Prepared by the North Dakota Legislative Council staff for the Legislative Audit and Fiscal Review Committee

September 2009

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2009-10 INTERIM - RECOMMENDATIONS AND REQUESTS MADE DURING PREVIOUS INTERIMS

The Legislative Management by statute appoints a Legislative Audit and Fiscal Review Committee as a division of its Budget Section. 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 with the following duties and responsibilities for the 2009-11 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association pursuant to Section 4-02.1-18.
2. **Ethyl alcohol and methanol producers** - Receive annual audit reports from any corporation that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-19.1-152, receive annual audit reports from any limited liability company that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-32-156, and receive annual audit reports from any limited partnership that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 45-10.2-115.
3. **Department of Human Services accounts receivable** - Receive annual reports on the status of accounts receivable for the Department of Human Services and Developmental Center at Westwood Park 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 36-22-09 provides for the audit report to be submitted to the Legislative Council. The Legislative Management 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 two 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.

REQUESTS AND RECOMMENDATIONS DURING PREVIOUS INTERIMS

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

1. **Discussion of audit findings prior to presentation of the report** - The State Auditor should consider discussing audit findings with appropriate boards or commissions prior to the audit report being presented to the committee.
2. **Actions taken by audited agency** - Audited agencies, boards, and commissions should report to the committee at the time the audit report is presented regarding actions taken as a result of audit findings contained in the report.
3. **Responses to recommendations** - Each audit report prepared by the State Auditor should include a summary of audit recommendations along with the audited agency's written response to the recommendations. The summary is to be in recommendation-response format.
4. **Acceptance of audit reports** - The Legislative Audit and Fiscal Review Committee receives audit reports as presented by the State Auditor's office and other independent auditors and by motion 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 six months after a report has been accepted by this committee. The State Auditor should report to this committee, or another appropriate legislative committee, regarding any recommendations not implemented.
7. **Copies of management letters** - The State Auditor should provide copies of management letters to committee members.
8. **Use of salaries and wages funding** - The State Auditor should consider including in audit reports information on the amount of salaries and wages funding spent on filled full-time equivalent (FTE) positions and the amount relating to vacant FTE positions which is spent for other purposes.
9. **Committee followup with agencies that have not complied with audit recommendations** - The Legislative Audit and Fiscal Review Committee, by motion, may direct the Legislative Council staff to send correspondence to an agency that has not complied with previous audit recommendations requesting the agency to appear before the Legislative Audit and Fiscal Review Committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
10. **Presentation of evidence to the Attorney General** - Pursuant to Section 54-35-02.2, whenever the Legislative Audit and Fiscal Review Committee determines or has reason to believe there may have been a violation of law relating to the receipt, custody, or expenditure of public funds by any state officer or employee, the committee is to present such evidence or information to the Attorney General. Upon receipt of the information, the Attorney General is to immediately commence an investigation. If the evidence supplied by the committee and through the investigation indicates the probability of a violation of law by any state official or employee, the Attorney General is to prosecute the state official or employee as provided by law.
11. **Report on significant findings and recommendations** - The State Auditor should consider providing a report to the 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 presented a summary of significant audit findings and recommendations from audit reports presented to the Legislative Audit and Fiscal Review Committee during the 2005-06 interim to the Appropriations Committees at the start of the 60th Legislative Assembly. A similar report was presented by the State Auditor's office at the start of the 61st Legislative Assembly for audit reports presented to the Legislative Audit and Fiscal Review Committee during the 2007-08 interim.

AUDIT GUIDELINES

During the 2005-06 interim, the Legislative Audit and Fiscal Review Committee received suggested changes from the State Auditor's office to revise the 12 audit guidelines as some of the guidelines were no

longer applicable to state agencies. The six new questions as proposed by the State Auditor's office to be addressed would highlight key areas and issues that are of interest to committee members and provide similar information to those made by auditors to an "audit committee." The committee also received input and approval from representatives of Eide Bailly LLP and Brady, Martz & Associates PC regarding the six new questions.

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

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

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

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

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

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, 2007 and 2006 was completed by Eide Bailly LLP. This audit report was reviewed and approved by the Legislative Audit and Fiscal Review Committee during the November 19, 2007, meeting.

The National State Auditors Association requires state auditor's offices to be subject to an external quality control review every three years. The system

of quality control encompasses the office's organizational structure and policies adopted and procedures established to provide reasonable assurance of conforming to governmental auditing standards. The most recent quality control review of the State Auditor's office for the period May 1, 2007, to April 30, 2008, is attached as an appendix. The review identified the following findings:

- The State Auditor's office should ensure that audit reports are dated and evidence obtained in accordance with generally accepted government auditing standards and American Institute of Certified Public Accountants standards.
- The State Auditor's office should discuss the importance of assessing control risk at low for classes of transactions or account balances related to major federal programs and should ensure auditors document the test of controls performed for all applicable requirements.
- The State Auditor's office should discuss the importance of documenting the expectation along with the factors considered in its development when performing analytical procedures.

PERFORMANCE AUDITS

During the 2007-08 interim, the committee received performance audit reports on the University of North Dakota (UND) School of Medicine and Health Sciences and the Wildlife Services program.

The following table lists the status of performance audits presented to the Legislative Audit and Fiscal Review Committee during the 1997-99 through 2007-09 bienniums:

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

UNIVERSITY OF NORTH DAKOTA SCHOOL OF MEDICINE AND HEALTH SCIENCES

In November 2007 the Legislative Audit and Fiscal Review Committee received the performance audit report of the UND School of Medicine and Health Sciences. The goal of the performance audit report was to determine if the UND School of Medicine and Health Sciences has established an adequate system for monitoring operations. Areas reviewed during the audit were:

1. Educational training related to primary care with an emphasis on family medicine;
2. Research efforts and research programs; and
3. Merger of the Department of Family Medicine and Department of Community Medicine.

The performance audit report contained 35 recommendations. Based on the performance audit, the State Auditor's office determined:

- The UND School of Medicine and Health Sciences has not established an adequate system for monitoring its operations. The State Auditor's office noted a number of areas of concern, including the UND School of Medicine and Health Sciences not complying with the legislative purpose and duties established for the school, a lack of monitoring of compliance

with state laws, a lack of adequate performance measures and benchmarks, and other issues.

- A consultant hired to review certain areas as part of the performance audit--DJW Associates--identified that the UND School of Medicine and Health Sciences has a tradition of educating and training primary care physicians who deliver health care in the state. The consultant noted improvements could be made relating to the residency and fellowship positions and identified a need for support in developing clinical research programs as well as providing incentives to encourage and reward faculty. DJW Associates concluded the merger of the Department of Family Medicine and the Department of Community Medicine was not unreasonable based on comparable depart-ments in other medical schools, although it resulted in unnecessary acrimony that far offset the financial savings offered as a rationale for the merger.
- The State Auditor's office identified several areas which are brought forth to the attention of public policymakers for informational purposes as well as areas which require consideration and possible action. The consultant recommended consideration be given for a regional model for the delivery of health care in rural and underserved areas which differs from the traditional model of placing a family medicine physician in every community. The consultant also noted it was essential to establish an effective organizational and management structure for residency programs and offered a model in which the health care delivery system (i.e., a consortium of major hospitals) act as the primary sponsor of the program with the UND School of Medicine and Health Sciences as an affiliate.
- The State Auditor's office noted real property will be obtained without legislative approval due to a financing arrangement with the UND Alumni Foundation. The State Auditor's office noted appropriated funds are used to supplement research but could not determine the extent to which this occurs. Due to the current accounting of general fund money, the State Auditor's office was unable to perform an analysis or identify information related to how general fund money is being specifically expended. The State Auditor's office identified a lack of accurate and reliable information being readily available to ensure the UND School of Medicine and Health Sciences stays within its legislatively authorized FTE amount.

WILDLIFE SERVICES

In July 2008 the Legislative Audit and Fiscal Review Committee received the performance audit report of the Wildlife Services program. The goal of the performance audit report was to determine if the state has established an adequate system for monitoring the Wildlife Services program.

The performance audit report contained 11 recommendations. Based on the performance audit, the State Auditor's office determined:

- Improvements are needed relating to expenses paid by the state, including verifying salaries and other costs, the percentage of pilots' salaries paid by the state, adequate documentation of travel time and field specialists' time charged to various categories, and verification of support and reasonableness of program billed amounts.
- More time should be allocated to the state blackbird problem.
- Improvements are needed in monitoring compliance with requirements in the cooperative service agreements and ensuring requirements of the agreements are adequate.
- Century Code requirements related to the Wildlife Services program should be reviewed and sections modified or clarified to make requirements clear and up to date.
- The monitoring and funding responsibilities of the program should be reviewed to determine if changes should be made to the responsibilities.
- Federal budget and expenditure information relating to the Wildlife Services program should be obtained for monitoring and budgeting purposes.

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. The 2009 Legislative Assembly approved $150,000 from the general fund, an increase of $50,000 from the 2007-09 biennium, for an information technology consultant to test state agency and political subdivision information technology system security.

North Dakota Network and Security Audit

In November 2007 a representative of ManTech Security and Mission Assurance presented the North Dakota network and security audit report. The audit focused on four tasks--external vulnerability assessment, internal vulnerability assessment, penetration testing, and application security assessment.

The external vulnerability assessment identified 313 systems at state agencies or organizations with at

least one vulnerability that would provide an external attacker with a possible attack vector that could lead to compromise of the state's network from the Internet. The external vulnerability assessment identified 10 unique high-risk vulnerabilities on multiple systems, 2 unique medium-risk vulnerabilities on multiple systems, and 4 unique low-risk vulnerabilities on multiple systems. The external vulnerability assessment resulted in the following general recommendations:

- Review content available on publicly accessible servers.
- Filter inbound access to all state systems.
- Ensure segregation between kindergarten through grade 12 and other education networks and the state network.

The internal vulnerability assessment identified 427 systems at state agencies or organizations with at least one vulnerability that would provide an attacker with a possible attack vector that could lead to compromise of the state's network and sensitive information. The internal vulnerability assessment identified 29 unique high-risk vulnerabilities on multiple systems, 8 unique medium-risk vulnerabilities on multiple systems, and 4 unique low-risk vulnerabilities on multiple systems. The internal vulnerability assessment resulted in the following general recommendations:

- Segment public facing servers from internal network.
- Internal segregation of critical servers and development systems.
- Include applications in formal patch management program.
- Implement outbound access control.
- Require use of encrypted protocols for remote management.

The penetration test identified nine state systems to target based on vulnerability assessment results. The test team was unsuccessful in exploiting eight of the systems but was successful in exploiting one system to create an account with administrator privileges. The penetration test resulted in the following general recommendations:

- Educate users on social engineering techniques.
- Ensure servers and desktops are kept current on all operating system and application patches.

An application security assessment was performed on the state's PeopleSoft application. The application security assessment identified two vulnerability findings with the application and its associated components--one high-risk vulnerability relating to the operating system installed on the application host and one low-risk design flaw. The application security assessment resulted in the following general recommendations:

- Ensure systems hosting applications are kept up to date.
- Prevent simultaneous logins.

The committee accepted the North Dakota network and security audit report.

Information Technology Department Information System Audit

A representative of the State Auditor's office presented the Information Technology Department information system audit for the year ended December 31, 2007. The audit resulted in the following three recommendations relating to the general controls of the Information Technology Department:

- Test the disaster recovery plan on a yearly basis.
- Develop a formal security plan.
- Develop a formal risk assessment framework.

The committee accepted the Information Technology Department information system audit report.

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 followup reports for the UND School of Medicine and Health Sciences and Wildlife Services program performance audits.
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 Legislative Audit and Fiscal Review 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 Developmental Center at Westwood Park.
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.

ATTACH:1