

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

Friday, August 3, 2001
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Ken Solberg, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Ken Solberg, Randel Christmann, Dwight Cook, Duaine C. Espegard, Jerome Kelsh, Jerry Klein, Kenneth Kroeplin; Representatives Ole Aarsvold, Jeff Delzer, Doug Lemieux, Andrew G. Maragos, Bob Skarphol, Mike Timm, Francis J. Wald, Lonny Winrich

Members absent: Representatives Rex R. Byerly, RaeAnn G. Kelsch

Others present: See attached appendix

LEGISLATIVE COUNCIL SUPPLEMENTARY RULES OF OPERATION AND PROCEDURE

At the request of Chairman Solberg, Mr. Jim W. Smith, Legislative Budget Analyst and Auditor, Legislative Council, reviewed the *Supplementary Rules of Operation and Procedure of the North Dakota Legislative Council* for the 2001-03 biennium.

COMMITTEE DUTIES AND RESPONSIBILITIES

At the request of Chairman Solberg, the Legislative Council staff reviewed a memorandum entitled *Legislative Audit and Fiscal Review Committee - Statutory Duties and Responsibilities for the 2001-03 Interim - Recommendations and Requests Made During Previous Interims*. The Legislative Audit and Fiscal Review Committee is a statutory committee of the Legislative Council. North Dakota Century Code (NDCC) Section 54-35-02.1 provides that the committee is created:

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

In addition, the committee is assigned the following statutory duties and responsibilities for the 2001-03 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association, pursuant to NDCC Section 4-02.1-18.
2. **Ethyl alcohol and methanol producers** - Receive annual audit reports from any corporation that produces agricultural ethyl alcohol or methanol in this state and receives a production subsidy from the state, pursuant to NDCC Section 10-19.1-152, and receive annual audit reports from any limited liability company that produces agricultural ethyl alcohol or methanol in this state and receives a production subsidy from the state, pursuant to Section 10-32-156.
3. **Department of Human Services accounts receivable** - Receive annual reports on the status of accounts receivable for the Department of Human Services and Developmental Center at Westwood Park, Grafton, pursuant to NDCC Sections 25-04-17 and 50-06.3-08.
4. **Low-risk incentive fund** - Receive annual audit reports and economic impact reports from the North Dakota low-risk incentive fund. North Dakota Century Code Section 26.1-50-05 provides for the audit report to be submitted to the Legislative Council, which has assigned the responsibility to this committee.
5. **Stockmen's Association** - Receive biennial audit report from the North Dakota Stockmen's Association. North Dakota Century Code Section 36-22-09 provides for the audit report to be submitted to the Legislative Council, which has assigned the responsibility to this committee.
6. **Job Service North Dakota** - Receive the biennial performance audit report for the divisions of Job Service North Dakota, pursuant to NDCC Section 52-02-18.
7. **Performance audits** - Determine performance audits of state agencies to be conducted by the State Auditor, pursuant to NDCC Section 54-10-01.
8. **Frequency of audits** - Determine the frequency of audits or reviews of state agencies, pursuant to NDCC Section 54-10-01.

9. **Political subdivisions** - Determine if the State Auditor is to perform audits of political subdivisions on a more frequent basis than once every two years, pursuant to NDCC Section 54-10-13, and direct the State Auditor to audit or review the accounts of any political subdivision, pursuant to Section 54-10-15.
10. **Study and review audit reports** - Pursuant to NDCC Section 54-35-02.2:
 - a. Study and review audit reports selected by the committee from those submitted by the State Auditor.
 - b. Confer with the State Auditor regarding the audit reports reviewed by the committee.
 - c. As necessary, confer with representatives of state departments, agencies, and institutions audited in order to obtain information regarding fiscal transactions and governmental operations.
11. **Workers Compensation Bureau** - Receive annual reports from the director of the Workers Compensation Bureau and the chairman of the Workers Compensation Bureau Board of Directors, pursuant to NDCC Section 65-02-03.3, and receive reports from the director of the Workers Compensation Bureau, the chairman of the Workers Compensation Bureau Board of Directors, and the auditor regarding the biennial performance audit of the Workers Compensation Bureau, pursuant to Section 65-02-30.
12. **Information Technology Department** - Receive a report on the development of performance measures to assist the Legislative Assembly in determining the effectiveness and efficiency of the operations of the Information Technology Department, pursuant to Senate Bill No. 2043, and receive annual reports on state information technology projects and plans, pursuant to NDCC Section 54-59-19.

AUDIT PROCESS FOR STATE AGENCIES

Chairman Solberg called on Mr. Ed Nagel, Jr., State Auditor's office, who presented a document entitled *The Audit Process for State Agencies and the Relationship Between the Office of the State Auditor and the Legislative Audit and Fiscal Review Committee*. A copy of the document is on file in the Legislative Council office.

PERFORMANCE AUDIT FOLLOWUP REPORTS

Chairman Solberg called on Mr. Gordy Smith, State Auditor's office, who presented followup reports

on the status of recommendations included in the following performance audits:

- State procurement practices - State agencies.
- State procurement practices - North Dakota University System.
- State personnel systems.

The report on state procurement practices of state agencies indicates that 11 of the original recommendations have been fully implemented, four of the original recommendations have been partially implemented, and one recommendation is no longer applicable.

Representative Timm asked if the Office of Management and Budget has developed an employee policy manual for state procurement practices. Ms. Linda Engmann, Director, Central Services Division, Office of Management and Budget, said the Central Services Division has completed a draft of a purchasing manual to be distributed to state agencies. She said the draft manual is currently being reviewed by the National Association of State Purchasing Officers to ensure that it contains "best practices." She said the Central Services Division has also developed a policy and procedure manual for the agency's own use.

In response to a question from Representative Wald, Ms. Engmann said NDCC Section 54-44.4-09 requires all vendors submitting bids or proposals on state contracts to be registered with the Secretary of State's office. She said this is not an imposition on North Dakota businesses because they are already registered with the Secretary of State's office. She said requiring out-of-state businesses to be registered with the Secretary of State's office creates a "level playing field" for North Dakota businesses.

Representative Skarphol asked under what circumstances the state does business with unregistered vendors. Ms. Sherry Nees, Procurement Manager, Central Services Division, Office of Management and Budget, said NDCC Section 54-44.4-09 provides limited exemptions to the state registration requirements, as authorized by the director of the Office of Management and Budget.

In response to a question from Representative Wald, Ms. Nees said requests for bid proposals are usually sent to all vendors listed in the state vendor data base for the particular product or service for which a bid is being requested.

Mr. Gordy Smith presented the followup report for the performance audit of state procurement practices of the North Dakota University System. The report indicates that nine recommendations have been fully implemented, six recommendations have been partially implemented, two recommendations have not been implemented, and three recommendations are no longer applicable.

Representative Skarphol said the State Auditor's office should be informed of scholarships, endowments, and other premiums received by the University

System related to bids accepted for products and services.

In response to a question from Representative Maragos, Mr. Gordy Smith said the recommendation of the State Auditor's office provides that the State Board of Higher Education should develop, implement, and ensure adherence to a policy to provide guidance to institutions in dealing with bids that include offers of scholarships, endowments, and other premiums.

Chairman Solberg called on Ms. Laura Glatt, Vice Chancellor for Administrative Affairs, North Dakota University System, to respond to committee questions relating to the followup report on the performance audit of state procurement practices of the North Dakota University System. She said NDCC Section 54-44.4-05 requires that state contracts be awarded to the lowest responsible bidder. She said the offering of scholarships, endowments, or premiums are only taken into consideration by the University System in the event of a tie between two bidders.

In response to a question from Representative Maragos, Mr. Thomas Akers, Director of Purchasing, North Dakota State University, Fargo, said once opened, all bids are open records and can be examined by other bidders.

Representative Delzer asked if scholarships, endowments, and other premiums are always included as part of a bid proposal, or if in some cases they are part of a separate agreement with the institution. Mr. Akers said when submitting a bid proposal, vendors are asked to list all endowments as part of the bid.

Representative Skarphol asked if North Dakota State University has ever requested that vendors include a scholarship, endowment, or other premium in a bid proposal. Mr. Akers said the only such instance he is aware of related to bids for food service for which the university requested that a percentage of the bid be used for student scholarships.

Representative Delzer asked how institutions of higher education fund lobbyist contracts and what services are provided to the institutions by lobbyists. Ms. Glatt said North Dakota State University, the University of North Dakota, and Minot State University employ lobbyists. She said the lobbyists work on behalf of the university with Congress and federal agencies to secure funding for various projects. Representative Delzer said Ms. Glatt provided information that indicates North Dakota State University pays approximately \$120,000 per year for lobbyist services, the source of funding is interest income; Minot State University pays approximately \$30,000 per year, the source of funding is local funds; and the University of North Dakota pays approximately \$100,800 per year for lobbyist services, the source of funding is local funds. Representative Delzer said the information indicates that local funds do not include legislatively appropriated funds or tuition income.

With the approval of Chairman Solberg, Representative Skarphol requested that the Legislative Council staff prepare a memorandum on statutory provisions relating to the state bidding process for contracts for goods and services. Representative Delzer requested the memorandum also include information on the appeal process, if any, for vendors not selected for state contracts and any penalties for agencies that violate state law relating to the purchase of goods and services.

With the approval of Chairman Solberg, Representative Skarphol requested that the State Auditor's office prepare information to be presented to the committee relating to scholarships, endowments, and premiums that have been accepted by institutions of higher education as part of bid proposals.

Representative Wald said in the past, certain state agencies have leased equipment items because the Legislative Assembly did not provide sufficient funding to purchase those items. He asked if the State Auditor's office reviews leases entered into by state agencies and reviews legislative intent to determine if the lease is appropriate. Mr. Gordy Smith said state law does not prohibit an agency from entering into a lease if the agency has adequate appropriation authority to make the lease payments. He said agencies must include in their budget request a listing of significant leases.

Representative Skarphol said during the 2001 legislative session, he requested from the Office of Management and Budget a listing of all outstanding leases for assets valued at under \$50,000. He requested that the Office of Management and Budget provide copies of that report to the committee. Chairman Solberg requested that the Legislative Council staff prepare a memorandum on information included in agency budget request forms relating to existing and proposed leases and related statutory provisions.

Representative Winrich said there are cases when the Legislative Assembly only provides funding adequate to lease an asset, even though it would be more cost-effective to purchase the asset. Representative Wald said agencies should complete a cost-benefit analysis of all proposed leases and submit that information to the Appropriations Committees during the legislative session.

Mr. Gordy Smith presented the followup report on the performance audit of state personnel systems. The report indicates 11 recommendations have been fully implemented, 14 recommendations have been partially implemented, and 5 recommendations have not been implemented. The report indicates the University System disagrees with the State Auditor's office regarding the status of the implementation of many of the recommendations. He said when preparing the performance audit followup report, the State Auditor's office submits a draft copy of the report to the agency involved in the audit. He said

this allows the agency an opportunity to provide comments, to note disagreements with the State Auditor's office, and to provide more current information. He said the University System did not take advantage of the opportunity to resolve differences with the State Auditor's office before issuance of the final copy of the report.

Chairman Solberg called on Ms. Glatt to comment on the report. She said in many cases the University System does not disagree with the State Auditor's findings but, due to limited staff, may be unable to implement the recommendations as anticipated by the State Auditor. She said differences between the University System and the State Auditor's office regarding the status of many of the recommendations are a result of a lack of communication. She said the University System did not see the State Auditor's concluding remarks to the University System comments until the report was put in final form, shortly before the Legislative Audit and Fiscal Review Committee meeting.

Chairman Solberg said the committee will postpone taking action on the followup report on the performance audit of state personnel systems and requested that prior to the next committee meeting, the North Dakota University System, the Central Personnel Division of the Office of Management and Budget, and the State Auditor's office work together to prepare a report regarding the current status of the recommendations and that the report be presented to the committee at its next meeting.

AUDITS OF STATE AGENCIES

Chairman Solberg called on Mr. Nagel who presented the audit report for the Information Technology Department for the period ended June 30, 2000. He said the report does not indicate any material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. He said the report includes three recommendations for improvement of the agency's operations.

Mr. Nagel presented the audit report for the Mill and Elevator Association for the years ended June 30, 2000 and 1999. He said the audit report includes an unqualified opinion and does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the State Seed Department for the years ended June 30, 2000 and 1999. He said the report does not indicate any material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. The report does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the Game and Fish Department for the year ended June 30, 2000. He said the report does not indicate any

material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. The report does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the Division of Emergency Management for the year ended June 30, 2000. He said the report does not indicate any material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. The report does not contain any findings or recommendations.

In response to a question from Senator Espeguard, Mr. Ross Mushik, Division of Emergency Management, said the notes payable amount shown on the statement of assets, liabilities, and fund equity relates to loans from the Bank of North Dakota used to match federal disaster funds, pursuant to NDCC Section 37-17.1-23. Mr. Mushik said disaster loans from the Bank of North Dakota are repaid prior to the end of each biennium through a deficiency appropriation provided by the Legislative Assembly.

Mr. Nagel presented the audit report for the Attorney General's office for the year ended June 30, 2000. He said the report contains one finding relating to charging and collecting fees for services provided by the State Fire Marshal.

In response to a question from Senator Solberg, Ms. Sandi Tabor, Deputy Attorney General, Attorney General's office, said the Attorney General's office performs all accounting functions relating to the Racing Commission; consequently, the operations of the Racing Commission are included in the audit of the Attorney General's office.

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

Mr. Nagel presented the audit report for the North Dakota University System office for the year ended June 30, 2000. He said the report does not indicate any material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. The report does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the Highway Patrol for the year ended June 30, 2000. He said the report includes one finding relating to the Highway Patrol's fixed asset records.

Mr. Nagel presented the audit report for the Adjutant General for the years ended June 30, 2000 and 1999. He said the report does not indicate any material weaknesses in the agency's internal control and does not identify any instances of noncompliance with legislative intent that are required to be reported under government auditing standards. The report does not contain any findings or recommendations.

Chairman Solberg called on Mr. Darrell Lingle, Eide Bailly LLP, Certified Public Accountants, Bismarck, who presented the audit report for the Bank of North Dakota for the years ended December 31, 2000 and 1999. Mr. Lingle said the report contains an unqualified opinion and does not include any findings or recommendations.

In response to a question from Representative Timm, Mr. Lingle said the Bank of North Dakota is also examined by the Department of Financial Institutions. He said the audit conducted by Eide Bailly includes a limited review of the Bank's loan portfolio but is primarily a financial statement audit. He said the review conducted by the Department of Financial Institutions includes a more extensive review of the Bank's loan portfolio.

In response to a question from Representative Wald, Mr. Lingle said the Bank of North Dakota is not examined by the Federal Deposit Insurance Corporation (FDIC) and the Bank's deposits are not FDIC insured. He said deposits at the Bank of North Dakota are guaranteed by the full faith and credit of the state of North Dakota.

Mr. Lingle presented the audit report for the Municipal Bond Bank for the years ended December 31, 2000 and 1999. He said the report contains an unqualified opinion and includes one finding relating to the segregation of accounting functions.

Mr. Lingle presented the audit report for the beginning farmer revolving loan fund for the years ended December 31, 2000 and 1999. He said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Eric Hardmeyer, Interim President, Bank of North Dakota, presented information on the beginning farmer revolving loan programs at the Bank of North Dakota, which include a real estate loan program and a chattel loan program. A copy of the information presented is on file in the Legislative Council office.

Mr. Lingle presented the audit report for the PACE fund for the years ended June 30, 2000 and 1999. He said the report contains an unqualified opinion and does not include any findings or recommendations.

Mr. Lingle presented the audit report for the Ag PACE fund for the years ended June 30, 2000 and 1999. He said the report contains an unqualified opinion and does not contain any findings or recommendations.

Mr. Lingle presented the audit report for the North Dakota Development Fund, Inc., for the years ended June 30, 2000 and 1999. He said the report contains an unqualified opinion and does not include any findings or recommendations.

Representative Skarphol said for the year ended June 30, 2000, the Development Fund incurred a loss of \$512,301. He requested the committee be furnished with information relating to the various losses incurred by the fund during fiscal year 2000

and information indicating if the various losses relate primarily to equity investments or loans. Mr. Hardmeyer said a representative of the Development Fund will provide the committee with the requested information within the limits of law.

In response to a question from Senator Espgaard, Mr. Lingle said when a loan is determined to be uncollectible, it is written off with board approval. Senator Espgaard asked for the amount of loans written off as uncollectible during fiscal year 2000. He said the amount of loans written off as uncollectible during the year is not included in the audit report but will be provided to the committee. He said the annual amount of loans receivable written off as uncollectible will be included in future audit reports.

Representative Delzer asked why the allowance for loan losses increased from \$2.7 million on June 30, 1999, to \$4.5 million on June 30, 2000. Mr. Lingle said the allowance increased in part due to additional loan activity and in part due to the outstanding loans of Technology Transfer, Inc., being transferred to the Development Fund, pursuant to 1997 Senate Bill No. 2019. Representative Delzer suggested future audit reports include the allowance for loan losses shown as a percentage of outstanding loans receivable.

Mr. Lingle presented the audit report for the North Dakota student loan trust for the years ended June 30, 2000 and 1999. He said the report includes an unqualified opinion and does not contain any findings or recommendations.

Chairman Solberg called on Mr. Donald LaFleur, State Auditor's office, who presented the information system audit report for the VISION - Temporary assistance for needy families computer system for the period July 1, 1999, through December 31, 2000. Mr. LaFleur reviewed the findings and recommendations included in the audit report.

Chairman Solberg announced the audits of the State Board of Nursing and the Potato Council will be presented at the committee's next meeting and, therefore, will not be acted on at this meeting. He said, in addition, the followup report on the performance audit of state personnel systems will not be acted on at this meeting to allow the State Auditor's office, the North Dakota University System, and the Central Personnel Division of the Office of Management and Budget to provide additional information.

It was moved by Representative Skarphol, seconded by Senator Klein, and carried on a roll call vote that pursuant to NDCC Section 54-35-02.2, the committee accept the following audit reports.

Audit reports presented to the committee:

- **Performance audit followup report on state procurement practices - state agencies**
- **Performance audit followup report on state procurement practices - North Dakota University System**

- Information Technology Department (June 30, 2000)
- Mill and Elevator Association (June 30, 2000 and 1999)
- State Seed Department (June 30, 2000 and 1999)
- Game and Fish Department (June 30, 2000)
- Division of Emergency Management (June 30, 2000)
- Attorney General (June 30, 2000)
- University System office (June 30, 2000)
- Highway Patrol (June 30, 2000)
- Adjutant General (June 30, 2000 and 1999)
- Bank of North Dakota (December 31, 2000 and 1999)
- Municipal Bond Bank (December 31, 2000 and 1999)
- Beginning farmer revolving loan fund (December 31, 2000 and 1999)
- PACE fund (June 30, 2000 and 1999)
- Ag PACE fund (June 30, 2000 and 1999)
- North Dakota Development Fund, Inc. (June 30, 2000 and 1999)
- North Dakota student loan trust (September 30, 2000 and 1999)
- VISION - Temporary assistance for needy families computer system (July 1, 1999, through December 31, 2000)

Audit reports available but not selected for presentation to the committee:

- Indian Affairs Commission (June 30, 2000 and 1999)
- Community water facility loan fund (December 31, 2000 and 1999)
- Developmentally disabled facility loan program (December 31, 2000 and 1999)
- State Board of Massage (June 30, 1999 and 1998)
- State Board of Veterinary Medical Examiners (June 30, 2000 and 1999)
- Private Investigative and Security Board (June 30, 2000 and 1999)
- North Dakota Stockmen's Association (December 31, 2000)
- State Board of Examiners for Nursing Home Administrators (June 30, 2000 and 1999)
- State Board of Counselor Examiners (June 30, 2000 and 1999)
- State Board of Chiropractic Examiners (December 31, 2000)
- State Board of Registration for Professional Engineers and Land Surveyors (June 30, 2000 and 1999)
- State Board of Architecture (June 30, 1999 and 1998)

- State Board of Water Well Contractors (June 30, 2000 and 1999)
- State Board of Funeral Service (June 30, 2000 and 1999)
- State Board of Optometry (June 30, 2000 and 1999)
- State Board of Pharmacy (June 30, 2000 and 1999)
- State Board of Cosmetology (June 30, 2000)
- Real Estate Commission (June 30, 2000 and 1999)

Senators Solberg, Christmann, Cook, Espegard, Kelsh, Klein, and Kroeplin and Representatives Aarsvold, Delzer, Lemieux, Maragos, Skarphol, Timm, Wald, and Winrich voted "aye." No negative votes were cast.

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Chairman Solberg called on Ms. Eileen Holwegner, Office of Management and Budget, who presented the Comprehensive Annual Financial Report (CAFR) for the state of North Dakota for the fiscal year ended June 30, 2000. Ms. Holwegner also presented reports entitled *Departmental Statements by Fund for the Fiscal Year Ended June 30, 2000* and *Interim 1999-2001 Biennium Budget and Actual Detail - (Budgetary Basis) For the Fiscal Year Ended June 30, 2000*. Copies of the Comprehensive Annual Financial Report and the related reports are on file in the Legislative Council office.

AUDIT REPORTS FROM ETHANOL PRODUCTION COMPANIES

At the request of Chairman Solberg, the Legislative Council staff presented a copy of the December 31, 2000 and 1999 audit report for Alchem, Ltd., LLP. Pursuant to NDCC Section 10-32-156, any limited liability company that produces agricultural ethyl alcohol or methanol in this state and receives a production subsidy from the state must file an annual audit report with the Legislative Audit and Fiscal Review Committee. The report was filed with the committee pursuant to this section. A copy of the report is on file in the Legislative Council office. The report indicates that for calendar year 1999, the company received an incentive payment of \$961,170 from the state of North Dakota but still incurred a net loss of \$988,457. For calendar year 2000, the company received an incentive payment of \$865,536, which contributed to the company's net income of \$1,492,824.

The meeting was adjourned subject to the call of the chair at 2:30 p.m.

Joe R. Morrisette
Senior Fiscal Analyst

Jim W. Smith
Legislative Budget Analyst and Auditor

ATTACH:1