



# NORTH DAKOTA OFFICE OF THE STATE AUDITOR

*State Auditor Joshua C. Gallion*

## North Dakota University System Governance Communication Including the Report on Internal Control, Compliance, and Other Matters

Audit Report for the Year Ended June 30, 2019  
*Client Code: 220*



Office of the  
State Auditor

## **KEY PERSONNEL**

### **State Auditor's Office Staff**

Robyn Hoffmann, CPA, Audit Manager  
Cory Wigdahl, CFE, Audit Supervisor  
Alex Mehring, CPA, Senior Auditor  
Travis Klinkhammer, CPA, Auditor  
Grant Hermanson M. Acc., Auditor  
Tyler Liebl, Auditor  
Jason Schwartz, Auditor

### **Client Staff Contacts**

Tammy Dolan, Chief Financial Officer  
Robin Putnam, CPA, Director of Financial Reporting

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**OFFICE OF THE STATE AUDITOR**  
FARGO BRANCH OFFICE  
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FARGO, NORTH DAKOTA 58103

## *Transmittal Letter*

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November 26, 2019

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, 2019. 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 finding, governance communication, and posted and passed audit adjustments. 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,

/S/

Joshua C. Gallion  
State Auditor

cc: Legislative Audit and Fiscal Review Committee  
Chris Kadrmas, Legislative Council Fiscal Analyst

## ***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 the 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 one internal control matter which needs to be addressed and corrected:

- NDUS – Inadequate Internal Controls over Affiliated Organizations

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

**4. Were there any indications of a 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. One pre-fiscal year 2014 prior recommendation was not implemented as follows:

- NDUS management had not obtained operating agreements and had not obtained a timely audit for all affiliated organizations in compliance with SBHE Policy 340.2. [2013, 2014, 2015, 2016, 2017 and 2018 audits]

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

No

## **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 most significant changes in accounting policies are related to the adoption of the provisions of Governmental Accounting Standards Board (GASB) Statement No. 83, *Certain Asset Retirement Obligations*, and GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. 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 2019 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
- Pension liability: \$162.1 million
- OPEB liability: \$7.1 million
- Scholarship allowance: \$65.9 million
- Allowance for uncollectible receivables:
  - Accounts: \$6.9 million
  - Loans and notes: \$4.6 million

The estimate for the fair value of investments is based on using quoted prices in active markets and discounted cash flow models. Management's estimate of the useful lives is based on the history of capital assets on each campus and is used to compute depreciation on capital assets. The estimate for the pension and OPEB liability is based on an actuary's calculation in accordance with employment contracts. The estimate for scholarship allowance is based on the difference between the tuition rates and charges and the amount actually paid by students and/or third parties making payments on behalf of students. The estimate for allowance for uncollectible receivables is based on aging categories and history. 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 financial accounting, reporting, or auditing matter that could be significant to the financial statements.**

We are pleased to report that there were no significant disagreements 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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## ***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**

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, 2019, and the related notes to the financial statements, which collectively comprise the North Dakota University System's basic financial statements, and have issued our report thereon dated November 26, 2019. 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.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described in the accompanying schedule of *Prior Recommendation Not Implemented and University System Response*, that we consider 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 finding identified in our audit is described in the accompanying schedule of *Prior Finding Not Implemented and University System Response*. The North Dakota University System's response was 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.

/S/

Joshua C. Gallion  
State Auditor

Fargo, North Dakota  
November 26, 2019

## ***Prior Recommendation Not Implemented and University System Response***

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Prior recommendation not implemented and client response, item #5 of the Responses to LAFRC Audit Questions.

### **NDUS – INADEQUATE INTERNAL CONTROLS OVER AFFILIATED ORGANIZATIONS**

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 Generally Accepted Accounting Principles (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 is in the final stages of being dissolved. Once the IRS has reviewed all applicable tax returns, a final receiver's report can be filed obtaining court approval of the final distribution process. The financial data was not included in the NDUS financial statements for fiscal year 2019, therefore a qualified opinion was issued for the Aggregate Discretely Presented Component Units;
- 1 out of the 29 affiliated organizations, did not have a signed operating agreement between the affiliated organization and the institution; and
- 5 out of the 20 affiliated organizations where an audit was required, could not obtain an audit on time.

Effect:

There is noncompliance with SBHE policy 340.2 regarding written operating agreements and obtaining an annual financial statement audit.

Cause:

There are inadequate internal controls by the NDUS to ensure the affiliated organizations comply with the applicable SBHE policy.

Criteria:

SBHE policy 340.2, section 3, in part states, a nonprofit affiliate is a private legal entity separate from the institution and must be governed accordingly to protect the nonprofit affiliate's private, independent status. However, because the SBHE is responsible for ensuring the integrity and reputation of the NDUS, it must be assured of the manner in which any nonprofit affiliate will operate. Therefore, each institution and each nonprofit affiliate shall negotiate and maintain a written operating agreement.

SBHE policy 340.2, section 5, in part states, a requirement to provide the institution an annual GAAP audit of the nonprofit affiliate, or a draft of an audited financial statement submitted for but pending nonprofit affiliate board approval by September 15 each year.

Recommendation:

We recommend the NDUS ensure for all affiliated organizations that operating agreements exist, and an annual GAAP audit is completed by September 15 of each year.

University System Response/Planned Corrective Actions:

*NDUS will carefully review the recommendation and any associated internal processes and procedures and will implement improvements where appropriate. Subsequent to June 30, 2019, an operating agreement was signed between the one remaining affiliated organization and the institution.*



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## ***Governance Communication***

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November 26, 2019

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, 2019 and have issued our report thereon dated November 26, 2019. 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 July 11, 2019. 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 certain asset retirement obligations and certain disclosures related to debt by adopting Governmental Accounting Standards Board (GASB) Statement No. 83, *Certain Asset Retirement Obligations*, and GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, respectively, in fiscal year 2019. We noted no transactions entered into by the governmental unit 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
- Pension liability: \$162.1 million
- OPEB liability: \$7.1 million

- Scholarship allowance: \$65.9 million
- Allowance for uncollectible receivables:
  - Accounts: \$6.9 million
  - Loans and notes: \$4.6 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 letters dated November 14, 2019 and November 26, 2019.

### **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 2019 because the financial data for Dickinson State University Foundation was not included with the aggregate discretely presented component units in the North Dakota University System's financial statements.

## 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 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

November 26, 2019

## Audit Adjustments

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### Posted Audit Adjustments

DESCRIPTION		DR	CR	EXPLANATION/DISPOSITION
<b>1. SNP</b>				
<b>BSC</b>	Unrestricted net position	8,200,450		To restrict net position per GASB 34
	Net investment in capital assets		8,200,450	
<b>2. SNP</b>				
<b>MASU</b>	Expendable debt service	663,937		To restrict net position per GASB 34
	Unrestricted net position		663,937	
<b>3. SRECNP</b>				
<b>NDUS</b>	Other nonoperating revenues	404,395		To reclassify the elimination entry for the Student Loan Service Center charges
	State grants and contracts		404,395	

SNP – Statement of Net Position

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

## Passed Audit Adjustments

	DESCRIPTION	DR	CR	EXPLANATION/DISPOSITION
<b>1.</b>	<b>SNP</b>			
<b>NDSU</b>	Accounts payable and accrued liabilities Unrestricted net position	3,541,989	3,541,989	To project a likely error for expenses that were recorded in FY19, but not incurred until FY20
	<b>SRECNP</b>			
	Net increase/decrease Operating expenses	3,541,989	3,541,989	
<b>2.</b>	<b>SNP</b>			
<b>NDSU</b>	Unrestricted net position Accounts payable and accrued liabilities	659,457	659,457	To project a likely error for expenses that were paid and recorded in FY20, but were incurred in FY19
	<b>SRECNP</b>			
	Cost of sales and services Net increase/decrease	659,457	659,457	
<b>3.</b>	<b>SNP</b>			
<b>MASU</b>	Notes receivable, net - current Notes receivable, net - noncurrent	467,347	467,347	To reclassify notes receivable between current and noncurrent
<b>4.</b>	<b>SNP</b>			
<b>UND</b>	Accounts receivable, net Unrestricted net position	800,000	800,000	To record patient accounts receivable for payments received in July 2019 for FY19 services
	<b>SRECNP</b>			
	Net increase/decrease Auxiliary Revenue	800,000	800,000	
<b>5.</b>	<b>SRECNP</b>			
<b>DCB</b>	Federal grants and contracts	411,901		
<b>DSU</b>	Federal grants and contracts non-operating		411,901	To reclassify federal grants and contracts revenue for Pell, SEOG and TEACH to federal grants and contracts non-operating per GASB.
<b>MASU</b>				
<b>UND</b>				

SNP – Statement of Net Position

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



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**NORTH DAKOTA STATE AUDITOR'S OFFICE**

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