

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

The Legislative Audit and Fiscal Review Committee is a statutorily created committee of the Legislative Council. Pursuant to North Dakota Century Code (NDCC) Section 54-35-02.1, the committee is created as a division of the Budget Section and its members are appointed by the Legislative Council. The committee's purposes are to:

- Study and review the state's financial transactions to assure the collection of state revenues and the expenditure of state money is in compliance with law, legislative intent, and sound financial practices.
- To provide the Legislative Assembly with objective information on revenue collections and expenditures to improve the fiscal structure and transactions of the state.

Pursuant to NDCC Section 54-35-02.2, the committee is charged with the duty of studying and reviewing audit reports submitted by the State Auditor. The committee is authorized to make such audits, examinations, or studies of the fiscal transactions or governmental operations of state departments, agencies, or institutions as it may deem necessary.

Committee members were Representatives Francis J. Wald (Chairman), Ole Aarsvold, Merle Boucher, Jeff Delzer, RaeAnn G. Kelsch, Andrew G. Maragos, David Monson, Chet Pollert, Earl Rennerfeldt, Bob Skarphol, Blair Thoreson, and Mike Timm and Senators Bill L. Bowman, Randel Christmann, Jerry Klein, Judy Lee, and Tim Mathern.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 2006. The Council accepted the report for submission to the 60th Legislative Assembly.

During the 2005-06 interim, the State Auditor's office and independent accounting firms presented 4 performance audit and evaluation reports and 86 financial or information technology application audit reports. An additional 70 audit reports were filed with the committee but were not formally presented. The committee's policy is to hear only audit reports relating to major agencies and audit reports containing major recommendations. However, other audit reports are presented at the request of any committee member. At the end of this report is a listing of the audit reports accepted by the committee.

The committee was assigned the following duties and responsibilities for the 2005-06 interim:

1. Receive the annual audit report for the State Fair Association (Section 4-02.1-18).
2. Receive the annual audit report from any corporation, limited liability company, or limited partnership that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state (Sections 10-19.1-152, 10-32-156, and 45-10.2-115).
3. Receive annual reports on the writeoffs of accounts receivable at the Department of

Human Services and Developmental Center at Westwood Park, Grafton (Sections 50-06.3-08 and 25-04-17).

4. Receive the annual audited financial statements and a report from the North Dakota low-risk incentive fund. (Section 26.1-50-05 provides for the financial statements and the report to be submitted to the Legislative Council. The Legislative Council assigned this responsibility to the Legislative Audit and Fiscal Review Committee.)
5. Receive the North Dakota Stockmen's Association audit report (Section 36-22-09 provides for the audit report to be submitted to the Legislative Council. The Legislative Council assigned this responsibility to the Legislative Audit and Fiscal Review Committee.)
6. Receive the performance audit report of Job Service North Dakota upon the request of the Legislative Audit and Fiscal Review Committee (Section 52-02-18).
7. Determine necessary performance audits. (Section 54-10-01(4) provides that the State Auditor is to perform or provide for performance audits of state agencies as determined necessary by the State Auditor or the Legislative Audit and Fiscal Review Committee.)
8. Determine the frequency of audits or reviews of state agencies (Section 54-10-01(2)).
9. Determine when the State Auditor is to perform audits of political subdivisions (Section 54-10-13).
10. Direct the State Auditor to audit or review the financial records and accounts of any political subdivision (Section 54-10-15).
11. Study and review audit reports submitted by the State Auditor (Section 54-35-02.2).
12. Receive reports from the Information Technology Department on state information technology projects and plans, pursuant to Section 54-59-19.
13. Receive reports from the director of Workforce Safety and Insurance and the chairman of the Workforce Safety and Insurance Board of Directors, including a report on the biennial performance evaluation of Workforce Safety and Insurance (Sections 65-02-03.3 and 65-02-30).
14. Study state agency and institution continuing appropriation authority (2005 House Concurrent Resolution No. 3036).

GUIDELINES FOR AUDITS OF STATE AGENCIES Previous Audit Guidelines

The committee received information on and reviewed the guidelines, which were developed by prior Legislative Audit and Fiscal Review Committees, relating to state agency and institution audits performed by the State Auditor's office and independent certified public

accountants. The guidelines require that audit reports address the following with respect to a particular agency:

1. Whether expenditures are made in accordance with legislative appropriations and other state and fiscal requirements and restrictions.
2. Whether revenues are accounted for properly.
3. Whether financial controls and procedures are adequate.
4. Whether the system of internal control is adequate and functioning effectively.
5. Whether financial records and reports reconcile with those of state fiscal offices.
6. Whether there is compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning.
7. Whether there is evidence of fraud or dishonesty.
8. Whether there are indications of lack of efficiency in financial operations and management of the agency.
9. Whether the actions have been taken by agency officials with respect to findings and recommendations set forth in audit reports for preceding periods.
10. Whether all activities of the agency are encompassed within appropriations of specific amounts.
11. Whether the agency has implemented the Statewide Accounting and Management Information System (SAMIS), including the cost allocation system.
12. Whether the agency develops a budget of anticipated expenditures and revenues and compares, on at least a quarterly basis, budgeted expenditures and revenues to actual expenditures and revenues accounted for using the accrual basis of accounting.

The purpose of the guidelines is to aid auditors in the development of audit programs and reports, so the audit reports will be of maximum value to the appropriate authority and the taxpayers of North Dakota. The guidelines were developed to assist the committee in meeting its statutory responsibilities and to encourage state entities to improve fiscal practices. Auditors generally review the answers to the 12 areas in the presentation of each audit report and the areas are addressed in a positive manner, indicating agencies take the issues seriously and attempt to comply. Areas that are not addressed in a positive manner can alert the committee to areas needing additional review.

New Audit Guidelines - Beginning With Audit Periods Ending June 30, 2006

The committee received suggested changes from the State Auditor's office to revise the 12 audit guidelines identified earlier, as some of the 12 audit guidelines were no longer applicable to state agencies. The six new questions 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 information similar to those made by auditors to an "audit committee." The committee received input and

approval from representatives of Eide Bailly LLP, Certified Public Accountants, and Brady, Martz & Associates, P.C., regarding the six new questions.

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

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

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

The eight issues to be communicated to the Legislative Audit and Fiscal Review Committee identify:

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

assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by auditors are directly related to the operations of an information technology system.

AUDIT OF THE STATE AUDITOR'S OFFICE

North Dakota Century Code Section 54-10-04 requires the Legislative Assembly to provide for an audit of the State Auditor's office. The Legislative Council contracted with Eide Bailly LLP for an audit of the State Auditor's office for the years ended June 30, 2005 and 2004. The firm presented its audit report at the committee's January 10, 2006, meeting. The audit report contained an unqualified opinion and did not include any findings or recommendations.

COMPREHENSIVE ANNUAL FINANCIAL REPORT

North Dakota Century Code Section 54-10-01 requires the State Auditor to provide for the audit of the state's general purpose financial statements and to conduct a review of the material included in the Comprehensive Annual Financial Report. The Comprehensive Annual Financial Report contains the audited financial statements for state agencies and institutions. The committee received and accepted the state's June 30, 2004, and June 30, 2005, Comprehensive Annual Financial Reports.

NORTH DAKOTA UNIVERSITY SYSTEM ANNUAL FINANCIAL REPORT

The committee received the North Dakota University System's annual financial report for the fiscal year ended June 30, 2005. An unqualified opinion was issued on the financial statements. As of June 30, 2005, the University System had total assets of \$916.6 million and total liabilities of \$265.4 million, resulting in a net assets total of \$651.2 million. The total net assets increased \$11.2 million during fiscal year 2005.

The annual degree credit headcount for the fall of 2004 was 42,503, a 2.1 percent increase over the previous fall enrollment. The revenues from student tuition and fees were \$181,280,000 for the fiscal year ended June 30, 2005, which is an increase of 20 percent as compared to the fiscal year ended June 30, 2004. During the 2004-05 academic year, the campuses raised tuition rates an average of 15.4 percent.

The committee reviewed information regarding 2004-05 tuition waivers provided by University System campuses. The information was from the University System February 2006 *Student Affordability Report*. Approximately \$20.3 million in tuition waivers was provided by the state campuses to a total of 7,844 students.

The committee learned that the University of North Dakota and North Dakota State University, which are both research institutions, provide the largest number of tuition waivers. Institutions provide tuition waivers to out-of-state students as a method to increase enrollment

figures. The tuition waivers to out-of-state students are often provided to reduce the out-of-state tuition rate to an amount closer to the state rate. The State Board of Higher Education plans to address the issue of tuition waivers and provide a recommendation to the 60th Legislative Assembly on solutions to control the use of waivers by the institutions.

PERFORMANCE AUDITS AND EVALUATIONS

Veterans Home Performance Audit Followup

The Legislative Audit and Fiscal Review Committee accepted the followup report presented to the committee on the Veterans Home performance audit. The original performance audit was presented to the Legislative Audit and Fiscal Review Committee in October 2002. The followup report indicated 25 of the original recommendations have been fully implemented, 15 of the original recommendations have been partially implemented, and 6 recommendations were determined not to be implemented. A representative of the State Auditor's office indicated that the Administrative Committee on Veterans Affairs has taken a very active role in the operations of the Veterans Home and is committed to implementing and following the performance audit recommendations.

The Administrative Committee on Veterans Affairs is a 15-member committee with 3 members from each of the five major veteran organizations in the state. A seven-member governing board for administration of the Veterans Home is appointed by the chairman and secretary of the administrative committee, subject to ratification by a majority vote of the administrative committee. Approximately three or four members of the administrative committee are also members of the governing board. The State Auditor's office recommended that the size of the administrative committee be reduced in order to better react to the needs of veterans. The Veterans Home response to this recommendation was that the committee's size was appropriate to represent the 60,000-plus veterans in North Dakota. The committee accepted the Veterans Home performance audit followup report.

Department of Emergency Services

The State Auditor's office was directed, pursuant to Section 5 of 2005 House Bill No. 1016, to conduct a performance audit of the Department of Emergency Services, including a review of fees collected for 911 services and the utilization of fees. The performance audit of 911 fees was done as a separate report and is discussed later in this report. The 2005 Legislative Assembly changed the name of the Division of Emergency Management to the Department of Emergency Services. Because the audit report covers the period July 1, 2002, through April 30, 2005, the performance audit report refers to the agency under its former name--Division of Emergency Management. The performance audit also includes State Radio, which was moved to the control of the Division of Emergency Management by executive order in September 2003.

A representative of the State Auditor's office presented the performance audit report for the Division of Emergency Management, including State Radio. The Division of Emergency Management is responsible for establishing a statewide system for mitigation, preparation for, response to, and recovery from disasters. The Division of Emergency Management is also responsible for preparing and maintaining a state emergency operations plan as well as being responsible for implementation of federal guidelines and programs related to homeland security.

State Radio provides a number of services and operates various programs through its communication center. The communication center is the 911 answering point for 22 small population counties, provides non-911 dispatching services to these 22 counties, is the state dispatch center for the Highway Patrol, and provides dispatching services for other state entities, such as the Game and Fish Department and the Attorney General's office. State Radio provides dispatching services for various federal entities, such as the National Park Service, the United States Border Patrol, and the United States Marshals Service. In addition, State Radio coordinates road closures, answers the security line for the Governor's residence and office, and answers "Report All Poacher" calls.

North Dakota Century Code Chapter 54-23.2 provides for requirements relating to the establishment and charging of fees for services provided by State Radio. State Radio collects fees from the 22 counties for providing 911 answering and dispatching services and collects fees related to the law enforcement telecommunications system (provides information on wanted felons, state-to-state information on crimes, and everyday police activities), and mobile data terminal services (provides law enforcement with mobile communications to access data bases and vehicle information). However, State Radio does not collect fees for the majority of the other services it provides and relies on a general fund appropriation for these costs. Fees for certain services provided by State Radio, such as non-911 dispatching to counties and dispatching for the Highway Patrol, are not provided for in the North Dakota Century Code.

The performance audit included 22 recommendations, including:

1. The Department of Emergency Services should comply with NDCC Sections 54-23.2-08 and 54-23.2-09 to ensure fees charged for 911 services, law enforcement telecommunications system, and mobile data terminal services cover applicable costs of services. At a minimum, the department should establish an adequate cost accounting system to track costs of services and use of special funds. The fees collected by State Radio do not appear sufficient to cover State Radio's costs associated with the 911 system, resulting in state general fund appropriations being used to pay certain costs associated with 911 services.
2. The Department of Emergency Services should improve the billing and collection process involving counties provided 911 services by the Division of State Radio. Counties are billed quarterly for 911 services based on the number of land line and wireless lines in each county. The line information is obtained directly from each county. As part of the billing process, the department should periodically verify information provided by the counties.
3. The Department of Emergency Services should take appropriate action to obtain legislative authority to provide dispatching services to various state entities, political subdivisions, and other entities and to charge fees for the services provided. After such authority is received and an adequate cost accounting system is established to identify estimated costs for services, respective entities should be charged for the costs of services provided.
4. The Department of Emergency Services should adequately manage and monitor the financial and accounting of the state hazardous chemicals preparedness and response program. At a minimum, the department should ensure all appropriate expenditures of the program are from special funds in order to save general fund money, and the department should review the effect of the increase in costs on the fund balance and, if necessary, take appropriate action to increase the fees.
5. The Department of Emergency Services should comply with the salary administration procedures established in North Dakota Administrative Code Chapter 4-07-02. All full-time equivalent (FTE) employees not on probation within the Division of Emergency Management and State Radio received a salary increase during the 2003-05 biennium. The salary increases provided to Division of Emergency Management employees were provided using federal homeland security grant funds. The salary increases provided to State Radio employees were provided using an emergency management performance grant received from the federal Department of Homeland Security. The salary increases were authorized by the former director of the Division of Emergency Management and were not approved by Human Resource Management Services within the Office of Management and Budget.
6. The State Personnel Board and Human Resource Management Services, with assistance from the Attorney General's office, should review the salary increases the Department of Emergency Services provided employees. As part of this review, a determination should be made as to whether any action should be taken regarding the instances of noncompliance with the North Dakota Administrative Code (see the section

later in this report entitled **STATUS OF DEPARTMENT OF EMERGENCY SERVICES SALARY INCREASES**).

7. The Department of Emergency Services should adequately document salary increases. At a minimum, increased amounts need to be defined and allocated by salary increase category as identified in North Dakota Administrative Code Chapter 4-07-02.
8. The Department of Emergency Services should formally review the scheduling of dispatchers at the Division of State Radio's communication center to determine whether the current number of dispatchers on duty is reasonable.

The committee received testimony from representatives of county government regarding the State Auditor's recommendation that the Department of Emergency Services should obtain legislative authority to provide dispatching services to various state entities, political subdivisions, and other entities and to charge fees for the services provided. The committee learned that many of the counties are opposed to the implementation of a fee for non-911 dispatching services.

The committee learned that the Department of Emergency Services has awarded a contract to Maximus, Inc., to do a complete review of State Radio costs and to provide a recommendation for an appropriate fee schedule for services provided, based on State Radio's actual costs. Several subcommittees have been formed consisting of representatives of the North Dakota 911 Association and the Department of Emergency Services Advisory Committee to address the performance audit recommendations. The committee accepted the performance audit report of the Department of Emergency Services.

Collection and Use of 911 Fees

A representative of the State Auditor's office presented the performance audit of the collection and use of 911 fees for the period July 1, 2002, through April 30, 2005. North Dakota Century Code Chapter 57-40.6 establishes the requirements relating to 911 fees. A monthly \$1 fee for each telephone access line and wireless access line is charged customers by telephone exchange access service providers and wireless service providers. The State Auditor's office, based on limited review of information, believes the 911 fee amount is more than sufficient to cover the 911 costs. The committee learned that prepaid wireless and Voice over Internet Protocol technologies are not required to participate in collection of the monthly \$1 per month service fee.

The telephone service providers are required to submit the 911 fees within 30 days of collection to the appropriate political subdivisions. The telephone service providers are allowed to retain a portion of the fees, not to exceed 5 percent of what is collected, for the actual costs of the administration for collection of the fees.

North Dakota Century Code Section 57-40.6-05 provides that after the 911 fees have been used to make the 911 system operational, the revenues in excess of

those obligations may only be used by the political subdivisions for maintaining and operating the emergency services communication system. An emergency services communication system is defined in the North Dakota Century Code as a "radio system, land lines communication network, wireless service network, or enhanced 911 (E911) telephone system, which provides rapid public access for coordinated dispatching of services, personnel, equipment, and facilities for law enforcement, fire, medical, or other emergency services."

The committee learned that to implement wireless 911 within the state, all political subdivisions receiving 911 fees contracted with the North Dakota Association of Counties to coordinate the implementation of the networking, nonpremise equipment upgrades, testing, and ongoing services necessary for wireless 911. The contracts between the North Dakota Association of Counties and the political subdivisions are for five years and will expire on June 30, 2008. Political subdivisions are to remit 50 cents per wireless access line per month to the North Dakota Association of Counties for the service. The North Dakota Association of Counties entered a contract with telephone service providers for implementing the wireless 911 system.

As of April 30, 2005, the 911 revenues accumulated by the North Dakota Association of Counties in excess of expenditures, or fund balance, were in excess of \$2.1 million. The committee learned the funding was accumulated in advance for anticipated fees related to implementing the wireless 911 system. The North Dakota Association of Counties has since returned \$500,000 of the fund balance to the participating jurisdictions based on the amounts of wireless 911 funds remitted to the North Dakota Association of Counties and reduced, as of July 1, 2005, the amount to be submitted to 40 percent of the amount received from wireless carriers. Any fund balance remaining after the five-year contract with the counties is completed will be returned to the counties.

A public service answering point (PSAP) is a communications facility operated on a 24-hour basis which first receives 911 calls from individuals in a 911 service area and which, as appropriate, may directly dispatch public safety services or extend, transfer, or relay 911 calls to appropriate public safety agencies. There are 23 PSAPs within the state, 22 of which are locally operated and 1 operated by the Division of State Radio. The majority of the 22 locally operated PSAPs are physically located and operated within law enforcement buildings and others are located in courthouses and commercial buildings. The PSAP operated by the Division of State Radio is located in the basement of a building at Fraine Barracks.

The State Auditor's office report recommended:

1. The political subdivisions receiving 911 fees should ensure the use of such funds comply with legislative intent. Certain political subdivisions need to improve their accounting of 911 fees. Many differences were noted in the use of 911 fees by the locally operated PSAPs. The State Auditor's office indicated that the Legislative

Assembly should consider granting specific authority to a state agency or board or commission to establish guidelines and standards related to the use of 911 fees and to be responsible for establishing a uniform system of accounting for 911 costs.

2. Political subdivisions receiving 911 fees need to ensure the amounts retained by telephone service providers for administration costs are appropriate. Political subdivisions should, at a minimum, ensure the maximum amount for administration costs is not exceeded and should ensure the amount retained by telephone service providers is reasonable by requiring documentation or other information regarding their administration costs. The State Auditor's office identified two telephone service providers that were withholding more than 5 percent of the 911 fee collected.

The committee asked the Legislative Council chairman for authority to have a four-member subcommittee meet with the Department of Emergency Services Advisory Committee to consider the recommendations in the State Auditor's office performance audit of the collection and use of 911 fees. The Legislative Council chairman did not approve the request. The committee accepted the performance audit report of the collection and use of 911 fees.

The North Dakota Association of Counties agreed that there is a lack of uniformity among counties and cities in the county's use of emergency services communication system revenues. The association indicated that urban areas have different emergency communication needs from rural areas of the state and forcing uniformity among the dissimilar jurisdictions may not meet citizen needs. The Department of Emergency Services Advisory Committee has proposed guidelines regarding the use of emergency services communication system revenues.

Department of Transportation Driver and Vehicle Services Performance Audit Followup

The Legislative Audit and Fiscal Review Committee accepted the followup report presented to the committee on the Department of Transportation Driver and Vehicle Services performance audit. The original performance audit was presented to the Legislative Audit and Fiscal Review Committee in September 2003. The followup report indicated 11 of the original recommendations have been fully implemented, 14 of the original recommendations have been partially implemented, and 11 recommendations were determined not to be implemented.

The committee learned that the Department of Transportation considered options to use a check recovery service as recommended by the State Auditor's office. The response from the Department of Transportation was that the task can be performed more efficiently within the division because of the relatively small number of nonsufficient funds (NSF) checks. The Department of Transportation has implemented a policy that if an individual has written two bad checks to the

department within the last five years, the department will only accept cash or a money order from that person.

The Bismarck office of the Department of Transportation Motor Vehicle Division reviews 100 percent of the new title and transfer work performed by the motor vehicle branch office due to the potential liability if errors are made. Five temporary Department of Transportation employees are responsible for conducting these reviews. The State Auditor's office identified their total salaries to be approximately \$68,000 per year. The State Auditor's office recommended the reviews of the new titles and transfers be done on a sample basis. However, the committee learned that the Department of Transportation is continuing to review 100 percent of the new title and transfer work performed by the motor vehicle branch offices. The Department of Transportation indicated it would discuss the issue with the Risk Management Division.

The State Auditor's office recommended that the Department of Transportation take appropriate action to change the requirements in the North Dakota Century Code to allow for an increase in the drivers' license four-year life cycle. Based on a sample from 10 other states, the average life cycle of a driver's license was 5.2 years. The Department of Transportation has not implemented the recommendation but indicated it will evaluate the life cycle of drivers' licenses, with an emphasis on safety concerns. The committee accepted the Department of Transportation Driver and Vehicle Services performance audit followup report.

Department of Corrections and Rehabilitation Performance Audit

During the 59th Legislative Assembly, the Legislative Audit and Fiscal Review Committee received and accepted the performance audit of the Department of Corrections and Rehabilitation. The committee consisted of members of the Legislative Assembly who served on the committee during the 2003-04 interim.

Future Performance Audits

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

- A performance audit of Workforce Safety and Insurance. (In late November 2006, a special meeting of the Legislative Audit and Fiscal Review Committee is scheduled to receive the performance audit of Workforce Safety and Insurance.)
- A performance audit of the University of North Dakota School of Medicine and Health Sciences.
- A performance audit on state agency cell phone usage, including a review of the propriety of state cell phone usage, the types of cell phone plans purchased, the number of minimally used cell phones, and various alternative methods to reimburse state employees for cell phone usage.
- A performance audit of Fleet Services.

Requests for Performance Audit Consultant

Pursuant to NDCC Section 54-10-01(4), the State Auditor's office may not hire a consultant to assist with conducting a performance audit of a state agency without the prior approval of the Legislative Audit and Fiscal Review Committee. The State Auditor's office is required to notify an agency of the need for a consultant before requesting approval by the Legislative Audit and Fiscal Review Committee. The agency that is audited is responsible for paying the cost of any consultant approved.

The 2005 Legislative Assembly provided in Section 44 of House Bill No. 1015 that the State Auditor's office may not conduct the performance audit of the University of North Dakota School of Medicine and Health Sciences until the completion of the school's accreditation process. The committee learned that the accreditation report was completed in July 2006. The State Auditor's office plans to complete the performance audit of the University of North Dakota School of Medicine and Health Sciences before the end of the 2007 legislative session.

The State Auditor's office requested approval from the committee to hire a consultant to assist with conducting the University of North Dakota School of Medicine and Health Sciences performance audit. The State Auditor's office will conduct a preliminary evaluation of the University of North Dakota School of Medicine and Health Sciences to determine the aspects of the performance audit which will require a consultant. The State Auditor's office plans to review the accreditation report and other recent reports regarding the University of North Dakota School of Medicine and Health Sciences during the preliminary evaluation process so that the performance audit will not duplicate subject areas covered by these reports. The committee approved the State Auditor's request to hire a consultant to assist with conducting the performance audit at a cost not to exceed \$100,000, to be paid by the University of North Dakota School of Medicine and Health Sciences, and that the performance audit include a review of the family practice residency programs in Bismarck, Minot, and Grand Forks.

STATUS OF DEPARTMENT OF EMERGENCY SERVICES SALARY INCREASES

The committee received a status report from a representative of the Human Resource Management Services of the Office of Management and Budget regarding salary increases provided to employees of the Department of Emergency Services. The Department of Emergency Services, including State Radio, provided salary increases to 53 employees during the 2003-05 biennium. Human Resource Management Services met with representatives of the Department of Emergency Services on several occasions to gather information relating to the reasons for the increases.

North Dakota Administrative Code provides for the following types of salary increases:

1. Promotion - Not specifically limited in amount but a promotional increase is to consider the magnitude of the job changes and internal salary relationships.
2. Equity - Up to 20 percent in a biennium, the limit was 10 percent in a biennium until June 30, 2004.
3. Relationship/workload - Up to 20 percent in a biennium, the limit was 10 percent in a biennium until June 30, 2004.
4. Performance - Up to a 5 percent in any 12-month period.

Human Resource Management Services indicated that 25 salary increases provided to employees of State Radio were improperly coded as a "responsibility" increase rather than an "equity" increase. The documentation for the salary increases was incorrect and was not submitted to Human Resource Management Services in a timely fashion; however, there was justification for the increases.

The overall mission of the Department of Emergency Services changed with the addition of homeland security functions. A representative of Human Resource Management Services indicated that 20 employees of the Department of Emergency Services received responsibility increases and those increases did not exceed the limit on these types of increases.

Human Resource Management Services indicated that six salary increases provided were analyzed on a case-by-case basis and were determined to be within North Dakota Administrative Code guidelines. The director who made the decisions to provide the salary increases is no longer employed with the agency. The deputy director, during the time the salary increases were provided, is also no longer employed with the agency.

The State Auditor's office indicated that while conducting the performance audit, the State Auditor's office asked the Department of Emergency Services to provide support for the salary increases provided, but the department was unable to provide that information. The State Auditor's office reported the conclusions presented in the Human Resource Management Services report appear to be based on information that either was not made available to the State Auditor's office or was based on after-the-fact allocation of raises that are not supported by appropriate documentation.

The committee learned that in October 2003, the Emergency Commission and Budget Section approved the Department of Emergency Services request to receive federal homeland security funding for the purpose of adding three FTE positions and for temporary employees. The federal homeland security funding was instead used to provide salary increases. Based on an Attorney General's opinion, the agency is limited to spending funding approved by the Emergency Commission to only those purposes as outlined in the agency's request to the Emergency Commission.

Recommendation

The committee makes no recommendation regarding the status of salary increases provided by the Department of Emergency Services.

INFORMATION TECHNOLOGY AUDITS

Information technology audits are audits of computer systems used by state agencies. The State Auditor's office conducted a risk assessment audit dated May 15, 2002, of 379 state computer systems. A risk rating was assigned to each system based on the potential for errors in the system or operation and related effect to the state of North Dakota. The report identified 31 high-risk computer systems and 218 moderate-risk computer systems. The risk rating is used by the State Auditor's office to determine where to best direct its audit resources. The committee received and accepted the following information technology audits:

- **ConnectND human resource management component** (for the year ended December 31, 2004) - ConnectND human resource management is used to maintain and process payroll records for employees of the state of North Dakota and the North Dakota University System.
- **ConnectND finance component** (for the year ended June 30, 2005) - ConnectND finance is used to support integrated enterprisewide business processing and maintain the official accounting records according to generally accepted accounting principles for the state of North Dakota and the North Dakota University System.
- **Information Technology Department** (for the year ended December 31, 2005) - The purpose of this audit was to ensure that necessary general controls of the Information Technology Department are in place and operating effectively. As part of this audit, the State Auditor's office contracted with ManTech International Corporation to test the security of state computer systems. The 2005 Legislative Assembly appropriated \$100,000 to the State Auditor's office to hire a consultant for this test. The committee learned that ManTech International Corporation identified some potentially vulnerable systems but was primarily unsuccessful in its attempts to "break into" the system. The specific vulnerabilities identified by ManTech International Corporation were not included in the audit report in order to keep the information from becoming public records.
- **Department of Corrections and Rehabilitation subject tracking and reporting system followup report** (May 18, 2006) - The original report was presented to the Legislative Audit and Fiscal Review Committee in October 2004. As a result of the followup review, two prior recommendations were determined to be fully implemented and one recommendation was determined not to be implemented.

COMMITTEE FOLLOWUP WITH AGENCIES THAT HAVE NOT COMPLIED WITH AUDIT RECOMMENDATIONS

Background

During the 2001-02 interim, the Legislative Audit and Fiscal Review Committee reviewed procedures for enhancing its followup efforts relating to the implementation of audit recommendations. Previous actions taken by the committee to make sure state agencies address audit findings included requiring agency responses in the initial audit reports, inviting agencies to comment, and requesting the State Auditor's office to do a six-month followup review. The committee approved the sending of correspondence to each agency that has not complied with previous audit recommendations requesting the agency to appear before the Legislative Audit and Fiscal Review Committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations. The Legislative Council staff is to issue the followup request on a case-by-case basis as directed by the committee.

Committee Followup - Department of Corrections and Rehabilitation

Pursuant to the procedures adopted during the 2001-02 interim, the committee requested by motion and received a followup report from the Department of Corrections and Rehabilitation regarding the implementation of previous State Auditor's office audit recommendations. The State Auditor's office report included recommendations relating to strengthening controls over the pharmacy inventory.

A representative of the Department of Corrections and Rehabilitation indicated that the department agrees with and accepts the State Auditor's office recommendation regarding strengthening internal controls over the pharmacy inventory. The committee learned the State Penitentiary pharmacy is operated by a pharmacist and a pharmacy technician. The pharmacy fills, on average, 3,900 prescriptions per month. In addition to filling and dispensing prescriptions, other duties of the two employees include formulary maintenance, drug research regarding side effects and cost-effectiveness, recordkeeping, ordering and receiving drugs, and stocking the pharmacy. Sound internal control requires segregation of duties, which is not possible with the limited pharmacy staff. The committee learned that the Department of Corrections and Rehabilitation will adopt other procedures that will help mitigate the lack of segregation of duties. These procedures include:

1. All drug purchases will be reviewed and approved for payment by the Department of Corrections and Rehabilitation medical director.
2. All prescriptions filled and dispensed by the State Penitentiary pharmacy will be subject to quarterly peer review.
3. Annual physical inventory of the pharmacy will be conducted by employees other than the pharmacists and pharmacy technician.

4. Drug purchases will be analytically reviewed by the Department of Corrections and Rehabilitation business office, on a quarterly basis, for dollar amount and number of orders.

CONTINUING APPROPRIATION STUDY

House Concurrent Resolution No. 3036 (2005) directed a Legislative Council study of state agency and institution continuing appropriation authority. A continuing appropriation is not specifically defined in the North Dakota Century Code. In general, a continuing appropriation can be defined as an appropriation of funds which is not specific in time or amount. Continuing appropriations are provided by a statutory authorization that remains in force or can be carried on from biennium to biennium, permitting state agencies, boards, or institutions to incur obligations and make payment for specified purposes or uses. The North Dakota Century Code contains many examples of explicit continuing appropriations. These are typically accomplished by using phrases such as "standing appropriation," "continuing appropriation," or "revolving fund."

Because continuing appropriations are not part of the regular legislative budget/appropriation process, the term "off-budget" is often applied to continuing appropriations. An FTE position funded by continuing appropriation authority is also classified as "off-budget." Examples of off-budget FTE positions include employees of state boards and commissions and positions funded by non-general fund revenues of higher education institutions.

Section 34 of Senate Bill No. 2015 (2003), the appropriation bill for the Office of Management and Budget, required executive branch agencies to report to the Appropriations Committees during the 2005 legislative session regarding expenditures made pursuant to continuing appropriations. The summary report compiled by the Office of Management and Budget included each agency's justification for needing the continuing appropriation authority and related revenues and fund balances for the 1999-2001, 2001-03, and 2003-05 bienniums to date and projections for the 2005-07 biennium.

House Bill No. 1282 (2005), which was not approved by the Legislative Assembly, would have amended NDCC Section 54-44.1-06 to require state agencies and institutions to include the statutory provisions authorizing the expenditure of funds, pursuant to continuing appropriation authority, and related revenues, expenditures, and fund balances for each current biennium and projected for the next biennium as part of budget presentations to the Legislative Assembly.

The Office of Management and Budget has directed executive branch agencies to include, as part of their budget requests, summaries of continuing appropriations, including justification for needing the continuing appropriation authority and related revenues, expenditures, and fund balances for the 2001-03, 2003-05, and 2005-07 bienniums to date and projections for the 2007-09 biennium. This continuing appropriations summary report will be made available to the 2007 Legislative Assembly.

The Legislative Audit and Fiscal Review Committee requested selected state agencies and institutions to present information to the committee regarding statutory authority for continuing appropriation authority within the agencies or institutions; justification for continuing the authority; and related revenues, expenditures, and fund balances for previous bienniums and projections for the 2005-07 biennium. The agencies and institutions presenting reports to the committee included:

1. **Workforce Safety and Insurance** - Twelve continuing appropriations funded solely through workers' compensation premiums and investment returns.
2. **Job Service North Dakota** - Three continuing appropriations relating to the federal interest repayment account; the unemployment insurance trust fund; and providing for job task analysis services, testing services, and personal reemployment account services.
3. **Department of Human Services** - Three continuing appropriations relating to the child support disbursement fund, child support improvement account, and cooperative agreements for child support enforcement services account.
4. **Attorney General's office** - Seven continuing appropriations of which three relate to the Racing Commission and the remaining four relate to the lottery, the asset forfeiture fund, the Attorney General refund fund, and the tactical team reimbursement fund.
5. **State Historical Society** - Three continuing appropriations relating to fees and concessions, gifts and bequests, and archaeological permits.
6. **Supreme Court** - Seven continuing appropriations relating to the indigent defense administration fund, the electronic filing administration fund, lawyers disciplinary system/Disciplinary Board, restitution collection assistance fund, court facilities improvement and maintenance fund, juvenile court reinvestment fund, and court receivables fund. The indigent defense administration fund was transferred to the Commission on Legal Counsel for Indigents on August 1, 2005.
7. **Office of Management and Budget** - Eight continuing appropriations relating to risk management premiums, workers' compensation premiums, Human Resource Management Services training fees, Capitol grounds planning funds, preliminary planning revolving funds, postage revolving funds, indigent civil legal services, and central supply revolving funds.
8. **Department of Public Instruction** - Three continuing appropriations relating to revolving printing funds, vision aids and appliances funds, and the displaced homemaker program.
9. **Industrial Commission** - Nine continuing appropriations relating to abandoned oil and gas well plugging and site reclamation funds, cash bond funds for plugging oil and gas wells and reclamation of oil and gas wells, cartographic

products funds, fossil excavation and restoration funds, global positioning system data funds, lignite research funds, North Dakota Building Authority, oil and gas reservoir funds, and oil and gas research funds.

10. **Adjutant General** - Four continuing appropriations relating to the National Guard emergency funds, National Guard military grounds funds, Veterans Cemetery maintenance funds, and Veterans Cemetery trust funds.
11. **State Department of Health** - Three continuing appropriations relating to the environmental quality restoration fund, organ tissue transplant fund, and local public health vaccine purchases.
12. **Department of Agriculture** - Three continuing appropriations relating to the honey promotion fund, turkey fund, and minor use fund.
13. **Department of Commerce** - Four continuing appropriations relating to the ethanol production incentive fund, North Dakota Development Fund, Inc., community development loan fund, and career guidance and job opportunities web site.

Findings

The judicial branch indicated that continuing appropriation authority for the electronic filing administration fund, as provided in NDCC Section 27-03-05, is not necessary as the Supreme Court could request an appropriation from the Legislative Assembly for these costs. In addition, the continuing appropriation authority for the juvenile court reinvestment fund, as provided in Section 54-56-03, is no longer necessary because federal funding for the program was discontinued as of June 30, 2004. The Supreme Court plans to submit a bill to the 2007 Legislative Assembly providing for removal of the statutory references for continuing appropriation authority relating to the electronic filing administration fund and the juvenile court reinvestment fund.

The committee learned that pursuant to NDCC Section 54-60-10, the Department of Commerce is authorized to provide career guidance and job opportunity services through an Internet web site. The Department of Commerce is to deposit in the department's operating fund any money received from subscriptions, commissions, fees, or other revenue from the web site. Money deposited in the operating fund of up to \$130,000 per biennium under this section is appropriated to the department on a continuing basis for payment of expenses related to administration of the Internet web site. Any additional amounts deposited in the operating fund during a biennium under this section may be spent pursuant to legislative appropriations or with Budget Section approval.

The committee learned that during 2004 a number of changes relating to web site management and partnership agreements occurred which negatively impacted the department's objective to provide a single statewide web site for posting job openings. After considering the changes and options available, the Department of Commerce discontinued the web site as of February 28, 2005. A representative of the

Department of Commerce indicated the department will include "language" in its 2007-09 biennium appropriation bill to remove the continuing appropriation authority for the career guidance and job opportunities web site.

The Legislative Assembly authorizes transfers from the environment and rangeland protection fund to the minor use fund. The Department of Agriculture indicated that the funding from the minor use fund could be appropriated each biennium by the Legislative Assembly rather than by a continuing appropriation.

Recommendation

The committee makes no recommendation regarding the study of continuing appropriations but requested that the Legislative Council staff provide information to the Appropriations Committees during the 2007 Legislative Assembly regarding the committee's review of continuing appropriations.

NORTH DAKOTA RACING COMMISSION AUDIT

Background

The committee received the audit report of the Racing Commission for the years ended June 30, 2004 and 2003, which included information regarding the cost of the racetrack in Fargo (the North Dakota Horse Park), and revenues and liability issues of the commission.

North Dakota Horse Park Construction Costs

The committee learned that 114.5 acres of farmland in Fargo was made available by Sheyenne Development LLP to initiate the process of developing the North Dakota Horse Park for a cost of \$250,000, which was paid by the city of Fargo. The land was divided as follows:

- Approximately 14.5 acres were deeded to North Dakota State University Development Foundation.
- Approximately 65 acres were leased on a 99-year lease to the North Dakota Horse Park Foundation for maintaining the racetrack. The North Dakota Horse Park Foundation is a 501(c)(3) nonprofit organization formed to guide and direct the building, management, and operation of the North Dakota Horse Park and to promote the programs associated with the facilities.
- The remaining 35 acres were leased on a 99-year lease to Horse Race North Dakota for the grandstand, parking lots, temporary offices, and adjacent grounds. Horse Race North Dakota is a 501(c)(4) nonprofit organization developed to promote the sport of live horse racing and all equine-related activities.

The committee learned that the city of Fargo provided \$1 million of tax increment financing district funds to assist in the construction of the racetrack. The repayment terms for the \$1 million of tax increment financing district funds provide for the North Dakota Horse Park property owners to defer or eliminate payment of special assessments based on development of the property surrounding the North Dakota Horse Park. If development does not occur or there is a

shortfall, the North Dakota Horse Park Foundation/Horse Race North Dakota would be levied special assessments totaling \$955,718, which would be assessed over a period not to exceed 25 years. The first payment would be due January 1, 2009. The annual assessment for the North Dakota Horse Park would be \$85,549. If the special assessments are not paid, the city of Fargo would assume ownership of the North Dakota Horse Park property.

The committee learned that a steering committee was formed to oversee the construction of the North Dakota Horse Park. The steering committee assisted in developing the original architect's estimate. The actual cost of the North Dakota Horse Park was \$3,598,000, or \$1,798,000 more than the original architect's estimate of \$1,800,000. Upgrades to the racetrack due to water and drainage issues and rail and fence safety concerns accounted for the majority of the additional costs above the estimate.

The committee learned that all project expenditures were approved by the project manager, the Racing Commission, and the Attorney General's office. The original architect's estimate was made before the construction bidding process. The actual bids were about 20 percent more than the architect's estimate. Approximately \$2.8 million of the funding for construction of the North Dakota Horse Park was from the Racing Commission promotion fund.

The committee learned that Horse Race North Dakota is planning to begin construction on Phase 1 of a three-phased "clubhouse/grandstand" project. Phase 1 of this project is estimated to cost \$1.5 million. The clubhouse will allow "year-round" events to be conducted and will generate additional revenues for the operations of the North Dakota Horse Park. There are

also future plans for simulcast wagering at the North Dakota Horse Park.

Racing Commission Revenues

The Racing Commission operates three separate funds:

- The breeders' fund, which is used to provide additional funds to North Dakota-born horses that race and win, place, or show in races at North Dakota tracks (NDCC Section 53-06.2-01(1));
- The purse fund, which is used to provide additional funds to North Dakota racetracks for purses for their live races (NDCC Section 53-06.2-01(10)); and
- The promotion fund, which is for promotion of horse racing and a variety of other functions, including providing funding for construction of the North Dakota Horse Park. In addition, the Racing Commission may receive up to 25 percent of this fund for the purpose of payment of operating expenses of the commission (NDCC Section 53-06.2-11(3)).

Parimutuel wagering, which includes both simulcast and live horse race wagering, is a system in which players bet against each other as opposed to the "house" or the management. The winners divide the total amount of the amount wagered, minus the percentage that goes to the house, otherwise known as the "rake," to pay for its expenses. The breeders' fund, the purse fund, the promotion fund, and the general fund each receive a percentage of the total amount wagered through parimutuel horse racing in North Dakota. The committee received information regarding revenues generated since the 1997-99 biennium from horse racing in North Dakota:

	1997-99 Biennium	1999-2001 Biennium	2001-03 Biennium	2003-05 Biennium	2005-07 Biennium (July 1, 2005, to September 30, 2005)
General fund	\$592,769	\$6,396,078	\$7,660,826	\$5,250,888	\$62,211
Breeders' fund	135,547	1,137,719	2,779,470	795,815	40,453
Purse fund	135,512	1,136,578	2,767,303	795,815	40,637
Promotion fund	308,234	2,071,931	5,229,897	1,391,644	69,392
Total	\$1,172,062	\$10,742,306	\$18,437,496	\$8,234,162	\$212,693

NOTE: Revenues decreased during the 2003-05 biennium due to a loss of the "big bettors." These were individual bettors that were wagering up to \$170 million per year on simulcast racing in North Dakota. These individuals moved their wagering operations to another state during the 2003-05 biennium.

The North American Pari-mutuel Regulators Association (NAPRA) is a tax-exempt organization incorporated in Kansas in 1997 to provide a cost-effective focal point for communications and dispersing information relating to the parimutuel industry. A representative of NAPRA indicated that virtually every horse racetrack in the United States is subsidized by simulcast wagering and without revenues from simulcast wagering nearly every horse track facility would lose money. Horse racetracks in Montana, South Dakota, Wyoming, and Nebraska are subsidized by simulcast wagering. In addition to receiving subsidies from simulcast wagering, a 24-hour card club is located at

Canterbury Park (Minnesota) and a casino is located at Prairie Meadows Racetrack (Iowa).

There are 18 days of live racing scheduled annually at the North Dakota Horse Park. Approximately 95 percent of the total amount wagered on horse racing in North Dakota is on simulcast racing and 5 percent is on live in-state racing.

The State Auditor's office indicated that based on projected revenues and expenditures, Horse Race North Dakota will have difficulty continuing without financial support from the Racing Commission. Based on an unaudited income statement, Horse Race North Dakota's total 2004 revenues were \$1,013,136, of which \$718,400 was from commission grants.

The committee learned that the audit report included a projection that based on estimated revenues and expenditures, the Racing Commission's breeders' fund, the purse fund, and the promotion fund have approximately three to five years of funding remaining. The commission has committed over \$2.8 million for construction of the North Dakota Horse Park. In addition, the commission provided funding of \$900,000 in 2003 and \$718,400 in 2004 for operation of the North Dakota Horse Park. The October 15, 2005, balances in each of the commission funds were:

- Breeders' fund - \$1,664,491.
- Purse fund - \$1,732,387.
- Promotion fund - \$1,140,287.

Liability of the Racing Commission

The committee learned that it would be very unlikely the state or the racing commissioners would be subject to liability for injuries occurring at races licensed by the Racing Commission. The commission does not conduct races or contract with any organization to conduct races. The commission grants licenses to organizations to conduct races. An action cannot be brought against a state employee and a state employee cannot be held personally liable for damages caused by that state employee acting within the scope of the employee's employment.

Conclusion

The committee accepted the audit report of the Racing Commission. The committee by motion asked the commission to request that the respective horse racing tracks licensed by the commission obtain a certificate of insurance extending liability insurance coverage to the state of North Dakota for a minimum amount of \$1 million or for the stated amount of the racetrack's liability insurance coverage if that amount is greater than \$1 million.

The committee learned that representatives of the Outdoor Recreation Development Association and the North Dakota Horse Park have indicated that they would seek to add the Racing Commission as an additional insured party.

OTHER REPORTS

Ethanol Production Companies

North Dakota Century Code Section 45-10.2-115 provides that any limited liability partnership that produces agricultural ethyl alcohol or methanol and receives a production subsidy from the state must submit an annual audit report to the Legislative Audit and Fiscal Review Committee. Pursuant to this section,

the audit report for Alchem, Ltd., LLP, for the year ended December 31, 2004, was filed with the committee.

North Dakota Century Code Section 10-19.1-152 provides that any corporation that produces agriculture ethyl alcohol or methanol and receives a production subsidy from the state must submit an annual audit report to the Legislative Audit and Fiscal Review Committee. Pursuant to this section, the audit report for Archer Daniels Midland Company for the year ended June 30, 2005, was filed with the committee.

Department of Human Services Accounts Receivable Writeoffs

Pursuant to NDCC Sections 25-04-17 and 50-06.3-08, the Department of Human Services is required to present a report to the Legislative Audit and Fiscal Review Committee regarding accounts receivable writeoffs at the State Hospital, Developmental Center, and human service centers as of June 30 of each fiscal year. The department's report for fiscal year 2005 was received and accepted by the committee. Accounts receivable writeoffs as of June 30, 2005, were \$4,474,037 at the State Hospital, \$215,162 at the Developmental Center, and \$913,730 at the human service centers.

The department's report for fiscal year 2006 was also received and accepted by the committee. Accounts receivable writeoffs as of June 30, 2006, were \$4,114,117 at the State Hospital, \$30,543 at the Developmental Center, and \$772,013 at the human service centers.

Information Technology Department

The committee received reports from a representative of the Information Technology Department on the status of information technology projects, services, plans, and benefits, pursuant to NDCC Section 54-59-19. The annual report contained:

- An executive summary of the benefits realized from investments in information technology.
- Executive highlights of the Information Technology Department's goals and accomplishments.
- A summary of the department's strategic planning and performance, including an update on the department's performance measures.
- Information Technology Department rate comparisons.
- Information Technology Department financial statements.
- A summary of major completed and active information technology projects.