size of the political subdivision. He said the average amount of time needed to review an audit report submitted by a public firm is two to two and one-half hours.

COMMITTEE DISCUSSION AND STAFF DIRECTIVES

Representative Skarphol asked that information be presented at a future committee meeting regarding commodity groups, including fund reserves, fees or rates, and length of time a group could operate on the fund reserves.

Representative Vig asked that the information relating to commodity groups also include each group's budget for research and promotion.

It was moved by Senator Christmann, seconded by Representative Skarphol, and carried on a roll call vote that pursuant to North Dakota Century Code Section 54-35-02.2 the committee accept the following reports presented to the committee:

1. **Mill and Elevator Association (June 30, 2009 and 2008).**
2. **North Dakota Lottery (June 30, 2009 and 2008).**
3. **Potato Council (June 30, 2008 and 2007).**

4. **Beef Commission (June 30, 2009 and 2008, and June 30, 2008 and 2007).**
5. **Milk Marketing Board (June 30, 2008 and 2007).**
6. **Dairy Promotion Commission (June 30, 2008 and 2007).**
7. **Dry Bean Council (June 30, 2008 and 2007).**
8. **Barley Council (June 30, 2008 and 2007).**
9. **Dry Pea and Lentil Council (June 30, 2008 and 2007).**
10. **Oilseed Council (June 30, 2008 and 2007).**
11. **Wheat Commission (June 30, 2008 and 2007).**
12. **Securities Commission (June 30, 2008 and 2007).**
13. **Ag PACE fund (June 30, 2009 and 2008).**
14. **PACE fund (June 30, 2009 and 2008).**
15. **Student loan trust fund (June 30, 2009 and 2008).**
16. **Guaranteed student loan program (September 30, 2009 and 2008).**
17. **Public Employees Retirement System (June 30, 2009 and 2008).**
18. **Workforce Safety and Insurance (June 30, 2009 and 2008).**
19. **North Dakota Development Fund, Inc. (June 30, 2009 and 2008).**
20. **State Fair Association (September 30, 2009 and 2008).**
21. **Board of University and School Lands (June 30, 2009 and 2008).**
22. **Housing Finance Agency (June 30, 2009 and 2008).**
23. **Job Service North Dakota (June 30, 2009 and 2008).**
24. **Retirement and Investment Office (June 30, 2009 and 2008).**
25. **State Auditor's office (June 30, 2009 and 2008).**
26. **Legislative Assembly (June 30, 2009 and 2008).**
27. **Legislative Council (June 30, 2009 and 2008).**
28. **State Board of Cosmetology (June 30, 2009, and June 30, 2008).**
29. **North Dakota network and security audit (June 30, 2009).**
30. **Vehicle registration and titling system (June 30, 2009).**

Senators Christmann and Klein and Representatives Boucher, Hatlestad, R. Kelsch, Kempenich, Kreidt, Skarphol, Thoreson, and Vig voted "aye." No negative votes were cast.

It was moved by Senator Klein, seconded by Representative Thoreson, and carried on a voice vote that pursuant to Section 54-35-02.2 the committee accept the following reports available but not selected for presentation:

1. **State Building Authority (June 30, 2009 and 2008).**
2. **Board of Medical Examiners (December 31, 2008 and 2007).**
3. **Electrical Board (June 30, 2009 and 2008).**
4. **Board of Examiners on Audiology and Speech-Language Pathology (June 30, 2008, 2007, and 2006).**
5. **Board of Examiners for Nursing Home Administrators (June 30, 2008 and 2007).**
6. **Peace Officer Standards and Training Board (December 31, 2008 and 2007).**
7. **Board of Public Accountancy (June 30, 2009).**
8. **Plumbing Board (June 30, 2009 and 2008).**
9. **Board of Dental Examiners (June 30, 2009 and 2008).**
10. **Board of Optometry (June 30, 2007 and 2006).**
11. **Board of Respiratory Care (January 31, 2009 and 2008).**
12. **Abstracters' Board of Examiners (August 31, 2007 and 2006).**
13. **Private Investigation and Security Board (December 31, 2008 and 2007).**
14. **Soybean Council (June 30, 2009).**

Senator Christmann said he anticipates the next meeting of the Legislative Audit and Fiscal Review Committee to be in April 2010.

No further business appearing, Vice Chairman R. Kelsch adjourned the meeting at 4:15 p.m.

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Becky Keller
Senior Fiscal Analyst

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Allen H. Knudson
Legislative Budget Analyst and Auditor

ATTACH:1