

North Dakota  
University System Office  
BISMARCK, NORTH DAKOTA

**Audit Report**

For the Two-year Period Ended  
June 30, 2012

ROBERT R. PETERSON  
STATE AUDITOR



Office of the State Auditor  
Division of State Audit

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## *Transmittal Letter*

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August 13, 2013

Honorable Jack Dalrymple, Governor  
Members of the North Dakota Legislative Assembly  
State Board of Higher Education  
Dr. Larry C. Skogen, Acting Chancellor, North Dakota University System Office

We are pleased to submit this audit of the North Dakota University System Office for the two-year period ended June 30, 2012. 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 Robyn Hoffmann, CPA. Mary Feltman, CPA, and Andrea Wike 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) 239-7289. We wish to express our appreciation to Dr. Skogen 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*

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## *Introduction*

The State Board of Higher Education is the governing board for the University System. The Board was created by Article VIII, Section 6 of the State Constitution. The North Dakota University System (NDUS) Office and the State Board of Higher Education (SBHE) are responsible for the control and administration of North Dakota's state higher education institutions.

The SBHE consists of eight voting and one non-voting members. The Governor, with the advice and consent of the Senate, appoints seven members who are qualified electors and taxpayers of the state, and who have resided in the state for not less than five years immediately preceding their appointments. The eighth member is a full-time resident student appointed by the Governor. A ninth member is a faculty member (non-voting) selected by the statewide Council of College Faculties.

The Chancellor of the NDUS is appointed by the SBHE and is responsible to the Board and shall be removable by the Board for cause. The Presidents of the respective institutions are appointed by the Board and report to the Chancellor.

The Board has full authority over the institutions under its control with the right to prescribe, limit, or modify the courses offered at the institutions. The Board has the control of the expenditure of funds belonging to, and allocated to the institutions, and also the funds appropriated by the Legislature.

## *Responses to LAFRC Audit Questions*

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 response are noted below.

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

An unqualified opinion was issued on the annual financial report of the North Dakota University System. The financial statements for the North Dakota University System Office were obtained from the Annual Financial Report of the North Dakota University System; however, the related note disclosures are not included in accordance with generally accepted accounting standards, so an opinion is not applicable.

### *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?*

Yes.

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?*

There were no 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 containing three recommendations concerning the review of personal service contracts by the North Dakota Department of Labor; potential use of purchase cards; and improved record retention was issued and is included on page 20 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.*

None noted.

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 most significant accounting estimate used by the North Dakota University System Office was the determination of useful lives of capital assets. Estimated useful lives are used to compute depreciation on capital assets. We evaluated the useful lives assigned to capital assets and determined they were reasonable in relation to the financial statements taken as a whole.

9. *Identify any significant audit adjustments.*

In our North Dakota University System audit report for fiscal year 2011, all of the material audit adjustments we proposed for the North Dakota University System Office were recorded. The adjustments included: \$1,363,289 of assets and liabilities, \$12,618,023 of expenses; and \$1,683,796 of unspent cash appropriation for System Information Technology Services (SITS) on the NDUSO's general ledger instead of at NDSU. There were no material fiscal year 2012 audit adjustments for NDUSO.

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), and the North Dakota Student Financial Assistance Program are high-risk information technology systems critical to the North Dakota University System Office.

# ***Audit Objectives, Scope, and Methodology***

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## ***Audit Objectives***

The objectives of this audit of the North Dakota University System Office for the two-year period ended June 30, 2012 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota University System Office'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 University System Office and are they in compliance with these laws?
3. Are there areas of the North Dakota University System Office's operations where we can help to improve efficiency or effectiveness?

## ***Audit Scope***

This audit of the North Dakota University System Office is for the two-year period ended June 30, 2012. 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 University System Office has operations in the following locations. Each location was included in the audit scope:

- The central office in the Capitol Building.
- The state approving agency at the campus of Bismarck State College.
- Information technology services at the campuses of North Dakota State University and the University of North Dakota.

## ***Audit Methodology***

To meet the objectives outlined above, we:

- Prepared financial statements from the data used in the fiscal year 2012 and fiscal year 2011 North Dakota University System Annual Financial Reports 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 the North Dakota University System Office'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***

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The accompanying financial statements have been prepared in a condensed form to present the North Dakota University System Office's financial position and results of operations in a manner similar to that used for financial reporting in the private sector. Also, the related note disclosures have not been included in this report. Accordingly, the accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

### ***Financial Summary***

Assets at June 30, 2012 were \$22,668,575 compared to \$21,826,607 at June 30, 2011. The increase was mainly due to cash and cash equivalents because of timing of payments for expenses for ConnectND funds and a deposit on hand for the second estimated payment for 2011-12 Minnesota reciprocity. Also, there was a decrease in Accounts Receivable in fiscal year 2012 due to the receivable that was recorded in fiscal year 2011 for the 2011-2012 Minnesota reciprocity payment.

Total liabilities at June 30, 2012 were \$9,966,982 compared to \$9,504,568 at June 30, 2011 and the increase is due to the timing of expense for ConnectND funds and timing of payments for the Education Incentive scholarships.

For the two-year period ended June 30, 2012, operations of the North Dakota University System Office were primarily supported by appropriations from the state's general fund (82%). Other revenue consisted primarily of ConnectND tuition and fees collected at the various campuses and used to partially fund System Information Technology Services at the system-wide level (12%). Total revenues were \$55,278,058 for the year ended June 30, 2012 as compared to \$50,611,149 for the year ended June 30, 2011. The increase in revenue for the year ended June 30, 2012 was primarily due to the timing of the drawdowns of state appropriations and an increase in the North Dakota University System Office's 2011-13 biennial appropriation.

Total expenses for the North Dakota University System Office were \$54,898,505 for the year ended June 30, 2012 as compared to \$50,085,323 for the prior year. This includes transfers to the Building Authority of \$5,855,984 and \$5,003,963 for June 30, 2012 and 2011, respectively. The increase in total expenses for June 30, 2012 was primarily due to correctly recording all vacation and sick leave accrual and health insurance costs for System Information Technology Service (SITS) employees on the North Dakota University System Office's financial statements and the salary and health insurance cost increase for System Office staff employees. Expenses also increased because of more funding being provided by the Legislature for Academic and Technology, SSIG, Education Incentive, and Tribal Community College scholarships: .

### ***Analysis of Significant Changes in Operations***

No significant changes noted.

### ***Analysis of Significant Variances - Budgeted and Actual Expenditures***

For the fiscal years ended June 30, 2012 and 2011, there were no significant variances between the original and final budgeted amounts or between the final budgeted and actual expenses except for \$29,785,973 and \$17,873,122 adjustments for technology funding during the biennium ended June 30, 2011 and the year ended June 30, 2012, respectively, and \$15,240,565 adjustment for security and emergency preparedness for the year ended June 30, 2012.

# Financial Statements

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## Statement of Net Assets

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 11,256,308	\$ 7,438,691
Accounts Receivable, Net	401,061	2,139,238
Due From State General Fund	1,909,134	1,482,398
Grants and Contracts Receivable, net	20,645	39,504
Other Assets	3,472	2,240
Unamortized Bond Discount & Cost of Issuance	16,277	32,557
Capital Assets, Net	9,061,678	10,691,979
<b>Total Assets</b>	<u>\$ 22,668,575</u>	<u>\$ 21,826,607</u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Liabilities	\$ 3,406,661	\$ 2,004,189
Accrued Payroll	371,273	344,728
Deposits	1,301,803	1,167,745
Other Noncurrent Liabilities	39,434	78,870
Due to Others	4,847,811	5,909,036
<b>Total Liabilities</b>	<u>\$ 9,966,982</u>	<u>\$ 9,504,568</u>
<b>NET ASSETS</b>		
Invested in Capital Assets, Net of Related Debt	\$ 5,229,513	\$ 5,025,877
Restricted for:		
Expendable:		
Other	115,271	97,716
Unrestricted	7,356,809	7,198,446
<b>Total Net Assets</b>	<u>\$ 12,701,593</u>	<u>\$ 12,322,039</u>

## Statement of Revenues, Expenses, and Changes in Net Assets

	<b>June 30, 2012</b>	<b>June 30, 2011</b>
<b>OPERATING REVENUES</b>		
Student Tuition and Fees	\$ 6,583,476	\$ 6,355,402
Federal Grants and Contracts	910,664	902,179
State Grants and Contracts	202,290	206,209
Nongovernmental grants and contracts	18,138	26,250
Sales and Services of Ed Depts.	1,060,444	1,312,873
<b>Total operating revenues</b>	<b>\$ 8,775,012</b>	<b>\$ 8,802,913</b>
<b>OPERATING EXPENSES</b>		
Salaries	\$ 10,410,563	\$ 8,810,059
Operating Expenses	9,805,864	9,945,039
Data Processing	4,487,992	3,682,087
Depreciation	1,778,926	1,961,602
Waivers/Scholarships/Fellowships	17,464,596	15,241,632
Costs of Goods Sold	342	
<b>Total operating expenses</b>	<b>\$ 43,948,283</b>	<b>\$ 39,640,419</b>
<b>Operating loss</b>	<b>\$ (35,173,271)</b>	<b>\$ (30,837,506)</b>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
State Appropriations	\$ 45,875,283	\$ 41,012,796
Gifts	84	
Endowment and Investment Income	102	973
Interest on Capital Asset Debt	(185,782)	(259,284)
General and Special Grant Expenses	(4,908,456)	(5,181,657)
Other Non Operating Revenue	627,577	444,467
<b>Net nonoperating revenues</b>	<b>\$ 41,408,808</b>	<b>\$ 36,017,295</b>
<b>Income before capital grants, gifts and transfers</b>	<b>\$ 6,235,537</b>	<b>\$ 5,179,789</b>
Transfer to Building Authority	\$ (5,855,984)	\$ (5,353,963)
Capital Grants and Gifts		350,000
<b>Total capital grants, gifts, and transfers</b>	<b>\$ (5,855,984)</b>	<b>\$ (5,003,963)</b>
<b>Increase in net assets</b>	<b>\$ 379,553</b>	<b>\$ 175,826</b>
<b>NET ASSETS</b>		
Net assets--beginning of year	\$ 12,322,039	\$ 12,146,213
Net assets--end of year	<b>\$ 12,701,592</b>	<b>\$ 12,322,039</b>

## Statement of Cash Flows

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Student tuition and fees	\$ 7,554,969	\$ 5,479,037
Grants and contracts	1,149,951	1,098,101
Payments to suppliers	(12,875,480)	(13,566,635)
Payments to employees	(9,646,900)	(8,634,276)
Payments for scholarships and fellowships	(17,464,596)	(15,241,632)
Sales and service of educational departments	660,119	1,312,873
Cash received/(paid) on deposits	134,058	(41,722)
Other receipts	626,345	443,347
<b>Net cash used by operating activities</b>	<u>\$ (29,861,534)</u>	<u>\$ (29,150,907)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State appropriations	\$ 45,839,501	\$ 40,923,719
Grants and gifts received for other than capital purposes	1,167,829	(1,167,745)
Grants given for other than capital purposes	(4,908,456)	(5,181,657)
<b>Net cash flows provided by noncapital financing activities</b>	<u>\$ 42,098,874</u>	<u>\$ 34,574,317</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Transfers to Building Authority	\$ (5,855,984)	\$ (5,353,963)
Capital appropriations	(390,954)	
Capital grants and gifts received		350,000
Purchases of capital assets	(148,625)	(170,914)
Principal paid on capital debt and lease	(1,798,342)	(1,795,391)
Interest paid on capital debt and lease	(225,918)	(297,913)
<b>Net cash used by capital and related financing activities</b>	<u>\$ (8,419,823)</u>	<u>\$ (7,268,181)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	\$ 102	\$ 973
<b>Net cash provided by investing activities</b>	<u>\$ 102</u>	<u>\$ 973</u>
<b>Net increase (decrease) in cash</b>	<b>\$ 3,817,619</b>	<b>\$ (1,843,798)</b>
CASH - BEGINNING OF YEAR	7,438,691	9,282,489
CASH - END OF YEAR	<u>\$ 11,256,310</u>	<u>\$ 7,438,691</u>

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**RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO  
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES**

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Operating loss	\$ (35,173,269)	\$ (30,837,506)
Adjustments to reconcile net loss to net cash provided (used) by operating activities		
Depreciation expense	1,778,926	1,961,602
Other nonoperating revenues	627,577	444,467
Change in assets and liabilities		
Accounts receivable adjusted for interest receivable	570,432	(876,365)
Grant & contract receivables	18,859	(36,537)
Other assets	15,048	15,160
Accounts payable and accrued liabilities adjusted for interest payable	1,403,172	44,211
Accrued payroll	26,544	158,212
Compensated absences	737,118	17,571
Deposits	134,058	(41,722)
<b>Net cash used by operating activities</b>	<u>\$ (29,861,535)</u>	<u>\$ (29,150,907)</u>

**SUPPLEMENTAL DISCLOSURE ON NON CASH TRANSACTIONS**

Assets acquired through capital lease	<u>\$ 127,500</u>
<b>Total non-cash transactions</b>	<u>\$ 127,500</u>

## Statement of Appropriations

### For The Biennium Ended June 30, 2011

OBJECT	2010-2011		FY10 Expense	FY11 Expense	Balance 6-30-11
	Original Appropriation	Appropriation Adjustments			
21550 Capital Assets	12,014,048		5,425,762	5,353,963	1,234,323
21560 Student Fin. Assistance Grants	19,374,022	556,787	8,520,595	9,193,628	2,216,586
21562 Scholars Program	2,113,584	343,242	926,369	1,134,579	395,878
21563 Title II Grant	695,600		276,340	333,480	85,780
21565 Native American Scholarships	381,292	1,175	190,700	191,550	217
21568 Technology	30,230,038	(29,785,973)	140,580	298,290	5,195
21569 Teacher Education Enhancement	1,500,000	(1,500,000)			
21570 Education Incentive Program	3,176,344	89,650	1,538,382	1,336,616	390,996
21571 Tribal Community College Grnts	700,000		350,000	350,000	
21572 Academic and Tech Ed Scholar.	3,000,000			1,868,646	1,131,354
21573 Student Exchange	3,337,100	283,755	1,344,554	1,611,080	665,221
21574 Professional Liability Insurance	1,100,000		550,000	550,000	
21575 Two-Year Campus Marketing	800,000		428,096	371,904	
21576 Security & Emergency Prepare.	750,000	(750,000)			
21578 Competitive Research Program	7,050,000		3,525,000	3,525,000	
21579 Biennium Carryover		384,206	264,983	73,656	45,567
21580 Grants	100,000	(100,000)			
21581 System Governance	7,185,612	345,962	3,308,350	3,803,865	419,359
TOTALS	93,507,640	(30,131,196)	26,789,711	29,996,257	6,590,476
General Fund Authority	88,758,682	(29,615,730)	25,288,895	28,441,852	5,412,205
Federal Fund Authority	1,320,138	349,203	753,775	740,445	175,121
Special Fund Authority	3,428,820	(864,669)	747,041	813,960	1,003,150
TOTALS	93,507,640	(30,131,196)	26,789,711	29,996,257	6,590,476



### Appropriation Adjustments:

Line Item	Amount	Reason
Student Financial Assistance Grt	\$ 553,546	2007-09 carryover
	3,241	Increase appropriation for LEAP programs
Scholars Program	343,242	2007-09 carryover
Native American Scholarships	1,175	2007-09 carryover
Technology	(14,571,624)	Transfer to NDSU & UND for technology funding
	64,563	2007-09 carryover
	(14,768,612)	Transfer to NDSU & UND for technology funding
	(510,300)	Transfer to NDSU for technology funding
Teacher Education Enhancement	(1,500,000)	Transfer to DSU, MASU, MISU, NDSU, UND & VCSU for STEM
Education Incentive Program	89,650	2007-09 carryover
Student Exchange	244,399	2007-09 carryover
	39,356	Refund from Iowa
Security and Emergency Prepared	(700,000)	Transfer to NDUS institutions
	(50,000)	Transfer to NDUS institutions
Biennium Carryover	384,206	2007-09 carryover
Grants	(100,000)	Transfer to UND for the Space Grant Consortium
System Governance	345,962	Increase for Access Challenge Grant
Total Appropriation Adjustments	<u>\$ (30,131,196)</u>	

**For The Year Ended June 30, 2012**

<b>OBJECT</b>	2012-2013		FY12 Expense	Balance 6-30-12
	Original Appropriation	Appropriation Adjustments		
Capital Assets	12,204,769		5,855,984	6,348,785
Student Fin. Assistance Grants	19,374,022	1,872,124	9,419,726	11,826,420
Scholars Program	2,113,584	395,836	1,124,262	1,385,158
Title II Grant	695,600	310,872	525,122	481,350
Native American Scholarships	574,267	217	283,200	291,284
Technology	36,006,667	(17,873,122)	150,768	17,982,777
Education Incentive Program	3,176,344	396,996	1,945,836	1,627,504
Tribal Community College Grnts	1,000,000		500,000	500,000
Academic and Tech Ed Scholar.	10,000,000	1,129,104	2,889,972	8,239,132
Student Exchange	3,321,438	442,754	1,759,934	2,004,258
Professional Liability Insurance	800,000		400,000	400,000
Two-Year Campus Marketing	800,000		370,257	429,743
Security & Emergency Prepare.	15,240,565	(15,240,565)		
Competitive Research Program	7,050,000		3,525,000	3,525,000
Biennium Carryover		297,848	44,463	253,385
Grants	150,000	(150,000)		
System Governance	6,877,272	339,067	3,651,002	3,565,337
<b>TOTALS</b>	<b>119,384,528</b>	<b>(28,078,869)</b>	<b>32,445,526</b>	<b>58,860,133</b>
General Fund Authority	116,629,810	(28,110,662)	30,622,954	57,896,194
Federal Fund Authority	1,332,724	301,511	1,364,238	269,997
Special Fund Authority	1,421,994	(269,718)	458,334	693,942
<b>TOTALS</b>	<b>119,384,528</b>	<b>(28,078,869)</b>	<b>32,445,526</b>	<b>58,860,133</b>

### Appropriation Adjustments:

Line Item	Amount	Reason
Student Financial Assistance Grt	\$ 2,220,552	2009-11 carryover
	(348,428)	Did not receive federal funding
Scholars Program	395,836	2009-11 carryover
Title II Grant	310,872	Increase in federal awards
Native American Scholarships	217	2009-11 carryover
Technology	(17,884,658)	Transfer to NDSU & UND for technology funding
	11,536	2009-11 carryover
Education Incentive Program	396,996	2009-11 carryover
Academic & Tech Ed Scholarship	1,129,104	2009-11 carryover
Student Exchange	442,754	2009-11 carryover
Security & Emergency Prepared	(15,240,565)	Transfer to NDUS institutions
Biennium Carryover	297,848	2009-11 carryover
Grants	(150,000)	Transfer to UND and NDSU
System Governance	131,000	Increase ND Partners in Prevention Grant
	208,067	Increase College Access Challenge Grant
Total Appropriation Adjustments	<u>\$ (28,078,869)</u>	

## ***Internal Control***

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In our audit for the two-year period ended June 30, 2012, we identified the following areas of the North Dakota University System Office's internal control as being the highest risk:

### ***Internal Controls Subjected to Testing:***

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenses.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.

The criteria used to evaluate internal control is 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 internal control was adequate.

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 did not identify any significant deficiencies in internal control. However, we noted one matter involving internal control that we have reported to management of the North Dakota University System Office in a management letter dated August 13, 2013.

## *Compliance With Legislative Intent*

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In our audit for the two-year period ended June 30, 2012, we identified and tested North Dakota University System Office's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Any unexpended funds appropriated from the permanent oil tax trust fund were transferred to the appropriate higher education institution's special fund at the end of the biennium (2011 HB 1003, chapter 3, section 3).
- \$12,204,769, or so much of the sum as may be necessary, included in the capital assets line item (subdivision 1 of section 1) was used by the State Board of Higher Education to satisfy outstanding bond obligations (2011 HB 1003, chapter 3, section 5).
- \$15,240,565 of the equity and student affordability line item (subdivision 1 of section 1) was transferred by the State Board of Higher Education to institutions based on existing formulas for equity and student affordability distributions (2011 HB 1003, chapter 3, section 6).
- Any additional funds up to \$5,000,000 were spent on the joint information technology building project which were made available from the University of North Dakota, North Dakota State University and the North Dakota University System 2011-2013 biennium information technology services funding resulting from one-time savings or efficiencies. If any funds were spent pursuant to this section, a report was made available to the budget section of the legislative management (2011 HB 1003, chapter 3, section 7).
- \$1,004,744, or so much of the sum as may be necessary included in subdivision 1 of section 1, from the student loan trust fund of which \$465,307 was used for the Professional Student Exchange program and \$539,437 was used for the ConnectND Campus Solutions positions (2011 HB 1003, chapter 3, section 10).
- The University System determined that funds allocated to operations in section 1 were needed for capital assets or extraordinary repairs and funds were transferred by the board from operations to capital assets and reported those transfers to the Office of Management and Budget (2011 HB 1003, chapter 3, section 12).
- The University System reported full-time position adjustments to the Office of Management and Budget before the submission of the 2013-2015 biennium budget request (2011 HB 1003, chapter 3, section 13).
- Funding appropriated for education incentive programs (subdivision 1 of section 1) were allocated to education incentive programs as determined by the State Board of Higher Education (2011 HB 1003, chapter 3, section 13).
- State Board of Higher Education members, except the student member, received as compensation \$148 per day for each calendar day spent devoted to the duties of office, and necessary expenses in the same manner and amounts as other state officials for attending meetings and performing other functions of office (2011 HB 1003, chapter 3, section 16).
- Each tribally controlled community college submitted an application as required by the State Board of Higher Education and the application included the name, address and enrollment status of each student who qualified for financial assistance (2011 HB 1003, chapter 3, section 17).

- Each tribally controlled community college that received assistance filed a report indicating graduation rate of nonbeneficiary students, the ratio between the amount of funding received by the tribally controlled community college and the college's annual budget (2011 HB 1003, chapter 3, section 17).
- The State Board of Higher Education develop a budget request for the NDUS for the 2013-2015 biennium that does not include a funding component for student affordability to limit student tuition increases or a funding component for equity distributions to institutions based on a peer institution comparison (2011 HB 1003, chapter 3, section 20).
- The North Dakota University System's Fall Enrollment reports should only include data for full-time students that are physically present on campus (2011 HB 1003, chapter 3, section 21).
- The State Board of Higher Education's performance and accountability report includes all the required information (NDCC 15-10-14.2).
- Proper use of the Higher Education Special Revenue Fund for scholarships and grants (NDCC 15-62.2-04).
- Travel-related expenditures are made in accordance with state statute (NDCC 44-08-03).
- Compliance with payroll related laws including statutory salaries for applicable appointed positions and certification of payroll.
- Proper use of the State Treasurer (State Constitution, Article X, section 12).
- Compliance with appropriations and related transfers (2009 and 2011 North Dakota Session Laws chapters 31 and 3, respectively).
- Adequate blanket bond coverage of employees (NDCC 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping and lease and financing arrangements in budget requests (NDCC 54-27-21 and NDCC 54-44.1-06 part 8).

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 has occurred or is 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 University System Office in a management letter dated August 13, 2013.

## ***Management Letter (Informal Recommendations)***

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August 13, 2013

Dr. Larry C. Skogen  
Acting Chancellor  
North Dakota University System Office  
600 E. Boulevard Avenue  
Bismarck, ND 58505

Dear Dr. Skogen:

We have performed an audit of the North Dakota University System Office for the two-year period ended June 30, 2012, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota University System Office'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 state or 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.

### **SUBMITTING INFORMATION TO ND DEPARTMENT OF LABOR (INFORMAL #1)**

Condition:

The North Dakota University System Office (NDUSO) entered into two consulting service contracts during our audit period for a CIO and Interim Vice Chancellor for Academic and Student Affairs. Both of these contracts were excluded from the normal payroll processes and appear to have created employee rather than independent contractor relationships.

Effect:

Payment to "employees" as independent contractors without proper documentation and support could raise legal and liability issues regarding state and federal withholding for taxes, unemployment, workers compensation, and additional labor issues (overtime, breaks, etc.).

Cause:

NDUSO used the 2010 agreement with the CIO and no formal evaluation of employee versus independent contractor status appears to have been done for either position.

Criteria:

Employees of a state entity are to be paid through the payroll system. North Dakota Century Code Section 34-05-01.4 authorizes the North Dakota Department of Labor to verify the independent contractor status of future or existing work relationships in the state. An affirmative verification of independent contractor status from the Department of Labor protects the state from retroactive liability if another agency later determines that the verified relationship is, in their view, an employment relationship. The independent contractor verification process is completely voluntary and offered at no cost to either party.

Recommendation:

We recommend the North Dakota University System submit future employment type agreements along with the necessary supporting information to the state Department of Labor to obtain formal verification of the employee/independent contractor status of workers considered as independent contractors and not being paid through payroll.

North Dakota University System Response/Planned Corrective Actions:

*Agree. As specified in the two contracts at issue, the parties expected the relationships would be those of independent contractors and operated accordingly. The expectation was based on common law factors such as the relationships' anticipated definite length, the allowance for discretion in the prioritization and performance of specific duties, and the allowance for discretion in the dates and locations of the performance of those duties. Nonetheless, we understand the relevant factors are subject to interpretation. When the status of a contracting party is significantly in question going forward, we will submit the relevant information to the Department of Labor for verification of the parties' employee/independent contractor status.*

**RESEARCH THE USE OF THE STATE'S P-CARD (INFORMAL #2)**

Condition:

The North Dakota University System Office is not utilizing the state's purchase card (P-card).

Effect:

Efficiencies are lost as it takes extra time processing checks. In addition, additional general fund revenue is lost based on the rebate program with JP Morgan during fiscal years 2012 and 2011.

Cause:

The North Dakota University System Office has not fully examined the cost savings and benefits of the P-card program to their agency.



Criteria:

OMB Purchasing Card manual – denotes some of the benefits of using the P-card to include:

- reducing administrative costs for the state;
- reducing the amount of paperwork; and
- reducing the number of checks issued.

Government Finance Officers Association (GFOA) Recommended Best Practices – use of purchasing cards improves the efficiency of purchasing procedures and reduces overall purchase processing costs.

National Association of Purchasing Professionals – estimates that P-cards can save 55% to 90% off the cost of a payment transaction.

RPMG Research Corp. – 2003 Purchasing Card Benchmarking Study demonstrated that P-cards reduce the procurement cycle by 74%.

RPMG Research Corp. – 2005 Purchasing Card Benchmarking Study Highlighted the cost savings of using a P-card ranges from \$24 (normal purchase process) up to \$67 (making a purchase via a purchase order) per transaction.

Recommendation:

We recommend the North Dakota University System Office research the use of P-cards as a form of payment to all vendors accepting p-cards.

North Dakota University System Response/Planned Corrective Actions:

*Agree. NDUS Office staff attended p-card training in June 2013 and are currently evaluating the potential use of the p-card. A final decision regarding use will be made by no later than October 1, 2013. If utilized, the p-card would be limited, as most NDUS Office payments are for financial aid programs and travel, both of which would not be p-card eligible.*

**PROPER CONTROLS SURROUNDING RECORD RETENTION FOR PROCUREMENT  
(INFORMAL #3)**

Condition:

During our test of procurement, we noted two expenses out of the five tested where the scoring documentation for the bid process was not maintained. As a result, we were unable to determine if the SBHE procurement procedures were properly followed.

Effect:

There is noncompliance with ND Record Retention laws and an inability to show compliance with SBHE procurement policies.

Cause:

The employee who had the scoring documentation resigned their position and the scoring documents were destroyed.

Criteria:

According to the ND General Records Schedule, the retention period for Competitive Solicitations is the life of the contract plus six years.

NDCC 54-46-05 part 2 states the head of each agency shall "make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures, and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and persons directly affected by the agency's activities.

Recommendation:

We recommend the North Dakota University System Office comply with records retention laws.

North Dakota University System Response/Planned Corrective Actions:

*Agree. As noted by the auditors, the former employee accidentally destroyed the records when cleaning out her office. By the end of calendar year 2013, the North University System Office will review its contract policy to more clearly address records retention requirements and will properly communicate requirements with all employees.*

I encourage you to call me at (701) 239-7291 or the audit manager at (701) 239-7289 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

A handwritten signature in cursive script that reads "Robyn Hoffmann".

Robyn Hoffmann, CPA  
Auditor in-charge

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