

Office of the State Auditor

Division of State Audit

Significant Audit Findings 2005-2006 Interim

Prepared at the Request of the Senate
and House Appropriations Chairmen

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State Auditor



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Performance Audits

Department of Corrections and Rehabilitation

Performance Audit – Contact: Gordy Smith 328-4990 gsmith@nd.gov

Making Changes with Confinement of “Short-Term” Inmates (2-1)

CJI recommends the Department of Corrections and Rehabilitation take appropriate action to formulate and implement a plan to confine convicted offenders under the jurisdiction of the Department only if they have more than a year and a day to serve when they are physically placed in the Department’s control. This plan will require the active involvement of state policy makers, court representatives, and local officials.

Making Changes with Confinement of “Short-Term” Inmates (2-2)

CJI recommends the Department of Corrections and Rehabilitation temporarily suspend the plans for constructing reception/orientation beds at the State Penitentiary and other proposed bed space additions, except for the improvements to the infirmary and medical areas, until the impact of implementing the preceding recommendation can be determined. If the state determines not to implement the plan, CJI recommends proceeding with all aspects of the capital construction project as currently proposed by an architect.

Reallocating Inmate Population within DOCR (2-3)

CJI recommends the Department of Corrections and Rehabilitation make even better use of the beds at the three adult facilities it operates and, assuming the male inmate population remains at or below its level in September 2004, return as many inmates as possible from Appleton, Minnesota to a Department facility to reduce costs.

Determining Whether to Continue to Contract with the New England Facility (3-1)

We recommend the Department of Corrections and Rehabilitation take the following actions related to the New England facility:

- Enter into a one or two year contract for the housing of female inmates;
- Work with the facility to implement recommendations for the cost savings identified in the audit as well as identifying additional areas where costs can be saved; and
- Adequately monitor the operations of the facility to determine whether significant changes are made.

If the Department determines sufficient progress is not made within the contract period or the facility does not implement areas identified by the Department where cost savings could result, the Department should identify and review alternatives related to the housing of female inmates and pursue such alternatives if cost savings can be realized. Such alternatives could include:

- Identifying the cost to either buy or lease the facility from the county consortium, identifying the cost for the Department to operate the facility itself using state employees and applicable contracts for services, and determining if the

Department could operate the facility at a rate that would result in cost savings; and

- Identifying other placement options that could be used, identifying the cost of such placement options, and determining whether other placement options would result in cost savings.

Making Improvements over Medical Expenditures (3-3)

CJI recommends the Department of Corrections and Rehabilitation ensure Medicaid rates (or the equivalent) are obtained for all New England facility medical expenditures and appropriate personnel at New England are involved in the review and approval of medical bills prior to payment.

Making Improvements in Pharmaceutical Areas (3-5)

CJI recommends the Department of Corrections and Rehabilitation ensure the New England facility joins the Amerinet buy group to purchase drugs and if admission is denied, the Department should provide drugs to the facility and be reimbursed accordingly.

Making Additional Improvements at the New England Facility (3-8)

We recommend the Department of Corrections and Rehabilitation have a representative of the Department on-site at the New England facility to ensure adequate monitoring and oversight of its operations.

Using DOCR Pharmacy for YCC Drug Purchases (4-6)

We recommend the Department of Corrections and Rehabilitation use the pharmacy at the State Penitentiary for obtaining drugs for juveniles at the Youth Correctional Center rather than obtaining the drugs through a contract with a local vendor.

Making Changes to the State Penitentiary Infirmary (4-10)

CJI recommends the Department of Corrections and Rehabilitation take appropriate action to obtain funding to make the State Penitentiary infirmary larger and more functional.

Making Improvements with Daily Rate Calculations (5-1)

We recommend the Department of Corrections and Rehabilitation develop formal policies and procedures for identifying the daily rate at their three adult facilities. At a minimum, the Department should:

- Determine how expenditures at each facility will be identified;
- Determine what population information is to be used for calculating rate information;
- Ensure that population information is being tracked accordingly; and
- Determine whether certain units within the facilities that are high in cost should be tracked separately

Enhancing the Quality of Information (5-2)

We recommend the Department of Corrections and Rehabilitation take appropriate action to establish management controls to assist in ensuring information provided is consistent and accurate. The Department could consider establishing a centralized process which would include formally tracking data and monitoring requests for information received.

Making Improvements with Recidivism Information (5-4)

We recommend the Department of Corrections and Rehabilitation make improvements in calculating the recidivism rate. At a minimum, the Department should:

- Establish formal policies and procedures for calculating the recidivism rate; and
- Review previously calculated recidivism information and revise accordingly.

Reviewing Good Time Release Requirements (5-5)

We recommend the Department of Corrections and Rehabilitation, with assistance from the Office of the Attorney General, review North Dakota Century Code requirements related to good time granted to inmates for the purpose of reducing their sentence, and take appropriate action to modify or clarify sections to make the requirements clear and concise.

Centralizing Contracting Functions (6-6)

We recommend the Department of Corrections and Rehabilitation take appropriate action to centralize the contracting function.

Integrating Information Management Systems (6-10)

CJI recommends the Department of Corrections and Rehabilitation integrate the management information systems of the Prisons Division and Field Services Division. The integration should have the capacity to provide each program with the ability to monitor the flow of inmates through their programs and to obtain both intermediate and follow-up outcome data.

Increasing Programming (7-1)

CJI recommends the Department of Corrections and Rehabilitation take the following actions to enhance the adequacy of treatment services provided:

- Conduct a feasibility study for the development of a community residential substance abuse treatment program (not within the Department's facilities) aimed at providing treatment for offenders with short sentences who are reportedly being sent to DOCR due to a lack of treatment availability in jails (this should be collaborated with courts and jails);
- Develop a Memorandum of Agreement (MOA) with DHS to provide training for community-based chemical dependency counselors on criminal justice population issues and to increase the capacity of the Human Resource Centers to serve offenders on community supervision (i.e., aftercare);

- Increase substance abuse staffing (i.e., two licensed addictions counselors) and provide increased programming at the Missouri River Correctional Center; and
- Support the Bismarck Transition Center in their efforts to develop a day treatment program and consider purchasing such services through an addendum to the contract with the transition center.

Division of Emergency Management

Performance Audit – Contact: Gordy Smith 328-4990 gsmith@nd.gov

Ensuring Compliance with Century Code (2-1)

North Dakota Century Code (NDCC) Chapter 54-23.2 grants authority to State Radio to provide 911 services to a political subdivision with a population of less than 20,000, operate the Law Enforcement Telecommunications System (LETS), and provide Mobile Data Terminal (MDT) services to interested local law enforcement agencies. NDCC identifies the requirements related to the establishment and charging of fees for State Radio to provide such services. We concluded there is noncompliance with these requirements which has resulted in additional general funds being used to support operations.

Making Improvements with 911 Billing and Collection (2-2)

We recommend the Department of Emergency Services improve the billing and collection process involving counties provided 911 services by the Division of State Radio. As part of this process, the Department should periodically verify information at the county level.

Obtaining Authority and Establishing Fees for Services (2-3)

We recommend the Department of Emergency Services take appropriate action to obtain proper legislative authority to provide dispatching services to various state entities, political subdivisions, and other entities and to charge fees for the services provided. After such authority is received and an adequate cost accounting system is established to identify estimated costs for services, respective entities should be charged for services provided.

Making Improvements with Salary Increases (3-1)

We recommend the Department of Emergency Services comply with the salary administration procedures established in North Dakota Administrative Code Chapter 4-07-02. The Department must ensure, at a minimum:

- Maximum salary increase amounts are not exceeded;
- Changes in workload or responsibility are documented and on file within the agency;
- Proper documentation is provided to Human Resource Management Services at the time an equity increase is given; and
- Consideration is given to the effect granting salary increases will have on internal equity.

Ensuring Compliance with Emergency Commission Approval (3-4)

We recommend the Department of Emergency Services expend funds only as outlined in the application request approved by the Emergency Commission.

Improving Communication and Management Style (3-5)

We recommend the Department of Emergency Services take immediate action to improve communications with employees and local Emergency Managers; and ensure an adequate management style is implemented to foster open communications and improve coordination and cooperation among divisions and with Emergency Managers.

Combining Administrative Areas (3-6)

We recommend the Department of Emergency Services (DES), in conjunction with appropriate personnel of the Office of the Adjutant General, formally review the financial, human resources, and other administrative areas of DES and determine whether the administration section, or portions of the section, can be combined with or be placed under the current administrative section within the Office of the Adjutant General.

911 Fees – Collection and Uses

Performance Audit – Contact: Gordy Smith 328-4990 gsmith@nd.gov

Complying with Legislative Intent (3-1)

We recommend political subdivisions receiving 911 fees ensure the use of such funds comply with legislative intent.

Ensuring Administration Costs are Appropriate (3-4)

We recommend political subdivisions receiving 911 fees ensure the amounts retained by phone providers for administration costs are appropriate. Political subdivisions should, at a minimum:

- Ensure the maximum amount for administration costs is not exceeded; and
- Ensure the amount retained by phone providers is reasonable by requiring documentation or other information regarding their administration costs.

911 Purchases Benefiting non 911 Purposes (Pages 15-17)

Public policy makers will need to make a determination as to the reasonableness of using 911 fees to purchase assets which are used by or benefit non 911 users.

Laws Relating to the Use of 911 Fees (Pages 15-16)

Legislative action could be taken to provide additional information and guidance regarding the use of 911 fees. Legislators could consider granting specific authority to a state agency and/or a board or commission to establish guidelines and standards related to the use of 911 fees.

Establishing a Uniform Method of Accounting (Pages 15-16)

Legislative action could be taken to add requirements related to the accounting for 911 costs. Legislators could consider granting specific authority to a state agency and/or a board or commission to be responsible for establishing a uniform system of accounting for 911 costs.

Needed Improvements With How 911 Fees are Collected (Pages 19-21)

Due to concerns noted with the requirements and the processes related to submission of 911 fees, a determination by public policy makers is required for improvements to be made. Legislative action could be taken to centralize the receipting process of 911 fees submitted by phone providers.

Workforce Safety and Insurance

Performance Audit – Contact: Gordy Smith 328-4990 gsmith@nd.gov

Improving Procurement Policies and Procedures (1-1)

We recommend Workforce Safety & Insurance take appropriate action to formally establish an adequate procurement system. The organization should, at a minimum:

- Ensure purchasing policies are thoroughly documented, communicated to appropriate employees, and implemented;
- Centralize recordkeeping of procurement information; and
- Establish an adequate monitoring process to monitor compliance with laws, Office of Management and Budget guidelines, and the organization's policies.

In establishing a formal procurement system, the organization should ensure changes are made to address all areas identified in the report as requiring improvement, including compliance issues.

Using WSI Procurement Office (1-2)

We recommend the Workforce Safety & Insurance Procurement Office be involved at the beginning of all competitive, limited competitive, noncompetitive, and negotiated purchases.

Improving the Use of Public Funds (1-3)

We recommend Workforce Safety & Insurance make improvements with how public funds are used. The organization should, at a minimum:

- Ensure expenditures comply with constitutional provisions, North Dakota Century Code requirements, and OMB Policies; and
- Ensure expenditures are for necessary and reasonable purposes.

Improving Appraisals and Pay for Performance (2-1)

We recommend Workforce Safety & Insurance improve the employee performance appraisal process and ensure the pay for performance system operates in an effective manner. The organization should, at a minimum:

- Ensure the performance appraisal process is adequately monitored for compliance with policies including appraisals being completed annually;
- Establish the criteria to be used for measuring performance at the beginning of an appraisal period;
- Update performance appraisal policies in a timely manner;
- Have supervisors evaluated by those they supervise; and
- Provide training to employees related to properly completing performance appraisals.

Establishing a Uniform Hiring Process and Formal Policies (2-3)

We recommend Workforce Safety & Insurance establish a consistent and uniform process for hiring employees. The organization should, at a minimum:

- Ensure selected applicants meet minimum qualifications of the position;
- Centralize the hiring process within the Human Resource Department;
- Establish a formal screening process and standardized scoring system which is consistently applied to all applicants;
- Ensure questions asked of applicants are relevant and pertain to the position's primary duties; and
- Verify work experience and education for all individuals hired.

Complying with Legislative Intent on General Increases (2-7)

We recommend Workforce Safety & Insurance ensure it complies with legislative intent related to employee compensation adjustments.

Complying with Bonus Requirements (2-8)

We recommend Workforce Safety & Insurance ensure payments made to employees comply with the bonus program requirements within North Dakota Century Code Chapter 54-06.

Improving How Investigations are Conducted (2-9)

We recommend Workforce Safety & Insurance make improvements with how investigations of incidents involving employees are conducted. The organization should, at a minimum:

- Ensure investigations are conducted by an independent source who is free of conflicts of interests;
- Ensure individuals conducting investigations receive proper training;

- Have interview sheets signed by the interviewee, specifically when interviews are conducted in a one-on-one setting; and
- Ensure final investigation reports are signed and dated.

Improving How Investigation Results are Implemented (2-10)

We recommend Workforce Safety & Insurance make improvements with actions taken related to results and recommendations of investigations involving employees. The organization should, at a minimum:

- Document actions taken or the justification for no actions taken in relation to recommendations from investigations;
- Improve the monitoring of actions to be taken;
- Document the reasons for changing conclusions or recommendations of investigations; and
- Have results of investigations provided to the Board of Directors Audit Committee when the investigation involves the Executive Director.

Taking Actions to Increase Morale (3-1)

We recommend the Workforce Safety & Insurance Executive Director make improvements with actions taken in order to increase morale of the organization. While this will encompass a number of areas, the Executive Director should, at a minimum:

- Ensure actions taken are not resulting in preferential treatment and/or favoritism; and
- Follow through with commitments or promises, ensure unreasonable commitments are not made, and notify all applicable parties if promises or commitments are unable to be adhered to.

Having an Effective Open Door Policy (3-2)

We recommend Workforce Safety & Insurance take appropriate action to have an effective open door policy under which employees can bring issues to management without actual retaliation or fear of retaliation.

Improving Communication (3-3)

We recommend Workforce Safety & Insurance make significant, timely improvements related to communication between executive management and other employees of the organization.

Improving the Use of Resources (3-4)

We recommend Workforce Safety & Insurance comply with legislative intent and ensure the Special Investigations Unit's resources are used appropriately.

Improving the Use of Resources (3-5)

We recommend Workforce Safety & Insurance comply with contractual provisions and ensure the Department of Transportation's driver's license image program is accessed for official use only

Improving the Use of Resources (3-6)

We recommend Workforce Safety & Insurance use resources in an efficient and proper manner to ensure the use of resources does not result in abuse.

Reviewing Staffing Levels (3-13)

We recommend Workforce Safety & Insurance conduct an in-depth review of the staffing level of Internal Audit and determine an adequate staffing level for Internal Audit to effectively fulfill its mission.

Complying with Legislative Intent (4-1)

We recommend the Workforce Safety & Insurance Board of Directors comply with legislative intent and effectively govern the organization.

Complying with the Carver Model (4-3)

We recommend the Workforce Safety & Insurance Board of Directors comply with the Carver Policy Governance Model.

Establishing Proper Outcomes (4-5)

We recommend the Workforce Safety & Insurance Board of Directors establish Outcomes that determine what good the organization is to accomplish, for whom, and at what cost or relative worth.

Establishing Measurable Performance Criteria (4-6)

We recommend the Workforce Safety & Insurance Board of Directors establish detailed, measurable performance criteria within the Outcomes and Executive Limitations policies.

Information Systems Audits

OMB ConnectND Finance

IS Audit – Contact Don Lafleur 328-4744 dlafleur@nd.gov

Default Accounts Not Locked

When we reviewed default accounts, we noted that one default account was unlocked. The unlocked account was the default system administrator account. This account was being used by administrators in the Information Technology Department. Default accounts pose a security risk because vendors provide lists of them freely. Hackers target the default accounts when attempting to gain access to systems.

Recommendation:

We recommend the Information Technology Department establish procedures to lock or remove all default accounts.

Agency Response:

Information Technology Department

ITD will:

- Generate an automated monthly report that will show us all accounts in an unlocked status. ITD will then review this report, determine if any are default PeopleSoft accounts, and if so ITD will then lock the accounts.
- Work with ITD Application Server Group for proper notification when system patches and updates will be applied so that the 'unlocked status' report can be re-run to see if any default PeopleSoft accounts were created or unlocked.
- This will in place by December 15, 2005.

No General Ledger Approval Function

During our review of security, we found the general ledger lacks an approval function for journal entries. Good internal controls require a segregation of duties between preparing and approving journal entries. The lack of proper approval increases the risk that errors and irregularities could occur.

Recommendation:

We recommend the Office of Management and Budget implement an approval function for journal entries and segregate this from preparing journal entries.

Agency Response:

Office of Management and Budget

OMB will implement General Ledger Workflow functionality to comply with this recommendation.

Auditor's Opinion

In our opinion, security roles do not provide access based on a demonstrated need to view, add, change, or delete data

Excess Superuser Access

We identified eight accounts that had inappropriate superuser access. In addition, we identified twenty-two accounts for the Office of Management and Budget to review to determine if they require superuser access. Good internal controls require that you grant access rights based on a demonstrated need. Unnecessary superuser access increases the risk that errors and irregularities could occur.

Recommendation:

We recommend the Office of Management and Budget limit superuser access to only those individuals with a demonstrated need for superuser access.

Agency Response:

Office of Management and Budget

OMB will review those accounts granted superuser access to determine if it is needed.

Auditor's Opinion

In our opinion, not all accounts that have been granted superuser access are necessary.

Financial Data in Sub-Modules Not in Agreement With the General Ledger

In reconciling the Student Administration module we found that the Student Administration module creates the general ledger journal entries. Student Administration sends these entries to ConnectND Finance, and they post to the general ledger. Prior to sending the entries to ConnectND Finance, an opportunity exists to modify the journal entries. For various reasons institutions modified journal entries which caused the final entry in ConnectND Finance to no longer agree to the detail in Student Administration.

Recommendation:

We recommend the North Dakota University System Office ensure that the sub-module detailed data agrees to the corresponding entries in the general ledger.

Agency Response:

North Dakota University System

Financial data is interfaced to Finance from the HRMS and Student databases. After the interface is complete, journals are created through the journal generation process in the nightly batch from student and manually by the HECN staff for the payroll. In either case, the journal generation is also set to edit, budget check and post the journal that is created.

There are many occasions when the journal will not post because of either a journal header error such as a chartfield missing or a budget checking error. Budget checking errors are typically resolved by creating budgets. When journal header errors occur, the only way to get the journal to post is to add/revise the chartfield on the journal. The correction is made in the journal and allowed to post to the general ledger. Because these differences are minor, it is not feasible to make the change in the student finance system.

In addition, some of the differences that occur between the GL and student finance are as a result of set up issues at the campuses and/or unexplainable system errors. Set-up issues can cause student finance journals to be created with errors such as duplicate lines, missing lines, etc. As a result, the student finance generated journals do not match the student finance database. As each campus discovers these issues, journal entries are posted to the GL to

correct the errors and changes to set-ups are made in Student Finance to eliminate these errors from occurring in the future. When these types of errors occur, campuses will keep documentation that will allow for an audit trail of the changes. In addition, campuses will be diligent in preparing set-up in student finance so as to avoid these types of errors in the future.

Based on user preferences, the institutions have the ability to determine who should have the authority at their institutions to change journals that are created through the journal generation process. As a result, there are only a few individuals at each institution that can change the journal and most journals are posted immediately in the nightly batch as they have no errors. Once a journal is posted, the journal cannot be revised.

Special Funds Can Be Overspent

ConnectND allows special funds to have a negative cash balance. Traditionally, controls prevented negative cash balances in special funds. Since special funds are designed to be self-funding this control should be continued.

Recommendation:

We recommend the Office of Management and Budget establish a policy and procedures to prohibit negative cash balances in special funds.

Agency Response:

Office of Management and Budget

OMB will monitor for this situation and will establish a policy outlining the procedures to be followed when it does occur.

Auditor's Opinion

In our opinion, edit checks are not adequate

ITD Information Systems Audit

IS Audit – Contact Don Lafleur 328-4744 dlafleur@nd.gov

Firewall Configurations Out of Date

ITD's firewalls have rules which no longer apply or are no longer in use. This includes hosts which are no longer on the network or hosts which no longer require connectivity.

Recommendation

We recommend that ITD review all firewall configurations to ensure the rules are necessary and applicable.

ITD Response

ITD agrees with this recommendation. We will include firewall configurations in our annual review of the security access granted by each agency.

ITD Lacks a Formal Risk Assessment Framework

While critical business processes have been identified, there is not a systematic approach to identifying, assessing, and mitigating or accepting risks to those business processes. Such a framework should incorporate a regular assessment of the relevant information risks to the

achievement of the business objectives, forming a basis for determining how the risks should be managed to an acceptable level. Management should ensure that reassessments occur and that risk assessment information is updated with results of audits, inspections and identified incidents. Without a formal risk assessment process management may not have adequate information to make sound decisions in the use of assets to mitigate risks.

Recommendation

We recommend the Information Technology Department develop a systematic risk assessment framework.

ITD Response

ITD agrees with the recommendation and will leverage our relationships with other security organizations in other states to determine best practices in this area.

Conclusion

We conclude that, except as noted above that risk assessments are done in an ad hoc manner, ITD has met the objective of assessing risks.

OMB ConnectND Human Resource Management System (HRMS)

IS Audit – Contact Don Lafleur 328-4744 dlafleur@nd.gov

Inappropriate Access to Sensitive Information

OMB and NDUS have developed inquiry roles which have display access to confidential information such as social security numbers and bank accounts. These roles also have display access to personally identifiable information. Personally identifiable information is defined as “information that identifies or can be used to identify, contact, or locate the person to whom such information pertains.” Examples of personally identifiable information include birth date, address, and telephone number. This presents an exposure risk for the confidential and personally identifiable information.

These roles were not reviewed closely enough by OMB and NDUS to ensure that inquiry roles did not have access to confidential or sensitive information. Also, screens or reports in ConnectND HRMS used for other purposes can contain social security numbers, bank account information, and personally identifiable information. Access to data should be provided based on the individual’s demonstrated need to view, add, change, or delete data.

Recommendation:

We recommend the Office of Management and Budget and the North Dakota University System:

- design roles to ensure that access to sensitive information is properly restricted; and
- communicate to agencies, colleges, and universities roles that have access to sensitive information to ensure such roles are properly assigned.

Agency Response:

Office of Management and Budget

OMB will review access to sensitive information and will ensure that access is only available in roles requiring that information or roles responsible for that information.

North Dakota University System

We agree that roles should be designed to restrict access to sensitive information, and have changed one role that contained inappropriate access after being made aware of this by the SAO.

Training has been made available to employees with access to sensitive data. The Security Group will develop and run queries to determine which roles have the sensitive information so that they can inform and train the Campus Access Control Officers about the assignment of those particular roles

Default Accounts Not Locked Timely

When we reviewed default accounts, we identified approximately 150 accounts matching the criteria for default accounts that were not locked out. This occurs because default accounts are restored and unlocked when updates are applied. Default accounts need to be either removed or disabled to prevent users from gaining unauthorized access to the system. After bringing this to the attention of the Information Technology Department, these accounts were locked.

Recommendation:

We recommend the Information Technology Department put procedures in place to ensure all default PeopleSoft accounts are locked in a timely manner when updating ConnectND HRMS.

Agency Response:

Information Technology Department

ITD Will:

- Generate an automated monthly report that will show us all accounts in an unlocked status. ITD will then review this report, determine if any are default PeopleSoft accounts, and if so ITD will then lock the accounts.
- Work with ITD Application Server Group for proper notification when system patches and updates will be applied so that the 'unlocked status' report can be re-run to see if any default PeopleSoft accounts were created or unlocked.
- This will in place by August 1st 2005

Excess Superuser Access

We found seven individuals and two system accounts that had improperly been given the ability to modify security rights. Access to data should be provided based on the individual's demonstrated need to view, add, change, or delete data. There is a risk that unauthorized changes could have been made to roles, permission lists, and user accounts from accounts that were improperly given the Security Administrator role. We notified the Information Technology Department (ITD) of the accounts with the Security Administrator role. ITD promptly removed this role from those accounts.

Auditor's Opinion

In our opinion, superuser access granted in ConnectND HRMS is necessary.

Ability to Update One's Own Payroll Data

Initially, we noted approximately 1,200 user accounts were not tied to the user's employee ID. The vast majority of these were for NDUS accounts. We reviewed users with access to update payroll information and found that there were 93 of them. Sixty of the 93 user accounts were

not tied to the employee ID. During our final review, we noted an additional six state accounts and four NDUS accounts were not tied to the user's employee ID. One of the state accounts had update access to payroll information.

Employees with update access may have been able to change their own payroll information. Good internal controls prevent an individual from changing their own payroll and ensure that the owner of each user account is identified.

Recommendation:

We recommend the Information Technology Department and the North Dakota University System ensure that all user accounts are properly attached to the user's employee ID number.

Agency Response:

Information Technology Department
ITD Will:

- Ensure that all ConnectND ADD requests on the ITD Work Management System require an employee ID.
- Generate a baseline report showing all valid user accounts that need no employee ID and have OMB verify this baseline report
- Generate an automated monthly report showing all non-baseline accounts that have no employee ID and forward this report to OMB for action.
- This will in place by August 1st 2005

North Dakota University System

This work had not been completed prior to the audit due to the final four campuses going live in 2005. This work has now been completed. The Security Team now has a rule whereby they will no longer create a user profile for anyone without an EmplID. They also run queries periodically to verify that all users have EmplIDs with the exception of consultants

In our opinion, proper security procedures are not implemented to ensure that users do not have update access to their own payroll information.

NDUS ConnectND Student Administration

IS Audit – Contact Don Lafleur 328-4744 dlafleur@nd.gov

Inappropriate Access to Social Security Numbers

Several screens throughout the system display social security numbers. This increases the risk of improper disclosure of Social Security Numbers. The Family Educational Rights and Privacy Act guidelines indicate Social Security Numbers should not be used as identifiers. NDUS collects and uses Social Security Numbers because federal reporting requires the use of Social Security Numbers.

Recommendation:

We recommend NDUS design roles to ensure access to social security numbers is properly restricted.

Agency Response:

The NDUS intends to implement the recommendation within the system limitations. Because of the limitations of the PeopleSoft system, the roles cannot be changed to accommodate this

request, but the screens in question can be re-designed to mask the Social Security Number (SSN). Oracle/PeopleSoft offers a method to mask certain fields in the permission lists within the roles, but only if the user has display-only access. In many cases the user needs to be able to create or update records containing the Social Security Number, which invalidates the masking. The Functional Leads for each module will evaluate the screens involved and submit an approved development request to have the screens modified to mask the SSN.

Password Changes Not Required

NDUS is not requiring password changes for non-student accounts in the System. NDUS turned off password change controls for all accounts as student accounts created more of a work load than the help desk could handle. Good security controls include regular password changes to prevent the risk of user accounts being compromised.

Recommendation:

We recommend NDUS require passwords to be changed for non-student accounts every 60-90 days.

Agency Response:

The NDUS intends to implement the recommendation. When the PeopleSoft Student Administration System was implemented, password expiration was in use and set at 60 days; but because of problems with inconsistency of passwords between the Portal and the Application databases, it was disabled. We have received the code the State uses to extend the expiration date of passwords and are in the process of reviewing it to see what changes need to be made to enable this program to work for our purposes. We hope to have this implemented in the very near future.

Credit Card Numbers Inappropriately Stored

Schools inappropriately enter and store credit card numbers in the System, increasing the risk of credit card fraud. Payment Card Industry Data Security Standards which apply to merchants accepting credit card payments state that a merchant has the duty to protect stored data relating to such payments. NDUS does not have a formal policy against storing credit card numbers.

Recommendation:

We recommend NDUS develop a formal policy to ensure credit card numbers are not stored in ConnectND Student Administration.

Agency Response:

The NDUS intends to implement the recommendation. HECN staff will perform edit checks via a SQL query periodically to ensure credit card numbers are not fully entered. HECN is currently planning to delete all stored credit card numbers. HECN will emphasize that credit card numbers are not to be fully entered into the system during the receipting process. In addition, the campus controllers have asked the Bank of North Dakota to provide training in credit card security to ensure the staff are properly following security regulations.

Default Accounts Not Locked

Some default accounts delivered with the System were not locked, increasing the risk of unauthorized access. Hackers target default accounts when attempting to gain access to systems. NDUS had not thoroughly reviewed all default accounts. Control Objectives for Information Technology, issued by the Information Systems Audit and Control Association, state management should perform a regular review of all accounts and related privileges.

Recommendation

We recommend NDUS perform a regular review of default accounts to ensure they are locked.

Agency Response

The NDUS intends to implement the recommendation. During our periodic review of locked accounts, one of the accounts was thought to be necessary for an automated application process, so it was not locked. We have since locked both default accounts. The default accounts will be monitored monthly to ensure that they are locked.

Auditor's Opinion

In our opinion, security roles provide access based on a demonstrated need to view, add, change, or delete data, except as noted above.

Financial Statement Audits

North Dakota State CAFR – 2004

Contact: Ron Tolstad 328-2243 rtolstad@nd.gov

Lack of Financial Reporting Controls (04-1)

The Office of Management and Budget and state agencies made numerous errors relating to the adjustments needed to report the state's balances and activities in accordance with generally accepted accounting principles (GAAP). We tested 714 GAAP adjustments of which 42 were found to be in error, for an unacceptable error rate of 6%. Of the 42 errors, state agencies made 26 errors and the Office of Management and Budget made 16 errors. These errors included audit adjustments exceeding \$13,500,000. These errors also resulted in uncorrected projected errors of nearly \$950,000.

Several factors contributed to the state's unacceptable GAAP adjustment error rate. These factors resulted in inadequate resources being committed to financial reporting and contributed to a breakdown in all five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring) as they relate to financial reporting. The most significant factor related to resources being diverted to the implementation of the state's new accounting system (ConnectND) while the GAAP adjustments and the state's financial statements were being prepared. Another factor related to the demands of preparation of the states 2005-07 budget and preparations for the 2005 legislative session.

Recommendation:

The Office of Management and Budget needs to commit sufficient resources to financial reporting to ensure adequate policies and controls are in place to prepare the state's financial statements in accordance with generally accepted accounting principles. To ensure policies and controls are in place, special attention needs to be placed on clearly communicating the financial reporting requirements to state agencies.

OMB Response:

Due to the implementation of the ConnectND accounting system, OMB did not have sufficient personnel available to prepare the state's financial statements for fiscal year 2004 nor to provide additional training to state agencies. We plan to provide adequate staffing and training for agencies in the future.

Lack of Payroll Access Controls (04-2)

The state implemented the ConnectND Human Resource Management System's payroll module in March and April of 2003. Properly designed security roles were not included as part of this implementation. As a result, the state's internal control for payroll does not include adequate access controls. Each person who was granted access to the payroll system has the same access to make changes. This deficiency made it impossible for state agencies, especially the larger state agencies, to implement controls to properly segregate payroll duties.

In accordance with the Office of Management and Budget's responsibility under N.D.C.C. section 54-44-01 to be the "central authority, vested with the control and supervision of the fiscal administration of the executive branch of government," the Office of Management and Budget is currently developing proper security roles.

Recommendation:

The Office of Management and Budget should continue to develop proper security roles and implement them as soon as practical. This implementation should include adequate policy guidance for state agencies on the importance of the various security roles in relation to the proper segregation of duties.

OMB Response:

The roles for standard HR/Payroll users have been revised to eliminate extraneous and inappropriate screens and access. Control Table access has been eliminated or restricted as appropriate. The Correct History capability has been removed from all agency users and remains only for system administration staff.

Security remains a 'work in progress' and will require ongoing efforts as new modules are implemented, software upgrades are implemented, and as self-service rollout continues.

North Dakota State CAFR - 2005

Contact: Paul Welk 328-2320 pwelk@nd.gov

Lack of General Ledger Transaction Approval Procedures (05-1)

The PeopleSoft general ledger lacks an approval function for journal entries. Until an online approval function is implemented, agencies are required to manually approve journal entries. We noted several agencies do not have proper approval procedures in place as they are not manually approving journal entries. Proper internal controls require the review and approval of all accounting transactions. Journal entries that are not reviewed and approved have a greater risk of errors or irregularities.

Recommendation:

The Office of Management and Budget needs to implement an online approval function for journal entries in the general ledger. Until then, they need to provide guidance to agencies for alternative approval procedures.

OMB Response:

OMB will implement General ledger Workflow functionality to comply with the recommendation.

PeopleSoft Access Control Weakness (05-2)

The security roles used by state agencies have a design flaw which results in a significant internal control weakness. As a result, people with the role to approve expenditure transactions

also have the ability to initiate the same transactions. Proper internal control dictates that these two functions be separated. The current weakness increases the risk of improper payments being processed.

Recommendation:

The Office of Management and Budget should continue to develop proper security roles and implement them as soon as practical.

OMB Response:

We agree with the recommendation. OMB intends on doing an in-depth review of PeopleSoft Roles/Permission Lists to tighten up security access. We will incorporate the recommendation in our scope.

Lack of Cash Account Reconciliation (05-3)

Since the implementation of the PeopleSoft accounting system, the Office of the State Treasurer has not reconciled cash at the Bank of North Dakota to cash on PeopleSoft. Prior to that time, cash was reconciled on a daily basis. The Office of the State Treasurer was unable to reconcile cash due to PeopleSoft implementation issues. The Office of Management and Budget, along with the Office of the State Treasurer, completed a cash reconciliation as of June 30, 2005 that was used for the 2005 Comprehensive Annual Financial Report (CAFR). The cash reconciliation included an unreconcilable difference that was below the CAFR immateriality amount.

Proper internal controls require a cash reconciliation of the bank balance to the book balance. Without this reconciliation, errors and irregularities would go undetected.

Recommendation:

The Office of the State Treasurer should reconcile the cash balance per the PeopleSoft accounting system to the Bank of North Dakota balance on a daily basis.

Office of the State Treasurer Response:

The Treasurers Office agrees with the finding. Although the conversion to the State's new accounting system made it difficult to balance on a daily basis our office did continue to verify transactions to the bank statements and maintained additional data which aided in the completion of the final 6-30-05 reconciliation. Our agency will complete reconciliations between the bank balance and PeopleSoft on a daily basis.

North Dakota University System CAFR - 2004

Contact: John Grettum 239-7250 jgrettum@nd.gov

Budget Transfer (04-1)

A portion of the North Dakota State College of Science (NDSCS) general fund authority was transferred to the North Dakota University System Office. NDSCS processed a \$196,133.76 check in December 2003 to the System Office with the description "articulation & transfer '03-'05

general fund authority budget balance". The payment was recorded in Fund 3508, Articulation and Transfer, and charged to TCC 311, Salaries-support staff. Article VIII, Section 6, paragraph 6e, of the ND Constitution, provides that the state board of higher education shall have the control of the expenditure of the funds belonging to, and allocated to such institutions and also those appropriated by the legislature for the institutions of higher education in this state; provided, however, that funds appropriated by the legislature and specifically designated for any one or more of such institutions, shall not be used for any other institution (emphasis added). In our opinion, the check and subsequent receipt effectively transferred appropriation authority from NDSCS to the NDUS in violation of Article VIII, Section 6, paragraph 6e, of the ND Constitution.

Also in December 2003, the System Office requested and received from the Office of Management and Budget an increase of \$196,134 in special fund appropriation due to Articulation and Transfer funds, pursuant to Section 7 of House Bill (HB)1003 (2003). Section 7 of HB 1003 (2003 session laws), provided that all funds, in addition to those appropriated in section 1 of the Act, from federal, private, and other sources, received by the institutions and entities under the control of the state board of higher education are appropriated to those institutions and entities, for the biennium beginning July 1, 2003, and ending June 30, 2005. All additional funds received under the North Dakota-Minnesota reciprocity agreement during the biennium beginning July 1, 2003, and ending June 30, 2005, are appropriated to the state board of higher education for reimbursement to institutions under the control of the board and for student financial assistance grants. In our opinion, section 7 of HB 1003, does not permit the transfer of funds from NDSCS to the System Office and therefore does not apply to this transaction.

Recommendation:

We recommend that the University System comply with Article VIII, section 6, of the Constitution and Section 7 of HB 1003 of the 2003 Session laws and not transfer funds specifically designated for one or more institutions.

Client Response:

Agree. However, the funds have continued to be used for their original purpose, with transfer occurring only to facilitate easier payroll and operating expense processing. Original funding for the Articulation and Transfer function was provided by transfers in previous biennia from the Board Initiative Fund to NDSCS. The NDUS negotiated with NDSCS for release time of a NDSCS faculty member to carry out the articulation and transfer responsibilities. The faculty member remained at NDSCS while performing this system-wide function.

At the end of the 01-03 biennium, the remaining \$218,655 of unspent original transfers was added to NDSCS's base operating appropriation in the 03-05 biennium, as part of the appropriation process. During fiscal year 2004, the NDSCS employee retired and the function was moved to the NDUS office where the replacement employee was to be located. At that time, \$196,134 remained and it was determined that a payment back to the system office was appropriate so the NDUS could process payroll and other expenses of the function. Because the NDUS Office has no spending authority beyond its appropriation, we worked with OMB to provide a special fund line item appropriation for the payment from NDSCS. Thus, it is clear set apart in the accounting records of the NDUS Office. In addition, the 05-07 NDUS budget request includes a requested reduction of \$218,655 in NDSCS's base appropriation and an increase in

the NDUS office's base appropriation to permanently move this function to the NDUS Office. If approved by the 2005 Legislative Assembly, the issue will be properly resolved.

Peoplesoft (04-2)

Mayville State University (MaSU) did not make the journal entries (JE's) nor performed reconciliations necessary to keep the fiscal year 2004 (FY 04) general ledger (GL) accurate and up to date. FY 04 entries to reflect cash and the corresponding deposits (account # 224002) and State Appropriation revenue (account # 461250) had not been made as of 7-8-04, and therefore the activity was not reflected on the general ledger. Furthermore, cash has not been moved into the various state appropriation funds so at this point they are all running deficit balances. Further, no reconciliation is being done between what is received from lenders on Stafford loans and what is paid out to students. These (cash, deposits & state appropriations) are simply the accounts we identified from a preliminary review of MaSU's records. Reported accrued payroll at MaSU and VCSU did not agree to the detailed supporting documentation. Accrued payroll at MaSU as of 6-30-04, (for accounts 223026, 223076 & 223001) was reported as \$71,376, but the supporting documentation totaled \$237,163, for a difference of \$165,787. Part of the difference was recorded as accounts payable when remittances to third parties of payroll withholdings were incorrectly applied back to year end. Also, part of the difference was due to unexplained debit balances in funds of the payroll withholdings account. Accrued payroll at Valley City State University (VCSU) as of 6-30-04 was reported as \$330,518, but the supporting documentation totaled \$358,227, for a difference of \$27,709. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that could be material in relation to the basic financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned duties. The GL serves as the basis for the preparation of the basic financial statements. If the general ledger is not kept current, the college can not provide accurate and complete financial statements. Controls over revenues, expenditures, cash and other accounts are missing or nonexistent when complete and timely entries are not made or reconciled to the general ledger.

Recommendation:

We recommend that the North Dakota University System (NDUS) research and determine whether:

1. Additional permanent staff needs to be hired to perform the accounting functions at MaSU, VCSU and potentially other campuses to keep current on all functions and train staff on Peoplesoft software;
2. The NDUS needs to temporarily reallocate resources necessary to ensure that MaSU's general ledger be brought current and remains current;
3. MaSU and VCSU input all data and complete all reconciliations on a timely basis starting with the June 30th, 2004 cash reconciliation.

Client Response:

The NDUS has taken an active role in monitoring the fiscal year 2004 audit and financial statement preparation process in the following ways:

- Beginning in mid-August, the Director of Financial Reporting, based upon request, has provided campuses assistance in the preparation of audit schedules and financial statements either via phone, email or in person.
- Financial statement templates were prepared and distributed to the campuses to ease financial statement preparation and consolidation.
- The System Office, the ConnectND project team, and NDSU provided assistance in the cash reconciliation process, where feasible and appropriate.
- The System Office was in regular communication with the campus controllers, Vice Presidents for Finance and, ultimately the presidents, on the status and completion of audit and financial statement information on the individual campuses.
- Manuals and procedures have been and will continue to be developed for campuses to utilize in completing accounting tasks, including the reconciliation process, in the new CND system.
- The campus controllers meet regularly (at least monthly) to share information and solutions and jointly address issues.

Campuses are charged with ensuring the preparation of timely and accurate statements and audit information and also ensuring adequate internal control procedures are in place. This includes determining the level of staffing and resources needed to carry out this responsibility. As an example, LRSC has recognized a staffing need in this area and has recently hired an individual to assist with business affairs. However, the System Office and SBHE Budget and Finance Committee will continue to monitor the timeliness of completion of these important tasks and take steps as necessary to address any continuing problem areas. Campus personnel have been overwhelmed with the implementation of ConnectND, in addition to their regular daily tasks, thereby limiting the time available for staff to dedicate to these complex, but important, tasks. All processes and tools previously used in completing these financial tasks have changed, further making tasks more difficult and time consuming to complete. All of the tools needed to facilitate a smooth reconciliation process have not been in place and functioning properly. For example, we just recently received a software fix for one piece of the reconciliation process. Nonetheless, the goal is to have the general ledger, through May 2005, reconciled to the bank statements by June 30, 2005 at all campuses. The reconciliation for June would be completed by early August and on a monthly basis from that point forward.

North Dakota University System CAFR - 2005

Contact: John Grettum 239-7250 jgrettum@nd.gov

Bank Reconciliations (05-1)

BSC, LRSC, MASU, NDSCS, UND, and WSC could not reconcile general ledger cash to bank cash. At June 30, 2005, the total unexplained difference was \$353,266. For LRSC and MASU, these are prior recommendations since June 30, 2003 and June 30, 2004, respectively.

Standardizing the bank reconciliation process could lead to improved reconciling procedures. If the institutions are unable to reconcile bank balance cash to general ledger cash, there can be no assurance that any entry on the general ledger is correct.

Recommendation:

We recommend that all schools expend necessary resources to get cash reconciled to the general ledger. Further, we recommend standardizing the bank reconciliation format.

University System Response:

Agree. This issue has been a top priority for resolution, as the NDUS office and the campuses were anxious to resolve the issue. Given the other significant demands on their time during the CND implementation and the steep learning curve, it's taking longer than expected. Several campuses have hired consultants to assist with identifying issues and to establish better procedures. In addition, through the controller's group and the ND HEUG conference, the NDUS will continue to refine and improve the process.

Classification and Coding Errors (05-2)

We noted numerous, significant misclassification and miscoding of accounts, funds, fund groups, and functions during our examination of the NDUS general ledgers, closing entries, and adjusting entries for fiscal year 2005. Consistency in coding and classification within institutions as well as among institutions is the most significant issue that emerged during our audit. See Appendix A for details and examples.

Institutions postpone transaction coding and classifications until year-end when time is the least abundant resource. Institutions should strive to initially record transactions correctly. This would greatly reduce the number of correcting and reclassifying journal entries at year-end. The sheer volume increases the potential for error.

Section 1300 of the Codification of Governmental Accounting and Financial Reporting Standards defines a fund as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on a specific activity or attaining certain objectives in accordance with special regulations, restrictions, or limitation, and section 1800.101 provides general principles regarding classification and terminology where the use of proper terminology and appropriate classification is essential throughout the budgeting, accounting, and reporting processes.

Recommendation:

We recommend that:

The NDUS properly use the account codes, funds, fund groups, and functions that are available on PeopleSoft to comply with GAAP. This includes the proper initial recording of all assets, liabilities, equities, revenues, and expenses.

University System Response:

In general, the NDUS agrees with the recommendations, with the following clarifications:

Agree, in part. The numerous cash and investment accounts on the PS system were set up for the purpose of being able to generate the financial statements directly from the system using nVision, not for GAAP purposes. Campuses were to code their activity to the accounts that work best for management of their cash and investments and for ease of cash balancing. At

year-end, adjustments were to be made to move cash and investments into financial statement accounts so the financial statements would be correctly stated. In the General Ledger Account Descriptions document, most of these accounts are described as “Used for financial statement entries”. However, where classification of deposits and investments do not interfere with the reconciliation process, campuses will be encouraged to use the additional accounts throughout the year, to reduce the number of entries at year-end. In all other circumstances, the current process will continue to be used and campuses will reclassify items appropriately at year-end.

Agree. When the conversion was made to PeopleSoft, the auxiliary accounting structure was changed -- auxiliary revenues would no longer be captured by fund, but by a range of revenue accounts. Only auxiliary funds were to use these revenue accounts in order to achieve accurate reporting. For NDSU, some auxiliary revenue account codes fit better for some non-auxiliary funds than the regular revenue account codes. Due to the training required during an already busy conversion time, NDSU allowed departments to use auxiliary revenue accounts in non-auxiliary funds. At year-end an entry was made to reclass the revenues for proper reporting in the financial statements. This practice was pre-approved by the system office. In fiscal year 2007, as time permits, we will review the accounts to consider ways to more effectively use the account structure.

Disagree. Salaries and benefits for some faculty and staff are divided between different funds and projects. This commonly occurs with grants and contracts that pay less than 100% of a position. Additionally, campuses have positions that have responsibilities that span multiple departments and/or functional areas. It is appropriate to charge payroll expenses to each department or function based on these responsibilities. Additionally, NDSU uses fringe benefit pools in seven state appropriated funds to budget and charge fringe benefit expenses. In these cases, salaries are charged to the department’s fund and fringes are charged to a pool fund. NDSU has had a long-standing management practice of budgeting fringe benefits as a pool; so that each department's payroll budget only includes their gross salaries and wages, as those are the expenses under each department's control and responsibility at NDSU. The use of the pools in the past was not due to the legacy system limitations, so they saw no need to change this practice in implementing PeopleSoft, as most campuses did. They realize there are pros and cons to this management practice, but believe it is a management responsibility delegated to NDSU under Board Policy and as a result, do not intend to change their practice.

Auditor Rebuttal:

Regarding the establishment of separate funds for fringe benefit pools in state appropriated funds, in our opinion, the NDUS should follow the guidance in GASB’s Codification of Governmental Accounting and Financial Reporting Standards Section 1300.118 which states “the general rule is to establish the minimum number of separate funds consistent with legal specifications, operational requirements, and the principles of fund classification discussed above. Using too many funds causes inflexibility and undue complexity in budgeting, accounting, and other phases of financial management, and is best avoided in the interest of efficient and economical financial administration.”

Fraud Risk Analysis (05-3)

Based on our review of NDUS policies and procedures, little has been documented describing appropriate fraud risk containment, detection, or deterrence. The Board Office has no policies or procedures directly addressing fraud and only one of the colleges and universities has any policies addressing misuse of state assets. Last year the Board Office responded that SBHE

policies 305.1 and 802.6 address the issue of fraud, however upon review, both of these policies maintain that the President of each institution is accountable for all funds, property, equipment, and other facilities assigned or provided to the institution. Further, with the implementation of the PeopleSoft computer system, there will be opportunities to commit fraud, which may go undetected for years due primarily to improper security or lack of proper internal controls.

SAS 99 clearly points out that it is management's responsibility to create, implement, and enforce proper internal controls to detect, deter and prevent fraud.

Recommendation:

We recommend that a wholesale review of procedures, practices, and policies be established to provide a minimum level of assurance that NDUS personnel are required to review and report any potential or actual fraud. In addition, we recommend that a specialist or internal auditor position be considered by the Board Office to detect, implement, and enforce anti-fraud policies and procedures.

University System Response:

Agree. A new SBHE policy with respect to fraud detection and deterrence is in the draft stages and was recently recommended for approval by the Administrative Affairs Council. This policy, if adopted by the board, would require each institution to develop and implement controls, provide a reporting process, designate an officer to receive reports, develop a process for investigation and provide recommendations for additional controls to prevent recurrence. Additionally, the Budget and Finance Committee will be considering recommendations from the system office related to fraud based on guidance from NACUBO.

HRMS Policies and Procedures (05-4)

We found that guidance is not available to institutions regarding internal controls for the payroll process in the form of policies and procedures.

Policies and procedures are necessary to minimize errors and increase operating efficiency.

Recommendation:

We recommend the NDUS develop a comprehensive payroll manual that outlines the policies and procedures to be used by all institutions. At a minimum, the manual should address proper internal controls and compliance with state law and institutional policy.

University System Response:

Agree. The NDUS agrees that guidelines are lacking for the payroll process. It is the intent of the Controller's Group and the Human Resource Council to work together to identify processes and procedures and develop a user guide to be used by the payroll department on all campuses.

Federal Single Audit - 2004

Contact Gordy Smith 328-4990 gsmith@nd.gov

Temporary Assistance for Need Families (04-6)

The Department of Human Services (DHS) is not properly determining unemployment in Indian country, nor are they properly determining whether or not TANF recipients live in Indian country to properly determine if a month should count towards the sixty month limit on TANF assistance.

The OMB Circular A-133 Compliance Supplement states that any family who has received TANF funds for sixty months (whether or not consecutive) is ineligible for additional federally funded TANF assistance, unless extended on the basis of hardship.

In determining the number of months for which the household has received assistance, the State must not count any months during which the family received the assistance while living in Indian country with a 50 percent unemployment rate.

The federal definition of Indian country, as provided by section 1151 of Title 18, United States Code, includes all land within the external limits of any Indian reservation, all dependent Indian communities, and all Indian allotments which have not been extinguished.

DHS's definition of Indian country is any county that includes Indian reservation lands and a significant Indian population. For example, Indian country for the Turtle Mountain Reservation according to the DHS definition, is all of Rolette County. Individuals living in the town of Dunseith (which is in Rolette County, but not on the reservation or allotment land) would not have their TANF payments limited to sixty months since DHS considers all of Rolette County to be exempt based on unemployment data, however, Dunseith is not "Indian country" as described in the federal definition.

The unemployment data received from Job Service North Dakota to determine if the 50 percent unemployment level is met is calculated incorrectly. Job Service is considering only the Native American population of the entire county when determining the unemployment rate (NDCC § 50-09-29(1)(o)).

However, for the TANF limit, the 50 percent unemployment level is to be determined based on all individuals living in Indian country, regardless of race and the information is to be gathered only on land meeting the federal definition of Indian country. In Rolette County, this should be only reservation and allotment lands. While the example given is Rolette County, the unemployment data methodology and the designation of residence is out of compliance with federal rules on the four reservations in the state. In addition, DHS can give no assurance that months of assistance have been properly counted for TANF families potentially living on lands in Sargent or Richland Counties that are part of the Lake Traverse Indian Reservation that is primarily in South Dakota.

Recommendation:

We recommend the Department of Human Services develop procedures which will enable them to correctly comply with the federal guidelines when enforcing the sixty month limit on TANF assistance. This will include working with Job Service North Dakota when determining the unemployment rates on Indian country and developing procedures to determine which

individuals are residing in Indian country within any areas where the unemployment rate for the Indian country is determined to be over 50 percent.

Corrective Action Plan:

The Department agrees with the recommendation. We will continue to work with ACF to develop a method of determining unemployment and residence in order to comply with federal guidelines when enforcing the sixty month limit on TANF assistance.

All DHS Grants With Data Processing Charges (04-12)

Data processing charges for the Department of Human Services (DHS) are not being allocated properly. DHS uses an Excel spreadsheet to allocate data processing charges to the various grants and programs controlled by the department.

Testing of the controls surrounding the allocation process revealed weaknesses. These weaknesses relate to the DHS's process of assigning their employees to the proper grants and indirect grants. Currently the department relies on departmental supervisors of DHS to notify the Division of Information Technology (DoIT) of all personnel changes including hiring, firing, and transfers. Once notified of the personnel change, DoIT updates the system. If DoIT is not notified of the personnel changes, the allocation process will be incorrect as employees are being charged to the grants and indirect grants based on old information, which is currently the case at DHS. During our audit procedures we reviewed sixteen out of approximately 2,300 DHS employees and found that of the sixteen employees tested, only five were properly assigned. Two no longer worked for the department, seven were assigned to the wrong grant or indirect grant, and two individuals should not have been assigned to any grant as they do not do any data processing.

OMB Circular A-87 states that for costs to be allowable, they must be allocable to the federal program. Since DHS is not properly allocating these costs, they may be unallowable.

Data processing charges allocated based on the method described above for the one month tested totaled approximately \$456,000. Due to the large number of employees working for DHS and the many different ways that data processing charges for each employee may be set up (some may be charged directly to a federal grant, some completely to state funds, and some to both a direct grant and indirect cost pool) we were unable to determine the questioned cost.

Recommendation:

We recommend the Department of Human Services develop internal controls that will ensure current and future employees are being assigned to the proper direct and indirect grants in the allocation of data processing charges.

Corrective Action Plan:

The Department agrees and will implement the above recommendation.

US Department of Defense Dopaminergic Transmission Systems (04-22)

UND drew down federal funds prior to incurring the expenses in direct violation of federal regulations. UND requested a contract advance of \$1,779,000 on contract number DATMO5-02-C-1252, apparently due to pressure exerted by the federal awarding agency's officer. Per UND, the Department of Defense (DOD) would not award the remainder of the contract until UND sent DOD a bill for the equipment it had purchased. UND informed him that that no equipment had yet been purchased, but that it had encumbered \$1,779,000, and it would be another 8 months before the actual expenditure would be made, and it would be against federal regulations if UND billed prior to the actual expenditures. UND was told that the DOD didn't care about UND's internal procedures and wanted a bill from them or the remaining award could be in jeopardy. This situation was then discussed with the rest of the UND Grants office and it was determined they had no other choice but to submit a billing based on the encumbrance rather than an actual expenditure, so UND submitted the Statement of Equipment Encumbrance in violation of federal regulations. There was no provision in the contract for the advancement of funds prior to expenses. Based on discussions with DOD, UND submitted what it called a Statement of Equipment Encumbrance to the DOD, and when the funds were received UND recorded them in funds 4201 & 7496 (both funds titled Dopaminergic Transmission Systems) as deferred revenue and/or prepaid expense.

Per the terms of the contract (Section G.1, Contract Payments), all requests for payments shall be submitted in accordance with Federal Acquisition Regulation System (FARS) clause 52.232-25, Prompt Payment. All requests for payment are also to be submitted on a SF 1034 (which UND did, but didn't have actual expenditures, only encumbrances). Also, 52.232-25 (a) (3) under Contractor's invoice states "The contractor shall prepare and submit invoices to the designated billing office specified in the contract. A proper invoice must include the items listed in paragraphs 9(a) (3) (i) through (a) (3) (x) of this clause". Item (a) (3) (iv) states "Description, quantity, unit of measure, unit price, and extended price of supplies delivered or services performed. As UND neither purchased any supplies nor furnished any services it would appear the invoice was not proper.

On the other hand, FARS 52.232-25(a) (3) goes on to say "If the invoice does not comply with these requirements, the designated billing office will return it within 7 days after receipt ...with the reasons why it is not a proper invoice." Instead of returning it as required, DOD incorrectly paid UND based on a Statement of Equipment Encumbrance. This transaction was authorized by DOD.

Recommendation:

We recommend that UND:

1. Draw-down federal monies on contracts only after the applicable expenses have been made (unless a clause in the contract allows otherwise); and
2. If faced with a similar situation in the future:
 - a. Contact their Federal Cognizant agency for advice;
 - b. Report to officials one level above the person pressuring it in the applicable federal agency; and
 - c. Seek legal advice from general counsel.

Corrective Action Plan:

Per the Manager, Grants and Contracts Administration:

1. We concur with drawing down federal monies only after the expenses have been incurred. This is an exceptional circumstance, where we either had to request the funds or face losing the funding to complete the project. The cover letter, Standard Form 1034 and the detailed invoice all made it clear that the funds were only encumbered and not expended. The excess funds were deposited and earned interest for the award until they were expended.
2. In the future we will seek advice from general counsel. While contacting the Cognizant agency or the Head of the Department would seem reasonable, the downside is the responses are not usually in a timely enough manner to salvage the project.

Operational Audits

108 – Office of Secretary of State

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Business Registration Packet Improvements (04-1)

Overview:

In 1993-1994, the Secretary of State's office coordinated the development of a consolidated packet of information, containing new business registration forms, which commonly came to be known as the "Green Book." This cooperative effort of 13 state agencies was intended to assist individuals in obtaining the information they needed to plan and establish a business. The "Green Book" continues today and it includes, but is not limited to, business planning, licensing, registrations, tax, and other state requirements. The packet primarily contains contact information on how to obtain the forms and licenses. Although there is a version on the Internet, the primary focus of the "Green Book" has been as a printed manual to provide information and instruction. It has not been an online process and as such is mostly intended to inform the reader where to find the additional information needed for the type of business they wish to start. During our audit of the Secretary of State we noted that the state of Utah and Washington, DC were recently recognized by Governing magazine for best practices in the use of technology to improve the efficiency and effectiveness of the business startup process. We reviewed the online version of the "Green Book," as found on the Secretary of State's website, and conducted a comparative analysis of that packet to those best practices websites noted above.

Observations:

From our review of the online "Green Book" we made several observations. Of the 13 state agencies, 11 have listed forms required from their respective agency for new business startups, with 5 having the actual forms included on the website while 3 included request forms to obtain the required form and another 3 agencies only included contact information to acquire those forms. Furthermore, only 2 of the 5 agencies linked the actual form so that it could be completed online. We observed that while all of the state agencies had hyperlinks to their own website from the contact us page, only 3 of the agencies had web addresses along with additional instructions directing the user to their forms page and none of the other web addresses provided throughout the packet were hyperlinked.

In our review of the websites from Utah and Washington, DC we recognized several features that made their websites notable. Utah provides a checklist for the user to ensure all necessary forms are completed for the type of business the individual is planning to start. An interactive screen with a series of yes/no questions is used to determine specifically which forms are required to be completed based on the new business type. While the type of startup business will affect the required forms to be completed, there are a certain number of forms that most all businesses would need to complete in order to do business within a state and these include registering the business name, obtaining a federal employer identification number, obtaining an employee income tax withholding number, obtaining an unemployment insurance employer identification number, securing a sales and use tax license, and applying for business or professional licenses. Washington, DC uses this same type of checklist format in an estimated fee calculator to total up the applicable fees that would pertain to the particular business startup.

This site also has a drop-down menu of prospective businesses that when selected will bring up a fact sheet indicating legal authority (state law references), license duration, fees, applicable requirements, website links, and/or contact information and availability of online licensure. This is a tremendous resource for the individual in knowing exactly what will be expected of them for each type of business startup.

Solution:

It would create a favorable business-friendly impression of North Dakota if it had a comparable one-stop online business registration process that provided online preparation, filing, and payment for all necessary applicable forms required to be filed. Along with that, a searchable database would allow individuals to indicate the particular type of startup business being planned and then obtain a complete listing of forms, licenses, fees, and any other necessary information related to starting that type of business. While it might take a fair amount of time, resources, and coordination among the various affected agencies to complete such a process it would certainly be worth exploring because of its potential significance to economic development.

Based on our review of the online version of the "Green Book" and our comparative analysis with the Utah and Washington, DC's websites for best practices, we have noted several areas where improvements could be made to facilitate the process of starting up a new business. The following improvements would make the process more efficient and much easier for the individual attempting to start up a new business. All web addresses should be hyperlinked so that direct access can be obtained for downloading applicable forms to be completed. For those forms that are provided, they should be available as an Adobe Acrobat file that can be completed online. Additionally, basic checklists for the different business types, and the basic forms required and respective fees for all affected agencies should be provided. This checklist could be created based on the answers to an online survey identifying the particular type of new business start-up.

Agency Response:

As the auditor's overview indicates, the New Business Registration website at www.state.nd.us/businessreg/ (referenced in the overview as the online version of the Green Book) is a cooperative effort of 13 state agencies. The only function of the Secretary of State's office, as one of the participating agencies, is to serve as the facilitating agency for the Green Book coordinating committee for both the printed and online versions.

In order to implement the proposed one-stop online solution, it will require an enterprise level of funding and coordination for North Dakota to have a website featuring comparable services as those available on the Utah and the District of Columbia websites. Therefore, the respective cooperating North Dakota agencies are currently limited to making improvements to the New Business Registration website, which can be accomplished within their specific agency capabilities and available funding resources.

On that basis, the coordinating committee met in July 2005 and considered the various recommendations in the audit's solutions section that could be made now. With funding support from the Secretary of State's office, numerous enhancements to the New Business Registration website are now being made as they relate to hyperlinks, consistency, formatting, elimination of duplication, descriptions, guides, and information.

In addition, ITD has been asked for cost estimates regarding two proposals. One proposal is regarding additional enhancements that could be made during the biennium. Each individual cooperating agency will determine if funding resources are available within their respective agency 2005/2007 budgets to support these enhancements. The second proposal is long-term in focus and is related to an enterprise-wide enhancement project for consideration and support by SITAC, the governor, and the legislature.

110 – Office of Management and Budget

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

1099 Reporting Improvements (05-1)

Challenge:

The Internal Revenue Service (IRS) requires the filing of Form 1099-MISC for rents or royalty payments, prizes and awards that are not for services, and payments for services performed for a trade of business by people not treated as its employees of \$600 or more (except for royalties of which is \$10 or more). Form 1099-A is to be filed for all amounts for the acquisition or abandonment of secured property. Form 1099-S is to be filed for amounts of \$600 or more for proceeds from real estate transactions. The due date for the forms to the recipient is January 31 of each year. The due date to the IRS is February 28 (or March 31 if you file electronically). The Office of Management and Budget's Vendor Registration Office (VRO) prepares Form 1099-MISC and files Form 1099-MISC with the IRS electronically. North Dakota state agencies prepare Form 1099-S and other Form 1099's, if applicable. North Dakota state agencies file their 1099 Forms with the IRS by the paper method. The review of the preparation of Form 1099 indicated the process was not effective and efficient and that Form 1099-MISC was incorrectly stated in some cases.

Noted Concerns:

The review of the Office of Management and Budget's 1099 reporting practices indicated several inefficiencies that caused the state agencies and vendors some confusion as well as incorrect amounts being prepared for Form 1099-MISC. Some of the information gathered during our review was as follows:

- Vendors were confused as to why they were receiving the vendor application several months after they had received payment from the state.
- State agency employees entering voucher data into PeopleSoft are not always knowledgeable as to what types of payments are reportable vs. non-reportable.
- State agencies received reports with a years worth of transactions to review for withholding. This was very time consuming for some state agencies.
- A number of vendors are receiving more than one Form 1099-MISC caused by duplicate vendors in the PeopleSoft vendor registry system.
- State agencies using vendor records are having some difficulty in finding vendors in the vendor registry system due to duplicate numbers and names.
- A name change by vendors has caused concern with the consolidation of the name on the PeopleSoft system. When the name change occurred, all prior payments in PeopleSoft Accounts Payable changed to the new name with no history. This made locating historical data difficult, if not impossible.
- There is not adequate online guidance for easy review.

Operational Improvement:

We recommend that the Office of Management and Budget enhance the current Form 1099 reporting procedures for ConnectND and other areas to include a more definitive set of accounting procedures that will allow the Office of Management and Budget and North Dakota state agencies to more effectively and efficiently process Form 1099's for North Dakota vendors and the Internal Revenue Service.

Office of Management and Budget Response:

The Office of Management and Budget has conducted state agency training in the management of 1099 payments to develop consistency in reporting and has established definite procedures to more effectively and efficiently process 1099 forms.

112 – Information Technology Department

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Computer Access Controls Weakness (04-1)

During our review of the Customer Information System access controls, we noted the following:

- Employees approving transactions also have access to add, delete, and update records.
- Employees have access to the system, but do not have any job duties related to the system.
- Employees taking annual inventories also have access to computerized records.

During our review of the PeopleSoft payroll access controls, we noted that the Information Technology Department has nine employees who have been given Superuser ID's. These Superuser ID's allow complete and unrestricted access to all aspects of the PeopleSoft payroll system.

Proper internal control dictates that access to data should be limited to those who need access to the data to perform their duties. Employees who approve transactions should not have access to process transactions and only a limited number of individuals should be permitted to have Superuser ID's. Without proper access controls, personnel have the opportunity to bypass many important controls, especially segregation of duties. Therefore, there is an increased risk of unauthorized transactions and also a greater chance of corruption of data.

Recommendation:

We recommend the Information Technology Department restrict access to the Customer Information System or begin using the PeopleSoft fixed asset module to ensure that personnel have access only to the information necessary to perform their job duties and keep the approval function separated from the processing function; and Reduce the number of individuals who have Superuser ID's and ensure that anyone who does have a Superuser ID does not have the ability to input data into the system.

Information Technology Department's Response:

ITD agrees with the recommendation and will comply. We agree that some of the permissions granted are incompatible with some employee's job functions. To mitigate this risk we reconcile fixed assets on a monthly and yearly basis. The security for the Customer Information System was not re-written since we are converting our fixed assets to PeopleSoft.

ITD agrees with the recommendation and will comply. ITD has limited SuperUser access to those staff members who are responsible for supporting the PeopleSoft system.

120 – Office of the State Treasurer

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Controller Job Classification (05-1)

The Office of State Treasurer has a controller position which is responsible for various professional accounting duties. Based on these duties and the function of the State Treasurer's Office, it is imperative that the office have a controller that, at a minimum, has an accounting degree. The classifications that most closely fit the duties of the controller are either an Accounting Manager or an Accounting/Budget Specialist II or III.

Prior to February 2002, the controller position was classified as an Accounting Manager I. The duties of that classification are consistent with the duties of the current controller. The minimum qualifications for an Accounting Manager I require a bachelor's degree with a major in accounting and four years of professional accounting experience. The controller position up until that time was filled by an individual with a degree in accounting. That individual left the employ of the Office of State Treasurer in February 2002. Although the duties of the position were not reduced, the Office of State Treasurer reclassified the controller position to an Administrative Staff Officer III at that time. The duties of that classification relate mostly to administrative support, and are not consistent with the duties performed by the controller. The minimum qualifications for an Administrative Staff Officer III require ten years of work experience in high-level administrative support duties.

Recommendation:

We recommend the Office of State Treasurer reclassify the controller position to an Accounting Manager or Accounting/Budget Specialist II or III classification.

Office of State Treasurer Response:

We agree that it is important to have strong accounting personnel in the Office of State Treasurer. The new administration has filled the Deputy position with a Certified Public Accountant. This issue will be addressed further when adequate resources are made available to add a full time employee with a minimum classification of an accountant/budget specialist III which will enable us to address the issue permanently.

Bank Reconciliations (05-2)

Since the implementation of the PeopleSoft accounting system, the Office of State Treasurer has been unable to reconcile the cash balance on PeopleSoft to the cash balance at the Bank of North Dakota. Prior to that time cash was reconciled on a daily basis.

Proper internal controls require a cash reconciliation of the bank balance to the book balance. Without this reconciliation, errors and irregularities would go undetected.

Recommendation:

We recommend the Office of State Treasurer work with the Office of Management and Budget to reconcile the state's cash balance on Peoplesoft to the Bank of North Dakota.

Office of State Treasurer Response:

The conversion to PeopleSoft was and continues to be a challenge for the Office of State Treasurer. Our agency has worked diligently with the Office of Management and Budget to obtain the necessary information needed to complete a daily cash reconciliation. Since June 30, 2006, cash has been reconciled on a daily basis.

Coal Severance Tax Distribution (05-5)

The monthly distributions of coal severance taxes were made incorrectly. There were three different types of errors that resulted in the improper distribution amounts.

The first type of error is the result of the Office of State Treasurer using incorrect average daily enrollment figures for fiscal years 2004 and 2005. Section 57-62-02 of the North Dakota Century Code (NDCC) requires that a portion of the coal severance tax distribution be made to school districts based on average daily enrollment.

The second type of error is the result of the Office of State Treasurer using incorrect land assessment values. NDCC section 57-62-02 requires that a portion of the coal severance tax distribution be made to counties based on land assessment values. Certifications of land assessment values are provided by the county director of tax equalization. The Office of State Treasurer did not use the current certifications when making the distributions for the first month in both fiscal year 2004 and 2005.

The third type of error resulted from the Office of State Treasurer not properly distributing amounts between coal producing and non-coal producing counties when any portion of the latter county lies within fifteen miles of the tipple (the initial place where the coal is unloaded after being severed from the mine). NDCC section 57-62-02 limits payments to those non-coal producing counties by stating that production revenue exceeding \$3.4 million in a calendar year is to be allocated entirely to the coal producing county. Distributions were made in February 2005, January 2006, and February 2006 to non-coal producing counties even though the production limitation had been met.

We reviewed the March 2004 – March 2006 coal severance tax distributions and due to the three types of errors mentioned above, noted that incorrect amounts were distributed to both school districts and counties. Twenty-one school districts received incorrect amounts, ranging from an underpayment of \$34,467 to an overpayment of \$31,966. Morton and Oliver counties were the only counties that received incorrect distribution amounts. In these distributions, Morton County received more than it should have and Oliver County received less than it should have by approximately \$28,000.

Recommendation:

We recommend the Office of State Treasurer:

- Use current average daily enrollment numbers, current land assessment values, and apply the proper production limitation for counties and schools subject to tipple when calculating the coal severance tax distributions in accordance with NDCC section 57-62-02; and
- Correct the erroneous payments made as required by NDCC section 54-11-01 subsection 18.

Office of State Treasurer Response:

We have developed new processes for collecting the average daily enrollment numbers and have worked directly with the Superintendents of Schools to ensure proper information is being submitted. An additional emphasis has been placed on collecting, inputting and calculating the information needed to complete these distributions. We are in the process of making the necessary adjustments.

Oil and Gas Production Tax Distribution (05-6)

The monthly distributions of oil and gas production taxes were made incorrectly. There were two different types of errors that resulted in the improper distribution amounts.

The first type of error resulted from the Office of State Treasurer not calculating the per capita limitation on an annual basis. Subsection 3 of section 57-51-15 of the North Dakota Century Code (NDCC) limits the amount of oil and gas production tax distributed to cities to five hundred dollars per capita. However, in determining the population for any city in which total employment increases by more than 200% seasonally due to tourism, a special calculation is necessary. The only city in North Dakota affected by this special calculation is Medora. The calculation of the population starts with the last official federal decennial census and adds numbers based on seasonal employees and visitors. The last time the Office of State Treasurer updated the population number used in determining the per capita limitation was 1998. The number should be calculated annually based on the employment and visitor information for the prior year.

During the current audit we tested fiscal years 2005 and 2006. Fiscal year 2004 was tested during the previous audit. As a result of the error noted above the city of Medora was overpaid \$21,250 and Billings County was underpaid by that amount for the two fiscal years tested.

The second type of error was due to the distribution system not readily accommodating the dissolution of a city. NDCC 57-51-15 states, "Twenty percent of all revenues allocated to any county must be paid no less than quarterly by the Office of State Treasurer to the incorporated

cities of the county based upon the population of each incorporated city according to the last official federal decennial census.” The cities of Larson in Burke County and Rawson in McKenzie County dissolved prior to July 2003 and were therefore removed from the distribution system by the Office of State Treasurer. Although the program distributed the total dollar amount it began to distribute incorrect amounts to the incorporated cities in Burke and Mckenzie counties. This error occurred from July 2003 through March of 2006 when the audit identified the programming error.

This error affected nine cities with errors ranging from an overpayment of \$2,202 to an underpayment of \$1,881.

Recommendation:

We recommend that the Office of State Treasurer:

- Compute Medora’s population on an annual basis for purposes of determining the per capita limitation;
- Work with Billings County and the city of Medora to correct the distribution errors made;
- Ensure that programming changes made to the distribution system are made properly; and
- Correct the erroneous payments made as required by NDCC section 54-11-01, subsection 18.

Office of State Treasurer Response:

We have been working with the City of Medora to ensure the proper population and employment statistics are gathered and submitted to the Office of State Treasurer in order to establish the proper per capital limitation. The Oil & Gas Production system has been updated to spread the total amount available to the remaining cities within the effected county when a city dissolves. We are in the process of making the necessary adjustments.

Proper Deposit of Funds (05-7)

The Office of State Treasurer is responsible for the deposit of funds into the Indigent Civil Legal Services Fund according to North Dakota Century Code (NDCC) 27-05.2-03 and the Indigent Defense Administration Fund and Court Facilities Improvement and Maintenance Fund in accordance with NDCC 29-26-22.

NDCC 27-05.2-03 states, “Any fees collected for deposit into the Indigent Civil Legal Services Fund which exceed \$400,000 in any biennium must be deposited by the Office of State Treasurer into the general fund.” For the audited biennium the Office of State Treasurer deposited \$422,023 into the fund, of which \$22,023 should have been deposited into the general fund and was not.

NDCC 29-26-22 states, “In all criminal cases except infractions, the court administration fee must include \$100. Of the additional \$100 court administration fee, the first \$750,000 collected per biennium must be deposited into the Indigent Defense Administration Fund and the next \$460,000 must be deposited into the Court Facilities Improvement and Maintenance Fund. After the thresholds have been collected, one-half of the additional court administration fee must be deposited in each fund.” For the audited biennium all the fees collected in fiscal year 2004

were deposited into the Indigent Defense Administration Fund and all the fees collected in fiscal year 2005 were deposited into the Court Facilities Improvement and Maintenance Fund; however at the end of both fiscal years the Office of State Treasurer made adjustments to the funds to correct the over-payments made. As the first \$750,000 are to be deposited into the Indigent Defense Administration Fund and next \$460,000 are to be deposited into the Court Facilities Improvement and Maintenance Fund, the Office of State Treasurer was not in compliance with NDCC 29-26-22.

Proper internal controls require that fees be credited to the proper fund when they are received. Without these controls, fees could be kept in the incorrect funds and the agency would not be in compliance with NDCC.

Recommendation:

- We recommend that the Office of State Treasurer:
- Implement controls to ensure that fees are deposited into the correct funds when initially received;
- Deposit only \$400,000 into the Indigent Civil Legal Services Fund per biennium in accordance with NDCC 27-05.2-03; and
- Deposit the first \$750,000 into the Indigent Defense Administration Fund and the next \$460,000 into the Court Facilities Improvement and Maintenance Fund in accordance with NDCC 29-26-22.

Office of State Treasurer Response:

The Office of State Treasurer has implemented procedures to monitor the applicable caps and make the appropriate transfers in a timely manner.

125 – Attorney General

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Implementation of Medicaid Fraud Control Unit (04-1)

Issue:

The first Medicaid Fraud Control Unit (MFCU) in the United States was established in 1977. Since that time, 48 states (plus the District of Columbia) have established MFCU's, which are independent divisions separate from the agency running the state's Medicaid program. In most states the MFCU is located in the Attorney General's office since they are responsible for prosecuting Medicaid fraud and patient abuse and neglect cases. North Dakota and Idaho are the only states without an MFCU. To encourage states to establish MFCU's, the federal government will provide 90% of the required funding for the first three years of the MFCU's existence and 75% thereafter. MFCU's require a minimum of 3 full-time employees that are 100% dedicated to the MFCU. These employees include an attorney, auditor, and senior investigator. Clerical and accounting duties would also need to be assumed by personnel within the Office of the Attorney General.

Per review of the United States Office of Inspector General's annual report on MFCU's for fiscal year 2003, a total of 1,507 people are employed by states in MFCU's. Federal funds provided

were \$120 million with total recoveries in excess of \$268 million. Recoveries are allocated between the state and the federal government at the state's Federal Medical Assistance Percentage (FMAP). It should be noted that North Dakota's FMAP rate has dropped from 70.42% in federal fiscal year 2000 to 65.85% for federal fiscal year 2006. This change will result in North Dakota paying a greater share of Medicaid payments, but will also result in a higher percentage of any recovery monies staying in North Dakota. Each state is required to have a Surveillance and Utilization Review Subsystem (SURS). In North Dakota, this is currently set up within the Department of Human Services (DHS). One of the purposes of the SURS division is to identify the providers most likely to commit fraud against the Medicaid program. Nationally, the SURS notifies the MFCU's of potential fraud cases for review. It has been noted from past DHS audits of the Medicaid program that the SURS doesn't have sufficient staff to either investigate or discover all potential fraud cases. The MFCU's can also get case information from referrals, toll free number hotlines, nursing home facilities, and whistleblowers.

Benefits:

While the implementation of a new MFCU unit would not directly improve the operations of the Office of Attorney General, it is possible the state may recoup recovery monies in excess of the general fund cost associated with the MFCU. Additional savings would result from the prevention of potential fraud cases once providers become aware of additional steps the state is taking to find and prosecute fraudulent providers. The MFCU would also be responsible for investigating and prosecuting cases of patient abuse – typically at nursing homes.

Per discussion with the MFCU Director in South Dakota, they had total recoveries of \$851,000 in federal fiscal year 2004 and have already surpassed \$1,000,000 in total recoveries for federal fiscal year 2005. South Dakota has a staff of 5 individuals. Montana had total recoveries of \$1,270,834 in federal fiscal year 2003 with a staff of 8.

Conclusion:

Based on the above background information, we recommend the Office of Attorney General consider implementing the MFCU division in North Dakota. This process would include asking the Legislature for additional FTE's for the division as well as additional general fund monies for the matching portion of the federal grant monies they would receive.

Office of Attorney General Response:

The office will implement the Medicaid Fraud Control Unit assuming the Legislative Assembly supports the recommendation and provides adequate funding and human resources for the unit.

Sex Offender System (04-2)

Overview:

The first sex offender registration statute in North Dakota was passed in the 1991 legislative session. In 2001 the sex offender website was created to primarily give parents access to useful information about convicted sex offenders who may be living in their neighborhoods, so they can better protect their children. It also serves as an important notification tool for the general public.

North Dakota has some of the strictest sexual offender laws in the country. The North Dakota Century Code (NDCC) allows “sexually dangerous individuals” (NDCC chapter 25-03.3) to be civilly committed and certain juvenile sexual offenders to be included in the registry of sexual offenders {NDCC chapter 12.1-32(13)}. North Dakota also provides information on all sexual offenders to the general public upon request {NDCC section 12.1-32-15 (13)}, while some states limit public access.

There is a heightened sense of concern over sexual offenders due to recent incidents that have been portrayed in the media both around the country and in North Dakota. It is for this reason that we decided to do a review of the Office of Attorney General’s (OAG) sex offender website and the ability to search for sex offenders living within a particular geographical area. Also part of our investigation was a review of which sexual offenders are listed on the website, the assessment and registration requirements relating to sexual offenders, and the notification and tracking procedures for those sexual offenders.

Website Search Issues:

Information on the lifetime and high-risk sexual offenders (currently 212 individuals) is available on the Internet {as allowed by NDCC section 12.1-32-15 (13)} at <http://www.ndsexoffender.com/>. This website contains a searchable database containing the current address, offense information, and a picture for each of these individuals. Information on the approximately 900 required registrants not included on the website is available in paper form (or e-mail) upon request from the OAG. The list can be received for the entire state or limited based on regional requests. We reviewed the Office of Attorney General sex offender website and noted several observations as well as areas of improvement that would enable the user to more readily find information on the location of registered sex offenders.

For example, if you search by the city of Bismarck, you would get a list of 81 offenders. You would then have to access the detailed information for each of the 81 offenders to check their street addresses. Pictures are currently available by accessing each offender’s detailed information. The offenders’ pictures are updated on the website only when there is a change of address. As a result, some pictures on the website are over 10 years old and have lost some of their effectiveness. Of the 212 offenders listed on the website, approximately 100 currently reside in the State Penitentiary, State Hospital, or an out-of-state institution. The OAG feels inclusion of these individuals provides a service and wishes to continue including them on the website. The website only contains information for lifetime and high-risk sexual registrants while information on moderate or low-risk sexual offenders must be requested from the OAG.

Based on these observations, we are making the following operational improvement recommendations:

- The search function would be improved if the offenders’ addresses were initially displayed on the results page after a search is completed so that each entry doesn’t have to be accessed in order to determine where the offender lives.
- Adding pictures to the initial results of a search may be helpful. Many states also include small pictures on the search page that allows you to scan up to twenty individuals. Accessing drivers’ license photos could be a possible solution to outdated pictures on the website.

- Additional search criteria used by other states could be included to enable people to input an address and list offenders based on proximity to location. Some states have incorporated a mapping function into the search feature which maps the sexual offender's location by residence or employment.
- The search function should be able to differentiate between incarcerated individuals and those out in public.
- It should be more apparent from the website, that the public can request information on the moderate and low-risk sexual offenders. This information should be listed on the opening page of the website, without scrolling or going to the Frequently Asked Questions (FAQ) link. The OAG should consider allowing the public to electronically request and receive the list of offenders not included on the Internet.

Office of Attorney General Response:

The redesign of the sex offender web site is a major project. Compounding the problem is the effort to create a sex offender search function at the national level. The Federal government decided to create a sex offender search capability nationwide utilizing web services and static web pages to share data. This system left many states, including North Dakota, unable to participate in the program. The Department of Justice (DOJ) provided an interim solution for web services to accommodate states that could not communicate via web services. DOJ has not come up with an interim solution for states that do not use static web pages. They are currently doing research in this area, and we are awaiting their response.

In addition to waiting for more information from DOJ, the Attorney General has requested several changes to the search function which correspond to several of the ideas discussed in this audit. Our information technology staff has also identified programming areas in need of change. To accommodate the approved changes, we will need to redesign the entire application. We anticipate this project will take at least nine months.

Mapping addresses will be addressed as a part of the redesign to determine the feasibility and method, if any, of mapping data. The database will need to contain the information in a format that will allow us to provide mapping either at the time of the redesign or sometime in the future. This will require time working with the state Geographic Information Systems (GIS) staff to define how best to achieve the results we desire. In the interim we have modified the present site by providing links to third-party mapping companies which use North Dakota data in a mapping search function. Since we do not have the resources to monitor the product offered by these parties, we cannot attest to the reliability of the mapping function performed.

During the redesign process we will consider incorporating other suggestions made by the Auditor's Office including adding addresses, pictures, and a mapping function of home addresses to initial search and results screen. A policy requiring offenders to have new photographs taken every two years is now final. These pictures will be included on the website.

We agree that separating the information regarding incarcerated offenders from those who are not incarcerated would be useful to the public and should be included in a redesign of the system. A redesign of the system could also provide for a more visible "contact us" link allowing easier access the low/moderate list which could be queried by city, county, state, or a combination thereof and forwarded as a PDF file via email.

Individuals Included on the Website:

The OAG is statutorily limited to including only the high-risk and lifetime registrants (which can be high, moderate, or low risk) on their website per NDCC 12.1-32-15(13). Our review indicated that several states list all adult registrants on their website, regardless of risk level. Several other states list all moderate and high-risk individuals on their website. The website www.parentsformeganslaw.com rated every state's sexual offender registration compliance procedures. North Dakota was one of five states to receive an "A" rating. By contrast, 22 states received an "F" rating. The results were based on the answers to 10 questions. The only question North Dakota did not get credit for was if they include all adult offenders on the Internet.

Of the individuals included in the sexual offender registration system, but not included on the website, 30 are high-risk (all currently residing out of ND), 215 are moderate-risk, and 464 are low-risk (for moderate and low, some reside outside of ND). In addition, there are 32 missing offenders which were assessed at low or moderate-risk but may be considered high-risk since they are missing. Although they are "lifetime" registrants, some of the individuals listed on the website are considered low-risk. This seems to contradict the purpose of the website to inform the public of the more dangerous individuals. Of the "lifetime" individuals currently listed on the website, 38 are classified as moderate-risk and 27 are classified as low-risk.

Per discussion with OAG personnel, the website receives approximately 132,000 hits per year. In contrast, the free list (paper form or e-mail) the public is able to obtain on all registered sexual offenders was requested only 145 times in 2004. This list is not as easily sorted as the website and may quickly become outdated. It appears most individuals are relying exclusively on the website for information on registered sexual offenders.

Based on these observations, we are making the following operational improvement recommendations:

We believe moderately rated sexual offenders should be included on the Internet. According to the OAG Risk Assessment Guidelines, individuals with a moderate rating have an approximate 45% likelihood of committing a subsequent sexual related offense. Therefore, we feel it is in the public interest to make information on these individuals as easy to obtain as possible.

The OAG should have the option to include low-risk rated offenders on the Internet if they feel it would be in the public's best interest, based on the type of offense committed. According to the OAG Risk Assessment Guidelines, individuals with a low rating have an approximate 16% likelihood of committing a subsequent sexual related offense.

The OAG should consider whether the 32 missing offenders, which were assessed low or moderate-risk, should now be considered high-risk and included on the website. The public may help in the apprehension of these individuals and it could discourage low and moderate-risk individuals from failing to register, if they know it will automatically move them to a high-risk category for the duration of their registration requirement.

Office of Attorney General Response:

Current statute provides that only high-risk offenders may be published on the web site. Including moderate and low-risk offenders simply for community notification would be a violation

of state law. The legislature has made this determination as a matter of policy, and any change would require an amendment to statute.

This office also disagrees with the suggestion that delinquent offenders automatically be designated as high-risk offenders. While failure to follow registration requirements is one factor used in making a risk assessment, there are other factors as well, including severity of the crime, and participation or lack of participation in treatment programs, among others. Good science and the assessment tools now being used do not support using just this one factor to trump all others. Nonetheless, we have added a "delinquent offenders" page to our website that at present includes high-risk offenders.

As this office is able to utilize emerging technology to re-write the sex offender database systems, delinquent offenders of all risk levels will be included on the "delinquent offenders" webpage. The presence of the offenders on this page would be due to their noncompliance with state law, and not because of their risk level. They would remain on the "delinquent offenders" page only as long as they remain at large and for a brief period to let the public know they have been apprehended. As mentioned in our initial discussions with the auditors, we are discussing the removal of low-risk, lifetime registrants from the web page and are currently in the process of compiling information for the Attorney General regarding low-risk, lifetime registrants.

Sexual Offender Assessment/Registration Requirements:

The OAG, with the assistance of the Department of Corrections and Rehabilitation and the juvenile courts, developed guidelines for the risk assessment of sexual offenders who are required to register {NDCC 12.1-32-15(12)}. Each sexual offender is assigned a risk level of low, moderate, or high based on the likelihood they will re-offend (not strictly on the type of crime they have committed).

The OAG should consider changing the procedures for assigning risk levels to offenders moving to North Dakota from other states. Currently, the other state as well as the offender moving to North Dakota will contact OAG and notify them of the impending move. Once the offender physically moves to North Dakota, the Risk Level Committee begins the process of assigning risk by completing a risk assessment report and gathering as much information as possible from the other state. Cooperation from the other states is sometimes limited and in certain instances, nonexistent until the individual commits a subsequent offense in North Dakota. The Risk Level Committee meets every other month and the individual is allowed an opportunity to appeal their rating, which would not be done until the next committee meeting. It could be possible for an individual to be residing in North Dakota for 6-8 months before the risk level is assigned and any public notifications are done.

The OAG is responsible for maintaining a registration of sexual offenders in North Dakota. NDCC section 12.1-32-15(8) requires sexual offenders to register for 10 years after the date of sentence or after release from incarceration, whichever is later; or for the life of the individual, if that individual: 1) is guilty of more than one sexual offense; 2) has committed certain sexual offenses; 3) has been civilly committed as sexually dangerous; or 4) is guilty of aggravated kidnapping involving a child who is not their own.

As noted above, NDCC strictly defines which individuals can be considered lifetime registrants. We noted one individual referred to the state's attorney for civil commitment that is not a lifetime registrant. This individual was re-incarcerated for a non-sexually based offense, so it is possible

for his 10-year registration requirement to lapse prior to his release from the State Penitentiary. This would result in his not having to register as a sexual offender under current law.

Based on these observations, we are making the following operational improvement recommendations:

All sexual offenders moving to North Dakota should be assessed a risk level based on their risk level in the state they were living in, until they are re-evaluated. The OAG should have the option to require certain offenders to be lifetime registrants. Time spent while incarcerated should not count towards the 10-year registration requirement.

Office of Attorney General Response:

We support tentatively assigning the risk level determined by the previous home state as long as the process is substantially similar to the Sex Offender Risk Assessment Committee's (SORAC) process, and the information is made readily available to the SORAC. The proposed national registry may eventually provide an avenue for our office to quickly retrieve this information.

State law dictates, and should continue to dictate what constitutes lifetime registration. Giving the executive branch the power to arbitrarily decide the length of registration raises constitutional concerns. However, in the event the responsibility to make this determination is moved to an agency, it would be best to leave this decision to the SORAC.

We would support a change in statute to require the registration period to include time outside of incarceration. Incarceration needs to be defined as time within the confines of a state prison, or city or county jail. Those offenders housed in half-way houses, quarter-houses, etc. are no longer incarcerated and should be included in the central registry as such, with this time going toward their registration requirement.

Notification/Tracking of Sexual Offenders:

The OAG is responsible for developing guidelines for public disclosure of offender registration information {NDCC section 12.1-32-15(13)}. The local law enforcement agencies are responsible for monitoring the movements of sexual offenders, notification to the public on sexual offender residences, and apprehension of sexual offenders who fail to register as required. The OAG is currently tracking approximately 1,450 registered offenders. Of these 1,450 individuals, approximately 360 are currently living outside of North Dakota. Sexual offenders are required to register with local law enforcement within 10 days of any address move. After this initial registration is done, OAG verifies the individual is still at the current address every 90 days for a lifetime registrant and every 6 months for all others, through notification from the post office. Once per year the OAG requires a written response from each offender, requiring them to verify address, employment, and schools being attended. As the address verification process is done without any actual physical contact between law enforcement and the sexual offender for individuals no longer on parole or probation, it could be possible for an individual to move without anyone's knowledge. The individual could keep receiving mail at their former address and law enforcement would never become aware that the individual's residence has changed.

If an individual is found to be delinquent in registering, the local law enforcement agency will investigate to determine if they can locate the individual. If unable to locate, a warrant is issued for their arrest. The penalty for failing to register is a minimum of 90 days in jail for the first offense (class A misdemeanor) and a maximum of 5 years in prison for the second offense (class C felony). Per discussion with OAG, 42 of the 1,450 offenders required to register are currently missing. Per review of the website, 10 of the 111 high-risk offenders not incarcerated are missing. Currently, searches for missing sexual offenders from other states are not conducted. Without this process, it would be relatively easy for an individual to move from another state, fail to register in North Dakota, and unless they become involved in some police matter, may never be found.

Public disclosure procedures on sexual offenders vary based on the local law enforcement agencies. For high-risk offenders, most law enforcement agencies will notify the community about the address of the offender through newspaper announcements as well as television announcements. This notification is made every time the sexual offender moves. For moderate and low-risk offenders, the notification procedures may vary from community to community. Law enforcement may use the same procedures noted above for high risk offenders, may go door to door to notify neighbors of the location of a sexual offender in the neighborhood, or they may notify only the individuals in the community against who the offender is likely to re-offend. This notification may be an ongoing notification or a one-time notification, which loses effectiveness over time.

While the local law enforcement agencies are primarily responsible for tracking missing sexual offenders, we noted some additional procedures that could be implemented to facilitate this process. These procedures would be most efficient if centralized and administered through the Bureau of Criminal Investigation of the OAG.

Based on these observations, we will make the following operational improvement recommendations:

- The OAG could cross-check missing sexual offenders against other state agency's databases such as Job Service, Child Support, Tax Department, and Game and Fish to determine if any of these agencies have location information on these missing sexual offenders. Likewise, this could also be done for missing offenders from neighboring states and Canada.
- Consider including the pictures of missing sexual offenders on the OAG main web page as "Most Wanted." It may also be beneficial to establish a reward system for information leading to the arrest of any of the missing offenders.
- Pictures of missing sexual offenders could be posted in all state newspapers by routing the information through the ND Newspaper Association.
- Consider proposing a legislative change to make the penalty for failing to register a felony rather than a misdemeanor for the first offense. This would aid in the extradition of offenders who fail to register and move to another state.
- For the highest risk sexual offenders a Global Positioning Satellite (GPS) system would be the most effective for tracking purposes. The GPS can be set up as an active or passive tracking system. The active system would allow the Department to know where an offender is at any given time in a geographical area. The passive system would download the information at night and the Department could determine where offenders have been during a certain time period. The system would allow probation officers to employ a computer to follow parolees 24 hours per day. This would enable the officers to find out whether their parolees are going

to work, meeting curfews, and staying away from forbidden areas. In addition, an exclusion zone or an inclusion zone could be programmed in the system to restrict where offenders could be without notification being sent to the local authorities. The system would permit quick checks and could help keep sex offenders away from schools, playgrounds, and previous victims. The technology is currently used in Oklahoma and Florida, with Tennessee officials recently launching a GPS pilot program for inmates.

Office of Attorney General Response:

We have incorporated a “delinquent” page on our website to provide the public with information regarding offenders who have not met the registration requirements. The site will allow concerned citizens to access a list of all delinquent offenders, including the offender’s photograph and last known address. We also have incorporated an email notification system as part of a new “sex offender information” link on the AG website. Citizens will be able to sign up to receive an e-mail notice when sex offenders move into or out of a specific city, county, or zip code, or even limit the notice to information about a specific offender. The e-mail notices are generated automatically and in “real time” as the information is updated on the sex offender database.

Presently and for many years, our office has followed up on leads and shared information with local law enforcement. We also already cooperate with officials from other states and Canada who are searching for missing offenders. Presently, local law enforcement is responsible for locating missing offenders, and the remaining recommendations made in this section should remain a local choice and under their control. We would support local agencies establishing a reward system and posting wanted information throughout their communities in addition to the state’s web page.

The DOCR is currently in the process of implementing a GPS system to track those offenders who are on parole/probation. The level of technology recommended in this audit may require additional funds. A change in statute would be necessary to define who is the “highest level offender” and therefore required to be tracked by GPS. In addition, a determination needs to be made regarding placing this responsibility with local law enforcement or within a state agency. Funds would be necessary to purchase the equipment and provide the required human resources to implement this level of tracking.

Licensing System Process Review (04-3)

Overview:

An overview was conducted of the Licensing Division of the Office of Attorney General (OAG). We reviewed the procedures for receipting, reviewing, and processing license applications and how that process flowed through the licensing system. The licensing system is used to record deposits and process all license applications. The system generates the licenses upon application completion. For purposes of this overview, we interviewed staff, inspected forms, and reviewed the information system which processes the applications for licenses.

Deposit Process:

All OAG divisions route their deposits to the Licensing Section except the Bureau of Criminal Investigation, which does their own deposits. The Lottery Division only sends initial applications to Licensing, as all renewals are received by electronic funds transfer (EFT).

The different types of revenues deposited include: gaming taxes, license fees, fines, court settlements, legal services, and miscellaneous revenues. Fees for licenses are hard-coded into the system but not for other types of deposits where the fee amount can vary. A list of deposits from the licensing system, is printed and reconciled to the checks. A summary of revenue types for entering into PeopleSoft is printed and entered into PeopleSoft. The Racing, Crime Lab, and Lottery Divisions get a separate printout of their own deposits while a report of all deposits goes to finance along with the State Treasurer's receipt.

Observations:

We noted that none of the license fees had changed recently and it is not known how recently the fees may have been reviewed. Of the 10 different fees reviewed, only 1 had been changed in the past 15 years; 6 in the past 20 years; and 3 haven't changed since 1967 (38 years). We also noted a lot of time is consumed entering the daily deposits into PeopleSoft.

Recommendations:

The license fees at the Office of Attorney General should be reviewed to determine how they compare to neighboring states. Also, the review should determine if the amounts charged cover the associated costs of issuing the licenses.

The licensing system should be set up so the deposit file can be uploaded directly into PeopleSoft. Until such time, a partially completed deposit could be saved as a template in the PeopleSoft general ledger so only the amount would need to be added each time a deposit is made. This would facilitate the data entry of the deposit decreasing the amount of time it takes and the chance of coding errors.

Office of Attorney General Response:

The office will research the fee charged for similar licenses collected by similar states. A PeopleSoft template will be set up to streamline deposit entry.

125R - Racing Commission

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Breeders Fund Payments (04-1)

Background:

Each year the Racing Commission determines the amount of monies to be disbursed from the Breeders Fund. The Racing Commission has recently set a policy of awarding 1/8 of the breeders fund balance each year. This policy was established to ensure funds will be available in future years for currently registered horses in the Breeder's Fund program. Generally, horses registered in the current year will not race or have offspring that will race for several years.

Awards from the Breeders Fund were \$283,000 for fiscal year 2003 and \$230,000 for fiscal year 2004. Awards are paid annually to all registered North Dakota bred horses that win, place, or show (take 1st, 2nd, or 3rd) in the races held either at Belcourt or Fargo. Breeders Fund monies are only paid for in-state race results and only in cases where the race purses are at least \$1,000. Monitoring this fund includes registering the horses (foal, mare, or sire), accumulating race results, and determining which horses are eligible to receive Breeder Fund disbursements.

The Breeders Fund is getting more complex and difficult to maintain since more owners have registered their horses due to the larger payouts. According to the Racing Commission, the manual process of registering horses can consume up to 12 weeks per year. However, it was determined to be cost prohibitive for the Attorney General's Office to develop a new IT system to run the Breeders Fund. The Racing Commission currently has approximately \$20,000 set aside for the purchase of a software package if one that will fit their needs can be found. Most states do not distribute their funds like North Dakota, and instead have used their breeders fund monies to supplement the purse amounts for in-state bred horse winners or have eliminated their Breeders Fund altogether.

Process:

In order to be eligible for Breeders Fund monies, a horse must be registered into the fund. The cost to register a foal or mare into the Breeder's fund is \$10; the cost to register a stallion is \$20. These registration fees are currently deposited into the state's general fund. The application is reviewed to determine if the mare is already in the fund by looking up the mare's owner on the computer. For every horse owner a separate Word® file table is created for all foals/mares/sires owned by that individual. If a foal is re-registered as a mare/sire then it will be included on both lists. Once the national certificate is received from the applicable organization (i.e.–National Foundation Quarter Horse Association) confirming the name of the horse, it is matched with the filed application. The file is not considered complete until this certification is received and the horse will not be paid if their file is incomplete.

Annual letters are sent to the horsemen to submit applications for Breeders Fund disbursements. The horse owners have until January 15 to request funds from the Breeders Fund. A separate Breeders Fund application form must be completed for each registered horse that placed 1st, 2nd, or 3rd in a North Dakota race. This application is primarily used to update addresses and to obtain the social security number for inclusion on the IRS 1099-MISC (Miscellaneous Income Form). All North Dakota bred horses receiving monies (approx. 540 in 2004) are checked against the Racing Commission records to verify the horse was eligible and properly registered. The race (win/place/show) results are separately compiled (on the North Dakota Breeders Fund Race Winners worksheet) and compared to the information submitted by the horse owner. These results are checked against the data compiled by Equibase Co. and TruForm Inc. to verify race results and that the purse amounts are greater than \$1,000. These hand-written worksheets are then typed up and forwarded to the Racing Commission's auditor to determine each horse's winnings. A point system allocates points for each foal's win, place, or show. The total amount of Breeders Fund monies available for distribution are then allocated to the foals based on their percentage of points to the total points awarded to North Dakota bred horses. The foal receives 60% of the monies, while the mare and sire of the winning foal receive 30% and 10%, respectively. If the mare or sire is not registered, their portion goes to the foal. A copy of the worksheet is sent with each check so that each horse owner can see how their foal's winnings were distributed.

Solution:

The following operational improvements would help considerably in streamlining the process of allocating monies from the Breeders Fund.

The fee (\$10) to get into the fund is too low and a higher amount (such as \$25) should be considered to offset the cost of maintaining the fund. This recommendation will only be effective if Senate Bill 2344, introduced in the 2005 Legislative Session, becomes law and allows the Racing Commission the ability to use license fees collected for operating purposes.

The Racing Commission should consider either outsourcing Breeders Fund distribution duties or develop/purchase a software program to streamline the process. Although the amount of dollars disbursed in 2004 decreased and may continue to decrease, the amount of time incurred to manage the fund has not decreased, as it is based on the number of horses registered.

The race winner worksheets are prepared because the breeders fund application forms do not include a place to indicate the foal's mare/sire and respective owners. The worksheet prepared by hand is subsequently typed up on the computer. These three forms, which virtually contain the same information, should be combined into one form. The breeders fund application form could be modified to include the necessary data from the race winner worksheets. These forms could then be verified against the race results, forwarded on to the auditor, and a copy returned to the horse owners with their calculated allocation. The only change needed would be to get the social security number, which could be added to the registration form for submitting a horse into the Breeders Fund.

To conclude, rather than having each horse owner with a separate table set up in a Word® document for foals, mares, and sires, there should be one database that holds all necessary and relevant information. This database could be set up in Access® or in a spreadsheet format such as in Excel®. This would facilitate verifying whether a horse is already registered in the Breeders Fund, or who the mare/sire of a particular foal is and would also save time from looking up several Word® documents or going through file cabinets. The Racing Commission currently has approximately \$20,000 available in the Breeders Fund Administrative fund, which could be used to purchase or develop a software program.

North Dakota Racing Commission Response:

In response to the streamlining of the breeder's fund, we are looking at several alternatives. We have been in contact with surrounding states, but are having a difficult time finding a program that we can use. This search is ongoing, but if we find none, we will develop our own.

Beginning with the 2005 colt crop, we will enter them into a database. By doing this for the next several years, by year six, we will have all eligible runners on a database that will allow us simpler access to all needed material. We are currently discussing the number of fields that would be necessary. Ms. Tessman has worked extensively with the development of such a database when she was employed by FEMA and is confident this can be done.

Upon the passage of SB 2344, the commission will review all license and registration fees. We realize there are several that should be raised to cover actual cost of administration.

Controls Over Simulcast Provider (04-2)

By law, RSI had a 30-day period to remit the tax monies owed the state's general fund and the Racing Commission's special funds. In October 2001, RSI was initially given a 60-day extension due to the slowdown to the whole system after the September 11, 2001 tragedy. This extension was for the special fund payment only; the general fund payment was always submitted within the allotted 30-day period. The extension was allowed to continue because several big bettors had moved into the state and were winning, so extra time was needed for RSI to collect the winnings from the tracks since their money pool wasn't large enough to pay off both the bettors and the state. Additionally, RSI was having troubles collecting winnings from several tracks that were having financial difficulties.

It was noted in the December 2002 meeting minutes that RSI's payments of special funds had been running 30-45 days behind the deadline and the Executive Director brought it to the Commission's attention because he was concerned that the late payments had continued for so long. The Racing Commission has the authority to charge a penalty and interest after the 30-day payment period had passed, but counsel for the Commission advised that if the delay was excusable then all or part of the penalty/interest could be waived. The Racing Commission was protected by a \$450,000 bond posted by RSI and since RSI had always been on time with the general fund payment, further action against RSI was tabled until a future meeting when more information on the need for the payment extension could be obtained.

It was noted in the July 2003 meeting minutes that the RSI issue had not been addressed so the Racing Commission gave RSI a 45-day deadline to bring current all special fund monies owed the Racing Commission or risk having their license revoked. Later in July it was confirmed that RSI was under federal investigation. In August 2003, the State Attorney General appealed to the Racing Commission not to revoke RSI's license at this time, as his office in conjunction with the FBI, had not completed their investigation. RSI only fell behind the extension and the general fund payment obligation when the parimutuel taxes from the non-licensed site were factored in.

The big bettors were already planning to leave the state because they were not receiving as large a refund as they could elsewhere, as the state tax rates were too high. In order to cut the big bettors a higher rebate, a non-licensed site was created by RSI. This site's handle was not reported as part of any state source, although it was included as part of the community (RSI bets from all states served). The Director of the Racing Commission noted an irregularity in the reports and subsequently helped the U.S. Department of Justice with their investigation. In a letter of commendation to the prior Racing Director, it was noted that, "Ms. Bala and RSI were convicted by a jury on all 12 counts of the federal indictment, and ordered to forfeit \$99 million, an amount equal to the bets run through the illegal 'stealth' site."

What can be done:

The Racing Commission contracts with a certified public accountant to conduct audit work. The Racing Commission's auditor receives the source reports for all bets placed in North Dakota, which includes a weekly handle report and a monthly summary report from Amtote and compares them to the reports received from RSI (now Lien Games Inc.). These source reports cannot be altered. However, this will only verify that the dollars bet at legal sites in North Dakota are properly reported.

Stealth simulcast sites are not just a North Dakota problem but an issue on a national level as well. A new technology (wagering transaction protocol or WTP) is in the process of being implemented by the racing industry and national regulators, which will allow the tracks to know where the bets are coming from. It is still under discussion how this will be funded, and who will oversee and regulate this new technology.

Currently, the only assurance the Racing Commission or the state of North Dakota has that the new source provider, Lien Games Inc., could not set up a stealth simulcast site would be for the Racing Commission's auditor to log into Amtote's national hub to see every dollar wagered through Lien Games Inc. Access would be needed to the entire Amtote database for the whole community (Lien Games Inc. bets from all states served) not just the source (Lien Games Inc. bets from North Dakota) because Lien Games Inc. also submits the handle from other states. It could be verified that the amounts bet match the reports received from Amtote and Lien Games Inc. To date the Racing Commission's auditor has not yet logged onto Amtote's hub in Maryland.

Recommendation:

We recommend that the Racing Commission arrange with its auditor to access the national database at Amtote. Consideration should be given to what training, if any, is required for the auditor to be able to access the necessary information and be able to read it so as to determine that all bets originating from a simulcast site in North Dakota are properly reported in the Racing Commission's monthly reports.

North Dakota Racing Commission Response:

A main concern of our office, and also one of the auditors, was the auditing of our simulcast sites and simulcast provider. Currently, our auditor is contracted to conduct audit work. He is paid by the commission, and we are reimbursed by the simulcast provider. Our concern has been that we are only able to audit the figures the provider gives us. If a "phantom" site was established, we may not be able to pick up on it unless we saw a decline in other sites.

Besides the audit that is done, we carefully track each week's handle at the simulcast sites. Each Thursday, we receive the figures from the previous week. Those figures are then compared with the previous week, and the previous year. On the times we have noted a discrepancy, such as a drop off in wagering, we have called to find out the reason.

At the February commission meeting, the commission approved travel expenditures to send our auditor to the hub in Maryland. There we will express our need for a method to track the dollars from the hub into each site, and an actual location of each site. The travel is tentatively planned to take place in May.

Areas of Interest from the Racing Commission Audit

Our audit of the North Dakota Racing Commission identified the following areas which should be brought to the attention of the Legislative Audit and Fiscal Review Committee, Racing Commission board members, and management of the Racing Commission:

Area of Interest - Fargo Horse Park

Background:

The Racing Commission was given the authority to adopt rules for the administration, implementation, and regulation of activities conducted pursuant to Chapter 53-06.2 of NDCC. Within the rules adopted, the Racing Commission has the express authority to use promotion fund dollars for developing racetracks in the state as noted in Section 69.5-01-12-03 of the Administrative Code.

Racetrack Bid Award:

Initial meetings for building a new track were held in Mandan, Minot, and Fargo during February 2000 while Fessenden was also interested in holding races. The deadline to submit proposals to the Racing Commission was October 2000 and only Mandan and Fargo submitted bid proposals by the deadline. In November 2000, the Racing Commission dedicated \$1,000,000 from the promotion fund for building a new track along with \$500,000 from the purse fund and \$500,000 from the promotion fund for keeping the new track running for 5 years.

In December 2000, the Racing Commission reviewed the primary concerns they had with the project plans submitted by both Fargo and Mandan.

Although not all of the commissioners were in agreement as to where and what type of track to construct, a motion was made to award the track to Fargo and allow the North Dakota Horse Park Foundation (NDHPF) to proceed with conducting a land survey and putting together a final construction plan and financing arrangement. The motion was approved unanimously.

In April 2001, the NDHPF submitted a revised site plan at a new location that was approved by the Racing Commission. In June 2001, NDHPF submitted a total project cost of \$7 million but the commissioners were concerned with what the actual cost would be due to changes to the project and expected costs. Additionally, the NDHPF couldn't itemize where the contributions discussed in their proposal would come from. The Racing Commission voted 4-1 to turn down the NDHPF proposal and moved to provide Mandan and Fargo the chance to resubmit a proposal by their August deadline.

In August 2001, both Mandan and Fargo resubmitted bids with Fargo's bid totaling \$2.1 million for Phase I of a 3-phase project. Mandan resubmitted their same bid of \$1.2 million. The Racing Commission felt that Mandan could not adequately address all previous concerns raised at that site. There was an ideological difference between the commissioners on whether construction should be for a standard track or a state of the art $\frac{3}{4}$ mile track. The Racing Commission voted 4-1 to give final approval to NDHPF for the construction of a race track in the Fargo area.

Racetrack Construction:

Sheyenne development, LLP donated 114.5 acres of farmland to initiate the process of developing the North Dakota Horse Park for a cost of \$250,000 paid by the city of Fargo. The city of Fargo provided in-kind materials of fill dirt and sand at a cost of approximately \$84,000.

An estimated 14.5 acres were set aside and deeded to the NDSU Development Foundation (Foundation). They received State Board of Higher Education approval to construct a \$3.2 million equine facility for the teaching of an equine studies program. The Foundation also assumed responsibility for raising monies to pay for and maintain that facility. Approximately 65 acres was leased on a 99-year lease to the NDHPF with the responsibility of maintaining the racetrack and the grounds on the east end of the NDSU facility. The NDHPF planned to raise funds to build additional stall barns to serve the needs of area horsemen and 4-H groups during the non-racing season. Another non-profit organization serving the interests of horsemen, Horse Race North Dakota, has a 99-year lease to the area on which the grandstand, bathrooms, parking lots, temporary offices, and adjacent grounds reside (approximately 35 acres).

A total of \$2,816,430 was given towards the construction of the North Dakota Horse Park from the North Dakota Racing Commission Promotion Fund. This includes the initial \$1 million allocated at the beginning of the project, an additional \$1.5 million granted in April 2002 due to cost overruns, a final payment in October 2003 of \$231,430 for outstanding contract payments owed and a last request, by Horse Race North Dakota, for \$85,000 to construct a bathroom facility. All monies given were supported by actual invoices that were approved by the project manager, Racing Commission, and the Attorney General's office. Additional funding received by the Horse Park Foundation includes: City of Fargo tax increment financing district (\$1,000,000); Cass County economic development loan (\$250,000); and Fargo-Moorhead Convention and Visitors Bureau (\$100,000).

Phase I was to include construction of a 6-furlong ($\frac{3}{4}$ mile) track, parking for 400 cars, parking for horsemen, underground utilities, grandstand and facilities for pari-mutuel betting, restrooms, and additional barns for off-season use. Phase II was to include an indoor arena with stalls, restaurant infrastructure, and landscaping. Phase III was to build a museum, expand the current infrastructure, expand the parking, and further grounds development.

The total cost of the North Dakota Horse Park to date is \$3,598,000 plus an additional \$1,122,487 in land value. This total book value (\$4,720,487) belongs in part to Horse Race North Dakota which has \$511,287 on their books while the North Dakota Horse Park Foundation has \$4,209,200 on their books. These figures do not include the value of the land owned by the NDUS Development Foundation or the cost of the building (approx. \$3,000,000) constructed by the Foundation. Phase I is not complete as they do not have a permanent grandstand, barns, and facilities for pari-mutuel betting (currently metal bleachers are used for grandstands and the pari-mutuel betting is set up in a large tent).

On page 25, Table 1 shows the costs of constructing the Fargo Horse Park. In that table, the amounts from the "Initial Bid" column came from the 3-phase projected budget submitted by the North Dakota Horse Park. Amounts from the "Actual Cost" column came from the Book Asset Detail obtained from the North Dakota Horse Park accountant. The grandstand/facilities cost only includes a bathroom facility and metal bleachers. Amounts from the "Estimate to Complete" column came from a request submitted to the Racing Commission, dated October 31, 2003, from the North Dakota Horse Park. This estimate is what it will take to complete Phase I, plus the necessary landscaping from Phase II. As noted in the table on page 25, the initial estimate for Phase I was \$2,100,000 and the actual plus estimated costs to complete Phase I has now risen to \$5,920,000.

Table 2

	Initial Bid (3 Phases)	Actual Cost (Phase I)	Completion Est. (Phase I)
Phase I			
Race Track	\$ 475,000	\$ 2,234,000	
Railing/Fencing	130,000	312,000	
Underground Utilities	30,000	443,000	\$ 15,000
Barns	400,000		250,000
Parking	100,000	174,000	
Grand Stand/Facilities	400,000	178,000	2,000,000
Other	565,000	161,000	153,000
<i>Subtotal</i>	\$ 2,100,000	\$ 3,502,000	\$ 2,418,000
Phase II			
Indoor Stall/Arena	\$ 750,000		
Restaurant Infrastructure	100,000		
Landscaping	100,000	\$ 96,000	\$ 30,000
Other	150,000		
<i>Subtotal</i>	\$ 1,100,000	\$ 96,000	\$ 30,000
Phase III			
Museum	\$ 650,000		
Expanded Infrastructure	150,000		
Backside Facilities	250,000		
Grounds Development	150,000		
Other	80,000		
<i>Subtotal</i>	\$ 1,280,000	\$ 0	\$ 0
TOTAL	\$ 4,480,000	\$ 3,598,000	\$ 2,448,000

This table does not include any costs associated w/the Equine Complex constructed by NDSU Foundation.

Other Racetrack Information:

The first season for the Fargo track was the fall of 2003. This season consisted of 16 days of actual racing (approximately 9 races per day) with an estimated total attendance of 41,000. The total of all the bets placed on the races run at the Fargo track for the 2003 race season was \$453,849, which resulted in a return of \$15,944 in taxes to the Racing Commission's special revenue funds and \$10,043 in taxes to the state general fund.

The 2004 race season consisted of 19 days of actual racing with an estimated total attendance of 36,500. The total of all the bets placed on the races run at the Fargo track for the 2004 race season was \$377,519, which resulted in a return of \$13,458 in taxes to the Racing Commission's special revenue funds and \$8,203 in taxes to the state general fund. The racing season generally runs from the beginning of August through Labor Day, running on Friday, Saturday, and Sunday.

As noted previously, the Racing Commission initially pledged \$500,000 from the Purse Fund and \$500,000 from the Promotional Fund to assist with the operations of the new track for 5 years. This initial pledge (November 2000) amounted to an annual contribution from the Racing Commission to the Fargo track of \$200,000 per year for the five-year period. As noted in Table 3 below, the actual contribution from the Racing Commission has been much higher.

Horse Race North Dakota is the charitable organization in charge of conducting the live races at the Fargo track. Per review of the Income Statement (unaudited) for Horse Race North Dakota for the years ended December 31, the following was noted:

Table 3

	<u>2003</u>	<u>2004</u>
Revenue		
Pari-Mutuel Revenue	\$ 91,000	\$ 103,999
Other Grants	100,269	108,704
Operating Revenue	79,324	80,731
Other Misc Rev.	4,283	1,302
Grants from North Dakota Racing Commission	<u>900,000</u>	<u>718,400</u>
Total Revenue	<u><u>\$ 1,174,876</u></u>	<u><u>\$ 1,013,136</u></u>
Expenses		
Purses	\$ 504,919	\$ 481,204
Operating Expenses	<u>506,054</u>	<u>488,382</u>
Total Expenses	<u><u>\$ 1,010,973</u></u>	<u><u>\$ 969,586</u></u>

The funds above in the "Grants from North Dakota Racing Commission" are taken from the three special revenue funds at the Racing Commission and exclude any payments made for construction (a total of \$2,816,430 to date has been given by the Racing Commission for track construction). As noted on page 8, these funds are being rapidly depleted and it appears the Racing Commission will only have the funds to maintain this level of support to the Fargo track for a two to three year period.

It should also be noted the Racing Commission has pledged \$799,000 for the 2005 racing season in Fargo and \$130,000 for the 2005 racing season in Belcourt. (NOTE: The Belcourt track pays taxes to the three Racing Commission funds, but does not pay taxes to the state general fund)

While the track in Fargo was built as a state-of-the-art track with the latest in safety features, one concern is whether or not it will be able to compete against the other facilities in close approximation to the Fargo track. These include the Assiniboia Downs (224 miles) in Winnipeg and Canterbury Park (245 miles) in Minnesota, which both run horse races from May to September.

Both of those tracks also feature more than live horseracing to pay for operations as both tracks feature simulcast racing seven days per week. Those horse parks are also supported by other

revenue from broadcasting their races to other tracks for simulcast betting, slot machines, poker rooms, corporate sponsorship, restaurants, hosting concerts, and snowmobile races.

We believe there may be concerns relating to the future of the Fargo track. These concerns relate to the ability of the Racing Commission to continue to provide the monetary support it currently provides. As noted above, the revenue generated by the Fargo track is insufficient to cover the operating expenses without a significant amount of additional revenue as received by other tracks or the return of the big bettors.

North Dakota Racing Commission Response:

As a new director, I appreciated very much the overview of the development of the track at Fargo. The commission is also very concerned with the future. The handle (total wager on racing) has dropped from \$173 million to \$5.2 million. This year, we are on pace to drop even farther. Hopefully, the passage of HB1389 will stop this downward spiral and bring about an increase in wagering.

The audit report does mention what other successful tracks are doing to succeed, or even expand. I believe we will need three things to happen to ensure the future of live racing. We will need an increase in wagering, corporate sponsorships, and the development of an entertainment center at the track. This could include card rooms, historic racing machines, or simulcasting.

At the current rate of expenditure, we can fund our tracks for two more years, then our promotion fund will be depleted. That gives us enough time to develop some legislative changes that should be made to make us competitive for the entertainment dollar.

Area of Interest - Effects of 2005 Legislative Action

Racing Commission Agency Status (SB2340):

Senate Bill 2340 was introduced in the 2005 Legislative Session to remove the Racing Commission from under the Office of the Attorney General and establish it as a separate state agency. There is no fiscal note attached to this bill. The Racing Commission would be funded primarily from their special funds and partly from the state's general fund.

In the 2001 Legislative Assembly the Racing Commission operations were completely supported by the state's general fund while the 2003 Legislative Assembly funded half the Racing Commission with general funds and half with special funds. Currently proposed in the 2005 Legislative Assembly, the Racing Commission will receive approximately one-third of its appropriation in general funds and must use its special funds for the remaining costs. The move towards making the Racing Commission more self-funded is coming at a time when the tax revenue from bets placed on pari-mutuel and simulcast racing is decreasing. This has resulted in declining special fund balances within the Racing Commission. See analysis on these fund balances on page 8 of this report.

The current special fund tax revenue is not sufficient to fund the present level of distribution from the special funds for purse money, breeders fund payments, or promotion dollars, plus the increased burden of paying for operating costs of the Racing Commission. Therefore, it will be only a few years before the special fund balances are depleted or the Racing Commission will not be able to support racing activities as it has the past 5 years.

The Racing Commission currently has 2 FTE's but most of the accounting functions are run through the Attorney General's office. These include handling the fixed asset and payroll records, payment of bills, and deposit of receipts. It is not known how the present staff could assume these additional accounting duties. The Racing Commission needs to contact OMB about helping them with their accounting work until they are able to get trained on PeopleSoft (the state's new accounting system).

Furthermore, if the Racing Commission were to do any monitoring of the charitable organizations running the simulcast sites as discussed below, this would place additional strain on both the financial and human resource aspects of the Racing Commission.

The Racing Commission currently licenses 6 charities to provide simulcast racing services. These sites are located as follows: 2 in Fargo, and 1 in Bismarck, Jamestown, Williston, and Grand Forks. There were 16 licensed sites during calendar year 2003 and 11 licensed sites during calendar year 2004.

Per review of the weekly report provided by the simulcast provider (RSI in 2003 and Lien Games in 2004) for the year ended December 31, 2003 and 2004, it was noted the total amount wagered was \$153,587,835 and \$5,237,935, respectively.

Per review of the reports for calendar year 2004, it appears there are two main simulcast sites that handle 2/3 of the total wagers. These sites are the Turf Club (Fargo) and Rumors (Grand Forks). The Turf Club's total wagers for 2004 were \$2,139,177. Rumors total wagers for 2004 were \$1,268,199. These appear to be the only sites that show a substantial profit from the simulcast sites, while the other sites are breaking even or losing money in providing simulcast betting.

Additionally, the Racing Commission has not been reviewing financial information to determine whether the charities have only spent operating profits for eligible uses and that only allowable expenses have been deducted in determining profits. NDCC 56-06.2-11 #5 states, "After paying qualifying expenses, the licensee shall use the remainder of the amount so withheld only for eligible uses allowed to charitable gambling organizations." The Gaming Division of the Office of the Attorney General reviews this information for charities that have other forms of gaming (blackjack, pull-tabs, etc.), but does not review revenue and expense information regarding pari-mutuel betting. Five of the 6 sites that provide simulcast betting also have other forms of gaming which are subject to review by the Gaming Division.

While monitoring of the charitable organizations is not a requirement of the Racing Commission, they do have the authority to request financial information and audits if needed. The last review of financial records was in 2001 for the Team Makers site in Fargo. Reviewing the charities expenses for proper use would not result in any additional funds received for the state of North Dakota or the Racing Commission. However, it is important that all organizations involved in any form of gaming receive scrutiny, as any improprieties discovered have a negative impact on current and future gaming interests. Since it appears no other organization is reviewing this information relative to the pari-mutuel betting, it would seem the Racing Commission is the logical choice to do so.

Bet Payoff Formula for Racing (HB1389):

House Bill (HB) 1389, will change the amount sent to each of the 3 Racing Commission special revenue funds to 1/16 of 1% (.000625) after the total amounts wagered for the biennium exceed

\$11 million. The general fund would also receive 1/16 of 1% of the wagers in excess of \$11 million. (See page 4-5 for current tax breakdown between funds)

It should be noted the current biennium total amounts wagered is expected to be around \$10 million. The change was made to try to entice the "big bettors" back to North Dakota, due to the possibility of rebating them a percentage of the amount that previously was received by the state and the Racing Commission.

HB 1389 would also change the way "breakage" is allocated. Breakage is the funds left over after the winning bets have been paid. All winning bets are rounded down to the nearest 10 cents. For example if your \$2 winning bet calculates to a win of \$4.28 you would get paid \$4.20 and the \$.08 is the breakage. All bets are calculated as if the original bet was made in \$2 increments – if you make a \$1,000 wager, you have effectively made 500 \$2 wagers, each of which would be subject to the breakage rounding.

Breakage on the first \$11 million is deposited in the Promotional Fund. After the \$11 million threshold is met, the breakage is split as follows: 1/3 to the Racing Commission; 1/3 to the charity where the bets were placed; and 1/3 to the service provided (Lien Games).

The following table is provided to calculate the amount of wagering necessary to allow the Racing Commission to continue at their current funding levels based on the revenue structure discussed above. It should be noted our expense information provided does not include any additional funds for continued construction at the Fargo track.

Table 4

Estimated Yearly Expenses based on Fiscal Year 2003, 2004, and 2005 actual or pledged expenses:

Operating / Salaries	\$ 150,000
Breeders Fund Disbursements	250,000
Funds Provided to Fargo Track	800,000
Funds Provided to Belcourt Track	130,000
Total Expenditures	<u>\$ 1,330,000</u>

Yearly Revenue:

1/2 General Fund Appropriations	\$ 73,000
1/2 of 1.5% of first \$11,000,000 wagered	83,000
Breakage - 1/2 of 1% of first \$11,000,000 wagered	55,000
Remaining Revenue Needed	<u>1,119,000</u>
Total Revenue	<u>\$ 1,330,000</u>

In our estimation, to raise the required revenue of \$1,119,000, based on the 1/16 of 1% each fund will receive and the 1/3 of 1% of breakage the Racing Commission will receive, we have calculated the amount wagered would need to be \$227 million per year (includes the initial \$11 million).

As noted previously, the current amount wagered is approximately \$5 million per year. The largest amount wagered while the big bettors were in North Dakota was approximately \$170 million per year. For each \$1 million in increased wagering over \$11 million, the Racing Commission will receive approximately \$5,175 and the general fund will receive \$625.

Racing Commission Fee Collections (SB2344):

Senate Bill 2344 would allow the Racing Commission to retain all license fees and fines collected and to use those monies to cover operating costs. These license fees are currently approximately \$30,000 per biennium.

201 – Department of Public Instruction

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Grant Monitoring Procedures (05-1)

Overview:

We completed a risk analysis of all of the grant programs at the Department of Public Instruction and selected five grant programs that were in the highest risk category. These five grant programs were reviewed in the grant application process; the grant disbursement process; and the grant oversight/monitoring process.

Of the five programs selected, we found the Coordinated School Health federal grant, Title VI-State Assessment and Accountability federal grant, and the Guidance and Testing state grant all appear to be properly managed and monitored and the disbursement of moneys are effective.

For the two remaining programs, 21st Century Community Learning Centers federal grant and Title V- Promoting Informed Parental Choice and Innovative Programs federal grant, we noted areas that could be improved.

For the 21st Century Community Learning Centers grant, a Request for Funds form is required before grant funds are distributed. The amount the grant recipient requests on the form is not broken down by category according to the way the original budget was set up - all expenditures are grouped into one total amount. Also, the Department of Public Instruction does not currently have a spreadsheet to track expenditures by category that were requested for each of the different grant recipients.

The Department of Public Instruction currently does a review of the monthly Request for Funds form submitted by the grant recipients to determine if the total monthly expenditures appeared consistent with previous months (if the grant manager determined the requests did not appear consistent, then he would request supporting documentation as needed). A periodic reconciliation of expenditures to the Request for Funds form is not currently being performed.

An on-site visit to observe the program, review the grant recipient's trial balance sheet, review the payroll records, and examine expenditures if time permitted has been done annually in the past but the client stated on-site visits may get reduced to once every other year due to time constraints.

Each grant recipient submits a Quarterly Project Narrative Report to the Department of Public Instruction on a quarterly basis listing the total enrollment for the quarter, total year-to-date enrollment, major accomplishments for the quarter, and major problems or needs. Per review of the report, it was noted the questions asked on the form appear vague which will allow the grant recipients to provide answers that may not be tied to the proposed program objectives approved in the original grant application.

For the Title V - Promoting Informed Parental Choice and Innovative Programs grant, the on-site visit monitoring program that was followed in the past is no longer being done due to time and staff constraints. The grant manager suggested implementing a paper audit to tie out actual expenditures to the original budget of each grant recipient. If problems are noted in the paper audit, then the Department of Public Instruction would conduct an on-site visit.

Recommendations:

Based on our review of the 21st Century Community Learning Centers (CCLC) Program, we recommend the following:

Follow through with the intent to request a break down of expenditures by category as supporting documentation for the amount being requested on the Request for Funds form and track and monitor the expenditures in an Excel spreadsheet by category to ensure the approved budgets are being followed. This process will help substantiate the need for additional support such as copies of receipts and invoices when any discrepancies are noticed.

Implement a periodic review of all expenditures and supporting documentation that make up the amount requested in the Request for Funds form by randomly selecting centers to test. We recommend that the expenditures are reconciled to the request. This will ensure that requests are properly supported and program expenditures are properly supported, approved, and are allowable in accordance with program guidance.

Since the programs should not change in scope after the initial start-up and due to limited resources affecting the feasibility of the on-site visits, we recommend the Department of Public Instruction continue to assist in the program start-up process by doing an initial on-site visit followed up with an on-site visit at the end of the first year to evaluate the progress of the program. Further on-site visits could then be limited to an as needed basis based upon the results of other monitoring steps.

Given that the questions asked in the Quarterly Project Narrative seem vague, we recommend the Department of Public Instruction rephrase the questions in order to obtain more specific answers, such as:

- How are the program objectives, as approved, being met?
- Does the program have adequate curriculum materials for the program offered? If not, how will this inadequacy be addressed?
- Describe the strengths of the project.

The questions should be stated in a manner so the answers can be tied to the progress of the program based on the center's stated objectives in their application.

Based on our review of the Title V - Promoting Informed Parental Choice and Innovative Programs, we recommend the following:

- The Department of Public Instruction should implement their proposed paper audit of LEA's with on-site visits being conducted as needed. We feel the paper audit should address, at a minimum whether:
- The program is operating as intended and/or that performance results are being achieved as applicable for the Title V grant.
- The expenditures are in line with the proposed budget.
- Program activities fall within Title V guidelines.

Department of Public Instruction Response:

The Department of Public Instruction concurs with this recommendation and will implement it accordingly.

Computer Access Control Weaknesses (05-2)

During our review of the PeopleSoft system access controls, it was noted there were several weaknesses at the Department of Public Instruction, State Library, School for the Deaf, and Blind/Vision Services.

Department of Public Instruction:

An individual had access to the accounts receivable module in PeopleSoft and the Department of Public Instruction does not use this module.

Numerous individuals had access beyond their listed job duties in the general ledger, accounts payable, and fixed asset modules of PeopleSoft.

State Library:

The individual that approved the payroll transactions also had the capability to update and modify payroll records in the payroll module.

School for the Deaf:

Several instances were noted where employees with approval responsibility also had access to computerized records.

An individual initiated and approved the same expenditure transaction. There was no evidence that management reviewed the transaction after it was completed.

Blind/Vision Services:

An individual no longer employed with Blind/Vision Services still had access to the PeopleSoft system.

Various individuals had access to PeopleSoft modules beyond their duties.

Individuals approving transactions also had the capabilities to update and modify records in the payroll and fixed asset modules.

Proper internal control dictates that access to data should be limited only to those who need access to perform their duties. Furthermore, personnel should only have access to the PeopleSoft modules necessary to perform their duties. Without proper access controls, personnel have the opportunity to bypass many important controls, especially segregation of

duties. Therefore, there is an increased risk of unauthorized transactions and also a greater chance of corruption of data.

Recommendation:

We recommend the Department of Public Instruction, State Library, School for the Deaf, and Blind/Vision Services properly restrict access to the PeopleSoft system to ensure only authorized personnel have access to make changes, record transactions, or approve transactions in accordance with their assigned duties to secure adequate segregation of duties.

Department of Public Instruction Response:

The Department of Public Instruction concurs with this recommendation and will implement it accordingly.

Noncompliance With Appropriation Laws – DPI (05-3)

The Department of Public Instruction (DPI) overspent the amount appropriated for the Operating Expenses line item by \$450,172. The Department incurred some unexpected costs near the end of the biennium. Since the billings from the vendors were not received timely, DPI was unable to charge the expenditures against their appropriation on the state's accounting system (PeopleSoft). DPI properly reported these operating expenditures on their accounts payable closing package, which when charged against their appropriation, caused them to exceed their Operating Expenses line item.

Section 54-16-03 of the North Dakota Century Code (NDCC) states it is unlawful to expend more than is appropriated. As a result, the Department of Public Instruction is not in compliance with NDCC.

Recommendation:

We recommend the Department of Public Instruction:

- 1) Comply with section 54-16-03 of the North Dakota Century Code by not overspending its operating expenses appropriation.
- 2) Carefully monitor their line item spending authority, including the affects of the accounts payable as reported on the accounts payable closing package.

Department of Public Instruction Response:

The Department of Public Instruction concurs with this recommendation and will implement it accordingly.

Website Improvements at the ND Vision Services / School for the Blind (05-3)

Challenge:

The North Dakota Vision Services / School for the Blind sells vision specific equipment and tools through their store. The client has an in-depth listing of all of its store items in catalog form but not on its website. "The Store" section of their website includes a listing of 15 general categories of items available in the store and a few specific items that are included within those

categories. The phone number and address for the School for the Blind are listed to request a store catalog, place an order, or stop and see the items available for sale. The North Dakota Vision Services/School for the Blind's website includes information on the different programs/services, staff contact information, schedule of events, news, training, and school background information but there is no frequently asked questions (FAQ's) section. The client has "Talking Book" players available for use by individuals that have a disability but the tapes are available only through the State Library. The State Library has over 65,000 tapes available for use. The client's website does not have a link to the State Library's website, where an individual could find out about talking book tapes and how to borrow them.

Recommendations:

We noted three areas where improvements could be made to the North Dakota Vision Services / School for the Blind website to make it more user-friendly:

The store section of the website could be expanded to list some additional items under each category and include additional clarification on how to access the store. We feel this will allow more visually impaired individuals, along with their friends, family, and relatives to know what items are available to purchase through the ND Vision Services / School for the Blind.

A frequently asked question (FAQ's) section could be added to the website to avoid unnecessary phone calls or other correspondence to answer common questions.

A direct link to the State Library's website would be beneficial to individuals that are interested in the Talking Book program and in borrowing tapes. This would allow an individual to go from the client's website directly to the State Library website where information on how to order tapes would be available along with a link to the database of all the talking books available in the nation.

Department of Public Instruction Response:

The Department of Public Instruction concurs with this recommendation and will implement it accordingly.

Noncompliance With State Aid Maintenance of Local Effort Law (05-4)

The North Dakota State Library did not follow the North Dakota Century Code in regards to the maintenance of local effort in determining whether public libraries were eligible to receive state aid. Section 54-24.2-04 (maintenance of local effort) of the North Dakota Century Code (NDCC) reads as follows:

No public library is eligible to receive any funds appropriated under this chapter during a fiscal year if the governing body has diminished the:

Mill levy on the taxable valuation below the average of the three preceding fiscal years; or
Appropriation for public library services below an amount equal to the revenue derived from the maximum mill levy for public library services authorized under section 40-38-02.

The North Dakota State Library has interpreted "mill levy on the taxable valuation" in subsection one of NDCC section 54-24.2-04 as meaning dollars generated from the mill levy, plus other public funds received. Our interpretation, in agreement with the Attorney General's office, is this means the number of mills levied. Therefore, if a public library's mill levy has diminished below

the average of the three preceding fiscal years, the public library is not eligible to receive state aid. As a result, the North Dakota State Library is not in compliance with NDCC.

The North Dakota State Library distributed a total of \$422,153 in fiscal year 2004 and \$422,154 in fiscal year 2005 in state aid funds to libraries across the state. In fiscal year 2004, 29 cities and 12 counties improperly received a total of \$154,266 in state aid. In fiscal year 2005, 35 cities and 9 counties improperly received a total of \$152,801 in state aid.

Additionally, the North Dakota State Library uses two separate spreadsheets for calculating the grant awards to public libraries. One spreadsheet is a summarization of all public libraries and their award amount while the other spreadsheet calculates and tracks the grant award and appropriate limitations for each individual library. Data that is common to both spreadsheets are typed in twice rather than linked. Much of the data found on the individual library spreadsheet that is manually inputted, is the type that comes from the county auditors or is found in statute and does not often change. A spreadsheet was developed during the biennium that incorporates all of the necessary elements in determining the grant award into one spreadsheet but it was not utilized by the North Dakota State Library.

Recommendation:

We recommend that the North Dakota State Library:

- Comply with Section 54-24.2-04 of the North Dakota Century Code by properly utilizing the maintenance of local effort criteria before awarding state aid to public libraries.
- Implement the new state aid spreadsheet that was created for calculating the grant awards to public libraries.

Department of Public Instruction Response:

The State Library will implement the new State Aid spreadsheet in processing State Aid. The State Library will work with the State Auditor's office and the Office of the Attorney General to properly utilize the maintenance of local effort criteria, as stated in 54-24.2-04, before awarding State Aid to public libraries.

Missed Deadline for the Data Envelopment Analysis Project (05-5)

The Department of Public Instruction did not complete the Data Envelopment Analysis Project within the required time period. Senate Bill 2421, section 34 of the 2003 Special Session stated the project shall be completed on or before September 1, 2004. The project was not completed until June 2005. Since the project has now been completed, we will not issue a recommendation.

231 - University of North Dakota

Operational Audit – Contact: John Grettum 239-7250 jgrettum@nd.gov

Nonemployee Travel (05-1)

During our test of non-employee/student travel, we noted 6 errors out of the 10 items tested. Five of those errors were lack of support for the expenses. There was no “Non-

Employee/Student Travel Expense Worksheet” completed as well as the non-employee/student receiving the payment did not certify that they were entitled to the payment. The other error noted was for a \$110 payment to a hotel for lodging expenses where the non-employee was a “no-show” for two nights and UND was charged for the room.

Verifying certified support prior to payment aids in the prevention of expenses that are invalid or incorrect. UND’s policy Non-Employee and Student Travel Policies states that the “Non-employee/Student Travel Expense Worksheet” should be included when reimbursing the non-employee and attached to the voucher. Canceling reservations immediately aids in the prevention of overpayments for rooms that were not used.

Recommendation:

We recommend that:

- Non-employees/students complete the “Non-Employee /Student Travel worksheet and certify it before a request for payment is completed; and,
- When a person is a “no-show” for a conference and it is for more than one night, the succeeding nights should be canceled.

University of North Dakota Response:

UND disagrees. Of the six “errors” cited, four were for reimbursements from one department that has made arrangements to include all the detail required directly on the voucher. In reviewing the five vouchers lacking support (totaling \$305.95), we find all the information provided that is required on the worksheet.

It is our intent to continue the business practice of allowing expense detail to be documented on a voucher or worksheet along with the responsible UND employee approving the payment.

UND agrees. The policy for employees will be implemented for non-employees.

Auditor Rebuttal:

The vouchers for the five errors did not have complete information, nor was it signed by the recipient. UND could not verify these payments were legitimate and projecting the error rate for this test, we can assume 60% of all non-employee travel expenditures were not legitimate.

239 – Dickinson State University

Operational Audit– Contact: John Grettum 239-7250 jgrettum@nd.gov

Leases (05-2)

We noted the following during a review of Dickinson State University’s leases:

- A new lease for \$57,024 for a Paragon Mailing System was not properly bid.

- This same lease was recorded as an operating lease and should have been recorded as a capital lease. The term of the lease is 4 years and the economic life is 5 years. The lease term is 80% of the economic life of the asset.

According to NDCC 54-44.4-01, “it is state policy to provide comprehensive purchasing services based upon sound procurement practices and principles wherein, through full competition with fair and equal opportunity to all qualified persons and firms to sell to the state, each state agency and institution shall obtain its necessary supplies and equipment at competitive cost, consistent with quality, time, and performance requirements.”

Also, NDCC 54-44.4-05 states, “Purchasing contracts must be awarded to the lowest responsible bidder considering conformity with specifications, terms of delivery, and quality and serviceability.”

State Board of Higher Education Policy 803.1 Part 3, states, “Personal property, equipment or supplies estimated at \$10,000 or more must be purchased from formal bids. As many sources as possible, including qualified North Dakota vendors should be solicited.”

SFAS (Statements of Financial Accounting Standards) No. 13 states that if one or more of the following conditions are met, the lessee treats the lease as a capital lease:

- Ownership actually transfers to the lessee at the end of the lease.
- A bargain purchase option is contained in the lease.
- The life of the lease is equal to or greater than 75% of the remaining economic life of the leased asset.
- The present value of the minimum lease payments over the life of the lease is equal or greater than 90% of the fair value of the property at the beginning of the lease.

Recommendation:

We recommend that Dickinson State University:

- Comply with NDCC sections 54-44.4-01 and 54-44.4-05 by bidding out all property greater than \$10,000.
- Record the mail machine lease as a capital lease and record the mail machine as a capital asset.

Dickinson State University’s response:

Agree. Dickinson State University will capitalize the asset and record the lease payable.

240 – Mayville State University

Operational Audit– Contact: John Grettum 239-7250 jgrettum@nd.gov

Payroll Weaknesses (05-1)

During our review of payroll transactions, it was noted that 18 of 73 items were not charged to the proper fund. Employer matching or employer paid fringe benefits were paid from a fund other than the fund that paid the salary. Proper funds should be used to ensure accurate, relevant financial information. In addition, we noted that one student had social security taxes

withheld from their wages even though they were enrolled in classes. Social Security Act section 210 (a) 10 provides that employment shall not include service performed in the employ of a university if such service is performed by a student who is enrolled and regularly attending classes at such university.

Recommendation:

We recommend that payroll expenses be coded to the proper account, fund, project and/or program and social security taxes not be withheld from student wages while employed and regularly attending classes.

Mayville State University Response:

We concur. We make every effort to code transactions properly. The PeopleSoft HRMS does not always allocate the salary and fringe benefits properly. Department managers receive Gross & Fringe Reports each pay period, and are asked to review the reports for accuracy and to inform the payroll office of needed changes.

Building Lease Revenue (05-2)

During the prior audit, the following condition was an informal recommendation. Mayville State University (MASU) was leasing building space to several lessees during our audit. The revenue from the building leases was recorded in fund 20490, Traill County Technology Center, a MASU department. For fiscal years 2005 and 2004, the building lease revenue was about \$25,300. State Board of Higher Education policy 909 provides that revenues from leases shall be credited to the fund or funds which are used for the support of the facility being leased.

Recommendation:

We recommend that revenues from building leases be recorded in the funds that are used to account for the support of the facilities being leased.

Mayville State University Response:

We concur. Future lease revenues will be recorded in compliance to SBHE Policy 909.

241 – Minot State University

Operational Audit – Contact: John Grettum 239-7250 jgrettum@nd.gov

Leases (05-1)

During our review of the new operating and capital leases at Minot State University, we noted the following problems:

- The capital lease for the Education Department copy machine was not bid. The amount of the lease was \$11,569.
- The operating lease for the two new copy machines for the Printing Department (\$165,381) was not recorded as a capital lease and was not recorded as a capital

asset. The term of the lease is 5 years and the economic life is 6 years. The lease term is 83% of the economic life of the asset.

- The operating lease for the postage meter that began in fiscal year 2004 for \$67,152 was not bid, was not recorded as a capital lease, and was not recorded as a capital asset. The present value of the minimum lease payments is 137% of the asset fair value.

NDCC 54-44.4-01 states that it is state policy to provide comprehensive purchasing services based upon sound procurement practices and principles wherein, through full competition with fair and equal opportunity to all qualified persons and firms to sell to the state, each state agency and institution shall obtain its necessary supplies and equipment at competitive cost, consistent with quality, time, and performance requirements.

NDCC 54-44.4-05 states that purchasing contracts must be awarded to the lowest responsible bidder considering conformity with specifications, terms of delivery, and quality and serviceability.

State Board of Higher Education policy 803.1 part 3 states that personal property, equipment, or supplies estimated at \$10,000 or more must be purchased from formal bids. As many sources as possible (including qualified North Dakota vendors) should be solicited.

Statements of Financial Accounting Standards No. 13 states that if one or more of the following conditions are met, the lessee treats the lease as a capital lease:

- Ownership actually transfers to the lessee at the end of the lease.
- A bargain purchase option is contained in the lease.
- The life of the lease is equal to or greater than 75% of the remaining economic life of the leased asset.
- The present value of the minimum lease payments over the life of the lease is equal or greater than 90% of the fair value of the property at the beginning of the lease.

Recommendation:

We recommend that Minot State University:

- Follow NDCC sections 54-44.4-01 and 54-44.4-05 and state board of higher education policy 803.1 by bidding out all property greater than \$10,000.
- Properly record the postage meter lease and the copy machine lease as capital leases and record the postage meter, and the copy machines as capital assets.

Minot State University Response:

MiSU agrees with the recommendation, and will be sure to bid those items that cost more than \$10,000. MiSU will use the template provided by the SAO for every lease to determine whether it is capital or operating.

301 - Department of Health

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Food Inspection Checklist (05-1)

Background:

North Dakota Century Code 23-09-11 states, "Each lodging establishment, food establishment, or assisted living facility must be inspected at least once every two years by the department." Food establishments include schools, restaurants, retail, meat markets, child care facilities, etc. The North Dakota Department of Health has established Administrative Code (Chapter 33-33-04) dealing with the Food Code to set the standards establishments must meet. The Department of Health has memorandums of understanding with the following 7 entities: 4 cities – Williston, Bismarck, Grand Forks, and Fargo; and 3 health units – Southwest District, Custer, and First District. These entities will provide the necessary inspections and licenses for certain food establishments within the boundaries of the entity. The Department of Health has 4 full-time employees responsible for conducting the necessary reviews of the remaining food establishments not covered in the memorandum of understandings noted above.

During calendar year 2005, the Department of Health conducted 1,960 inspections of food establishments.

Challenge:

Currently the Department of Health does not have any type of checklist form to be used by the inspectors; they are required to remember the applicable sections of code (which is 115 pages long), as well as the specific requirements contained within those sections. The current food inspection report lists only the violations noted by the inspector, without providing any assurance that all the applicable areas of concern were adequately addressed.

Operational Improvement:

We recommend the Department of Health develop a checklist to be used by food inspectors in determining whether food establishments are complying with regulations.

North Dakota Department of Health Response:

The Department has developed a new two page inspection Report form modeled after the Federal Inspection form. Each condition on the form makes reference to specific sections of the Administrative Code.

313 – ND Veterans Home

Operational Audit – Contact: John Grettum 239-7250 jgrettum@nd.gov

Segregation of Duties (05-2)

The same person could write, sign, and mail checks, in addition to recording the activity in the check register for the custodial and resident trust checking accounts. The cash balance in

these checking accounts was about \$70,000 at June 30, 2005. In addition, PeopleSoft roles were not immediately deleted for terminated employees. The roles of the prior Administrator were still active on June 26, 2006, even though he left in February 2006.

Inadequate segregation of duties for outside checking accounts and the continuation of computer access for terminated employees enhance the risk of undetected loss of assets.

Recommendation:

We recommend that:

- The disbursement and approval duties for the outside checking accounts be segregated and
- Immediate cancellation of Computer access for terminated employees.
- North Dakota Veterans' Home Response:
- Agree. Procedures were immediately implemented to correct internal controls.

North Dakota Veterans' Home Response:

Agree. Procedures were immediately implemented to correct internal controls.

325 – Department of Human Services

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Cross Check Food Stamp Payments with Incarcerated Individuals (05-1)

Background:

Per review of the Department of Human Services Food Stamp policy manual (430-05-65-25), individuals should be removed from a food stamp family unit no later than 30 days from their date of incarceration.

Observation:

Our testing found 6 individuals that were included in the food stamp benefit calculation after the 30-day period had expired. These family units received additional benefits they were not entitled to receive.

Two of these individuals were still being included in the benefit calculation as of our test date (September 2005), but had been incarcerated in the State Penitentiary since 3/9/05 and 5/5/05. The other four were included in the benefit calculation from 1 to 3 extra months after incarceration.

Operational Improvement:

We recommend the Department of Human Services implement procedures to ensure food stamp eligibility determinations are cross-checked against the Department of Corrections and Rehabilitation records to ensure only eligible family members are included in the benefit calculation.

Department of Human Services Response:

The Department agrees with the operational improvement noted. The Department currently uses a Federal database called the State Verification Exchange System (SVES) to match individuals participating in the Food Stamp program with the Social Security Administration's Prisoner Verification System. The Department will continue to use SVES and will also work with North Dakota Department of Corrections and Rehabilitation to implement procedures to crosscheck food stamp eligibility determinations against their records.

Public Assistance Reporting Information System Implementation (05-2)

Background:

The Public Assistance Reporting Information System (PARIS) is an information exchange system designed by the Administration for Children and Families to provide State Public Assistance Agencies with appropriate data as a result of a federal computer matching initiative. The Department of Human Services could provide information on participants in Medical Assistance, Medicaid, Temporary Assistance to Needy Families (TANF), and Foods Stamps to the federal government, who would then match these individuals against the Veterans Administration (VA), Department of Defense/Office of Personnel Management, and information provided from other states.

One purpose of the match is to identify individuals receiving Medicaid benefits that may also be eligible to receive VA benefits. The state costs are reduced when individuals receive benefits from the VA (100% federally funded), rather than Medicaid (state match).

Another purpose of this match is to identify individuals receiving active or retired federal or military pay to ensure individuals receiving these payments have properly reported them to the Department of Human Services.

The final purpose is to match individuals who may be receiving similar benefits in multiple states. For example, individuals receiving TANF benefits in both North Dakota and South Dakota would be identified and could be removed where applicable.

Observation:

33 states have participated in the PARIS information exchange. Several states have reported a significant savings by participating in the program.

During fiscal year 2005, the Office of Financial Services did have 8 grants available for up to \$150,000 to encourage states to implement PARIS.

The state of Oregon provided information that the cost of implementing PARIS was approximately \$10,000 for their state.

Once implemented, other than a minimal cost to run/submit the data to the federal government, the only cost to the state would be the time spent reviewing matches and determining if benefits should be reduced or denied. Data transmission costs and matching reports are provided at no cost to the state.

Operational Improvements:

We recommend the Department of Human Services implement the Public Assistance Reporting Information System.

Department of Human Services Response:

Based upon our research of PARIS over the last several years the Department does not agree with the operational improvement at this time.

It is believed PARIS is of limited utility if adjoining states do not also participate. Neither Minnesota nor Montana have ever participated and South Dakota allowed its participation to lapse.

Medicaid eligible individuals, who are also eligible to receive VA benefits, have the choice to receive either the VA benefits or Medical Assistance. Because VA services and the availability of those services in North Dakota are limited, and the mobility of veterans eligible for Medicaid may also be limited, the veteran often chooses Medical Assistance.

Military retirement and survivors benefits will be captured with the Department's UFO query to the IRS database that is run monthly since these amounts are reported on the 1099-R.

The Department will continue to examine the effectiveness of PARIS as well as other information exchange systems that can be used to detect program violations.

Lack of Controls Over Drug Inventory (05-3)

Both the State Hospital and Developmental Center have on-site pharmacies. Both pharmacies have a computer system in place which would track drug inventory if properly used; however, neither institution has ever updated the beginning inventory numbers.

All 8 Human Service Centers (HSC) receive donated anti-depressants and anti-psychotic drugs from various drug representatives during the year for use by HSC patients. Currently there are not adequate controls in place at all Human Service Centers to safeguard the drug inventory to prevent unauthorized use.

Without adequate controls, it would be possible for individuals with access to drugs to remove drugs from the supply inventory for personal use or gain without being detected.

Recommendation:

We recommend the Department of Human Services strengthen controls over drug inventories at the Human Service Centers, State Hospital, and Developmental Center.

Department of Human Services Response:

The Department agrees with the recommendation. Procedures will be put in place to tighten security surrounding the access to drugs at the Human Service Centers. Also perpetual inventory systems will be implemented at the State Hospital and Developmental Center.

413 – Department of Financial Institutions

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Online Consumer Applications (04-1)

Issue:

Currently, the Department of Financial Institutions licenses approximately 840 consumer-type businesses but only 15% currently apply online; the remaining license applications or renewal forms are received through the mail. It takes the Department approximately 15 minutes to manually enter a license application into the Records Management System (System) and as a result a significant amount of resources are spent each year entering the application information. Time is also spent reviewing the annual renewal forms and manually updating any changed information. Additional time is spent each year opening mail, receipting checks, preparing deposits, posting payment amounts, and reconciling records. If the payment was made electronically all of these functions would be performed automatically.

Process:

We reviewed the procedures for processing consumer license applications and payments with management of the Department of Financial Institutions. Their System currently processes annual consumer license applications and renewals along with the license fees for money brokers, collection agencies, consumer finance companies, agents for deposits, and sale of check businesses through the Internet. All consumer license applications processed online are entered by the applicant and require no additional data entry by department employees. The online renewal form automatically updates the appropriate data on the System. All license applications not processed online are mailed to the department where an employee manually enters the license application information, or any changed data from the renewal form, into the System. The initial application is only filed once; however, a renewal form and the filing fee must be resubmitted on an annual basis. Since approximately the same percentage of payments are made online as applications filed, it can be determined that if an entity initially files an application by mail that same entity will continue to file the renewal form and payment by mail each year thereafter.

Possible Solution:

The Department of Financial Institutions developed the Records Management System in an effort to make the financial institution's data more accessible to the Department as well as the public, and reduce the amount of time spent licensing consumer companies for both the Department of Financial Institutions and applicants. The Department of Financial Institutions has done an excellent job of utilizing the System's capabilities; however, if more consumer license applications and renewals were processed online, a significant amount of resources could be saved by the Department of Financial Institutions.

Based on our analysis we recommend the Department of Financial Institutions adopt appropriate policies and procedures to encourage consumer companies to complete their consumer license applications and subsequent renewals online.

Department of Financial Institution's Response:

We recognize the inefficiency of having to manually enter application information or edit renewal information as well as the associated resources expended. Prior to the audit recommendation we had discussed this issue and were struggling with how to get a higher level of licensees to apply or renew online. Each year we send each licensee a unique code along with the renewal forms in an effort to encourage the online renewal and this met with limited success initially we are seeing more online renewals. We do intend to implement the solutions offered by the audit staff in an attempt to increase the use of the online application or renewals; however, some of the incentives necessary may require legislative changes.

504 – Highway Patrol

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Inadequate Internal Controls Surrounding Federal Revenues and Expenditures (04-2)

During our review of internal controls surrounding federal revenue and expenditures at the North Dakota State Highway Patrol, four weaknesses were identified:

- On six instances totaling \$526,726, the North Dakota State Highway Patrol incorrectly transferred revenue and expenditures from one federal grant to another. The North Dakota State Highway Patrol does not have a control in place to detect this type of error.
- The North Dakota State Highway Patrol does not reconcile all federal fund requests submitted to the federal government to the receipt of those funds. This weakness resulted in two instances totaling \$19,384 - where federal funds requested by the North Dakota State Highway Patrol were not received.
- The North Dakota State Highway Patrol tracks all federal revenues and expenditures using an Excel spreadsheet. The Department relies on this spreadsheet for their grant information. Revenues and expenditures recorded on the state accounting system are not relied on by the Department. As a result, when federal revenues and expenditures are erroneously recorded on the state accounting system the errors go undetected. For the reasons mentioned above the federal fund balance as shown on the state accounting system for both fiscal years 2004 and 2003 was incorrectly stated. Also, due to these weaknesses the grant receivable closing packages for both fiscal years 2004 and 2003 were incorrectly completed.
- Two separate federal grants were identified on the state accounting system with the same grant number. Due to this weakness, federal activity for these grants on the state accounting system is inaccurate.

A system of strong internal controls requires all revenues and expenditures be properly recorded on the state accounting system, federal fund requests be reconciled to the receipt of those funds, federal grants to be identified by unique grant numbers, and year – end grant receivable closing packages be properly completed.

Recommendation:

We recommend the North Dakota State Highway Patrol develop controls to ensure:

- Grant revenues and expenditures are properly recorded.

- All federal funds requested are received.
- Grant receivable closing packages are properly completed.
- All grants have unique grant numbers.

North Dakota State Highway Patrol's Response:

Procedures have been implemented to do the following:

- All grant expenses and revenues will be properly recorded. When corrections are made to federal reimbursements, the reclass entry will be made to the federal expense portion of the transaction.
- All federal reimbursements requested will be reconciled to federal funds received and a monthly report will be submitted to management. During the audit period a reconciliation procedure utilizing EXCEL spreadsheets was in use, but this procedure was not adequately monitored so as to be completely effective. However, the errors specified were discovered by the NDHP and corrective action was taken before the NDHP was informed by the auditors that the reimbursements had not been received and would be noted as audit errors.
- Grant receivable closing packages will be properly completed.
- All grants will be assigned unique grant numbers.

Maintenance of Clearing Accounts (04-2)

Challenge:

As of June 30, 2004 the North Dakota State Highway Patrol maintained 27 clearing accounts which were located around the state. These accounts are used for the deposit of funds collected by the Highway Patrol around the various parts of the state. Currently, on all but one account, manual checks are written on each of these accounts at least twice a month to transfer the funds from these clearing accounts to the Bank of North Dakota (BND). As part of this manual process, manual check registers are maintained for each of the accounts and at the end of the month bank reconciliations are completed for each account. The one account mentioned above is currently being electronically cleared through a process similar to that mentioned below.

Possible Solution:

Based on phone interviews conducted with five of the banks utilized by the North Dakota State Highway Patrol and overall industry practices, we developed the following recommendation:

Each of the clearing accounts should be cleared to the BND electronically through an electronic funds transfer or ACH once a month rather than writing multiple checks from each account. This would eliminate a significant amount of administrative duties and costs such as writing checks, having checks signed, preparing checks to be mailed, and postage. In addition to eliminating administrative duties and costs this process would also eliminate the need to keep check books for these accounts, thereby eliminating all risks associated with blank checks.

As part of this electronic process, all check registers should be maintained in an electronic format such as Excel. By having the registers in an electronic format the information in the registers can be more efficiently and effectively utilized. In addition, as checks will no longer be written from these accounts, the only activity in the register for each month would be the

electronic transfer of funds from the account to the BND. As the activity in each account would be minimal, the month-end bank reconciliations would be simplified compared to the current reconciliation process.

Disposition:

The NDHP has one account which is currently using electronic transfers and will implement electronic transfer procedures for all of the remaining bank accounts.

Bank Reconciliations (04-3)

As of June 30, 2004 the North Dakota State Highway Patrol maintained 27 clearing accounts at various banks around the state. These accounts are used for depositing funds collected and clearing them to the Bank of North Dakota and eventually the State Treasurer's Office.

At the end of the month a bank reconciliation is prepared for each account. Currently, these reconciliations are being done by an individual who has access to cash and are not being reviewed and approved.

Additionally, we noted that amounts deposited with the State Treasurer's Office were not being reconciled back to the original receipts by someone independent of deposit preparation.

A system of strong internal controls requires that bank reconciliations prepared by an individual with access to cash must be reviewed and approved by an appropriate individual. In addition, all amounts deposited with the State Treasurer's Office must be reconciled back to the original receipts by someone who does not have access to cash and is independent of deposit preparation.

Recommendation:

We recommend the North Dakota State Highway Patrol develop internal controls to ensure:

- Bank reconciliations are reviewed and approved by an appropriate individual.
- All amounts deposited with the State Treasurer's Office are reconciled to the original receipts by someone who does not have access to cash and is independent of deposit preparation.

North Dakota State Highway Patrol's Response:

Bank reconciliations are now being approved by someone independent of preparing the reconciliations, and amounts deposited with the State Treasurer are being reconciled by an employee who is not involved in the procedures for depositing cash receipts.

Monitoring Grant Recipients (04-3)

Challenge:

The North Dakota State Highway Patrol awards grants to local law enforcement agencies to support an Underage Drinking Program and to the North Dakota State University (NDSU) for the development of the Query Central computer system to be used by all federal motor carriers in the United States.

The Highway Patrol reimburses the local law enforcement agencies based on time certifications submitted to the Department. The Highway Patrol has not performed any onsite reviews of the Underage Drinking Programs implemented nor have they verified the accuracy of the time certifications submitted to the Department for reimbursement.

The Highway Patrol reimburses NDSU based on a standard billing form submitted by NDSU. Our review of the standard billing form received indicated that source documentation for the expenditures claimed for reimbursement was not being submitted for review.

Possible Solution:

As source documentation is not being received, on-site reviews are not being performed, and time certifications are not being verified as to their accuracy; it is not possible for the Highway Patrol to determine if expenditures claimed for reimbursement are reasonable and allowable.

We recommend the North Dakota State Highway Patrol develop adequate grant monitoring procedures for both the Underage Drinking Program and the Query Central grant to ensure all grant monies awarded are being used in accordance with all grant agreements.

Disposition:

The NDHP will implement all necessary procedures to adequately monitor all federal grant subgrantees. Increased monitoring will include requesting subgrantees to provide copies of payroll records; provide quarterly reports on workhours, costs, and activities; and conduct random audits by phone or on-site visits to review timesheets and obtain program evaluation information.

Maximizing Use of Federal Grant Funds (04-4)

Challenge:

The North Dakota State Highway Patrol has not been spending all the federal grant funds awarded to them. It was noted that during the audit period over one million dollars of the Motor Carrier Safety Assistance Program (MCSAP) grant funds available to the agency had not been requested for use.

A review of the Highway Patrol's indirect cost allocation procedures identified numerous expenditures that were being paid with state funds that could have been paid with MCSAP grant funds. Some of the expenditures identified that were paid with state funds include copier leases, ammunition for sworn MCSAP officers, and administrative salaries. Our auditing procedures indicated that a portion of these expenditures should have been paid with MCSAP grant funds and they were not.

Possible Solution:

Per discussion with the North Dakota State Highway Patrol's grant administrator and review of the MCSAP grant compliance requirements, there are several areas where they could be charging additional expenditures to the grant, especially in the areas of salaries and indirect costs.

The North Dakota State Highway Patrol should implement procedures to adequately plan and budget for maximizing the use of MCSAP and other federal grant monies. The grant

administrator, accountant, and budgeting personnel should re-evaluate the grants to determine which additional expenditures could be charged to the grants in order to save state funds.

Disposition:

The NDHP has significantly increased total federal expenses in the last two fiscal years and will continue efforts to fully utilize all federal funds available. Federal MCSAP program expenses increased from \$1.41 million during the 2001-2003 biennium to \$1.917 million during the 2003-2005 biennium for an increase of 36%.

540 – Adjutant General Including DEM

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

Noncompliance With NDCC for Fees Charged by State Radio Communications (04-3)

State Radio Communications Division has not reviewed the actual costs for fees for law enforcement telecommunications systems (LETS), mobile data terminals (MDT), and 911 fees. It appears costs for LETS have not been reviewed since 1991 and for MDT since at least 1999. In addition, State Radio Communications Division has not determined if \$.20 is adequate to cover the cost of providing 911 services nor updated the number of access lines reported by the counties for 911 fees since July 1, 2003.

North Dakota Century Code (NDCC) section 54-23.2-08 states the State Radio Communications Division must base its fees for LETS on actual costs. NDCC section 54-23.2-09 states State Radio must base its fees for MDTs on actual costs and 911 fees of at least \$.20 are to be charged per telephone access line and wireless access line for 911 services.

Recommendation:

We recommend the Division of Emergency Management:

- a) Establish a method to ensure fees charged by State Radio Communications for services provided are based on actual costs;
- b) Ensure political subdivisions are being charged for the correct number of access lines for 911 fees; and
- c) Establish a reasonable time frame for reviewing costs of services and updating the number of systems, devices, or access lines for which the fees are being charged.

Office of the Adjutant General Response:

Regarding the recommendations for State Radio Communications fees, the agency concurs with the finding. The Department of Emergency Services is currently undergoing a Performance Audit pursuant to Section 5 of House Bill 1016. This section requires the Office of the State Auditor to conduct a performance audit to include a review of fees collected for 911 fees and the utilization of the fees during the biennium. The department will defer any program changes until the completion of the Performance Audit.

601 - Department of Commerce

Operational Audit - Contact: Paul Welk 328-2320 pwelk@nd.gov

National Resources Bond Application Process (02-1)

Overview:

North Dakota Century Code (NDCC) Chapter 21-11 (enacted in 1963) allows any privately or cooperatively owned enterprise to apply for a loan for the purpose of planning, constructing, acquiring, equipping, improving, or extending facilities for the conversion of North Dakota's natural resources into low-cost power, the generation and transmission of such power, and the acquisition of real and personal property and water and mineral rights needed for such facilities, or any of such purposes. The application is to be in the form required by Economic Development and Finance (ED&F), a division of the Department of Commerce (DOC). If ED&F considers an applicant eligible and in compliance with all requirements, the DOC shall collect an application fee of no more than \$50,000. A continuing appropriation was created for the purpose of investigating the applicant and evaluating the technical and economic feasibility of the operation plan submitted by the applicant. After sufficient research, the applicant is approved or denied. If approved, the application is filed with the State Industrial Commission.

Current Status:

ED&F was not aware of this North Dakota Century Code section.

Therefore, ED&F has not developed an application form for companies interested in applying for this loan and are unaware of any company having expressed interest in obtaining such a loan.

Operational Improvement:

Due to the lack of knowledge surrounding this statute, we recommend DOC investigate the field of potential applicants to determine the feasibility of this bond program as currently provided for in North Dakota Century Code. Based on the research, if DOC determines this bond program is not used because potential applicants are unaware of it, we recommend ED&F initiate this program and develop a review process. In addition, they should set up a fund to account for the fees collected from the applicants. If the research reveals the restrictions and provisions set forth in statute hinder companies from applying, we recommend the barriers within the bond application process be presented to legislature for possible change. However, if today's corporate structure indicates no company would be interested in this type of bond, we recommend DOC make a request to the legislature to have this section of NDCC repealed.

Department of Commerce Response:

The Department of Commerce Commissioner will conduct a review of the history of the statute and its non-use. Upon completion of the review the Governor's Office will be consulted regarding repealing the provision. If it is determined it is not appropriate to request the provision be repealed, we will begin our duties to promote the statute, develop an application and

701 – Historical Society

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Accounting for Capital Assets (04-1)

During our review of the Historical Society's capital assets closing package and capitalization and depreciation procedures, several deficiencies were noted.

- Improper capitalization of appropriate architectural and utility line costs for capital improvements.
- Failure to include as additions, the costs for building improvements incurred within the fiscal year for which payment was made after the fiscal year end.
- Failure to reduce accumulated depreciation for disposed assets.
- Improper calculation of accumulated depreciation resulting from incorrect service dates for historical buildings owned by the Historical Society for over 50 years which should
- have been fully depreciated.
- Certain equipment items over \$5,000 were not capitalized in accordance with OMB Policy.
- The capital asset closing package "net correction to prior year balances" for adjusted value of capitalized buildings and improvements did not agree to support.

The Governmental Accounting Standards Board (GASB) Statement 34, Generally Accepted Accounting Principles (GAAP), and OMB Policy require reporting capital assets (buildings, building improvements, and equipment) at historical cost (donated capital assets are valued at estimated fair market value on the date of donation), including appropriate depreciation.

Recommendation:

- We recommend the Historical Society:
- Implement procedures to ensure all applicable costs associated with new construction be properly capitalized.
- Ensure the capital assets closing package agrees with support.
- Properly capitalize equipment and building improvement costs incurred each fiscal year.
- Properly compute building depreciation expense and accumulated depreciation taking into consideration any residual value, purchase or donation dates, and capital improvement project dates, and disposed assets.

Historical Society Response:

The Society has project numbers set up for all costs associated with new construction. The Society will review all project numbers when considering the capitalization of costs. This should ensure that all construction costs, no matter what the source of funding, agree with the support. Based on the audit recommendations, the Society will modify its internal capitalization policy. During the current audit and in coordination with the auditing team, modifications have been made to the agency building inventory to properly compute the building depreciation expense and accumulated depreciation taking into consideration residual value, purchase or donation dates and capital improvement project dates. The revised inventory was reviewed by the

auditing team and management and both were in agreement that the revised inventory met the needs of the recommendation and will be maintained in the future.

770 – State Water Commission

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FINANCIAL REPORTING (05-2)

The financial statements prepared by the State Water Commission for the 2004 and 2005 Comprehensive Annual Financial Reports (CAFR) had some misstated accounts. Material corrections to some accounts were made within the balance sheet and statement of revenues, expenditures, and changes in fund balance for debt service and capital projects funds. The misstatements required additional audit time to research and correct.

Recommendation:

We recommend the State Water Commission accurately prepare their financial statements for the state's CAFR.

State Water Commission Response:

It is the intent of the agency to accurately prepare our financial statements for the State's CAFR. One adjustment made by the State Auditor's Office was a result of a premium being received on the bond issue, and how it was presented. The other adjustment was to record the expenses of a refunding issue in the Debt Service account rather than the Capitol Projects account. Should any of these types of transactions occur in the future the Agency will present them in accordance with the State Auditor's recommendations.