

## LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE - STATUTORY DUTIES AND RESPONSIBILITIES FOR THE 2015-17 BIENNIUM

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 or Legislative Management assignment with the following duties and responsibilities for the 2015-17 biennium:

1. **State Fair Association** - Receive annual audit reports from the State Fair Association pursuant to Section 4-02.1-18.
2. **State Board of Higher Education** - Receive a report from the State Board of higher Education on the operations of Dickinson State University pursuant to Section 40 of 2015 House Bill No. 1003. The section requires for the report to be provided to the Legislative Management. The Legislative Management has assigned the responsibility to this committee.
3. **Ethyl alcohol and methanol producers** - Receive annual audit reports from any corporation that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 10-19.1-152, and receive annual audit reports from any limited partnership that produces agricultural ethyl alcohol or methanol in this state and which receives a production subsidy from the state pursuant to Section 45-10.2-115.
4. **Department of Human Services' accounts receivable** - Receive annual reports on the status of accounts receivable for the Department of Human Services and the Life Skills and Transition Center (formerly the Developmental Center at Westwood Park), Grafton, pursuant to Sections 25-04-17 and 50-06.3-08.
5. **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.
6. **North Dakota Stockmen's Association** - Receive a biennial audit report from the North Dakota Stockmen's Association. Section 4.1-72-08 provides for the audit report to be submitted electronically to the Legislative Council. The Legislative Management has assigned the responsibility to this committee.
7. **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.
8. **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.
9. **Frequency of audits** - Determine the frequency of audits or reviews of state agencies pursuant to Section 54-10-01.
10. **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.
11. **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 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 committee, by motion, may direct the Legislative Council staff to send correspondence to an agency that has not complied with previous audit recommendations requesting the agency to appear before the committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
10. **Presentation of evidence to the Attorney General** - Pursuant to Section 54-35-02.2, whenever the committee determines or has reason to believe there may have been a violation of law relating to the receipt, custody, or expenditure of public funds by any state officer or employee, the committee is to present such evidence or information to the Attorney General. Upon receipt of the information, the Attorney General is to immediately commence an investigation. If the evidence supplied by the committee and through the investigation indicates the probability of a violation of law by any state official or employee, the Attorney General is to prosecute the state official or employee as provided by law.
11. **Report on significant findings and recommendations** - The State Auditor should consider providing a report to the House and Senate Appropriations Committees and each member of the Legislative Audit and Fiscal Review Committee at the beginning of each legislative session regarding significant audit findings and recommendations contained in the financial and performance audit reports presented to the Legislative Audit and Fiscal Review Committee during the previous interim. The State Auditor's office has prepared summaries of significant audit findings and recommendations from audit reports presented to the

Legislative Audit and Fiscal Review Committee and presented, upon request, these summaries to the Legislative Council or the Appropriations Committees at the start of legislative sessions.

### **AUDIT GUIDELINES**

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

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

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

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

The eight issues to be communicated to the committee identify:

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

### **AUDIT APPROACH**

During the 1999-2000 interim, the committee received testimony from a representative of the State Auditor's office regarding the agency's plan to change the audit approach used in conducting audits of state agencies and institutions. For audits of state agencies and institutions conducted by the State Auditor's office, governmental auditing standards for performance audits are more applicable than governmental auditing standards for financial audits. A report on an audit conducted using performance auditing standards includes audited financial

statements but does not include an opinion on those financial statements because the audit will not determine if the financial statements are prepared in accordance with generally accepted accounting principles. The committee supported the proposal presented by the State Auditor's office to begin conducting audits of state agencies and institutions using governmental auditing standards for performance audits.

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

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

Section 54-10-04 requires the Legislative Assembly to provide for a financial statement audit of the State Auditor's office. A copy of the audit report must be filed with the Governor and with each house of the Legislative Assembly. The State Auditor's office audit report for the fiscal years ended June 30, 2013, and 2012 was completed by Eide Bailly LLP. This audit report was reviewed and approved by the committee during the January 21, 2014, 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 quality control review of the State Auditor's office for the period March 1, 2013, to March 31, 2014, was received by the committee in June 2014.

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

### PERFORMANCE AUDITS

During the 2013-14 interim, the committee received performance audit reports on State Water Commission's water use permitting process part 2, and the Game and Fish Department's private land open to sportsman (PLOTS) and the department's compliance with laws, rules, and policies related to human resources and the use of resources. During the 2015 Legislative Assembly, the committee received a performance audit report on the North Dakota University System institutions tuition waivers and student stipends.

The following table lists the status of performance audits presented to the committee during the 1997-99 through 2013-15 bienniums:

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

Performance Audit	Status
Workforce Safety and Insurance (performance review)	October 20, 2008
<b>2009-11 biennium</b>	
Department of Commerce	September 30, 2009
University System capital projects	May 12, 2010
Medicaid provider and recipient fraud and abuse	October 21, 2010
<b>2011-13 biennium</b>	
Dickinson State University	March 27, 2012
Use of state-supplied vaccines by a provider (State Department of Health)	March 27, 2012
State Department of Health Family Health Division	June 21, 2012
Fees charged at North Dakota State University and University of North Dakota	July 26, 2012
State Water Commission's regulation of industrial water use in the state	January 24, 2013
University System office	March 12, 2013
<b>2013-15 biennium</b>	
State Water Commission's water use permitting process	July 29, 2013
Game and Fish Department	July 16, 2014
University System institutions tuition waivers and student stipends	April 21, 2015
<b>2015-17 biennium</b>	
Department of Trust Lands	In progress
University foundations	In progress
Space utilization study	In progress

## STATE WATER COMMISSION'S WATER USE PERMITTING PROCESS - PART 2

In January 2013, a representative of KPMG, LLP, presented Part 1 of the performance audit report of the Water Appropriations Division of the State Engineer's office. The objective of the performance audit was to provide an assessment of the industrial water use monitoring and reporting policies and procedures used by the Water Appropriations Division.

In December 2012, the committee expanded the performance audit of the State Water Commission's regulation of industrial water use to include a review of the water permitting process of the State Water Commission and to authorize costs of up to an additional \$50,000 for hiring a certified public accounting firm to assist with the performance audit.

In July 2013, the committee received Part 2 of the performance audit report for the Water Appropriations Division of the State Engineer's office. The State Auditor contracted with KPMG, LLP, to perform an assessment of the industrial water use permitting process used by the Water Appropriations Division of the State Engineer's office. The audit period for which information was reviewed was January 2010 through June 2012.

The performance audit report contained 25 recommendations in two areas including compliance and operational efficiencies. In addition, the audit report included a review of five states with similar water rights and laws.

The committee accepted the performance audit of the Water Appropriations Division of the State Engineer's office.

## GAME AND FISH DEPARTMENT

In July 2014, the committee received the performance audit report of the Game and Fish Department. The objective of the audit was to provide an assessment of the PLOTS program to determine if it is operating effectively and to conduct an assessment of the Game and Fish Department to determine if it is in compliance with laws, rules, and policies related to human resources and the use of resources. The audit period for which information was reviewed was July 2010 through April 2013.

The performance audit report contained 44 recommendations in five areas including the private land program, procurement and contracting, use of funds, human resource-related issues, and other areas. Based on the performance audit, the State Auditor's office determined the department's PLOTS program goal of one million acres is not a reasonable goal for the program. The goal was originally established in 2003, and since, there have been significant changes affecting PLOTS and no changes have been made to the original goal, the department was in noncompliance with procurement requirements, the department had not established appropriate agreements for services being received, and the department had not properly inventoried and was unaware of the location of a number of guns used in its volunteer hunter education program.

The committee accepted the Game and Fish Department audit report.

## UNIVERSITY SYSTEM INSTITUTIONS TUITION WAIVERS AND STUDENT STIPENDS

In April 2015, the committee received the performance audit report of University System institutions tuition waivers and student stipends. The audit period for which information was reviewed was the 2010-11 through 2013-14 academic years. The objective of the performance audit was to determine:

- The number and amount of waivers or discounts granted at each institution due to statutory requirements.
- The number and amount of waivers or discounts granted at each institution due to reciprocity agreements with other states.
- The number and amount of waivers or discounts granted at each institution to graduate students.
- The average amount of tuition waived or discounts for each student receiving a waiver or waivers, including the average percentage of total tuition waivers compared to gross tuition charges for the students by institution.
- The number and amount of waivers granted at the University of North Dakota School of Medicine and Health Sciences.
- The number and amount of stipends or other payments awarded at each institution to graduate students, including the source of funds.
- The number of students that received both a waiver or discount and a stipend or other payment at each institution.
- The number of internships at each institution and those paid or subsidized by state internship programs.
- The number of Dickinson State University employees terminated during the 2009-11 biennium and the number of those employees that have been rehired.
- Recommendations for improving accountability for the awarding of tuition waivers and student stipends.
- Recommendations for improvements to the information included in student unit records and to the use of the information.
- The number and amount of waivers or discounts for resident students, nonresident students, and international students.

The performance audit report contained 10 recommendations. Based on the performance audit, the State Auditor's office determined improvements were needed with tuition discounts, tuition waivers, and student stipends to increase uniformity and establish accountability.

### PERFORMANCE AUDITS IN PROGRESS

The State Auditor's office is in the process of completing the following three performance audits:

- **Department of Trust Lands** - The Performance Audit Division of the State Auditor's office is currently in the process of conducting a performance audit of the Department of Trust Lands' operations and financial-related activities, including:
  - Minerals management, including the administration of the state's mineral interests and lease auctions;
  - Surface management, including grazing and agricultural leases, rights of way, and site reclamation;
  - Unclaimed property, including claims payments;
  - Investments, including management of assets in trust funds and distributions from trust funds;
  - Revenue compliance, including mineral royalty collections, mineral-related payments, surface rents, and nonproducing leases; and
  - Energy Infrastructure and Impact Office grants, including the distribution of funds and compliance with legislative intent.
- **University foundations** - The Performance Audit Division of the State Auditor's office is currently in the process of conducting a performance audit of the foundations at the University of North Dakota, North Dakota State University, and Dickinson State University for fiscal years 2012, 2013, and 2014.

- **Space utilization study** - The Performance Audit Division of the State Auditor's office is currently in the process of conducting a performance audit of the space utilization study completed for the State Board of Higher Education during the 2013-15 biennium. The audit includes a review of the involvement of board members, board office staff, and campus personnel in the study, the comprehensiveness of the study, the contractor's compliance with terms of the contract, and State Board of Higher Education actions as a result of the study.

### **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.

#### **North Dakota Network and Security Audit**

In June 2014, a representative of ManTech Security and Mission Assurance presented the North Dakota network and security audit report. The audit focused on five tasks--external vulnerability assessment, internal vulnerability assessment, application vulnerability assessment, security assessment of nonconsolidated information technology services, and penetration testing. The findings included the following:

- The external vulnerability assessment identified three high-risk vulnerability findings, seven medium-risk vulnerability findings, and one low-risk vulnerability finding. The findings were classified into two categories--misconfigured systems or applications and operating systems or software applications that were missing critical security patches.
- The internal vulnerability assessment identified 24 high-risk vulnerability findings and 3 medium-risk vulnerability findings. The findings are classified into two categories--misconfigured systems or applications and operating systems or software applications that were missing critical security patches.
- The application vulnerability assessment of the NDGOV State Portal identified one medium-risk vulnerability finding, and the application vulnerability assessment of the criminal justice information sharing (CJIS) application identified two medium-risk vulnerability findings.
- The security assessment of nonconsolidated information technology services identified that the physical security measures varied greatly between the agencies depending on the specific mission of the agency assessed. The physical security of the agencies assessed was determined to be adequate to very good.
- The penetration test team was able to access either user- or system-level access during five of nine executed scenarios. The test team did not succeed in achieving system access on the remaining four scenarios.

The external vulnerability assessment, internal vulnerability assessment, application vulnerability assessment, security assessment of nonconsolidated information technology services, and penetration testing resulted in the following general recommendations:

- Implement a formal patch management program.
- Internal segregation of critical servers and development systems.
- Require use of encrypted protocols for remote management.
- Restrict access to protocols for remote management from the Internet.
- Develop a formal vulnerability scanning program.

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

#### **Odyssey Case Management Information System Audit**

In October 2014, the committee received an information systems audit report for the Odyssey Case Management System. The objective of the audit was to determine if:

- Security is designed to provide access based on a demonstrated need to view, add, change, or delete data.
- Data is consistent, valid, and complete.

- The accounts receivable process is properly managed.

The information system audit report contained three recommendations. Based on the performance audit, the State Auditor's office determined the Odyssey Case Management System's security is designed to provide access based on a demonstrated need to view, add, change, or delete data, and that data appeared to be consistent, valid, and complete.

The committee accepted the Odyssey Case Management Information System audit report.

### **ConnectND Human Capital Management Information System Audit**

In October 2014, the committee received the information systems audit report for the ConnectND Human Capital Management System. The objective of the audit was to determine if:

- The pay classification system is enforced and managed by ConnectND Human Capital Management.
- Payroll withholdings and deductions are handled timely and accurately.
- Leave balances are maintained correctly by the system.
- Security roles are designed to provide access based on a demonstrated need to view, add, change, or delete data.

The information system audit report contained one recommendation. Based on the performance audit, the State Auditor's office determined the ConnectND Human Capital Management Information System's pay classification system is properly enforced and managed, payroll withholdings and deductions are handled timely and accurately, and leave balances were properly maintained by the system.

The committee accepted the ConnectND Human Capital Management Information System audit report.

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

The Legislative Assembly appropriated \$100,000 during the 2013-15 biennium to conduct a technology security audit and vulnerability assessment of the University System.

In January 2015, a representative of Enterprise Security and Protection, TeleCommunication Systems, which represented L.R. Kimball, presented the University System's technology security audit and vulnerability assessment. The objective of the audit was to provide external and internal vulnerability assessments of the networks associated with the University System, which included campuses and networks at Bismarck State College, Dakota College at Bottineau, Dickinson State University, Lake Region State College, Mayville State University, Minot State University, North Dakota State College of Science, North Dakota State University, University of North Dakota, Valley City State University, Williston State College, and University System offices in Fargo, Bismarck, and Grand Forks.

The technology security audit and vulnerability assessment audit report provided 12 findings which contained 28 recommendations. The findings were considered critical or high based on the common vulnerability scoring system and included unsupported operating systems, missing software patches or required upgrades, easily guessed or default credentials, unsupported web servers, well-known internal network assessment exploits, publicly accessible web applications, firewall and network address translations, cross-site scripting, clear text passwords, session tokens in uniform resource locator, structured query language injections, and serialized objects in hypertext transfer protocol messages.

The committee accepted the University System's technology security audit and vulnerability assessment 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 reports on the status of operations of Dickinson State University and its development foundation.



4. Receive followup reports for the State Water Commission's water use permitting process, the Game and Fish Department's PLOTS program and the department's compliance with laws, rules, and policies related to human resources and the use of resources, and the University System institution tuition waivers and student stipends.
5. Receive information technology audit reports, including an Information Technology Department system audit report and a North Dakota network and security audit report.
6. Request a performance audit be conducted, as deemed necessary by this committee, for Job Service North Dakota pursuant to Section 52-02-18.
7. Direct the Legislative Council staff to send correspondence, as deemed necessary, to each agency that has not complied with previous audit recommendations requesting the agency to appear before the committee to explain the reason for noncompliance with audit recommendations or steps taken to address recommendations.
8. Receive annual reports on the status of accounts receivable for the Department of Human Services and the Life Skills and Transition Center (Developmental Center at Westwood Park), Grafton.
9. 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.
10. Develop recommendations and related bill drafts.
11. Prepare the final report for submission to the Legislative Management.