

## LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2017-19 BIENNIUM

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

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

### STATUTORY DUTIES AND RESPONSIBILITIES

The committee is charged by statute or Legislative Management assignment with the following duties and responsibilities for the 2017-19 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association pursuant to Section 4.1-45-17.
2. **Ethyl alcohol and methanol producers** - Receive annual audit reports from any corporation that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-19.1-152, and receive annual audit reports from any limited partnership that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 45-10.2-115.
3. **Department of Human Services' accounts receivable** - Receive annual reports on the status of accounts receivable for the Department of Human Services and the Life Skills and Transition Center pursuant to Sections 25-04-17 and 50-06.3-08.
4. **Low-risk incentive fund** - Receive annual audit reports and economic impact reports from the North Dakota low-risk incentive fund. Section 26.1-50-05 provides for the audit report to be submitted to the Legislative Council. The Legislative Management has assigned the responsibility to this committee.
5. **North Dakota Stockmen's Association** - Receive a biennial audit report from the North Dakota Stockmen's Association. Section 4.1-72-08 provides for the audit report to be submitted electronically to the Legislative Council. The Legislative Management has assigned the responsibility to this committee.
6. **Job Service North Dakota** - Receive a performance audit report, upon the request of the committee, for Job Service North Dakota pursuant to Section 52-02-18.
7. **Performance audits** - The State Auditor is to conduct or provide for performance audits of state agencies as determined necessary by the State Auditor or this committee, and the State Auditor must obtain approval from this committee prior to hiring a consultant to assist with conducting a performance audit pursuant to Section 54-10-01.
8. **Frequency of audits** - Determine the frequency of audits or reviews of state agencies pursuant to Section 54-10-01.
9. **Political subdivisions** - Determine if the State Auditor is to perform audits of political subdivisions on a more frequent basis than once every 2 years pursuant to Section 54-10-13 and direct the State Auditor to audit or review the accounts of any political subdivision pursuant to Section 54-10-15.
10. **Study and review audit reports** - Pursuant to Section 54-35-02.2, the committee is charged with the following responsibilities:
  - a. To study and review audit reports selected by the committee from those submitted by the State Auditor.
  - b. To confer with the State Auditor regarding the audit reports reviewed by the committee.
  - c. As necessary, to confer with representatives of state departments, agencies, and institutions audited in order to obtain information regarding fiscal transactions and governmental operations.

In addition, the 65<sup>th</sup> Legislative Assembly, in House Bill No. 1173, amended Section 54-35-02.2 to allow the committee to recommend that the Legislative Assembly reduce a state agency, department, or institution's

appropriation if the state agency, department, or institution has failed to correct, within 2 bienniums, an audit finding the committee determines critically important.

## REQUESTS AND RECOMMENDATIONS DURING PREVIOUS INTERIMS

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

1. **Discussion of audit findings prior to presentation of the report** - The State Auditor should consider discussing audit findings with appropriate boards or commissions prior to the audit report being presented to the committee.
2. **Actions taken by audited agency** - Audited agencies, boards, and commissions should report to the committee at the time the audit report is presented regarding actions taken as a result of audit findings contained in the report.
3. **Responses to recommendations** - Each audit report prepared by the State Auditor should include a summary of audit recommendations along with the audited agency's written response to the recommendations. The summary is to be in recommendation-response format.
4. **Acceptance of audit reports** - The committee receives audit reports as presented by the State Auditor's office and other independent auditors and, by motion, accepts the reports. The motion is not a directive for the adoption of the audit recommendations. A representative of the State Auditor's office will follow up on any previous audit findings and recommendations at the time of the next audit. If the agency has not taken steps to address the recommendation or cannot document a justifiable reason for not implementing the recommendation at the time of the next audit, it will be again included as an audit finding and recommendation.
5. **Implementation of recommendations** - Each state agency and institution should comply with and implement, within the limits of the law, recommendations contained in audit reports prepared by the State Auditor's office. Such compliance and implementation should be viewed toward improvement of government operations, including fiscal operations and to full execution of the law.
6. **Six-month review** - The State Auditor's office should determine whether agencies have complied with the auditor's recommendations within 6 months after a report has been accepted by this committee. The State Auditor should report to this committee, or another appropriate legislative committee, regarding any recommendations not implemented.
7. **Copies of management letters** - The State Auditor should provide copies of management letters to committee members.
8. **Use of salaries and wages funding** - The State Auditor should consider including in audit reports information on the amount of salaries and wages funding spent on filled full-time equivalent (FTE) positions and the amount relating to vacant FTE positions which is spent for other purposes.
9. **Committee followup with agencies that have not complied with audit recommendations** - The committee, by motion, may direct the Legislative Council staff to send correspondence to an agency that has not complied with previous audit recommendations requesting the agency to appear before the committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
10. **Presentation of evidence to the Attorney General** - Pursuant to Section 54-35-02.2, whenever the committee determines or has reason to believe there may have been a violation of law relating to the receipt, custody, or expenditure of public funds by any state officer or employee, the committee is to present such evidence or information to the Attorney General. Upon receipt of the information, the Attorney General is to immediately commence an investigation. If the evidence supplied by the committee and through the investigation indicates the probability of a violation of law by any state official or employee, the Attorney General is to prosecute the state official or employee as provided by law.
11. **Report on significant findings and recommendations** - The State Auditor should consider providing a report to the House and Senate Appropriations Committees and each member of the Legislative Audit and Fiscal Review Committee at the beginning of each legislative session regarding significant audit findings and recommendations contained in the financial and performance audit reports presented to the Legislative Audit and Fiscal Review Committee during the previous interim. The State Auditor's office has prepared summaries of significant audit findings and recommendations from audit reports presented to the Legislative Audit and Fiscal Review Committee and presented, upon request, these summaries to the Legislative Council or the Appropriations Committees at the start of legislative sessions.

## AUDIT GUIDELINES

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

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

The committee approved replacement of the 12 audit guidelines with 6 audit questions and 8 other issues to be communicated by the auditors to the committee. For audit periods covering fiscal years ending June 30, 2006, and thereafter, auditors of state agencies and institutions are requested to address the following six audit questions:

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

The eight issues to be communicated to the committee identify:

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

## AUDIT APPROACH

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

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

### AUDIT REQUIREMENTS FOR THE STATE AUDITOR'S OFFICE

Section 54-10-04 requires the Legislative Assembly to provide for a financial statement audit of the State Auditor's office. A copy of the audit report must be filed with the Governor and with each house of the Legislative Assembly. The State Auditor's office audit report for the fiscal years ended June 30, 2015 and 2014, was completed by Eide Baily LLP. This audit report was reviewed and approved by the committee during the January 14, 2016, meeting.

The National State Auditors Association requires state auditor's offices to be subject to an external quality control review every 3 years. The system of quality control encompasses the office's organizational structure and policies adopted and procedures established to provide reasonable assurance of conforming to governmental auditing standards. The quality control review of the State Auditor's office for the period March 1, 2013, to March 31, 2014, was received by the committee in June 2014.

The next quality control review of the State Auditor's office is anticipated to be completed in June 2017.

### PERFORMANCE AUDITS

During the 2015-16 interim, the committee received performance audit reports on Department of Trust Lands Energy Infrastructure and Impact Office, trust assets and department resources, and unclaimed property. During the 2017 Legislative Assembly, the committee received a performance audit report on the space utilization study of the State Board of Higher Education.

The following table lists the status of performance audits presented to the committee during the 1997-99 through 2015-17 bienniums:

Performance Audit	Status
<b>1997-99 biennium</b>	
State procurement practices	October 7, 1997, and January 21, 1998
State employee classification system	October 6, 1998, and January 27, 1999
Workers' Compensation Bureau (performance review)	October 6, 1998
Job Service North Dakota	October 6, 1998
<b>1999-2001 biennium</b>	
Contracts for services	May 22-23, 2000
Child support enforcement program (Department of Human Services)	October 16-17, 2000
Workers' Compensation Bureau (performance review)	October 16-17, 2000
Job Service North Dakota	October 16-17, 2000
<b>2001-03 biennium</b>	
Aging Services, service payments for elderly and disabled, and expanded service payments for elderly and disabled programs (Department of Human Services)	November 26, 2001
Veterans' Home	October 2, 2002, and January 22, 2003
Workers' Compensation Bureau (performance review)	October 2, 2002
Job Service North Dakota	October 2, 2002
<b>2003-05 biennium</b>	
Driver and Vehicle Services (Department of Transportation)	September 3-4, 2003
Administrative Committee on Veterans' Affairs and the Department of Veterans' Affairs	August 10, 2004
Workforce Safety and Insurance (performance review)	October 27, 2004
Job Service North Dakota	October 27, 2004
Department of Corrections and Rehabilitation	January 24, 2005
<b>2005-07 biennium</b>	
Division of Emergency Management	January 10, 2006
Collection and use of 911 fees (Division of Emergency Management)	January 10, 2006, and June 19, 2006
Workforce Safety and Insurance (performance audit)	November 29, 2006
Workforce Safety and Insurance (performance review)	November 29, 2006
<b>2007-09 biennium</b>	
University of North Dakota School of Medicine and Health Sciences	November 19, 2007
Wildlife Services program	July 8, 2008
Workforce Safety and Insurance (performance review)	October 20, 2008
<b>2009-11 biennium</b>	
Department of Commerce	September 30, 2009
North Dakota University System capital projects	May 12, 2010
Medicaid provider and recipient fraud and abuse	October 21, 2010

Performance Audit	Status
<b>2011-13 biennium</b>	
Dickinson State University	March 27, 2012
Use of state-supplied vaccines by a provider (State Department of Health)	March 27, 2012
State Department of Health Family Health Division	June 21, 2012
Fees charged at North Dakota State University and University of North Dakota	July 26, 2012
State Water Commission's regulation of industrial water use in the state	January 24, 2013
University System office	March 12, 2013
<b>2013-15 biennium</b>	
State Water Commission's water use permitting process	July 29, 2013
Game and Fish Department	July 16, 2014
University System institutions tuition waivers and student stipends	April 21, 2015
<b>2015-17 biennium</b>	
Department of Trust Lands	April 21, 2016
Higher Education space utilization study	March 6, 2017
<b>2017-19 biennium</b>	
University foundations	Deferred until further notice

### DEPARTMENT OF TRUST LANDS - ENERGY INFRASTRUCTURE AND IMPACT OFFICE

In April 2016, the committee received the performance audit report of the Department of Trust Lands - Energy Infrastructure and Impact Office. The objective of the audit was to determine if the Energy Infrastructure and Impact Office effectively administers its grants, including distributions of funds and compliance with legislative intent. The audit period for which information was reviewed was January 2010 through April 2012.

The performance audit report contained 13 recommendations. Based on the performance audit, the State Auditor's office determined that aspects of grant administration functions were operating ineffectively.

The committee accepted the performance audit of the Department of Trust Lands - Energy Infrastructure and Impact Office.

### DEPARTMENT OF TRUST LANDS - TRUST ASSETS AND DEPARTMENT RESOURCES

In April 2016, the committee received the performance audit report of the Department of Trust Lands trust assets and department resources. The objective of the audit was to determine if the department is obtaining, accounting for, and using resources efficiently and effectively, including the administration of the state's mineral interests and lease auctions; grazing and agriculture leases, rights-of-way, and site reclamation; management of assets in trust funds and distributions from trust funds; and mineral royalty collections, mineral-related payments, surface rents, and nonproducing leases. The audit period for which information was reviewed was July 1, 2011, through June 30, 2015.

The performance audit report contained 29 recommendations. Four areas of trust assets and department resources were audited, including surface and mineral areas, financial areas, human resource areas, and additional areas needing improvement. Based on the performance audit, the State Auditor's office determined that the department was not obtaining, accounting for, and using certain resources efficiently and effectively, and the department was not assigning land tracts to the correct trust.

The committee accepted the performance audit of the Department of Trust Lands trust assets and department resources.

### DEPARTMENT OF TRUST LANDS - UNCLAIMED PROPERTY

In April 2016, the committee received the performance audit report of the Department of Trust Lands unclaimed property function. The objective of the audit was to determine if the Department of Trust Lands is effectively administering unclaimed property, including claims payments. The audit period reviewed was July 1, 2011, through June 30, 2015.

The performance audit report contained 19 recommendations. Based on the performance audit, the State Auditor's office determined that aspects of the unclaimed property program were operating ineffectively.

The committee accepted the performance audit of the Department of Trust Lands unclaimed property.

## **STATE BOARD OF HIGHER EDUCATION - SPACE UTILIZATION STUDY**

During the 2017 Legislative Assembly, in March 2017, the committee received the performance audit report of the State Board of Higher Education - Space utilization study. The objective of the audit was to conduct a review of the involvement of board members, board office staff, and campus personnel in the space utilization study, the comprehensiveness of the study, the contractor's compliance with terms of the contract, and the State Board of Higher Education actions as a result of the study.

Based on the performance audit, the State Auditor's office determined the report prepared for the State Board of Higher Education regarding classroom and teaching laboratory utilization was not complete, lacked necessary information, and included inconsistent information.

The committee accepted the performance audit of the space utilization study for the State Board of Higher Education.

## **PERFORMANCE AUDITS IN PROGRESS**

### **University Foundations**

In April 2015, the committee passed a motion to require the State Auditor's office to conduct a performance audit of the foundations at the University of North Dakota, North Dakota State University, and Dickinson State University for fiscal years 2012, 2013, and 2014.

In April 2016, the committee amended its motion to require the performance audit of the foundations at the University of North Dakota, North Dakota State University, and Dickinson State University, requested by the committee at its April 21, 2015, meeting, to include:

- The major foundation of each university that provides both academic and ancillary contributions in support of the university;
- Fiscal years 2013, 2014, and 2015; and
- The Dickinson State University Foundation not be conducted, but instead a summary review of the conclusions of the Attorney General's office investigation and receivership of the foundation.

In October 2016, the committee passed a motion that the State Auditor's office defer any further action on the performance audit of the foundations at the University of North Dakota and North Dakota State University until further direction is provided by committee.

## **INFORMATION TECHNOLOGY AUDITS**

Section 54-10-29 provides that the State Auditor's office may conduct a review and assessment of computer systems and related security systems. Tests conducted in connection with this review and assessment may include an assessment of system vulnerability, network penetration, potential security breach, and susceptibility to cyber attack or cyber fraud. The State Auditor's office may procure the services of a specialist in information security systems or other contractors deemed necessary for the assessment.

### **University System's Technology Security Audit and Vulnerability Assessment**

In January 2015, the committee received the University System's technology security audit and vulnerability assessment report. The objective of the audit was to evaluate external and internal vulnerability assessments on the networks of the University System, including Bismarck State College, Dakota College at Bottineau, Dickinson State University, Lake Region State College, Mayville State University, Minot State University, North Dakota State College of Science, North Dakota State University, University of North Dakota, Valley City State University, Williston State College, and University System offices in Fargo, Bismarck, and Grand Forks. The period of the audit when information was reviewed was October 1 through October 31, 2014.

Based on the assessment, the auditors identified major findings and recommendations related to unsupported operating systems, missing software patches or required upgrades, easily guessed or default credentials, unsupported web servers, well-known internal network assessment exploits, publicly accessible web applications, firewall and network address translations, cross-site scripting, clear text password, session token in uniform resource locator (URL), structured query language (SQL) injection, and serialized object in hypertext transfer protocol (HTTP) message. The auditors determined most of the findings and recommendations have been addressed by the University System and many of the corrections were made onsite during the audit.

The committee accepted the audit of the University System's technology security audit and vulnerability assessment.

### **North Dakota Information Technology Security Audit - Vulnerability Assessment and Penetration Testing**

In October 2016, the committee received the *2016 North Dakota Information Technology Security Audit Vulnerability Assessment and Penetration Testing Executive Report*. The audit reviewed six major project tasks, including external vulnerability assessment, internal vulnerability assessment, application vulnerability assessment, security infrastructure review, incident response review, and penetration testing. The period of the audit when information was reviewed was January 1 through March 31, 2016.

Based on the assessment, the audit provided recommendations relating to enforcing a structured enterprise patch management program; providing additional training to staff; updating, finalizing, and enforcing policies and procedures; reviewing and updating all encryption; and creating, following, and enforcing an effective continuous monitoring policy and procedures. The auditors determined security of the network could be improved by providing the Information Technology Department with the authority to disconnect noncompliant systems from the network.

The committee accepted the audit of the *2016 North Dakota Information Technology Security Audit Vulnerability Assessment and Penetration Testing Executive Report*.

### **Information Technology Department Service Organization Audit**

In January 2016, the committee received the Information Technology Department service organization audit report. The objective of the audit was to evaluate the fairness of the presentation of department's description of controls. The audit period when information was reviewed was April 1 through October 1, 2014.

The audit found that the department lacks a formal risk assessment framework and that it does not conduct a periodic review of enabled ports or services. The audit provided recommendations relating to developing a systematic risk assessment framework, completing a periodic review of all enabled services and ports to identify if they are still being used, updating current policies to define escorted access to department facilities, and completing an annual review of the Enterprise Architecture standards.

The committee accepted the audit of the Information Technology Department service organization audit.

### **PROPOSED ACTION PLAN**

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

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