

North Dakota
Veterans' Home
LISBON, NORTH DAKOTA

Audit Report

For the Biennium
June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

July 9, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Mark Johnson, Administrator

We are pleased to submit this audit of the North Dakota Veterans' Home for the biennium ended June 30, 2011. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Angela Klubberud. Kristi Morlock and Lindsey Ulrich were the staff auditors. John Grettum, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Administrator Johnson and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Veterans' Home is a state-sponsored institution whose general supervision and government is vested in the Administrative Committee on Veterans' Affairs (Committee) as noted in Chapter 37-18.1 of the North Dakota Century Code. The chairman and secretary of the Committee, acting jointly, shall appoint a seven-member governing board for the administration of the Home, from within or outside the Committee, subject to ratification by a majority of the Committee. The Home is located on a 90-acre tract of land adjacent to the city of Lisbon and has been in operation since 1893.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's responses are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the North Dakota Veterans' Home in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "improper coding" (page 9) and "lack of approval of adjustments" (page 10), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

The North Dakota Veterans' Home has implemented all recommendations included in the prior audit report.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

Yes, a management letter was issued and is included on page 14 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The North Dakota Veterans' Home's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

14. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), MDI Technologies, and Speed Script are high-risk information technology systems critical to the North Dakota Veterans' Home.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the North Dakota Veterans' Home for the biennium ended June 30, 2011 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Veterans' Home's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Veterans' Home and are they in compliance with these laws?
3. Are there areas of the North Dakota Veterans' Home's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the North Dakota Veterans' Home is for the biennium ended June 30, 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The North Dakota Veterans' Home's sole location is its Lisbon office which was included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.

- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed North Dakota Veterans' Home's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion and Analysis

The accompanying financial statements have been prepared to present the North Dakota Veterans' Home's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2011, operations of the North Dakota Veterans' Home were primarily supported by appropriations from the state's general fund. This is supplemented by federal funding and fees credited to the agency's operating fund.

Financial Summary

Revenues consisted primarily of federal funds, as well as charges for services which are reported as care and treatment, and loans from the Bank of North Dakota to cover spring 2009 flood expenditures reported as loan related revenues. These all remained fairly constant for the North Dakota Veterans' Home, except for the decline in revenue from federal government related to the completion of the new Veterans' Home. Total revenues were \$10.6 million for the year ended June 30, 2011 as compared to \$15.8 million for the year ended June 30, 2010.

Total expenditures for the North Dakota Veterans' Home were \$20.9 million for the year ended June 30, 2011 as compared to \$24.1 million for the prior year. The decrease in total expenditures for the audited period reflects primarily the completion of the new Veterans' Home. All other expenditures remained fairly constant, except for equipment costs which consist primarily of office furniture and furnishings, hospital equipment, and other equipment for the new Veterans' home.

Total Custodial and resident trust funds balances were \$259,568 and \$214,915 as of June 30, 2011 and June 30, 2010, respectively. This change is due to residents keeping higher balances.

Analysis of Significant Changes in Operations

The North Dakota Veterans' Home completed construction of a new Veterans' Home. Total expenditures through June 30, 2011 were \$26,454,847.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The excess of salary and wages and operating expenses appropriations over actual expenditures of \$439,565 and \$549,755 were due to a lowered resident census in preparation of moving to the new Veterans' Home and the later than anticipated opening of the new Veterans' Home in the spring 2011. The operating expenses variance is also due to the resident census being lower than budgeted, due to the later opening of the new Veterans' Home. The variance between the final budgeted and actual expenditures for New Veterans' Home and 2009 Flood Expenses was due to the expenses for each were estimated high. No federal stimulus funds were spent as the projects for the new Veterans' Home did not qualify.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<u>Revenues and Other Sources:</u>		
Revenue from Federal Government	\$ 5,161,932	\$ 12,135,024
Care and Treatment	2,598,329	2,965,037
Loan Related Revenues	2,575,152	33,554
Charges for Services	149,492	139,887
General Government	12,601	10,879
Contributions and Private Grants	1,986	2,288
Leases, Rents, and Royalties	1,048	259,290
Interest and Investment Earnings	451	801
Transfers In	138,000	301,929
Total Revenues and Other Sources	\$ 10,638,991	\$ 15,848,689
<u>Expenditures and Other Uses:</u>		
Construction In Progress	\$ 10,968,222	\$ 16,512,826
Salaries and Benefits	6,002,188	5,258,459
Equipment	1,119,712	41,632
Professional Services	468,242	582,522
Food and Clothing	420,263	343,576
Medical, Dental, and Optical	415,004	376,271
Utilities	363,879	269,016
Equipment over \$5,000	310,528	13,609
Supplies	337,274	187,497
Land and Buildings	108,526	85,964
Repairs	127,536	29,561
Travel	57,736	82,916
Operating Fees and Services	86,337	158,079
Professional Development	49,961	32,045
Data Processing and Communications	81,465	86,806
IT Contractual Services and Repairs	24,885	14,189
Total Expenditures and Other Uses	\$ 20,941,758	\$ 24,074,968

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 11,538,855	\$ 91,901	\$ 11,630,756	\$ 11,191,191	\$ 439,565
Operating Expenses	4,561,857	0	4,561,857	4,012,102	549,755
Capital Assets	259,906	0	529,906	125,428	134,478
New Veterans' Home	11,028,983	16,892,484	27,921,467	26,454,847	1,466,620
2009 Flood Expenses	0	862,574	862,574	193,743	668,831
Federal Stimulus Funds – 2009	3,158,005	0	3,158,005	0	3,158,005
Contingent Appropriations	3,039,414	0	3,039,414	3,039,414	0
Totals	<u>\$ 33,587,020</u>	<u>\$17,846,959</u>	<u>\$ 51,433,979</u>	<u>\$ 45,016,725</u>	<u>\$ 6,417,254</u>
Expenditures by Source:					
General Fund	\$ 16,751,722	\$ 91,901	\$ 16,843,623	\$ 14,959,582	\$ 1,884,041
Other Funds	16,835,298	17,755,058	34,590,356	30,057,144	4,533,212
Totals	<u>\$ 33,587,020</u>	<u>\$17,846,959</u>	<u>\$ 51,433,979</u>	<u>\$ 45,016,725</u>	<u>\$ 6,417,254</u>

Appropriation Adjustments:

The \$91,901 increase in the Salaries and Benefits line item includes \$90,000 from the Office of Management and Budget allocated as the North Dakota Veterans' Home's portion of the salary equity pool as authorized by House Bill 1015 of the 2009 Legislative Session. The remaining \$1,901 was from the Office of Management and Budget for the State Internship Stipend Program for the hiring of a nursing intern.

The \$16,892,484 increase to the New Veterans' Home appropriation line was due to construction carryover from the prior biennium.

The \$862,574 adjustment was approved by the emergency commission to accept funds for expenses related to spring 2009 flooding.

Internal Control

In our audit for the biennium ended June 30, 2011, we identified the following areas of the North Dakota Veterans' Home's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the front window receipting system (MDI Technology) and the pharmacy inventory system (Speed Script).

The criteria used to evaluate internal control are published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate, noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of North Dakota Veterans' Home in a management letter dated June 25, 2012.

Improper Coding (Finding 11-1)

Condition:

The North Dakota Veterans' Home is not properly coding transactions. More than \$29,450 was coded to the wrong account and \$16,000 coded to the wrong class.

Criteria:

Internal Control – Integrated Framework from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission states that good internal controls should ensure the reliability of financial statements. Proper account coding is one of the required elements of accurate financial statement reporting.

Cause:

Proper controls are not in place to ensure expenditures are accurately coded.

Effect or Potential Effect:

Failure to descriptively code expenditures could have a negative impact on the financial statement presentation and inhibit a meaningful analysis of expenditures.

Recommendation:

We recommend the North Dakota Veterans' Home properly code expenditures using PeopleSoft coding that is consistent with the nature of the expenditures.

North Dakota Veterans' Home Response:

Agree. Expenses will be coded properly.

Lack of Approval of Adjustments (Finding 11-2)

Condition:

Adjustments applied to resident accounts are not reviewed and approved. Adjustments are made in the front window system (MDI Technologies) to correct resident billings. However, there is no review of adjustments entered in the system to determine they are proper.

Criteria:

Internal Control – Integrated Framework from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission states that accounting transactions should be properly approved to ensure their accuracy, reliability and compliance with management objectives.

Cause:

The North Dakota Veterans' Home has not implemented proper procedures to ensure all receivable adjustments are approved.

Effect or Potential Effect:

Resident accounts incorrect. Increased risk of accounting errors and possible fraud and/or fraudulent behavior.

Recommendation:

We recommend the North Dakota Veterans' Home implement proper procedures to ensure all adjustments to resident accounts are properly approved.

North Dakota Veterans' Home Response:

Agree. All adjustment to resident billings will be reviewed and approved by someone other than the individual making the adjustment.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2011, we identified and tested North Dakota Veterans' Home's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapter 2075).
- Compliance with OMB's Purchasing Procedures Manual.
- 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 criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the North Dakota Veterans' Home in a management letter dated June 25, 2012.

Operations

This audit did not identify areas of North Dakota Veterans' Home's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

July 9, 2012

Mr. Mark Johnson, Administrator
North Dakota Veterans' Home
PO Box 673
Lisbon, ND 58054

Dear Mr. Johnson:

We have performed an audit of the North Dakota Veterans' Home for the biennium ended June 30, 2011, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Veterans' Home's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

LEGISLATIVE INTENT

Informal Recommendation 11-1: Controls to ensure proper procurement procedures are consistently followed are not in place. We recommend the North Dakota Veterans' Home ensure procurement procedures are performed in accordance with North Dakota Procurement Office Guidelines.

Informal Recommendation 11-2: A purchase was charged to Special Funds that per the Session Laws should have been charged to the general fund. We recommend the North Dakota Veterans' Home follow the intent of the Legislature when coding purchases and use the specified funding sources.

PAYROLL

Informal Recommendation 11-3: The person who approves the payroll register can also adjust payroll. We recommend the North Dakota Veterans' Home properly segregate access to payroll records from approval of payroll.

Informal Recommendation 11-4: We recommend the North Dakota Veterans' Home review and document the reasonableness of overtime and determine whether there are more cost-effective alternatives available.

PERVASIVE CONTROLS

Informal Recommendation 11-5: The Veteran's Home code of conduct lacked certain important elements. We recommend the North Dakota Veterans' Home update their Code of Conduct to include the following:

- What constitutes fraudulent behavior,
- Information regarding compliance with applicable governmental rules, laws, and regulations, and
- Ensure employees in accounting or financial reporting oversight roles annually confirm their receipt and reading of the code.

Management of North Dakota Veterans' Home agreed with these recommendations.

I encourage you to call myself at 328-2241 or an audit manager at 239-7289 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Angela Klubberud
Auditor in-charge

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