

NORTH DAKOTA UNIVERSITY
SYSTEM OFFICE

BISMARCK, NORTH DAKOTA

Audit Report

For the Two-year Period Ended
June 30, 2016

Office of the State Auditor
Division of State Audit

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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
FARGO BRANCH OFFICE
1655 43rd STREET SOUTH, SUITE 203
FARGO, NORTH DAKOTA 58103

Transmittal Letter

June 5, 2017

Members of the North Dakota Legislative Assembly
North Dakota State Board of Higher Education
Dr. Mark R. Hagerott, Chancellor, North Dakota University System

We are pleased to submit this audit of the North Dakota University System Office for the two-year period ended June 30, 2016. 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 Travis Klinkhammer, CPA. Mikka Wold, CPA was the staff auditor and Robyn Hoffmann, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7291. We wish to express our appreciation to Chancellor Hagerott 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 "Joshua C. Gallion".

Joshua C. Gallion
State Auditor

Executive Summary

Introduction

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

The SBHE consists of eight voting and two 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 and the tenth member is a staff member (non-voting) selected by the Staff Senate.

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

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

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?

The financial statements for the North Dakota University System Office were obtained from the Annual Financial Reports 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. An unmodified opinion was issued on the annual financial reports of the North Dakota University System for the business-type activities.

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 was issued and is included on page 18 of this report, along with management's responses.

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, or significant unusual transactions were identified.

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.*

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 Capital Management (HCM), and the North Dakota Student Financial Assistance Program are high-risk information technology systems critical to the North Dakota University System Office. None of the exceptions noted were directly related to the operation of an information technology system.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the North Dakota University System Office for the two-year period ended June 30, 2016 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, 2016. We conducted our 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 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:

- Bismarck office in the State Capitol
- Core Technology Services in Grand Forks and Fargo

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the data used in the fiscal years 2016 and 2015 North Dakota University System 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 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

The accompanying financial statements have been prepared in a condensed form to present the North Dakota University System's 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).

For the two-year period ended June 30, 2016, operations of the North Dakota University System Office were primarily supported by appropriations from the state's general fund.

Financial Summary

Assets at June 30, 2016 were \$19,747,585 compared to \$19,285,840 at June 30, 2015. Though there was only a slight increase in total, there were significant fluctuations. Cash and cash equivalents decreased \$3 million, due from state general fund decreased \$1.9 million and capital assets increased \$1.5 million. The increase in cash was mainly due an increase in state appropriations in fiscal year 2016 for CTS carryover which had not been spent at the end of fiscal year 2016. The decrease in due from state general funds is due to the timing of state appropriations. The decrease in capital assets is due to the increase of depreciation.

Total liabilities at June 30, 2016 were \$5,921,651 compared to \$8,170,880 at June 30, 2015. The decrease in accounts payable is due \$1.4 million Challenge Grants awarded but not funded and \$1.6 million education incentive funds paid June 2016 for fiscal year 2016 (normally not paid until next fiscal year).

Revenues consisted primarily of state appropriations (\$144 million). Other revenues during the audited period included student tuition and fees (\$10.6 million) and sales and services of educational departments (\$10.4 million). These all remained fairly constant for the North Dakota University System Office, increasing only slightly. Total revenues were \$85,848,737 for the year ended June 30, 2016 as compared to \$85,004,825 for the year ended June 30, 2015.

Total expenses for the North Dakota University System Office were \$82,971,369 for the year ended June 30, 2016 as compared to \$84,710,424 for the prior year. The fluctuation in total expenses for the audited period reflects a decrease in general and special grant expenditures of \$3.9 million and an increase in scholarships and fellowships of \$2.3 million. General and special grant expenditures decreased in fiscal year 2016, because there were less Challenge Grants awarded than the prior year. Scholarships and fellowships increased because more scholarships were given in fiscal year 2016 for State Student Incentive Grant (\$1.5 million) and the Academic and Technical Education Scholarship (\$800,000). All other expenses remained fairly constant.

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, 2016 and 2015 there were no significant variances between the original and final budgeted amounts, between the final budget and actual expenses except for the appropriation adjustments that reflect transfers to NDUS institutions, or carryover amounts. For detail, see pages 12 and 14.

Financial Statements

Statement of Net Position

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
ASSETS		
Cash and cash equivalents	\$ 13,300,736	\$ 10,269,841
Accounts receivable, net	6,117	1,032
Due from other NDUS institutions	1,320,165	460,578
Due from state general fund	219,088	2,144,125
Grants & contracts receivables, net		188
Other assets	21,903	12,570
Capital assets, net	4,879,576	6,397,506
Total Assets	<u>\$ 19,747,585</u>	<u>\$ 19,285,840</u>
Deferred outflows of resources	\$ 382,217	\$ 296,368
LIABILITIES		
Accounts payable and accrued liabilities	\$ 1,446,396	\$ 3,939,527
Accrued payroll	1,098,638	806,184
Deposits	35,743	167,606
Other noncurrent liabilities	16,258	40,819
Pension liabilities	1,663,014	1,511,132
Due to others	1,661,602	1,705,612
Total Liabilities	<u>\$ 5,921,651</u>	<u>\$ 8,170,880</u>
Deferred inflows of resources	\$ 214,434	\$ 294,979
NET POSITION		
Invested in capital assets	\$ 4,502,742	\$ 6,397,506
Restricted for:		
Expendable:		
Institutional	13,908	
Other	(12,519)	154,055
Unrestricted	9,489,586	4,564,788
Total Net Position	<u>\$ 13,993,717</u>	<u>\$ 11,116,349</u>

Statement of Revenues, Expenses, and Changes in Net Position

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
REVENUES AND OTHER ADDITIONS		
State appropriations	\$ 70,645,283	\$ 73,374,210
Student tuition and fees	5,754,671	4,854,490
Sales and services of educational departments	4,964,297	5,390,008
Other nonoperating revenue	3,565,425	484,378
Federal grants and contracts	774,664	464,597
Nongovernmental grants and contracts	122,500	10,000
Gifts	13,400	
Inter-institutional transfers	8,497	426,881
Endowment & investment income		261
Total revenues and other additions	<u>\$ 85,848,737</u>	<u>\$ 85,004,825</u>
EXPENSES AND OTHER DEDUCTIONS		
Scholarships and fellowships	\$ 22,227,151	\$ 19,920,734
Grant and special grant expenditures	19,051,143	22,944,192
Salaries and wages	17,287,098	18,452,106
Operating expenses	12,593,466	10,844,891
Data processing	5,650,037	5,894,923
Transfers to the Industrial Commission	4,481,399	4,804,252
Depreciation	1,681,075	1,849,326
Total expenses and other deductions	<u>\$ 82,971,369</u>	<u>\$ 84,710,424</u>
Revenues over expenses	<u>\$ 2,877,368</u>	<u>\$ 294,401</u>
NET POSITION		
Net Position-beginning of the year, as restated	<u>\$ 11,116,349</u>	<u>\$ 10,821,948</u>
Net Position-end of the year	<u>\$ 13,993,717</u>	<u>\$ 11,116,349</u>

Statement of Cash Flows

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	\$ 4,998,500	\$ 4,265,556
Grants and contracts	897,352	474,409
Payments to suppliers	(20,886,543)	(21,607,651)
Payments to employees	(17,279,810)	(18,963,500)
Payments for scholarships and fellowships	(22,227,151)	(19,920,734)
Sales and service of educational departments	4,855,795	8,925,785
Cash received on deposits	893	2,487
Other receipts	3,701,051	1,180,147
Net cash used by operating activities	<u>\$ (45,939,913)</u>	<u>\$ (45,643,501)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	\$ 70,921,101	\$ 73,205,841
Grants and gifts received for other than capital purposes	13,400	
Grants and gifts given for other than capital purposes	(19,051,143)	(22,944,192)
Agency fund cash increase	11,374	858,934
Transfers to Industrial Commission	(4,481,398)	(4,804,252)
Net cash flows provided by noncapital financing activities	<u>\$ 47,413,334</u>	<u>\$ 46,316,331</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital appropriations	\$ 1,649,219	\$ 4,021,608
Purchases of capital assets	(91,745)	(107,243)
Net cash provided by capital and related financing activities	<u>\$ 1,557,474</u>	<u>\$ 3,914,365</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	_____	\$ 261
Net cash provided by investing activities	_____	<u>\$ 261</u>
Net increase in cash	\$ 3,030,895	\$ 4,587,456
CASH - BEGINNING OF YEAR	\$ 10,269,841	\$ 5,682,385
CASH - END OF YEAR	<u>\$ 13,300,736</u>	<u>\$ 10,269,841</u>

(continued)

(Statement of Cash Flows – continued)

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

Operating loss	\$ (47,822,695)	\$ (46,242,885)
Adjustments to reconcile net loss to net cash provided (used by operating activities)		
Depreciation expense	1,681,075	1,849,326
Other nonoperating expenses	3,710,384	1,186,399
Change in assets and liabilities		
Accounts receivable adjusted for interest receivable	(864,673)	2,946,843
Grant & contract receivables	188	(188)
Other assets	(9,333)	(6,252)
Accounts payable and accrued liabilities adjusted for interest payable	(2,643,038)	(4,867,838)
Pension liability	151,882	142,427
Net change in deferred outflows	(85,849)	(247,375)
Net change in deferred inflows	(80,545)	
Accrued payroll	298,231	(435,986)
Compensated absences	(276,433)	29,541
Deposits	893	2,487
Net cash used by operating activities	<u>\$ (45,939,913)</u>	<u>\$ (45,643,501)</u>

SUPPLEMENTAL DISCLOSURE ON NONCASH TRANSACTIONS

Assets acquired through capital lease	\$ 71,400	
Expenses paid by capital lease/special assessment	161,021	\$ 48,384
	<u>\$ 232,421</u>	<u>\$ 48,384</u>

Statement of Appropriations

For the Biennium Ended June 30, 2015

OBJECT	2013-2015		FY14 Expense	FY15 Expense	Balance 6-30-15
	Original Appropriation	Appropriation Adjustments			
Capital Assets	\$ 10,436,045		\$ 5,614,449	\$ 4,804,252	\$ 17,344
Deferred Maintenance Pool	10,000,000	\$ (10,000,000)			
Master Plan & Space Study	1,000,000		956,486	43,514	
Capital Projects Contingency	5,483,413	(5,483,413)			
Student Fin. Assistance Grants	21,245,679	1,148,621	9,630,809	8,785,480	3,978,011
Veterans Assistance Programs	325,000		325,000		
Scholars Program	2,113,584	226,840	1,114,371	1,032,465	193,588
Title II Grant	1,006,472		386,284	335,816	284,372
Native American Scholarships	649,267	18,084	310,200	356,526	625
Technology	38,662,551	159,559	18,858,391	19,075,433	888,286
Education Challenge Fund	29,000,000		4,987,236	23,063,217	949,547
Education Incentive Program	3,349,000	18,055	1,779,500	1,585,620	1,935
Tribal Community College Grnts	1,000,000		500,000	500,000	
Academic & Tech Ed Scholar.	10,000,000	4,158,262	5,407,750	5,778,609	2,971,903
Student Exchange	4,275,015	186,533	1,923,093	1,930,397	608,058
Two-Year Campus Marketing	800,000	33,271	383,269	420,857	29,145
Performance Funding Pool	5,000,000	(4,000,000)			1,000,000
Student Mental Health	282,520		40,989	50,602	190,929
Competitive Research Program	7,050,000		3,525,000	3,525,000	
Biennium Carryover		212,351	146,124	66,227	
System Governance	12,666,502		5,252,375	6,232,831	1,181,296
TOTALS	\$ 164,345,048	\$ (13,321,837)	\$ 61,141,326	\$ 77,586,846	\$ 12,295,039
General Fund Authority	\$ 162,045,136	\$ (13,321,837)	\$ 60,218,211	\$ 77,082,613	\$ 11,422,475
Federal Fund Authority	1,295,168		506,107	455,870	333,191
Special Fund Authority	1,004,744		417,008	48,363	539,373
TOTALS	\$ 164,345,048	\$ (13,321,837)	\$ 61,141,326	\$ 77,586,846	\$ 12,295,039

Appropriation Adjustments:

Line Item	Amount	Reason
Deferred Maintenance Pool	\$ (10,000,000)	Transfer to NDUS institutions
Capital Projects Contingency	(5,483,413)	Transfer to NDUS institutions
Student Financial Assistance Grt	1,148,621	2011-13 carryover
Scholars Program	226,840	2011-13 carryover
Native American Scholarships	18,084	2011-13 carryover
Technology	159,559	2011-13 carryover
Education Incentive Program	18,055	2011-13 carryover
Academic & Tech Ed Scholarship	4,158,262	2011-13 carryover
Student Exchange	186,533	2011-13 carryover
Two-Year Campus Marketing	33,271	2011-13 carryover
Performance Funding Pool	(4,000,000)	Transfer to NDUS institutions
Biennium Carryover	212,351	2011-13 carryover
Total Appropriation Adjustments	<u>\$ (13,321,837)</u>	

For the Year Ended June 30, 2016

OBJECT	2016-2017		FY16 Expense	Balance 6-30-16
	Original Appropriation	Appropriation Adjustments		
Capital Assets	\$ 8,368,836	\$ (1,467,375)	\$ 4,481,399	\$ 2,420,062
Deferred Maintenance Pool	8,700,000	(5,722,658)		2,977,342
Student Fin. Assistance Grants	25,634,276	2,993,001	11,124,307	17,502,970
Veterans Assistance Programs	325,000		325,000	
Scholars Program	2,113,584	182,682	1,024,583	1,271,683
Title II Grant	1,006,472	266,039	266,039	1,006,472
Native American Scholarships	649,267	600	332,624	317,243
Commendatory Grants	4,800	(194)		4,606
Technology	46,330,965	(660,886)	20,070,915	25,599,164
Education Challenge Fund	23,500,000	99,047	14,060,536	9,538,511
Education Incentive Program	3,349,000	18,883	1,784,970	1,582,913
Tribal Community College Grnts	1,000,000	(20,250)	489,875	489,875
Academic & Tech Ed Scholar.	14,054,677	2,406,439	6,243,250	10,217,866
Student Exchange	4,275,015	397,184	1,892,991	2,779,208
Open Education Resources	110,000		62,720	47,280
Two-Year Campus Marketing	800,000	(3,254)	328,608	468,138
Campus Security funding pool	3,000,000	(3,000,000)		
Student Mental Health	316,000	190,929	195,913	311,016
Competitive Research Program	7,050,000	(285,525)	3,525,000	3,239,475
Biennium Carryover		1,098,649	808,427	290,222
System Governance	7,702,343		3,986,933	3,715,410
Internal Audit Pool	300,000	(12,150)	104,451	183,399
Contingent Appropriation	1,050,000	(1,050,000)		
TOTALS	\$ 159,640,235	\$ (4,568,839)	\$ 71,108,541	\$ 83,962,855
General Fund Authority	\$ 154,629,019	\$ (4,834,878)	\$ 67,230,243	\$ 82,563,898
Federal Fund Authority	1,006,472	266,039	266,039	1,006,472
Special Fund Authority	4,004,744		3,612,259	392,485
TOTALS	\$ 159,640,235	\$ (4,568,839)	\$ 71,108,541	\$ 83,962,855

Appropriation Adjustments:

Line Item	Amount	Reason
Capital Assets	\$ (1,467,375)	Budget allotment
Deferred Maintenance Pool	(5,722,658)	Transfer to NDUS institutions
Student Financial Assist Grants	4,031,189	2013-15 carryover
	<u>(1,038,188)</u>	Budget allotment
	<u>2,993,001</u>	
Scholars Program	182,682	2013-15 carryover
Title II Grant	266,039	Additional federal funding
Native American Scholarships	600	2013-15 carryover
Commendatory Grants	(194)	Budget allotment
Technology	(660,886)	Budget allotment
Education Challenge Fund	949,547	2013-15 carryover
	<u>(850,500)</u>	Budget allotment
	<u>99,047</u>	
Education Incentive Program	18,883	2013-15 carryover
Tribal Community College Grants	(20,250)	Budget allotment
Academic & Tech Ed Scholarship	2,975,653	2013-15 carryover
	<u>(569,214)</u>	Budget allotment
	<u>2,406,439</u>	
Student Exchange	551,477	2013-15 carryover
	<u>(154,293)</u>	Budget allotment
	<u>397,184</u>	
Two-Year Campus Marketing	29,146	2013-15 carryover
	<u>(32,400)</u>	Budget allotment
	<u>(3,254)</u>	
Performance Funding Pool	(3,000,000)	Transfer to NDUS institutions
Student Mental Health	190,929	2013-15 carryover
Competitive Research Program	(285,525)	Budget allotment
Biennium Carryover	1,098,649	2013-15 carryover
Internal Audit Pool	(12,150)	Budget allotment
Contingent Appropriation	(1,050,000)	Budget allotment
Total Appropriation Adjustments	<u>\$ (4,568,839)</u>	

Internal Control

In our audit for the two-year period ended June 30, 2016, 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.
- Control surrounding the processing of state grants/scholarships.

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 other matters involving internal control that we have reported to management of the North Dakota University System Office in a management letter dated June 5, 2017.

Compliance with Legislative Intent

In our audit for the two-year period ended June 30, 2016, 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:

- Compliance with use of electronic mail, file server administration, database administration, application server, and hosting services (2015 HB 1003, section 8).
- Compliance with systemwide funding pools, transfer authority and legislative management report (2015 HB 1003, section 25).
- Compliance with campus capital projects – project management (2015 HB 1003, section 26).
- Compliance with student loan trust fund requirements (2015 HB 1003, section 29).
- Compliance with the University of North Dakota School of Medicine and Health Sciences funding allocation (2015 HB 1003, section 20).
- Compliance with the use of 2013-15 biennium appropriations exemption and contingent appropriation reduction (2015 HB 1003, section 33).
- Compliance with full-time equivalent position adjustments (2015 HB 1003, section 36).
- Compliance with the requirements of the data inconsistencies report to the legislature (2015 HB 1003, section 42).
- Compliance with the requirements of the higher education institution permanent funds report to the legislature (2015 HB 1003, section 43).
- Compliance with the Challenge Grant requirements (2015 HB 1151).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2013 and 2015 North Dakota Session Laws chapters 34 and 3, respectively).
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping.
- 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 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 June 5, 2017.

Operations

In our audit for the two-year period ended June 30, 2016, we identified the following areas of potential improvements to operations, as expressed by our operational objectives surrounding state grants/scholarship processing:

- Were grants/scholarships awarded to students in compliance with applicable rules and regulations per the grant agreements?
- Are the amounts awarded in compliance with the grant agreements/scholarships stipulations?
- Were payments made to students who attended approved institutions per the grant/scholarship requirements?

We concluded the operational objectives for state grant/scholarship processing were operating efficiently and effectively.

Management Letter (Informal Recommendations)

June 5, 2017

Dr. Mark Hagerott, Chancellor
North Dakota University System Office
600 E Boulevard Avenue
Bismarck, ND 58505

Dear Dr. Hagerott:

We have performed an audit of the North Dakota University System Office for the biennium ended June 30, 2016, 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 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.

CTS – LACK OF APPROVAL OF GENERAL LEDGER TRANSACTIONS

Condition:

During our review of general ledger transactions (ONL's) we noted that 15 out of 16 entries did not have an approval by Core Technology Services (CTS).

Criteria:

Committee of Sponsoring Organizations (COSO) of the Treadway Commission publication *Internal Control - Integrated Framework* states that proper design and implementation of internal control policies and procedures for performance measures, segregation of duties, approval, monitoring, and verification methods are necessary to ensure objectives are effectively achieved.

Effect:

CTS is susceptible to an increased risk of error going undetected or not being caught in a timely manner.

Cause:

CTS does not have proper procedures in place to ensure that there is a review and approval by an appropriate CTS individual.

Informal Recommendation 16-1:

We recommend that CTS review and approve direct general ledger transactions before they are posted.

North Dakota University System Office Response/Planned Corrective Action:

Core Technology Services (CTS) partially agrees with the recommendation and will modify existing business practices where necessary within our UND Service Level Agreement to conform with OMB policy.

As part of our Service Level Agreement with UND, their personnel do currently have signature authority granted and documented by CTS to approve general ledger transactions. If this is unacceptable as part of the SLA, we will change our internal procedure to ensure a CTS employee reviews and approves all general ledger transactions.

CTS – INADEQUATE CONTROLS OVER PROCUREMENT**Condition:**

We noted CTS purchased three items without following proper procurement procedures. One item was for an IT contract for \$528,000, the second item noted was for a work order service agreement to operate information system environments for \$1,691,910 signed in June of 2013. The work order was an amendment to original contract that dates back to 2006 which had an original term of 3 years inclusive and a 3 year renewal term, however between change orders and amendments this contract keeps getting renewed without the chance for bids to be let (the original contract was never procured or sole sourced). The last one was a service contract to implement online access for \$110,460.

Criteria:

NDCC 54-44.4-02.1 states in part, all services purchased by an agency or institution must comply with the standards and guidelines for procurement of services established by the OMB.

SBHE Policy 803.1 states for services \$100,000 and over, they must be purchase from formal bid process or a Request for Proposal (RFP).

SBHE Procedure 803.1 part 4 states that sole source, emergency or purchases made from discount contracts under a group alliance or consortium for goods or services do not require competition based on written approval of the procurement officer or other official delegated that authority and as documented on the Alternate Procurement Request form. Sole source requests based on personal preference, cost or price, perceived quality, vendor performance, delivery time, trade-in allowance or no cost options or accessories or other special packages or deals are not permitted; rather, these items may be considered in evaluating bids or proposals.

Effect:

Without soliciting formal bids, competitive pricing was not obtained as required in NDCC 54-44.4-02.1, SBHE Policy 803.1 and SBHE Procedure 803.1.

Cause:

The reason for not soliciting, not obtaining formal quotes, and/or obtaining an approved Alternate Procurement Request form was due to CTS not being aware that most services, whether unique or not, need to go through the procurement process.

Informal Recommendation 16-2:

We recommend that CTS:

- Comply with the SBHE Procurement Policies to ensure competitive pricing is obtained; and
- If a competitive procurement process is unique, the Alternative Procurement Request form is completed and approved by procurement officer.

North Dakota University System Office Response/Planned Corrective Action:

Core Technology Services (CTS) agrees with the recommendation and will continue to improve and standardize its procurement practices.

Prior to becoming its own business unit, CTS relied on the procurement staff at NDSU and UND for procurement. In our initial years as a business unit, we continued to rely on the campuses for some of our procurement needs. In the spring of 2015, CTS designated a new Director, (Dirk Huggett) as a new lead for all procurement efforts. Most of the findings above were from the first six months of this transitional period. Mr. Huggett started by focusing on aligning CTS business practices with the State Procurement Office (SPO) practices. He and the ND Chief Procurement Officer worked with the system office to develop the current SBHE procurement policy. Also, since that time, CTS has had 10 staff members trained to Level 2 SPO certifications and four trained to Level 3 certification. (Note: one of the Level 3 trained staff has left the organization, and two others are full time project managers.) CTS has started utilizing approved state and national contracts for more of their purchases. CTS has also moved to electronic storage of all contracts and procurements. Unfortunately, in all the transitions, many of the original procurement documents have not been located. As contracts renew, CTS has updated and documented the contracts/procurements to the limits of current staffing resources.

CTS - CONTROLS OVER PURCHASE CARDS**Condition:**

Core Technology Services (CTS) ran an agency statement from JP Morgan but did not have their purchasing card administrator reconcile it to the individual statements.

Criteria:

OMB's Policy 300 states that card administrators should run an agency statement with the State's card provider and reconcile it to the individual statements. They should sign the agency statement denoting reconciliation.

Effect:

CTS is not in compliance with OMB's policy regarding the reconciliation process for purchase cards.

Cause:

When CTS started utilizing UND to process their purchasing cards, they may not have started this reconciliation process.

Informal Recommendation 16-3:

We recommend that CTS comply with OMB's purchasing card policy by ensuring that the individual statements are reconciled to the agency statement and signing the agency statement signaling that the reconciliation was completed.

North Dakota University System Office Response/Planned Corrective Action:

Core Technology Services (CTS) partially agrees with the recommendation and will modify existing business practices where necessary within our UND Service Level Agreement to conform with OMB policy.

As part of our Service Level Agreement with UND, their personnel do currently run the statement of account report from the Payment Net system, which includes all cardholder statements, to verify them against the card statement. They verify they match the commercial card statement total before uploading the information into Peoplesoft.

I encourage you to call me at 701-239-7294 or the audit manager at 701-239-7291 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Travis Klinkhammer, CPA
Auditor in-charge

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

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