

PERFORMANCE AUDIT REPORT

Department of Commerce
Report No. 3027

August 11, 2009

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Honorable John Hoeven, Governor

Members of the North Dakota Legislative Assembly

Transmitted herewith is the performance audit report on aspects of the Department of Commerce. This report contains the results of our review of the adequacy of the department's monitoring system and the application process and monitoring of the Centers of Excellence.

We conducted this audit under the authority granted within North Dakota Century Code Chapter 54-10. Included in the report are the objectives and scope, findings and recommendations, and management responses.

We want to extend our appreciation to the staff of the Department of Commerce for their assistance and cooperation during this audit.

Sincerely,

Robert R. Peterson
State Auditor

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Executive Summary

Results and Findings

Recommendations addressed in this report are listed in Appendix A. Discussions relating to individual recommendations are included in Chapters 1 through 4.

Centers of Excellence Accountability

We determined the application process and monitoring of the Centers of Excellence has not provided adequate accountability for the use of state funds. No determination has been made as to whether the Centers of Excellence are having the desired economic impact as required by state law. There is a lack of formal policies and procedures for the application process, evaluating applications, monitoring Centers of Excellence, and matching requirements. We identified changes are necessary in determining approved funding amounts, entering into formal agreements, and monitoring compliance.

Monitoring Department Operations

We determined the Department of Commerce has not established an adequate system for monitoring department operations. We identified improvements are needed to have an effective department-wide monitoring function. Changes are needed with the monitoring of grant and loan programs to improve efficiencies and effectiveness. We identified changes are necessary to ensure compliance with state laws, legislative intent, and policies. Also, improvements are needed to ensure policies and procedures are reviewed and updated periodically.

Development Fund, Inc.

Our review of the Development Fund, Inc. identified improvements are needed. Improvements are needed to ensure policies are reviewed, updated, and complied with. There is a lack of documentation regarding the monitoring activities taking place with investments. In addition, we identified improvements are needed with the authority granted to staff, complying with open meeting requirements, and establishing a Code of Ethics.

Agricultural Products Utilization Commission

Our review of the Agricultural Products Utilization Commission (APUC) grant program identified improvements are needed. We identified changes are necessary to ensure compliance with North Dakota Administrative Code. Improvements are needed to ensure policies are reviewed, updated, and complied with. Changes with monitoring are necessary to improve efficiencies and effectiveness. A Code of Ethics should be established.

Centers of Excellence Accountability

Introduction

An objective of this performance audit was to answer the following question:

“Does the application process and monitoring of the Centers of Excellence provide adequate accountability for the use of state funds?”

We determined the application process and monitoring of the Centers of Excellence has not provided adequate accountability for the use of state funds. Significant improvements needed with the application process and monitoring are included in this chapter. Improvements of less significance were communicated in separate letters to management of the Department of Commerce and the Chair of the Centers of Excellence Commission.

To determine whether the application process and monitoring of the Centers of Excellence was providing adequate accountability for the use of state funds, we:

- Reviewed applicable laws and procedures;
- Reviewed 11 applications approved by the Centers of Excellence Commission;
- Reviewed 6 applications not approved by the Centers of Excellence Commission;
- Reviewed applicable monitoring procedures;
- Reviewed supporting documentation for selected Centers of Excellence at four campuses; and
- Interviewed selected personnel.

Centers of Excellence

Three Centers of Excellence have been granted such status pursuant to state law (established by the 2003 Legislature with a specific appropriation). Other Centers of Excellence receive the designation and funding through an application process. This process was established by the 2005 Legislature and was continued by the 2007 Legislature (\$20 million available each biennium). The State Board of Higher Education was originally provided the statutory authority to be administratively responsible for applications. The 2007 Legislature modified state law to require the Department of Commerce to be administratively responsible and assist with monitoring at the request of the Centers of Excellence Commission.

Applications are submitted to the Centers of Excellence Commission which is comprised of 6 members, 3 each from the State Board of Higher Education and the North Dakota Economic Development Foundation. The Commission makes funding recommendations for Commission approved applications to the State Board of Higher Education, the North Dakota Economic Development Foundation, the Emergency Commission, and the Budget Section. None of the applications approved by the Centers of Excellence Commission have been disapproved by the other governmental bodies.

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The Centers of Excellence Commission has approved 24 applications. Approved applicants must meet certain requirements in order to receive the funding. Two approved applicants were unable to meet such requirements and, thus, did not receive funding. Four Centers of Excellence have received funding twice (once in each biennium). See Appendix B for a listing of Centers of Excellence.

Determining Whether Centers are Having Desired Economic Impact

No analysis is readily available to measure whether the Centers of Excellence are having the desired economic impact.

North Dakota Century Code (NDCC) Section 15-69-04, Subsection 5 requires the Centers of Excellence Commission to “monitor the center’s activities in order to determine whether the center is having the desired economic impact.” Based on our review of information regarding the monitoring of the Centers of Excellence, there is no determination being made as to whether the Centers of Excellence are having the desired economic impact. We identified no comparisons performed on the desired economic impact in applications to what the actual economic impact has been. As a result, there is no analysis readily available to measure whether the Centers of Excellence are having the desired economic impact.

An economic impact report was completed by a professor of North Dakota State University. This report used 2007 payroll and expenditure data reported by the Centers of Excellence for computing the direct economic impact of the Centers of Excellence. We identified concerns related to the accuracy of the information reported by the Centers of Excellence. For example, supporting documentation included by a Center of Excellence did not agree with reported amounts. We also identified concerns with the accuracy of certain numbers within the economic impact report. For example, a table in the report identified 296.25 direct jobs and 408 secondary jobs created for a total employment effect of 799.25 (related to research and development activities). The total of the two numbers is 704.25. The 799.25 number is stated in various places of the report.

Recommendation 1-1

We recommend the Centers of Excellence Commission ensure compliance with North Dakota Century Code Section 15-69-04, Subsection 5 and determine whether Centers of Excellence are having the desired economic impact.

Management’s Response

Agree with the recommendation. The Centers of Excellence Commission will work with the Department of Commerce to develop a method to compare each Center’s desired economic impact with the actual economic impact being realized. The mathematical error contained in the economic impact report has been corrected.

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Making Improvements with Application Process

Applications to become a Center of Excellence are provided by and submitted to the Department of Commerce. An initial review of the applications is conducted by the Department of Commerce for completeness and compliance with legislative requirements. We identified improvements should be made with the review performed. Limited formal policies and procedures have been established by the Centers of Excellence Commission for the application process.

Ensuring Compliance with State Law

Budgeted expenditures included in an application did not appear to comply with state law.

In our review of 11 applications approved by the Centers of Excellence Commission, we identified an application included \$165,000 for two outreach programs (total amount approved for the project was \$2.95 million). The outreach programs are intended to motivate students to consider certain areas for study and career. While both outreach programs were in existence previous to the application, one of the programs (budgeted for \$105,000) would appear to use Centers of Excellence funding for supplanting current outreach operations. NDCC Section 15-69-05, Subsection 1 states:

“A center shall use funds awarded under this chapter to enhance capacity; enhance infrastructure; and leverage state, federal, and private sources of funding. A center awarded funds under this chapter may not use the funds to supplant funding for current operations or academic instructions or to pay indirect costs.”

The outreach programs do not appear to be within the legislative intent of the Centers of Excellence program. The use of Centers of Excellence funds to supplant current operations would result in noncompliance with state law (at the time of our review, no Centers of Excellence funds for this project had been expended). A discussion with a campus representative of this Center of Excellence identified outreach programs are a required part of federal grants in this area. Outreach programs are not a requirement of the Centers of Excellence program.

Recommendation 1-2

We recommend the Department of Commerce ensure applications provided to the Centers of Excellence Commission contain budgeted expenditures which are in compliance with state law.

Management’s Response

Agree with the recommendation. The Department of Commerce will review applicants’ budgeted expenditures to determine compliance with state law prior to consideration by the Centers of Excellence Commission.

Establishing Policies and Procedures

NDCC Section 15-69-04, Subsection 1 requires the Department of Commerce to forward completed applications to the Centers of Excellence Commission in accordance with guidelines established by the Commission. We determined no guidelines have been established.

In review of approved and disapproved applications, we identified the following:

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Policies and procedures should be established for the application process.

- Definitions for key terms used in the application process have not been identified. While one criteria for funding is determining whether the applicant will create “high-value private sector employment opportunities in this state,” no definition or other criteria for “high-value” has been established.
- While applicants identify a requested funding amount, the Commission can, and typically does, lower this funding amount in approving applications. The Commission has not established a formal policy regarding what is to be submitted by applicants when this occurs. During the 2007-2009 biennium, applicants were required to submit new applications reflecting the lowered funding amount. These new applications had to be submitted in a relatively short time period. For example, an application requesting \$3.5 million was recommended by the Commission to be funded at \$1.5 million. The campus needed to submit a new application within a week.
- Centers of Excellence who have previously been awarded funding are submitting additional applications in the subsequent biennium. We identified 4 Centers who received funding in two bienniums. While the Commission discussed receiving additional information on these Centers in the second biennium, an informal process was used to obtain information late in the application process.

Recommendation 1-3

We recommend the Centers of Excellence Commission establish formal policies and procedures for the application process. At a minimum, the policies should address:

- a) Definitions of key terms used in the application;
- b) Submission of revised applications, budgets, and/or other information when recommending a lesser amount than is being requested;
- c) Submission of information from Centers of Excellence previously receiving funding; and
- d) Completed applications being forwarded to the Commission.

Management’s Response

Agree with the recommendation. The Centers of Excellence Commission has now formalized in writing the policies and procedures for the application process which address the identified items.

Making Improvements to Application Evaluations

Once an application has been determined to be complete and in compliance with legislative requirements by the Department of Commerce, the application is provided to the Centers of Excellence Commission. Each applicant is provided time at a Commission meeting for a presentation on the application. Following such presentations, the Commission provides a preliminary recommendation for funding. In our review of the evaluation process of applications, we identified a lack of formal policies and procedures and requested funding amounts being lowered without a formal analysis. We also identified changes were needed with technical reviews and due diligence work being conducted.

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Establishing Policies and Procedures

Policies and procedures should be established for evaluating applications.

In considering whether to approve or disapprove an application, NDCC Section 15-69-04, Subsection 3 requires the Commission to consider various elements. For example, the Commission is to consider 9 elements such as whether the Center of Excellence will create high-value private sector employment opportunities in the state, leverage other funding, and become financially self-sustaining. The Centers of Excellence Commission has established no formal policies regarding how applications are to be approved and disapproved. We were unable to determine whether the Commission had adequately taken into consideration the established legislative elements when determining whether applications would be approved or disapproved. While an evaluation guide was developed when the Commission was established, the guide was not adopted. When previously funded Centers of Excellence requested additional funds in a subsequent biennium, the Commission used an informal process in collecting additional information and did not establish how previously funded Centers of Excellence would be evaluated for subsequent approval.

Recommendation 1-4

We recommend the Centers of Excellence Commission establish formal policies and procedures for the evaluation of applications. At a minimum, the policies should address:

- a) A process incorporating all elements in North Dakota Century Code for consideration in approving and disapproving applications; and
- b) Additional elements of consideration on applications from Centers of Excellence which were previously approved.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission has now formalized in writing the policies and procedures for the evaluation of applications.

Determining Approved Funding Amount

No formal analysis was conducted when requested funding amounts were reduced.

Applications submitted by campuses and college associated foundations to become Centers of Excellence include a requested funding amount. The Centers of Excellence Commission reduced the requested amount by 30% or more on 13 of 24 approved applications. There was no formal analysis conducted for determining the amount to be approved and no formal analysis on the impact of lowering requested amounts. In review of the Commission meeting minutes, it was apparent the Commission made the decision to attempt to fund as many projects as possible. Of the 7 applications which were fully approved at the requested amount, 5 were approved in the final round of application awards in the 2007-2009 biennium. The Commission had over \$15 million of the appropriated \$20 million to award. This was due to two previously approved applications (totaling \$4.6 million) not receiving funding as they were unable to meet requirements.

Recommendation 1-5

We recommend the Centers of Excellence Commission establish criteria to be used for determining the approved funding amount in applications and analyze the effects of changing requested funding amounts of projects.

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Management's Response

Agree with the recommendation. The Centers of Excellence Commission has now formalized in writing the criteria and process for determining the appropriate level of funding for a Center. This includes the process to analyze the effects of changing the requested funding amounts.

Establishing a Technical Review Process

The Centers of Excellence Commission has statutory authority to contract for independent, expert reviews of applications to determine whether proposed Centers of Excellence are viable and whether they are likely to have the desired economic impact. No such technical reviews have been performed on Centers of Excellence applications. The Commission has established no formal policies and procedures detailing a process for technical reviews. In review of the application process, it is unclear whether sufficient time would even be available to conduct technical reviews if it was determined necessary.

Recommendation 1-6

We recommend the Centers of Excellence Commission establish formal policies and procedures for technical reviews of applications. At a minimum, the policies should address:

- a) A process for identifying proposals requiring a review;
- b) Selection of a vendor to perform the review; and
- c) Ensuring sufficient time exists to allow a review to be performed.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission has now formalized in writing the policies and procedures used to determine whether an application requires a technical review.

Reviewing Due Diligence

Due diligence work was required to take place in a relatively short period of time.

After applications receive a preliminary recommendation for funding by the Centers of Excellence Commission, the applications have due diligence work performed on the private sector partners. This work is conducted by an employee of the Economic Development and Finance Division of the Department of Commerce. Information regarding likelihood of viability of the project, risks, matching requirements, job creation projections, and other areas are reviewed. We identified such work was required to take place in a relatively short period of time as a report on the due diligence was provided to the Commission at the following meeting (average time available for conducting the work was 11 calendar days).

We identified changes were made to the due diligence reports starting in the 2007-2009 biennium which alleviated certain concerns we had noted with previous reports. In our review of due diligence reports, we did identify concerns with certain work not being performed in the time allotted. For example, the private partner on one application who represented approximately 50% of the matching funds and 50% of the projected job creation was "unavailable for verification." This application was approved contingent upon the verification of the match (verification was received prior to the funds being released). Without proper due diligence being completed, significant concerns associated with an

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application may not be properly identified and taken into consideration by the Centers of Excellence Commission.

Recommendation 1-7

We recommend the Centers of Excellence Commission review the due diligence requirements and either:

- a) Move the due diligence work to the beginning of the application process; or
- b) Ensure an adequate amount of time is provided to allow the Department of Commerce to complete the due diligence work.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission has moved the due diligence work to the beginning of the application process for the upcoming funding round.

Entering into Formal Agreements

No formal agreements are entered into between the Centers of Excellence Commission and approved applicants. Thus, no contract provisions are specifically identified related to the appropriate use of funds and other requirements which must be followed.

As part of this audit, we selected 11 approved Centers of Excellence applications. Of the 11 approvals, one did not meet certain requirements and did not receive funding. The remaining 10 applications selected for review were Centers of Excellence at Dickinson State University, Lake Region State College, North Dakota State University, and the University of North Dakota. We reviewed supporting documentation for certain expenditures which were paid with Centers of Excellence funds. Our reviews identified the following:

Operating Expenditures

We reviewed 242 operating expenditures and identified 19 expenditures were not reasonable. We identified 2 expenditures (totaling over \$100,000) paid for tuition and fees on behalf of students taking courses at a university. State law prohibits the use of Centers of Excellence funds to supplant current operations or academic instruction. The use of Centers of Excellence funds to pay for student fees (such as mandatory activity fees and university fees) appears to supplant current operations. Due to the time involved with determining the fees charged to each individual enrolled in the particular classes, we did not identify a total amount associated with supplanting current operations. Also, we identified 5 expenditures (totaling approximately \$3,850) used Centers of Excellence funds for purposes which did not meet the intent of the approved project. For example, a campus paid travel expenses for an individual on a trip which was not related to the Center of Excellence. Other expenditures we identified as not being reasonable were a result of campuses' noncompliance with established purchasing policies and procedures.

We identified two expenditures in which Centers of Excellence funds appear to have been used to supplant current operations which is prohibited by state law.

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Salary Expenditures

We reviewed documentation supporting the use of Centers of Excellence funds for salaries for selected employees at each of the four campuses. The four campuses do not have standardized documentation supporting salary expenditures. We identified certain campuses were using Personnel Activity Confirmation Reports (PACR) to support salary expenditures. The reports reflect an employee's time charged to grants (typically federal). The employee is required to sign reports three times a year signifying the information is an accurate reflection of the time they spent on grants. Typically, an employee working on grant projects is not completing timesheets or logging their time and the PACR is the only support for charging salary costs to grants. Results of our review at each campus follow:

We identified concerns related to the support for salaries paid with Centers of Excellence funds.

- Dickinson State University: we reviewed 12 PACR at this campus and identified 3 reports as not being signed in a timely fashion and one report was signed prior to work being performed.
- Lake Region State College: this campus is only completing PACR for federal grants. Thus, the campus had no PACR to support salaries paid with Centers of Excellence funds. Also, there were no timesheets or other evidence to support salaries being paid with Centers of Excellence funds.
- North Dakota State University: a department on this campus completes timesheets rather than using a PACR to document their time worked on projects. We identified no concerns with the use of timesheets to support salaries paid with Centers of Excellence funds. Of the 25 PACR reviewed, we identified 9 were not signed within two months of the end of the period covered by the report.
- University of North Dakota: we reviewed 51 PACR at this campus and identified 21 reports as not being signed in a timely fashion.

When PACR are not signed in a timely manner, it is unclear how employees can accurately recall how their time was spent on various projects from several months prior. Without reliable and accurate information being completed, the reasonableness of salaries being paid with Centers of Excellence funds could be questionable.

Recommendation 1-8

We recommend the Centers of Excellence Commission enter into formal agreements with approved applicants. At a minimum, the agreements should address:

- a) Criteria for the use of state funds;
- b) Documentation requirements for payroll expenses; and
- c) Compliance with applicable purchasing policies.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission will enter into formal agreements with approved applicants which will address the identified items.

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Making Improvements with Monitoring Process

State law requires the activities of the Centers of Excellence to be monitored for a minimum of 6 years and no more than 10 years. In our review of the monitoring performed on the Centers of Excellence, we identified a lack of formal policies and procedures. Also, improvements were needed to have monitoring be more efficient and effective, to ensure required audits have been performed, and to evaluate performance on current criteria.

Updating Functional Review

The functional review is an annual report completed by the Centers of Excellence themselves which is then submitted to the Department of Commerce. This self-reporting process requires the Centers of Excellence to provide updates, progress information, and the status of the project. The Centers of Excellence are specifically required to provide information in 12 areas. Examples include documenting the \$2/\$1 match, project timeline, and tracking expenditures.

Using the same applications we selected for reviewing expenditure information, we obtained copies of functional reviews submitted by certain Centers of Excellence. In our review of the information, we identified a number of concerns related to various aspects including:

- Match amounts included in the application were not addressed in the functional review. For example, an application lists \$775,000 of in-kind matches from North Dakota companies. Information related to these matches was not addressed by the Center of Excellence in the functional review.
- The functional review states the Centers of Excellence should attach support to corroborate reported contributions. A donor letter or other documentation was not attached as support to a functional review listing in-kind contribution of \$383,000 for use of equipment from corporate partners. Also, we identified no donor letters of intent for 5 cash donors listed (total of \$50,000) in the functional review.
- Inconsistencies in reporting information were identified in various functional reviews. For example, summary financial information attached to the functional review did not agree to what was included in the functional review itself. Also, the functional review requests information on private sector equivalent jobs created. These are defined as jobs created at the university whose salaries are not paid by state general fund dollars. While a Center of Excellence identified no private sector equivalent jobs being created, we identified four positions being created which were paid in full or 50% from Centers of Excellence funds.

Improvements are
needed with the self-
reporting process.

In addition to the above concerns, we identified a number of questions on the functional review do not appear to be relevant to the purpose of the functional review or improve the accountability of the Centers of Excellence. For example, Centers of Excellence are required to identify the cost per job. Such information does not appear to have been used as a means of assessing the program.

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Recommendation 1-9

We recommend the Centers of Excellence Commission update the functional review to improve the efficiency and effectiveness of the monitoring and reporting process.

Management's Response

Agree with the recommendation. On June 3, 2009 the Centers of Excellence Commission authorized the Department of Commerce to update the functional review format. The functional review format has been updated.

Establishing Policies and Procedures

Policies and procedures should be established for monitoring the progress of Centers of Excellence.

NDCC Section 15-69-04, Subsection 2 states, in part, the Centers of Excellence Commission has the responsibility to "monitor centers for compliance with award requirements; review changes in assertions made in center applications; and conduct postaward monitoring of centers." In our review of the monitoring process, we identified no formal policies and procedures for monitoring the progress of the Centers of Excellence. While certain procedures have been established for monitoring, we identified such procedures were not efficient or effective for monitoring the Centers of Excellence. As a result, the monitoring system does not provide adequate accountability of the use of state funds.

As previously mentioned in this audit report, we identified certain concerns with how state funds have been used as well as information reported by Centers of Excellence in the functional review. We identified no specific meetings held by the Centers of Excellence Commission for the purpose of receiving information on monitoring or meetings in which functional reviews were reviewed by the Commission. While the Department of Commerce did conduct on-site visits with Centers of Excellence in late calendar year 2008, contacts with Centers of Excellence could be made on a more frequent basis.

Recommendation 1-10

We recommend the Centers of Excellence Commission establish formal policies and procedures for monitoring the Centers of Excellence. At a minimum, the policies should address:

- a) Establishing quarterly monitoring requirements;
- b) Assessing job creation activities;
- c) Assessing significant variations from the applications;
- d) Establishing different reviews after the match has been met or after a specified period of time has expired; and
- e) Establishing the frequency of updates to the Commission and/or holding meetings specifically for monitoring.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission has now formalized in writing the policies and procedures for monitoring the Centers of Excellence which address the identified items.

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Complying with Annual Audit Requirement

NDCC Section 15-69-05, Subsection 2 states, in part:

“As a condition for receipt of funds under this chapter, a center shall agree to provide the board, foundation, and budget section of the legislative council with annual audits on all funds distributed to the center under this chapter.”

Annual audits required by state law are not being conducted.

The Centers of Excellence engaged accounting firms to perform certain agreed-upon procedures on the funds received. Examples of procedures performed included reviewing cash match and other contributions received, reviewing support for jobs created, and reviewing a sample of expenditures for compliance with state law. We identified two Centers of Excellence combined their agreed-upon procedures work for two years rather than having the work done annually. We also identified one Center of Excellence did not have work done for one year.

The agreed-upon procedures work was done in an attempt to comply with the annual audit requirement in state law. Based on our review of the agreed-upon procedures work and other information, we conclude such work is not an “audit.” No assertions are being tested by auditors and the auditors are expressing no opinions.

Recommendation 1-11

We recommend the Centers of Excellence Commission monitor compliance with North Dakota Century Code Section 15-69-05, Subsection 2 and ensure annual audits are completed or take appropriate action to modify the requirement for annual audits of Centers of Excellence.

Management’s Response

Agree with the recommendation. The Centers of Excellence Commission intends to request that the legislature clarify whether a full fiscal audit is required. The Commission is currently considering its options on how best to proceed with the annual audit requirement prior to the next legislative session.

Requiring Annual, Measurable Goals/Objectives

In monitoring the Centers of Excellence, selected information on the progress of the Centers of Excellence is obtained. Comparing the progress of Centers of Excellence to expectations can be difficult as certain projects may take an extended period of time to be completed. Thus, a determination whether expectations are being met or were achieved may not be accomplished for a long period of time. Also, changes with partners may occur or other factors can change which delay projects and have an impact on measuring performance of the Centers of Excellence. Monitoring of the Centers of Excellence is required by statute to be performed for a minimum of six years. The expectations identified in applications may not provide an effective means for monitoring year to year performance. Measuring performance should be based on current criteria.

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Recommendation 1-12

We recommend the Centers of Excellence Commission require the Centers of Excellence to establish measurable goals and objectives at least annually.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission will request each applicant to submit measurable goals and objectives as part of their application. In addition, each Center will be required to submit measurable goals and objectives on an annual basis.

Identifying Actions to Take

In our review of aspects of the Centers of Excellence, we identified noncompliance issues related to state law, noncompliance with reporting requirements, and indications of Centers of Excellence not meeting expectations. For example:

- Centers of Excellence funds appear to have been used to supplant current operations which is prohibited by state law.
- When reporting information in the functional review, Centers of Excellence are required to attach support to corroborate reported contributions. In certain functional reviews, we identified a lack of support and support which was not consistent with reported amounts.
- One Center of Excellence application projected job creation of 35-38 private sector positions. Based on information provided by the Center of Excellence, a total of one private sector job and six positions at the university have been created in the three year span of the project.
- One Center of Excellence received their total approved amount of \$2 million in May 2006. Information in the 2008 functional review identified only \$2.7 million in matching funds had been obtained (\$4 million required).

Policies and procedures should be established to identify actions to take when noncompliance exists and expectations are not being met.

The Centers of Excellence Commission has no established policies for actions to be taken by either the Commission or the Department of Commerce when noncompliance issues are identified or when expectations are not being met. For the 2007-2009 biennium, the Department of Commerce received legislative authority and established a process in which the Centers of Excellence were not awarded the full amount approved at the beginning of the project. Rather, the Department of Commerce set up a payment schedule for each Center of Excellence in order to obtain information prior to release of additional funds.

Recommendation 1-13

We recommend the Centers of Excellence Commission establish formal policies and procedures addressing actions to be taken when Centers of Excellence are in noncompliance with requirements and when Centers of Excellence are not meeting stated expectations.

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Management's Response

Agree with the recommendation. The Centers of Excellence Commission will establish written policies and procedures addressing action to be taken when Centers are not in compliance with requirements or are not meeting stated expectations. These policies and procedures may include provisions being inserted into the formal award agreements with the Centers on what the actions will be. Any potential actions will be within the authority granted to the Commission in state law.

Establishing Policies and Procedures for Matching

The purpose of the first objective of the functional review is to document the receipt of cash or commitment of in-kind contributions declared in the application. This is done in an attempt to confirm \$2 of private sector or other funds were received for each \$1 of state funds. The purpose of the second objective in the functional review is to have Centers of Excellence document other funds obtained not identified in the application ("leveraged" funds). We identified inconsistencies with the reporting and verification of these funds. For example:

- Centers of Excellence were not providing information as to match amounts or leveraged funds identified in the application.
- Amounts reported were not accurate or supported by documentation. A donor letter or other documentation was not attached as support to a functional review listing in-kind contribution of \$383,000 for use of equipment from corporate partners.
- While the functional review requests information as to the cash amount received as of the date of review, we identified Centers of Excellence used reports reflecting requests for reimbursement from federal agencies rather than reporting the actual amount of cash received.

Policies and procedures should be established related to verification of matching or leveraged funds received.

The Centers of Excellence Commission has no established policies or procedures related to verification of matching or leveraged funds being received. In certain instances, the letters of commitment included in the application continue to be used as supporting documentation by the Centers of Excellence in the functional reviews.

Recommendation 1-14

We recommend the Centers of Excellence Commission establish formal policies and procedures related to matching requirements. At a minimum, the policies should address:

- a) Required documentation to receive Centers of Excellence funds after an application is approved; and
- b) Requirements for verifying match and leverage amounts are actually received.

Management's Response

Agree with the recommendation. The Centers of Excellence Commission will formalize in writing the policies and procedures related to matching requirements.

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Establishing Orientation Training

When the Centers of Excellence Commission was established (2005 Session Law), a Code of Ethics was adopted which required provisions of the code to be reviewed and signed by each Commission member at the time of appointment. Commission members were not signing a statement regarding their review of the Code of Ethics. We also identified no formal orientation training process for newly appointed members.

Recommendation 1-15

We recommend the Centers of Excellence Commission establish a formal orientation training process for its members. At a minimum, the process should include:

- a) Identifying all state law requirements of the Commission; and
- b) Ensuring compliance with Code of Ethics requirements.

Management's Response

Agree with the recommendation. A formal orientation and training process has now been established. The most recently appointed Centers of Excellence Commission member has been through this process and the existing members have received the orientation materials. Each current member of the Centers of Excellence Commission has signed an acknowledgement agreeing to the Code of Ethics requirements.

Centers of Excellence Established in State Law

The 2003 Legislature established the following three Centers of Excellence within state law (specific appropriation amount for each is in parenthesis):

- North Dakota State University Beef Systems Center of Excellence (\$800,000)
- North Dakota State University Center for Technology Enterprise (\$1.25 million)
- University of North Dakota Center for Innovation (\$800,000)

These particular Centers of Excellence are not monitored by the Centers of Excellence Commission. Also, the three are not required to have an annual audit conducted as is required of those approved by the Centers of Excellence Commission.

We had discussions with representatives of the Center for Technology Enterprise (now called the Research and Technology Park) regarding the use of state funds, operations, and history. We also toured the facility in Fargo.

We reviewed a lease agreement between North Dakota State University (NDSU) and the Research and Technology Park. The agreement identifies 55 acres of state owned land is leased to the Research and Technology Park for \$1 per year for 75 years. We identified a similar agreement at the University of North Dakota (UND) entered into with the UND Research Foundation for the Center of Excellence in Life Sciences and Advanced Technologies (\$1 per year for 30 years). We had

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concerns regarding the lease of state land for a low dollar amount. Based on discussions with a representative of the Office of the Attorney General, the authority granted in state law to the State Board of Higher Education would appear to make such lease agreements legal and would not violate constitutional provisions.

We conducted a limited review of the Beef Systems Center of Excellence. We had discussions with representatives regarding the use of state funds, operations, and history. We also toured the facility in Fargo. We reviewed 15 expenditures of this Center of Excellence and determined two of the expenditures used state funds inappropriately. While the amount of the expenditures is nominal (approximately \$330), appropriated funds were not used for their intended purpose. A NDSU representative stated both expenditures were inadvertently posted to the Center of Excellence.

Monitoring Department Operations

Introduction

An objective of this performance audit was to answer the following question:

“Has an adequate system for monitoring operations of the Department of Commerce been established?”

We determined an adequate system for monitoring operations of the Department of Commerce (Commerce) has not been established. While Commerce has made certain changes with monitoring since it was established in 2001, additional improvements are needed. Significant improvements needed with monitoring are included in this chapter. Improvements of less significance were communicated in a separate letter to management.

To determine whether an adequate system for monitoring operations of Commerce had been established, we:

- Reviewed applicable laws, polices, and procedures;
- Reviewed 6 grant and loan programs administered by Commerce (information related to our review of the Development Fund, Inc. and the Agricultural Products Utilization Commission is included in Chapters 3 and 4 respectively);
- Reviewed established plans, performance measures, and benchmarks;
- Reviewed applicable studies and reports;
- Reviewed supporting documentation for selected expenditures; and
- Interviewed selected personnel.

Establishing Department-Wide Monitoring

Improvements are needed to have an effective department-wide monitoring function.

Through our review of limited aspects of Commerce, we identified a number of areas where improvements were needed. Improvements related to compliance, efficiencies, and other areas were identified and are addressed in this chapter as well as Chapters 3 and 4. There is a lack of centralization of functions and uniform processes as each division within Commerce appears to operate independently of other divisions. We identified limited department-wide monitoring efforts of Commerce have been established.

In review of recent legislative changes related to Commerce, we identified a number of programs and various requirements have been added. Commerce needs to invest a significant amount of time establishing appropriate processes and procedures for these new duties. This, in turn, takes away resources available to existing operations.

Recommendation 2-1

We recommend the Department of Commerce establish an effective department-wide monitoring function emphasizing compliance, consolidation of processes and procedures, and efficient operations. If reallocating resources is not possible to establish such a function, the Department should take appropriate action to obtain additional full-time equivalent positions and/or other necessary resources.

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Management's Response

Commerce agrees with the recommendation and will review available resources and determine whether it is possible to reallocate resources or if Commerce will need to seek additional full-time equivalent positions to establish a department-wide monitoring function.

Making Improvements to Monitoring the Community Development Block Grant Program

As part of the performance audit, we selected certain grant and loan programs to review. Our review of the Community Development Block Grant (CDBG) program identified improvements were needed. We identified administrative costs at the local level were not adequately monitored. In addition, other monitoring improvements should be made and changes are needed with certain contracts.

The CDBG program provides financial assistance to eligible units of local governments in the form of grants and loans for public facilities, housing rehabilitation, and economic development projects. The primary beneficiaries of these projects must be low income individuals. The federal CDBG program was established by Congress in the Housing and Community Development Act of 1974. In 1981, Congress amended the act to authorize state governments to administer the State CDBG Program. The Division of Community Services within Commerce administers the program.

Verifying Administrative Costs are Adequately Supported and Reasonable

The CDBG grant funds provided to local governments include funds to pay for project costs and grant administration costs. We identified Commerce monitors the use of the project funds provided. However, there is no monitoring of the funds provided to local governments for administration costs.

Federal funds provided for local grant administration are not monitored.

Local governments enter into contracts with their respective Regional Planning Council for grant administration. Program information identified by Commerce estimated over \$300,000 a year of CDBG funds were used for local grant administration. We identified concerns regarding a lack of support for expenditures incurred by the councils. As a result, federal funds could be put at risk.

Recommendation 2-2

We recommend the Department of Commerce ensure administrative costs of local recipients paid with Community Development Block Grant funds are reasonable and adequately supported.

Management's Response

Commerce agrees with the recommendation. Commerce believed the current process reasonably monitored the administrative costs of the local recipients. In order to evaluate the current process, we intend, in consultation with the Auditor's Office, that this issue will be presented to the U.S. Department of Housing and Urban Development (HUD) and the formal guidance provided by them (signed by an appropriate federal official) will be followed.

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Improving Monitoring

Commerce performs grant administration work which should be performed at the local level.

The CDBG program reimburses local governments for work performed on the project when Request for Funds is submitted. Except in certain circumstances, Commerce does not require supporting documentation to be submitted when a Request for Funds is submitted. However, in review of 25 projects, we identified the majority of requests include supporting documentation. Commerce invests time to review such documentation and determines whether expenditures are appropriate. Such grant administration work should be performed at the local level, not by Commerce. CDBG funding is provided to local governments specifically for grant administration on each project.

In grant administration, it is not a common practice to require all support to be submitted when funds are requested. Typically, grantees are required to maintain supporting documentation and provide it only when requested. The current process of Commerce reviewing supporting documentation on Requests for Funds is not an efficient or effective use of time.

Recommendation 2-3

We recommend the Department of Commerce make improvements to Community Development Block Grant program monitoring processes to increase efficiency and effectiveness. At a minimum, the Department of Commerce should:

- a) Identify information to the grant administrators on their responsibilities and duties;
- b) No longer accept and review supporting documentation on all Request for Funds; and
- c) Periodically select various grants and loans to verify adequate support for expenditures is retained.

Management's Response

Commerce agrees with part A of the recommendation and beginning Oct. 1, 2009, grant administrative duties and responsibilities will be listed on CDBG awards. Commerce disagrees with part B and C of the recommendation. Commerce believes it is in the best interest of the program to determine the amount of review needed. Commerce intends to continue to collect supporting documentation on all projects and will continue its practice of reviewing selected information.

State Auditor's Concluding Remarks

Management's response states it will continue to collect supporting documentation on all projects and will continue reviewing selected information. Collecting documentation which will not be reviewed is highly inefficient and we question the benefit of having to maintain such documentation when it is not to be used by Commerce.

Reviewing supporting documentation for all Request for Funds is also inefficient. Reviewing detailed supporting documentation to determine appropriateness is a primary duty of grant administration. Commerce provides over \$300,000 a year to local governments for grant administration. If adequate grant administration is not being provided at the local level, Commerce should evaluate the reasonableness of dollars being expended for a service which is not adequately performed. If

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Commerce is going to have to continue to perform grant administration services, it should be compensated for this responsibility (withhold federal funds for administration purposes) and ensure adequate resources are available to perform this function.

Improving Contracts with Regional Planning Councils

Certain regions use a scoring system weighted relatively high on subjective criteria to evaluate applications.

Commerce enters into a contract with each Regional Planning Council for the evaluation of applications to receive CDBG funding. The top ranked applications at the regional level are forwarded to Commerce for approval. Each of the 8 councils has developed their own scoring and ranking systems. In limited review of scoring systems, we identified a relatively large amount of the total score was based on subjective criteria. For example, one Regional Planning Council uses 60% subjective criteria and 40% objective criteria to rank each project to determine those which will be forwarded to Commerce.

The contract with the Regional Planning Councils contains Code of Conduct and Conflict of Interest statements which prohibits council members from obtaining a financial interest or benefit. However, neither statement requires members to sign acknowledgment of these statements on an annual basis. There is no assurance all council members evaluating applications are aware of applicable requirements and their responsibilities in making decisions regarding the use of federal funds.

Recommendation 2-4

We recommend the Department of Commerce make changes to the contracts entered into with the Regional Planning Councils for scoring and ranking Community Development Block Grant applications. At a minimum, the contracts should:

- a) Identify a maximum amount for subjective scores; and
- b) Require a Conflict of Interest and/or Code of Conduct statement be developed and signed annually by individuals conducting the scoring and ranking of applications.

Management's Response

Commerce agrees with part B of the recommendation and will require signed Conflict of Interest statements from all board members participating in regional scoring and ranking sessions. Commerce disagrees with part A of the recommendation and will continue with the current scoring and ranking system, due to the unique needs and objectives of the eight regions.

Improving the Operation Intern Program

As part of the performance audit, we selected certain grant and loan programs to review. Our review of the Operation Intern grant program identified improvements were needed. We identified concerns with contract administration and monitoring procedures. We also identified improvements were needed with verifying student eligibility and obtaining reviews.

The Operation Intern program was created by the 2007 Legislature. The program provides matching funds to support the expansion of internships

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and work experience opportunities with North Dakota employers for students enrolled in a postsecondary school in the state. Commerce will pay 50% of the students' salary with a maximum of \$3,000 per student per year. Each student can participate in the program for up to two years.

Making Improvements with Monitoring

The Operation Intern program reimburses employers for student interns' salary expenses. Commerce requires employers to submit supporting documentation for every reimbursement request. This is a significant amount of information being submitted, including time sheets, payroll reports, etc. In grant administration, it is not a common practice to require all support to be submitted when funds are requested. Typically, grantees are required to maintain supporting documentation and provide it only when requested. Also, our review of other fiscal monitoring performed by Commerce identified the same information was being reviewed multiple times. The monitoring procedures are not an efficient or effective use of time.

Recommendation 2-5

We recommend the Department of Commerce make improvements to Operation Intern monitoring procedures to increase efficiency and effectiveness. At a minimum, the Department of Commerce should:

- a) No longer require supporting documentation be submitted for all Requests for Funds;
- b) Periodically select various employers to verify adequate support for expenditures is retained; and
- c) Eliminate redundant monitoring processes.

Management's Response

Commerce agrees with the recommendation and effective September 1, 2009, supporting documentation will no longer be required at the time of the Request for Funds. Commerce will select various employers to verify that adequate support for expenditures has been retained. Commerce has begun to review and will continue to review our monitoring processes to eliminate redundancy.

Verifying Eligibility and Providing Information

Commerce requests certain information from students participating in Operation Intern. Students are to certify on the application form they are a United States citizen and are enrolled in a North Dakota college or university. Other eligibility requirements established by Commerce include:

- Minimum 2.75 GPA;
- Not delinquent on student loans; and
- Applying for an experience that corresponds with his or her academic major or course of study.

Student eligibility requirements are not verified.

In review of information and in discussion with Commerce representatives, eligibility requirements are not verified. Thus, there is limited assurance students have met eligibility requirements. Rather than Commerce investing the necessary resources, assurance of eligibility could be obtained by requiring employers to verify certain

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information (such as obtaining a transcript from the students). Employers are in a better position to verify eligibility than Commerce.

To assist in monitoring the program, Commerce requests students and employers to complete midpoint and exit reviews. These communications are used by Commerce to evaluate the students' and employers' experiences during the internships. In review of selected files we identified 7 out of 9 employers did not have all midpoint reviews completed during the internships. Additionally, 5 out of 6 employers did not have exit reviews completed following the internships. Employers have relationships with the students and should be able to initiate such reviews being performed rather than Commerce. This should assist in increasing the response rate to a more appropriate level.

Recommendation 2-6

We recommend the Department of Commerce include requirements in the Operation Intern contracts to have employers:

- a) Verify student eligibility and maintain documentation confirming eligibility; and
- b) Provide the midpoint and exit review materials to students at the appropriate time during the internships.

Management's Response

Commerce agrees with the recommendation and will include employer requirements in Operation Intern contracts. We will ask employers to verify student eligibility and maintain documentation confirming eligibility. Commerce has begun to provide employers with an electronic survey of midpoint and exit student reviews. We will encourage the use of this survey tool to gather valuable program feedback.

Making Improvements with Contracts

Commerce enters into a contract with employers for the Operation Intern program. Our review of the contract identified standard terms and conditions were not consistent with the guidelines established by the Office of the Attorney General. Commerce representatives stated the Operation Intern contract has not been reviewed by legal counsel.

A new contract is entered into by Commerce for changes made to contractual terms. A standard contract amendment document would make such changes more efficient.

In review of 9 employers, we identified 5 employers were reimbursed for costs which were incurred prior to contracts being executed. Also, we identified 2 instances in which contract extensions were executed after the expenditures had already been incurred.

Recommendation 2-7

We recommend the Department of Commerce make improvements to the Operation Intern program contracts. At a minimum, the Department of Commerce should:

- a) Develop a contract template using recommended language from the Office of the Attorney General's Contract Drafting and Review Manual;
- b) Develop a contract amendment document;

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- c) Ensure the contract template and amendment are reviewed and approved by legal counsel; and
- d) Ensure contracts with employers and applicable amendments are executed prior to students beginning work.

Management's Response

Commerce agrees with the recommendation and will make improvements to the Operation Intern program contracts in consultation with the Attorney General's Office.

Improving Tourism Infrastructure and Expansion Grants

Our review of the Tourism Infrastructure and Expansion Grant Program identified improvements were needed. We identified noncompliance with a program policy and identified no formal agreements were entered into with grant recipients.

Tourism Infrastructure and Expansion Grants support new or expanding tourism facilities, recreation facilities, and designated development areas primarily through infrastructure projects. Non-profit organizations may apply to Commerce for infrastructure project funding. A project may receive a maximum award of \$24,000. Organizations must have a cash match of at least 50% of the award.

Complying with Grant Policy

A policy was established for the Tourism Infrastructure and Expansion Grant Program identifying the criteria to receive a grant. One criteria required applicants to provide a cash match. In review of six grants, we identified one applicant used a land donation as its match. The Tourism Director stated an exception was made for this project as this type of attraction is in high demand. If the land value was excluded from the match amount, it appears the project would have been ineligible for consideration. Changing criteria can lead to an unfair process as potential applicants may not have applied due to not meeting stated criteria.

Recommendation 2-8

We recommend the Department of Commerce comply with its policy when evaluating Tourism Infrastructure and Expansion Grant Applications to provide a fair system for all potential applicants.

Management's Response

Commerce agrees with the recommendation and will comply with our policy in reviewing Tourism Infrastructure and Expansion grant applications. The policy has been revised to allow for real estate and equipment.

Entering Into Formal Agreements

Commerce sends a letter to recipients notifying them when they have been approved for a Tourism Infrastructure and Expansion Grant. No formal agreement is entered into with recipients containing appropriate grant language, providing the appropriate liability/insurance coverage for the state, and reducing the risk involved with funds being spent inappropriately.

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Recommendation 2-9

We recommend the Department of Commerce enter into formal agreements with Tourism Infrastructure and Expansion Grant recipients.

Management's Response

Commerce agrees with the recommendation and is drafting a formal agreement to be included with the next grant award letters.

Complying with North Dakota Century Code

Through a review of North Dakota Century Code (NDCC) and discussions with Commerce representatives, we identified improvements were needed to ensure Commerce was in compliance with state law requirements. A process for periodically reviewing state law should be established and appropriate actions may need to be taken to make changes to state law.

Ensuring Compliance with North Dakota Century Code

In a review of selected NDCC requirements, we identified instances in which Commerce appeared to be in noncompliance. Examples include:

- NDCC Section 54-44.5-08 requires the Division of Community Services to inform all state agencies and institutions of the State Facility Energy Improvement Program by August 15 of each odd-numbered year. The notification is provided through a letter sent to all state facility managers with information on how to apply for funding to improve energy efficiency at their facilities. No letter appears to have been sent in 2007.
- Prior to the 2009 Legislative Session, NDCC Section 54-34.4-04 required a North Dakota motion picture development office to be a part of the Division of Tourism. We identified Commerce was in noncompliance with this section as no such office was in existence for an extended period of time. While the office was apparently funded and staffed at one time, the Tourism Director stated the office had not been in existence for at least six years. At the request of Commerce, the motion picture development office language was removed from NDCC by the 2009 Legislature.
- Prior to the 2009 Legislative Session, NDCC Section 54-60-03 stated the Commerce Commissioner was to prepare a list of economic development moneys included in budget requests of certain agencies. We identified this was not being accomplished. This requirement of the Commissioner was removed from NDCC by the 2009 Legislature.

Improvements are needed to ensure compliance with state law.

Recommendation 2-10

We recommend the Department of Commerce periodically review applicable North Dakota Century Code sections and ensure compliance with requirements or take appropriate action to make changes.

Management's Response

Commerce agrees with the recommendation and will continue to strive to comply or will take the appropriate action to make changes.

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Making Improvements with the Value-Added Agriculture Promotion Board

NDCC Section 54-34.3-12 establishes the Value-Added Agriculture Promotion Board. The Board consists of a minimum of nine and a maximum of eleven members. Prior to the 2007 Legislative Session, the Board's role included reviewing proposals for value added agriculture projects, prioritizing projects, and appointing financing advisory groups for projects. In review of information, it appears Commerce was reviewing projects without consulting the Board due to the rapid change and development of projects. The 2007 Legislature modified the Board's role to:

- a) Serve in an advisory role to the Commissioner of Commerce on issues related to value-added agriculture;
- b) Meet at times determined by the Commissioner; and
- c) Promote the formation, development, and growth of value-added agriculture projects across the state.

At the time of our review, the Board had not met in nearly three years. We are unsure how the Board is fulfilling its responsibilities. In addition, while state law requires the Board to consist of at least 9 members, the total number of members is 8.

Recommendation 2-11

We recommend the Department of Commerce make improvements with the Value-Added Agriculture Promotion Board by either

- a) Ensuring compliance with state law requirements; or
- b) Taking appropriate action to amend state law.

Management's Response

Commerce agrees with the recommendation. Commerce anticipates taking action to amend state law to either eliminate the Value-Added Agriculture Promotion Board or more carefully prescribe its role and its discretionary status.

Complying with Open Meeting Requirements

The North Dakota Commerce Cabinet is comprised of the directors of each Commerce division, executive heads of certain other state agencies, and the Commerce Commissioner. The Cabinet is to coordinate and communicate economic development and tourism efforts of the agencies represented. We identified the Cabinet is in noncompliance with open meeting requirements as no public notice is given in advance of meetings as required.

Recommendation 2-12

We recommend the Department of Commerce ensure the Commerce Cabinet complies with state law requirements related to meetings of public entities or take appropriate action to modify state laws.

Management's Response

Commerce agrees with the recommendation and has now implemented the requirements related to meetings of public entities.

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Making Improvements with Procurement

Based on a review of the Department of Commerce procurement process, we identified improvements were needed. We identified payments were made before services were performed. In addition, we identified changes were needed to improve compliance with procurement laws and policies.

Improving Payments for Services

In review of payments, we identified the Department of Commerce was making pre-payments to contractors. For example, a contract required Commerce to pay \$36,000 in advance of services being received. Also, while Commerce typically withholds final payments to presenters or promotional representatives until services are received, we did identify a payment was made before the event was held.

Payments were made in advance of services being performed.

When advance payments are made, there is a risk the goods or services will not be received or required specifications will not be met. Withholding payment until satisfactory performance has been accomplished is one way to ensure the state receives goods or services in compliance with contract terms.

Recommendation 2-13

We recommend the Department of Commerce ensure contractual payments are made after services have been performed to the department's satisfaction.

Management's Response

Commerce agrees with the recommendation and has improved our procurement process to ensure contractual payments are generally made after services have been performed. Commerce also understands that some exceptions are permitted and will ensure that all exceptions will be in accordance with information provided to us by the State Auditor's Office.

Complying with Purchasing Policies and Procedures

In a review of 63 procurement related expenditures, we identified 7 instances of noncompliance with procurement laws, policies, and procedures. For example, we identified Commerce purchased software (\$13,000) from a vendor no longer included on the state contract for software. In the Department of Commerce financial audit report for the biennium ended June 30, 2007, a recommendation was made related to noncompliance with procurement requirements. While Commerce has made certain changes to the procurement process, improvements are still needed to ensure compliance.

Recommendation 2-14

We recommend the Department of Commerce make improvements to procurement processes to ensure compliance with laws and policies.

Management's Response

Commerce agrees with the recommendation and will make improvements with our procurement processes to ensure compliance with laws and policies.

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Improving Monitoring of Contracts

In review of 5 contracts, we identified improvements were needed with the monitoring of contracts. For example, in all 5 contracts reviewed, appropriate insurance documentation was not obtained and/or the insurance documentation did not identify the appropriate insurance requirements as required by the contract. We identified inconsistencies with documenting changes to contracts and changes were needed with centralizing contract administration.

Recommendation 2-15

We recommend the Department of Commerce make improvements with the monitoring of contracts. At a minimum, the Department of Commerce should:

- a) Centralize contract administration and record keeping; and
- b) Ensure appropriate insurance certificates or endorsements are obtained.

Management's Response

Commerce agrees with the recommendation and will make improvements with the monitoring of contracts.

Complying with Legislative Intent

In review of Session Laws and Commerce expenditure information, we identified improvements were needed to ensure compliance with legislative intent. Two instances identified included:

- Starting in the 2001-2003 biennium and continuing through the next two bienniums, Commerce's appropriation included a line item funding amount for "Lewis and Clark bicentennial." In review of 5 expenditures paid by Lewis and Clark appropriated funds, we identified one expenditure was unrelated to Lewis and Clark activities (\$4,000). While Commerce representatives stated they believed this line item was intended to pay for more than just Lewis and Clark activities, our review identified the specific appropriation was required to be expended only on Lewis and Clark activities. We also identified the other four expenditures reviewed included Lewis and Clark and non Lewis and Clark expenses related to other tourism areas. Lewis and Clark appropriated funds paid for the entire expenditure. Commerce representatives stated splitting bills and allocating costs would have been time consuming. Also, Commerce representatives stated other funding sources were used to pay for Lewis and Clark activities. However, no listing was maintained of Lewis and Clark activities paid with other funds.
- Based on a review of legislative information, the 2005 Legislature provided one full-time equivalent (FTE) position to Commerce for operating an American Indian Business Development Office within the department. The FTE position provided for this office was used by Commerce to hire a human resource person in February 2007. In the spring of 2006, the American Indian Business Development Office was established through a contractual relationship with an outside vendor. Based on guidance we received from the Office of the Attorney General, it

Lewis and Clark appropriated funds were used to pay non Lewis and Clark expenses.

An FTE position provided to Commerce for operating an American Indian Business Development Office was used to hire a human resource person.

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appears Commerce had legal authority to do this based on the broad authority granted to the Commissioner within NDCC Chapter 54-60. However, we conclude the FTE position was specifically given by the Legislature to Commerce for operating an American Indian Business Development Office within the department and this did not occur.

Recommendation 2-16

We recommend the Department of Commerce comply with legislative intent for use of line item appropriations and full-time equivalent positions.

Management's Response

Commerce agrees with the recommendation, however, Commerce believes it complied and will continue to comply with the legislative authority and intent granted to Commerce for use of line item appropriations and full-time equivalent positions. See Appendix D for the remainder of Commerce's response.

State Auditor's Concluding Remarks

While Commerce states it agrees with the recommendation, Commerce states it believes it complied with legislative intent. Thus, it appears Commerce actually disagrees with our conclusion regarding noncompliance with legislative intent. See Appendix D for the remainder of the State Auditor's concluding remarks.

Making Changes with Calculating Overtime and Compensatory Time

Based on a review of salary information and payments to employees of Commerce, we identified employees were being paid overtime and earning compensatory time in weeks when annual or sick leave was used. This contradicts Commerce's policy on calculating overtime and allows the employee to convert such leave into additional pay. For example, an employee who worked 39 hours in a week also recorded 16 hours of sick leave. Rather than reduce the amount of sick leave taken to one hour, the employee received 15 hours of compensatory time.

Recommendation 2-17

We recommend the Department of Commerce ensure employees are paid overtime and earn compensatory time only when hours actually worked exceed 40 in a week.

Management's Response

Commerce agrees with the recommendation and immediately implemented it after it was brought to our attention.

Establishing a Uniform Hiring Process

Based on a review of information regarding how employees of Commerce are hired, we identified the hiring process was decentralized and improvements were needed. Each division uses their own screening and hiring process. We identified various point scales used by divisions to evaluate candidates. In one instance, the point scale included an inadequate amount of veterans' preference points for applicable candidates.

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Recommendation 2-18

We recommend the Department of Commerce establish a consistent and uniform process for hiring employees. At a minimum, the Department of Commerce should:

- a) Centralize the hiring process;
- b) Establish a standardized scoring system; and
- c) Ensure compliance with laws and policies.

Management's Response

Commerce agrees with the recommendation and will establish a more uniform hiring process.

Improving Policies and Procedures at Commerce

Based on a limited review of policies established by Commerce, we identified improvements were needed. We identified a policy contradicted an Office of Management and Budget (OMB) policy, certain policies may be outdated, and certain programs within Commerce had no established policies and procedures.

Making Changes to the Cell Phone Policy

Reimbursements to employees for cell phone charges were for more than what was allowed by OMB policy.

OMB Policy 523 states an employee is eligible for reimbursement for business calls made on a cell phone only if the employee has exceeded the "free minutes" given to the employee by their cell phone provider. Commerce's policy was to reimburse employees for business related calls on personal cell phones regardless of whether the "free minutes" were exceeded due to the business calls. In review of selected payments to employees, we did identify Commerce was reimbursing employees under their policy rather than OMB policy. As a result, payments were made to employees for more than what was allowed by OMB policy. We also identified the policy by Commerce did not address the personal use of state issued cell phones.

Recommendation 2-19

We recommend the Department of Commerce make changes to their cell phone policy. At a minimum, the policy should:

- a) Be consistent with Office of Management and Budget policy; and
- b) Address the use of state issued cell phones for personal use.

Management's Response

Commerce agrees with the recommendation and will amend our cell phone policy.

Ensuring Policies and Procedures are Established

In review of six Commerce grant and loan programs, we identified improvements were needed with certain policies and procedures. In certain programs reviewed, we identified policies did not reflect current practices as changes made to programs were not appropriately reflected in updated policies.

While all programs within Commerce were not reviewed, we did identify certain programs did not appear to have policies and procedures established. Policies should be established and kept current in order to ensure consistency with program operations. Without effective guidelines, program operations may not be administered efficiently and effectively.

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Recommendation 2-20

We recommend the Department of Commerce ensure programs and services have established policies and procedures which are reviewed and updated periodically.

Management's Response

Commerce agrees with the recommendation and will establish policies and procedures for all appropriate programs and services. These policies and procedures will be reviewed and updated periodically.

Making Improvements with Records Management

The Records Management Division of the Information Technology Department is responsible for establishing, implementing, and administering a records management program for all state agencies. Guidance provided by this division is to be followed by state agencies to ensure creation, maintenance, retention, and disposition of records. In review of selected Commerce programs, we identified a number of improvements were needed related to records management. Examples include:

- Certain documents used by Commerce do not contain an appropriate State Form Number (SFN). For example, applications used for Centers of Excellence awards, Development Fund, Inc. investments, and Operation Intern grants do not have a SFN assigned.
- Record series descriptions should be established to identify all appropriate records of the program and/or operation. We identified certain documents did not have a record series established. For example, letters sent to companies who are late on a loan payment to the Development Fund, Inc. are not included in a record series. Such documents are not maintained by the Development Fund, Inc.
- A record series has been established related to Centers of Excellence documents such as minutes, applications, and functional reviews. This series has an established retention period of four years. However, state law requires the Centers of Excellence to be monitored for not less than six years.

Improvements are needed with documents and records created and maintained by Commerce.

Recommendation 2-21

We recommend the Department of Commerce work with the Records Management Division of the Information Technology Department to make improvements to the records management program. At a minimum, actions should be taken to:

- a) Review all operations to identify appropriate records;
- b) Ensure appropriate records series descriptions and retention periods are identified; and
- c) Assign State Form Numbers to documents where appropriate.

Management's Response

Commerce agrees with the recommendation and has begun to work with Records Management to make improvements to our records management program.

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Using Secured Websites

An online application for students for the Operation Intern program was available on Commerce's website. The website used to gather student information, including social security numbers, addresses, and phone numbers, was not secure. Students' confidential or sensitive information is vulnerable to unauthorized use if someone were to gain access to the website submissions. Once the security concern was identified to representatives of Commerce, appropriate action was immediately taken.

Recommendation 2-22

We recommend the Department of Commerce ensure confidential or sensitive information is obtained through secured websites.

Management's Response

Commerce agrees with the recommendation and has removed the confidential and sensitive information from the online student application and will monitor all future online forms and documents.

North Dakota Development Fund, Inc.

Introduction

As part of the performance audit, we selected certain grant and loan programs to review. Our review of the North Dakota Development Fund, Inc. identified improvements were needed. Significant improvements are included in this chapter. Improvements of less significance were communicated in a separate letter to management.

The Development Fund, Inc. is established in North Dakota Century Code (NDCC) Chapter 10-30.5 as a nonprofit development corporation. It has the authority to provide capital for new or expanding businesses in this state, or relocating businesses to this state. Capital is provided through loans, equity investments, and other financing mechanisms. The corporation's principal mission is the development and expansion of primary sector businesses in this state.

The Development Fund, Inc. is responsible for the administration and management of the Development Fund, the Regional Rural Development Revolving Loan Fund, and the New Venture Capital Program. Those interested in obtaining funding submit an application to or contact representatives of the Development Fund, Inc. Investments are evaluated by an eight member Board of Directors. The Board is comprised of the Commissioner of the Department of Commerce or designee and representatives appointed by the Governor. The Development Fund staff are employees of the Department of Commerce.

To review the Development Fund, Inc., we:

- Reviewed applicable laws, polices, and procedures;
- Reviewed the application evaluation process;
- Reviewed documentation for 17 selected investment files;
- Reviewed applicable studies and reports;
- Reviewed contract management practices; and
- Interviewed selected personnel.

Making Improvements with Policies

Policies have been established for the administration of the North Dakota Development Fund, Inc. (Development Fund). We selected 17 investment files and compared the application process, payments to the recipient, and monitoring activities to the policies. We identified improvements should be made with reviewing and complying with investment policies.

In review of Development Fund investment files, we identified noncompliance with certain policies. Examples include:

- Personal guarantees were not obtained as required from individuals owning 20% or more of the company in which the Development Fund made investments.
- Investments were made in which no local institution was financially committed. The investment policy states the borrower must have a financially committed local financial institution.

Improvements are needed with reviewing and complying with investment policies.

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North Dakota Development Fund, Inc.

Development Fund staff stated exceptions to investment policies are made on a case-by-case basis depending on the compensating strengths of each proposed investment. However, exceptions and compensating factors were not being sufficiently documented in the investment files.

Development Fund policies require updating as they do not reflect current practices in all cases. For example, the investment policies identify limits for maximum investment per job created or retained as \$10,000 for urban and \$20,000 for rural. The Development Fund CEO stated those limits had been increased to \$20,000 urban and \$30,000 rural effective May 2008.

Recommendation 3-1

We recommend the North Dakota Development Fund, Inc. ensure compliance with policies for investments. In instances of exceptions or waivers of policies, reasons should be adequately documented.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and will ensure compliance with investment policies. Exceptions and waivers will be adequately documented and the reasoning for the exception and/or waiver will be added to the respective customer file.

Recommendation 3-2

We recommend the North Dakota Development Fund, Inc. make improvements with the policies established for investments. At a minimum, the Development Fund, Inc. should:

- a) Review and update current policies;
- b) Update policies when changes occur to the investment program;
- and
- c) Establish a periodic review process.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and will review the Fund's policies on a semi-annual basis. Any changes to the policies will be implemented as soon as they are changed.

Documenting Monitoring Activities

Relevant matters concerning investments were not documented.

The Development Fund's investment policy states:

"A file must be maintained for each investment approved by the Fund. Each file must contain sufficient information to provide a single reference source for all relevant matters concerning the investment. This information must include documentation on all action taken or proposed to be taken and all approvals and signatures required by this policy and established investment procedures."

The Development Fund staff is responsible for monitoring loans and equity investments. In our review of investment files, we identified all relevant matters were not documented. For example, staff do not

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document meetings held in person or via phone with companies who have a loan which is not being paid. In certain instances, we were unable to determine what monitoring activities or actions occurred.

Recommendation 3-3

We recommend the North Dakota Development Fund, Inc. ensure all relevant matters concerning investments, including monitoring activities and actions taken, are documented.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and will establish a system and requirement that all relevant matters concerning investments, including monitoring activities, are documented.

**Making
Improvements with
Staff Authority**

The Development Fund investment policies state the Board of Directors is responsible for the general supervision of all affairs of the Fund, including establishing the investment policies of the Fund and approving all projects. We identified improvements should be made with establishing the authority granted to the Development Fund staff.

*Establishing Authority of
Fund Staff*

The policy manual states the Board may assign lending authority to the Development Fund staff as deemed appropriate. We identified very minimal to no formal authority being granted to staff. In review of a selection of Development Fund investments, we identified decisions were made by Development Fund staff regarding investment terms and conditions, including changes to Board approvals, without documented Board review and approval. Examples include:

Investment terms and conditions were being changed by Development Fund staff without documented Board review or approval.

- Approval conditions requesting life insurance and personal guarantees on key individuals of an investment file were waived by Development Fund staff.
- Development Fund staff was identified as making changes to interest rates and fees and extended approval periods without Board approval.

While the underlying reasoning provided by Development Fund staff appears to support the decisions made, there was no documented authority allowing the staff to make such decisions.

Recommendation 3-4

We recommend the North Dakota Development Fund, Inc. formally establish the authority granted to the staff regarding changes to terms and conditions of investments.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and the Board and staff will identify authoritative limits.

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Increasing Approval Authority

Development Fund investment policy requires investment applications over \$50,000 be approved by the Development Fund Board. Investment applications under \$50,000 can be approved by Development Fund staff. Summary information on requests less than \$50,000 is presented to the Board. However we identified very few investment applications less than \$50,000.

The Development Fund staff investment authority is low.

In review of a selection of Development Fund investment files, the Board agreed with the staff's investment recommendations on all of the investment files reviewed. The only investment which was not approved by the Development Fund Board also aligned with the Development Fund staff's do-not-approve recommendation. It appears the Development Fund staff investment authority of \$50,000 is low and could be increased.

Recommendation 3-5

We recommend the North Dakota Development Fund, Inc. increase the dollar limit of investments the staff is authorized to approve.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and the Board and staff will identify appropriate authoritative limits.

Complying with Open Meetings Laws

Discussions related to public information were held in executive session.

NDCC Section 10-30.5-07 states commercial or financial information of any entity in which an equity interest is purchased or considered or to which a loan has been made is confidential. For this reason, the Board is required to move into executive session when discussing the confidential information. In review of executive session meeting minutes, we identified discussions were held in executive session which were not related to confidential matters. For example, while in executive session discussion was held on the financial status of the Development Fund. We also identified actions were taken in executive session which should have occurred during an open meeting.

Recommendation 3-6

We recommend the North Dakota Development Fund, Inc. review, with assistance from the Office of the Attorney General, open meeting law requirements and make appropriate changes to comply with these requirements.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and will review the open meeting law requirements with the Office of the Attorney General and will make the appropriate changes.

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North Dakota Development Fund, Inc.

Developing a Code of Ethics

In review of Development Fund policies, we identified a Code of Ethics has not been established for the Board of Directors. A Code of Ethics identifies the ethical principles each Board member is expected to follow in carrying out their duties. A signed Code of Ethics ensures Board members are aware of their responsibilities in making decisions regarding the use of public funds.

Recommendation 3-7

We recommend the North Dakota Development Fund, Inc. establish a Code of Ethics to be signed annually by all members of the Board of Directors to guide ethical decision making regarding the use of public funds.

Management's Response

The North Dakota Development Fund, Inc. agrees with the recommendation and will establish a Code of Ethics to be signed annually by all members of the Board of Directors.

Agricultural Products Utilization Commission

Introduction

As part of the performance audit, we selected certain grant and loan programs to review. Our review of the Agricultural Products Utilization Commission (APUC) grant program identified improvements were needed. Significant improvements are included in this chapter. Improvements of less significance were communicated in a separate letter to management.

The APUC grant program is funded through the Agricultural Fuel Tax Fund, created by North Dakota Century Code Section 4-14.1-02, and general fund appropriations. The mission of APUC is to create wealth and jobs through the development of new and expanded uses of North Dakota's agricultural products. APUC grants are intended for North Dakota companies that add value to a raw North Dakota agriculture commodity.

Those interested in obtaining an APUC grant are required to submit a grant application. Applications are evaluated by a nine member Board of Directors. The Board is comprised of representatives appointed by the Governor and state agency designees.

To review the APUC grant program, we:

- Reviewed applicable laws, polices, and procedures;
- Reviewed the application evaluation process;
- Reviewed documentation for 30 selected grant files;
- Reviewed applicable studies and reports;
- Reviewed contract management practices; and
- Interviewed selected personnel.

Monitoring North Dakota Administrative Code

North Dakota Administrative Code (NDAC) Chapter 95-02-02 establishes the scoring system to be used by the Board of Directors to evaluate each application. We identified grant applications from one category, Farm Diversification, were not scored as required by NDAC. When this grant category was created, APUC determined a subcommittee would evaluate the applications rather than using a scoring system. As a result, APUC is in noncompliance with NDAC. We identified NDAC for APUC has not been modified in an extended period of time.

Recommendation 4-1

We recommend the Agricultural Products Utilization Commission make improvements with the monitoring of requirements in North Dakota Administrative Code Title 95. At a minimum, the Agricultural Products Utilization Commission should:

- a) Ensure compliance with requirements established in rules; and
- b) Take appropriate action to ensure rules are updated as necessary.

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Management's Response

The Agricultural Products Utilization Commission agrees with the recommendation. APUC began updating their Administrative Code at their quarterly meeting on July 23, 2009 and will ensure compliance with requirements established in those rules.

Retaining Evaluation Documentation

NDAC Chapter 95-02-02 requires each application to be evaluated using the following scoring system:

- Maximum 30 points for demonstration of high probability of job and wealth creation;
- Maximum 30 points for technical and commercial feasibility;
- Maximum 15 points for high probability of rapid commercialization;
- Maximum 10 points for demonstration of a shared commitment for matching funding;
- Maximum 5 points for geographical considerations (preference given to nonurban locales); and
- Maximum 10 points based on the Board member's judgment.

Documentation of Board members' evaluation of applications is not maintained.

No documentation is maintained identifying Board members' evaluation of applications using the above scoring system. Board members are only providing a total score for each application. We were unable to determine whether each Board member evaluated applications in accordance with NDAC.

Recommendation 4-2

We recommend the Agricultural Products Utilization Commission retain scoring documentation for each member of the Board of Directors.

Management's Response

The Agricultural Products Utilization Commission agrees with the recommendation. APUC has kept an overall score sheet with all of the individual scores for each project from each commissioner. As of the July 23, 2009 quarterly meeting, APUC now retains the individual score sheets from each Commissioner.

Making Improvements with Guidelines

We selected 30 grant files and compared the application process, payments to the grantee, and monitoring activities to the guidelines established for the administration of the APUC grant program. We identified improvements should be made with reviewing and complying with program guidelines. Examples related to noncompliance include:

- Nature-Based Tourism and Prototype guidelines state peer reviews will be obtained for projects in these categories. Peer reviews were not obtained for the three grant applications we reviewed in these categories.
- Upon approval, 50% of the awarded amount is provided to the grantee. Grantees are required to submit supporting documentation before the final payment is made. We identified a

Improvements are needed with reviewing and complying with program guidelines.

Chapter 4 Agricultural Products Utilization Commission

final payment was made to a grantee when no receipts or supporting documentation were included in the grant file.

- The Nature-Based Tourism guidelines state the maximum grant for a single enterprise is \$1,000. The Board approved a grant for a single enterprise under this category for \$10,000.

APUC guidelines have not been updated since July 2005 and do not appear to be reflecting current practices. For example, the APUC Director stated peer reviews were not obtained for Nature-Based Tourism and Prototype grants as they did not add value to the process.

Recommendation 4-3

We recommend the Agricultural Products Utilization Commission ensure compliance with established guidelines for the grant program.

Management's Response

The Agricultural Products Utilization Commission agrees with the recommendation. The Commission reviewed current guidelines during the July 23, 2009 quarterly meeting and will ensure compliance with established guidelines.

Recommendation 4-4

We recommend the Agricultural Products Utilization Commission make improvements with guidelines established for the grant program. At a minimum, the Agricultural Products Utilization Commission should:

- a) Review and update current guidelines;
- b) Update guidelines when changes occur to the grant program; and
- c) Establish a periodic review process.

Management's Response

The Agricultural Products Utilization Commission agrees with the recommendation. The Commission is currently reviewing the guidelines and will make changes that better reflect new policy. A yearly review schedule has been implemented.

Monitoring Expenditures

APUC performs grant administration work which should be performed at the local level.

APUC generally distributes grant funds in two payments. The first half is paid when the grant is awarded and the second half is paid after supporting documentation for expenditures is received. Grantees are required to submit supporting documentation for every expense included in the reimbursement request. This is a significant amount of information being submitted, including time sheets, payroll reports, receipts, etc.

In grant administration, it is not a common practice to require all support be submitted when funds are requested. Typically, grantees are required to maintain supporting documentation and provide it only when requested. The current monitoring procedures are not an efficient or effective use of time. In addition, examples of APUC making the second payment when all required expenditure support had not been received were identified.

Chapter 4 Agricultural Products Utilization Commission

Recommendation 4-5

We recommend the Agricultural Products Utilization Commission make improvements to expenditure monitoring procedures to increase efficiency and effectiveness. At a minimum, the Agricultural Products Utilization Commission should:

- a) No longer require supporting documentation be submitted for all reimbursement requests; and
- b) Periodically select various grantees to verify adequate support for expenditures is retained.

Management's Response

The Agricultural Products Utilization Commission disagrees with the recommendation. The recommended monitoring process has been utilized in the past. It was determined at that time to not be an effective process due to numerous inconsistencies and misunderstandings at the local level regarding specific use of funds.

State Auditor's Concluding Remarks

Management's response indicates the recommended monitoring process was used previously and was determined to not be an effective process. The reason identified for this relates to inconsistencies and misunderstandings at the local level regarding the use of funds. This appears to relate to a problem with the grant awarding process. Such misunderstandings should be addressed upfront in the grant process through education at the local level as well as being adequately addressed in grant agreements. These problems do not relate to the changes we recommend for monitoring. Commerce provided no evidence indicating the past problems encountered still exist. In our review of 30 grant files, we did not identify one instance in which APUC identified an inconsistency or misunderstanding of how the funds were to be used.

Reviewing detailed supporting documentation to determine appropriateness is a primary duty of grant administration. APUC grant applications require a fiscal agent to be identified. The fiscal agent would be responsible to account for the APUC grant funds and ensure they are spent appropriately. If the fiscal agents are not fulfilling their responsibilities, APUC should evaluate the reasonableness of dollars being expended for a service which is not adequately performed.

Developing a Code of Ethics

In review of APUC guidelines, we identified a Code of Ethics has not been established for the Board of Directors. A Code of Ethics identifies the ethical principles each Board member is expected to follow in carrying out their duties. A signed Code of Ethics ensures Board members are aware of their responsibilities in making decisions regarding the use of public funds.

Recommendation 4-6

We recommend the Agricultural Products Utilization Commission establish a Code of Ethics to be signed annually by all members of the Board of Directors to guide ethical decision making regarding the use of public funds.

Chapter 4
Agricultural Products Utilization Commission

Management's Response

The Agricultural Products Utilization Commission agrees with the recommendation and a Code of Ethics will be developed, adopted and signed annually by the Board of Directors.

Audit and Commerce Background Information

Purpose and Authority of the Audit

The performance audit of aspects of the Department of Commerce (Commerce) was conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code (NDCC) Chapter 54-10.

Performance audits are defined as engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so management and those charged with governance and oversight can use the information to improve performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. The purpose of this report is to provide our analysis, findings, and recommendations regarding our limited review of the Department of Commerce.

Background Information

Commerce was established by the 2001 Legislature and combined various state agencies into one department. Commerce is responsible for coordinating and focusing the state's economic development resources. Commerce's mission is to "lead North Dakota's efforts to attract, retain, and expand wealth."

Commerce is comprised of four divisions: Economic Development and Finance, Community Services, Workforce Development, and Tourism. Commerce strives to improve the quality of life of the people of North Dakota and targets five industries to broaden the state's economic base, create new wealth, and generate quality jobs for the state's people. The target industries are advanced manufacturing, tourism, energy, technology-based business, and value-added agriculture. Additional information on Commerce divisions and programs can be seen at Appendix C. Appropriation information is included in the following table.

Biennium	General Funds	Other Funds	Total
2005-2007	\$19,137,553	\$57,189,994	\$76,327,547
2007-2009	\$26,278,544	\$55,761,293	\$82,039,837
2009-2011 ¹	\$58,476,303	\$138,261,105	\$196,737,408

¹ Includes adjustments and additional funds provided to Commerce not in the department's appropriation bill (\$68.6 million of federal fiscal stimulus funds are included).

NDCC Chapter 15-69 establishes a Centers of Excellence program. Centers of Excellence projects are partnerships between colleges, universities, or related foundations (who receive the Centers of Excellence funds) and private sector companies to enhance economic development. This program is overseen by a six member Centers of Excellence Commission comprised of members from the North Dakota

Chapter 5 Audit and Commerce Background Information

Economic Development Foundation and the State Board of Higher Education. NDCC Section 15-69-04 states Commerce is responsible for managing the application process, reviews, and postaward monitoring at the request of the Commission.

The Centers of Excellence program received appropriation authority to award up to \$20 million in each of the 2005-2007, 2007-2009, and 2009-2011 bienniums.

Objectives of the Audit

The objectives of this performance audit are listed below:

“Does the application process and monitoring of the Centers of Excellence provide adequate accountability for the use of state funds?”

“Has an adequate system for monitoring operations of the Department of Commerce been established?”

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit field work was conducted from the middle of January 2009 to the middle of August 2009. The audit period for which information was collected and reviewed was July 1, 2005 through December 31, 2008. In certain cases, additional information was reviewed. This was done, in part, to obtain additional information on certain events and to take into consideration changes made during the 2009 Legislative Session. Specific methodologies are identified in the respective chapters of this report.

Employee Survey

Our office conducted an employee survey in November 2008 as part of the performance audit. Overall, the employee survey results identified a high positive response rate. For example, in response to the statement “Senior management communicates well with employees,” 87% of respondents selected “Agree” or “Strongly Agree.” In response to the statement “I am able to take issues to or can disagree with senior management without fear of consequences,” 72% selected “Agree” or “Strongly Agree.” Other positive response rates were identified in the areas of job satisfaction, favoritism not being an issue in raises and promotions, supervision, and the availability of necessary training and information systems.

Appendices

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Supplemental Response and Concluding Remarks	D1

List of Recommendations

- Recommendation 1-1** We recommend the Centers of Excellence Commission ensure compliance with North Dakota Century Code Section 15-69-04, Subsection 5 and determine whether Centers of Excellence are having the desired economic impact.
- Recommendation 1-2** We recommend the Department of Commerce ensure applications provided to the Centers of Excellence Commission contain budgeted expenditures which are in compliance with state law.
- Recommendation 1-3** We recommend the Centers of Excellence Commission establish formal policies and procedures for the application process. At a minimum, the policies should address:
- a) Definitions of key terms used in the application;
 - b) Submission of revised applications, budgets, and/or other information when recommending a lesser amount than is being requested;
 - c) Submission of information from Centers of Excellence previously receiving funding; and
 - d) Completed applications being forwarded to the Commission.
- Recommendation 1-4** We recommend the Centers of Excellence Commission establish formal policies and procedures for the evaluation of applications. At a minimum, the policies should address:
- a) A process incorporating all elements in North Dakota Century Code for consideration in approving and disapproving applications; and
 - b) Additional elements of consideration on applications from Centers of Excellence which were previously approved.
- Recommendation 1-5** We recommend the Centers of Excellence Commission establish criteria to be used for determining the approved funding amount in applications and analyze the effects of changing requested funding amounts of projects.
- Recommendation 1-6** We recommend the Centers of Excellence Commission establish formal policies and procedures for technical reviews of applications. At a minimum, the policies should address:
- a) A process for identifying proposals requiring a review;
 - b) Selection of a vendor to perform the review; and
 - c) Ensuring sufficient time exists to allow a review to be performed.
- Recommendation 1-7** We recommend the Centers of Excellence Commission review the due diligence requirements and either:
- a) Move the due diligence work to the beginning of the application process; or
 - b) Ensure an adequate amount of time is provided to allow the Department of Commerce to complete the due diligence work.

Appendix A List of Recommendations

- Recommendation 1-8** We recommend the Centers of Excellence Commission enter into formal agreements with approved applicants. At a minimum, the agreements should address:
- a) Criteria for the use of state funds;
 - b) Documentation requirements for payroll expenses; and
 - c) Compliance with applicable purchasing policies.
- Recommendation 1-9** We recommend the Centers of Excellence Commission update the functional review to improve the efficiency and effectiveness of the monitoring and reporting process.
- Recommendation 1-10** We recommend the Centers of Excellence Commission establish formal policies and procedures for monitoring the Centers of Excellence. At a minimum, the policies should address:
- a) Establishing quarterly monitoring requirements;
 - b) Assessing job creation activities;
 - c) Assessing significant variations from the applications;
 - d) Establishing different reviews after the match has been met or after a specified period of time has expired; and
 - e) Establishing the frequency of updates to the Commission and/or holding meetings specifically for monitoring.
- Recommendation 1-11** We recommend the Centers of Excellence Commission monitor compliance with North Dakota Century Code Section 15-69-05, Subsection 2 and ensure annual audits are completed or take appropriate action to modify the requirement for annual audits of Centers of Excellence.
- Recommendation 1-12** We recommend the Centers of Excellence Commission require the Centers of Excellence to establish measurable goals and objectives at least annually.
- Recommendation 1-13** We recommend the Centers of Excellence Commission establish formal policies and procedures addressing actions to be taken when Centers of Excellence are in noncompliance with requirements and when Centers of Excellence are not meeting stated expectations.
- Recommendation 1-14** We recommend the Centers of Excellence Commission establish formal policies and procedures related to matching requirements. At a minimum, the policies should address:
- a) Required documentation to receive Centers of Excellence funds after an application is approved; and
 - b) Requirements for verifying match and leverage amounts are actually received.

Appendix A

List of Recommendations

- Recommendation 1-15** We recommend the Centers of Excellence Commission establish a formal orientation training process for its members. At a minimum, the process should include:
- a) Identifying all state law requirements of the Commission; and
 - b) Ensuring compliance with Code of Ethics requirements.
- Recommendation 2-1** We recommend the Department of Commerce establish an effective department-wide monitoring function emphasizing compliance, consolidation of processes and procedures, and efficient operations. If reallocating resources is not possible to establish such a function, the Department should take appropriate action to obtain additional full-time equivalent positions and/or other necessary resources.
- Recommendation 2-2** We recommend the Department of Commerce ensure administrative costs of local recipients paid with Community Development Block Grant funds are reasonable and adequately supported.
- Recommendation 2-3** We recommend the Department of Commerce make improvements to Community Development Block Grant program monitoring processes to increase efficiency and effectiveness. At a minimum, the Department of Commerce should:
- a) Identify information to the grant administrators on their responsibilities and duties;
 - b) No longer accept and review supporting documentation on all Request for Funds; and
 - c) Periodically select various grants and loans to verify adequate support for expenditures is retained.
- Recommendation 2-4** We recommend the Department of Commerce make changes to the contracts entered into with the Regional Planning Councils for scoring and ranking Community Development Block Grant applications. At a minimum, the contracts should:
- a) Identify a maximum amount for subjective scores; and
 - b) Require a Conflict of Interest and/or Code of Conduct statement be developed and signed annually by individuals conducting the scoring and ranking of applications.
- Recommendation 2-5** We recommend the Department of Commerce make improvements to Operation Intern monitoring procedures to increase efficiency and effectiveness. At a minimum, the Department of Commerce should:
- a) No longer require supporting documentation be submitted for all Requests for Funds;
 - b) Periodically select various employers to verify adequate support for expenditures is retained; and
 - c) Eliminate redundant monitoring processes.

Appendix A List of Recommendations

- Recommendation 2-6** We recommend the Department of Commerce include requirements in the Operation Intern contracts to have employers:
- a) Verify student eligibility and maintain documentation confirming eligibility; and
 - b) Provide the midpoint and exit review materials to students at the appropriate time during the internships.
- Recommendation 2-7** We recommend the Department of Commerce make improvements to the Operation Intern program contracts. At a minimum, the Department of Commerce should:
- a) Develop a contract template using recommended language from the Office of the Attorney General's Contract Drafting and Review Manual;
 - b) Develop a contract amendment document;
 - c) Ensure the contract template and amendment are reviewed and approved by legal counsel; and
 - d) Ensure contracts with employers and applicable amendments are executed prior to students beginning work.
- Recommendation 2-8** We recommend the Department of Commerce comply with its policy when evaluating Tourism Infrastructure and Expansion Grant Applications to provide a fair system for all potential applicants.
- Recommendation 2-9** We recommend the Department of Commerce enter into formal agreements with Tourism Infrastructure and Expansion Grant recipients.
- Recommendation 2-10** We recommend the Department of Commerce periodically review applicable North Dakota Century Code sections and ensure compliance with requirements or take appropriate action to make changes.
- Recommendation 2-11** We recommend the Department of Commerce make improvements with the Value-Added Agriculture Promotion Board by either
- a) Ensuring compliance with state law requirements; or
 - b) Taking appropriate action to amend state law.
- Recommendation 2-12** We recommend the Department of Commerce ensure the Commerce Cabinet complies with state law requirements related to meetings of public entities or take appropriate action to modify state laws.
- Recommendation 2-13** We recommend the Department of Commerce ensure contractual payments are made after services have been performed to the department's satisfaction.
- Recommendation 2-14** We recommend the Department of Commerce make improvements to procurement processes to ensure compliance with laws and policies.

Appendix A List of Recommendations

- Recommendation 2-15** We recommend the Department of Commerce make improvements with the monitoring of contracts. At a minimum, the Department of Commerce should:
- a) Centralize contract administration and record keeping; and
 - b) Ensure appropriate insurance certificates or endorsements are obtained.
- Recommendation 2-16** We recommend the Department of Commerce comply with legislative intent for use of line item appropriations and full-time equivalent positions.
- Recommendation 2-17** We recommend the Department of Commerce ensure employees are paid overtime and earn compensatory time only when hours actually worked exceed 40 in a week.
- Recommendation 2-18** We recommend the Department of Commerce establish a consistent and uniform process for hiring employees. At a minimum, the Department of Commerce should:
- a) Centralize the hiring process;
 - b) Establish a standardized scoring system; and
 - c) Ensure compliance with laws and policies.
- Recommendation 2-19** We recommend the Department of Commerce make changes to their cell phone policy. At a minimum, the policy should:
- a) Be consistent with Office of Management and Budget policy; and
 - b) Address the use of state issued cell phones for personal use.
- Recommendation 2-20** We recommend the Department of Commerce ensure programs and services have established policies and procedures which are reviewed and updated periodically.
- Recommendation 2-21** We recommend the Department of Commerce work with the Records Management Division of the Information Technology Department to make improvements to the records management program. At a minimum, actions should be taken to:
- a) Review all operations to identify appropriate records;
 - b) Ensure appropriate records series descriptions and retention periods are identified; and
 - c) Assign State Form Numbers to documents where appropriate.
- Recommendation 2-22** We recommend the Department of Commerce ensure confidential or sensitive information is obtained through secured websites.
- Recommendation 3-1** We recommend the North Dakota Development Fund, Inc. ensure compliance with policies for investments. In instances of exceptions or waivers of policies, reasons should be adequately documented.

Appendix A List of Recommendations

- Recommendation 3-2** We recommend the North Dakota Development Fund, Inc. make improvements with the policies established for investments. At a minimum, the Development Fund, Inc. should:
- a) Review and update current policies;
 - b) Update policies when changes occur to the investment program; and
 - c) Establish a periodic review process.
- Recommendation 3-3** We recommend the North Dakota Development Fund, Inc. ensure all relevant matters concerning investments, including monitoring activities and actions taken, are documented.
- Recommendation 3-4** We recommend the North Dakota Development Fund, Inc. formally establish the authority granted to the staff regarding changes to terms and conditions of investments.
- Recommendation 3-5** We recommend the North Dakota Development Fund, Inc. increase the dollar limit of investments the staff is authorized to approve.
- Recommendation 3-6** We recommend the North Dakota Development Fund, Inc. review, with assistance from the Office of the Attorney General, open meeting law requirements and make appropriate changes to comply with these requirements.
- Recommendation 3-7** We recommend the North Dakota Development Fund, Inc. establish a Code of Ethics to be signed annually by all members of the Board of Directors to guide ethical decision making regarding the use of public funds.
- Recommendation 4-1** We recommend the Agricultural Products Utilization Commission make improvements with the monitoring of requirements in North Dakota Administrative Code Title 95. At a minimum, the Agricultural Products Utilization Commission should:
- a) Ensure compliance with requirements established in rules; and
 - b) Take appropriate action to ensure rules are updated as necessary.
- Recommendation 4-2** We recommend the Agricultural Products Utilization Commission retain scoring documentation for each member of the Board of Directors.
- Recommendation 4-3** We recommend the Agricultural Products Utilization Commission ensure compliance with established guidelines for the grant program.
- Recommendation 4-4** We recommend the Agricultural Products Utilization Commission make improvements with guidelines established for the grant program. At a minimum, the Agricultural Products Utilization Commission should:
- a) Review and update current guidelines;
 - b) Update guidelines when changes occur to the grant program; and
 - c) Establish a periodic review process.

Appendix A

List of Recommendations

Recommendation 4-5

We recommend the Agricultural Products Utilization Commission make improvements to expenditure monitoring procedures to increase efficiency and effectiveness. At a minimum, the Agricultural Products Utilization Commission should:

- a) No longer require supporting documentation be submitted for all reimbursement requests; and
- b) Periodically select various grantees to verify adequate support for expenditures is retained.

Recommendation 4-6

We recommend the Agricultural Products Utilization Commission establish a Code of Ethics to be signed annually by all members of the Board of Directors to guide ethical decision making regarding the use of public funds.

List of Centers of Excellence

The table below lists all approved Centers of Excellence grouped by institution and including the date approved by the Budget Section, approved amount, and a brief description of the use of funds. Excluded from the list are the University of North Dakota's Center of Excellence for Biomedical Device Research, Development, and Commercialization; and Minot State University's Great Plains Knowledge and Data Center. These Centers were approved on 10/30/07 but did not meet the requirements to receive funding.

Name	Date	Amount	Description
<i>Bismarck State College</i>			
National Energy Center of Excellence	12/15/05	\$3,000,000	Construct an Energy Technology Center for energy workforce training and environmental research
<i>Dickinson State University</i>			
Center for Entrepreneurship and Rural Revitalization – Institute for Technology and Business	6/14/06	\$1,150,000	Promote economic development through entrepreneurial strategies to help technology-based businesses start or expand in rural communities
<i>Lake Region State College</i>			
Dakota Center for Technology-Optimized Agriculture	12/15/05	\$450,000	Develop technology-optimized products to improve North Dakota agriculture
Dakota Center for Technology-Optimized Agriculture (Phase II)	10/30/07	\$400,000	Expand initial grant by addressing the need to harness emerging control technologies for agronomic knowledge
<i>Minot State University – Bottineau</i>			
Entrepreneurial Center for Horticulture	9/25/08	\$400,000	Support entrepreneurship in the organic and specialty vegetable industry
<i>North Dakota State University</i>			
Center for Advanced Electronics Design and Manufacturing	12/15/05	\$3,000,000	Research design and development of highly marketable products involving advanced electronics
Center for Surface Protection	3/8/06	\$2,000,000	Conduct research and development and provide consulting services relating to surface protecting coatings
Center for Surface Protection II	10/30/07	\$2,000,000	Expand research from initial grant to conduct market research and development related to gun barrel coatings
Center of Excellence for Agbiotechnology	3/8/06	\$2,000,000	Develop soybean and canola varieties with higher oil content to expand uses
Center of Excellence for Agbiotechnology: Oilseed Development II	10/30/07	\$1,500,000	Expand research from initial grant to work on different strains of seeds
Center for Integrated Electronic Systems	9/25/08	\$2,050,000	Perform market research and development projects involving systems integration of electronics hardware and software

Appendix B
List of Centers of Excellence

Name	Date	Amount	Description
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North Dakota State University (continued)

Center for Biopharmaceutical Research and Production	9/25/08	\$2,000,000	Perform research and development of biopharmaceuticals
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University of North Dakota

Energy and Environmental Research Center (EERC) National Center for Hydrogen Technology	12/15/05	\$2,500,000	Construct a facility to conduct research on and demonstrate usability of hydrogen as an energy source
Unmanned Aerial Vehicle and Simulation Applications Center of Excellence	3/8/06	\$1,000,000	Promote commercialization of new unmanned-related products and services and help attract new unmanned-related business ventures
Unmanned Aircraft Systems Center of Excellence (Phase II)	10/30/07	\$1,500,000	Continue research from initial grant by focusing on the integration of unmanned aircraft systems and human factors in flight performance
SUNRISE BioProducts	9/25/08	\$2,950,000	Develop and commercialize crop oil-derived chemicals, polymers, and composites
Petroleum Research, Education, and Entrepreneurship Center of Excellence	9/25/08	\$3,000,000	Pursue commercialization of the development of oilfield thermal energy
Center of Excellence in Space Technology and Operations	9/25/08	\$1,000,000	Perform collaborative research with an aerospace company and operate a university-built sensor onboard the international space station

University of North Dakota Research Foundation

Center of Excellence in Life Science and Advanced Technology	3/8/06	\$3,500,000	Construct a biosafety secured facility for offices, laboratories, pilot manufacturing sites, and advanced technology research
Center for Passive Therapeutics	9/25/08	\$2,650,000	Develop and commercialize multiple passive therapeutic antibodies

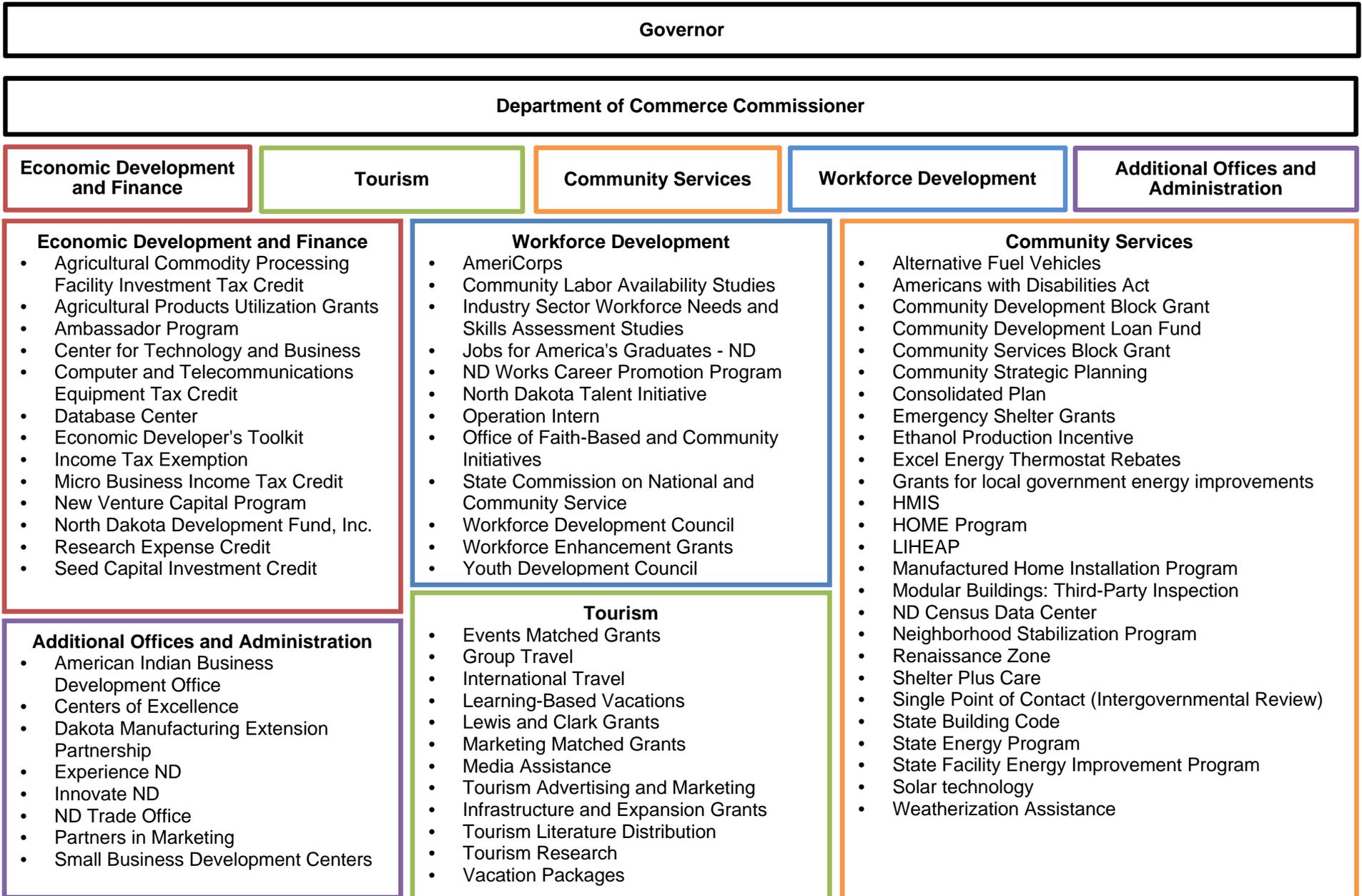
Valley City State University

Enterprise Applications Model – Institute for Customized Business Solutions	3/8/06	\$1,000,000	Provide knowledge and skills to companies seeking intellectual products such as customized coursework and training programs
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Williston State College

Petroleum Safety and Technology Center	3/8/06	\$400,000	Develop and operate a training site for individuals in oilfield industry careers
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Organization Chart With Programs and Functions



Supplemental Response and Concluding Remarks

Management's Response to Recommendation 2-16

Lewis & Clark Marketing

Commerce believes it complied with legislative intent and authority in regards to Lewis and Clark marketing. Examples of the cooperative nature of tourism marketing were provided to the Legislature during testimony in 2003 and 2005 as the marketing program was developed. Experiences along the Lewis and Clark Trail were used as the primary lure to attract visitors during the bicentennial years. Due to the nature of tourism marketing, other activities, attractions and events were marketed cooperatively and resources were leveraged to offer a complete package to visitors who, in many cases, traveled many miles to get to North Dakota.

Full-time Equivalent Positions

Commerce believes it complied with legislative authority and intent concerning the American Indian Business Development Office (AIBDO) and the associated FTE.

All new FTEs are provided in the context of Commerce's preexisting legal authority and duty to deploy limited resources, both human and financial, in the most efficient and effective way possible. This includes broad legislative authority and intent for Commerce to reclassify FTE positions when necessary to achieve this end. The 2005 appropriations bill did not contain anything contrary to this preexisting legal authority.

Also, as intended by the legislature, Commerce does not fall under the State Human Resource Management System. Under that system, if an agency desires to reclassify an FTE, it must seek approval and authority from the Office of Management and Budget. The Department of Commerce, on the other hand, was structured by the legislature to have more flexibility than this to reclassify positions, not less. If Commerce implemented a more restrictive view on FTEs it would not be able to adapt swiftly and responsively to changing needs in North Dakota's economy, communities, and workforce as the legislature otherwise intends.

During the 2005-07 biennium, Commerce determined that in order to achieve the results envisioned by the legislature, the AIBDO would be best handled by a vendor. This plan to contract with a vendor was detailed in testimony and in a written report to the interim Legislative Council Economic Development Committee. This interim committee was charged by Section 46 of Senate Bill 2018 to receive a report from Commerce on the AIBDO, including whether there were potential changes that could be made to enhance the support of American Indian businesses. At that time, Commerce was evaluating the first six months of the vendor's performance and kept the FTE open during this evaluation period. Toward the end of 2007, after being satisfied with the vendor's initial performance, Commerce began examining plans to reclassify the FTE as part of a reorganization plan for Commerce.

Appendix D Supplemental Response and Concluding Remarks

During the 2007 session, Commerce testified during legislative hearings about its implicit authority to contract and introduced legislation, which was subsequently approved, to make AIBDO statutory language consistent with other offices out-sourced by Commerce. Thus, Commerce's decision and authority to contract out the AIBDO was appropriately communicated to legislators and ultimately ratified by the 2007 legislature.

In all appropriate documents and testimony from Commerce during the 2007 legislative session, Commerce outlined plans to either fill or reclassify open FTE positions. This was done in the context of requesting two additional FTEs. Commerce ultimately received four additional FTEs in its 2007 appropriations bill.

State Auditor's Concluding Remarks

Commerce states it believes it complied with legislative intent and authority in regards to Lewis and Clark marketing. Chapter 18 of the 2003 Session Laws provided Commerce with \$2.9 million "only for defraying the tourism division's expenses of marketing the Lewis and Clark bicentennial celebration." Also, a motion in a legislative committee during the 2003 Legislative Session to change the terminology of Lewis and Clark bicentennial to a more comprehensive tourism appropriation was defeated. Based on this information and discussions with a representative of the Office of the Attorney General, it is clear to us Lewis and Clark funds should not have been expended on non Lewis and Clark activities.

Commerce states it believes it complied with legislative authority and intent concerning the American Indian Business Development Office (AIBDO) and the associated FTE. The FTE position for this office was not included in Commerce's budget request. Rather, this position was included in Commerce's appropriation bill near the end of the 2005 Legislative Session. When this position was added to the appropriation bill, the Statement of Purpose of Amendment stated: "Funding and 1 FTE position are added for operating costs of the American Indian Business Development Office within the Department of Commerce." The intent for this position being provided was clearly identified. Commerce entered into a contract to operate AIBDO and subsequently used the FTE for another purpose.

Commerce states the plan to contract with a vendor was detailed in testimony and in a written report to an interim legislative committee. This is a misleading statement. At the time the report was presented to the legislative committee, Commerce had already entered into a contract with a vendor to operate AIBDO. This report did not specifically disclose the fact Commerce was provided an FTE position. The report merely identifies in the background information the fact a contractual relationship existed to operate AIBDO.

Commerce states the decision and authority to contract out AIBDO was appropriately communicated to legislators and ultimately ratified by the

Appendix D
Supplemental Response and Concluding Remarks

2007 legislature. This is a misleading and irrelevant statement. While Commerce communicated information regarding contracting for a service, Commerce did not communicate in this same information the fact they were given an FTE position to operate AIBDO. The fact the legislature ultimately ratified the contracting of the service is irrelevant as this occurred after the fact.