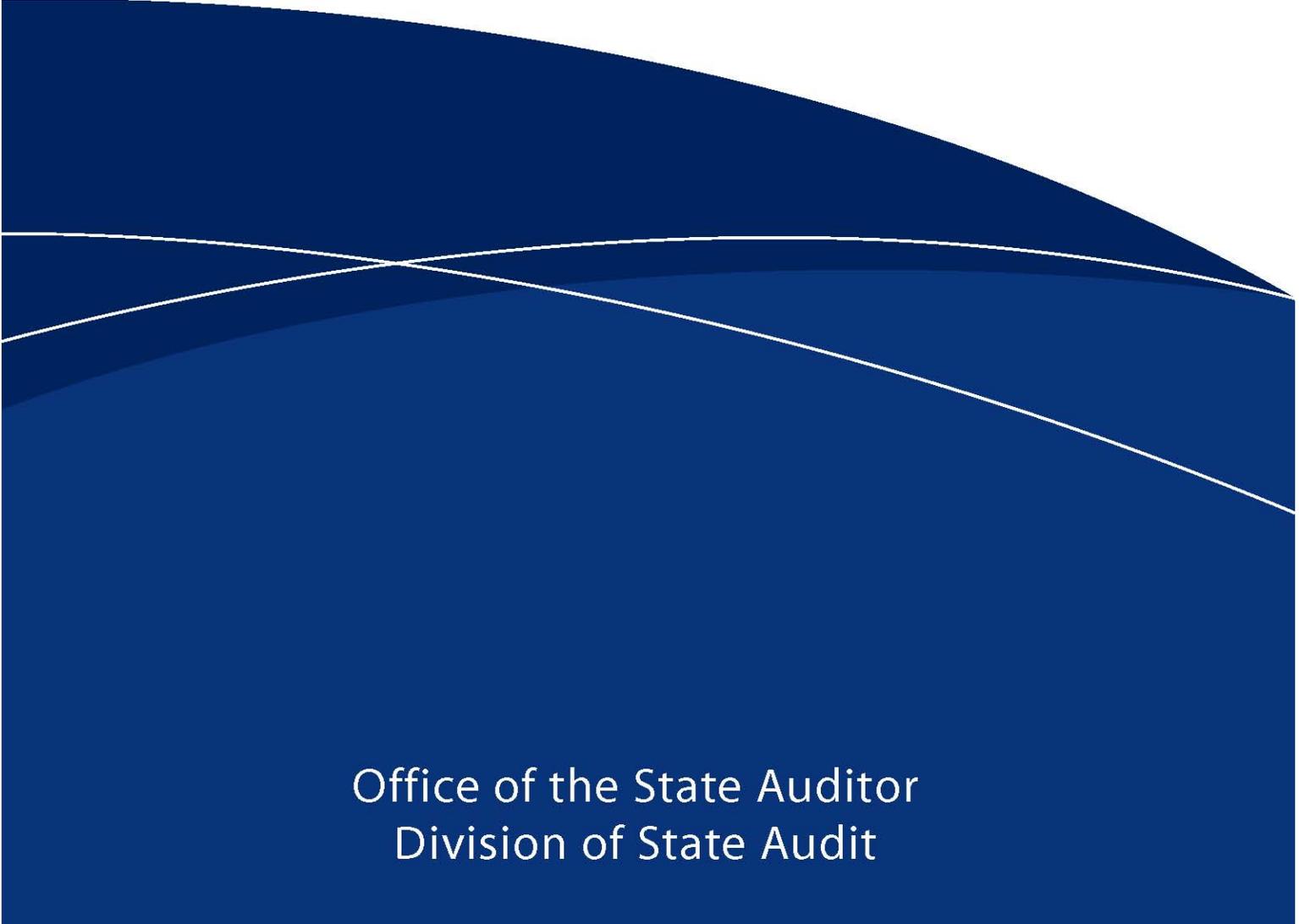


# NORTH DAKOTA UNIVERSITY SYSTEM

## **Governance Communication Including the Report on Internal Control, Compliance, and Other Matters**

For the Year Ended  
June 30, 2016

JOSHUA C. GALLION  
STATE AUDITOR



Office of the State Auditor  
Division of State Audit

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## **Table of Contents**

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<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards</i>	<i>5</i>
<i>Prior Recommendations Not Implemented and University System Responses</i>	<i>7</i>
<i>Governance Communication</i>	<i>12</i>
<i>Audit Adjustments</i>	<i>15</i>
<i>Posted Audit Adjustments</i>	<i>15</i>
<i>Passed Audit Adjustments</i>	<i>16</i>
<i>Management Letter</i>	<i>18</i>



STATE OF NORTH DAKOTA  
**OFFICE OF THE STATE AUDITOR**  
FARGO BRANCH OFFICE  
1655 43<sup>rd</sup> STREET SOUTH, SUITE 203  
FARGO, NORTH DAKOTA 58103

## ***Transmittal Letter***

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December 7, 2016

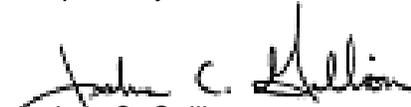
Honorable Doug Burgum, Governor  
Members of the North Dakota Legislative Assembly  
State Board of Higher Education

I am pleased to submit our report on internal control and compliance for the North Dakota University System. This report relates to the audit of the North Dakota University System's financial statements for the year ended June 30, 2016. This report on internal control and compliance has been completed in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States.

Also enclosed you will find our audit findings, governance communication, posted and passed audit adjustments, and management letter. These communications are required by generally accepted auditing standards.

The audit manager for this audit was Robyn Hoffmann, CPA. Inquiries or comments relating to this audit may be directed to Ms. Hoffmann by calling (701) 239-7291. I wish to express our appreciation to the North Dakota University System for the courtesy, cooperation, and assistance they provided to us during the audit.

Respectfully submitted,

  
Joshua C. Gallion  
State Auditor

# Executive Summary

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## 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 institutions:

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

Unmodified on Business-Type Activities and Qualified on the Aggregate Discretely Presented Component Units.

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?*

No. We noted the following three internal control matters which need to be addressed and corrected:

- NDUS – Fraud Risk (Prior Recommendations Not Implemented #1)
- SBHE & NDUS – Governance and Internal Controls of Foundation Audits (Prior Recommendations Not Implemented #2)
- LRSC, MISU, NDSCS, and WSC – Background Checks (Prior Recommendations Not Implemented #3)

For additional commentary see *Prior Recommendations Not Implemented and University System Responses* as listed in the table of contents.

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 the prior audit?*

No. Three (two pre-fiscal year 2014 and one fiscal year 2014) prior recommendations were not implemented as follows:

- NDUS management has not conducted a comprehensive fraud and control risk assessment by each institution. [2008, 2009, 2010, 2011, 2012, 2013, 2014, and 2015 audits]
- NDUS management had not obtained GAAP-compliant financial statements or an annual GAAP audit for all component units and has not obtained operating agreements for all affiliated organizations in compliance with SBHE Policy 340.2. [2013, 2014, and 2015 audits]
- LRSC, MISU, NDSCS, and WSC did not complete employee criminal history background checks for all employees prior to beginning employment. [2014 and 2015 audits]

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

Yes. We made the following four informal recommendations to which management responded and agreed to implement. For additional commentary and management responses, see the management letter as listed in the table of contents.

1. WSC – Incomplete bank reconciliation
2. NDUS – Inadequate fraud awareness training
3. NDUS – Improper termination benefits note template
4. NDUS – Insufficient monitoring of service organizations

## **LAFRC Audit Communications**

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

The NDUS changed accounting policies related to investments by adopting GASB Statement No. 72, *Fair Value Measurement and Applications*. There were no management conflicts of interest or significant unusual transactions noted. The NDUS's commitments and contingent liabilities are reported in the notes to the financial statements, as listed in the table of contents of the fiscal year 2016 NDUS Annual Financial Report.

2. *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.*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements:

- Fair value of investments
- Useful lives of capital assets
- Scholarship allowance: \$68 million
- Allowance for uncollectible receivables:
  - Accounts: \$6.2 million
  - Loans and notes: \$7.7 million

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the financial statements taken as a whole.

3. *Identify any significant audit adjustments.*

The Posted Audit Adjustments schedule, as listed in the table of contents, lists material misstatements detected as a result of audit procedures that were corrected by management.

The Passed Audit Adjustments schedule, as listed in the table of contents, summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

4. *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.*

We are pleased to report that no significant disagreements arose during the course of our audit.

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

None.

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

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

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

None.

8. *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 Systems (HCM), and Campus Solutions are the most high-risk information technology systems critical to the North Dakota University System. None of the exceptions noted were directly related to the operation of an information technology system.



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FARGO, NORTH DAKOTA 58103

## ***Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards***

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### **Independent Auditor's Report**

Honorable Doug Burgum, Governor  
Members of the Legislative Assembly  
State Board of Higher Education

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities and the aggregate discretely presented component units of the North Dakota University System as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the North Dakota University System's financial statements, and have issued our report thereon dated December 7, 2016. Our report was qualified because management did not include the financial data for one of the reporting entity's discretely presented component units. Our report includes a reference to other auditors who audited the financial statements of the discretely presented component units, as described in our report on the North Dakota University System's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the North Dakota University System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the North Dakota University's internal control. Accordingly, we do not express an opinion on the effectiveness of the North Dakota University System's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of *Prior Recommendations Not Implemented and University System Responses*, we

identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies numbered 1 and 2 in the accompanying schedule of *Prior Findings Not Implemented and University System Responses* to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency numbered 3 in the accompanying schedule of *Prior Findings Not Implemented and University System Responses* to be a significant deficiency.

### **Compliance and Other Matters**

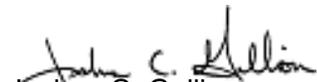
As part of obtaining reasonable assurance about whether the North Dakota University System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **North Dakota University System's Response to Findings**

The North Dakota University System's response to the findings identified in our audit are described in the accompanying schedule of *Prior Findings Not Implemented and University System Responses*. The North Dakota University Systems responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

  
Joshua C. Gallion  
State Auditor

Fargo, North Dakota

December 7, 2016

## ***Prior Recommendations Not Implemented and University System Responses***

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Prior recommendations not implemented and client responses, item #5 of the Special Comments Requested by the Legislative Audit and Fiscal Review Committee.

### **1. NDUS – FRAUD RISK**

Condition:

During the 2008 and subsequent audits, we recommended the NDUS require a comprehensive fraud and control risk assessment by each institution.

Current Status:

During fiscal year 2016, a comprehensive fraud and control risk assessment was not completed. However, an initial step was taken toward a comprehensive fraud risk assessment. A fraud risk assessment survey was distributed to all permanent, benefitted employees of NDUS. This survey was used to identify areas where there may be increased risk.

Effect:

The lack of adequate risk assessments at any level can create significant areas of risk of material misstatements in the general ledger and the financial statements.

Cause:

The NDUS started the process in fiscal year 2016 with the fraud risk assessment survey, but now needs to proceed to the next step and develop a fraud risk assessment.

Criteria:

COSO (Committee on Sponsoring Organizations of the Treadway Commission) outlines five essential components of an effective internal control system. Risk assessment, which involves the identification and analysis by management of relevant risks to achieving predetermined objectives, is one of these five essential components.

Recommendation:

We recommend the North Dakota University System require a comprehensive fraud and control risk assessment by each institution.

University System Response/Planned Corrective Actions:

Agree. NDUS Audit Services is currently in the process of developing a phased Enterprise Risk Management (ERM) plan for the system. This process and evaluation tool will be introduced by June 30, 2017, with institutional implementation anticipated by March 31, 2018.

## 2. SBHE & NDUS – GOVERNANCE AND INTERNAL CONTROLS OF FOUNDATION AUDITS

### Condition:

During the 2013 and subsequent audits, we recommended the NDUS, as part of its governance responsibility, direct the impacted foundations to improve operations and reporting to obtain GAAP compliant financial statements as required by SBHE Policy 340.2 and review all institution affiliated organizations operating agreements annually.

### Current Status:

We noted:

- The DSU Foundation was unable to receive an audit opinion due to inadequate financial records which lead to litigation, being forced into receivership, and ultimately in the process of being dissolved;
- Five out of the 30 affiliated organizations, did not have a signed operating agreement between the affiliated organization and the campus; and
- Six out of the 25 affiliated organizations where an operating agreement existed, were not updated.

### Effect:

There is noncompliance with SBHE policy 340.2, a qualified opinion on the NDUS discretely presented component unit financial statements, bond rating, and reputational issues which could affect future funding.

Additionally, NDUS institutions could become financially liable for costs associated with foundations in financial distress that are being dissolved.

### Cause:

There is inadequate oversight by the NDUS to ensure the affiliated organizations comply with the applicable SBHE policies.

### Criteria:

SBHE policy 340.2, section 3, in-part states, a foundation is a private legal entity separate from the institution and must be governed accordingly to protect the foundation's private, independent status. However, because the State Board of Higher Education is responsible for ensuring the integrity and reputation of the University System, it must be assured of the manner in which any affiliated foundation will operate. Therefore, each institution and its foundation(s) shall negotiate and maintain a written operating agreement.

SBHE policy 340.2, section 3e, in-part states, a requirement to provide the institution with GAAP-compliant financial statements and an annual GAAP audit of the foundation, or a draft of an audited financial statement submitted for but pending foundation board approval by September 15 each year for:

- all entities considered component units of the NDUS under GASB 39, and
- all other related organizations that are not component units, whose total assets exceed \$1 million and total program expenses exceed \$100,000, for the previous fiscal year-end.

SBHE policy 340.2, section 4, states that agreements shall be reviewed annually, and updated as necessary. A copy of each agreement shall be filed with the NDUS General Counsel.

Recommendation:

We recommend the NDUS:

- Ensure the DSU Foundation provides GAAP compliant financial statements; and
- Ensure operating agreements exist for all institution affiliated organizations, operating agreements are reviewed annually and updated in a timely manner, and that the agreements are filed with the proper personnel.

University System Response/Planned Corrective Actions:

*Agree. Proposed revisions to Policy 340.2 are in development and will be presented to the SBHE in 2017. The changes will enhance oversight of foundations and related operating agreements.*

### 3. LRSC, MISU, NDSCS, and WSC – BACKGROUND CHECKS

#### Condition:

MISU did not complete employee criminal history background checks for four out of seven employees before their start date. Two of these employees were hired after the SBHE procedure was changed on July 1, 2015.

#### Current Status:

During our review of background investigations, we noted the following:

- LRSC and NDSCS did not complete Criminal History Records Checks and Sex Offender Registry Checks prior to beginning employment for one of the three employees reviewed.
- MISU did not complete Criminal History Records Checks and Sex Offender Registry Checks prior to beginning employment for one of the six employees reviewed.
- WSC did not complete Criminal History Records Checks and Sex Offender Registry Checks prior to beginning employment for two of the three employees reviewed.

#### Effect:

There is noncompliance with the SBHE procedure and an unnecessary risk to the NDUS of hiring of persons who have civil or criminal histories for sensitive jobs.

#### Cause:

For LRSC and NDSCS, there is a lack of communication between departments regarding new hires and the need for background checks. For MISU and WSC there is a lack of compliance with SBHE procedure 602.3.

#### Criteria:

State Board of Higher Education Procedure, 602.3 Job Applicant/Employee Criminal History Background Checks part 4 states, Criminal History Records Checks and Sex Offender Registry Checks are required for new hires for the following positions:

1. All benefited positions; and
2. Non-benefited positions, including volunteers who:
  - a. have access to confidential or proprietary information;
  - b. have master keys;
  - c. have access to cash, credit, debit, or other financial transactions;
  - d. are resident hall and/or apartment managers, directors, or assistants;
  - e. are child-care employees and other employees who have unsupervised contact with minor children;
  - f. are responsible for, or with access to, controlled substances and other drugs, explosives, or potentially dangerous chemicals and other substances;
  - g. are instructional faculty and staff, including graduate teaching assistants; and,
  - h. are counselors and coaches.

#### Recommendation:

We recommend that LRSC, MISU, NDSCS, and WSC complete background investigations for all employees including student workers before access is given to PeopleSoft.

#### University System Response/Planned Corrective Actions:

*LRSC: Agree. New hires at LRSC are no longer established in the PeopleSoft HRMS system until a required background investigation has been completed. Access rights to PeopleSoft systems cannot be granted to individuals who have not been established in the HRMS system.*

*MiSU: Agree. MiSU hired a new HR Director as of June 2016. Beginning in FY17, all background checks are being performed in accordance with the NDUS policy.*

*NDSCS: Agree. NDSCS will review its communication practices to ensure background checks are completed prior to employees given Peoplesoft access. NDSCS will also incorporate a revised hiring checklist to ensure compliance. This will be implemented immediately.*

*WSC: Agree. WSC has implemented the recommendation in the current fiscal year (FY17). Background checks, including criminal history and sex offender registry for all employees, are being completed.*



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## ***Governance Communication***

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December 7, 2016

State Board of Higher Education

Legislative Audit and Fiscal Review Committee

We have audited the financial statements of the business-type activities and the aggregate discretely presented component units of the North Dakota University System for the year ended June 30, 2016, and have issued our report thereon dated December 7, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 15, 2016. Professional standards also require that we communicate to you the following information related to our audit.

### **Significant Audit Findings**

#### **Qualitative Aspects of Accounting Practices**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the North Dakota University System are described in Note 1 to the financial statements. As described in Note 1 to the financial statements, the North Dakota University System changed accounting policies related to fair value of certain investments, as well as guidance for disclosures related to fair value measurements by adopting Statement of Governmental Accounting Standards (GASB Statement) Nzos. 72, *Fair Value Measurement and Application*, in fiscal year 2016. This statement required an adjustment of \$9.4 million to increase beginning net position. Accordingly, the cumulative effect of the accounting change as of the beginning of the year is reported in the Statement of Net Position. We noted no transactions entered into by the NDUS during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements:

- Fair value of investments
- Useful lives of capital assets
- Scholarship allowance: \$68 million
- Allowance for uncollectible receivables:
  - Accounts: \$6.2 million
  - Loans and notes: \$7.7 million

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

### **Difficulties Encountered in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing and completing our audit.

### **Corrected and Uncorrected Misstatements**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

The Posted Audit Adjustments schedule, as listed in the table of contents, lists material misstatements detected as a result of audit procedures that were corrected by management.

The Passed Audit Adjustments schedule, as listed in the table of contents, summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated November 30, 2016.

### **Management Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

## **Other Audit Findings or Issues**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

We issued a qualified opinion on the aggregate discretely presented component units for fiscal year 2016 because the financial data for Dickinson State University Foundation were not included with the aggregate discretely presented component units in the North Dakota University System's financial statements. This is addressed in Prior Recommendations Not Implemented #2 – SBHE/NDUS – Governance and Internal Controls of Foundation Audits.

## **Other Matters**

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information, except the Deficit Net Position Balances > \$100,000 and the Financial Information for Revenue Producing Buildings, to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of North Dakota State Board of Higher Education, the Legislative and Fiscal Review Committee, and management of the North Dakota University System and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,



Robyn Hoffmann, CPA  
Audit Manager, Division of State Audit

December 7, 2016

## Audit Adjustments

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### Posted Audit Adjustments

DESCRIPTION		DR	CR	EXPLANATION/DISPOSITION
<b>1. SCF</b>				
<b>UND</b>	Direct lending receipts	31,300,740		To include all loans for the fiscal year
	Direct lending payments		31,300,740	
<b>2. CU-SOA</b>				
<b>BSCF</b>	Investment income	71,946		To reclassify change in split interest agreements to agree to IPA report
	Change in split-interest agreement		71,946	
<b>NDSUDF</b>	Investment income	125,448		
	Change in split-interest agreement		125,448	
<b>UND</b>	Investment income	2,773,492		
<b>Alumni</b>	Change in split-interest agreement		2,773,492	
<b>MISUDF</b>	Change in split-interest agreement	35,841		
	Investment income		35,841	

SCF – Statement of Cash Flows

CU – SOA – Component Unit Statement of Activities

## Passed Audit Adjustments

	DESCRIPTION	DR	CR	EXPLANATION/DISPOSITION
1.	<b>SCF</b>			
<b>UND</b>	Proceeds from issuance of debt	1,489,517		To include premium from bond issuance
	Interest paid on capital debt and lease		1,489,517	
2.	<b>SCF</b>			
<b>NDUS</b>	Interest paid on capital debt and lease	366,352		To project misstatement of interest paid on capital debt.
	Payment to suppliers		366,352	
3.	<b>SNP</b>			
<b>NDSU</b>	Unrestricted net position	620,919		To project error of FY16 expenses recorded in FY17.
	Account payable and accrued liabilities		620,919	
	<b>SRECNP</b>			
	Sales and services of educational departments	620,919		Net increase/decrease
	Net increase/decrease		620,919	
4.	<b>SNP</b>			
<b>WSC</b>	Cash and cash equivalents	1,254,634		To project error for unsupported Student Finance expenditures.
	Unrestricted net position		1,254,634	
	<b>SRECNP</b>			
	Net increase/decrease	1,254,634		Scholarships and fellow ships
	Scholarships and fellow ships		1,254,634	
5.	<b>SRECNP</b>			
<b>NDSU</b>	State appropriations-capital assets	3,000,000		To correct coding of revenue from Strategic Investment and Improvements Fund
	Capital grants and gifts		3,000,000	
6.	<b>SNP</b>			
<b>WSC</b>	Accounts receivable, net	394,347		To agree general ledger to accounts receivable subsidiary.
	Unrestricted net position		394,347	
	<b>SRECNP</b>			
	Net increase/decrease	394,347		Student tuition and fees
	Student tuition and fees		394,347	
7.	<b>SNP</b>			
<b>NDUS</b>	Accounts payable and accrued liabilities	395,687		To correct elimination entry schedule
	Unrestricted net position		395,687	
8.	<b>SNP</b>			
<b>WSC</b>	Invested in capital assets	352,994		To correct net position for restrictions set by GASB
	Unrestricted net position		352,994	

(continued)

**Passed Audit Adjustments – continued**

DESCRIPTION		DR	CR	EXPLANATION/DISPOSITION
9. SNP				
DCB	Unrestricted net position	516,718		To correct cash for errors in bank reconcilements
MASU	Cash and cash equivalents		516,718	
NDSCS				
WSC				
10. SRECNP				
DCB	Federal grants and contracts nonoperating	375,185		To reclassify work study revenue
MISU	Federal grants and contracts		375,185	
NDSCS				
WSC				

SNP – Statement of Net Position

SRECNP – Statement of Revenues, Expenses and Changes in Net Position

SCF – Statement of Cash Flows

## *Management Letter*

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December 7, 2016

Ms. Robin Putnam  
Director of Financial Reporting  
North Dakota University System  
600 East Boulevard Avenue, 10<sup>th</sup> Floor  
Bismarck, ND 58505-0230

Dear Ms. Putnam:

The Office of the State Auditor has completed its financial audit of the North Dakota University System for the year ended June 30, 2016. As part of our examination, we gained an understanding of the internal control over financial reporting and tested compliance with laws and regulations to the extent we considered necessary. We have issued our report on internal control over financial reporting and compliance and other matters dated December 7, 2016.

Our audit procedures are designed primarily to enable us to report on the internal control over financial reporting and compliance with laws and regulations as they relate to the financial statements, and may not bring to light all deficiencies in internal control or noncompliance with laws and regulations that may exist. We aim, however, to use our knowledge gained during our work to make comments and suggestions, which we hope will be useful to you.

In connection with the audit, we noted certain conditions that we did not consider reportable within the context of your audit report. These matters, which do not have a material effect on the financial statements, involve control deficiencies and/or instances of noncompliance with laws and regulations. The recommendations presented below are intended to improve or correct control deficiencies and noncompliance with laws and regulations. During future audit engagements, we will review the status of these recommendations to ensure that procedures have been initiated to address these recommendations. If no action has been taken, we will consider the appropriate course of action. Action could consist of inclusion in future audit reports.

I would encourage you to contact our Fargo office if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Robyn Hoffmann, CPA  
Audit Manager, Division of State Audit

## 1. WSC – Incomplete Bank Reconciliation

### Condition:

WSC is not properly preparing complete monthly bank reconciliations. We noted they did not include one of their bank accounts in the monthly reconciliation.

### Effect:

If cash is not reconciled fully every month, errors or misappropriations may occur and not be detected in a timely manner.

### Cause:

This was an oversight by WSC.

### Criteria:

Proper internal control reduces the risk of asset loss and helps ensure the reliability of the financial statements. To adequately safeguard cash and ensure the reliability of the financial statements, reconciliations of bank balances to the general ledger are imperative.

### Recommendation:

We recommend that WSC prepare complete monthly bank reconciliations for all bank accounts on a monthly basis.

### University System Response/Planned Corrective Actions:

Agree. WSC began completing monthly bank reconciliations for all their accounts beginning in June 2016. An unreconciled difference of \$958.38 will be resolved in early 2017.

## 2. NDUS – Inadequate Fraud Awareness Training

### Condition:

We reviewed the results from the required annual fraud awareness training for the NDUS and noted that:

- 419 employees out of 6,057 (7%) had not completed the required training by the due date; and
- 102 of the 419 employees (25%) who did not complete the required training, completed alternate training that was not approved.

### Effect:

Without completing the annual required fraud awareness training, known fraud could be occurring within NDUS, and it could go undetected or unreported because not all personnel are properly trained to know what fraud is, how to report it, or the consequences of knowing about the fraud and not reporting it.

### Cause:

There was inadequate monitoring and enforcement of the required training, partially due to NDUS not reassigning job duties as necessary, as no one was in a position to approve alternate fraud awareness training since November 2014.

### Criteria:

SBHE Policy 611.10, part 6, Each institution and the system office shall require that each benefited employee annually complete fraud awareness training. The training requirement may be satisfied by classroom instruction, a seminar or online training, provided it is approved by the NDUS Chief Auditor. The training must include a review of this policy and the required Code of Conduct. Each employee must agree to comply with the policy and Code of Conduct and each institution and the system office shall enforce this policy and document annual training.

Recommendation:

We recommend:

- NDUS comply with SBHE policy 611.10, part 6, by monitoring the completeness of the fraud awareness training and ensuring all required employees complete the training by the due date; and
- If alternate fraud awareness training is sought, the training is approved and monitored by the proper personnel.

University System Response/Planned Corrective Actions:

*Agree: During the period covered by the audit, the internal audit and compliance positions were vacant. The positions were responsible for monitoring fraud awareness training requirement including approval of alternate training courses. The positions were filled in March 2016. The compliance officer is now fulfilling the monitoring role. Additional procedures for compliance and monitoring, including a software application which automates training notifications, reminders and reporting, is being considered for system-wide implementation within the next year.*

### **3. NDUS – Improper Termination Benefits Note Template**

Condition:

Based on our review of the early retirement note disclosure template, we noted several inconsistencies among the campuses and noncompliance with GASB 47.

Effect:

There is noncompliance with GASB 47 and therefore, the institutions may not be appropriately recording and disclosing termination benefits.

Cause:

There is a lack of understanding of GASB 47 requirements.

Criteria:

GASB 47 paragraph 8 states that an employer should account for termination benefits in accordance with the measurement and recognition requirements of paragraphs 9 through 16 of this Statement, as applicable, and should include, as part of the cost of termination benefits, any fringe benefits related to the termination benefits and any directly resulting changes in the estimated costs of other employee benefits such as compensated absences, if reliably measurable.

GASB 47 paragraph 9 states that an employer should measure the cost of healthcare-related termination benefits, including healthcare continuation under COBRA, by calculating the discounted present value of expected future benefit payments.

GASB 47 paragraph 10 states that an employer should measure the cost of termination benefits that are not healthcare related as follows:

- If the benefit terms establish an obligation to pay specific amounts on fixed or determinable dates, the cost of non-healthcare-related termination benefits should be calculated as the discounted present value of expected future benefit payments, including an assumption regarding changes in future cost levels during the periods covered by the employer's commitment to provide the benefits.

Recommendation:

We recommend that all institutions of the NDUS report their termination benefits in compliance with GASB 47.

University System Response/Planned Corrective Actions:

Agree. The template will be reformatted for the FY17 year-end close to ensure termination benefits are properly reported.

#### **4. NDUS – Insufficient Monitoring of Service Organizations**

Condition:

Through the review of the identified service organizations, we noted that there was insufficient monitoring of service organizations by utilizing the Service Organization Control (SOC) reports. The SOC reports were not fully utilized by the user entity, but rather obtained for the user auditors. The SOC reports were not reviewed for deficiencies, and the applicable complimentary user entity controls were insufficiently monitored and documented to ensure they were in place and operating effectively.

Effect:

Due to not utilizing the SOC reports and monitoring the complimentary user entity controls:

- Risk that was passed onto the service organizations has increased;
- Deficiencies could exist jeopardizing the integrity, security, and privacy of data processed by the service organizations; and
- The reputation of the institutions has potentially been threatened.

Cause:

The institutions were unaware of the importance and significance of the SOC reports, and why the complimentary user entity controls need to be monitored to ensure their effectiveness.

Criteria:

Complimentary user controls, as defined by SSAE No. 16 (AT Section 801), Definitions .07, Controls that management of the service organization assumes, in the design of the service provided by the service organization, will be implemented by user entities, and which, if necessary to achieve the control objectives stated in management's description of the service organization's system, are identified as such in that description.

Recommendation:

We recommend the identified service organization's SOC reports are utilized by the proper personnel to ensure there are no deficiencies noted that would affect the institution and the institutions monitor and document their monitoring results of how the applicable complimentary user entity controls are in place and how they are operating effectively.

University System Response/Planned Corrective Actions:

*CTS: Partially agree. After additional review of the SOC documents, NDUS believes that current procedures and actions meet the required monitoring. However, documentation of monitoring procedures and entry controls was lacking. NDUS will development the necessary documentation by June 30, 2017. Additionally, NDUS will complete a critical review of current procedures for gaps in user entry controls, document changes to address SAO concerns and increase compliance.*

*SLSC: Agree. SLSC will conduct an annual review of the Heartland ECSI SOC Report to include assessment of audit opinion and control tests as well as complimentary user-entity controls. Exceptions to control tests will be reviewed with ECSI to ensure appropriate response, exceptions to complimentary user-entity controls will be addressed by the SLSC and its supporting NDUS offices. Review, exceptions and corrective action or justification for control failure will be documented and summarized for review by the SAO. The review for the 2016/2017 SOC Report will be completed by November 1, 2017.*

*BSC, UND: Agree. Beginning in FY17, the Bank Mobile SOC will be reviewed on an annual basis.*

You may obtain reports by contacting the  
Division of State Audit  
at the following address:

Office of the State Auditor  
600 East Boulevard Avenue – Department 117  
Bismarck, ND 58505-0060  
(701) 328-2241

Reports are also available on the internet at:  
[www.nd.gov/auditor/](http://www.nd.gov/auditor/)