

Office of the State Auditor

Biennial Report

For the Biennium Ending
June 30, 2017



Joshua C. Gallion
State Auditor

STATE AUDITOR
Joshua C. Gallion



Phone
(701)328-2241

STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
STATE CAPITOL
600 E. BOULEVARD AVENUE - DEPT 117
BISMARCK, NORTH DAKOTA 58505

November 13, 2017

Honorable Doug Burgum
Governor of North Dakota

Honorable Al A. Jaeger
Secretary of State of North Dakota

Dear Sirs:

I am pleased to submit the biennial report for the Office of the State Auditor for the biennium ended June 30, 2017. This biennial report was prepared in accordance with North Dakota Century Code section 54-06-03.

As applicable the guidelines offered by the Biennial Report Committee were followed for the preparation of this report. I would like to thank them for the thoughtful guidance.

I would be happy to respond to any questions relating to the operations of the Office of the State Auditor.

Respectfully submitted,



Joshua C. Gallion
State Auditor

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Agency Functions and Organization

Brief History of the Office of the State Auditor

Territorial Auditors	
L. M. Purdy	1881-1882
Geo. L. Ordway	1883-1884
E. W. Caldwell	1885-1886
James A. Ward	1887-1888
J. C. McNamare	November, 1889
State Auditors	
November 4, 1889 – To Date	
John P. Bray (Resigned)	1889-1892
Archie Currie (Appointed to fill vacancy September 10, 1892)	1892
A. W. Porter	1893-1894
Frank A. Briggs	1895-1896
N. B. Hannum	1897-1898
A. N. Carlblom	1899-1902
H. L. Holmes	1903-1908
D. K. Brightbill	1909-1912
Carl O. Jorgenson	1913-1916
Carl R. Kositsky	1917-1920
D. C. Poindexter	1921-1924
John Steen	1925-1932
Berta E. Baker	1933-1956
Curtis Olson	1957-1972
Robert W. Peterson	1973-1996
Robert R. Peterson	1997-2016
Joshua C. Gallion	2017-

North Dakota became the thirty-ninth state on November 2, 1889. North Dakota's first State Auditor took office on November 4, 1889. Much as county and city auditors function to this day, for the first 72 years of the state's existence the State Auditor functioned as a bookkeeper or accountant rather than a true "auditor." Effective July 1, 1961 the State Auditor's responsibilities were changed to performing the post audit of all financial transactions of state government. At the time, this meant auditing 100 separate departments. During 1973 the State Auditor modernized operations of the office by adopting generally accepted auditing standards.

In accordance with legislative changes made in 1967 the State Auditor began performing audits of political subdivisions on July 1, 1969. The 1971 Legislature gave counties the option to contract for their own audits and soon after that other political subdivisions were given the same power. In July of 1991 the State Auditor's Division of Local Government Audit became self-sufficient by the establishment of an operating fund for its revenues and expenditures.

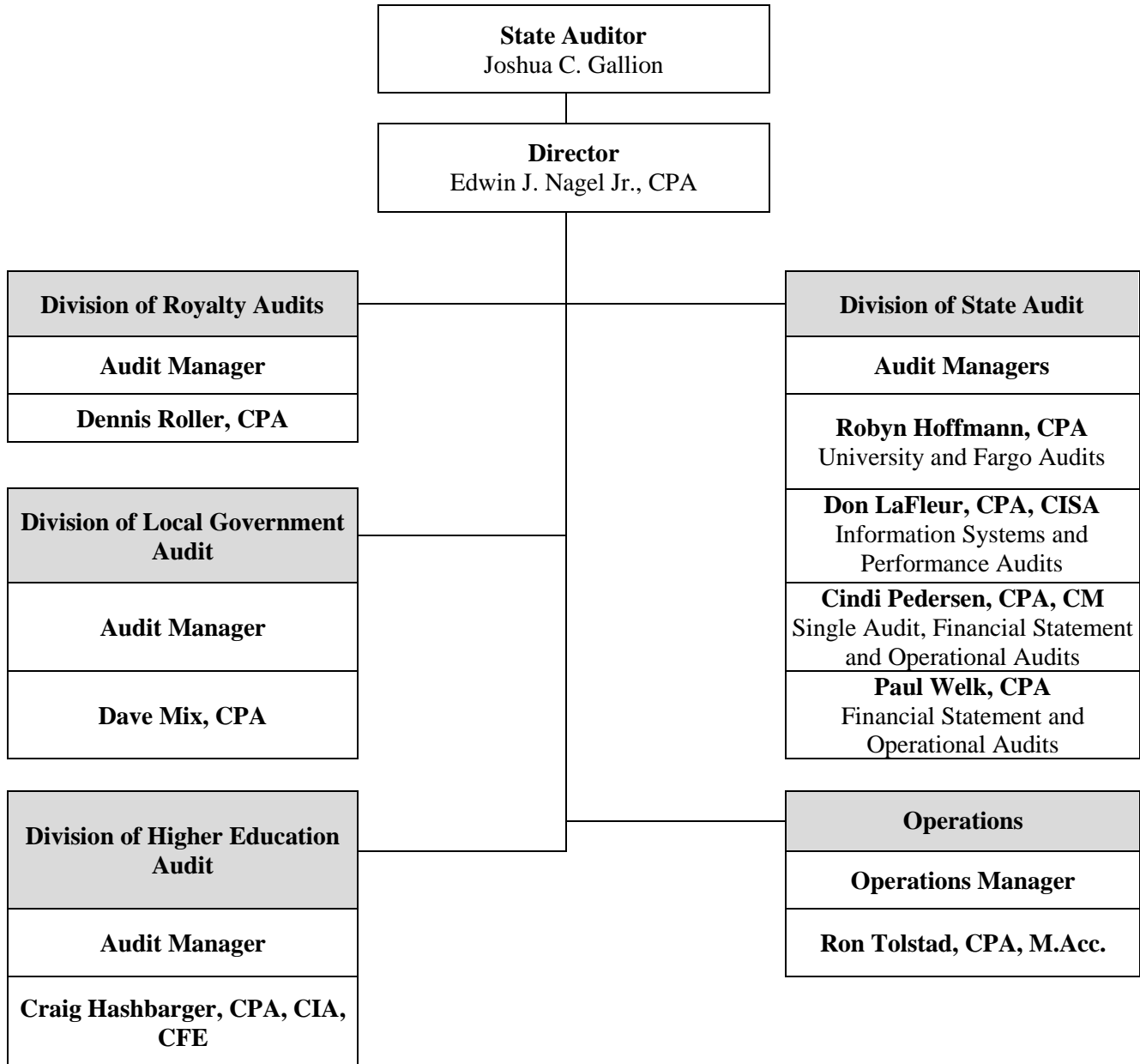
In 1982 the State Auditor was given the responsibility for performing royalty audits to ensure royalties are properly paid on federal oil, gas, and coal leases. Also related to the Federal government, for recipients of federal funds the Single Audit Act of 1984 combined the responsibility for auditing compliance with requirements relating to Federal financial assistance with the audit of financial statements. This change significantly increased the work load of the Office of the State Auditor.

In the mid-1970s the Office of the State Auditor started to conduct performance audits to help improve the effectiveness and efficiency of state government. Because of the demands associated with auditing compliance requirements relating to Federal financial assistance, performance audits were discontinued in

the mid-1980s. In 1991 the Legislature funded additional positions to establish a performance audit function in the Office of the State Auditor. Also in 1991, the Legislature required the State Auditor to audit the state-wide financial statements. At this time, biennial agency audit reports went from including financial statements prepared in accordance with generally accepted accounting principles to only including reports on internal control and compliance with laws and regulations. In 1997 agency audits started to include a statement of revenues and expenditures and an appropriations statement. These statements were audited in accordance with the financial statement audit standards.

To provide more value to our stakeholders the Office of the State Auditor began performing most biennial audits in accordance with the performance auditing standards. These standards give the office the flexibility to set audit objectives beyond the financial statement audit objective which is to determine if the financial statements are fairly stated. The objectives for biennial agency performance audits are to: provide reliable financial statements, identify and test controls for the most important areas of internal control; identify and test compliance for the most significant and high-risk areas of legislative intent, and; determine if there are areas of agency operations where we can help to improve efficiency or effectiveness.

Organization Chart



Summary of Constitutional and Statutory Responsibilities

Article V, Section 2 of the North Dakota Constitution established an independently elected State Auditor. That section states that the powers and duties of the state auditor shall be prescribed by law. Chapter 54-10 of the North Dakota Century Code prescribes the powers, duties and responsibilities of the State Auditor, including:

- Perform the post-audit of all financial transactions of the state government, detecting and reporting any defaults, and determining that expenditures have been made in accordance with law and appropriation acts.
- Perform or provide the audit of the state's financial statements and a review of the material included in the comprehensive annual financial report of the state.
- Determine the scope and report contents of agency audits.
- Perform or provide the audits and reviews of state agencies once every two years.
- Conduct audit work required by the Federal government.
- Perform or provide performance audits of state agencies as determined necessary by the State Auditor or the Legislative Audit and Fiscal Review Committee.
- Perform audit related functions of the state board of higher education.
- Perform or review audits of local governments.
- Being a member of the State Board of Equalization.

Summary of Major Programs and Activities

The Office of the State Auditor has organized into four distinct programs (or divisions) to meet its statutory responsibilities. The Operations Division supports the other divisions. The audit divisions include the Division of State Audit, the Division of Local Government Audit and the Division of Mineral Royalty Audit. Each of these audit divisions are discussed below.

Division of State Audit

The Division of State Audit is the largest division in the Office of the State Auditor. This division has the responsibility for annual audits of the state's financial statements and the University System financial statements, the biennial state-wide federal single audit, biennial agency audits and performance audits.

Division of Local Government Audit

The Division of Local Government Audit has the power to audit various political subdivisions as listed in N.D.C.C. Section 54-10-14 including counties, cities, school districts and park districts. Political subdivisions may, at their option, select a certified public accountant or a licensed public accountant to perform their audit. Such audits are statutorily required to be in the form, and contain the information, required by the State Auditor.

In addition to performing financial statement audits, the Division of Local Government Audit also reviews audits of local governments performed by private firms, this division also performs fraud audits requested by the State Bonding Fund and reviews annual reports submitted by those local units of government who are not required to obtain financial statement audits. Those entities eligible for filing annual reports with the Office of the State Auditor, in lieu of obtaining audits were: school districts with less than 100 enrolled students, cities with a population less than 500, State Boards with annual receipts less than \$200,000, and

political subdivisions with less than \$300,000 of annual receipts (excluding any federal funds passed through the political subdivision to another entity).

Division of Royalty Audit

The Office of the State Auditor has provided audit support to the U.S. Department of Interior through its delegation of authority from the Secretary of Interior since 1982 to ensure that royalties are properly paid on federal oil, gas, and coal leases from which North Dakota receives revenues. North Dakota receives 50 percent of all royalties paid on public domain federal leases.

Summary of Legislation Passed During the Biennium

The 65th Legislative Assembly faced challenging budget issues and reduced general funds to most state agencies including the State Auditor. The State Auditor faced general funds cuts of 3.8 FTE and \$963,000.

Summary of Responsibilities Added or Deleted During the Biennium

The 64nd Legislative Assembly added a new audit group to the Office. The Office was required to establish a higher education audit division to perform all audit related functions of the state board of higher education, including the examination and evaluation of the adequacy and effectiveness of the board's governance, risk management, internal controls, performance of constitutionally and statutorily required duties, and other areas as determined by the state auditor.

Evaluation

Summary of Accomplishments and Activities During the Biennium

To help ensure high quality audits the Office of the State Auditor follows *Government Auditing Standards*, issued by the Comptroller General of the United States. As required by *Government Auditing Standards* the Office of the State Auditor receives an external quality control review once every three years. This quality control review is conducted by the National State Auditor's Association (NSAA). The NSAA selects audit professionals from other state audit organizations to perform an independent assessment of compliance with auditing standards. The last external quality control review was conducted in June of 2017 and resulted in a rating of "pass," which is the best rating available.

During the 2015-2017 biennium, the state's general fund received \$29 million in royalties and interest from Federal lease lands located in North Dakota. These royalties and interest collections are in part due to the Division of Royalty Audit's work in finding under or improperly reported royalties from Federal lease lands.

Identification of Trends in Direction

The world of government accounting and auditing is evolving at a rapid pace. Technology changes have had a major impact on the Office of the State Auditor. To meet the demands brought on by modern information systems the Office of the State Auditor has been providing training to its financial and performance auditors to enable them to audit small and medium sized information systems. Larger more complex systems continue to be audited by our information systems audit specialists.

This discussion would not be complete without addressing trends relating to governmental accountability. The nature of governmental accountability continues to evolve beyond financial accountability. Governments need to be accountable for maintaining adequate internal control over operations, laws and regulations as well as financial reporting. The Office of the State Auditor has implemented an audit approach for state agencies which helps to provide accountability over financial matters as well as legislative intent (laws and regulations) and governmental operations. These operational audits have been well received by law makers and audit clients alike.

Short and Long-Range Plans and Goals

The mission of the Office of the State Auditor is "to provide innovative audit services designed to improve governmental operations and to provide accountability for the benefit of the citizens of North Dakota." The office has gone further to define its vision as follows: "the Office of the State Auditor is represented by professionals who are equally recognized for their creative approach for solving problems, as they are for their auditing skills, objectivity and integrity." The Office of the State Auditor has adopted the following strategy statement.

As a team, the Office of the State Auditor will:

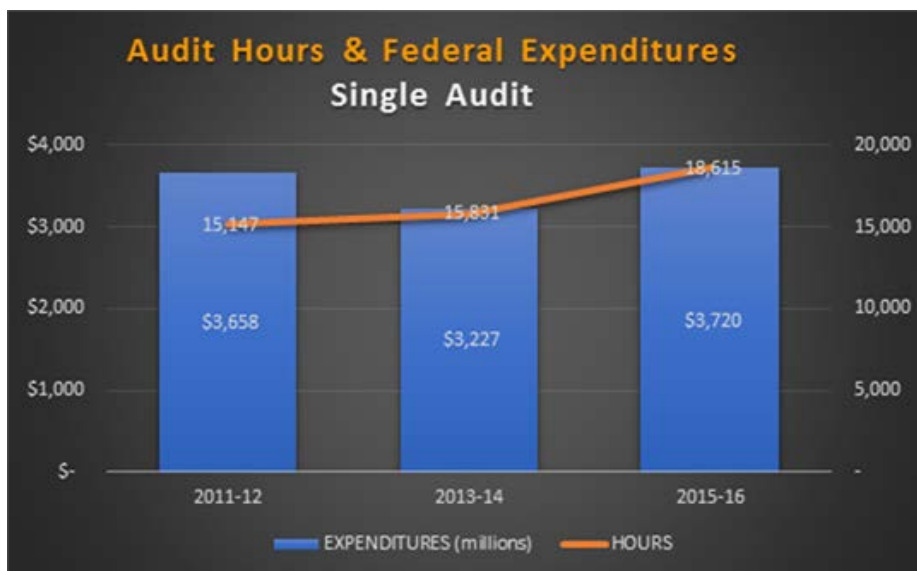
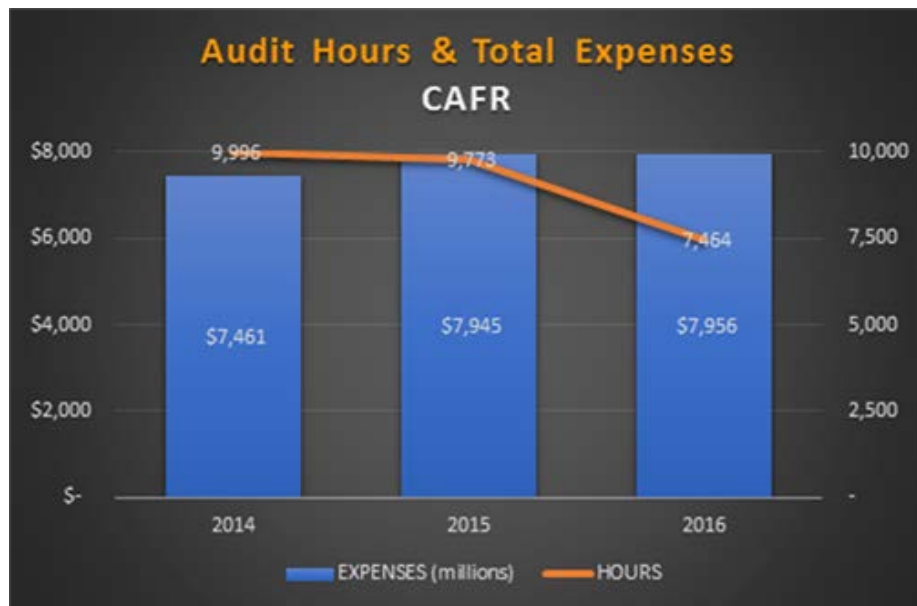
1. Continue to perform the single audit and the audit of the state and university system CAFRs in the most efficient yet effective manner possible.
2. Continue to increase the value of our work product to our stakeholders by helping to provide and improve financial and operational accountability.
3. Continue providing information systems audits of critical computer systems focusing on high risk systems including those used by decision makers to make "real time" decisions. Incorporating wherever applicable recommendations relating to system efficiency and effectiveness.
4. Continue to provide quality in-depth performance audits, concentrating on areas where we can have demonstrable positive affect on the economy and efficiency of state government.

5. Continue to provide local governments with quality financial statement audits.
6. Continue to ensure that the State of North Dakota is receiving the oil, gas, and coal royalties due to the state from oil, gas, and coal leases on federal lands located within the state of North Dakota.

In addition to continuing to make positive contributions to state government accountability, the Office of the State Auditor will make a concerted effort to better demonstrate our accomplishments and the value we provide to the legislature and audit clients.

Statistical Information Relating to Operations

The State Auditor's two largest audits are the audit of the state's comprehensive annual financial statements (CAFR) and the Federal Biennial Single Audit. The charts below show expenditures for each of those audits compared to audit hours.



Summary of Expenditures and Revenues for the 2015-2017 Biennium

Revenues:	
Political Subdivision Charges for Services	\$ 1,665,378
Revenue from Federal Government	1,150,734
State Agency Charges for Services	1,819,432
Conference Revenues	8,000
	<u>\$ 4,643,544</u>
Expenditures:	
Salaries	\$ 7,913,537
Temporary and Overtime	178,246
Benefits	2,988,416
Travel	113,837
Supplies - IT Software	3,630
Professional Materials	14,623
Building and Vehicle Supply	4,687
Miscellaneous Supplies	3,083
Office Supplies	16,233
Postage	5,982
Printing	6,788
IT Equipment under \$5,000	4,745
Other Equipment under \$5,000	5,522
Office Equipment and Furniture	89,513
Insurance	3,353
Lease of Equipment	6,472
Lease of Building	230,391
Repairs	9,722
IT Data Processing	413,480
IT Communications	48,347
Professional Development	97,826
Operating Fees and Services	21,780
Professional Services	472,601
Interior Repairs	63,406
IT Equipment over \$5,000	21,221
Conference Expenses	8,000
	<u>\$12,745,441</u>
Total Expenditures	

Resources and Publications

Audit reports of state entities and local governments are available at the Office of the State Auditor in the state capitol. In addition to the audit reports prepared by the Office of the State Auditor audit reports prepared by private firms are also maintained. The Office of the State Auditor's internet home page located at: **www.nd.gov/auditor** includes the State Auditor's most recently issued state and local government audit reports.