

# NORTH DAKOTA LEGISLATIVE COUNCIL

## Minutes of the

### LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

Wednesday and Thursday, September 3-4, 2003  
Roughrider Room, State Capitol  
Bismarck, North Dakota

Representative Francis J. Wald, Chairman, called the meeting to order at 9:05 a.m.

**Members present:** Representatives Francis J. Wald, Ole Aarsvold, Larry Bellew, RaeAnn G. Kelsch, Bob Skarpohl, Blair Thoreson, Mike Timm, Amy Warnke, Lonny Winrich; Senators John M. Andrist, Randel Christmann, Jerry Klein, Aaron Krauter

**Members absent:** Representatives Al Carlson, Jeff Delzer, Andrew Maragos

**Others present:** See attached appendix

#### LEGISLATIVE COUNCIL SUPPLEMENTARY RULES OF OPERATION AND PROCEDURE

At the request of Chairman Wald, the legislative budget analyst and auditor reviewed the *Supplementary Rules of Operation and Procedure of the North Dakota Legislative Council* for the 2003-05 biennium.

#### COMMITTEE DUTIES AND RESPONSIBILITIES

At the request of Chairman Wald, the Legislative Council staff reviewed a memorandum entitled *Legislative Audit and Fiscal Review Committee - Statutory Duties and Responsibilities for the 2003-04 Interim - Recommendations and Requests Made During Previous Interims*. The Legislative Audit and Fiscal Review Committee is a statutory committee of the Legislative Council. North Dakota Century Code (NDCC) Section 54-35-02.1 provides that the committee is created:

- To study and review the financial transactions of the state.
- To assure the collection of revenues and the expenditures of money are in compliance with law, legislative intent, and sound financial practices.
- To provide the Legislative Assembly with formal, objective information on revenue collections and expenditures.

In addition, the committee is assigned the following duties and responsibilities for the 2003-05 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 45-10.1-71.
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. **North Dakota Stockmen's Association** - Receive 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 the biennial performance audit report for the divisions of Job Service North Dakota, pursuant to NDCC Section 52-02-18.
7. **Performance audits** - Determine performance audits of state agencies to be conducted by the State Auditor, 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. Study and review audit reports selected by the committee from those submitted by the State Auditor.
    - b. Confer with the State Auditor regarding the audit reports reviewed by the committee.
    - c. As necessary, 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 Workforce Safety and Insurance, the chairman of the Workforce Safety and Insurance Board of Directors, and the auditor regarding the biennial performance audit of Workforce Safety and Insurance, pursuant to Section 65-02-30.
  12. **Information Technology Department** - Receive annual reports on state information technology projects and plans, pursuant to NDCC Section 54-59-19.
1. Were expenditures made in accordance with legislative appropriations and other state fiscal requirements and restrictions?
  2. Were revenues accounted for properly?
  3. Were there adequate financial controls and procedures?
  4. Was the system of internal control adequate and functioning effectively?
  5. Do financial records and reports reconcile with state fiscal offices?
  6. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?
  7. Was there any indication of fraud or dishonesty?
  8. Were there any indications of lack of efficiency in financial operations and management of the agency?
  9. Has action been taken on findings and recommendations included in prior audit reports?
  10. Were all activities of the agency encompassed within appropriations of specific amounts?
  11. Has the agency or institution implemented the Statewide Accounting and Management Information System (SAMIS), including the cost allocation system?
  12. Has the agency developed budgets of actual anticipated expenditures and revenues on at least a quarterly basis and compared, on at least a quarterly basis, actual expenditures and revenues on the accrual basis to budgeted expenditures and revenues?

## AUDIT PROCESS FOR STATE AGENCIES

The Legislative Council staff also presented a memorandum entitled *Audit Guidelines for State Agencies - 12 Questions*. The Legislative Council staff said the 12 questions are a list of statements to be addressed by auditors of state agencies as part of the postaudit program. The scope of audit examinations requires certain audit procedures from which the auditor can address these statements. Auditors are directed to answer and quantify exceptions to the questions and provide a summary of any recommendation to correct the deficiency. The 12 questions were developed in part to assist the Legislative Audit and Fiscal Review Committee in addressing its statutory responsibilities to study and review the financial transactions of the state and to assure that the collection of revenues and the expenditures of money are in compliance with law. The 12 questions are:

Chairman Wald called on Mr. Ron Tolstad, State Auditor's office, who presented a document entitled *The Audit Process for State Agencies and the Relationship Between the Office of the State Auditor and the Legislative Audit and Fiscal Review Committee*. A copy of the information presented is on file in the Legislative Council office. Mr. Tolstad said the purpose of a financial statement audit is to express an opinion on whether the financial statements are presented fairly in all material respects. He said the audited entity's management is responsible for the financial statements. He said the State Auditor's office performs annual financial statement audits, biennial financial-related operational audits, a biennial audit of the state's federal financial assistance, and performance audits. Mr. Ed Nagel, Jr., State Auditor's office, said copies of completed audit reports are available on the State Auditor's office web page.

In response to a question from Senator Andrist, Mr. Tolstad said the State Auditor's office prepares a followup report nine months to one year after completing a performance audit to make sure audit recommendations have been implemented. He said

biennial audit reports include a section on the status of prior audit recommendations.

In response to a question from Representative Winrich, Mr. Tolstad said performance audits are conducted using governmental auditing standards for performance audits, which is the method used by the State Auditor's office. This method includes more detailed testing of an agency's compliance with laws and regulations than audits conducted using governmental auditing standards for financial audits.

### **OFFICE OF DRIVER AND VEHICLE SERVICES PERFORMANCE AUDIT**

Chairman Wald called on Mr. Gordy Smith, State Auditor's office, who presented the performance audit of the Office of Driver and Vehicle Services, Department of Transportation. Mr. Smith said the Motor Vehicle Division is responsible for all vehicle registration and titling activities and has contracted with 13 private entities and three county treasurer offices throughout the state to act on behalf of the division to register vehicles. He said the State Auditor's office identified the following four goals in conducting the performance audit:

1. Is the driver's license program operating efficiently and effectively?
2. Is the motor vehicle title, license, and registration program operating efficiently and effectively?
3. Are motor carrier, dealer licensing, and traffic safety significant laws, rules, regulations, and policies complied with?
4. Are the organizational structure and programs administered by the Office of Driver and Vehicle Services providing an efficient and effective use of resources?

Mr. Smith said the State Auditor's office contracted with MTG Management Consultants, L.L.C., to provide expertise in the area of driver and vehicle services. He said the audit period for which information was collected and reviewed was July 1, 2000, through December 31, 2002.

In response to a question from Representative Skarphol, Mr. Smith said the Department of Transportation eliminated seven full-time equivalent (FTE) positions in 1998 related to anticipated staff savings from implementing the vehicle registration and titling system (VRTS). He said the department's use of temporary employees and increase in overtime have resulted in a net savings of only an estimated one FTE position.

In response to a question from Representative Skarphol, Mr. Smith said the State Auditor's office would report on the ConnectND project, including the benefits of the project to the State Auditor's office, at the next Legislative Audit and Fiscal Review Committee meeting.

In response to a question from Senator Krauter, Mr. Smith said the Department of Transportation used

a temporary staffing agency for data entry services related to the VRTS, which was accounted for as operating costs rather than salaries.

In response to a question from Representative Wald, Mr. Smith said the Department of Transportation has established 44 driver's license sites across North Dakota, including eight fully automated major sites, 20 automated field sites, and 16 nonautomated field sites. He said the driver's license sites are operated by state employees.

In response to a question from Representative Skarphol, Mr. Smith said the performance audit includes a recommendation that the Department of Transportation's Motor Vehicle Division review and analyze the benefits of utilizing a nonsufficient fund (NSF) check recovery service. In response to a question from Representative Kelsch, Mr. Smith said the Drivers License Division does utilize an NSF check recovery service.

In response to a question from Senator Krauter, Mr. Smith said the performance audit includes a recommendation that the Department of Transportation's Drivers License and Traffic Safety Division's central office provide additional credit card authorization machines in order to minimize delays in completing transactions.

Mr. Smith said the vehicle registration and titling contracts awarded to 13 private vendors are "political" appointments. He said it is recommended that the Department of Transportation evaluate the process for awarding the branch office contracts, including the need to amend state law and consider the use of competitive contracts for branch office operations.

In response to a question from Representative Aarsvold, Mr. Smith said all new title and title transfer transactions from the 16 branch offices are reviewed by the Bismarck office. He said the errors identified are not documented. He said the department estimates an overall error rate of 5 to 10 percent on new title and title transfer transactions.

In response to a question from Representative Wald, Mr. Smith said it is the agency's responsibility to follow laws or propose changes to existing laws. Representative Skarphol said the State Auditor's office should consider including a section in each performance audit identifying sections of the North Dakota Century Code relating to the audited agency that should be reviewed.

Mr. Smith said the department's typical "turn-around time" or the period from which customer documentation is received until the licensing documents are issued is approximately one and one-half weeks. He said prior to implementation of the VRTS, the "turnaround time" was three weeks. He said the State Auditor's office recommends the department consider extending the "turnaround" to three weeks and if acceptable, the current business process could be redesigned to reduce staffing requirements.

In response to a question from Representative Wald, Mr. Smith said the performance audit includes a recommendation for the department to review the cost, work performed per examiner per hour, and other information at the 44 driver's license sites in order to either close or adjust hours of operations at the least productive or most costly sites.

In response to a question from Representative Timm, Mr. Smith said the 16 motor vehicle branch office locations conduct approximately one-third of all registration and titling transactions and the central office in Bismarck conducts approximately two-thirds of all transactions.

In response to a question from Representative Timm, Mr. David Sprynczynatyk, Director, Department of Transportation, said approximately 37,000 of the total 191,000 driver's license renewals submitted during 2002 were completed at the central office in Bismarck. He said 4,000 driver's license transactions were conducted at the 16 nonautomated sites and 187,000 transactions were conducted at the 28 automated sites. He said there are five collocated driver's license and motor vehicle branch offices in North Dakota.

In response to a question from Senator Krauter, Mr. Smith said a request for proposal (RFP) was issued for a consultant to assist in the performance audit and a total of nine bids were received by the State Auditor's office. He said based on proposals received, the contract was awarded to the consulting firm of MTG Management Consultants, L.L.C., at a cost of \$92,916.

Chairman Wald called on Mr. Eric Roechs, Project Manager, MTG Management Consultants, L.L.C., who presented background information on MTG Management Consultants, L.L.C. He said MTG has been in existence since 1997 and is based in Seattle, Washington. He said the company employs 23 consultants, four of whom worked on this project. He said state transportation agencies are MTG's primary clients.

In response to a question from Senator Andrist, Mr. Roechs said MTG conducted a "best practices" survey of other states similar to North Dakota. He said the "best practices" survey results were made available to the Department of Transportation. He said in some states the driver's license issuance and renewal responsibilities are conducted at the county level of government.

In response to a question from Senator Krauter, the legislative budget analyst and auditor said the Legislative Audit and Fiscal Review Committee has on occasion proposed draft legislation, as appropriate.

Mr. Smith said the Department of Transportation was very cooperative with the State Auditor's office during the period the performance audit was conducted.

Mr. Sprynczynatyk said the motor vehicle registration system used prior to the implementation of the VRTS was approximately 30 years old and difficult to maintain. He said due to delays in the VRTS implementation, the original estimated contract completion date of October 1997 was not met. He said the system was implemented in October 2000. He said the developer was overly optimistic in the time it would take to develop this vehicle registration system. He said the actual cost of the VRTS was approximately \$120,000 more than the \$3.2 million originally estimated for the project.

Mr. Sprynczynatyk said seven FTE positions were eliminated before the VRTS was implemented at an annual savings of approximately \$125,000. He said the temporary employee workload is decreasing. He said the department's motor vehicle registration and titling workload has increased since 1997. He said the VRTS system has been a success.

In response to a question from Representative Wald, Mr. Sprynczynatyk said the Department of Transportation regularly communicates with automobile dealerships to keep them informed of changes in the law and to answer questions regarding title and registration requirements.

In response to a question from Representative Skarphol, Mr. Sprynczynatyk said the VRTS provides the department and customers with a reliable system, salary savings, ability for customers to conduct business and "walk out" with registration and titling documentation, on-line registration, shorter "turnaround time," and increased customer satisfaction.

In response to a question from Representative Aarsvold, Mr. Sprynczynatyk said the department will review the need for fee increases before the 2005 legislative session.

In response to a question from Senator Krauter, Mr. Sprynczynatyk said branch offices are contacted by the central office when an error is identified. He said he is confident the department can reduce its current quality control procedures but will contact Risk Management before implementing any changes.

In response to a question from Senator Andrist, Mr. Sprynczynatyk said the Department of Transportation feels the four-year pilot program, approved by the 2001 Legislative Assembly, in which three motor vehicle registration sites--Bowman, Emmons, and McKenzie Counties--were located in the county treasurer's office has been a success.

Chairman Wald asked the Legislative Council to research NDCC Section 39-06-08, relating to the requirement that an application of any minor for an instruction permit or operator's license must be signed by a sponsor and the related liability of the sponsor or of the state if a sponsor's signature is not obtained.

In response to a question from Senator Klein, Mr. Sprynczynatyk said law enforcement is responsible for enforcement of vehicle registration laws. He said in some instances, if the law enforcement agency

is the recipient of vehicle registration fines, laws may be more strictly enforced.

In response to a question from Representative Timm, Mr. Sprynczynatyk said the Highway Patrol is in the process of closing three highway scale sites by the end of 2003 and four additional sites by the end of 2004. He said the Highway Patrol will implement three "weigh in motion" sites in 2003 and up to 10 additional "weigh in motion" sites in 2004.

In response to a question from Representative Winrich, Mr. Sprynczynatyk said Department of Transportation examiners have the authority to deny a request for renewal of license for medical reasons. Ms. Marsha Lembke, Director, Drivers License and Traffic Safety Division, Department of Transportation, said specific procedures must be followed by examiners before a license renewal can be denied, including offering a road test and/or a medical examination.

The committee recessed for lunch from 12:25 to 1:30 p.m.

### **AUDITS OF STATE AGENCIES**

Chairman Wald called on Mr. John Mongeon, Brady, Martz & Associates, P.C., Certified Public Accountants, who presented the audit report for Job Service North Dakota for the year ended June 30, 2002. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Timm, Mr. Mongeon said \$32.9 million was available for unemployment insurance on June 30, 2002. He said that amount does not include \$15 million of federal Reed Act distributions, which are available for unemployment benefit payments or other restricted purposes, including unemployment administration costs. Ms. Maren Daley, Executive Director, Job Service North Dakota, said the unemployment trust fund balance changes seasonally.

In response to a question from Senator Andrist, Ms. Daley said the 1999 Legislative Assembly established a required level of solvency for the unemployment trust fund to be reached within a seven-year period. She said the fund is on schedule to meet the required solvency level. She said the unemployment trust fund balances are updated on a weekly basis. She said it is possible unemployment insurance rates may decrease when the required solvency level is met.

In response to a question from Representative Skarphol, Ms. Daley said the required target level is based on a formula which considers previous years' unemployment payments and thus changes from year to year. She said the current targeted solvency rate is \$71 million, which is anticipated to decrease. She said the current trust fund balance is \$49.6 million, which includes the \$15 million of Reed Act distributions.

In response to a question from Representative Wald, Ms. Daley said Job Service North Dakota is in the process of implementing a method for unemployment forms to be submitted electronically.

Mr. Mongeon presented the audit report for the Retirement and Investment Office for the years ended June 30, 2002 and 2001. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Senator Krauter, Mr. Steve Cochrane, Executive Director, Retirement and Investment Office, said the increase in salaries and wages expenditures was due to the 2001 Legislative Assembly authorizing one additional accounting position for the Retirement and Investment Office.

In response to a question from Representative Skarphol regarding the investment income earned by the trust funds controlled by the Retirement and Investment Office, Mr. Cochrane distributed information to the committee. A copy of the information presented is on file in the Legislative Council office. He said the net total return for fiscal year ended June 30, 2003, was 3.85 percent for the pension trust. He said the pension trust had \$2.39 billion in assets as of June 30, 2003.

Mr. Mongeon presented the audit report for the Public Employees Retirement System for the years ended June 30, 2002 and 2001. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

Mr. Mongeon presented the audit report for the Board of University and School Lands for the year ended June 30, 2002. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Skarphol, Mr. Gary Preszler, Land Commissioner, Board of University and School Lands, said the trust funds controlled by the Board of University and School Lands realized a net investment loss of \$500,000 in fiscal year ended June 30, 2003, as compared to a \$10 million net investment loss in fiscal year ended June 30, 2002.

Mr. Rick Awalt, Brady, Martz & Associates, P.C., Certified Public Accountants, presented the audit report for the Workers Compensation Bureau (Workforce Safety and Insurance) for the years ended June 30, 2002 and 2001. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

Chairman Wald called on Ms. Lanette Hellman, noncertified member, Board of Massage, to comment on the audit report for the Board of Massage for the years ended June 30, 2001 and 2000. Ms. Hellman said she was not informed that the auditor would not be present at the meeting. She said the report included a finding relating to a prior board member misplacing board funds. She said the funds have been returned to the Board of Massage.

Senator Christmann said the committee should receive updated information regarding the findings included in the audit report. Representative Skarphol said the auditor for the Board of Massage should be asked to present the audit report at the next meeting.

Mr. Paul Welk, State Auditor's office, presented the audit report for the Information Technology Department for the years ended June 30, 2002 and 2001. He said the report contains one reportable internal control weakness relating to computer access controls. He said the report contains two findings of noncompliance with legislative intent and two recommendations for operational improvement. He said two prior audit recommendations were not implemented.

Mr. Nagel presented the audit report for the North Dakota University System office for the years ended June 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the report does not contain any findings or recommendations.

Mr. Welk presented the audit report for the State Historical Society for the years ended June 30, 2002 and 2001. He said the report contains three reportable internal control weaknesses relating to inventory control, documentation control, and cash control. He said the report contains two findings of noncompliance with legislative intent and one recommendation for operational improvement.

In response to a question from Representative Skarphol, Mr. Welk said the State Historical Society has not requested assistance from the State Auditor's office to implement audit recommendations. Mr. Merl Paaverud, Director, State Historical Society, said the State Historical Society will work with the State Auditor's office to implement the audit recommendations.

Representative Skarphol asked the State Historical Society to present a followup report to the Legislative Audit and Fiscal Review Committee when the audit recommendations have been implemented.

Mr. Bob Schlobohm, Assistant Director, State Historical Society, said the State Historical Society plans to comply with the State Auditor's office. He said some previous audit recommendations were misunderstood to be only suggestions. He said the State Historical Society will make a presentation at the next Legislative Audit and Fiscal Review Committee meeting regarding the audit recommendations. He said because the State Historical Society employs only one store manager, it is difficult to segregate inventory duties.

In response to a question from Representative Wald, Mr. Schlobohm said it would be very difficult to bid all items purchased for the museum store. He said the State Historical Society's store committee reviews the quantity and quality of all items purchased. He said the State Historical Society will improve the documentation of the purchasing process.

Mr. Welk presented the audit report for the Secretary of State for the years ended June 30, 2002 and 2001. He said the audit report does not contain any findings of noncompliance with legislative intent. He said the report does contain two recommendations for operational improvement.

Mr. Alvin A. Jaeger, Secretary of State, said the State Auditor's office recommendation that the Secretary of State add a "polling place" site on its web page is inappropriate for a financial audit.

Mr. Nagel presented the audit report for the Securities Department for the years ended June 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the report does not contain any findings or recommendations.

Mr. Tolstad presented the audit report for the Division of Emergency Management for the years ended June 30, 2002 and 2001. He said the report contains one internal control finding regarding inadequate controls surrounding recording of expenditures. He said the report contains one finding of noncompliance with legislative intent.

Mr. Nagel presented the audit report for the Game and Fish Department for the years ended June 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the report does not contain any findings or recommendations.

In response to a question from Representative Skarphol, Mr. Nagel said the compliance with the legislative intent section is not included in state agency audit reports conducted by private auditors.

In response to a question from Representative Wald, Mr. Nagel said audits of certain state entities are required by law to be completed by private auditors. He said the State Auditor's office conducts more detailed testing of compliance of legislative intent than private auditors. He said private auditors would likely have to increase fees if required to perform additional compliance testing.

Mr. Nagel presented the audit report for the Highway Patrol for the years ended June 30, 2002 and 2001. He said the report contains three internal control findings regarding failure to implement policies for credit card sales and refunds, to obtain a federal identification number for checking accounts located outside the Bank of North Dakota, and to reconcile the requests for and receipt of federal funds. He said the report contains three recommendations for operational improvement and no findings of noncompliance with legislative intent.

Representative Winrich said the use of the language "possible solution" in the recommendations for operational improvement may lead to the conclusion that the recommendation is only a suggestion.

In response to a question from Representative Skarphol, Captain David Kleppe, Support Services Commander, Highway Patrol, said the audit identified that the Highway Patrol has not been able to spend all of the federal funding available under the United

States Department of Transportation's Motor Carrier Safety Assistance Program (MCSAP). He said approximately \$750,000 of federal funds were spent in each of the last two years, with a balance of approximately \$400,000 per year unspent. He said the balance remains available and the Highway Patrol is confident it will increase the utilization of the available federal funds. A copy of the information presented to the committee is on file in the Legislative Council office.

Mr. Nagel presented the audit report for the Department of Veterans Affairs for the years ended June 30, 2002 and 2001. He said the report contains three findings of noncompliance with legislative intent. He said the report does not contain any recommendations for operational improvement.

Mr. Smith said 2003 House Bill No. 1007 requires the State Auditor's office to conduct a performance audit of the Department of Veterans Affairs and present the results of the performance audit to the Legislative Audit and Fiscal Review Committee by July 1, 2004.

Mr. Nagel presented the audit report for the Protection and Advocacy Project for the years ended June 30, 2002 and 2001. He said the report contains one finding of noncompliance with legislative intent. He said the report does not contain any recommendations for operational improvement.

### **MEDICAID MANAGEMENT INFORMATION SYSTEM AUDIT**

Mr. Donald LaFleur, State Auditor's office, presented the information system audit of the Medicaid management information system (MMIS) for the period October 1, 2001, through September 30, 2002. He said the objective of the audit of the MMIS was to answer the following questions:

- Are security controls for the Department of Human Services adequate?
- Are controls preventing duplicate payments adequate?
- Is the financial report used to report MMIS expenditures accurate?
- Is the department giving adequate priority to a replacement system for MMIS?
- Are claims with a third-party liability accurately processed?
- Does MMIS adequately process suspended claims?
- Are suspended claims properly adjudicated?

Mr. LaFleur said the report contained three findings relating to inadequate controls surrounding duplicate payments, inefficiencies in the automatic denial of claims, and errors in the review of suspended claims.

In response to a question from Representative Skarphol, Mr. LaFleur said MMIS was selected for audit because it is considered a high-risk information system for the state of North Dakota according to the

*Application Risk Assessment Report* of all state computer systems and because an audit has not previously been completed on this system. He said there are between 25 to 30 identified high-risk information systems and MMIS has the highest risk.

In response to a question from Senator Krauter, Mr. Roger Hertz, Director for Information Technology, Department of Human Services, said the department is considering various options for the new MMIS. He said the Department of Human Services anticipates requesting funding for the system in its 2005-07 budget.

In response to a question from Representative Aarsvold, Mr. Hertz said the MMIS is subject to federal certification because of the enhanced federal matching funds received for the system.

Mr. Hertz said the Department of Human Services did implement additional security policies as part of the Health Insurance Portability and Accountability Act (HIPAA).

### **PERFORMANCE AUDITS**

Mr. Smith said the State Auditor's office is anticipating completing and presenting to the Legislative Audit and Fiscal Review Committee during the 2003-04 interim the following performance audits:

- A followup of the performance audit of the Department of Human Services child support enforcement;
- The Department of Veterans Affairs and the Administrative Committee on Veterans Affairs;
- A followup of the performance audit on the service payments for elderly and disabled (SPED) and expanded SPED; and
- The Department of Corrections and Rehabilitation.

Mr. Smith said the State Auditor's office will request approval for the hiring of a consultant for the Department of Corrections and Rehabilitation performance audit at the next Legislative Audit and Fiscal Review Committee meeting. In response to a question from Representative Wald, Mr. Smith said the Department of Corrections and Rehabilitation will be responsible for the cost of the consultant.

In response to a question from Representative Skarphol, Mr. Smith said the State Auditor's office would present a list at the next Legislative Audit and Fiscal Review Committee meeting of potential performance audits.

### **COMPLIANCE AND INTERNAL CONTROL REPORT AND AUDIT COMMITTEE COMMUNICATION**

Mr. Tolstad presented the compliance and internal control report and audit committee communication for the state's financial statements. A copy of the information presented is on file in the Legislative Council

office. He said the report does not contain any findings or recommendations.

Representative Skarphol asked the State Auditor's office to provide the committee members a list of component units which are "blended into" state reporting entities.

The committee recessed at 4:50 p.m., Wednesday, September 3, 2003, and reconvened at 9:00 a.m., Thursday, September 4, 2003.

## STATE AGENCY AND INSTITUTION AUDIT REPORTS

Chairman Wald called on Mr. Greg Honl, Eide Bailly LLP, Certified Public Accountants, who presented the audit report for the Bank of North Dakota for the years ended December 31, 2002 and 2001. Mr. Honl reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Wald, Mr. Honl said the Bank's total assets, total net assets, and Tier 1 leverage ratio balances on December 31, 2002, were lower than the balances at the end of the previous year primarily due to transfers made to the general fund. He said the balances remain at acceptable levels.

In response to a question from Representative Timm, Mr. Honl said the Bank of North Dakota sold \$86 million of student loans to the student loan trust in 2002. He said the student loan trust is eligible to generate more revenue from the federal government from student loans than if the loans were owned by the Bank of North Dakota.

In response to a question from Senator Krauter, Mr. Eric Hardmeyer, President, Bank of North Dakota, said the rate earned on the student loans results in approximately a 9.5 percent yield to the student loan trust as compared to approximately a 4 percent yield earned by the Bank of North Dakota. He said the student loan trust and the Bank of North Dakota share equally on the gain in yield.

In response to a question from Senator Krauter, Mr. Hardmeyer said increases in delinquent and nonaccrual loans is a result of nationwide economic conditions. He said the increase in delinquent loans appears to be stabilizing in 2003. He said the Bank is entitled to federal reimbursement 270 days after default for student loans payable in monthly installments and 330 days for student loans payable in less frequent installments.

Chairman Wald called on Ms. Barb Aasen, Eide Bailly LLP, Certified Public Accountants, who presented the audit report for the Municipal Bond Bank for the years ended December 31, 2002 and 2001. Ms. Aasen reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion. She said the report contains two findings related to lack of segregation of

accounting duties, due to the limited number of staff and a failure to provide required information to subrecipients.

In response to a question from Representative Timm, Mr. Tim Porter, Executive Director, Municipal Bond Bank, said the Municipal Bond Bank issues bonds for municipalities. He said some municipalities have chosen to use other entities for bond issuances based on the municipalities' "stand alone" rating. He said the Municipal Bond Bank has an A- rating as determined by Standard and Poors.

In response to a question from Senator Christmann, Mr. Porter said the Municipal Bond Bank's purpose is not to compete with the private sector but primarily to assist smaller communities with bond issuances.

In response to a question from Senator Andrist, Mr. Porter said the Municipal Bond Bank has discussed the possibility of merging into the Bank of North Dakota.

Mr. Honl presented the audit report for the student loan trust for the year ended June 30, 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Senator Krauter, Mr. Ed Sather, Senior Vice President, Bank of North Dakota, said the 2001 Legislative Assembly authorized a \$9 million transfer during the 2001-03 biennium from the student loan trust to the general fund. He said as of June 30, 2002, this amount was recorded as an appropriation payable on the balance sheet and as an operating transfer on the statement of revenues, expenses, and changes in fund net assets. He said the actual transfer to the general fund was made in early 2003.

In response to a question from Senator Krauter, the legislative budget analyst and auditor said when an audit is completed the Legislative Council is notified by the State Auditor's office and the report is then added to the agenda of the next Legislative Audit and Fiscal Review Committee meeting.

In response to a question from Representative Winrich, Mr. Honl said the audit report is required to disclose any significant transactions regarding the agency that occur between the end of the period covered by the audit and the time of completion of the audit.

In response to a question from Senator Andrist, Mr. Honl said the new Government Accounting Standards Board (GASB) Statement No. 34 provided significant changes in reporting standards. He said the previous years' statements, if presented, would have been required to be restated under GASB Statement No. 34 guidelines. He said because of additional costs that would have been incurred, management decided a single year statement would be acceptable as a one-time occurrence.



In response to a question from Representative Wald, Mr. Honl said all of the audits that are interrelated to the Bank of North Dakota are combined in a single request for proposal.

Mr. Honl presented the audit report for the guaranteed student loan program for the years ended September 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Skarphol, Mr. Honl said according to the Higher Education Act of 1965, the student loan program is required to maintain a minimum reserve ratio of .25 percent of the original principal amount of guarantees outstanding. He said the student loan program had a reserve ratio of .41 percent and .81 percent at September 30, 2002 and 2001, respectively. He said the change in reserve rate is due to decreases in the levels of federal reinsurance, creating a greater state liability. He said based on trends, the reserve ratio is estimated to be .27 percent on September 30, 2003. He said the program will either have to increase student fees or will require a cash transfer.

Mr. Honl presented the audit report for the beginning farmers revolving loan fund for the years ended December 31, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Mr. Honl presented the audit report for the developmentally disabled facility loan program for the years ended December 31, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Wald, Mr. Honl said due to limited activity, Bank of North Dakota management is considering options for the program, including a possible "phaseout."

In response to a question from Representative Timm, Mr. Honl said the audit fee for the developmentally disabled facility loan program was approximately \$2,400 to \$2,500.

Mr. Honl presented the audit report for the community water facility loan fund for the years ended December 31, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Timm, Mr. Hardmeyer said the community water facility loan fund is managed by the Bank of North Dakota and the fund is charged a fee for services provided by the Bank's loan officers. He said the

community water facility loan fund's assets could be consolidated with the Bank of North Dakota.

In response to a question from Representative Skarphol, Mr. Honl said the primary savings of consolidating the funds and programs managed by the Bank of North Dakota into the Bank of North Dakota would be the cost of the audits. Senator Andrist encouraged the Bank of North Dakota to further examine the possibility of consolidation of these entities.

Mr. Honl presented the audit report for the partnership in assisting community expansion (PACE) fund for the years ended June 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Senator Krauter, Mr. Honl said the PACE fund provides "buydown" dollars, to the extent available, to reduce the borrower's interest rate from 1 percent to a maximum of 5 percent. He said the fund's "buydown" payments are made at the same time as the loan payments. He said escrowed "buydown" funds are returned to the PACE fund if there is a loan default.

Mr. Honl presented the audit report for the Ag PACE fund for the years ended June 30, 2002 and 2001. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Ms. Aasen presented the audit report for the State Building Authority for the year ended June 30, 2002. She reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Ms. Aasen presented the audit report for the Development Fund, Inc., for the years ended June 30, 2002 and 2001. She reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Ms. Aasen presented the audit report for the State Fair Association for the years ended September 30, 2002 and 2001. She said the report contains one finding relating to segregation of accounting duties due to limited number of staff.

Chairman Wald called on Ms. Lynnell Rude, Senger, Mahlum & Goodhart, P.C., Certified Public Accountants. Ms. Rude said the report for the North Dakota Stockmen's Association contains an unqualified opinion. She said the report contains two findings related to segregation of accounting duties due to limited number of staff and identified bank balances in excess of Federal Deposit Insurance Corporation (FDIC) coverage of \$100,000.

**It was moved by Senator Krauter, seconded by Senator Andrist, and carried on a roll call vote**

that, pursuant to NDCC Section 54-35-02.2, the committee accept the following reports presented to the committee:

1. Office of Driver and Vehicle Services, Department of Transportation, performance audit (July 1, 2000, through December 31, 2002).
2. Job Service North Dakota (June 30, 2002).
3. Retirement and Investment Office (June 30, 2002 and 2001).
4. Public Employees Retirement System (June 30, 2002 and 2001).
5. Workers Compensation Bureau (Workforce Safety and Insurance) (June 30, 2002 and 2001).
6. Board of University and School Lands (June 30, 2002).
7. Information Technology Department (June 30, 2002 and 2001).
8. North Dakota University System office (June 30, 2002 and 2001).
9. State Historical Society (June 30, 2002 and 2001).
10. Secretary of State (June 30, 2002 and 2001).
11. State Securities Department (June 30, 2002 and 2001).
12. Division of Emergency Management (June 30, 2002 and 2001).
13. Game and Fish Department (June 30, 2002 and 2001).
14. Highway Patrol (June 30, 2002 and 2001).
15. Department of Veterans Affairs (June 30, 2002 and 2001).
16. Department of Veterans Affairs (June 30, 2000 and 1999).
17. Protection and Advocacy (June 30, 2002 and 2001).
18. Medicaid management information system - Information system audit (September 30, 2002).
19. Bank of North Dakota (December 31, 2002 and 2001).
20. Municipal Bond Bank (December 31, 2002 and 2001).
21. Student loan trust (June 30, 2002).
22. Guaranteed student loan program (September 30, 2002 and 2001).
23. Beginning farmers revolving loan fund (December 31, 2002 and 2001).
24. Developmentally disabled facility loan fund (December 31, 2002 and 2001).
25. Community water facility loan fund (December 31, 2002 and 2001).
26. PACE fund (June 30, 2002 and 2001).
27. Ag PACE fund (June 30, 2002 and 2001).
28. State Building Authority (June 30, 2002).
29. Development Fund, Inc. (June 30, 2002 and 2001).
30. State Fair Association (September 30, 2002 and 2001).
31. North Dakota Stockmen's Association (December 31, 2002 and 2001).
32. Reports available but not selected for presentation:
  - a. Adjutant General (June 30, 2002 and 2001).
  - b. Indian Affairs Commission (June 30, 2002 and 2001).
  - c. Seed Department (June 30, 2002 and 2001).
  - d. Board of Examiners on Audiology and Speech-Language Pathology (June 30, 2001 and 2000).
  - e. State Board of Chiropractic Examiners (December 31, 2002).
  - f. State Board of Chiropractic Examiners (December 31, 2001).
  - g. Board of Counselor Examiners (June 30, 2002 and 2001).
  - h. State Board of Funeral Service (June 30, 2002 and 2001).
  - i. Firefighter's Association (April 30, 2002).
  - j. Board of Registration for Professional Engineers and Land Surveyors (June 30, 2001).
  - k. State Board of Examiners for Nursing Home Administrators (June 30, 2002 and 2001).
  - l. Real Estate Commission (June 30, 2002).
  - m. Real Estate Appraiser Qualifications and Ethics Board (June 30, 2001 and 2000).
  - n. Housing Finance Agency (June 30, 2002 and 2001).

Representatives Wald, Aarsvold, Bellew, Skarphol, Thoreson, and Timm and Senators Andrist, Christmann, Klein, and Krauter voted "aye." No negative votes were cast.

### **AUDIT REPORTS FROM ETHANOL PRODUCTION COMPANIES**

At the request of Chairman Wald, the Legislative Council staff distributed a copy of the December 31, 2002 and 2001 audit report for Alchem, Ltd., LLP. Pursuant to NDCC Section 10-32-156, any limited liability company that produces agricultural ethyl alcohol or methanol in this state and receives a production subsidy from the state must file an annual audit report with the Legislative Audit and Fiscal Review Committee. The report was filed with the committee pursuant to this section. A copy of the

information presented is on file in the Legislative Council office.

## DEPARTMENT OF HUMAN SERVICES ACCOUNTS RECEIVABLE

Chairman Wald called on Ms. Brenda Weisz, Department of Human Services, who presented information on the status of the department's accounts receivable, pursuant to NDCC Sections 25-04-17 and 50-06.3-08. A copy of the information presented is on file in the Legislative Council office. Ms. Weisz said the total amount written off by the Department of Human Services for fiscal year 2003 was \$23,547,868, of which \$184,835 related to human service centers, \$3,804,060 related to the State Hospital, and \$19,558,973 related to the Developmental Center.

Ms. Weisz said during the 2001-03 biennium the Department of Human Services conducted a conversion of its accounts receivable system, which included an analysis of accounts receivable. She said prior to 1961 the state of North Dakota paid 100 percent of the cost for individuals at the Developmental Center. She said from 1961 through 1989 parents and clients had varying responsibilities for costs incurred at the Developmental Center. She said the analysis included a bookkeeping adjustment in which the Developmental Center's uncollectible receivables, some dating back to 1961, were written off.

In response to a question from Senator Krauter, Ms. Weisz said the amount of parent accounts receivables written off was \$531,656 and the remaining balance is \$879,210. She said the parent accounts receivable were written off if both parents are deceased. She said the department will continue to seek to recover written-off accounts receivables from estates of the parents. She said all of the client accounts receivables were written off as of June 30, 2003. She said due to lack of income, only a small percentage of cost reimbursement is received from Developmental Center clients over age 21.

**It was moved by Representative Aarsvold, seconded by Senator Krauter, and carried on a voice vote that pursuant to NDCC Sections 25-04-17 and 50-06.3-08, the committee accept the report on the status of the accounts receivable of the Department of Human Services.**

## COMMITTEE DISCUSSION AND STAFF DIRECTIVES

Representative Skarphol asked the State Auditor's office to provide the committee a list of state agencies, boards, and institutions identifying whether their audits are required by statute to be completed by the State Auditor's office or by independent auditors, and if no requirement exists, whether the State Auditor's office or independent auditors completed the most recent audit.

In response to a question from Senator Andrist, Mr. Smith said there are primarily only two independent accounting firms bidding for the audits of state agencies--Eide Bailly LLP and Brady, Martz & Associates, P.C. He said the audit agreements generally are for a three- to four-year period.

In response to a question from Representative Wald, Mr. Smith said the State Auditor's office would provide information to the Legislative Audit and Fiscal Review Committee at the next meeting regarding suggestions for changes to the 12 questions required by auditors of state agencies to be addressed upon completion of the audit report.

In response to a question from Senator Krauter regarding the interim Public Services Committee study of the Seed Department, the legislative budget analyst and auditor said the motion for acceptance of audits includes the audit of the Seed Department even though it was not presented to the committee. He said the audit of the Seed Department would be available for the Public Services Committee to review.

In response to a question from Representative Skarphol, the legislative budget analyst and auditor said he was not aware of the Legislative Council receiving information from the Firefighter's Association regarding a list of assets of North Dakota fire departments.

**It was moved by Representative Skarphol, seconded by Representative Thoreson, and carried on a roll call vote that, pursuant to NDCC Section 54-10-01, the Legislative Audit and Fiscal Review Committee ask the State Auditor's office to conduct a performance audit of Fleet Services.** Representatives Wald, Aarsvold, Bellew, Skarphol, Thoreson, Timm, and Warnke and Senators Andrist, Christmann, Klein, and Krauter voted "aye." No negative votes were cast.

In response to a question from Representative Wald, Mr. Smith said the followup report on the performance audit of the Veterans Home is anticipated to be completed within 12 months.

In response to a question from Representative Skarphol, Mr. Smith said the State Auditor's office would be willing to present the Information Technology Department audit report to the Information Technology Committee and provide copies of the report to the information technology advisory group.

**It was moved by Representative Skarphol, seconded by Representative Timm, and carried on a voice vote that a letter be sent to the State Historical Society noting the agency has not taken steps to implement previous audit recommendations and requesting the agency to appear before the next meeting of the Legislative Audit and Fiscal Review Committee and provide a written explanation for the agency's noncompliance and steps taken to address the recommendations.**

In response to a question from Representative Skarphol, Mr. Smith said the eight regional planning

councils are political subdivisions under state law. He said a majority of the regional planning council's most recent audit reports are presented based on the accounting principles of a nonprofit corporation. He said it is his understanding that starting in 2004 government auditing standards will mandate the statements be presented based on the accounting principles of a political subdivision.

Representative Skarphol requested the State Auditor's office provide information to the Legislative Audit and Fiscal Review Committee regarding the circumstances regarding a \$500,000 grant or funds received by the Lake Agassiz Regional Planning Council.

Chairman Wald asked the State Auditor's office to review the audit reports of each of the regional planning councils for irregular transactions, including any transferring of funds to nonprofit corporations.

In response to a question from Senator Krauter, the legislative budget analyst and auditor said the audit reports of the eight regional planning councils are required to be submitted to the State Auditor's office pursuant to NDCC Section 54-10-14. He said political subdivisions are allowed to choose their own auditor.

**It was moved by Representative Skarphol, seconded by Representative Bellew, and carried on a voice vote that the State Auditor's office report at the next meeting of the Legislative Audit and Fiscal Review Committee on the eight regional planning councils, including a summary of findings from the most recent audit reports.**

The meeting was adjourned subject to the call of the chair at 12:00 noon.

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Donald J. Wolf  
Senior Fiscal Analyst

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Jim W. Smith  
Legislative Budget Analyst and Auditor

ATTACH:1