

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

Monday, April 19, 2004
Roughrider Room, State Capitol
Bismarck, North Dakota

Representative Francis J. Wald, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Francis J. Wald, Ole Aarsvold, Al Carlson, Jeff Delzer, Andrew Maragos, Bob Skarphol, Blair Thoreson, Mike Timm, Lonny Winrich; Senators John M. Andrist, Randel Christmann, Jerry Klein, Aaron Krauter

Members absent: Representatives Larry Bellew, RaeAnn G. Kelsch, Amy Warnke

Others present: See attached appendix

It was moved by Representative Carlson, seconded by Representative Thoreson, and carried on a voice vote that the minutes of the December 22, 2003, meeting of the Legislative Audit and Fiscal Review Committee be approved as distributed.

STATUS OF RACING COMMISSION REVENUES

Chairman Wald called on Mr. Paul J. Bowlinger, Director, Racing Commission, who presented information regarding the status of Racing Commission revenues. A copy of the information presented is on file in the Legislative Council office. Mr. Bowlinger said for every dollar wagered on horse racing in North Dakota two and one-half cents goes to the general fund and one and one-half cents goes to the Racing Commission. He said taxes are collected on the gross amount wagered, regardless of whether the wager won or lost.

Mr. Bowlinger said the North Dakota simulcast system total annual "handle," or total amount wagered, began to increase significantly in 1998 due to a "whale," or an individual who wagers a large amount of money, using the North Dakota simulcast system. He said he informed the Office of Management and Budget that horse racing gaming and excise tax collections for fiscal years ended 2000, 2001, and 2002 were significantly more than forecasts due to the parimutuel racing industry experiencing very unusual and substantive activity from a small group of "players" and that it was uncertain how long this extraordinary level of activity would continue. Mr. Bowlinger said he testified during the 2003 Legislative Assembly that "market forces," in particular the amount of gaming taxes imposed by the state, would eventually cause major "players" to move to other

locations to place wagers, most likely Indian reservations.

Mr. Bowlinger said based on actual collections to date, the North Dakota simulcast system 2003-05 biennium total "handle" will be approximately \$12 million, or \$6 million per year. He said a \$12 million "handle" will generate \$300,000 in general fund revenues, which is approximately the amount projected by the Racing Commission. This compares to \$3,270,000 included in the 2003-05 executive budget revenue forecast.

In response to a question from Representative Delzer, Mr. Bowlinger said the North Dakota simulcast system total "handle" for calendar year 2003 was approximately \$153 million. He said it is difficult to determine the exact "handle" because during the year an illegal simulcast site was discovered in Fargo and the related "handle" was subsequently reported.

In response to a question from Representative Delzer, Mr. Bowlinger said the Racing Commission has a balance of \$4 million in its breeder fund. He said the balance in the breeder fund is sufficient for the Racing Commission to operate the Fargo racetrack for five or six years without any additional revenue.

In response to a question from Senator Krauter, Mr. Bowlinger said the indigenous "handle" has been averaging approximately \$6 million per year. He said with opening of the racetrack in Fargo and an increase in interest in horse racing in North Dakota, the indigenous "handle" could increase to \$10 million per year.

In response to a question from Representative Wald, Mr. Bowlinger said the tax rate is the same for live and simulcast horse racing. He said 85 percent of horse race wagering conducted in the United States was conducted by simulcast across state lines in 2000. In 2002, he said, a single individual wagered \$161 million through North Dakota simulcast racing. He said that individual is currently placing wagers through a simulcast site on an Indian reservation in Oklahoma.

In response to a question from Representative Maragos, Mr. Bowlinger said the 2003 Legislative Assembly did not consent to all the requests made by Ms. Susan Bala, President, Racing Services, Inc., related to 2003 Senate Bill No. 2285. He said

Ms. Bala initially requested that the parimutuel tax rate that goes to the state be reduced beginning with the first dollar wagered. The Legislative Assembly reduced the state tax rate on parimutuel racing from 2 to .5 percent on win, place, or show wagers on the amount wagered by an individual in excess of \$35.5 million in a year. Senate Bill No. 2285 reduced the state tax rate from 2.5 to .25 percent on exotic wagers on the amount wagered by an individual in excess of \$102.4 million in a year. He said the Racing Commission took no formal position on Senate Bill No. 2285. He said he believes Ms. Bala supported a reduced tax rate for major "players" in order for North Dakota to stay competitive with other states with regard to "market forces." Mr. Mike Cichy, Lien Games, Fargo, said the nonprofit organization that operated the parimutuel racing site where the major "player" was placing wagers proposed the legislation to reduce the state gaming tax rate for horse racing.

In response to a question from Representative Wald, Mr. Bowlinger said the operators of the illegal simulcast site operated in Fargo are being prosecuted by the federal government and the North Dakota Attorney General's office.

In response to a question from Representative Aarsvold, Mr. Bowlinger said 80 percent of North Dakota parimutuel site's "handle" goes back to the bettor. He said typically the remaining 20 percent is divided evenly between the racetrack, government, racing services provider, and the charitable organization that operates the site. He said a charitable organization may "rebate" a percentage of its "handle" in order to keep a major "player."

In response to a question from Representative Skarphol, Mr. Bowlinger said parimutuel racing is not operated by charitable organizations in every state, thus an additional 5 percent can be made available as rebates to major "players." He said the Oklahoma Racing Commission does not have control over tribal horse racing.

In response to a question from Representative Carlson, Mr. Bowlinger said he believes the Fargo horse track is debt-free.

In response to a question from Representative Maragos, Mr. Bowlinger said he has previously stated that the Fargo horse track would not generate a profit.

In response to a question from Senator Andrist, Mr. Bowlinger said betting on horses is a skill. He said a rebate of 7 to 10 percent of wagers is enough to guarantee a profit for a skilled bettor.

In response to a question from Senator Christmann, Mr. Bowlinger said offering rebates is an industry practice to lure major "players" from one site to another.

STATE AGENCY AND INSTITUTION AUDIT REPORTS

Chairman Wald called on Mr. Darrell Lingle, Eide Bailly LLP, Certified Public Accountants, who presented the audit report for the Bank of North Dakota for the years ended December 31, 2003 and 2002. Mr. Lingle reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Wald, Mr. Kirby Martz, Chief Financial Officer, Bank of North Dakota, said total nonappropriated expenditures for the fiscal year ended June 30, 2003, were approximately \$46 million, which consisted primarily of interest expense paid to depositors.

In response to a question from Representative Skarphol, Mr. Lingle said the Management Discussion and Analysis section of the audit report is not "covered" by the audit opinion; however, the numbers included in the section are reviewed by the auditors to make sure they correspond to the audited financial statements.

In response to a question from Senator Krauter, Mr. Eric Hardmeyer, President, Bank of North Dakota, said the Bank's income before operating transfers was \$29.3 million under Governmental Accounting and Standards Board reporting methods for the year ended December 31, 2003. He said the Bank's projected 2003-05 biennium profits are expected to be sufficient to transfer the obligated \$60 million to the general fund.

In response to a question from Representative Skarphol, Mr. Hardmeyer said the Bank of North Dakota annually prepares a strategic plan to determine the goals and direction of the Bank for two or three years in the future. Representative Carlson suggested state agency audit reports include the agency's performance measures and a summary of how the measures compare to the audited financial statements.

In response to a question from Representative Delzer, Mr. Hardmeyer said the total loan portfolio for the Bank of North Dakota is approximately \$1.4 billion. He said the Bank has approximately \$372 million in outstanding student loans, which are 98 percent guaranteed by the United States Department of Education. He said approximately 52 to 53 percent of the Bank's total loan portfolio is guaranteed by the federal government.

In response to a question from Representative Carlson, Mr. Hardmeyer said 2003 Senate Bill No. 2335 authorized the North Dakota Development Fund, Inc., to borrow funds not to exceed \$5 million from the Bank of North Dakota for investing in North Dakota venture capital investments. He said the Bank of North Dakota has currently committed approximately one-half of the total funds authorized

for the program. He said the investments can be made by providing loans or receiving equity positions.

In response to a question from Representative Skarphol, Mr. Hardmeyer said the balance of accruing loans 90 days or more past due was approximately \$25.7 million on December 31, 2003. He said the Bank's loan chargeoffs for the year ended December 31, 2003, were approximately \$2 million. He said the Bank's rate of loan chargeoffs is very low in comparison to industry average. Mr. Hardmeyer distributed information regarding a 10-year summary of Bank of North Dakota loan chargeoffs and recoveries. A copy of the information presented is on file in the Legislative Council office. Representative Carlson said a goal of the Bank of North Dakota should be to make sure the loan chargeoffs are as low as possible.

In response to a question from Representative Timm, Ms. Julie Kubisiak, Director, Student Loan Program, Bank of North Dakota, said 17 loans have been provided totaling \$62,000 under a new loan program created by 2003 Senate Bill No. 2360, which provided for the Bank to administer a loan program to assist truckdriver training program students.

In response to a question from Senator Krauter, Mr. Hardmeyer said the Board of University and School Lands is statutorily required to invest a certain percentage of its total portfolio in farm real estate loans. He said the Bank of North Dakota has a cooperative agreement to sell loans to the Board of University and School Lands.

In response to a question from Senator Krauter, Mr. Ed Sather, Senior Vice President, Bank of North Dakota, said the Bank has sold \$80 million of student loans to the student loan trust fund, the maximum amount allowed under federal law which provides for a 9.5 percent rate of return.

In response to a question from Representative Wald, Mr. Hardmeyer said the Bank is not audited or regulated by the Federal Deposit Insurance Corporation (FDIC) but is occasionally audited by the United States Department of Education and the United States Department of Housing and Urban Development in addition to the annual state audit.

In response to a question from Representative Skarphol, Mr. Hardmeyer said the amount of the Bank's outstanding loans to state agencies and institutions was \$45 million on December 31, 2003, as compared to \$26 million on December 31, 2002. He said he does not anticipate the state agency and institution loan balance will continue to significantly increase.

Mr. Lingle presented the audit report for the beginning farmers revolving loan fund for the years ended December 31, 2003 and 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Mr. Lingle presented the audit report for the community water facility loan fund for the years ended

December 31, 2003 and 2002. He reviewed the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Mr. Lingle presented the audit report for the developmentally disabled facility loan program for the years ended December 31, 2003 and 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

Chairman Wald called on Ms. Barb Aasen, Eide Baily LLP, Certified Public Accountants, who presented the audit reports for the Municipal Bond Bank for the years ended December 31, 2003 and 2002. Ms. Aasen reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion. She said the report contains two findings related to segregation of duties due to the limited number of staff and failure to timely file a federal award program status report.

Mr. Lingle presented the audit report for the guaranteed student loan program for the years ended September 30, 2003 and 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Skarphol, the legislative budget analyst and auditor said 2003 Senate Bill No. 2015, the appropriations bill for the Office of Management and Budget, requires executive branch agencies to report to the Appropriations Committees during the 2005 legislative session regarding expenditures made pursuant to continuing appropriations and justification for continuing the authority.

AUDITS OF STATE BOARDS

Ms. Aasen presented the audit report for the Board of Nursing for the years ended June 30, 2003 and 2002. She reviewed the auditor's responses to the committee's guidelines and said the audit report contains an unqualified opinion and does not contain any findings or recommendations.

In response to a question from Representative Delzer, Ms. Connie Kalanek, Executive Director, Board of Nursing, said the approximate number of North Dakota licensed professionals and corresponding licensing fees are:

- 8,500 registered nurses (\$90 for a two-year period).
- 3,500 licensed practical nurses (\$80 for a two-year period).
- 3,000 nurse assistants and medication aides (\$10 for a two-year period for nurse assistants, which will increase to \$15 for a two-year period on July 1, 2004, and \$20 for a two-year period for medication aides).

Ms. Kalanek said there has been a substantial increase in the number of individuals in nursing education programs over the last year.

In response to a question from Representative Timm, Ms. Kalanek said the rules establishing the various levels of nursing programs went into effect on April 1, 2004. She said the Board of Nursing has not currently received a proposal for site review for either a two-year registered nurse or one-year certified nurse assistant program. Senator Klein said there has been general agreement with the rules approved by the Board of Nursing and the new nursing programs will be moving forward as planned.

Chairman Wald called on Ms. Rhonda Mahlum, Senger, Mahlum & Goodhart, P.C., Certified Public Accountants, who presented the audit report for the North Dakota Stockmen's Association for the years ended December 31, 2003 and 2002. Ms. Mahlum said the report includes an unqualified opinion and contains four findings related to segregation of duties due to limited number of staff, deposits in excess of FDIC coverage of \$100,000, reconciliation of quarterly payroll reports, and maintaining supporting documentation for transfers between accounts.

In response to a question from Representative Delzer, Mr. Wade Moser, Executive Vice President, North Dakota Stockmen's Association, said the nonpoint source pollution control program has been very successful. He said during the first year of the program 100 ranches were visited for program review.

AUDITS OF STATE AGENCIES

Chairman Wald called on Mr. Paul Welk, State Auditor's office, who presented the audit report for the State Treasurer's office for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains one internal control finding, six findings of noncompliance with legislative intent, and two recommendations relating to ambiguous sections of the North Dakota Century Code. He said the State's Auditor's office audit recommendations for the State Treasurer's office are as follows:

1. Position reclassification - Reclassify the controller position to an accounting manager or accounting budget specialist II or III classification.
2. Coal conversion tax distributions - Use the current average daily enrollment numbers to calculate the distribution of coal conversion taxes in accordance with North Dakota Century Code (NDCC) Section 57-60-15 and consult with the Attorney General's office regarding the proper remedy for the erroneous payments made to school districts.
3. Coal severance tax distributions - Use current average daily enrollment numbers, current land assessment values, and correct percentages when calculating coal severance tax distributions in accordance with NDCC

Section 57-62-02 and consult with the Attorney General's office regarding the proper remedy for the erroneous payments made to counties and school districts.

4. State aid distribution - Use the correct population figures in the calculation of the state aid distribution in accordance with NDCC Section 57-39.2-26.1 and maintain support for any changes made to population numbers and consult with the Attorney General's office regarding the proper remedy for the erroneous payments made to cities and counties.
5. Computer system enhancements - Update the computer system to correctly calculate the state aid distributions to cities based on their total population, regardless of county location; ensure that computer systems are updated in a timely manner for law changes which affect the calculations of distributions; implement a system, which could include contacting the Secretary of State to ensure timely removal of dissolved cities; and consult with the Attorney General's office regarding the proper remedy for the erroneous payments made to cities and counties.
6. Oil and gas production tax distribution - Compute Medora's population on an annual basis for purposes of determining the per capita limitation for oil and gas production tax distributions and work with Billings County and the City of Medora to correct any distributions that were made in error.
7. Highway tax distributions - Implement controls to ensure that the numbers used in the distribution of money in the highway tax distribution fund are proper and consult with the Attorney General's office regarding the proper remedy for the erroneous payments made to cities and counties.
8. Propose legislation to amend NDCC Section 57-51-15 to clarify whether the \$5 million per biennium limitation for the oil and gas impact grant fund is based on when the oil and gas is produced or when the revenue is collected.
9. Propose legislation to amend NDCC Section 57-27-19 to clarify whether the cities' share of highway tax distribution fund money is actually limited to 27 percent of the counties' share.

In response to a question from Representative Delzer, Mr. Welk said North Dakota Century Code Section 57-62-02 was changed, effective August 1, 2001, so that 70 percent of the coal severance taxes are to be distributed to the counties, rather than 35 percent as the previous law stated. He said the State Treasurer's office distributed the correct total amount to the counties but did not correctly allocate the money between coal-producing counties and non-coal-producing counties where any part of the

non-coal-producing county lies within 15 miles of the tippie of a currently active coal mining operation.

In response to a question from Representative Skarphol, Mr. Welk said the State Auditor's office recommendation is that the State Treasurer's office should consult with the Attorney General's office regarding the proper remedy for correction of the erroneous payments. He said the State Auditor's office typically does not consult with the Attorney General's office regarding an audit unless it has a question regarding interpretation of law.

In response to a question from Representative Maragos, Mr. Welk said he was not aware of any correspondence or complaints from cities, counties, or school districts regarding incorrect distributions. Senator Christmann said the political subdivisions are probably not aware of the errors because they rely on the state to correctly calculate the distributions.

In response to a question from Representative Carlson, Mr. Welk said NDCC Section 57-39.2-26.1, as amended by 2001 House Bill No. 1211, provides that through July 1, 2003, distributions from the state aid distribution fund to the counties and cities are to be based on the 1990 census population figures. He said for distributions made in July 2003 the State Treasurer's office incorrectly used the 2000 federal decennial census numbers for the distributions. North Dakota Century Code Section 1-01-47 defines the term "population" as the number of inhabitants as determined by the last preceding state or federal census.

In response to a question from Senator Krauter, the legislative budget analyst and auditor said 2001 House Bill No. 1211 was sponsored by four legislators. Representative Skarphol asked when the 1990 census figures were first used for state aid distribution calculations, pursuant to NDCC Section 57-39.2-26.1. North Dakota Century Code Section 1-01-47 defines population to mean the last preceding state or federal census, so without a change in law the 1990 census would have been used as soon as available to the state.

In response to a question from Representative Wald, Mr. Welk said the State Treasurer's office uses a computer system to calculate the highway tax distribution amounts to be distributed to the counties and cities. He said the number of registered vehicles in each county is uploaded from the vehicle registration and title system maintained by the Department of Transportation. He said there was a problem with the uploading of the registration data that caused the total number of vehicles used by the highway tax distribution system to be incorrect, while the number of vehicles within each county was correct. He said the Department of Transportation corrected this computer system problem in January 2003.

In response to a question from Representative Aarsvold, Mr. Welk said he was unsure why there is a delay in collecting oil and gas production taxes of up to five years after actual production. He said the Tax

Department is responsible for collecting oil and gas production taxes. Mr. Rick Clayburgh, Tax Commissioner, said oil and gas production tax revenues received from audits or amended returns are accounted for in the year in which the oil was produced, rather than when received.

In response to a question from Representative Skarphol, Mr. Welk said the State Auditor's office provided the State Treasurer's office with 16 informal audit recommendations and 16 oral audit recommendations.

In response to a question from Senator Krauter, Mr. Welk said several of the audit recommendations relate only to the current audit period. He said new technology has allowed the State Auditor's office to do more extensive recalculations and sampling. He said changes in audit procedures have allowed the State Auditor's office to spend more time testing for compliance with laws and regulations and operational improvements.

In response to a question from Representative Skarphol, Mr. Welk said the State Auditor's office uses software which can download a client's data and test calculations.

In response to a question from Senator Christmann, Mr. Welk said the duties of the controller position include making the tax distributions. He said he was not certain if the State Treasurer or deputy state treasurer reviewed the controller's work.

Ms. Kathy Gilmore, State Treasurer, said she was "unhappy" with the number of findings. She said a majority of the errors occurred because the controller was new in the position. She said the controller was hired during a busy time and just prior to the deputy state treasurer retiring. Ms. Gilmore provided draft spreadsheets detailing the corrections that needed to be made to correct the tax distribution errors and a copy of the informal audit recommendations made by the State Auditor's office. A copy of the information presented is on file in the Legislative Council office.

In response to a question from Representative Carlson, Ms. Gilmore said she has had discussions with cities and counties and will work with the Attorney General's office to develop a method and schedule for repayment of tax overpayments to political subdivisions.

In response to a question from Senator Christmann, Ms. Gilmore said the deputy state treasurer is responsible for supervising the controller. She said, however, the current deputy state treasurer was not with the office when the errors were made. She said the controller is accountable for the distributions but she was hired for the position during a difficult time and is currently "right on the money." Senator Christmann said because of financial limitations, small school districts may have difficulty in repaying the overpayments. He said he is concerned that cities and counties will not have accurate information to prepare their budgets.

In response to a question from Representative Timm, Ms. Kathy Kirschman, Deputy State Treasurer, said the larger overpayments and underpayments are generally limited to the larger school districts.

In response to a question from Representative Skarphol, Ms. Kirschman said the State Treasurer's office has asked the State Auditor's office to review the recalculations. Representative Skarphol said he is not "comfortable" that tax distributions from previous bienniums are accurate.

In response to a question from Representative Carlson, Ms. Gilmore said the State Treasurer's office currently does not employ an individual with an accounting degree. She said the controller has 25 years of experience.

In response to a question from Senator Christmann, Ms. Kirschman said she did not "track" the legislation which amended NDCC Section 57-39.2-26.1, relating to using the new census figures for state aid distributions. She said repayments to and collections from cities and counties will be in accordance with the Attorney General's recommendations.

In response to a question from Representative Delzer, Ms. Kirschman said state aid distribution payments made to dissolved cities were returned by the bank and the funds were deposited in the general fund.

In response to a question from Representative Carlson, the legislative budget analyst and auditor said the Legislative Council staff would research what statutory authority exists to require political subdivisions to repay overpayments of tax distributions. Representative Skarphol asked the Legislative Council staff also to research if the state has authority to deduct overpayments from future tax distributions.

Chairman Wald said the Legislative Council staff prepared a memorandum entitled *Duties of State Treasurer - Changes*. A copy of the memorandum was distributed to the committee.

In response to a question from Representative Carlson, Ms. Gilmore said the State Treasurer's office will propose legislation as recommended by the State Auditor's office to clarify ambiguities in the North Dakota Century Code.

In response to a question from Representative Aarsvold, Ms. Gilmore said the State Treasurer's office has to accept the Department of Transportation's registration numbers as fact. She said the State Treasurer's office employees do not have time to "second guess" the numbers provided.

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

Mr. Welk said the State Auditor's office reviewed the reclassification request for the controller's position from accounting manager I to administrative staff officer III and determined the accounting duties were identical to those performed by the previous controller, with the exception of some supervising responsibilities. He said some additional tax

distribution duties have been assigned to the new controller. He said the State Auditor's office detected errors that occurred as late as August and September 2003.

In response to a question from Representative Timm, Mr. Welk said the controller cannot be terminated without due cause; however, the position can be reclassified to require minimum qualifications.

Representative Skarphol asked the State Auditor's office to provide the Legislative Audit and Fiscal Review Committee with a list of all state agencies that either collect or distribute taxes and whether the agency employs an individual with an accounting degree.

It was moved by Senator Christmann, seconded by Representative Skarphol, and carried on a roll call vote that the State Auditor's office review the State Treasurer's office tax distribution recalculations for accuracy and provide a followup report to the Legislative Audit and Fiscal Review Committee during its next meeting regarding the tax distribution payment errors and the plan for correction or adjustment of payments to affected cities, counties, and school districts. Representatives Wald, Carlson, Delzer, Maragos, Skarphol, Thoreson, and Timm and Senators Andrist, Christmann, Klein, and Krauter voted "aye." Representatives Aarsvold and Winrich voted "nay."

Representative Winrich said the method to repay the incorrect tax distributions is an issue to be resolved by the Attorney General's office.

Mr. John Grettum, State Auditor's office, presented the audit report for the Veterans Home for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee's guidelines and said the audit report contains two internal control weaknesses relating to approval and coding of expense vouchers and procedures for purchase card transactions. He said the report contains one instance of noncompliance with legislative intent relating to the documentation of salary increases provided to the administrator, interim commandant, and commandant and one prior audit recommendation which was not implemented.

Mr. Ed Nagel, State Auditor's office, presented the audit report for the Office of Administrative Hearings for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the Industrial Commission for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the report contains one internal control finding related to inventory control.

Mr. Nagel presented the audit report for the judicial branch for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee

guidelines and said the audit report does not contain any findings or recommendations.

Mr. Nagel presented the audit report for the Public Service Commission for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report does not contain any findings or recommendations.

Mr. Welk presented the audit report for the Tax Commissioner for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the report contains one internal control finding related to access controls to computer systems. He said the report contains three findings of noncompliance with legislative intent related to incorrect amounts deposited into the cigarette tax distribution fund, not ensuring the limitations on the agribusiness tax credit, and conducting an inventory of fixed assets.

In response to a question from Representative Wald, Mr. Welk said the Tax Commissioner's office deposited incorrect amounts into the cigarette tax distribution fund for 18 of the 24 months of the audit period. He said the differences per month ranged from \$4 up to \$10,000 with the net result of \$6,378 being deposited into the general fund that should have been deposited into the cigarette tax distribution fund and distributed to the incorporated cities.

In response to a question from Senator Krauter, Mr. Welk said the Tax Commissioner's office incorrectly transferred funds to the general fund that should have gone to cities. He said there were no overpayments made to cities.

In response to a question from Representative Carlson, Mr. Clayburgh said the Tax Commissioner's office corrected the overpayment to the general fund by reducing a later deposit. He said the department has legal authority to adjust general fund deposits to ensure proper transfers to special funds.

In response to a question from Representative Delzer, Ms. Glenda Anderson, Controller, Tax Commissioner's office, said there is a cutoff date in August in which an agency can make adjustments to the previous biennium.

In response to a question from Senator Krauter, Mr. Clayburgh said the agribusiness tax credit is a new credit available for taxpayers beginning with the 2001 tax year. He said only about 400 taxpayers may potentially be eligible for any business investment tax credit, including the agribusiness tax credit. He said with so few potential filers, the cost to build controls into the individual income tax computer system to ensure that the allowed agribusiness tax credits are not exceeded in accordance with NDCC Section 57-38.6-03 would be cost-prohibitive. He said the Tax Department has developed an audit plan, which includes a tracking program created to "read" the individual income tax computer system and list all taxpayers claiming a business tax credit. He said the data base is reviewed to make sure the credit claimed

by the individual does not exceed what is allowed by law.

It was moved by Senator Krauter, seconded by Representative Carlson, and carried on a roll call vote that the State Auditor's office review the Tax Commissioner's office cigarette tax distribution recalculations for accuracy and provide a followup report to the Legislative Audit and Fiscal Review Committee during its next meeting regarding the tax distribution payment errors and the plan for correction or adjustment of payments to affected cities. Representatives Wald, Aarsvold, Carlson, Delzer, Skarphol, Thoreson, Timm, and Winrich and Senators Andrist, Christmann, Klein, and Krauter voted "aye." No negative votes were cast.

Representative Skarphol asked that the Legislative Council staff research the statutory authority for the Tax Commissioner's office to redistribute cigarette tax collections and to adjust general fund deposits to correct underpayments to cities.

Mr. Nagel presented the audit report for the Department of Transportation for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report does not contain any findings or recommendations.

In response to a question from Representative Delzer, Mr. Nagel said testing conducted during the State Treasurer's office audit discovered an error in the Department of Transportation computer system which resulted in incorrect data being provided for the highway tax distribution fund allocation. During the Department of Transportation audit this error was not noticed either because it was not part of the audit test sample or sampling did not detect errors in the system.

AUDITS OF INSTITUTIONS OF HIGHER EDUCATION

Mr. Grettum presented the audit report for Bismarck State College for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report contains two findings of noncompliance with legislative intent relating to maintaining the required amounts in the bond and interest sinking funds and improperly accounting for a copier under an operating lease rather than a capital lease.

In response to a question from Representative Carlson, Ms. Laura Glatt, Vice Chancellor of Administrative Affairs, North Dakota University System office, said the State Board of Higher Education requires each campus to submit a plan of correction for both formal and informal audit recommendations.

In response to a question from Representative Wald, Mr. Dave Clark, Executive Vice President, Bismarck State College, said transfers of interest and principal payments were made when the payments

were due rather than a monthly basis as required by the bond agreement.

Mr. Grettum presented the audit report for the State College of Science for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report contains two findings of internal control weaknesses related to receiving proper support for expense reimbursements and providing written documentation of housing arrangements for the college president.

Mr. Grettum presented the audit report for Dickinson State University for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report contains one finding of noncompliance with legislative intent relating to receiving proper authorization from the State Board of Higher Education for construction projects that exceed \$100,000. He said Dickinson State University did not receive authorization from the board for the flag court project which cost \$137,282.

Mr. Grettum presented the audit report for Mayville State University for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the report contains two findings of internal control weaknesses relating to improperly accounting for a copier under an operating lease rather than a capital lease and the conversion of the Higher Education Computer Network to PeopleSoft. He said the report contains two instances on noncompliance with legislative intent relating to maintaining the required amounts in the bond and interest sinking funds and receiving proper support for expense reimbursements.

In response to a question from Representative Aarsvold, Mr. Grettum said the University System chose not to simultaneously run two systems for comparison and support purposes during the conversion to PeopleSoft because of cost and time concerns. In response to a question from Representative Delzer, Mr. Grettum said it will be a challenge for higher education institutions to compile all the information required for the audit process using the new system. Representative Skarphol said the new system provides all the needed information; however, it is presented in a different format.

Mr. Grettum presented the audit report for Minot State University for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report contains one internal control finding relating to improperly accounting for a copier under an operating lease rather than a capital lease. He said the report contains one finding of noncompliance with legislative intent relating to the university's conflict of interest policy.

Mr. Grettum presented the audit report for Valley City State University for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report

contains one internal control weakness relating to the conversion of the Higher Education Computer Network to PeopleSoft.

In response to a question from Representative Delzer, the legislative budget analyst and auditor said NDCC Section 54-35-02.2 provides for the powers and duties of the Legislative Audit and Fiscal Review Committee. He said depending on the seriousness of findings the committee can present evidence of violations of law to the Attorney General's office.

In response to a question from Representative Carlson, the legislative budget analyst and auditor said if the evidence of violations are submitted to the Attorney General's office by the Legislative Audit and Fiscal Review Committee, the investigation findings would be reported back to the committee. He said the Attorney General's office would also work with the State Board of Higher Education on matters relating to higher education institutions' compliance with state laws.

Mr. Grettum presented the audit report for Minot State University - Bottineau for the years ended June 30, 2003 and 2002. He reviewed the auditor's responses to the committee guidelines and said the audit report did not contain any findings or recommendations.

SUMMARY OF ACCOUNTS - NORTH DAKOTA UNIVERSITY SYSTEM

Chairman Wald called on Ms. Glatt who presented a summary of accounts used at each institution, including information on the number, purposes, and balances of the accounts. A copy of the information presented is on file in the Legislative Council office. She said the North Dakota University System uses nearly 15,000 accounts in the Legacy system (Higher Education Computer Network). She said these accounts are used to track and manage financial activity for a variety of programs, functions, and activities, many of which have external restrictions on the use of the money. She said because the Legacy system is not able to account for these activities in a more efficient way, the number of accounts is significant; however, it is necessary to ensure the proper amount of control and accountability. She said the North Dakota University System is in the process of replacing the Legacy system with PeopleSoft. She said the project accounting system capabilities of PeopleSoft will allow the North Dakota University System to reduce the number of accounts maintained to approximately 10,000.

In response to a question from Representative Delzer, Ms. Glatt said the larger foundations have accounting staff to administer accounts; however, the smaller foundations may receive in-kind services under agreement with the related college or university accounting staff to administer accounts. She said of the 5,698 accounts operated at the University of North

Dakota approximately 2,200 belong to the University of North Dakota Foundation.

In response to a question from Representative Skarphol, Ms. Glatt said the State Auditor's office audits all general ledger accounts of state institutions.

In response to a question from Senator Christmann, Ms. Glatt said the PeopleSoft system provides for project level reporting rather than fund level reporting used under the Legacy system which will decrease the total number of accounts. She said accounts are required for accounting purposes to be maintained for each project. For example, she said, when a play is performed at a college an account is established and maintained until all revenue and expenses related to the play are accounted for.

NORTH DAKOTA UNIVERSITY SYSTEM OFFICE AUDIT REPORT

Ms. Glatt presented the audit report for the North Dakota University System office for the year ended June 30, 2003. A copy of the information presented is on file in the Legislative Council office. She said the State Auditor's office issued an unqualified opinion on the financial statements. She said state general fund appropriations account for 33 percent of total annual revenues.

In response to a question from Representative Carlson, Ms. Glatt said the majority of academic costs incurred by state higher education institutions are funded by state general fund money.

In response to a question from Representative Skarphol, Ms. Glatt said she would provide an estimate of the percentage of tuition and fees that are used to fund academic costs. Representative Winrich asked that the North Dakota University System office provide a historical perspective of the amount of academic or instruction costs funded by state general fund appropriations.

Mr. Grettum presented the independent auditor's report on compliance and on internal control for the North Dakota University System for the fiscal year ended June 30, 2003. He said the report contains two internal control findings relating to conversion to PeopleSoft and proper application of the veterans' dependent tuition waiver.

In response to a question from Representative Carlson, the legislative budget analyst and auditor said during the 2001-02 interim the Legislative Audit and Fiscal Review Committee approved a process in which a letter may be sent requesting a representative of an agency to appear before the committee to respond to reasons why prior audit recommendations have not been implemented.

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Mr. Grettum presented the State Auditor's office report on the State of North Dakota internal control and compliance report for the fiscal year ended

June 30, 2003. The report indicates that the State Auditor's office has audited the general purpose financial statements for the State of North Dakota for the year ended June 30, 2003. He said the report contains one instance of noncompliance with legislative intent relating to the Department of Public Instruction overspending the grants line item by \$2.9 million. He said this was related to the increased funding by the federal government for the "No Child Left Behind Act of 2001."

Ms. Eileen Holwegner, Office of Management and Budget, presented the Comprehensive Annual Financial Report (CAFR) for the State of North Dakota for the fiscal year ended June 30, 2003. Ms. Holwegner reviewed the information contained in the report and a supplemental report entitled *2001-03 Biennium Budget and Actual Detail*. Copies of both reports are on file in the Legislative Council office.

FUTURE PERFORMANCE AUDITS

Chairman Wald called on Mr. Gordy Smith, State Auditor's office, who presented a summary of potential future performance audits for consideration by the Legislative Audit and Fiscal Review Committee. Mr. Smith presented the committee with a list of nine potential performance audits, including the estimated time each one would take to complete and whether an outside consultant would be recommended to complete the audit. A copy of the information presented is on file in the Legislative Council office. Mr. Smith said the State Auditor's office is in the process of beginning a performance audit of the Department of Corrections and Rehabilitation and a followup audit of the Veterans Home. He said these performance audits will take until early 2005 to complete.

Representative Wald said other possibilities for performance audits could include the feasibility of contracting with an independent vendor to provide a state motor pool and the feasibility of assisting in the development of a private prison.

Representative Winrich said he would like the State Auditor's office to at some time conduct a performance audit of agricultural commodity groups and the related costs associated with administrative personnel.

In response to a question from Representative Aarsvold, the legislative budget analyst and auditor said the Legislative Council staff would provide the committee at the next meeting a history of an interim study which was conducted several years ago regarding consolidation of commodity groups.

Senator Christmann said commodity groups compete for funding and research grants. He said it is important that they each have their own identity and he would not support a consolidation study.

It was moved by Representative Delzer, seconded by Senator Klein, and carried on a voice vote that, pursuant to subsection 4 of NDCC Section 54-10-01, the State Auditor's office be

requested to conduct a performance audit on state cell phone usage, including a review to determine the propriety of state cell phone usage, the types of cell phone plans purchased, the number of cell phones that are used minimally, and various alternative methods to reimburse individuals for cell phone usage.

REGIONAL PLANNING COUNCILS

Mr. Gordy Smith presented information regarding the auditors of regional planning councils. A copy of the information presented is on file in the Legislative Council office. Mr. Smith said NDCC Section 54-10-14 provides that political subdivisions, which include regional planning councils, are allowed to select their auditors. He said six of the regional planning councils have a December 31 yearend, one has a fiscal yearend of March 31, and one has a fiscal yearend of June 30. Currently, he said, the State Auditor's office completes one of the eight regional planning council audits and the other seven are completed by independent auditors. He said if legislation is proposed to require the State Auditor's office to complete all eight regional planning council audits, sufficient time should be allowed for the regional planning councils to terminate their relationships or agreements with current auditors.

Representative Wald said the fiscal year of the regional planning councils should all be consistent with the state fiscal year.

The committee did not make a formal recommendation regarding auditor requirements for the regional planning councils. The chairman said individual legislators could propose legislation regarding the regional planning councils.

NORTH DAKOTA DEVELOPMENT FUND AND STATE FAIR ASSOCIATION - AUDITOR REQUIREMENTS

The Legislative Council staff presented a memorandum entitled *State Fair Association and North Dakota Development Fund, Inc. - Auditors*. The memorandum provides the legislative history relating to the requirement that the audits of the State Fair Association and North Dakota Development Fund, Inc., be prepared by independent auditors, pursuant to NDCC Sections 4-02.1-18 and 10-30.5-08.

The Legislative Council staff said the 1965 Legislative Assembly provided for the establishment of the State Fair Association for the purpose of conducting an annual North Dakota state fair. The State Auditor's office was required to annually examine the records and accounts of the State Fair Association. The 1979 Legislative Assembly approved House Bill No. 1024, which provided for the State Fair Association to annually be audited by a certified public accountant and, in addition, the State Auditor's office was required to biennially audit the general fund

money appropriated to the State Fair Association. The 1989 Legislative Assembly approved House Bill No. 1109, removing the requirement that the State Auditor biennially audit the general fund money appropriated to the State Fair Association to eliminate duplicate accounting.

The Legislative Council staff said the 1995 Legislative Assembly approved House Bill No. 1021 providing that the regional rural development revolving fund and the North Dakota Future Fund be combined into a newly established North Dakota Development Fund, Inc. The section of law providing for the establishment of North Dakota Development Fund, Inc., was modeled after repealed NDCC Chapter 10-30.3, relating to the North Dakota Future Fund. The North Dakota Future Fund was required to be audited annually by a certified public accounting firm.

COMMITTEE DISCUSSION AND STAFF DIRECTIVES

Representative Aarsvold asked that the audit report of the Board of Massage for the period ended June 30, 2003 and 2002 be presented at the next Legislative Audit and Fiscal Review Committee meeting.

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

- **Bank of North Dakota (December 31, 2003 and 2002).**
- **Beginning farmer revolving loan fund (December 31, 2003 and 2002).**
- **Community water facility loan fund (December 31, 2003 and 2002).**
- **Developmentally disabled facility loan fund (December 31, 2003 and 2002).**
- **Municipal Bond Bank (December 31, 2003 and 2002).**
- **Guaranteed student loan program (September 30, 2003 and 2002).**
- **Board of Nursing (June 30, 2003 and 2002).**
- **North Dakota Stockmen's Association (December 31, 2003 and 2002).**
- **State Treasurer (June 30, 2003 and 2002).**
- **Veterans Home (June 30, 2003 and 2002).**
- **Office of Administrative Hearings (June 30, 2003 and 2002).**
- **Industrial Commission (June 30, 2003 and 2002).**
- **Judicial branch (June 30, 2003 and 2002).**
- **Public Service Commission (June 30, 2003 and 2002).**
- **Tax Commissioner (June 30, 2003 and 2002).**

- Department of Transportation (June 30, 2003 and 2002).
- Bismarck State College (June 30, 2003 and 2002).
- State College of Science (June 30, 2003 and 2002).
- Dickinson State University (June 30, 2003 and 2002).
- Mayville State University (June 30, 2003 and 2002).
- Minot State University (June 30, 2003 and 2002).
- Valley City State University (June 30, 2003 and 2002).
- Minot State University - Bottineau (June 30, 2003 and 2002).
- North Dakota University System (June 30, 2003).
- North Dakota Comprehensive Annual Financial Report (June 30, 2003).
- Reports available but not selected for presentation:
 - Abstracters' Board of Examiners (August 31, 2003 and 2002).
 - Board of Addiction Counseling Examiners (June 30, 2003 and 2002).
 - Board of Architecture (June 30, 2003 and 2002).
 - Board of Chiropractic Examiners (December 31, 2003).
 - Board of Clinical Laboratory Practice (June 30, 2003 and 2002).
 - Board of Cosmetology (June 30, 2003).
 - Board of Dental Examiners (June 30, 2003 and 2002).
 - Electrical Board (June 30, 2003 and 2002).
 - Board of Medical Examiners (December 31, 2002 and 2001).
 - Board of Occupational Therapy Practice (June 30, 2003 and 2002).
 - Board of Plumbing (June 30, 2003 and 2002).
 - Board of Social Work Examiners (June 30, 2003 and 2002).
 - Board of Respiratory Care (January 31, 2003 and 2002).

Representatives Wald, Aarsvold, Carlson, Delzer, Skarphol, Timm, and Winrich and Senators Christmann and Klein voted "aye." No negative votes were cast.

OTHER BUSINESS

Representative Winrich presented information regarding the Engelstad Arena at the University of North Dakota. A copy of the information presented is on file in the Legislative Council office. He said it was his understanding that upon completion of construction, the arena would be deeded to the University of North Dakota as a gift. He said he also understood that the total gift of \$100 million promised by Mr. Engelstad would be used in such a way that \$50 million would go toward construction of the hockey arena and \$50 million would be used to support academic programs at the university. He said he would like the State Auditor's office to address these issues during its next audit of the University of North Dakota or the North Dakota University System. Representative Skarphol said the Engelstad Arena should not be singled out.

Representative Delzer said the Legislative Council staff could research the agreement relating to the Engelstad Arena and if additional information is needed the State Auditor's office could incorporate it into a future audit.

The legislative budget analyst and auditor said the Legislative Council legal staff could research the history of the related legislation; however, an Attorney General's opinion may be necessary and could be requested by a legislator.

Representative Winrich asked the Legislative Council staff to research the construction and control of the Engelstad Arena and whether legislative intent is being followed. He asked that the information be provided to him as soon as possible.

Chairman Wald said the committee will postpone the report regarding the changes to the 12 questions required to be addressed by the auditor of state agencies upon completion of the audit report until the next meeting. The legislative budget analyst and auditor said the committee received a copy of the State Auditor's office plan for the 12 questions. Chairman Wald asked that a copy of the memorandum prepared by the Legislative Council staff regarding the 12 questions be mailed to committee members prior to the next meeting.

The meeting was adjourned subject to the call of the chair at 5:15 p.m.

Donald J. Wolf
Senior Fiscal Analyst

Jim W. Smith
Legislative Budget Analyst and Auditor

ATTACH:1