

Office of the State Auditor

Division of State Audit

Significant Audit Findings 2007-2008 Interim

Prepared at the Request of the Senate
and House Appropriations Chairmen

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State Auditor



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Performance Audits

University of North Dakota School of Medicine and Health Sciences

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

Comply With State Law Regarding Purpose and Duties (1-1)

We recommend the School of Medicine and Health Sciences comply with state laws regarding the purpose and duties of the medical school or take appropriate action to modify state laws.

Ensure Mission Statement is Consistent with State Law (1-2)

We recommend the School of Medicine and Health Sciences ensure their mission statement is consistent with legislative intent established in state law.

Establish Formal Process For Monitoring Compliance (1-4)

We recommend the School of Medicine and Health Sciences establish a formal process to ensure compliance with state laws. This process should include a periodic review to ensure laws are not outdated, and a plan to take appropriate action to update laws if necessary.

Investigate Increasing the Number of Residency and Fellowship Positions (2-1)

DJW recommends the School of Medicine and Health Sciences investigate increasing the number of residency and fellowship positions supported by Medicare Direct Medical Education (DME) and Indirect Medical Education (IME) and carefully review any plans to increase residency or fellowship positions with the Residency Review Committee requirements.

Improve How Major Management Decisions Are Made (2-5)

DJW recommends the School of Medicine and Health Sciences develop a culture within the school in which major management decisions begin with a formal, internal review process with all key partners and an attempt to build a consensus to support the desired outcome.

Establish Specific Performance Measures (3-1)

We recommend the School of Medicine and Health Sciences establish specific performance measures for monitoring the effectiveness of the operations of the school. Appropriate benchmarks or other standards to measure the school's performance should be identified.

Improve Monitoring of the Dean's Performance (3-4)

We recommend the University of North Dakota ensure areas identified as requiring improvement are adequately addressed, documented, and monitored in the evaluation process of the Dean of the School of Medicine and Health Sciences.

Develop Additional Incentive to Keep Graduating Students in the State (3-24)

We recommend the School of Medicine and Health Sciences, in conjunction with the Medical Center Advisory Council, develop additional incentives and continue to take appropriate steps for keeping graduating students within the state.

Wildlife Services Program

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

Ensure Expenses Paid are Verifiable (1-1)

We recommend the Department of Agriculture pay salaries of the Wildlife Services' field specialists and other cost(s) which can be verified in a timely and efficient manner.

Review Pilot Time Charged (1-2)

We recommend the Department of Agriculture review the time of the pilot charged to the Wildlife Services Program and determine what percentage of the pilot's salary will be paid by the state.

Require Time to be Dedicated to Blackbird Problem (1-6)

We recommend the Department of Agriculture require the Wildlife Services' field specialists dedicate a certain amount of time in the fall to the state blackbird problem.

Make Appropriate Changes to Agreements (1-8)

We recommend the Department of Agriculture ensure appropriate changes are made to the Cooperative Service Agreements to address recommendations included in this audit report as well as to:

- a. Approve or require information be provided for salary increases of Field Specialists prior to being effective;
- b. Establish performance measures to evaluate the program;
- c. Require only necessary reports or information regarding the program; and
- d. Identify if, when, and where state funds are to be used for issues arising in urban areas.

Performance Audit Follow- Up Report Recommendations

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

During the 2007-2009 biennium, the Office of the State Auditor also issued four performance audit follow-up reports. These reports identified the status of recommendations made in previously issued performance audits. Information regarding the status of recommendations follows:

Performance Audit Follow-Up Report	Status of Recommendations			
	Fully Implemented	Partially Implemented	Not Implemented	No Longer Applicable
Administrative Committee on Veterans' Affairs and Department of Veterans' Affairs	18	8	1	0
Department of Corrections and Rehabilitation	26	19	5	1
Division of Emergency Management and 911	13	9	4	0
Workforce Safety & Insurance	19	36	3	2

As seen by the table above, the majority of performance audit recommendations have been fully or partially implemented. As a result, changes have been made to improve operations, reduce costs, facilitate decision making, and increase accountability within state government. For example, in the follow-up report of the Department of Corrections and Rehabilitation, we identified the department was saving over \$915,000 a year due to implementing five recommendations.

Information Systems Audits

Information Technology Department Information System Audit

Information System Audit – Contact Donald Lafleur 328-4744 dlafleur@nd.gov

ITD lacks a formal Security Plan

Security plans are needed to provide centralized direction and control over information security. The lack of a formal security plan increases the risk that information security will not be consistently applied across the organization and increases the dependence on the expertise of current employees.

Recommendation

We recommend that ITD develop a security plan that provides centralized direction and control over information security.

ITD Response

ITD agrees with the recommendation and plans to develop a formal security plan. ITD does have dedicated security staff who focus on enterprise security issues and procedures, however we do agree that there is value in formalizing existing processes and standards into an overall plan.

Finding: 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 plans to leverage our relationships with other security organizations in other states to determine best practices in this area.

North Dakota University System Information System Audit

Information System Audit – Contact Donald Lafleur 328-4744 dlafleur@nd.gov

Excess Superuser Access

Good internal controls require that you grant access rights based on a demonstrated need. A superuser account is an account that has access to all or nearly all functions, or can modify

security. Unnecessary superuser access increases the risk that errors and irregularities could occur. We noted superuser accounts that we considered to be inappropriate.

Recommendation:

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

Agency Response:

North Dakota University System

We concur. The University System will review which individuals have superuser access and evaluate the appropriateness of that access.

Office of Management and Budget

OMB has complied with this audit recommendation. We reviewed the list of individuals with superuser access and took it away from those who we determined did not need it. We also provided the State Auditor's Office a list of individuals who will have superuser access. Many of the superusers were the PeopleSoft IT developers and their security access is addressed in the recommendation below.

Developer access to PeopleSoft Production Environment

Software developers have access to the production environment in ConnectND Finance. This increases the likelihood of unauthorized access to confidential or sensitive information and fraud. Proper segregation of duties requires software developers' access to the production environment be limited.

Recommendation:

We recommend the North Dakota University System and the Office of Management and Budget properly limit developer's access to the production environment.

Agency Response:

North Dakota University System

We concur. The University System will work with OMB and the State Auditor's Office to define a level of access for developers that allows them to provide necessary assistance with production issues, while respecting an appropriate segregation of duties. The proper balance is critically important since programmers provide front-line support to help troubleshoot and resolve userproblems and must be able to replicate user functionality.

Office of Management and Budget

OMB agrees with this audit recommendation and will limit the PeopleSoft IT developers' security access in the production environment. We will work closely with the State Auditor's Office and the PeopleSoft IT development team to create the roles and permission lists necessary for the developers to maintain and enhance the PeopleSoft production environments.

Financial Data in Other Modules Not in Agreement With the General Ledger

In reconciling the sub-module records to general ledger journal entries we found that the data does not always agree. Differences are mostly in the account, fund, or project used not in amount. These differences are likely the result of the general ledger journal entry produced by the module being edited prior to posting it to the general ledger. Data in the other modules must agree to what is recorded in the general ledger to maintain the integrity of the data. If the

modules do not agree to the general ledger it is difficult to rely on the detailed data from the modules.

Recommendation:

We recommend the North Dakota University System and the Office of Management and Budget ensure that financial data within the modules agrees with the general ledger.

Agency Response:

North Dakota University System

We concur. Through continued analysis of specific audit findings, the University System will confirm whether the financial system is the cause or not for differences between the general ledger and other modules. If it is found that changes made at the institutional level are the cause of the differences, institutions will be reminded to only change system-generated transactions manually in rare circumstances, and then to clearly document the need for the manual changes.

Office of Management and Budget

OMB agrees with this recommendation and will comply in the future. OMB does monitor the financial data within the PeopleSoft modules to determine they are in sync. When problems are found, OMB analyzes what went wrong and determines how to correct them. OMB was aware of the instances cited by the State Auditor's Office and had made corrections to the general ledger to fix what were system problems. We did not in all cases correct the sub-module records.

Financial Statement Audits

North Dakota State CAFR – 2007

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

Lack of General Ledger Transaction Approval Procedures

(Prior Recommendation Not Implemented)

ConnectND does not have an online approval process for general ledger (GL) transactions. In addition, the Office of Management and Budget has not implemented controls to ensure state agencies have manual approval procedures. Without proper approval, internal control is compromised. This increases the risk of errors and fraud to unacceptable levels. These GL transactions can affect both revenues and expenditures of the state's various funds.

Recommendation:

We recommend the Office of Management and Budget implement ConnectND online approval for General Ledger transactions or provide guidance and training to agencies for alternative approval procedures.

OMB Response:

OMB agrees with the recommendation. ConnectND online approval for General Ledger transactions has been implemented.

Limiting Access to Information Technology Applications

Individuals have access to information technology applications beyond what is necessary to perform their job duties. We noted this security weakness at the following agencies with the applications shown in parenthesis:

- Office of Management and Budget - (ConnectND Human Resource Management System access granted by OMB to Information Technology Department employees).
- Department of Human Services - (Child Care Assistance, Vocational Rehabilitation Information System, Technical Eligibility Computer System, Comprehensive Child Welfare Information and Payment System, Low-Income Home Energy Assistance, Regional Office Automation Program, and VISION).
- Department of Public Instruction - (Foundation Aid and Food and Nutrition).

Policies and procedures should be in place to ensure: individuals only have access necessary to perform their job duties; an individual is assigned the responsibility of controlling access to all applications; and ongoing reviews are performed to ensure access rights are properly maintained. Without these controls, there is an increased likelihood of unauthorized access to confidential or sensitive information and fraud.

Recommendations:

We recommend agencies:

- Establish policies and procedures to restrict access privileges to only necessary individuals.
- Assign ongoing responsibility for security for each information technology application.
- Perform continuing reviews of access privileges.

Agency Responses:

OMB agrees with the recommendation. We will periodically review and evaluate the security roles given to ITD developers to determine if they are necessary to perform their job duties. The Department of Human Services will continue to enhance procedures surrounding access to technology applications. The Department of Public Instruction concurs with the finding and has implemented procedures to comply with the recommendations.

Errors in Closing Packages and Adjusting Entries

Closing packages prepared by state agencies and used in the preparation of the state's Comprehensive Annual Financial Report contained several errors. We also noted several of the Office of Management and Budget's (OMB) adjusting entries were either made incorrectly or were not properly supported.

Several of the closing packages we tested contained errors, with the largest being \$12 million. Of the errors in OMB prepared adjusting entries, the largest two were reclassification errors of \$14.8 million and \$15.4 million. We noted other OMB prepared entries where the amounts were not properly supported. Had these errors not been detected during the CAFR audit, the state's financial statements would have been materially misstated.

Recommendation:

- The Office of Management and Budget should address the problem of numerous errors occurring at the state agency and the CAFR compilation levels including:
 - Evaluate the training needs for OMB and agency personnel including individuals that approve closing packages.
 - Address control environment issues including: management's commitment to competency by ensuring closing packages are completed accurately; and management's philosophy and operating style by improving attitudes and actions toward financial reporting.
 - Clearly communicate to the approvers of closing packages their duties and responsibilities.
 - Monitoring and approval activities at OMB should be enhanced relating to both the review of agency closing packages as well as entries prepared by OMB staff and consultants.

Office of Management and Budget Response:

OMB partially agrees with this recommendation. OMB provides agencies with closing package instructional manuals and provides assistance to agencies at their request. We conduct training sessions when there are significant changes to warrant these sessions. We plan to conduct training before the next CAFR.

We will again emphasize to agencies the importance of the closing packages to the CAFR, the need for all closing packages to be completed accurately, and will also remind approvers of closing packages of their responsibilities. However, we cannot ensure that addressing management's philosophy will improve attitudes toward financial reporting.

We plan to require state agencies to submit their CAFR information earlier in order to give us more time to review their closing packages and to prepare and review adjustments.

Lack of Proper Cash Reconciliation and Cash Balance Reporting at the Department of Transportation

The Department of Transportation (DOT) is not properly reconciling their motor vehicle clearing account to the report of amounts processed and pending each month. Due to a coding error in the Single State Registration System, DOT improperly transferred \$2.3 million from their motor vehicle clearing account to the Highway Fund from 2000-2007. DOT noticed the error and correctly transferred the money back to their clearing account in June 2007. Had the clearing account been properly reconciled, this coding error would have been detected promptly.

We also noted that DOT did not properly complete their Cash and Investments Summary Form closing package. This form is required by the Office of Management and Budget in preparing the state's Comprehensive Annual Financial Report (CAFR). On that form, DOT reported their entire unrecorded Bank of North Dakota cash balance in the Highway Fund. However, a material portion of the \$14 million unrecorded cash reported as belonging to the Highway Fund should have been allocated to other funds. Had the errors not been detected, it would have resulted in the state's financial statements being materially misstated.

Recommendations:

We recommend the Department of Transportation:

- Properly reconcile their motor vehicle clearing account to the report of amounts processed and pending each month.
- Properly complete their Cash and Investments Summary Form.

Department of Transportation Response:

NDDOT concurs with the findings and will implement the recommendations.

Establishing Adequate Fraud Programs and Controls

The state of North Dakota does not have adequate fraud programs and controls. This includes not having: 1) policies or procedures relating to a formal systematic risk assessment process which should include a thorough fraud risk assessment; 2) policies requiring agencies to have a comprehensive code of conduct; and 3) adequate policies relating to background investigations. The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework includes discussions about the importance of adequate risk assessment, code of conduct, and background investigations.

We are not aware of any state agency that has an adequate risk assessment process. Some state agencies have adequate codes of conduct, but many do not. OMB policy 112 "Employee Criminal History Background Checks" requires background checks for certain people who have access to personal information stored on the state's PeopleSoft system. However, the policy does not include all individuals with access to personal information, positions of accounting and financial oversight, and positions of trust.

Without adequate fraud risk programs and controls the state exposes itself to risk of loss of assets, potential liabilities, and damage to the state's reputation.

Recommendation:

We recommend the Office of Management and Budget ensure state agencies have adequate policies and procedures relating to: 1) formal systematic risk assessment process which includes a thorough fraud risk assessment; 2) comprehensive code of conduct; and 3) adequate background investigations.

Office of Management and Budget Response:

OMB agrees with the recommendation. We will review our statewide policies and develop additional policies or enhance current policies as needed.

Improper Financial Reporting by Information Technology Department

The Information Technology Department (ITD) did not include certain required financial information in their financial statements submitted for inclusion in the state's Comprehensive Annual Financial Report (CAFR). However, once the omissions were brought to their attention, they revised their financial statements so that the correct amounts were included in the state's CAFR.

Initially, ITD did not capitalize or report software purchases of \$5,000 or more from outside vendors as required by Office of Management and Budget fixed assets accounting policies. This resulted in an understatement of approximately \$2.8 million to net capital assets. ITD also failed to report prepaid items as required by generally accepted accounting principles. These prepaid items were the portion of maintenance agreements which were paid in advance and extend beyond the current fiscal year. This resulted in an understatement to prepaid assets of approximately \$1.6 million.

Recommendation:

We recommend Information Technology Department include all required information in their financial statements submitted for inclusion in the state's Comprehensive Annual Financial Report.

Information Technology Department Response:

We agree with the recommendation and have already made changes to our accounting procedures to correctly account for capitalized software and prepaid items.

Improper Transaction Coding by Protection and Advocacy Project

The Protection and Advocacy Project incorrectly coded a transaction on the state's accounting system. Had this error not been detected by the Office of the State Auditor, it would have resulted in federal fund revenue and expenditures being understated by \$1 million in the state's Comprehensive Annual Financial Report.

The Protection and Advocacy Project received a \$1 million grant which they properly coded as revenue. However, when the grant funds were distributed they improperly coded them as a reduction of revenue instead of grant expenditures. Generally accepted accounting principles require transactions to be reported at their gross amount rather than their net amount.

Recommendation:

We recommend Protection and Advocacy Project properly record grant expenditures on the state's accounting system.

Protection and Advocacy Project Response:

The Protection and Advocacy Project agrees with the finding and will properly code such transactions in the future.

North Dakota State CAFR – 2006

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

Lack of Cash Account Reconciliation

(Prior Recommendation Not Implemented)

A daily bank reconciliation is a critical control for the State of North Dakota. Due in large part to implementation issues with the state's new accounting system, prior to June 30, 2006 the Office of State Treasurer was unable to perform a complete bank reconciliation for 21 months. This allowed accounting errors to go undetected, resulting in a prior period adjustment of approximately \$1.4 million recorded in the State's 2006 financial statements. The Office of State Treasurer began performing daily bank reconciliations on June 30, 2006. However, as of December 12, 2006, the Office of State Treasurer had only performed daily bank reconciliations through October 10, 2006.

Recommendation:

We recommend the Office of the State Treasurer timely reconcile the cash balance on the state's accounting system to the cash balance at the Bank of North Dakota on a daily basis.

Office of the State Treasurer Response:

Throughout the conversion period and up to the present date of this report our agency has accounted for all transactions processed through the bank. All checks and ACH's transactions written and cleared from PeopleSoft, MMIS, Child Support, TANF and Foster Care have been accounted for on a daily basis.

The process of reconciling transactions back to PeopleSoft has been hampered by the lack of detail provided by the system. Examples include the following:

- The lack of having a PeopleSoft check register that foots.
The fact that the 9/30/04 ending balance on SAMIS was not the beginning balance on PeopleSoft on 10/1/04.
- The fund balance report did not include all funds until October 2006.
- Interagency billings processed through PeopleSoft create timing differences that effect cash for what is normally a non-cash transactions.
- The failure of the system to post Accounts payable and Accounts receivable transaction to the General Ledger on the same day they occur.
- Gaining an understanding of the intricacies of the system has been an evolutionary process for all state agencies. The difficulty in obtaining accurate and detailed information from the system has made reconciling to PeopleSoft very time consuming. This process continues to evolve and will continue into the future. Our agency has and will work diligently with the Office of Management and Budget to obtain the necessary information needed to complete a daily cash reconciliation in a timely manner.

Lack of General Ledger Transaction Approval Procedures

(Prior Recommendation Not Implemented)

ConnectND does not have an online approval process for general ledger (GL) transactions. Further, the Office of Management and Budget has not implemented controls to ensure state agencies have manual approval procedures. Without proper approval, internal control is compromised. This increases the risk of errors and fraud to unacceptable levels. These GL transactions can affect both revenues and expenditures of the state's various funds.

Recommendation:

We recommend the Office of Management and Budget implement ConnectND online approval for General Ledger transactions or provide guidance and training to agencies for alternative approval procedures.

OMB Response:

OMB agrees with the recommendation and will implement General Ledger workflow in PeopleSoft.

Accounts Payable Transaction Approval

During the audit period more than 12,000 accounts payable (payment) transactions did not have evidence of approval. This is due to personnel using incorrect ConnectND procedures (navigation) and some individuals having the ability to initiate and approve the same transactions. Without documented independent approval of payments there is an unacceptable risk of errors and fraud.

Recommendation:

We recommend the Office of Management and Budget establish controls to ensure all payments are properly approved and that approval is documented.

OMB Response:

OMB has contacted the agencies/individuals who were using incorrect procedures to approve vouchers and were instructed on the proper way to do so. OMB has since developed a query to identify individuals who both initiate and approve the same transactions. We will run this query at least monthly and will contact those in violation of prescribed procedures.

Reporting of Federal Fund Balances

The state accounts for federal revenue and expenditures in a single fund called the federal fund. Since federal expenditures are offset by federal revenue, most state agencies' should report a zero fund balance in the federal fund. The Office of Management and Budget does not: 1) provide adequate guidance to state agencies, or 2) timely monitor federal fund balances reported by state agencies. Guidance related problems include the grants receivable closing package instructions. Relating to monitoring federal fund balances, large errors are often found late in the reporting process (for example, offsetting errors of over \$3 million and \$5 million were found late in the 2006 audit. These errors are usually the result of incorrect reporting of receivables and payables in the fund, not from drawing down excess federal revenue.

Recommendation:

To ensure proper reporting of the federal fund, we recommend the Office of Management and Budget provide better guidance to state agencies and timely monitor and investigate any significant federal fund balances.

OMB Response:

OMB will provide additional guidance to state agencies in the grants receivable closing package manual and will monitor federal fund balances earlier in the CAFR process in the future.

North Dakota University System Annual Financial Report - 2006

Contact: John Grettum 239-7289 jgrettum@nd.gov

Centers of Excellence Funding – NDUS (06-1)

During fiscal year 2006, \$20,000,000 of Centers of Excellence funds were distributed or committed to distribution without proper audit stipulations. NDCC section 15-69-05 requires centers to agree to provide the board, foundation, and budget section of the legislative council with *annual audits of all funds distributed (emphasis added)*. Such an audit would be accomplished if done on a grant award specific basis in accordance with Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States. These procedures would not only require an auditor's report on the financial statements, but also require an auditor's report on internal controls and compliance.

Recommendation:

We recommend the Board of Higher Education:

1. Develop policies and procedures to ensure these annual grant specific audits are done on a timely basis and submitted to the board, foundation and budget section of the legislative council for all current and future grants awards beginning with the year ended June 30, 2007.
2. Clearly indicate in the Centers of Excellence Application a requirement that all institutions or nonprofit foundations that receive state grant awards through the Centers of Excellence must obtain annual grant award specific GAGAS audits on all funds distributed.

University System Response:

Agree in part. While the NDUS agrees an audit of the funds distributed to the Centers of Excellence is required by NDCC 15-69-05.3, there is no indication that the intent of the language was to require a comprehensive GAGAS audit. Individuals who were involved in the tracking of this legislation in 2005 were not aware of any discussion to that affect. We feel that the legislature desired assurance that the funds were spent in accordance with the award agreement. Webster's Ninth New Collegiate Dictionary defines the word "audit" as: a methodical examination or review. We feel it was the intent of the legislature that the centers obtain a methodical examination or review of the funds distributed under section 15-69.

The Department of Commerce has created a very detailed document that must be completed by the centers annually. It is the basis by which the Department of Commerce determines compliance with the application. The report includes documentation of receipt of the match requirement, documentation supporting project expenditures, evidence of self-sustainability and material variations from the application. The report is reviewed by the Department of Commerce. The NDUS will work with the Department of Commerce to determine appropriate procedures necessary to satisfy the audit requirement of NDCC 15-69-05.3. Given that the state auditors have indicated they do not have the resources to assist with these procedures, the NDUS campuses will likely need to employ an external firm to complete the review.

Component Unit Audits (06-2)

Four of the 15 discretely presented components units in the NDUS basic financial statements did not receive financial statement audits or did not prepare financial statements in accordance with generally accepted accounting principles (GAAP). Two (VCSU Foundation and WSC Foundation) component units had accountant's compilations one (MASU Foundation) component unit had a compilation by a MASU official, and one component unit (NDSU Research Foundation) prepared its financial statements on a modified cash basis, a comprehensive basis of accounting not in compliance with GAAP.

The AICPA Audit and Accounting Guide, State and Local Governments, paragraph 14.22 states a departure from GAAP in the financial statements for an opinion unit may lead the auditor to qualify the opinion or express an adverse opinion on that unit. Some of the departures from GAAP that, depending on the materiality of the effect, would require an opinion modification for one or more opinion units include – a portion of the reporting entity does not apply GAAP, for example, a component unit is on a cash basis of accounting.

Recommendation:

We recommend that the NDUS adopt and enforce policies and procedures that ensure all component units prepare their financial statements in accordance with GAAP and receive annual financial statement audits.

University System Response:

Agree. The NDUS would like audited statements of all related entities that appear in the consolidated financial statements. The NDUS will propose adding language to SBHE Policy 340.2 that campuses require annual GAAP-audited financial statements of all discretely presented component units.

Grants and Contract Receivables/Revenues UND (06-5)

UND's system for year-end entries and project accounting appears ineffective. Assets, revenue and liabilities are being misstated and the current business process is not detecting it. We noted the following material problems with UND's year-end procedures surrounding the recognition of Grants and Contracts receivable:

1. UND established its receivables based solely on project's negative equity balances instead of evaluating each project, they then simply selected several projects in which they posted these incorrectly calculated receivable balances thereby misstating most of the projects;
2. UND failed to review and adjust for deferred revenues in its projects even though many deferred revenue balances exceeded cash less related liability balances within the project. Items 1 & 2 here resulted in UND booking a \$2,640,483 adjustment to its general ledger;
3. UND made an error in reversing its fiscal year 05 year-end closing entry thereby misstating revenue and receivables in fiscal year 06 by approximately \$4,800,000. Instead of debiting revenue in fiscal year 06, receivables were debited thereby overstating both revenue and receivables by that amount in FY 06. This was not discovered by UND until we started looking at the grant and contract balances.
4. UND did not adjust its receivable balance related to FEMA for amounts which could be uncollectible. Upon review they booked an adjusting entry for \$3,005,823.

5. Numerous grants and contract receivable balances had no change from fiscal year 05 to fiscal year 06. Either UND collected nothing or the system is not properly reducing receivables as monies are collected.

Recommendation:

We recommend that UND:

1. Account for and review general ledger amounts on a project basis, and at year-end establish and post receivables on a project by project basis;
2. Determine what the problem is with deferred revenues and why the system is apparently not working correctly so that these balances are not misstated;
3. Utilize the capabilities of the Peoplesoft system for year-end entries that they plan to reverse in the next year and set them to automatically reverse to proper accounts to avoid human error;
4. Review projects on the general ledger periodically to ensure that everything happening in the grants system is being properly reflected and reconciled to the general ledger;
5. Establish better communications and understanding between the accounting and grants offices to ensure the grants office understands the general ledger is being affected, and that accounting knows what should be happening based on activity in the project resource tables of the grant system.

University System Response:

Agree. Item 1: UND reviewed grant and contract fund balances by project and summary posted the year-end receivable entry. In the future, UND will change its procedures and post receivables to the appropriate projects. Items 2-5: UND concurs with the recommendations and will work to improve the areas noted.

North Dakota University System Annual Financial Report - 2007

Contact: John Grettum 239-7289 jgrettum@nd.gov

Financial Reporting System – NDUS (07-1)

The financial reporting system of the NDUS was not adequate to offer reasonable assurance that management is able to produce financial statements that comply with generally accepted accounting principles (GAAP). In fiscal year 2007, there were material auditor-identified audit adjustments of \$45,903,840, \$94,003,259, \$43,256,853, \$19,165,520, \$6,110,840 and \$6,050,457 to total assets, total liabilities, total equity, total revenue, total expenses and increase/decrease in net assets, respectively. For details, see Posted Audit Adjustments beginning on page 23 of the FY07 NDUS audit report. For comparison, in fiscal year 2006, there were material auditor-identified audit adjustments of \$18,558,409, \$8,042,055, \$54,400,834, \$24,952,450 and \$13,708,494 to total assets, total liabilities, total equity, total revenue and total expenses, respectively. Fiscal year 2007 was not an improvement over fiscal year 2006.

In our opinion, all of the accounting issues that required audit adjustments should have been detected by appropriate internal controls or corrected by management responsible for the preparation of GAAP compliant financial statements. The system employs vice-presidents, controllers and accountants who are or should be instrumental in the preparation of the statements and who should be aware of GAAP requirements.

Management is responsible for establishing internal controls that provide for the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term financial reporting relates to the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles.

Recommendation:

We recommend that NDUS management establish appropriate internal controls and provide sufficient training to personnel so that the NDUS is able to prepare financial statements in conformity with GAAP.

University System Response:

Agree. While the NDUS believes the financial reporting system is adequate to offer reasonable assurance that management is able to produce financial statements that comply with generally accepted accounting principles (GAAP), we do recognize that there is always room for improvement. The NDUS will continue to work to improve its financial reporting system through continued diligence and education. It should be noted that the adjustments reported above are the absolute total values of the gross adjustments. The net adjustment to net assets was \$3,937,720 or .56% of total net assets at June 30, 2007. This compares to a net adjustment of \$3,242,861 or .46% of net assets at June 30, 2006.

Indications of Lack of Efficiency in Financial Operations and Management – NDUS (07-2)

We noted three instances where management appears to have acted in a manner that could be considered abuse under current government auditing standards, as follows:

1. NDSU and UND are leasing facilities, and reporting liabilities at June 30, 2007 of over \$33,000,000, for facilities they will not own. The universities are making the principal and interest payments and paying operating costs, including insurance, utilities and normal repairs and maintenance. At NDSU, the facilities include Research and Technology Park Buildings 1 & 2, and the Downtown Campus. At UND, the facility included was the UND Aerospace hangar and ground support equipment. For all of these facilities, the universities are making payments equal to or greater than direct ownership of the facilities, yet will not own them.
2. Based on a difference of opinion between the Chancellor and a majority of the State Board of Higher Education (SBHE) concerning the scope of the Chancellor's authority to apply SBHE policies and directives equally to all campuses, the Chancellor resigned and agreed to complete the remainder of his contract term as a consultant. For these consulting services, he was paid his remaining salary and benefits, or about \$193,500, which included a housing and travel allowance of about \$18,000 and \$9,900, respectively. However, none of the consulting duties outlined in the agreement were completed because the Chancellor left North Dakota to accept employment in another state. In our opinion, since the agreement was not fulfilled, the consulting payments should not have continued.
3. We noted that one ConnectND staff member's position was located in Fargo, but the employee was living in Grand Forks and being reimbursed for lodging, meals and internet access of about \$400 to \$500 per month. This arrangement has been going on for over two years and is still continuing. Normally, if an employee chooses to live in one location and commute to work, travel expenses are not allowed. Also, since this position is computer based, it would appear this position could work from anywhere as long as they had internet access.

Government Auditing Standards, paragraph 4.12 states "abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider

reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement.”

Recommendation:

We recommend that the NDUS act in a manner that a prudent person would consider reasonable and necessary given the facts and circumstances

University System Response:

1. Disagree. While the lease between UNDAF and UND for the aircraft storage hangar/ground support equipment facility specifies the building is the property of UNDAF and remains the property of UNDAF after the termination of the lease, UNDAF's by-laws state that upon dissolution of the Foundation, the assets of the Foundation will be distributed to the University of North Dakota for use in connection with the School of Aerospace Sciences. Additionally, the UNDAF is operated exclusively for support of UND.

The Downtown Campus renovation was initially financed through tax credits and a conventional loan. When the tax credit period expires the project will be refinanced on a tax-exempt basis. In the case of the Research Centers, the NDSU Research & Tech Park, Inc. will retain title after the bonds are repaid. However, NDSU–RTP articles of incorporation state that it is “to be operated exclusively for the benefit of North Dakota State University

Whether the facilities are owned by NDSU or by an affiliated non-profit corporation, NDSU and the State of North Dakota will derive substantial benefits for many years. In all cases the financing was structured in the most efficient, cost effective manner possible by obtaining millions of dollars through tax credits and low financing rates.

2. Disagree. The SHBE had two options: 1) attempt to struggle along for a year with a CEO that did not have the full support of the SBHE, NDUS presidents and the governor and face a potential lawsuit, thereby negatively impacting the NDUS ability to focus on important strategic priorities and momentum; or 2) negotiate a settlement to compensate Potts for the remaining year on his contract. The SBHE decided the second option was in the best short-term and long-term interest of the NDUS.
3. Disagree. ConnectND staff are located in both Grand Forks and Fargo. A long-time UND employee was hired for this position. The initial assumption was that the employee would spend time in Grand Forks and Fargo given the difficulty of the original implementation it has been more beneficial for the individual to spend the majority of their time in Fargo to work with the technical staff. This is a temporary arrangement; it is expected to continue through the Finance system 9.0 upgrade and will be reevaluated after that time.

Internal Balances Between State Agencies and Colleges and Universities– NDUS (07-3)

The procedures for identifying year end balances or activity with state agencies and between colleges and universities needs improvement. This information is needed so the balances or activity can be properly eliminated or reclassified when preparing the State’s Comprehensive Annual Financial Report and the NDUS’s annual financial statements. Following are some examples:

1. OMB reported payments of about \$1,000,000 to UND by state agencies in July 2007, yet UND reported a due from other state agencies of only \$40,684.
2. There were over \$1,000,000 in payments between colleges and universities in July 2007, yet no elimination entry was made for these inter-entity receivables and payables.

3. Certain system wide projects accounted for in agency funds at NDSU and UND totaling over \$1,000,000 were not properly reclassified as institutional funds. As an example, the salary and operating expenses (about \$290,000) of the interim chancellor were recorded in an NDSU agency fund, but the Board Office recorded the activity as non-operating expenses, instead of operating expenses.
4. ConnectND established a reserve fund in fiscal year 2007 (with a balance of \$3,231,146 at June 30, 2007) at NDSU. These funds are reported as NDSU's unrestricted net assets, even though they are system wide funds that are intended to be used to implement the NDUS's *Recommendations to Improve ConnectND* and for other ConnectND projects.

GASB 34, paragraph 57 provides that in the process of aggregating data for the financial statements, some amounts reported as inter-entity activity and balances should be eliminated or reclassified.

See Posted Audit Adjustment 2 on page 23 of the FY07 NDUS audit report and Passed Audit Adjustments 5, 6, 7, 8, and 9 beginning on page 27 of the FY07 NDUS audit report.

Recommendation:

We recommend that the NDUS establish uniform procedures for identifying year-end balances and activity with state agencies and between NDUS colleges and universities.

University System Response:

Agree. The NDUS will establish more comprehensive procedures for identifying and eliminating or reclassifying inter-entity activity with state agencies and between NDUS colleges and universities prior to end of FY08.

Peoplesoft Access Rights – NDUS (07-4)

We reviewed the access rights on PeopleSoft at all institutions. We noted instances where individuals had access to computer application rights for processes they did not need. It appeared that these individuals were given access to extra applications when PeopleSoft was first implemented, but access was not adequately monitored or updated, as needed. We also noted that terminated individuals or individuals that switched departments did not have their access rights removed or changed.

Good internal controls require proper restrictions as to access privileges for computer applications and procedures to monitor the need for changes in access rights as individuals switch duties and departments or end employment.

Recommendation:

We recommend that each campus assign one individual to monitor PeopleSoft access rights, so access privileges are restricted to necessary individuals and perform a review of access privileges on at least an annual basis.

University System Response:

Agree. For each of the three PeopleSoft systems, each campus and the system office already have a designated access control officer whose responsibility is to assign available roles to their staff. The control officers will perform a review of access privileges on an annual basis or as personnel and/or roles change.

Imaging – NDUS (07-5)

Based on our review of campus departments that are using electronic imaging systems for e-file record retention, numerous internal control, audit trail and system security issues were noted. For details by school and department please see Appendix A after response. The effects of these conditions range from loss of sensitive information to the web to potential loss of vital information on their systems without their knowledge to a possible catastrophic loss of information in the event of a critical system failure.

All computer systems must comply with SBHE policy 1901.2. In addition, to protect vital sensitive data, the institutions must apply strict and comprehensive internal controls. It is management's responsibility to insure the safety, security, reliability and authenticity of the data placed on these systems.

Recommendation:

We recommend management ensure that:

1. All imaging systems in use today and in the future are structured under a comprehensive internal control system to mitigate the potential loss or misuse of any information.
2. It assumes its role of designing, testing, and monitoring all computerized systems used by their institutions.
3. It assumes its role of establishing comprehensive policies and procedures to ensure proper internal controls and operating environments for imaging systems and source documents.
4. All imaging systems in use today and in the future comply with SBHE and other governmental policies.

University System Response:

Agree. Prior to the completion of FY09, the NDUS will develop a system procedure for the implementation and management of imaging systems.

Student Loan Service Center (07-6)

The Student Loan Service Center (SLSC) uses the borrower's Social Security number as their account number instead of the borrower's Student ID number.

Failure to establish good internal controls increases the risk of identity theft and possible legal consequences.

Recommendation:

We recommend that the Student Loan Service Center stop using Social Security numbers as account numbers and start using their Student ID instead.

University System Response:

Agree. The SLSC does not use the Social Security number as an account number; however, the recommendation is referring to the electronic storage of social security numbers. The social security numbers are not hidden on the primary screen or in reports. The reports are mailed to the schools via certified mail. It should be noted that SLSC is only using Student Identification Numbers on correspondence with SLSC borrowers.

Federal Single Audit - 2006

Contact Gordy Smith 328-4990 gsmith@nd.gov

Centers for Medicare and Medicaid Services (06-5)

The Department of Human Services (DHS) made at least 2 incorrect payments to providers totaling \$225,230.

Due to a programming error in the Medicaid Management Information System (MMIS) providers were able to charge more than 1 unit of service for services that should only have one unit billed. In one instance we noted that as many as 705 units were billed and reimbursed. This resulted in incorrect reimbursements being made to providers.

OMB Circular A-87, Attachment A, paragraph C.2 requires expenditures to be necessary and reasonable for the performance and administration of the award.

Other payments of the same type as those found to be in error were not tested, but also have more than 1 unit of service and project to a possible total error in benefit payments of \$325,957.

Recommendation:

We recommend DHS implement controls over claims processed on MMIS to prevent incorrect payments.

Corrective Action Plan:

The majority of the questioned costs have been appropriately adjusted and the remaining amounts will be adjusted as necessary. A system change request has been submitted and providers will continue to receive training on proper completion of claim forms.

Administration for Children and Families (06-8)

The Department of Human Services (DHS) has incorrectly calculated Child Care benefit payments, resulting in both overpayments and underpayments to clients for Child Care services. We tested 60 benefit payments and 6 were incorrect, a 10% error rate.

The Child Care Bureau of the Administration for Children and Families requires that payments for Child Care services be made on a sliding fee scale basis which takes into consideration the client's income and family size. Benefit payments are determined at the county level by eligibility workers, but DHS actually processes the Child Care payments.

The DHS Program Administrator of the Child Care Assistance Program created an Excel spreadsheet that automatically calculates the benefit payment amount using the information from the sliding fee schedule. This spreadsheet has been tested and works correctly to calculate benefit payments. However, all 6 errors were caused by input errors.

Three of the errors were income-related, where the income documentation received from the client did not match the income data that was entered onto the spreadsheet. These errors resulted in two underpayments and one overpayment. The other three errors resulted from incorrectly transferring data from the Child Care Billing Report onto the spreadsheet, such as provider type, the number of weeks the child was in the provider's care, and the number of

hours being billed. These errors resulted in two underpayments and one overpayment. The net effect of all 6 errors was an overpayment of \$249.

The errors noted above, when projected against the entire population, project to a possible error in benefit payments of \$ 237,822.

Recommendation:

We recommend the Department of Human Services notify eligibility workers of the proper procedures that must be followed when inputting data into the Excel Child Care spreadsheet and that DHS provide additional training in this area as needed.

Corrective Action Plan:

The Department will continue to sample and review county case files and train county eligibility workers on the proper procedures to follow when inputting data on the child care spreadsheet.

Administration for Children and Families (06-11)

The Department of Human Services (DHS) is not properly determining unemployment in Indian Country, nor are they properly identifying residence of TANF recipients in Indian Country to properly determine if a month should count towards the 60 month limit on TANF assistance.

Per review of the compliance supplement, any family who has received TANF funds for 60 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. Indian Country for the Turtle Mountain Reservation is all of Rolette County, according to the DHS definition. Therefore, it is possible that an individual living in the city of Dunseith, which is not "Indian country" as defined by the federal definition, would not have their TANF payments limited to 60 months – as DHS considers all of Rolette County to be exempt based on unemployment data.

The unemployment data received from Job Service 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)).

In reality 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 allotted 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 DHS develop procedures which will enable them to correctly comply with the federal guidelines. 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:

North Dakota systematically complies, and complied throughout the fiscal years ended June 30, 2006 and 2005, with the federal requirement at 42 U.S.C. § 608(a)(7) limiting to 60 months the time an adult may receive TANF assistance, and providing exceptions:

- North Dakota limits the Indian country exception to residents of "Indian country" as defined in N. D. Admin. Code § 75-02-01.2-35.1(4)(b), an administrative rule with the force and effect of law, identically to the definition at 18 U.S.C. §1151, as referenced in 42 U.S.C. § 608(a)(7)(D)(ii);
- North Dakota amended its TANF State plan on October 1, 2006, to conform to the requirements of N. D. Admin. Code § 75-02-01.2-35.1; and
- North Dakota determines levels of unemployment in Indian country using data consistent with the requirements of 42 U.S.C. § 608(a)(7)(D)(i) and 45 CFR § 264.1, the applicable federal statute and regulation.
- Upon receipt of the related finding in the SFY 2003 and 2004 Single Audit, North Dakota began reviewing all Rolette County TANF cases to verify accurate TANF lifetime limit count months.

Auditor Rebuttal:

The department contends that they systematically complied with the 60 month limitation on TANF benefits. This is only true in areas that are not considered Indian country, and Indian country is what this recommendation pertains to. Throughout the 2006, 2005 audit period, DHS continued to define Indian country in a manner that was not consistent with the federal definition in 18 USC 1151 as noted by the fact that their state plan was not amended until October 2006. The review of the Rolette County TANF cases was not complete until after the audit period. Further, the review of TANF cases in Rolette County only addresses a portion of the matter as our finding states that particular county as an example, but the condition could exist on any reservation that falls within the state. In a letter from the U.S. Department of Health and Human Services dated September 15, 2006 the department was notified that reasonable cause was granted for that one occasion, however the letter also states that the department has been misapplying the exemption requirement on a continuous basis. Therefore we stand by our recommendation.

Temporary Assistance for Needy Families (06-12)

The Department of Human Services (DHS) failed to properly sanction individuals receiving TANF benefits based on their non-cooperative status with the Child Support Enforcement division.

The OMB Circular A-133 Compliance Supplement states that if the Child Support Enforcement division determines that an individual is non-cooperative with the State in establishing paternity, or in establishing, modifying or enforcing a support order with respect to a child of the individual,

and reports that information to the State agency responsible for TANF, the State TANF agency must sanction the individual.

Per review of DHS policy 400-17-20-20, "If Child Support Enforcement notifies the county social service office of the custodian's failure to cooperate; the latter must use this information when determining the custodian's eligibility for assistance. The custodian who refuses to cooperate with Child Support Enforcement is ineligible to receive TANF. The sanction may progress to the entire household if the custodian continues his or her refusal to cooperate."

Based on our testing of non-cooperative case reports provided by Child Support Enforcement, we noted 57 cases where sanctions were not properly imposed. Improper benefit payments totaling \$197,713 were made.

Recommendation:

We recommend Department of Human Services enforce the requirement that all individuals not cooperating with Title IV-D (child support) who are receiving TANF benefits are properly sanctioned.

Corrective Action Plan:

The Department respectfully disagrees with the questioned costs noted above as the failure to impose a sanction in every case is not an improper payment. The Department has been in compliance with 42 USC 608(a)(2), and continues to improve and enhance procedures and provide training and guidance to the county eligibility workers.

The Department respectfully disagrees with the questioned costs for the following reasons:

- Federal guidance provided to the Department by the Administration for Children and Families stated that no federal statute, regulation, or written policy of the federal agency, requires that a sanction be imposed within any specific time after the State IV-D agency notifies the State IV-A agency that an individual is not cooperating.
- The costs in question may not take into account all applicable sections of the Department's policy manual involving sanctions.

Auditor Rebuttal:

As our finding states, there were 57 cases where sanctions were not imposed when they should have been and agency personnel did not produce evidence of good cause for these cases. While the federal regulations do not set a time frame for imposing sanctions, the average length of time from when the custodial parent was noted as non-cooperative until TANF benefits ceased was 13 months, with the longest being 95 months. We do not consider this a reasonable time frame.

Twenty-First Century Community Learning Center Grant (06-20)

The Department of Public Instruction (DPI) does not have a written policy on allowable costs under the 21st Century Community Learning Center (21st CCLC) program, nor does DPI have adequate staffing to review subrecipient expenses to ensure allowability. The only requirements for the grant are for the expenditures to be reasonable. At this time what DPI considers to be reasonable is not always what the subrecipients consider to be reasonable.

We selected one payment from each of the 16 subrecipients with current 21st CCLC grants. We requested the subrecipient provide support for the one pay request selected. Of the 16 payments tested, 12 were found to have unallowable expenditures or were lacking support for

their documented payment request. Without support, we were unable to determine if the payments were for allowable items.

Examples of unallowable expenditures included a high power rifle (for a raffle), an air hockey table, pellet gun, and overstaffing salary costs.

The Department of Public Instruction does not have adequate procedures in place for monitoring the Learning Centers that receive funding from this grant. Learning Centers have an audit completed by DPI as often as possible but there is no set procedure for this. As a result audits get delayed and not completed as often as necessary.

The questioned costs, when taken to the entire population, project to a potential error of \$216,347.

Recommendation:

We recommend to the Department of Public Instruction that they create more definitive guidelines for the learning centers to follow under the 21st Century Community Learning Center Grant. We also recommend that they review expenditures for the learning centers on a more consistent basis.

Corrective Action Plan:

Audits are currently being conducted on grantees by an outside audit firm. In addition, the Department of Public Instruction is considering a requirement that each grantee contract with an outside CPA firm for an annual A-133 audit in compliance with state and federal requirements. This audit requirement will be at the grantee's expense and must be filed with the Department of Public Instruction before funds are released for the next grant cycle.

The Department of Public Instruction is currently reviewing expenditures on a monthly basis using an Excel spreadsheet that contains the same budget codes used by the Department of Public Instruction. This procedure was already in place at the time of the audit performed by the State Auditor's Office and continues at this time.

Operational Audits

112 – Information Technology Department

Operational Audit - Contact: Paul Welk 328-2320

Security Roles Control Weakness 06-1

The security roles used by the Information Technology Department had a design flaw which resulted in a significant internal control weakness. As a result, individuals with the role to approve expenditure transactions also had the ability to initiate the same transactions. Proper internal controls dictate that these two functions be separated. The Office of Management and Budget is responsible for these security roles. OMB has redefined these roles during our audit period so no recommendation will be made to ITD.

Segregation of duties over accounts receivable 06-2

The Information Technology Department has not properly segregated duties related to their accounts receivable function. Individuals with access to cash were also responsible for posting debits and credits to accounts receivable records. Additionally, individuals charged with the responsibility of approving write-offs and adjustments to accounts receivable records also had access to make adjustments to the accounts receivable records. The lack of segregation of duties within the accounts receivable function has increased the risk of errors going undetected, fraudulent activity occurring, and data being corrupted.

To limit the Department's exposure to the risks noted above, proper segregation of duties is critical. Individuals with access to cash or are charged with the responsibility for approving write-offs and adjustments to accounts receivable records should not be responsible for posting adjustments to or have access to update accounts receivable records.

Recommendation:

We recommend the Information Technology Department properly segregate duties to ensure individuals with access to cash and individuals responsible for approving write-offs and adjustments to accounts receivable records do not have the responsibility or access to update accounts receivable records.

Response:

We agree with the recommendation and will implement changes to our existing business processes to mitigate this risk.

Computer Access Controls Weakness 06-6

The Information Technology Department and Division of Independent Study employees have access rights to 4D (tracks student accounts including courses being taken and payments made), Customer Information System, and PeopleSoft's financial environment which are not necessary to perform their normal job duties. Our review noted the following critical issues:

- Employees have access to PeopleSoft modules not currently used by the Department;
- Employees approving transactions have access to add, delete, and update records;
- Employees have access to the Customer Information System, but do not have any job duties related to the system;

- Employees taking annual inventories also have access to computerized fixed asset records; and
- All financial personnel at the Division of Independent Study have unlimited access to the student accounts including making adjustments, posting debits and credits to student accounts, and modifying account information.

Proper internal control dictates that access to data be limited to those who require access to perform their duties. Employees who approve transactions should not have access to process transactions. 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 and Division of Independent Study properly restrict access to the various roles or areas in 4D, Customer Information System, and PeopleSoft's financial environment to only those individuals who require access to perform their normal job duties and assign maintaining security for each system to an individual. The individual should perform a review of all access rights on at least an annual basis to ensure that the access is appropriate based on the job duties of the personnel.

Information Technology Department Response:

We agree with the recommendation and will strengthen our controls surrounding access to the identified systems. The ND state portal against other top ranking state portals to reveal other areas for potential improvement.

120 – Office of the State Treasurer

Operational Audit - Contact: Paul Welk 328-2320

Coding and Approval Controls Weakness 07-1

Controls surrounding the coding of PeopleSoft transactions and approval of those transactions are inadequate. The State Treasurer's Office is responsible for transferring millions of dollars between funds using account codes developed by the Office of Management and Budget (OMB) which allow for the proper accounting and reporting of these transfers. Although monies were transferred to the correct funds, our audit identified a significant number of transfers for which incorrect transfer codes were used and were not detected by management during the approval process.

Using incorrect transfer codes had the following effects:

Reports generated from PeopleSoft to determine where funds were transferred to/from do not accurately reflect the transfers for oil and gas tax distributions as well as coal tax distributions; Additional analysis and adjustments of the PeopleSoft data related to the transfers incorrectly coded by the Office of State Treasurer must be performed by OMB to ensure compliance with Generally Accepted Accounting Principles during preparation of the state's Comprehensive Annual Financial Report;

There is an increased risk of material misstatements going undetected by the Office of State Treasurer as the approval function is not operating effectively.

OMB developed account codes in PeopleSoft and through training has instructed agencies to use the proper account codes when recording transactions into PeopleSoft. In addition, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control

– Integrated Framework defines many different types of control activities including checks for accuracy and authorization of transactions. This framework dictates that control activities such as approval must be performed thoughtfully, conscientiously, and consistently to be effective.

Recommendation:

We recommend the Office of State Treasurer ensure all transactions recorded on PeopleSoft are coded properly; and develop an approval process that will ensure transactions recorded on PeopleSoft are proper.

Office of State Treasurer Response:

We agree that incorrect transfer codes were used. Our office has implemented additional procedures to track transfer codes as part of the fund balance reconciliation and we will take more care in properly coding and reviewing transfers to ensure coding issues are minimized in the future.

Control Environment 07-2

The control environment at the Office of State Treasurer has many deficiencies which are primarily related to financial controls and controls surrounding compliance with laws and regulations.

These deficiencies have resulted in accounting errors going undetected, which in a number of instances has led to non-compliance with state laws and regulations and OMB policy. In addition, the lack of these critical controls has resulted in the Office of State Treasurer not performing the oil and gas production tax distribution and coal severance tax distribution in accordance with NDCC for a period of six years. Audit recommendations for each of these distributions will be issued for the 3rd consecutive audit.

Management of the Office of State Treasurer is responsible for the implementation and monitoring of the internal control functions of the Office. Statement on Auditing Standards (SAS) No. 112 states that an ineffective control environment is a control deficiency in itself and that control deficiencies in other components of internal control may be considered

Recommendation:

We recommend the Office of State Treasurer develop and implement internal controls surrounding critical business functions including compliance with laws and regulations; and monitor internal controls to ensure they are operating efficiently and effectively.

Office of State Treasurer Response:

We agree that the Treasurer's Office has had a long history of control environment issues. This administration has worked with the Auditor's Office and the Office of Management and Budget to address several high risk areas. We have made significant improvements in the areas of Cash Management and Tax Distributions. However, we have not been able to address all the challenges in just 3 years of service. We have and will continue to prioritize and address the most critical areas in order to achieve compliance in this area.

125 – Office of Attorney General

Operational Audit - Contact: Paul Welk 328-2320

Implementation of Medicaid Fraud Control Unit

Issue:

The state of North Dakota does not have a Medicaid Fraud Control Unit (MFCU). The first MFCU in the United States was established in 1977. Since that time, 49 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. 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.

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:

This office was involved in crafting 2007 Senate Bill No. 2126, the legislation authorizing investigations into alleged Medicaid fraud claims, which provided authority to the Attorney General to bring a civil action against a person violating the act. This legislation was defeated.

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.

127 – Office of the Tax Commissioner

Operational Audit - Contact: Paul Welk 328-2320

Lack of background investigations 07-1

The Office of State Tax Commissioner does not perform background investigations for new hires that will have access to sensitive information such as tax returns, social security numbers, and bank account information.

The lack of these investigations makes it difficult to detect if new hires have a criminal history in areas such as identity theft, embezzlement, fraud, etc.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework dictates that a background investigation be completed for employee candidates, particularly with regard to prior actions or activities considered unacceptable.

Recommendation:

We recommend the Office of State Tax Commissioner develop a policy that, at a minimum, would require background investigations to be done for candidates being considered for full-time equivalent positions with duties that include: accounting; financial oversight; access to personal information; and access to tax information.

Office of State Tax Commissioner Response:

The Office of State Tax Commissioner agrees and will seek legislative authority to utilize the Bureau of Criminal Investigation to provide a statewide and nationwide criminal history record as provided under NDCC §12-60-24(2).

180 – Judicial Branch

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

Unified Court Information System Control Weaknesses 07-2

Access controls over the Unified Court Information System (UCIS) are not adequate. We noted the following weaknesses:

- Several individuals have improper access to UCIS and no formal review process is in place to ensure access is limited to those individuals requiring access to perform their duties.
- Adjustments can be made to accounts on UCIS by any Clerk of Court for suspensions, payments from outside

receipts, or voids. It was noted that individuals could void a receipt they entered without approval.

- There is no written guidance on how to properly handle suspensions or payments from outside receipts.
- No reconciliation is being performed of adjustments made on UCIS to supporting documentation.

Good internal controls, as documented in the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's *Internal Control – Integrated Framework*, include limiting access to computer systems to only individuals that need access for their job duties. Further, proper segregation of duties reduces the likelihood of errors or irregularities.

Recommendation:

We recommend the Judicial Branch properly designate a knowledgeable individual to review access privileges of the Unified Court Information System on a regular basis and properly restrict access appropriate for individual employee duties; document the proper procedures for handling adjustments in the “Cash Management in ND Courts” written policy manual; and ensure that procedures surrounding adjustments are being followed according to written guidelines by performing a monthly random reconciliation of adjustments made to accounts on UCIS to supporting documentation.

Judicial Branch Response:

We are in agreement with the finding and all three recommendations. The Judicial Branch recognizes the lack of internal controls in its case management system and intends to address this weakness through the planned replacement of the system. We are unable to eliminate these weaknesses because on-site staff must have access to establish accounts, receipt payments, and make adjustment to records as ordered by the court or as proof of payment from outside receipts as received. Because the system does not allow us to restrict access to certain functions, we rely on management control and oversight to protect against fraud or loss. We will train district personnel to perform random audits of voids, suspensions, and adjustments. Random audits will be performed twice a year, as we have insufficient staff to conduct monthly audits of all 53 courts. A planned revision to the “Cash Management in ND Courts” will include documentation of the management controls and audit functions, as well as documentation on handling adjustments, suspensions, and voids.

Review and Approval of Correcting Entries 07-3

The Judicial Branch is not properly documenting their review and approval of correcting journal entries in the PeopleSoft general ledger.

An individual independent of preparation should review and approve all correcting entries after being posted to PeopleSoft to ensure they have been entered correctly. There was no documented review after correcting entries had been posted by the Office of Management and Budget or Office of State Treasurer, nor was there a review of correcting entries posted by the Judicial Branch. Without a proper review, errors or irregularities may go undetected.

Recommendation:

We recommend the Judicial Branch have an appropriate individual review and approve all correcting entries including entries posted by the Office of Management and Budget and the Office of State Treasurer.

Judicial Branch Response:

We are in agreement with the finding and recommendation. The Judicial Branch has not always been aware of when changes have been made by Executive Branch agencies and requests notification whenever adjustments are made by the State Treasurer's Office. Upon notification, accounting staff will review and approve any changes.

Proper Fixed Assets Records and Inventory 07-4

The Judicial Branch uses the PeopleSoft Asset Management System to maintain a list of their fixed assets but they do not have procedures in place to ensure this system is updated on a timely basis. Several items that were noted during the fiscal year 2006 inventory to be broken or sent to Surplus Property were still recorded as "In Service" on PeopleSoft. Additionally, the Judicial Branch does not have procedures to complete an annual inventory of fixed assets as no inventory was taken during fiscal year 2007.

Section 44-04-07 of the North Dakota Century Code (NDCC) states all agencies shall maintain a complete and current inventory record of all property of sufficient value and permanence and each year shall take an inventory of such property. As a result, the Judicial Branch is not in compliance with NDCC.

Recommendation:

We recommend the Judicial Branch maintain complete and current fixed assets records and take an annual fixed assets inventory in accordance with section 44-04-07 of the North Dakota Century Code.

Judicial Branch Response:

We are in agreement with the finding and recommendation. Fixed Assets records will be reconciled with PeopleSoft and an annual inventory process will be developed and implemented

201 – Department of Public Instruction

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

Purchase Card Usage 07-3**Challenge:**

The Department of Public Instruction, State Library, School for the Deaf, and Blind/Vision Services have implemented the use of purchase cards (P-cards) for use in the procurement of small dollar purchases. However, the P-cards were not used as often as they could have been. The Department of Public Instruction used the P-card for 38% of the total operating expenditures that may have qualified under the P-card program (\$160,823 was spent of a possible \$423,374).

The State Library used the P-card for .8% of the total operating expenditures that may have qualified under the P-card program (\$2,214 was spent of a possible \$274,432).

The School for the Deaf used the P-card for 28% of the total operating expenditures that may have qualified under the P-card program (\$120,684 was spent of a possible \$439,120).

The School for the Blind used the P-card for 46% of the total operating expenditures that may have qualified under the P-card program (\$81,111 was spent of a possible \$177,634).

Generally, small purchases make up a large percentage of purchasing transactions but represent only a small percentage of dollars spent. Therefore, reducing the administrative costs of processing these small dollar purchases is very important. The state P-card program was developed to reduce the paperwork and administrative costs associated with small purchases.

Operational Improvement:

We recommend that the Department of Public Instruction, State Library, School for the Deaf, and Blind/Vision Services utilize the P-card program by using purchasing cards whenever possible, following the guidelines contained in OMB Policy 300 – Purchasing Card and the Purchasing Card Users Manual issued by the Office of Management and Budget.

Department of Public Instruction Response:

The Department of Public Instruction, State Library, School for the Deaf and Blind/Vision Services agree with the Operational Improvement noted, and will continue to enhance the P-Card program and will comply with the OMB Fiscal Policy Number 300.

227 - Bismarck State College

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Segregation of Duties (07-1)

Bismarck State College's assistant business office manager has access to cash, opens mail, restrictively endorses checks received, writes receipts and reconciles daily receipts to daily deposits.

Good internal control requires adequate segregation of duties between cash functions including receiving cash payments, writing receipts and reconciling receipts to deposits.

Recommendation:

We recommend that BSC review the status of internal control surrounding cash, revenue, and receivables and provide the proper segregation of duties to ensure adequate safeguards of its assets.

Bismarck State College Response:

Agree. The assistant business office manager's primary cash duties include reconciling daily receipts to deposits that have been prepared by the cashiers. He does not reconcile the bank statement. In a small office, segregation of duties is not always possible. When the cashier's are out of the office for a day, he serves as back-up to the cashiers, and therefore he accesses cash, endorses checks and writes receipts. When this happens, the business office manager will reconcile the receipts to the deposit as an added control.

230 – University of North Dakota

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Coaches and Support Staff Travel (07-1)

UND coaches and support staff are not required to complete individual travel reimbursement vouchers when traveling with their respective teams. Their expenses are included as part of team travel and charged to account 521105, Travel – Students, rather than being charged as employee expenses. For our audit period, the total expenses charged to account 521105 were over \$2.8 million.

State Board of Higher Education (NDUS Human Resource Policy Manual section 31) and UND Accounting Services “Employee Travel Policies” both require employees who are authorized to travel at institutional expense to submit a detailed record of travel expenses on a travel reimbursement voucher. Following those policies provides the mean for complying with state statute including NDCC sections:

- 44-08-04 which provides the allowable reimbursement rates for employees and states employees who are authorized to travel at institutional expense are required to make a claim including a lodging receipt. (Current procedures throughout the state are to make claim(s) by submitting a detailed record of travel expenses on a travel voucher.)
- 44-08-05.1 (1) which states any public officer or employee who has the power to approve a payment for travel expenses or any other expenditure of public funds shall determine before approving the payment: If for employee travel reimbursement, the sums claimed for travel expenses are actually due the individual who is seeking reimbursement, allowance, or payment.

Recommendation:

We recommend that UND:

- Comply with State Board of Higher Education and UND travel policies and require all employees including coaches and support staff to submit a detailed record of travel expenses, as an employee, on a travel reimbursement voucher for all travel, and;
- Code employee travel to the appropriate employee travel account numbers.

University of North Dakota Response:

Disagree. UND athletic team travel is a high dollar budget item for athletics, coding this expense to account 521105 allows UND athletics to manage team travel efficiently. The expense account 521105 (travel-students) is located in the same expense category as all other UND travel expense. The other travel expense accounts are used for non-team travel such as recruiting expenses.

Disagree. UND will ask UND Human Resources to review NDUS Human Resource Policy Manual section 31. If we are not in compliance with the intent of their policy, we will ask for approval to continue to reimburse coaches and staff as part of team travel.

Coaches and support staff traveling with the team and not separating lodging and other receipts in common practice in Athletics across the country. An example is an out of town football game, 15 to 20 coaches and support staff travel with the team, the logistics of obtaining separate hotel

bill and other receipts would significantly increase paperwork and be extremely labor intensive for Athletics and all other departments on campus involved in processing payments.

Auditor's Concluding Remarks:

Miscoding transactions does not seem to be either an efficient or effective management practice. It should not take any longer to code transactions properly. Individual travel vouchers are needed to document that allowable, statutory employee travel reimbursement rates have not been exceeded, since there is no similar limitation on students.

235 – North Dakota State University

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Coaches and Support Staff Travel (07-1)

NDSU coaches and support staff are not required to complete individual travel reimbursement vouchers when traveling with their respective teams. Their expenses are included as part of team travel and charged to account 521105, Travel – Students, rather than being charged as employee expenses. For our audit period, the total expenses charged to account 521105 were over \$3.7 million.

State Board of Higher Education (NDUS Human Resource Policy Manual section 31) requires employees who are authorized to travel at institutional expense to submit a detailed record of travel expenses on a travel reimbursement voucher. Following this policy provides the mean for complying with state statute including NDCC sections:

- 44-08-04 which provides the allowable reimbursement rates for employees and states employees who are authorized to travel at institutional expense are required to make a claim including a lodging receipt. (Current procedures throughout the state are to make claim(s) by submitting a detailed record of travel expenses on a travel voucher.)
- 44-08-05.1 (1) which states any public officer or employee who has the power to approve a payment for travel expenses or any other expenditure of public funds shall determine before approving the payment: If for employee travel reimbursement, the sums claimed for travel expenses are actually due the individual who is seeking reimbursement, allowance, or payment.

Recommendation:

We recommend that NDSU:

1. Comply with State Board of Higher Education policy and require all employees including coaches and support staff to submit a detailed record of travel expenses, as an employee, on a travel reimbursement voucher for all travel, and
2. Code employee travel to the appropriate employee travel account numbers.

North Dakota State University Response:

Disagree. Requiring separate detailed vouchers for each employee traveling with athletic teams unnecessarily creates added paperwork and administrative burdens. Coaches and support staff traveling with the team and not separating lodging and other receipts is common practice in athletics across the country, at least among Division 1 institutions.

In the opinion of both the NDSU and NDUS legal counsels, the current practices do not need be changed to provide a means for complying with the laws cited above. The auditors may want to discuss this opinion with the NDSU or NDUS legal counsel for more information.

NDSU agrees with the recommendation on the need to comply with State Board of Higher Education policy. As a result, a policy amendment will be made to update the NDUS Human Resource Policy Manual to allow for the current practice of accounting for athletic team travel expenses to continue.

The expense coding is a matter of choosing between various account codes within the travel line item. NDSU's account coding guidelines currently allow for coding the travel expenses of coaches, or other employees accompanying the students/athletes, to be included with the rest of team trip expenses. Coding the expenses in this manner provides more useful management information than splitting up the costs.

Auditor's Concluding Remarks:

Miscoding transactions does not seem to be either an efficient or effective management practice. It should not take any longer to code transactions properly. Individual travel vouchers are needed to document that allowable, statutory employee travel reimbursement rates have not been exceeded, since there is no similar limitation on students.

239 – Dickinson State University

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Segregation of Duties (07-1)

Dickinson State University's controller has access to cash, reconciles receipts to deposits, prepares bank reconciliations, and can approve write-offs and receivable adjustments. In addition, the Student Finance Coordinator is responsible for billing, has access to cash, access to accounts receivable records, and can update accounts receivable records.

Good internal control requires adequate segregation of duties between cash and accounts receivable functions including billing functions, preparing bank reconciliations, reconciling receipts to deposits, and approving write-offs and adjustments.

Recommendation:

We recommend that Dickinson State University review the status of internal control surrounding cash, revenue and receivables and provide the proper segregation of duties to ensure adequate safeguards of its assets.

Dickinson State University's Response:

Agree, however existing physical space restrictions providing access to cash to all Business Office personnel, as well as the current limited number of personnel make complying with the recommendation impossible without severely impacting the services DSU provides to students, faculty, and staff, or without the expenditure of additional resources in the form of salaries and wages. DSU has an excellent record of providing adequate internal controls, and at the same time providing excellent service to the campus with limited personnel resources. DSU would have to add additional personnel resources and find additional physical space in order to restrict access to cash to adequately comply with the recommendation.

240 – Mayville State University

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Approvals and Support (07-1)

We noted the following conditions when testing direct general ledger transactions (ONL's):

1. Twenty three of 32 ONL's were not properly approved. Of the 23 ONL's not properly approved, 15 had no approval and eight were approved by the preparer.
2. Six of 32 ONL's had no support attached to the document.

Good internal controls require approval by an authorized person, other than the preparer, of all transactions that affect the general ledger. For this approval to be meaningful, adequate supporting documents should be attached to the document. Failure to properly review and approve transactions increases the risk of undetected errors, fraud and theft.

Recommendation:

We recommend that Mayville State University properly approve and attach supporting documents to ONL transactions.

Mayville State University Response:

Mayville State has implemented the necessary changes including dual authorization of journal entries and review of support documentation.

Coaches Travel (07-2)

MaSU coaches are not required to complete individual travel reimbursement vouchers when traveling with their respective teams. Their expenses are included as part of team travel and charged to account 521105, Travel – Students, rather than being charged as employee expenses. For our audit period, the total expenses charged to account 521105 were over \$230,000.

State Board of Higher Education (NDUS Human Resource Policy Manual section 31) requires employees who are authorized to travel at institutional expense to submit a detailed record of travel expenses on a travel reimbursement voucher. Following those policies provides the mean for complying with state statute including NDCC sections:

- 44-08-04 which provides the allowable reimbursement rates for employees and states employees who are authorized to travel at institutional expense are required to make a claim including a lodging receipt. (Current procedures throughout the state are to make claim(s) by submitting a detailed record of travel expenses on a travel voucher.)
- 44-08-05.1 (1) which states any public officer or employee who has the power to approve a payment for travel expenses or any other expenditure of public funds shall determine before approving the payment: If for employee travel reimbursement, the sums claimed for travel expenses are actually due the individual who is seeking reimbursement, allowance, or payment.

Recommendation:

We recommend that MaSU:

- Comply with State Board of Higher Education travel policies and require all employees, including coaches, to submit a detailed record of travel expenses, as an employee, on a travel reimbursement voucher for all travel.
- Code employee travel to the appropriate employee travel account numbers

Mayville State University Response:

Mayville State is currently working on implementing credit card purchasing/travel procedures. This will eliminate travel advances for coaches and require that coaches pay for their expenses and request reimbursement per SBHE travel policies.

Physical Inventory or Property (07-3)

An inventory of property was not taken by MASU during fiscal year 2006 or fiscal year 2007.

NDCC section 44-04-07 states that the person in charge of any state institution shall maintain a complete and current inventory record of all property of sufficient value and permanence as to render such inventory record practical. Each year such person shall make a complete inventory of all such property, and shall maintain such inventory, with the person's certificate thereto attached. Said inventory record must provide a comprehensive description of each item, together with manufacturer's serial number, or other means of positive identification, and must include statements of all property disposed of by any means whatsoever and must be in such form and detail as may be prescribed by the department charged with the duty of auditing or examining such records.

Recommendation:

We recommend that MaSU comply with NDCC 44-04-07 and complete a physical inventory of property each year, with the person's approval thereto attached.

Mayville State University Response:

Mayville State will improve physical inventory counts.

243 – Minot State University – Bottineau Campus

Operational Audit – Contact: John Grettum 239-7289 jgrettum@nd.gov

Online Approvals (07-1)

Minot State University - Bottineau Campus's online transactions are not being approved. In our test of 32 online transactions, none were approved.

Good internal controls require approval by an authorized person of all transactions that affect the general ledger. Failure to properly review and approve transactions increases the risk of undetected errors, fraud and theft.

Recommendation:

We recommend the Minot State University - Bottineau Campus print a standard form for all online transactions with approval noted or utilize the workflow function.

Minot State University - Bottineau Campus Response:

All on-line transactions that affect the general ledger are prepared by either the Director of Business Affairs or the Business Office Manager. These MiSU-BC positions are the only ones that have security and access to create and post a journal entry. Current practice requires the preparer to initial the printed version of the journal entry before filing the document. Beginning immediately, JEs created by the Business Office Manager will be initialed (approved) by the Director of Business Affairs and visa versa.

Segregation of Duties (07-3)

Minot State University – Bottineau Campus’s accountant has access to cash, prepares deposits, reconciles receipts to cash drawers, reconciles receipts to deposits, prepares bank reconciliations, reconciles deposits to PeopleSoft student finance and reconciles student finance to the general ledger.

Good internal control procedures require that adequate management oversight controls must be utilized to compensate for a lack of segregation of duties. A concentration of duties assigned to a single position could result in a loss from fraud or theft.

Recommendation:

We recommend the Minot State University - Bottineau Campus review the status of internal control surrounding cash, revenue, receivables and payroll to provide adequate management oversight or the proper segregation of duties to ensure adequate safeguards of its assets.

Minot State University - Bottineau Campus Response:

MiSU-B recognizes that the accountant position (Business Office Manager) has the ability and system access to perform all of the functions associated with cash, deposits and reconciliations. However, the accountant has never performed all of these duties. The small size of the business office staff necessitates that the Business Office Manager be able to perform most of the office functions in order that operations continue during staff absences. Although we believe that adequate separation of duties is in place to safeguard cash assets, we recognize these safeguards can be strengthened. Therefore, effectively immediately, we will remove the authority for the Office Manager to open or close the cash draw, to receipt and to prepare the reconciliation of the cash draw.

325 – Department of Human Services

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

Computer Access Control Weaknesses 07-1

Access controls over various computer information systems are not adequate. Good internal controls, as documented in the Committee of Sponsoring Organizations (COSO) of the Treadway Commission’s *Internal Control - Integrated Framework*, include limiting access to computer systems to only individuals that need access for their job duties. The following weaknesses were noted:

Several programs were found to have individuals with improper access rights assigned. Several individuals were found with improper access to the PeopleSoft General Ledger and Accounts Payable module.

Programmers at the State Hospital had access to the “live” AIMS system for programming changes, rather than a “test” system.

Recommendation:

We recommend the Department of Human Services correct the findings noted above, and procedures be improved to ensure access privileges grant the least access required for individuals to do their jobs.

Department of Human Services Response:

The Department will continue to enhance procedures surrounding access to technology applications.

Lack of Controls Over Drug Inventory 07-2

At the State Hospital and Developmental Center, there is a lack of segregation of duties regarding the pharmacy inventory procedures, as the inventory is taken by the pharmacists that have custody of the stock throughout the year. Also, no one was monitoring adjustments made to the drug inventory during the year.

All 8 Human Service Centers (HSC) receive donated anti-depressants and anti-psychotic drugs from the various drug representatives during the year for use by HSC patients. Currently there are not adequate controls in place at all HSC’s to safeguard the drug inventory and 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 will implement procedures to strengthen controls surrounding the drug inventories at the State Hospital and the Developmental Center. However, the Department believes the controls surrounding drug inventories at the Human Service Centers are adequate. Appropriate physical controls are in place for all drug inventories and a perpetual inventory is maintained for all controlled substances. The Department concluded that maintaining a perpetual inventory for other types of donated sample medication was not cost effective.

Background Checks for Employees 07-3

North Dakota Century Code section 12-60-24 allows for state and national background checks for several specific areas of state employees. However, it appears certain Department of Human Services employees are not covered under this law, including individuals responsible for patient care at the Developmental Center, State Hospital, and Human Service Centers.

Some of these individuals have had a North Dakota background check, but not a national background check. Any employee hired since 2001 will have a North Dakota background check done by the Bureau of Criminal Investigations. Also potential employees are required to provide previous employment and residence history. If a potential employee includes employment history or residence in a state other than North Dakota, the Department of Human Services will have a contractor run a background check for the other state or states.

However, if a potential employee was convicted of a crime in a neighboring state or excludes employment and residence history for a state they know they have a record; it is possible the Department of Human Services will not find out about certain aspects of a potential employee's background.

As a result, it is possible that the Department of Human Services could hire applicants for positions of trust over vulnerable people that could have done something in the past that should disqualify them from employment.

Based on the level of vulnerability of some people served by the Department of Human Services, it is imperative applicable employees are checked to ensure proper care and treatment of vulnerable people.

Other jobs within the Department of Human Services could also be found to necessitate national background checks if dealing with patients, sensitive information, or other possible reasons.

Recommendation:

We recommend the Department of Human Services review employee job duties department-wide and determine which employees should be subject to a national background check, and take the actions needed to obtain the background checks as determined appropriate.

Department of Human Services Response:

The Department has been proactive in performing background checks on potential employees. In addition to the procedures noted above the Department also checks the federal and state sexual offender websites and the state's Child, Abuse and Neglect database for all potential employees. The Department did attempt to obtain national or FBI background checks on all potential employees, however, learned they can not be obtained unless authorized by state law. Therefore the Department will work with the Attorney General's Office in requesting the 2009 Legislative Assembly to consider an amendment to the current law which was passed by the 2007 legislative Assembly.

Our audit of the Department of Human Services identified the following areas of potential improvements to operations:

Foster Care Adoption Improvements 07-1

Challenge:

Are there barriers to the foster care adoption process, as currently structured, in North Dakota?

We modeled our audit after the approach used in a nationwide study entitled "Listening to Parents: Overcoming Barriers to the Adoption of Children from Foster Care" sponsored by the Evan B. Donaldson Adoption Institute. We studied adoption policies, procedures, and practices; analyzed statistical data relating to adoptions; conducted focus study groups with both parents and workers; and reviewed case records of adoptive parents.

The Children and Family Services Division of the Department of Human Services (DHS) contracts with Catholic Charities North Dakota and PATH ND to run the Adults Adopting Special Kids (AASK) program throughout the state of North Dakota. The AASK program provides adoption services to children in the state foster care system. While many positive aspects to this process came forth during our audit process, we also uncovered some sources of frustration by both adoptive parents and adoption caseworkers.

The nationally recognized foster care adoption expert Jeff Katz, author of the study noted above, was hired as a consultant. He conducted the focus study groups which were held in the cities of Bismarck and Fargo. He issued a separate report, from which we have included his most significant barriers to foster care adoptions in North Dakota.

The following barriers were found within the foster care adoption process:

There is too much paperwork as the questions are often redundant between various forms as well as between forms that have to be completed for both the foster care and adoption programs.

Processing of fingerprints for prospective adoptive parents often has to be redone; and even if not redone the timeframe can take several months, as there are only two part-time people handling all the background check information.

The adoption subsidy amounts are not viewed as being fair, consistent, or equitable since they vary by county.

There are not enough state matching funds available to access additional federal dollars in order to provide post-adoption services.

For financial reasons, at times parents need to transfer the legal custody of their adopted children to the state so their adopted children can receive intensive services, such as residential treatment.

After transfer of legal custody, child support is assessed against the family. The Child Support Enforcement Unit follows the normal collection policies which could be a contributing factor in a family filing for bankruptcy.

In addition, there were other less critical (although still formidable) barriers to adoption that were mentioned in a separate letter to management. The separately issued report by Jeff Katz entitled "Adoption in North Dakota," is available by request or can be found at the following website:

http://www.nd.gov/auditor/reports/FCA_07.pdf

This report goes into much greater detail on both the good and the bad points found within the adoption process for the state of North Dakota.

Operational Improvement:

We recommend the Department of Human Services work with their adoption partners to determine what steps can be taken to overcome the noted barriers to the adoption process.

Department of Human Services Response:

The Department will enhance the adoption process where possible within federal and state regulations and legislative appropriations.

Public Assistance Reporting Information System Implementation 07-2

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 Food 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 Minnesota would be identified and could be removed where applicable.

Observation:

Forty-two states have participated in the PARIS information exchange. Several of these states have reported a significant savings by participating in the program.

Operational Improvement:

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

Department of Human Services Response:

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

401 – Insurance Department

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

Segregation of Duties Surrounding Accounts Receivable 07-2

During our review of accounts receivable at the Insurance Department, we noted control procedures are not adequate.

The individual assigned to post debits and credits to accounts and prepare billings for the Petroleum Tank and Bonding funds collections also opens the mail, endorses checks, prepares the remittance listing, and performs data entry of revenue into the Insurance Department's deposit information system and Connect ND Financials.

According to the Committee of Sponsoring Organizations (COSO) *Internal Control – Integrated Framework Executive Summary*, segregation of duties is a control activity used to ensure necessary actions are taken to address an entity’s operating risks. Properly designed segregation of duties requires an individual independent of billing and maintaining accounts receivable records receive or handle revenue collections.

Recommendation:

We recommend the Insurance Department properly segregate duties surrounding accounts receivable by ensuring an individual independent of access to cash maintain accounts receivable and prepare billings.

Insurance Department Response:

The Insurance Department concurs with the recommendation. Job duties of Department staff have been reassigned to ensure proper segregation of duties.

Inadequate Controls Surrounding Payroll 07-3

During our review of payroll processes and procedures, we identified the following weaknesses surrounding control activities and monitoring of payroll:

- the individual assigned responsibility to approve the monthly payroll register also has access to payroll records on ConnectND Human Resource Management System (HRMS);
- the personnel action forms (PAF) are not reconciled to the initiating form; and
- the ConnectND one-time payment query, which summarizes all one-time payments processed through ConnectND HRMS, is not reviewed by the Insurance Department.

According to the Committee of Sponsoring Organizations (COSO) *Internal Control – Integrated Framework Executive Summary*, segregation of duties, reconciliations, and approvals are control activities used to ensure necessary actions are taken to address an entity’s operating risks. Properly designed control activities surrounding payroll require:

- an individual independent of access to update payroll records, approve the payroll register;
- an individual independent of data entry for personal action form (PAF) information reconcile the updated PAF to the initiating form; and
- the ConnectND HRMS one-time payment query be reviewed for unusual transactions and approved by an appropriate level of management on a regular basis.

Recommendation:

We recommend the Insurance Department strengthen controls surrounding payroll by:

Ensuring an individual independent of access to update payroll records on ConnectND HRMS approves the payroll register.

Assigning responsibility to reconcile the personnel action forms (PAF) to the initiating form to an individual independent of payroll data entry.

Implementing procedures to ensure the ConnectND one-time payment query is reviewed and approved by an appropriate level of management on a regular basis.

Insurance Department Response:

The Insurance Department concurs with the recommendation. Job duties of Department staff have been reassigned to ensure an individual independent of access to update payroll records on ConnectND HRMS approves the payroll register.

The Insurance Department concurs with the recommendation. Job duties of Department staff have been reassigned to ensure an individual independent of payroll data entry reconciles the personnel action forms (PAF) to the initiating form.

The Insurance Department concurs with the recommendation. Procedures have been implemented to ensure that the ConnectND one-time payment query is reviewed and approved on a regular basis.

Lack of General Ledger Transaction Approval Procedures 07-4

The ConnectND general ledger did not have online approval capabilities for journal entries during our audit period, and the Insurance Department did not have documented approval of transactions processed through the general ledger.

According to the Committee of Sponsoring Organizations (COSO) Internal Control – Integrated Framework Executive Summary, verifications and approvals are control activities used to ensure necessary actions are taken to address an entity’s operating risks. Properly designed 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:

We recommend the Insurance Department establish procedures to confirm approval of ConnectND General Ledger transactions.

Insurance Department Response:

The Insurance Department concurs with the recommendation. Procedures have been implemented to ensure that general ledger transactions are approved by an appropriate level of management.

Noncompliance With Procurement Policies 07-5

The Insurance Department does not have control procedures in place to properly monitor compliance with State Procurement Office procurement policies, and as a result, improper procurement procedures were used to purchase services and items greater than \$2,500.

State Procurement Office (SPO) Procurement Manual Section 6.1 states that for purchases between \$2,500 and \$25,000, solicitation of no fewer than three vendors shall be made, insofar as practical, to submit oral or written informal bids or proposals. If the three bids or proposals are not received, written justification is required. Four instances were noted where the Insurance Department did not document the proper number of informal bids.

SPO Procurement Manual Section 3.2 states that emergency purchases must be made with the level of competition practicable under the circumstances. A written determination of the basis for the emergency and selection of the particular contractor must be included in the contract file. An Emergency Purchase Determination form must be completed and promptly forwarded to the OMB State Procurement Office after the purchase has been made. Three instances were noted

where the Insurance Department did not properly document the basis for emergency purchases and contractor selection and notify OMB of the purchases.

Per SPO Procurement Manual Section 2.2, officers of procurement shall maintain courteous, professional relationships with all vendors, and avoid any activities, relationships, and communications that in any way diminish, or appear to diminish, fair and impartial treatment of vendors. One instance was noted where the Insurance Department did not provide comparative information to all vendors.

Recommendation:

We recommend the Insurance Department implement an adequate review process by an individual knowledgeable of the procurement policies to establish proper procurement procedures and documentation in compliance with State Procurement Office Guidelines.

Insurance Department Response:

The Insurance Department concurs with the recommendation. Procedures have been put in place to ensure compliance with State Procurement Office Guidelines. Included in those procedures is additional training for Department staff and the appointment of procurement officers to oversee the Departments procurement activities.

Investment Procedure Improvements 07-1

Background:

The Insurance Department is responsible for investing monies with the State Investment Board (SIB). The Insurance Department's process passes investment monies from the State Treasurer through four money market demand clearing accounts (MMDA): Bonding, Fire and Tornado, Petroleum Tank, and Insurance Regulatory Trust to the SIB. Investment funds are electronically transferred between the MMDAs and the SIB; however, the Insurance Department processes and hand delivers numerous checks several times a month when transferring monies between the State Treasurer and the MMDAs. In addition, the Insurance Department maintains a separate investment transaction register for reconciling purposes. Request and approval procedures are performed for all movements of investment funds.

Operational Improvements:

According to the Committee of Sponsoring Organizations (COSO) Internal Control – Integrated Framework Executive Summary, the assurance of objectives achieved through properly designed internal control include efficiency of operations. Consultation with the Office of Management and Budget and the Office of the State Treasurer verified that maintaining MMDAs as clearing accounts for investing funds with the SIB is not required and creates inefficiency. Funds can be transferred directly from the Office of State Treasurer to the SIB. By discontinuing maintenance of the MMDAs, processing checks, maintaining the manual investment transaction register and performing additional approval procedures related to the MMDAs would be eliminated within the investment process.

Recommendation:

We recommend the Insurance Department perform investment transactions through electronic transfer between the State Treasurer and the State Investment Board.

Insurance Department Response:

The Insurance Department concurs with the recommendation. The four money market demand accounts (MMDA) have been eliminated. Funds are now being transferred between the State Investment Board (SIB) and the State Treasurer electronically.

Information Systems Managing Accounts Receivable 07-2

Background:

The Insurance Department maintains an Oracle database deposit system and information subsystems to manage receivables related to fire and tornado, company licensing, petroleum tank, and boiler inspection accounts. Collections are manually entered into the deposit system daily and then subsequently manually entered into each applicable subsystem to update the accounts receivables. The Insurance Department also utilizes Excel to manage additional account information for company licensing. Reconciliations are required between the deposit system and the subsystems as well as ConnectND Financials and the fire and tornado subsystem to ensure proper entry of transactions applied to accounts.

Operational Improvement:

According to the Committee of Sponsoring Organizations (COSO) Internal Control – Integrated Framework Executive Summary, the assurance of objectives achieved through properly designed internal control include efficiency of operations. Implementing a synchronized process to record collections entered in the deposit system to electronically update the accounts receivable managed in the subsystems would eliminate the inefficient need to re-enter collections. Developing the company licensing information subsystem to manage all account information would eliminate maintenance of a separate Excel spreadsheet.

Recommendation:

We recommend the Insurance Department explore the possibility of interfacing the deposit system with information subsystems utilized to manage accounts receivable.

We also recommend the Insurance Department identify the necessary company licensing information managed in Excel and implement changes to utilize the Company Licensing subsystem to manage companies.

Insurance Department Response:

The Insurance Department concurs with the recommendation. The Department is currently evaluating alternative databases that incorporate a deposit system for agent licensing, company licensing, form/rate filing and premium tax collection. The systems being considered are web based and offered by the National Association of Insurance Commissioners. They would offer integration at an affordable price. At this time the new system being considered will not meet the needs of the Special Fund Division. The Department will continue to look for ways to improve or replace the subsystems being used by the Special Funds Division. The modification of those systems to meet this recommendation is cost prohibitive and would require additional appropriation from the legislature.

412 – Aeronautics Commission

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

Aircraft Registration Fee Collection Improvements 07-1

There is a potential to improve the efficiencies of operations at the Aeronautics Commission by allowing registrants to apply for and pay aircraft registrations online. This would save agency personnel time to perform other tasks and save aircraft registrants time and money. Additionally, the Aeronautics Commission is having its registration system rewritten and the federal government is paying 95% of the cost. Therefore the state's cost to bring this online would be minimized.

Currently, the Aeronautics Commission prepares approximately 1,700 aircraft registrations a year using a manual process. The current process for aircraft registrations is as follows: The Aeronautics Commission uses their Aviation Information Management System (AIMS) to print out the registration cards for every registered aircraft in the state. The registration cards are mailed to the aircraft owners. The aircraft owners sign the registration cards, write a check for the registration fee listed on the cards, and mail the items back to the Aeronautics Commission in an envelope provided by the Aeronautics Commission. Collectively, aircraft owners could potentially save an estimated \$700 in postage paid to return the cards and payment back to the Aeronautics Commission.

Aeronautics Commission records the payment information into AIMS, tears off a portion of the registration card, and mails the card back to the aircraft owner.

The manual aircraft registration process noted above has several inefficiencies that can take a significant amount of time. These inefficiencies include: the time it takes to open the return envelopes; locate the aircraft information in AIMS and enter the payment information; double check the payment information to ensure it was entered properly; tear off the aircraft registration card stub and mail it back to the aircraft owner, and file the portion of the registration card retained by the Aeronautics Commission.

Operational Improvement:

Looking at the success of other state agency's online services being offered to their customers and overall industry best practices, we developed the following recommendation:

Aeronautics Commission should provide online aircraft registration services to registrants enabling them to process and pay their aircraft registration fee online.

Aeronautics Commission Response:

The Aeronautics Commission has investigated and will continue to investigate the cost factors to the agency in going to an online registration system. We will take into consideration the projected \$700 savings in postage costs for the state's 1,700 aircraft owners.

504 – North Dakota Highway Patrol

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

Fee Collections 06-4

The North Dakota Highway Patrol collects size and weight permits for the Motor Vehicle Division of the Department of Transportation (DOT), fuel taxes for the North Dakota Tax Department, and escort fees which are deposited into the general fund. North Dakota Century Code (NDCC) and North Dakota Administrative Code (NDAC) determine the fee amounts and where the funds are to be deposited.

We reviewed 54 unusual fee amounts collected by the North Dakota Highway Patrol and determined that 11 fees were collected for the wrong amount, 13 fees were coded incorrectly in the North Dakota Highway Patrol's Receipt System, and 3 fees were deposited into the wrong fund. A factor contributing to the errors is that not all the fees charged by the North Dakota Highway Patrol are listed on the receipt. By listing the fees to be charged on the receipt the North Dakota Highway Patrol officer would be able to use the receipt as a guide to determine the correct fee amount and the individual paying the fee would be able to easily determine that they were not charged the correct amount.

As part of the review above we also identified one transaction where \$43,970 was deposited into the General Fund that should have been deposited into DOT's State Highway Fund.

Recommendation:

We recommend the North Dakota Highway Patrol ensure:

- Proper fee amounts are collected in accordance with NDCC and NDAC;
- Fees are properly coded into the Receipt System;
- Fees for the various fee categories are printed on the receipt; and
- Amounts are deposited into the proper fund in accordance with NDCC and NDAC.

North Dakota Highway Patrol Response:

Steps have been taken to ensure that proper fee amounts are collected in accordance with NDCC and NDAC and that such fees are correctly coded into the department receipt system. The department is in the process of preparing a document listing all fee categories to be made available to both our officers and permit users. This will better enable the Highway Patrol to ensure that all fees are deposited into the proper funds as specified by NDCC and NDAC.

Inadequate blanket bond coverage

Implementation of the Purchase Card 06-1

Challenge:

The North Dakota Highway Patrol implemented the use of purchase cards (P-Cards) for making small dollar purchases. However, during our audit period they were only utilized to pay 104 transactions totaling \$13,120. Review of the agency's expenditures revealed that as many as 4,284 additional transactions totaling approximately \$1,003,000 were for items that could have been paid with a P-Card.

Noted Inefficiency:

Generally, small purchases make up a large percentage of purchasing transactions but only represent a small percentage of dollars spent. Therefore, reducing the administrative costs of processing these small dollar purchases is very important. The state P-Card program reduces the paperwork and administrative costs for small purchases.

Solution:

The North Dakota Highway Patrol should extend their use of the P-Card whenever making purchases up to \$2,500.

North Dakota Highway Patrol Response:

The number of employees with purchase cards has been increased to the level which includes all those who have the need to make purchases of sizable dollar amounts on a regular basis.

Maintenance of Clearing Accounts 06-2

Challenge:

As of June 30, 2006 the North Dakota State Highway Patrol maintained 22 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. One of the accounts is currently being electronically cleared through a process similar to that mentioned below.

Solution:

Based on phone interviews conducted with five of the banks utilized by the North Dakota 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, 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.

North Dakota Highway Patrol Response:

The department is in the process of establishing procedures to electronically clear funds from local banks to the Bank of North Dakota on a monthly basis to eliminate the need to use manual checks and registers.

Timing of Federal Reimbursement Requests

Challenge:

The North Dakota Highway Patrol made 81 federal reimbursement requests for expenditures related to the Motor Carrier Safety Assistance Program (MCSAP) during the audit period.

A review of the North Dakota Highway Patrol's procedures for completing federal reimbursement requests identified numerous inefficiencies that delayed the federal reimbursement requests from being submitted to the Federal Government in a timely manner. Some of the inefficiencies include:

- not properly utilizing PeopleSoft accounting reports;
 - making unnecessary adjustments to operating expenditures claimed; and
 - making adjustments to payroll expenditures claimed due to incorrect payroll procedures adopted by the North Dakota Highway Patrol.
- The effect of the delays noted above resulted in the state's general fund losing at least \$14,000 of interest revenue over the course of the audit period.

Solution:

We recommend the North Dakota Highway Patrol develop and implement procedures related to federal reimbursement claims made to ensure they are submitted to the Federal Government in a timely and efficient manner.

North Dakota Highway Patrol Response:

The PeopleSoft accounting reports are now being utilized more effectively to better enable the timely request of federal reimbursements. This will also eliminate the need for periodic adjustments to federal payroll expenses.

Federal Expenditures Paid With General Funds 06-4

Challenge:

The North Dakota Highway Patrol's processes and procedures used for ensuring that all allowable expenditures are charged to the Motor Carrier Safety Assistance Program (MCSAP) are not operating effectively.

A review of the North Dakota Highway Patrol's grant activity identified the following weaknesses:

At least \$56,000 of administrative expenditures paid with general fund monies could have been claimed for reimbursement from the federal government and were not; \$156,000 of federal indirect expenditures claimed for reimbursement from the Federal Government were not properly recorded on PeopleSoft and as a result were charged to the North Dakota Highway Patrol's general fund inadvertently allowing federal fund balances to build; and \$680,000 of federal grant funds available to the agency for the MCSAP program had not been requested for use at the end of the grant period during the current audit period.

Solution:

The North Dakota Highway Patrol should implement policies and procedures to ensure all allowable expenditures are charged to the MCSAP program; ensure federal indirect expenditures are properly recorded on PeopleSoft; and adequately plan and budget for maximizing the use of MCSAP grant monies. The grant administrator, accountant, and budgeting personnel should re-evaluate the grants to determine which additional expenditures could be charged to the program in order to save state funds.

North Dakota Highway Patrol Response:

Steps have been taken to ensure that administrative salaries are included in the indirect cost pool and that indirect costs are properly recorded in the PeopleSoft accounting reports. The Highway Patrol continues to try to utilize federal MCSAP program funds to the maximum possible extent in line with current staffing levels and enforcement demands.

530 – Department of Corrections and Rehabilitation

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

Lack of Segregation of Duties for Inmate Account 07-2

A lack of segregation of duties has created a weakness in the internal control system surrounding inmate accounts. As duties are presently assigned, the individual responsible for maintaining (posting deposits and withdrawals) the individual inmate accounts and calculating inmate payroll (excluding Roughrider Industries) is also responsible for making deposits and for preparing checks for signature. By not properly segregating these duties one individual has access to both cash and accounting records. In addition, although individual accounts are being reconciled to the bank statement and individual account statements are provided to inmates on a monthly basis, we noted that the controlling account has not been reconciled to the either the

bank account or the individual accounts. This along with the noted lack of segregation of duties results in an increased risk that errors or irregularities in the inmate account may go undetected.

The Department maintains an account at the Bank of North Dakota that includes individual inmate accounts and inmate betterment funds. Individual inmate accounts consist of personal funds typically earned from working within the prison system or received as gifts from family members or friends. The inmate account also holds funds that are to be used for the purpose of inmate betterment. Inmate betterment funds are derived from the operation of inmate activities such as commissary profits, inmate telephone system commissions and special projects approved of by the Warden. These funds are to be used exclusively for the betterment of inmates either singularly or as a group. Inmate betterment funds can only be used when authorized in writing by the Warden.

Recommendations:

The individual who posts activity to the inmate accounts should not have access to cash or the ability to initiate disbursements.

The individual inmate accounts need to be reconciled to the bank account.

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) concurs with this recommendation.

To improve the internal control surrounding the inmate account duties involving the receipt, disbursement, and recording of cash will either be properly segregated or mitigating procedures will be implemented. Also a complete reconciliation of the control account to the bank statement and the individual accounts will be done on a monthly basis.

540– Office of Adjutant General

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

Noncompliance With North Dakota Century Code For Fees Charged by State Radio (06-2)

During our audit period, the Division of State Radio Communications had 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 the early 1990's and for MDT since at least 1999. In addition, the State Radio Communications Division has not determined if \$.20 is adequate to cover the cost of providing 911 services nor have they 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 Department of Emergency Services:

Establish a method to ensure fees charged by State Radio Communications for services provided are based on actual costs; ensure political subdivisions are being charged for the correct number of access lines for 911 fees; and 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.

Response

(a) State Radio will identify actual costs and identify the appropriate fee schedule to finance the services provided to be implemented in the 2009 budget cycle allowing local jurisdictions time to plan and budget.

(b) State Radio will identify and implement an accountability process with local government to verify access lines in actual service, on a quarterly basis at a minimum.

(c) State Radio will identify the requirements for modernization required to catch up with, and become interoperable with technology currently fielded and being utilized at the larger Dispatch Centers in North Dakota, as well as the requirements for modernization regarding Voice over Internet Protocol (VIOP) and Next Generation 911 coming technology. The timeframe for reviewing costs once State Radio is current will be on an annual basis to accommodate yearly increases in costs.

601 – Department of Commerce

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

Noncompliance With Procurement Practices 07-3

In our audit for the biennium ended June 30, 2007, we identified and tested the Department of Commerce's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Proper use of the State Treasurer (State Constitution, article X, section 12).

Compliance with appropriations (2005 North Dakota Session Laws chapter 46).

Compliance with procurement procedures (OMB Purchasing Procedures Manual, ND Administrative Code Chapter 4-12).

Travel-related expenditures are made in accordance with OMB policy and state statute.

Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.

Adequate blanket bond coverage of employees (NDCC section 26.1-21-08)

Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.

Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The results of our tests disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards*. This finding is described below. Other than this finding, we concluded there was compliance with the legislative intent identified above.

Finding

The Department of Commerce does not have controls in place to properly ensure procurement procedures are performed in accordance with Dakota Century Code (NDCC), North Dakota Administrative Code (NDAC) Chapter 4-12, and North Dakota State Procurement Office Guidelines.

During testing procedures, several instances were noted where the Department of Commerce did not follow proper state procurement procedures and documentation for contracts under which payments were made during the audit period.

NDAC Section 4-12-08-04, subsection 10, states that after proposals have been evaluated and a successful vendor selected, notice of intent to award must be promptly issued to all offerors that submitted proposals. Two instances were noted where the Department of Commerce did not issue a notice of intent to award letter.

NDAC Section 4-12-11-02, states that preference given to North Dakota bidders must be equal to the preference given or required by the state of nonresident bidders, in accordance with NDCC 44-08-01. Two instances were noted where the Department of Commerce did not document indication of North Dakota bidder preference in evaluating and selecting vendors.

NDAC Section 4-12-08-04 subsection 2 states that request for proposals must include all contractual terms and conditions as well as the relative importance of price and other factors or subfactors, if any. In addition, NDAC 4-12-11-01 states that a contract award will be made according to the evaluation criteria specified in the solicitation. Two instances were noted where the Department of Commerce issued request for proposals that had insufficient or no specified solicitation criteria. Subsequently, the evaluation criteria and relative weight of criteria factors did not correlate with the solicitation criteria.

NDCC 54-44.4-09 requires vendors to be approved through the Office of Management of Budget and applicable vendors to register with the Secretary of State. Any waiver of the approval requirement must be stated in the solicitation. In addition, State Procurement Office Guidelines Chapter 6.3 indicates bidders should be required to provide proof of license, permit, or registration to perform business in North Dakota. The Department of Commerce did not state a waiver for the approval requirement and does not appear to require proof of licensure, permit, or registration and subsequently entered into contracts with two vendors that were not approved with the Office of Management and Budget nor registered with the Secretary of State to perform business in North Dakota.

NDCC 34-14-04.1 requires every employer to withhold from compensation due to employees those amounts which are required by state or federal law to be withheld. State Procurement Office Guidelines Chapter 5.13 outlines conditions that indicate an employer/employee relationship may exist. The Department of Commerce entered into a contract with a former employee where the employer/employee relationship conditions are evident by: providing a state government owned computer and email address; bidder's lack of authorized vendor registration with the Secretary of State indicating the individual is not in business to provide the same or similar services to other entities or the general public; unspecified scope of work including 'other duties as assigned'; and allowing the potential bidder to provide consultation as to the scope of work of the project.

Recommendation

We recommend the Department of Commerce obtain adequate training of the state procurement procedures and requirements, implement adequate review procedures by an individual knowledgeable of the procurement process, and establish proper documentation to ensure compliance with North Dakota Administrative Code Chapter 4-12, NDCC 54-44.4-09 and State Procurement Office Guidelines.

Response

The Department of Commerce clearly recognizes the importance of procurement regulations. In the Spring of 2007 our Procurement Officer received additional training and then implemented an in-house training session for all of Commerce staff. We will conduct these in-house training sessions on an annual basis. As a result of this recommendation Commerce reorganized duties internally and assigned a new staff person who has 8 years of state procurement experience with another agency to manage the procurement process. A detailed procurement policy specific to Commerce has been drafted and is currently being approved by senior staff and the state Procurement Office. Commerce will be in compliance with all procurement procedures in the future.

Economic Development Grants Improvements 07-4**Point of Interest:**

The Department of Commerce administers economic development grants to public and private entities for the primary purpose of creating, expanding, or retaining businesses and jobs throughout the state. There is increasing public scrutiny of how tax dollars are being used to award economic development grants to businesses on the premise of creating jobs and economic growth to their community. Monitoring plans for economic development grants need to be properly structured and implemented to ensure funds are used as intended.

Challenge:

Economic development grants provided through the Partners in Marketing discretionary grant, Community Development Block Grant (CDBG), and Centers of Excellence grant programs were selected in reviewing the Department of Commerce's policies and procedures compared to best practice guidelines. During the audit period, approximately \$27 million of federal and state funded grants and loans were provided through these programs to city and county governments, college and universities, and community development foundations.

The Department of Commerce is authorized to distribute Partners in Marketing discretionary grants pursuant to Senate Bill 2018, Section 27 of the 59th Legislative Assembly. CDBG program grants are distributed within federal grant appropriation authority. It should be noted that during our audit period, responsibility for performance monitoring of the Centers of Excellence grants did not reside with the Department of Commerce. We commend the Department of Commerce for recognizing that Centers of Excellence grants were not being monitored and working proactively to have legislation introduced to amend North Dakota Century Code Chapter 15-69 (effective August 1, 2007) authorizing the Centers of Excellence Commission to request the Department of Commerce to assist with pre-award reviews and post-award monitoring.

Improvements:

Our review of the Department of Commerce's process and procedures for ensuring grant accountability and performance monitoring of economic development grants resulted in the following potential improvements: Partners in Marketing Program Discretionary Grants Documented performance monitoring of grant award guidelines need to ensure that award activity is carried out as intended, funds are spent appropriately, and the grant is achieving the desired results.

Expenditures reimbursed through the grant award should be based on appropriate verified evidence to avoid improper payments and misuse or waste of funds.

A final contract or agreement should be signed by both the grantor and grant recipient to ensure acknowledgment and acceptance of grant award terms.

CDBG

Post-completion inspection or reporting should be performed or required to ensure created jobs are retained for a reasonable period.

Centers of Excellence

Recognizing that the responsibility for the Centers of Excellence program did not reside with the Department of Commerce during the audited period, the following best practices should be addressed by Commerce in implementing appropriate monitoring procedures:

- Application for funds should include a work plan indicating how the monies will be spent and in what timeframe.
- Assessments to support funding decisions should include appropriate investigation and be properly documented.
- Award agreements should include conflict of interest statements, information and reports the grantee is required to provide, results expected to be achieved and methods used to measure the results, and consequences for not achieving expected results.
- Policies and procedures should be prepared to include provisions for holding awarding organizations and grantees accountable for properly using funds and achieving agreed-upon results.
- Monitoring standards should be established and documented to ensure consistency in monitoring procedures.
- Site visit procedures should be developed to allow for consistent on-site monitoring, quantifying results, and performing comparisons over time and against preset standards.
- Performance monitoring evaluations should be documented to ensure award activity is carried out as intended, funds are spent appropriately, and the grant is achieving the desired results such as job creation.

Criteria:

The best practices used for our recommendations were selected from the following four publications: Guide to Opportunities for Improving Grant Accountability; Best Practice Guide for the Administration of Grants; Best Practices in Carrying Out State Economic Development Efforts; and Guide on Grants, Contributions, and Other Transfer Payments. These best practice studies were prepared by federal and state organizations including the Department of Treasury and Finance and the National State Auditor's Association to focus attention on the importance of grant accountability and provide sufficient best practice for establishing guidelines that will result in efficient, effective, and accountable grant administration and performance monitoring.

Recommendation

We recommend the Department of Commerce strengthen grant accountability administration and monitoring policies and procedures surrounding economic development grants.

Response

The Department of Commerce has implemented all of the above recommendations regarding the Partners in Marketing Program. The Community Development Block Grant Program is funded through federal funds and therefore is excluded from the accountability legislation. Nevertheless, in implementing the accountability legislation in the 2005-07 biennium, Commerce voluntarily applied the accountability legislation to the Community Development Block Grant Program when the funds are used for business development purposes. Therefore,

the Community Development Block Grant Program will comply with the recommendation by virtue of compliance with the accountability legislation. As indicated, Commerce recognized early on the need for monitoring procedures for the Centers of Excellence program. Many of the above suggestions have already been implemented and Commerce is in the process of implementing the appropriate remaining procedures. Commerce is currently hiring an Accountability Officer to focus on this monitoring. Commerce intends to continue to work with the Auditor's Office to research how the University System and/or university or college conflict of interest policies might apply to programs or projects funded through the Centers of Excellence program. The Centers of Excellence Commission's ability to enforce consequences is limited to withholding undistributed funds. Withholding of funds is an extreme event in which serious operational problems are identified that create unanticipated risk and compromise the state's investment in the Center.

624 – Beef Commission

Operational Audit - Contact: Ron Tolstad rtolstad@nd.gov

Inadequate Controls Over the Beef Gift Certificate Checking Account (Finding 624-07-2)

The North Dakota Beef Commission manages a Gift Certificate program where individuals and businesses can purchase "Gift Certificates" from the Commission. These "Gift Certificates" are checks written from an independent checking account maintained by the Commission. The checks are to be used for the purchase of beef related products at grocery stores or prepared meals at restaurants, however, there is nothing that requires this use as they are simply checks and could be deposited into the receiver's bank account, cashed, or used for any other purchase.

All three employees of the North Dakota Beef Commission have access to write and sign checks from the Beef Gift Certificate Program. As such, there is no way for the North Dakota Beef Commission to have adequate segregation of duties regarding reconciliation of the bank statements. Due to the nature of the program, many of the checks do not have a payee on the check when written, as they are given as prizes at later events, or are payable to a grocery store or restaurant.

A good internal controls structure requires segregation of duties to allow employees to catch any potential errors or fraudulent activity during the course of their job duties. This weakness was included in the 2003 North Dakota Beef Commission audit report.

The bank account currently has a balance of approximately \$35,000 due to outstanding checks – some of which were issued years ago and appeared to have been lost and will remain uncashed. The North Dakota Beef Commission is in the process of determining how it will clear up some of these old outstanding checks.

RECOMMENDATION:

We recommend the ND Beef Commission establish proper internal controls over the gift certificate checking account.

AGENCY'S RESPONSE:

The ND Beef Commission has worked to implement all past recommendations related to the Beef Gift Certificate program and the two bank accounts that have been used for this program. The original account will be closed within the next 18 months and funds remaining in the account will be returned to Beef Gift Certificate purchasers if they can be located. Any funds left

that cannot be returned will be turned over to Unclaimed Property. Then the account for Beef Gift Certificates at the Bank of North Dakota then will become the only account used.

The issue of proper internal control has been discussed at length relative to this account. However, the ongoing problem always comes back to the fact that a customer wanting to purchase a Beef Gift Certificate at the Beef Commission office must be able to walk in with their order and leave in minutes with a Certificate. The Commission only has three staff members. There are many situations that arise when only one staff person is in the office. Because of this, all three staff members must be authorized to issue and sign Beef Gift Certificates so that when that staff person is the only one available, customers can be serviced. While the ND Beef Commission understands there is an internal control risk handling the account in this manner, it is one that the Commission feels is necessary in order to make the program effective

670 – Racing Commission

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

Administrator's Account for Breeders' Awards 07-1

We noted a lack of segregation of duties surrounding the administrator's account used to make breeders' awards payments and pay administrative costs. We also noted that money deposited into this account (at a local bank) exceeded the amount required for the Breeders' awards payments and yearly administrative costs, and at times exceeded the \$100,000 amount covered by the Federal Deposit Insurance Corporation (FDIC).

Currently the fund administrator's (an independent contractor) duties include: receiving, endorsing, and depositing the annual check received from the North Dakota Racing Commission into a local bank account; calculation of the check amount for each eligible horseman; writing and signing (dual endorsement) approximately 75 checks for the award payments and administrative costs each year; and reconciling the bank statement to the book balance. Internal controls would be improved by having the fund administrator calculate the breeders' award amounts and providing that information to the Racing Commission for payment through the state's accounting system. This would reduce the likelihood of errors or irregularities.

We noted the balance in the administrator's account had grown to approximately \$49,000 in September 2007, after all the 2006 breeders' award checks had been cashed. The account balance is accruing due to the amount allocated for administrative costs exceeding the actual costs. We also noted that at times the account balance exceeded the FDIC coverage of \$100,000 until enough checks cleared to drop the balance below that amount. Also, as the fund administrator is not a state employee, he is not bonded through the Insurance Department.

Recommendation:

We recommend the North Dakota Racing Commission have the fund administrator calculate the breeders' award payments and provide that information to the Racing Commission for payment through the state's accounting system.

We also recommend the local bank account (administrator's account) be closed and the remaining balance be returned to the breeders' fund at the Bank of North Dakota.

North Dakota Racing Commission Response:

The Racing Commission agrees with this finding.

The independent auditor has and will continue to calculate the breeders' award payment as previously been done. However further research is required to determine the efficiency and cost effectiveness of making the individual payments through the PeopleSoft system.

The request for the independent auditor to close the local bank account (the Breeders' Administrative Fund which was established in the mid 1996) and transfer the balance to the Breeders' Fund will be presented to the Commission at a future meeting for their consideration.

Tax Collection on Simulcast Wagers 07-2

Procedures need to be improved to ensure that the state is receiving the proper amount from simulcast wagers.

There are two simulcast providers in North Dakota: Lien Games and Premier Turf Club (starting February 2007). The Racing Commission has contracted with a local accountant to be their simulcast auditor. His duty is to track the handle (wagers placed in ND) from the simulcast provider sites, verify that data, and compile it in both monthly and annual reports to the Racing Commission. The handle is tracked based on information received from the simulcast providers. This data is then verified by comparing it to reports generated from the AmTote (licensed tote company) system. However, we noted per discussion with the simulcast auditor, the reports with the AmTote information are not received directly from AmTote, but are routed through the two simulcast providers.

A monthly report for each provider is prepared by the simulcast auditor for the Racing Commission, noting the amounts wagered for various types of bets and how much will be received in state tax dollars plus contributions to the Commission's purse, breeders, and promotion funds.

Per North Dakota Century Code section 53-06.2-11, the amount of taxes and special fund contributions changes once a certain threshold or cap is reached. During our testing of this law we noted the July, August, and September of 2005 AmTote reports could not be located.

When reviewing the monthly simulcast auditor reports received by the Racing Commission, it was noted that the March 2007 report for Lien Games wasn't received until June 2007 while the Premier Turf Club report wasn't received until October 2007. For the October 2007 reports, one was received in December 2007 while the other one was received in January 2008. As of April 2008, the January 2008 report had yet to be received. The recap report is based on the calendar year, only received annual year-to-date totals. This makes it difficult to use the report for managerial purposes such as budgeting and monitoring the wager caps when the tax law changes.

Recommendation:

We recommend the North Dakota Racing Commission ensure reports for AmTote handle information be received by the simulcast auditor directly from AmTote, rather than routed through the simulcast provider where they could be changed. We recommend the simulcast auditor maintain all supporting documentation. We recommend the North Dakota Racing Commission require monthly simulcast auditor reports be received in a timely manner. We recommend the recap report be received monthly, be prepared on a fiscal year basis, and include a column for year-to-date information.

North Dakota Racing Commission Response:

The Racing Commission agrees.

Both Lien Games and Premier Turf Club provide the simulcast auditor access so he can retrieve the AmTote data independent of them. This provides the auditor with the proper information to complete a proper audit. The Racing Commission demands that the simulcast auditor use AmTote reports retrieved independent of the Service Providers when completing his audit.

The Director of Racing implemented additional procedures independent of the simulcast auditor. The licensed tote (Amtote) notifies the Racing Commission office just a few days after the end of each month alerting the commission as to the total amount wagered through each service provider. This office then compares that figure with the reported amount and they should be equal. As director I felt this verification by the Racing Commission was necessary and the Director of Gaming agreed. This is our in house method of checks and balances and all the proper taxes have been paid.

It is definitely the responsibility of the simulcast auditor to properly maintain support documentation. The simulcast auditor shall comply. The Commission feels that the simulcast audits should be completed prior to the monthly report provided by the service providers which includes payment of taxes.

In a discussion with the simulcast auditor the director was informed that this method of late reporting has been the norm and has been carried out in a similar fashion when reporting to the three previous directors. In reviewing the 2005 season when Mr. Meyer was director the February 2005 simulcast audit was not submitted to the Racing Commission until August 31st and the March 2005 simulcast audit was not submitted until September 6th.

The new contract signed by the simulcast auditor does require submission of reports in a timely manner. The simulcast auditor shall be required to be in compliance with the new contract.

The recap report would be easier to work with off of a fiscal year report rather than a calendar year. The Racing Commission is currently receiving the reports monthly and will require all reports have a column for year-to-date information.

Auditor Clarification

As noted in paragraph two of their response, the Racing Commission states the simulcast auditor has direct access to AmTote reports and they demand he use those reports. However, this is not the current procedure.

Code of Ethics/Code of Business Conduct/Fraud Assessment

The North Dakota Racing Commission has not completed a fraud risk assessment and does not have a Code of Ethics or a Code of Business Conduct. The Committee of Sponsoring Organizations' Internal Control – Integrated Framework identifies these as important elements of adequate internal control.

Periodic fraud risk assessments are necessary to identify potential areas of fraud to help ensure adequate controls are put into place. A proper Code of Ethics or Code of Business Conduct helps establish a sound control environment. This will help communicate to employees what behaviors are expected and what behaviors will not be tolerated and the consequences of not complying with these important policies.

The North Dakota Racing Commission was unaware of these requirements.

Recommendation:

We recommend the North Dakota Racing Commission perform periodic fraud risk assessments and properly address significant risks that are identified. In addition, the North Dakota Racing Commission should establish a formal Code of Ethics or a Code of Business Conduct.

North Dakota Racing Commission Response:

The Racing Commission agrees with this finding.

The State Auditors informed the Racing Commission that the Racing Commission along with other state agencies, are being informed that these two new policies are to be completed before the next scheduled audit. The Racing Commission was unaware of these two new requirements until informed by the State Auditors in March 2008.

The Racing Commission will seek assistance from the Office of Management and Budget in completing the Code of Ethics or a Code of Business Conduct and a fraud risk assessment.

Noncompliance with Contract Award Requirements

We are unable to determine if the North Dakota Racing Commission awarded a contract to the lowest responsible bidder in accordance with North Dakota Century Code (NDCC).

House Bill 1324 of the 2007 session created a new section of North Dakota Century Code 53-06.2-04.1, which states: "The commission shall provide for registration of a North Dakota-bred horse for qualification for breeders' fund awards and purse supplements. The commission shall contract with a private person to maintain the registry. Through a competitive bidding process, the commission shall award the contract to the lowest responsible bidder. The cost of the contract must be paid from the breeders' fund."

The Commission used a Request for Proposal process to award the contract. Bid proposals were evaluated and points were awarded for contract cost, experience and qualifications, and understanding of the contract. We noted the Commission received two bid proposals, one for \$11,520 and the other for \$7,200. During their November 19, 2007 commission meeting the North Dakota Racing Commission scored each bid proposal and subsequently awarded the contract to the highest scoring vendor that bid \$11,520.

The scoring process used by the Commission was not appropriate, as the contract was to be awarded to the lowest responsible bidder. The Commission should have used a scoring process that required the award to be made to lowest responsible bidder, and provided justification if any bidders were determined to be not 'responsible.'

Recommendation:

We recommend that the North Dakota Racing Commission comply with North Dakota Century Code section 53-06.2-04.1 and award the contract for the breeders' administrator to the lowest responsible bidder.

North Dakota Racing Commission Response:

We agree that the Racing Commission, in coordination with the Office of Management, State Procurement Office, inadvertently used a procurement method not contemplated in the statute. The Racing Commission worked with the State Procurement Office to develop the solicitation to

select the contractor to maintain the Registry. The State Procurement Office used a Request for Proposal process which is the type of solicitation normally used for management services contracts (See N.D.C.C. § 54-44.4-10, N.D.A.C. § 4-12-08-04 and Level 1 Procurement Manual, Section 5.4). The request for proposal process is generally considered best practice when procuring professional services because it enables the agency develop evaluation criteria to determine which proposal or contractor is most advantageous, based upon cost and other factors, such as experience and qualifications.

Action has been taken. The first contract was terminated without cause by the contractor in May 2008. The Racing Commission worked with the OMB State Procurement Office to develop an Invitation for Bid to award a contract for North Dakota Breeders' Fund Administration services to the lowest, responsible bidder. The Invitation to Bid was issued on June 4, 2008, and bids are due on July 2, 2008.

Use of Breeders' Funds for Purse Supplements

We are unable to determine if the North Dakota Racing Commission is in compliance with North Dakota Century Code section 53-06.2-11 regarding the use of breeders' funds for purse supplements.

House Bill 1324 of the 2007 session amended North Dakota Century Code 53-06.2-11, section 6, which references the breeders' fund, purse fund, and racing promotion fund and states that the commission may not transfer money among the funds.

According to one of the sponsors of House Bill 1324, it was their intent that this amendment prevents the North Dakota Racing Commission from using funds from the breeders' fund for any purses.

The North Dakota Racing Commission's legal counsel from the Attorney General's Office has interpreted the law as not having any effect on the use of breeders funds for purse supplements as they have never 'transferred' money between funds.

The North Dakota Racing Commission does use funds from the breeders' fund to supplement purses for races at the two North Dakota tracks. Races that receive this purse supplement are exclusively for North Dakota bred horses, which are also eligible for breeders' award payments. Per review of the February 11, 2008 North Dakota Racing meeting minutes, they approved payments of \$125,000 for the 2008 racing season from the breeders' fund for purse supplements.

We reviewed bill testimony and feel it is unclear if this law would forbid the use of breeders' fund dollars to be used for purse supplements as is currently the case.

Recommendation:

We recommend the North Dakota Racing Commission seek a formal Attorney General's opinion to determine if their current practice is in compliance with the state law.

North Dakota Racing Commission Response:

The Racing Commission agrees that an opinion from the Attorney General for the use of Breed Fund money to supplement purses for certified North Dakota Bred races is a wise move to resolve this issue. This opinion was requested March 30th.

Continuance of Declining Fund Balance

We noted certain areas of concern in regards to the continued declining fund balance in the three funds run by the North Dakota Racing Commission.

Background:

Based on review of the year-end fund balance amounts for the three North Dakota Racing Commission funds (breeders', purse, and promotion), the continued decline in the fund balance presents future concerns regarding the ability of the North Dakota Racing Commission to continue functional operations – including payments to tracks and breeders.

Per our review of the February 11, 2008 meeting minutes, the North Dakota Racing Commission has authorized payments of \$630,000 for the 2008 racing season for the Belcourt and Fargo tracks (\$125,000 breeders' fund, \$305,000 purse fund, and \$200,000 promotion fund).

While the scheduled 2008 disbursements appear to be a decrease in what has been allocated in prior years, it is still apparent that the future of these funds is in jeopardy.

Of the \$330,971 of income for the three funds in calendar year 2007, \$72,538 (22%) is interest income, which will continue to decrease based on declining fund balances. Out of the total 2007 calendar year expenditures of \$1,669,801, we also noted \$123,171 of salaries for Racing Commission employees.

If the fund balance decline continues, it appears the North Dakota Racing Commission will be able to continue its current funding pattern through the 2009 racing season before the funds will be substantially depleted and drastic cuts will be necessary.

The following table shows the balances for the North Dakota Racing Commissions fund as of calendar year end.

Breeders Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 2,369,555	\$ 1,939,451	\$ 1,676,001	\$ 1,327,612
Income	30,136	135,352	77,612	82,016
Expenses	(460,240)	(398,802)	(426,001)	(666,844)
Ending Fund Balance	\$ 1,939,451	\$ 1,676,001	\$ 1,327,612	\$ 742,784
Purse Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 2,415,584	\$ 2,010,078	\$ 1,746,488	\$ 1,355,275
Income	30,705	137,030	80,288	84,389
Expenses	(436,211)	(400,620)	(471,501)	(522,054)
Ending Fund Balance	\$ 2,010,078	\$ 1,746,488	\$ 1,355,275	\$ 917,610
Promotion Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 1,943,744	\$ 1,420,890	\$ 1,144,174	\$ 873,268
Income	80,170	243,165	188,788	164,566
Expenses	(603,024)	(519,881)	(459,694)	(480,903)
Ending Fund Balance	\$ 1,420,890	\$ 1,144,174	\$ 873,268	\$ 556,931
Total Fund Balances	\$ 5,370,419	\$ 4,566,663	\$ 3,556,155	\$ 2,217,325

Operational Improvement:

We recommend the North Dakota Racing Commission implement a plan that allows for sustained future operations. This plan should not be based on any assumption of future increased revenue – either through increased pari-mutuel betting through simulcast or account wagering sites or increased gambling opportunities presented at the Horse Park.

North Dakota Racing Commission Response:

The racing commission agrees. The commissioner would like to see that racing industry leaders formulate legislation for the financial growth of the racing industry. At the current time the Commission is working with Horsemen's Council seeking their recommendations

Breeders' Registry Contract 07-2

We noted the length of time for the North Dakota Racing Commission to set up the contract for the Breeders' Registry seemed excessive.

Background:

House Bill 1324, which was signed by the Governor on March 21, 2007, required the commission to contract with a private person to maintain the registry of North Dakota-bred horses for qualification for breeders' fund awards or purse supplements.

The one-year contract with a private person to maintain the registry was signed on December 4, 2007, which was more than eight months after the house bill became law.

We also noted during April 2008, the vendor terminated their contract with the North Dakota Racing Commission.

Operational Improvement:

We recommend the North Dakota Racing Commission ensure they minimize the time necessary to award future contracts.

North Dakota Racing Commission Response:

We agree. Action has been taken. The Racing Commission worked with the Office of Management and Budget, State Procurement Office to issue an Invitation for Bid for North Dakota Breeders' Fund Administration Services that will open on July 2, 2008. The contract will run through June 15, 2009 with annual renewal options. Thus future solicitations will be conducted in approximately April-May and awarded in June. This schedule will enable the contractor to be sufficiently prepared for the heavy workload and required disbursement of Breed Fund awards in December.

Moreover, the initial contract allowed either party to terminate the contract without cause upon 30 days notice, which proved to be insufficient. The new contract requires a 90 day termination notice, which would enable the Racing Commission to select a new contractor prior to the contract being terminated without cause.

720 – Game and Fish Department

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

Private Land Initiative Improvements 06-1

Challenge:

Individual hunters find it difficult obtaining access to private land. Lack of land access can be a deciding factor for some hunters to give up hunting or create dangerous overcrowding of available land by hunters.

In terms of overall acreage, approximately 90% of North Dakota is in private ownership, 8% in public ownership, and 2% are tribal trust lands. The 8% public ownership is comprised of 5.2% in fee title by the federal government (this includes water acres such as Lake Sakakawea), 2.3% in state ownership (mostly state trust lands), and .5% city/county owned (roadsides and township property).

According to a Game and Fish survey, 7 of 10 hunters would pay higher fees to fund habitat and access programs. License fees comprise a relatively small portion of actual hunting costs for most individuals.

The Private Lands Initiative successfully opened approximately 900,000 acres (2% of overall acreage) of privately held land for hunters in North Dakota through their Private Land Open to Sportsmen (PLOTS) program. Revenue from the sale of Habitat Stamps and accrued interest from the Department's operating fund balances fund the PLOTS program.

Current revenue adequately funds the PLOTS program; however, future revenues are determined largely by the number of hunting licenses issued. Therefore, fewer license sales would result in less revenue for PLOTS and reduced land available for hunters, resulting in fewer hunters and decreased license revenue. Reduced license sales could be the result of fewer opportunities because of land access as well as reduced game populations due to a severe winter or disease outbreak.

Operational Improvement:

It is our conclusion the PLOTS program should be expanded through increased fees charged hunters. This could be done through a fee increase in various hunting licenses or the requirement of an additional stamp required to hunt on PLOTS land.

Requiring a separate PLOTS stamp allows the people that utilize the PLOTS land to help fund the program.

The additional revenue used exclusively to increase the number of acres enrolled in PLOTS. This could be accomplished by increasing rental payments to encourage more landowners to sign up for PLOTS or providing more habitat enhancement programs.

The Department should also consider additional nonmonetary landowner benefits they can provide to enhance the PLOTS programs benefits. An example would be to allow a "PLOTS gratis" licenses for landowners willing to enroll their land in the PLOTS program. This would allow them to hunt all PLOTS land in their hunting unit.

North Dakota Game and Fish Department Response:

The Department will work with the Legislature concerning funding for the PLOTS program in future legislative sessions. With a fund balance of over \$25 million, the Department has been able to supplement interest and habitat stamp revenue with other revenue. The Legislature has been steadily increasing the price of the habitat stamp to \$10. The Legislature will also dictate when and how any fee increases are implemented. There probably will be a need to address this in the 2009 legislative session.

It should be noted that 90 percent of the land in North Dakota is privately owned and that most hunting takes place on land that is not enrolled in PLOTS. The goal of 1 million acres of land for hunting access will soon be reached, but this is only a very small part of the hunting land in North Dakota and the program's main emphasis is pheasant hunting. While PLOTS is a popular, successful program, hunters still must depend on contacts and relationships with landowners as their primary source of hunting land. While \$5,000,000 per year for plots is a significant amount, it only covers a very small portion of the hunting areas in North Dakota.

Lottery Refunds

Challenge:

Approximately 50% of the license applications are now received over the internet and paid by credit card.

In 2006 the North Dakota Game and Fish Department issued approximately 17,000 refunds for deer, pronghorn, and turkey licenses. Currently the North Dakota Game and Fish Department issues refund checks for all unsuccessful applicants regardless if they initially paid with a credit card.

For each check issued there is a cost not only to the agency issuing the check, but also to the Office of Management and Budget and the State Treasurer's office. This would include the task of issuing, processing, and printing the checks.

A severe winter could result in a substantial decrease in the number of licenses available – which in the case of deer licenses could result in a substantial increase in the number of refunds issued.

Operational Improvement:

As the current lottery system will be re-written sometime in the next few years, we believe the North Dakota Game and Fish Department should consider implementing procedures to issue refunds back to credit cards as part of the system re-write.

North Dakota Game and Fish Department Response:

The Department would like to issue refunds to credit card customers who are unsuccessful in the license lotteries. This will be looked at when the lottery software is replaced in the next 1-2 years. If an efficient cost effective solution is available, this will be a good time to implement it.
Deer Donation Program

Challenge:

Sportsman Against Hunger processed 360 deer (16,000 lbs.) in 2006. According to the North Dakota Community Action Association, food pantries would be able to accept 71,000 pounds of venison per year, which would equate to 1,600 deer. Many hunters may be willing to purchase an extra doe license and donate the extra venison to a food pantry if they were not required to pay the entire processing cost (approximately \$60 per deer).

We also believe hunters would be willing to donate money to the venison program if the donation request was small and included in the license purchase.

Operational Improvement:

The North Dakota Game and Fish Department should consider modifying its deer license application procedures (paper and internet) to include the opportunity for the purchaser to donate a small amount (\$1-\$2) to the deer donation program.

Any funds raised could be sent to the various sponsoring sportsmen clubs across North Dakota enabling them to pay processing costs for additional deer.

North Dakota Game and Fish Department Response:

The Department is already considering funding sources for the deer donation program. Making it part of the paper application system would make it very difficult to reconcile money with batches of applications. This suggested option would work best for online applicants. The suggestion to consider an optional donation program will be considered by the Department's Management Team.

750 – Parks and Recreation

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

State Park Revenue Controls Weakness

Controls for monitoring and reconciling state park permits, receipts, and revenue are not adequate. Our audit procedures identified the following weaknesses:

- Inconsistent reporting methods at the state parks do not allow for adequate monitoring of permit and receipt book inventory and reconciling of sales to revenue collected.
- An individual annual interpretive center permit has not been established and daily Interpretive admittance passes are not alternated for color or design to limit multiple uses of one pass.

- Multiple fee amounts assigned to an individual permit does not allow for adequate reconciling of permits sold to revenue collected.
- Permit reconciling procedures are not in place when issuing duplicate permits to verify an original permit was issued.
- Reservation registration and revenue reconciling procedures are not in place when admitting reserved camping registrations at the state parks.
- Lack of monitoring policies and procedures surrounding permits and receipt books to ensure all are accounted for.
- Lack of segregation of duties for Park Rangers having authority to collect revenue and issue citations.

According to the Committee of Sponsoring Organizations (COSO) *Internal Control – Integrated Framework Executive Summary*, monitoring, verifications, reconciliations, and segregation of duties are control activities used to ensure necessary actions are taken to address an entity's operating risks. Proper monitoring procedures require consistent reporting methods be implemented for state parks to report unused permits and receipt book inventory and revenue collections. Documented policies will ensure procedures are properly communicated. Properly designed controls require initially issued permits be verified before issuing duplicates and reservation registration numbers be reconciled to the reservation registration system to ensure proper revenue collections. Properly designed reconciliation of revenue requires reconciliation of sales to revenue collections. An individual fee for each permit will allow for proper reconciliation. Proper reconciliation of permit and receipt inventory requires distributed permits and receipts be reconciled to those issued and unissued. Properly designed segregation of duties requires segregation between individuals that initiate and approve transactions and have access to cash.

Recommendation:

We recommend the Parks and Recreation Department strengthen controls surrounding revenue collected at the state parks by:

- Developing consistent methods for state parks to report permits, receipts, and revenue;
- Developing appropriate individual permits assigned a single fee;
- Performing reconciling procedures on permits sold and reservation registrations to revenue collected;
- Verifying original permits sold when issuing duplicates;
- Developing documented monitoring policies and implementing monitoring procedures over permits and receipt books; and,
- Ensuring segregation of duties assigned to park rangers.

Parks and Recreation Department Response:

The NDPRD agrees, in part, but also disagrees with components of finding 07-2. While the Department is of the opinion that business practices pertaining to park permits, receipts and revenue are consistent and do exist, there is always room for improvement. The implementation of the recent Online Management System (OMS) and subsequent staged implementation steps are designed to strengthen these practices. Development of an accounting business rules manual is under discussion to set forth a documentation system by enhancing the department's standard practices and processes for reporting, monitoring, reconciling and verification procedures for revenue collections.

It is important to reiterate the fact that revenue collections have increased annually for the past decade. The respective park operations rely solely on revenues collected from visitors to cover their operating costs thus maintain sharp focus on revenue collection and correlations to

deposits. Application of the above noted business rules will improve tracking of revenues. Development of individual permits assigned a single fee could be considered and in fact one of the three permits reviewed and that caused most consternation for auditors will be eliminated. Printing individual permits for each park fee structure will be a costly exercise to implement. For example, the Annual Pass and Senior Citizen Pass were combined into a single pass as recommended by the legislative assembly ten years ago for efficiency yet retained a \$5 discount for senior citizens, age 65. That procedure has been a very cost effective and beneficial public service although it does create risk exposure. Camping passes contain a multitude of fee variance to include the daily pass fee with a day multiplier included on a single permit. This style of permit is standard practice across the national state park systems, in the national parks and other federal land managed areas. More evaluation is needed to make a prudent decision on implementation of this recommendation to current procedures.

The NDPRD agrees that segregation of park ranger duties would be an ideal situation, however with already limited staff and salary allocations it poses a hardship. We continue with extreme difficulty hiring qualified seasonal staff thus face the results of assigning multiple duty responsibilities. Several parks do not have a full time ranger position requiring the park manager a sole responsibility for these functions. During peak visitor season these single staffed operations place multiple duties on seasonal employees. Should the legislature approve funding and additional positions, segregation of duties would be more viable and the exposure to risk would be minimized.

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

Computer Access Controls Weakness 07-1

Access controls over ConnectND Finance, Human Resource Management System (HRMS), Motor Pool, and Drivers License systems are not adequate.

Proper internal controls, as documented in the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's *Internal Control - Integrated Framework*, include limiting access to computer systems to only individuals that need access for their job duties. The following weaknesses were noted:

Several individuals have the ability to both process and approve transactions. Several individuals have access to systems beyond what was required for their job duties. Former employees still have access to certain systems.

Several Highway Patrol employees have access to change usage transactions of other agencies in the Motor Pool billing system.

Policies and procedures should be in place to ensure: individuals only have access necessary to perform their job duties; an individual is assigned the responsibility of controlling access to all applications; and ongoing reviews are performed to ensure access rights are properly maintained. Without these controls, there is an increased likelihood of unauthorized access to confidential or sensitive information and fraud.

Recommendation:

We recommend the Department of Transportation:

- Establish policies and procedures to restrict access privileges to only necessary individuals.
- Assign ongoing responsibility for security for each information technology application.
- Perform continuing reviews of access privileges.

Department of Transportation Response:

We concur with the finding. The recommendations as set forth by the State Auditor's Office will be implemented.

Motor Vehicle Division Bank Reconciliation 07-2

The Department of Transportation (DOT) is not properly reconciling their motor vehicle clearing account to the report of amounts processed and pending each month. Due to a coding error in the Single State Registration System, DOT improperly transferred \$2.3 million from their motor vehicle clearing account to the Highway Fund from 2000-2007. DOT noticed the error and correctly transferred the money back to their clearing account in June 2007. Had the clearing account been properly reconciled, this coding error would have been detected promptly.

We also noted that DOT did not properly complete their Cash and Investments Summary Form closing package. This form is required by the Office of Management and Budget in preparing the state's Comprehensive Annual Financial Report (CAFR). On that form, DOT reported their entire unrecorded Bank of North Dakota cash balance in the Highway Fund. However, a material portion of the \$14 million unrecorded cash reported as belonging to the Highway Fund should have been allocated to other funds. Had the errors not been detected, it would have resulted in the state's financial statements being materially misstated.

Recommendations:

We recommend the Department of Transportation:

- Properly reconcile their motor vehicle clearing account to the report of amounts processed and pending each month.
- Properly complete their Cash and Investments Summary Form.

Department of Transportation Response:

We concur with the finding. The State Auditor's recommendations have already been substantially implemented.

Internal Audit Function

The Department of Transportation is not adequately monitoring its internal control system as a result of the Internal Audit Services Division's shift in focus over the last several years towards non-internal audit functions. They primarily review federally-mandated annual motor carrier registrations and conduct on-site reviews of the inventory procedures at their district sites. The Internal Audit Services Division did not compile a risk-based analysis and annual work plan to allow the Audit Committee to properly determine the most efficient use of internal audit resources. In addition, the Internal Audit Services Division still reports to the Director of the Financial Management Division.

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework, internal control consists of five interrelated components. One of the components is monitoring and that internal control systems need to be

monitored through a process that assesses the quality of the system's performance over time. Monitoring can be accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. COSO also identifies the roles and responsibilities individuals within an entity have in effecting internal control. Internal auditors' roles and responsibilities are to directly examine internal controls and recommend improvements. COSO cites the Standards established by the Institute of Internal Auditors by stating that the scope of internal auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibility.

Recommendations:

We recommend the Internal Audit Services Division:

- Change their scope to encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibility.

- Compile a risk-based analysis and annual work plan to be presented to and approved by the Audit Committee to properly determine the most efficient use of internal audit resources.

- Report their audit results and findings directly to the Audit Committee.

Department of Transportation Response:

We concur with the finding. The State Auditor's recommendations will be incorporated into NDDOT's action plan for the internal audit function.

As noted in the audit finding, the NDDOT auditors primarily conduct federally mandated reviews of third parties. The volume of these mandated reviews has increased to the point that virtually all available NDDOT audit resources are expended on them. NDDOT management is well aware of the necessity and benefits of an audit function that is focused on internal activities and we strongly support this concept.

The NDDOT must continue to meet its federally mandated review obligations. Therefore, successful implementation of an effective internal audit function will require additional resources beyond those currently available. The department will pursue additional resources as a part of the 2009-2011 biennium budget request.

The NDDOT will also take the following steps to restore an effective internal audit function:

The department will assign additional audit staff and/or funds to outsource additional audit activities at a level that will enable the department to continue meeting the federally mandated review obligations and carry out an effective internal audit function.

An audit committee will be reestablished. The committee will be responsible for reviewing and approving the annual work plan for the audit function, reviewing and approving staffing and other resource levels necessary to achieve the annual work plan, and reviewing and approving the findings and recommendations resulting from the internal audit activities.

The audit unit will conduct or contract for a risk based analysis, the results of which will be incorporated into the annual work plan for the audit unit.

The department's audit unit will no longer report directly to the Financial Management Director (i.e. the department's chief financial officer) on matters involving audit activities. Rather, it will report to the Deputy Director for Business Support and the department's audit committee. This action is being implemented to avoid potential situations that could result in a conflict of interest and in accordance with the State Auditor's recommendation.

The department's audit policies will be rewritten to encompass these improvements.

Overspending Appropriation Authority 07-4

The Department of Transportation (DOT) overspent their Drivers and Vehicle Services line item by \$131,559 during the 2005-2007 biennium. DOT was aware of the potential of overspending the line item and received an additional \$250,000 of spending authority approved by the Emergency Commission in June 2007. However, after receiving the additional spending authority, they still overspent their line item by \$131,559.

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

Recommendation:

We recommend that the Department of Transportation develop control procedures to ensure they do not overspend their appropriation authority in accordance with NDCC section 54-16-03.

Department of Transportation Response:

We concur with the finding and will fully implement the auditor's recommendation.

This over expenditure of appropriation resulted primarily from an over commitment of federal funds for traffic safety grant activities by the Drivers License and Traffic Safety Division (DLTS) of the NDDOT. As such, the federal funds were available to cover the related costs; however, the department did not have adequate appropriation authority available to carry out that level of activity in the 2005-2007 biennium. As noted by the State Auditor's Office, NDDOT was aware of the potential for overspending this appropriation and did address the issue with the Emergency Commission. Unfortunately, the DLTS calculation of outstanding commitments was too low; as a result, our Emergency Commission request was likewise inadequate. While the department did over expend the Driver and Vehicle Services program appropriation, it should be noted that the NDDOT did not over expend the total of its entire program appropriations; the department had a positive biennium ending balance for all appropriations when considered in total.

Since this occurrence, the department has taken several steps to insure tighter controls over DLTS spending, including the following:

A business manager position has been created within the DLTS division. This position is staffed by an individual possessing significantly greater fiscal skills than previously available within the DLTS division. This position will be responsible for insuring that contract commitments are in line with available federal revenue and appropriation authority and for monitoring, coordinating, and communicating expectations and results with DLTS management and program staff, NDDOT executive management staff, and NDDOT fiscal staff.

NDDOT executive management has strongly reemphasized to DLTS management the importance of a high level of fiscal responsibility, integrity, and quality on their part. Also, the

necessity for compliance with NDDOT executive and fiscal management directives has been strongly reemphasized.

The NDDOT is no longer operating under a program budget concept. Rather, it now operates under a traditional appropriation line budget. While this change in no way modifies NDDOT's responsibility for staying within the appropriate appropriation boundaries, it does provide an effective mechanism to easily remedy some appropriation difficulties that may otherwise be encountered in a smaller, program based budget. Had the agency been operating under a traditional appropriation line budget during the 2005-2007 biennium, it is quite likely that the NDDOT would have been able to transfer funds internally and still remain within the appropriation line constraints.