

HISTORICAL SOCIETY

BISMARCK, NORTH DAKOTA

Audit Report

Two-year Period Ended
June 30, 2012

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

**LEGISLATIVE AUDIT AND FISCAL REVIEW
COMMITTEE MEMBERS**

***Representative Dan Ruby – Chairman
Senator Terry M. Wanzek – Vice Chairman***

Representatives

*Dick Anderson
Tracy Boe
Patrick Hatlestad
Keith Kempenich
Gary Kreidt
Andrew Maragos
Corey Mock
David Monson
Chet Pollert
Bob Skarphol*

Senators

*Joan Heckaman
Jerry Klein
Judy Lee*

Contents

<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Introduction</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Audit Objectives, Scope, and Methodology</i>	<i>5</i>
<i>Discussion and Analysis</i>	<i>7</i>
<i>Financial Summary</i>	<i>7</i>
<i>Analysis of Significant Changes in Operations</i>	<i>7</i>
<i>Analysis of Significant Variances - Budgeted and Actual Expenditures</i>	<i>7</i>
<i>Financial Statements</i>	<i>9</i>
<i>Statement of Revenues and Expenditures</i>	<i>9</i>
<i>Statement of Appropriations</i>	<i>10</i>
<i>Statement of Appropriations</i>	<i>12</i>
<i>Internal Control</i>	<i>14</i>
<i>Inventory Segregation of Duties Weaknesses (Finding 12-1)</i>	<i>14</i>
<i>Lack of Controls Surrounding Complimentary Admissions at Historic Sites (Finding 12-2)</i>	<i>16</i>
<i>Compliance With Legislative Intent</i>	<i>17</i>
<i>Construction in Progress Not Properly Reported (Finding 12-3)</i>	<i>17</i>
<i>Not Properly Capitalizing Purchases and Projects (Finding 12-4)</i>	<i>19</i>
<i>Operations</i>	<i>20</i>
<i>Prior Recommendations Not Implemented</i>	<i>21</i>
<i>Management Letter (Informal Recommendations)</i>	<i>22</i>

STATE AUDITOR
ROBERT R. PETERSON



PHONE
(701) 328 - 2241
FAX
(701) 328 - 1406

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

Transmittal Letter

August 16, 2013

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Merlan Paaverud, Jr., Director, Historical Society

We are pleased to submit this audit of the Historical Society 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 Andrea Wike. Cindi Pedersen, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Mr. Paaverud and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

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

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Historical Society is governed by the State Historical Board. The Board consists of seven members appointed by the Governor and five statutory members. The Secretary of State, Parks and Recreation Department Director, Department of Transportation Director, Tourism Division Director of the Department of Commerce, and the State Treasurer are statutory members of the Board and shall take care that the interests of the state are protected. The Historical Society portrays the history of North Dakota through the collection, preservation, exhibition, and interpretation of significant and representative artifacts, documents, specimens, sites, buildings, and works of art. They operate museums and historic sites for public edification and enjoyment. The agency works to create a greater understanding of the history and prehistory of the state, and to enrich appreciation for the human and natural resources of North Dakota as they relate to the state's heritage.

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

Responses to LAFRC Audit Questions

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

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

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

Other than our findings addressing "Construction in Progress Not Properly Reported" (page 17) and "Not Properly Capitalizing Purchases and Projects" (page 19), the Historical Society was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Other than our findings addressing the "Inventory Segregation of Duties Weakness" (page 14) and "Lack of Controls Surrounding Complimentary Admissions at the Historic Sites" (page 16), we determined internal control was adequate.

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

There were not any indications of a lack of efficiency in financial operations and management of the Historical Society.

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

The Historical Society implemented one of the previous two recommendations but failed to implement "Inventory Segregation of Duties Weaknesses" as shown on page 23. This finding has been issued in the three previous audits.

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 22 of this report, along with management's response.

LAFRC Audit Communications

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

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

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

The Historical Society's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

There was one significant audit adjustment in which \$545,445 had to be removed from Land and Buildings expenses and placed into Transfers Out as a result of a bond payment made to the Industrial Commission being coded incorrectly.

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 Retail Pro (inventory application) are high-risk information technology systems critical to the Historical Society.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Historical Society 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 Historical Society'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 Historical Society and are they in compliance with these laws?
3. Are there areas of the Historical Society's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Historical Society 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 Historical Society has operations in the following locations. Each location was included in the audit scope:

- The headquarters office in the Heritage Center
- Chateau De Mores
- Fort Abercrombie
- Fort Buford
- Fort Clark
- Former Governor's Mansion
- Gingras Trading Post
- Camp Hancock
- Pembina State Museum
- Fort Totten
- Missouri-Yellowstone Confluence
- Ronald Reagan Minuteman Missile Site

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.

- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Historical Society's processes and procedures.

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

Discussion and Analysis

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

For the two-year period June 30, 2012, operations of the Historical Society were primarily supported by appropriations from the state's general fund. Both general funds and special funds were appropriated for the Heritage Center Expansion. Federal funds from the Department of the Interior supplement operations of the Historic Preservation Division. Additional federal funds are dedicated to the completion of specific projects of fixed duration.

Financial Summary

Capital assets, net of depreciation, increased from \$20,329,462 for the year ended June 30, 2011 to \$32,979,707 for the year ended June 30, 2012. The significant increase was construction in progress for the Heritage Center expansion project. Capital assets also include buildings, equipment, and land throughout the state of North Dakota.

Revenues and other sources consist primarily of federal revenue/reimbursements, admission and concession sales (which are reported in the financial statements as part of charges for services/sales), and transfers in. Other revenues during the audited period include donations, monies for copies and facility rent, and other miscellaneous revenue. The significant increase in transfers in is a result of the transfers received during fiscal year 2012 from the Independent Study Fund for the costs incurred by the Historical Society for the independent studies program that is operated by the Centers for Distance Education that were not received the previous fiscal year. All other revenues remained fairly constant. Total revenues and other sources were \$2,021,427 for the year ended June 30, 2012 as compared to \$1,631,757 for the year ended June 30, 2011.

Total expenditures for the Historical Society were \$20,958,327 for the year ended June 30, 2012 as compared to \$11,386,727 for the prior year. A majority of this increase was for Land and Buildings, which increased by \$9,475,749 due to the Heritage Center Expansion project. All other expenditures remained fairly constant.

Analysis of Significant Changes in Operations

The Historical Society began work during fiscal year 2011 on the Heritage Center Expansion project. Pursuant to House Bill 1481 of the 61st Legislative Assembly, \$51.7 million was appropriated to the Historical Society for the completion of this project.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The Historical Society had appropriations over actual expenditures for the biennium ended June 30, 2011 of \$46,373,466 in the Heritage Center Addition line. North Dakota Century Code 54-44.1-11 allows the State Historical Society to carryover unexpended appropriations from one biennium to the next. Groundbreaking on the Heritage Center Expansion project took place in

November 2010. The unexpended appropriation amount was carried over to continue construction of the Heritage Center Expansion project.

The Historical Society had appropriations over actual expenditures for the biennium ended June 30, 2011 of \$1,594,814 in the Capital Assets line. Approximately \$736,000 of this amount was for exhibits, compact archive shelving at the Heritage Center, and extraordinary repairs and security equipment at historic sites that were not purchased during the 2009-2011 biennium. North Dakota Century Code 54-44.1-11 allows the State Historical Society to carryover unexpended appropriations from one biennium to the next. The remaining unexpended appropriation was a result of federal grant funds in the amount of \$800,000 not being received from the Department of Transportation for building repairs at the Fort Totten Historic Site.

The Historical Society had appropriations over actual expenditures for the biennium ended June 30, 2011 of \$624,717 in the Grants line. This amount was unused federal appropriations in the Historic Preservation federal program that were not granted to subrecipients during the 2009-2011 biennium. North Dakota Century Code 54-44.1-11 allows the State Historical Society to carryover unexpended appropriations from one biennium to the next.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue/Reimbursements	\$ 844,655	\$ 830,539
Charges for Services/Sales	599,453	709,828
Contributions and Private Grants	150,996	55,649
Miscellaneous General Revenue	39,530	1,518
Leases, Rents, and Royalties	20,617	34,222
Transfers In	366,176	
Total Revenues and Other Sources	<u>\$ 2,021,427</u>	<u>\$ 1,631,757</u>
<u>Expenditures and Other Uses:</u>		
Land and Buildings	\$ 13,260,403	\$ 3,784,654
Salaries and Benefits	4,748,444	4,512,325
Operating Fees, Services, and Supplies	1,347,287	1,619,812
Grants, Benefits, and Claims	572,274	410,665
Travel	164,535	115,974
Equipment	116,930	247,706
Transfers Out	748,453	695,592
Total Expenditures and Other Uses	<u>\$ 20,958,327</u>	<u>\$ 11,386,727</u>

Statement of Appropriations

For The Fiscal Year Ended June 30, 2012

Expenditures by Line Item:	Original <u>Appropriation</u>	<u>Adjustments</u>	Final <u>Appropriation</u>	<u>Expenditures</u>	Unexpended <u>Appropriation</u>
Salaries and Wages	\$ 9,537,660	\$ 14,750	\$ 9,552,410	\$ 4,379,628	\$ 5,172,782
Operating Expenses	2,677,916		2,677,916	1,282,299	1,395,617
Capital Assets	2,835,736	60,000	2,895,736	1,056,034	1,839,702
Construction Carryover		736,481	736,481	277,149	459,332
Heritage Center Carryover		46,373,466	46,373,466	12,688,110	33,685,356
Grants	1,025,000		1,025,000	159,296	865,704
Cultural Heritage Grants	504,500		504,500	306,226	198,274
Yellowstone- Missouri-Ft Union	4,492		4,492		4,492
Totals	<u>\$ 16,585,304</u>	<u>\$47,184,697</u>	<u>\$ 63,770,001</u>	<u>\$ 20,148,743</u>	<u>\$ 43,621,258</u>
Expenditures by Source:					
General Fund	\$ 13,034,891	\$35,124,697	\$ 48,159,588	\$ 19,194,253	\$ 28,965,335
Other Funds	3,550,413	12,060,000	15,610,413	954,490	14,655,923
Totals	<u>\$ 16,585,304</u>	<u>\$47,184,697</u>	<u>\$ 63,770,001</u>	<u>\$ 20,148,743</u>	<u>\$ 43,621,258</u>

Appropriation Adjustments:

The increase in the Salaries and Wages line of \$14,750 was for money received from the Human Resources Management Services (HRMS) Division of the Office of Management and Budget to provide internships for various historical programs through the state student internship program. HRMS received this funding through Senate Bill 2015, section 7 of the 62nd Legislative Assembly.

The increase in the Capital Assets line of \$60,000 is additional spending authority to accept funds from the Historical Impact Emergency Fund for emergency mitigation of adverse conditions impacting the historic integrity and security of the Stutsman County Courthouse. The adjustment was properly approved by the Emergency Commission.

The increase in the Construction Carryover line of \$736,481 and the increase in the Heritage Center Carryover line of \$46,373,466 were authorized by section 54-44.1-11 of the North Dakota Century Code that allows the State Historical Society to carry forward unexpended appropriations from one biennium to the next.

Expenditures Without Appropriations Of Specific Amounts:

Historical Society Gifts and Bequests Fund has a continuing appropriation authorized by NDCC section 55-01-04 (\$31,456 of expenditures for this fiscal year).

Historical Society Revolving Fund has a continuing appropriation authorized by NDCC sections 55-03-04 and 55-01-02 (\$41,021 of expenditures for this fiscal year).

Historical Society Concessions Fund has a continuing appropriation authorized by NDCC section 55-02-04 (\$690,210 of expenditures for this fiscal year).

Historical Impact Emergency Fund received a transfer of unexpended general fund appropriation (\$44,798) authorized by NDCC section 55-02-09.

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 8,368,675	\$ 333,618	\$ 8,702,293	\$ 8,233,757	\$ 468,536
Operating Expenses	2,359,210	13,350	2,372,560	1,973,339	399,221
Capital Assets Construction	3,896,212		3,896,212	2,301,398	1,594,814
Carryover		646,571	646,571	614,274	32,297
Heritage Center Addition	51,700,000		51,700,000	5,326,534	46,373,466
Grants	1,000,000	28,500	1,028,500	403,783	624,717
Cultural Heritage Grants	504,500		504,500	470,457	34,043
Yellowstone- Missouri-Ft Union	4,492		4,492	4,492	
Federal Stimulus Funds - 2009	685,000		685,000	208,579	476,421
Totals	<u>\$ 68,518,089</u>	<u>\$ 1,022,039</u>	<u>\$ 69,540,128</u>	<u>\$ 19,536,614</u>	<u>\$ 50,003,514</u>
Expenditures by Source:					
General Fund	\$ 52,174,252	\$ 819,361	\$ 52,993,613	\$ 17,838,867	\$ 35,154,745
Other Funds	16,343,837	202,678	16,546,515	1,697,746	14,848,769
Totals	<u>\$ 68,518,089</u>	<u>\$ 1,022,039</u>	<u>\$ 69,540,128</u>	<u>\$ 19,536,614</u>	<u>\$ 50,003,514</u>

Appropriation Adjustments:

\$328,000 out of the \$333,618 increase in the Salaries and Wages line item is due to an appropriation allocated by the Office of Management and Budget from the statewide salary equity pool appropriated pursuant to House Bill 1015 of the 61st Legislative Assembly for salary and market equity compensation adjustments. The remaining \$5,618 increase was for money received from the Human Resources Management Services (HRMS) division of the Office of Management and Budget to provide internships for various historical programs through the state student internship program. HRMS received this funding through House Bill 1015, section 10 of the 61st Legislative Assembly.

The increase in the Operating Expenses line of \$13,350 was for money received from the Human Resources Management Services (HRMS) division of the Office of Management and Budget to provide internships for various historical programs through the state student internship program. HRMS received this funding through House Bill 1015, section 10 of the 61st Legislative Assembly.

The increase in the Construction Carryover line of \$646,571 was authorized by section 54-44.1-11 of the NDCC that allows the State Historical Society to carry forward unexpended appropriations from one biennium to the next.

The increase in the Grants line of \$28,500 is additional spending authority to accept funds from the Historical Impact Emergency Fund for emergency mitigation of historic properties damaged by natural disaster in Northwood, ND in August 2007. The adjustment was properly approved by the Emergency Commission.

Expenditures Without Appropriations Of Specific Amounts:

Insurance Recoveries Property Fund has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$15,000 of expenditures for this biennium).

Historical Society Revolving Fund has a continuing appropriation authorized by NDCC sections 55-03-04 and 55-01-02 (\$45,256 of expenditures for this biennium).

Historical Society Gifts and Bequests Fund has a continuing appropriation authorized by NDCC section 55-01-04 (\$136,870 of expenditures for this biennium).

Historical Society Concessions Fund has a continuing appropriation authorized by NDCC section 55-02-04 (\$1,334,001 of expenditures for this biennium).

Historical Impact Emergency Fund received a transfer of unexpended general fund appropriation (\$32,265) authorized by NDCC section 55-02-09.

Internal Control

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

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer-based inventory (Retail Pro) application.
- Controls surrounding the issuance of complimentary admissions at the historical sites.

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 that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of the Historical Society in a management letter dated August 16, 2013.

Inventory Segregation of Duties Weaknesses (Finding 12-1)

Condition:

Controls surrounding inventory are not adequate. One individual has control of inventory records, custody of inventory, and prepares miscellaneous adjustments to inventory for all museum stores. The same individual also establishes system user access privileges, collects revenue, and prepares miscellaneous cash register adjustments at the Heritage Center museum store location.

The Historical Society operates museum stores at the Heritage Center and seven historic sites. Inventory records are maintained through the Retail Pro application for inventory at the Heritage Center and three of the historic sites, while manual records are maintained for the four remaining sites.

Criteria:

Committee of Sponsoring Organizations (COSO) of the Treadway Commission publication Internal Control - Integrated Framework states, "Proper segregation of duties requires inventory records be maintained by an individual with duties independent of system access administration, reconciliation procedures, custody of inventory, revenue collections and cash register adjustments."

Cause:

The State Historical Society failed to implement this recommendation in the past three audits.

Effect or Potential Effect:

Possible theft or misappropriation of inventory.

Recommendation:

We recommend inventory records be maintained by an individual with duties independent of system access administration, custody of inventory, revenue collections, and cash register adjustments.

Historical Society Response:

The State Historical Society of North Dakota agrees with the finding. We are in the process of hiring one additional store staff person which will allow us to implement proper internal controls. We believe additional store revenues generated because of the opening of the Heritage Center expansion will be sufficient for us to hire and maintain this additional staff person.

Lack of Controls Surrounding Complimentary Admissions at Historic Sites (Finding 12-2)

Condition:

The Historical Society does not have a documented policy on the issuance of complimentary tickets. It was noted the agency was giving a significant amount of complimentary tickets in comparison to what they were receiving in admissions. We noted at the Pembina State Museum that 25% of the tickets given out during the audit period were complimentary. The Chateau de Mores had 5% of tickets being complimentary and the Fort Buford/Missouri-Yellowstone Confluence Interpretive Center had 1% of the tickets being complimentary.

In addition, the Historical Society is not monitoring the issuance of complimentary tickets at the historic sites.

Criteria:

The Committee of Sponsoring Organizations of the Treadway Commission's Internal Control – Integrated Framework states that controls activities, which include both policies and procedures should be established and executed to help ensure risks are mitigated.

Cause:

The Historical Society was unaware of the need to develop a written policy related to the issuance of complimentary tickets and to monitor the issuance of those tickets.

Effect or Potential Effect:

Potential admission revenue may not be collected.

Recommendation:

We recommend the Historical Society:

- a) develop a written policy on the issuance of complimentary tickets; and
- b) implement procedures to monitor the issuance of complimentary admissions at the historic sites.

Historical Society Response:

The State Historical Society of North Dakota agrees with the finding. We will review the issuance of complimentary tickets at the Historic Sites and a written policy will be developed to provide guidance to Historic Site staff.

Compliance With Legislative Intent

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

- Proper use of the Concession Fund (NDCC 55-02-04).
- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapter 18, 2009 North Dakota Session Laws chapter 28, and 2011 Session Laws chapter 44).
- Process in place to document and inventory all property with historic or artistic significance held for every state official or entity (North Dakota Century Code section 1-08-04.1).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code*, *North Dakota Session Laws*, and *Office of Management and Budget Policies and Procedures*.

Government Auditing Standards requires 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 two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These findings are described below. Other than those findings, we concluded there was compliance with the legislative intent identified above.

Construction in Progress Not Properly Reported (Finding 12-3)

Condition:

The Historical Society has capitalized costs of the Heritage Center Expansion Project as construction in progress that should not be capitalized. These costs include, but are not limited to, salaries, travel costs and supplies not associated with the actual building itself. In addition, the Historical Society has included as construction in progress equipment that should have been separately capitalized into the equipment classification. Also, the Historical Society has coded substantially all expenditures associated with the Expansion Project to one account code (Building Construction-New) in the ConnectND accounting system and has not accounted for them in the accounts that most accurately reflect the type of expenditures they actually are (engineering, architect fees, equipment, etc.)

Criteria:

Generally Accepted Accounting Principles (GAAP) state that only ancillary charges necessary to place an asset into use can be capitalized as part of the asset.

The OMB Closing Procedures Manual states that equipment may be attached to a structure for purposes of securing the item, but unless it is permanently attached to, or an integral part of the building or structure, it will be classified as Equipment and not Buildings and Building Improvements.

Good internal controls require proper coding of transactions to ensure accuracy of accounting information.

Cause:

The Historical Society did not gain a full understanding of capitalization rules under GAAP and Office of Management and Budget fixed asset policies and did not recognize the need for expenditures to be properly coded.

Effect or Potential Effect:

Incorrect amounts are being capitalized and the agency's financial records do not reflect accurate categories of expenditures.

Recommendation:

We recommend the Historical Society correctly capitalize fixed assets at proper amounts and code expenditures to the proper account codes.

Historical Society Response:

The State Historical Society of North Dakota agrees with the finding. Society staff met with staff from the Office of Management and Budget to get clarification on the capitalization policies. Corrections have been made based on their guidance.

Not Properly Capitalizing Purchases and Projects (Finding 12-4)

Condition:

The Historical Society is not properly capitalizing some building projects and fixed asset purchases. We noted two instances where the agency failed to capitalize a fixed asset purchase or a building project. One instance was the purchase of a security surveillance system for \$12,037. The other instance, the agency failed to capitalize a portion of the Fort Abercrombie Interpretative Center building project in the amount of \$18,425.

Criteria:

OMB Fixed Asset Policy states that equipment, buildings, and building improvements should be capitalized if its cost is \$5,000 or more. The policy also states fixed asset components that have a unit cost under stated capitalization levels should be capitalized if they are originally acquired as part of a system and the system cost equals or exceeds capitalization levels. The logic behind capitalizing each individual component as part of the entire system is that the component, standing alone, cannot function or serve its intended purpose by itself.

Cause:

The Historical Society did not gain a full understanding of capitalization rules under Office of Management and Budget fixed asset policies.

Effect or Potential Effect:

The State Historical Society is not in compliance with OMB Fixed Asset Policies. In addition, the fixed asset records are not accurate and depreciation will not be properly calculated.

Recommendation:

We recommend the Historical Society properly capitalize fixed asset purchases and building projects.

Historical Society Response:

The State Historical Society of North Dakota agrees with the finding. Society staff met with staff from the Office of Management and Budget to get clarification on the capitalization policies. Corrections have been made based on their guidance.

Operations

This audit did not identify areas of Historical Society's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note certain matters involving operations that we have reported to management of the Historical Society in a management letter dated August 16, 2013.

Prior Recommendations Not Implemented

One prior recommendation has been implemented and one recommendation has not been implemented:

Inventory Segregation of Duties Weakness (Finding 10-1)

Recommendation:

We recommend inventory records be maintained by an individual with duties independent of system access administration, custody of inventory, revenue collections, and cash register adjustments.

Status:

Not implemented. This finding is readdressed on Page 14.

Management Letter (Informal Recommendations)

August 16, 2013

Mr. Merlan E. Paaverud, Jr., Director
State Historical Society
612 E. Boulevard Avenue
Bismarck, ND 58505-0830

Dear Mr. Paaverud:

We have performed an audit of the Historical Society 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 Historical Society'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.

CONTROL DEFICIENCIES

Informal Recommendation 12-1: We recommend the Historical Society implement procedures to ensure a review has been done to distinguish between public improvements and capital assets for purchases that are made.

Informal Recommendation 12-2: We recommend the Historical Society implement review procedures for assets added to the PeopleSoft Asset Management System after they have been entered to ensure they were entered correctly.

Informal Recommendation 12-3: We recommend the Historical Society keep documentation of the reconciliation between the items sold on Amazon and the amount of funds wired by Amazon to ensure proper payment is received. We also recommend the agency keep proper supporting documentation from the Retail Pro system showing that items sold online were removed from inventory.

Informal Recommendation 12-4: We recommend the State Historical Society implement controls to periodically review and update the ConnectND security access roles to ensure these roles are restricted to employees requiring access.

Informal Recommendation 12-5: We recommend the State Historical Society strengthen controls surrounding the review of coding of vouchers and correcting entries to ensure the proper coding is used.

OPERATIONS

Informal Recommendation 12-6: We recommend the Historical Society continue to find ways to increase usage of the purchase card.

Informal Recommendation 12-7: We recommend the Historical Society consider the cost/benefit of selling items on Amazon.

Management of the Historical Society agreed with these recommendations.

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

Sincerely,



Andrea Wike
Auditor in-charge

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241