Office of the State Auditor

Division of State Audit

Comprehensive Annual Financial Report State of North Dakota

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

For the year ended June 30, 2009
Client Code 100

Robert R. Peterson
State Auditor

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

Transmittal Letter

December 17, 2009

Legislative Audit and Fiscal Review Committee

Honorable John Hoeven, Governor

Members of the North Dakota Legislative Assembly

Pam Sharp, CPA, Director
Office of Management and Budget

I am pleased to submit our report on internal control, compliance, and other matters for the state of North Dakota. This report relates to the audit of the state's basic financial statements for the year ended June 30, 2009. This report on internal control, compliance, and other matters has been completed in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States.

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

The audit manager for this audit was Ron Tolstad Jr., M. Acc., CPA. Inquiries or comments relating to this audit may be directed to Mr. Tolstad by calling him at (701) 328-2243. I would like to express my appreciation to Ms. Sharp and her staff for the courtesy, cooperation, and assistance they provided to this office during the audit.

Respectfully submitted,

Bob Peterson

Robert R. Peterson
State Auditor

Executive Summary

Responses to LAFRC Audit Questions

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

   An unqualified (clean) opinion was given on the state of North Dakota's financial statements.

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

   Yes.

3. *Was internal control adequate and functioning effectively?*

   No. See the six significant deficiencies included in this report under "Findings, Recommendations, and Management Response." Findings 09-1, 09-2 and 09-3 are material weaknesses.

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

   No.

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

   No. Findings 09-1 and 09-2 are prior recommendations that have not been implemented.

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

   A management letter was not issued.

LAFRC Audit Communications

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

   There were no significant changes in accounting policies, and no management conflicts of interest or significant unusual transactions noted. The state's commitments and contingencies are reported on pages 113-116 of the Comprehensive Annual Financial Report.

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

   Management's estimates of claim losses relating to insurance activities include Workforce Safety and Insurance, Risk Management Fund, and the Fire and Tornado Fund. For Workforce Safety and Insurance, actuaries are employed to assist in calculating the liability. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuary's qualifications in determining that it is reasonable in relation to the financial statements taken as a whole. Estimated claim losses for the other insurance activities are made by professional insurance adjusters on a case by case basis. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

   Management's estimates of pension liabilities are based on valuation of actuarial amounts, provided by reputable actuaries. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that pension liabilities are reasonable in relation to the financial statements taken as a whole.

   Management's estimate of the Medicaid liability is based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

   Allowance for loan losses and receivables are based on management's periodic review of their collectability in the light of historical experience, the nature of the receivable, adverse situations that may affect the borrower's ability to repay, and where applicable the value of any collateral and loan guarantees. Other auditors and we evaluated the key factors and assumptions used to develop the allowance in determining the allowances were reasonable in relation to the financial statements taken as a whole.

   Tax refunds payable are based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining if it is reasonable in relation to the financial statements taken as a whole.

3. *Identify any significant audit adjustments.*

   Significant audit adjustments are discussed in Findings 09-1, 09-2 and 09-6.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

   We did not have any disagreements with management that were significant to the financial statements.

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

   We did not experience any serious difficulties in performing the audit.

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

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

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

   While OMB does employ consultants to assist in the preparation of the CAFR, we are not aware of any applicable management consultations with other accountants.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

   ConnectND Finance and Human Resource Management System (HRMS) are the most high-risk information technology systems critical to the operations of the state. There are numerous other high-risk systems which are identified in the agency audit reports. The significant deficiencies identified as Findings 09-2, 09-3 and 09-4 directly relate to ConnectND.

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable John Hoeven, Governor
of the State of North Dakota

Members of the Legislative Assembly
of the State of North Dakota

Pam Sharp, CPA, Director
Office of Management and Budget

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the state of North Dakota as of and for the year ended June 30, 2009, which collectively comprise the state's basic financial statements and have issued our report thereon dated December 17, 2009. Our report was modified to include a reference to other auditors, for the emphasis of a matter (the actuaries for the ND Teachers' Fund for Retirement and the ND Public Employee Retirement System found the statutory contribution rates are insufficient) and as described in Note 17 to the basic financial statements, the Bank of North Dakota elected to present an unclassified balance sheet because the presentation of a classified balance sheet would be misleading to the extent that the financial statements may be materially misstated. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. As described in our report on the state of North Dakota's financial statements, other auditors audited the financial statements of the following entities:

- Bank of North Dakota
- Beginning Farmer Revolving Loan Fund
- Board of University and School Lands
- Building Authority
- College SAVE Plan
- Community Water Facility Loan Fund
- Developmentally Disabled Facility Loan Program
- Guaranteed Student Loan Program
- Housing Finance Agency
- Job Service North Dakota
- Mandan Remediation Trust
- PACE and AG PACE Funds
- Public Employees Retirement System
- Retirement and Investment Office
- State Fair Association
- Student Loan Trust
- Workforce Safety and Insurance
- All Discretely Presented Component Units

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the North Dakota University System's component units, which were audited by other auditors, were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the state of North Dakota's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the state of North Dakota's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the state of North Dakota's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings, recommendations, and management responses (**Findings 09-1 through 09-6**) to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider **Findings 09-1, 09-2 and 09-3** to be material weaknesses.

Compliance and Other Matters

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

The state of North Dakota's responses to the findings identified in our audit are included in the accompanying schedule of findings, recommendations, and management responses. We did not audit the state of North Dakota's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Office of Management and Budget and others within the state, Legislative Audit and Fiscal Review Committee, members of the North Dakota Legislative Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Robert R. Peterson
State Auditor

Edwin J. Nagel, Jr., CPA
Director

December 17, 2009

Findings, Recommendations, and Management Responses

<u>Lack of Adequate Resources Devoted to Financial Reporting</u>

Finding 09-1 (Prior Recommendation not implemented)

<u>Condition:</u>
The number of material and significant errors indicates there are several related internal control significant deficiencies, including material weaknesses, which have a common cause. That is, the lack of adequate resources being dedicated to financial statement preparation. The most significant errors and weaknesses include:

- Of 747 records tested in CAFR adjustments 84 were in error. A record is each individual line within the adjustments. 40 of these 84 errors were made by the Office of Management and Budget (the other 44 were agency closing package errors). The records in error that were made by OMB totaled $116,271,367 out of the total error of $134,225,594.
- Inadequate procedures were put in place to implement a new accounting standard. Specifically GASB Statement 49 "Accounting and Financial Reporting for Pollution Remediation Obligations."
- Due to consultants not being familiar with the State's operations, a receivable was not recognized in the Tobacco Prevention and Control Trust Fund in the amount of $6,489,966.
- The Office of Management and Budget incorrectly interpreted the requirements for reporting restricted net assets (Centers of Excellence Fund restricted net assets overstated by $6,620,541).
- Capital lease payable between the North Dakota University System and its component units was not segregated as required.
- Several significant adjustments had to be made to various note disclosures.

<u>Effect:</u>
Financial statements contained material errors.

<u>Cause:</u>
Lack of resources, in house and contracted, dedicated to completing the CAFR.

<u>Criteria:</u>
Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission

<u>Recommendation:</u>
The Office of Management and Budget should address the areas noted and take the steps necessary to ensure there are adequate resources dedicated to financial statement preparation so their professional staff has the time to prepare the financial statements with fewer errors.

(Continued)

Finding 09-1 (Continued)

Views of Responsible Officials / Planned Corrective Actions:

OMB has adequate resources dedicated to financial statement preparation. However, we will continue to ask agencies to submit their financial information in a more timely manner to allow OMB to take more time in preparation of the CAFR. In addition, we want to comment on the 40 errors noted above. These are 40 transaction line errors. OMB processes over 7600 transaction line adjustments to produce the CAFR. Errors in transactions will usually create two or more transaction lines to be in error. For example, CAFR adjustments for two non-routine transactions done by the State Treasurer's Office created 8 of these 40 transaction line errors, which accounted for nearly $103 million of the $116 million in errors.

Financial Reporting Errors by the State Treasurer

Finding 09-2 (Prior Recommendation not implemented)

Condition:
Numerous errors were noted in information prepared by the State Treasurer's Office for the Office of Management and Budget. Errors included:

- The "Accounts Payable Closing Package" for fund 435 did not include payables equaling $12,260,018;
- The "Accounts Payable Closing Package" for fund 401 did not include payables equaling $5,542,358;
- The "Accounts Payable Closing Package" for fund 427 did not include payables equaling $2,070,252;
- $1,469,354 was incorrectly reported on the "Payments to Other State Agencies Closing Package" for fund 427;
- The distribution list prepared for the Office of Management and budget contained an error for Fund 400 in the amount of $1,230,000 million, and;
- The "Accounts Payable Closing Package" for fund 454 did not include payables equaling $736,289. This amount was incorrectly reported on the "Payments to Other State Agencies Closing Package."

Effect:
The effect of this control deficiency was numerous material errors to the financial statements. Further, fixing these errors cause unnecessary complications for the Office of Management and Budget. This introduces the risk of additional errors occurring during a period of peak work demands for the Office of Management and Budget.

Cause:
Individuals responsible for preparing and approving the closing packages do not understand the closing package process and the requirements of generally accepted accounting principles.

Criteria:
The criteria for this finding are contained in the Office of Management and Budget CAFR Closing Manual and generally accepted accounting principles.

Recommendation:
We recommend the Office of State Treasurer ensure that individuals responsible for preparing and approving the closing packages have adequate knowledge and training to ensure closing packages are properly completed.

Views of Responsible Officials / Planned Corrective Actions:
The Office of State Treasurer acknowledges that errors were made in the completion of these closing packages. The errors were a result of the preparing employee not following established guidelines and a difference in understanding between the State Treasurer's Office and the Office of Management and Budget regarding what is needed in these particular packages. In the future, the Office of State Treasurer will ensure that employees preparing the closing packaged follow clearly established guidelines consistent with the direction of the Office of Management and Budget on all closing packages.

State Treasurer Inability to Perform Cash Reconciliation

Finding 09-3

Condition:
Beginning April 27, 2009, the Office of the State Treasurer was not able to perform the important daily reconciliation of cash at the Bank of North Dakota to the ConnectND ledger. This daily reconciliation was not performed for several months. On October 30, 2009 the Office of the State Treasurer had reconciled through June 30, 2009. As of December 9, 2009 the reconciliation was performed through July 8, 2009.

Effect:
Without a daily reconciliation, there is an unacceptably high risk of material errors and fraud.

Cause:
The Office of the State Treasurer experienced turn over in the position that had the ConnectND knowledge necessary to perform the reconciliation. No one else in the office had the knowledge or the ability to perform the reconciliations timely. A contributing factor was that the process was not adequately documented.

Criteria:
Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission

Recommendation:
We recommend the Office of State Treasurer:

- Ensure that individuals responsible for reconciling the ConnectND cash balance to the cash balance at the Bank of North Dakota have adequate knowledge and training relating to ConnectND to ensure reconciliations are properly completed;
- Timely reconcile the ConnectND cash balance to the cash balance at the Bank of North Dakota on a daily basis, and;
- Cross train personnel and document procedures so others have the ability to perform the reconciliation and other critical functions of the office.

Views of Responsible Officials / Planned Corrective Actions:
The STO agrees that the office was delayed in reconciling cash. However, the STO did reconcile to BND daily. There are several reconciliations within the overall cash reconciliation process. The portion of cash which was not reconciled daily stemmed from the PeopleSoft portion of the reconciliation process. While some of the delay in reconciliation was caused by turnover, the major challenge with cash reconciliation stemmed from a series of PeopleSoft errors occurring April 29, 30, and May 1st. The STO communicated these errors to OMB and it was determined that the STO did not receive the proper queries available to OMB. That was corrected. Further, the STO and OMB worked collaboratively to identify the issues from PeopleSoft in order to work through the problem days. A series of items did not post, some posted days later, and the check register for May 1st included the checks which had been written on prior days. In the future, we will work with OMB to ensure that all information available to OMB regarding cash reconciliation is available to the STO. Further, the STO has cross-trained employees on cash reconciliation and is working to develop a more efficient cash reconciliation process.

Accounts Payable Approval Documentation

Finding 09-4

Condition:
Approval IDs are not identified for all accounts payable (AP) transactions.

Effect:
Without adequate approval documentation it is not possible for management to ensure AP transactions are proper, increasing the risk of errors and fraud.

Cause:
AP transactions can be approved through an improper ConnectND work list link which does not document who approved the transaction. Further the Office of Management and Budget does not adequately monitor this problem, and therefore does not notify the people who are improperly using ConnectND.

Criteria:
Internal Control – Integrated Framework from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission

Recommendation:
We recommend the Office of Management and Budget take steps to ensure proper approval documentation is available for all AP transactions.

Views of Responsible Officials / Planned Corrective Actions:
OMB agrees with the recommendation and will develop a query to monitor agencies' use of the accounts payable worklist for approval.

Vehicle Registration and Titling System (VRTS)

Finding 09-5

Condition:
The Department of Transportation is not properly reconciling the Motor Vehicle Money Market Account. Thus, the accuracy of distribution reports is not adequately ensured.

Effect:
Without a complete reconciliation there is an unacceptably high risk of errors or fraud.

Cause:
The Vehicle Registration & Titling System was not designed as a financial system and does not provide a book balance to reconcile to the Motor Vehicle Money Market Account.

Criteria:
The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission

Recommendation:
We recommend that the Department of Transportation:

- Properly reconcile the motor vehicle clearing account to the report of amounts processed and pending each month, and;
- Ensure the accuracy and validity of the Distribution Report.

Views of Responsible Officials / Planned Corrective Actions:
NDDOT agrees with the findings.

Regarding reconciliation of the motor vehicle clearing account, we are currently reviewing the VRTS processing to determine options for balancing the monies in the work queue that have not been distributed. We are working on updating our current reconciliation process to include a process of reconciling pending items to the money remaining in the clearing account after the distribution of funds is complete.

With regards to the accuracy and validity of the Distribution Report, we will continue to research distribution process and validity. Items discovered during the audit have already been corrected.

Financial Reporting Error by the State Water Commission

Finding 09-6

Condition:
The State Water Commission failed to recognize a liability for $2,033,809 which should have been applied to the fiscal year ended June 30, 2009.

Effect:
Accounts payable and expenditures were understated by $2,033,809.

Cause:
The State Water Commission was not aware of the proper expenditure recognition criteria for these types of grants.

Criteria:
GASB Statement 33 and Office of Management and Budget Policy 200 states that every agency is required to identify and record liabilities and other financial statement data at the close of each fiscal year.

Recommendation:
We recommend the State Water Commission record liabilities and the related expenditures in the proper period.

Views of Responsible Officials / Planned Corrective Actions:
The Water Commission received the request for reimbursement from the City of Fargo after the deadline for charging prior period expenditures back to the previous biennium in the PeopleSoft system. We agree that we should have included it in our closing package listing of accounts payable. We will place extra effort in reviewing the charges that occur after the PeopleSoft biennium closing and before the closing package submission.

Governance Communication

Legislative Audit and Fiscal Review Committee
North Dakota Legislative Assembly

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the state of North Dakota for the year ended June 30, 2009, and have issued our report thereon dated December 17, 2009. Professional standards require that we provide you with the following information related to our audit.

Qualitative Aspects of Accounting Practices
Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the state of North Dakota are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2009. We noted no transactions entered into by the state during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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

- Management's estimates of claim losses relating to insurance activities include Workforce Safety and Insurance, Risk Management Fund, and the Fire and Tornado Fund. For Workforce Safety and Insurance, actuaries are employed to assist in calculating the liability. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that it is reasonable in relation to the financial statements taken as a whole. Estimated claim losses for the other insurance activities are made by professional insurance adjusters on a case by case basis. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Management's estimates of pension liabilities are based on valuation of actuarial amounts, provided by reputable actuaries. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that pension liabilities are reasonable in relation to the financial statements taken as a whole.

- Management's estimate of the Medicaid liability is based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Allowance for loan losses and receivables are based on management's periodic review of their collectability in the light of historical experience, the nature of the receivable, adverse situations that may affect the borrower's ability to repay, and where applicable the value of any collateral and loan guarantees. Other auditors and we evaluated the key factors and assumptions used to develop the allowance in determining the allowances were reasonable in relation to the financial statements taken as a whole.

- Tax refunds payable are based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit
We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements
Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The schedule titled "Passed (Uncorrected) Audit Adjustments" summarizes uncorrected misstatements of the financial statements and is included on pages 21 and 22 of this report. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. Findings 09-1, 09-2 and 09-6 discuss material misstatements detected as a result of audit procedures that were corrected by management.

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

Management Representations
We have requested certain representations from management that are included in the management representation letter dated December 17, 2009.

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

Other Audit Findings or Issues
We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management. However, these discussions occurred in the normal

course of our professional relationship and our responses were not a condition to our retention. It should be noted that the retention of the State Auditor is a matter of state law and is not under the control of the Office of Management and Budget.

Our opinion on the June 30, 2009 financial statements included the following paragraphs that emphasize significant problems with the funding of two of the state of North Dakota's pension plans:

> The actuary for the North Dakota Teachers' Fund for Retirement has determined the Fund's unfunded actuarial accrued liability is approximately $546 million at June 30, 2009. The funding for the actuarial accrued liabilities is predicated on employer and employee funding rates mandated by North Dakota statutes. The actuary has determined that the current statutory contribution rates will never fully fund the unfunded actuarial accrued liability based on the current actuarial assumptions.
>
> The actuary for the North Dakota Public Employees Retirement System has determined that the Fund's unfunded actuarial accrued liability is approximately $284 million at June 30, 2009. The funding for the actuarial accrued liabilities is predicated on employer and employee funding rates mandated by North Dakota statutes. The actuary has determined that the current statutory contribution rates are insufficient to meet the actuarially determined requirement, based upon the current assumptions, unless there are sufficient actuarial gains in the future to offset the recent investment losses.

These problems go back several years. They were first emphasized in the Teachers' Fund for Retirement's 2005 auditor's report and the Public Employees Retirement System's 2006 auditor's report.

This information is intended solely for the use of Legislative Audit and Fiscal Review Committee, the Legislative Assembly and management of state of North Dakota and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully yours,

Ron Tolstad

Ron Tolstad Jr., M. Acc., CPA

Passed (Uncorrected) Audit Adjustments

Note: Errors below the Auditor's trivial misstatement amounts are not included below.

1. Passed Audit Adjustment

An error was found when testing accounts payable closing packages. This is a projected likely error.

Entity-Wide Statement Effect	**Debit**	**Credit**
Governmental Activities		
Expenses	869,961	
Accounts Payable		869,961
Fund Statement Effect		
Remaining Funds		
Expenditures	869,961	
Accounts Payable		869,961

2. Passed Audit Adjustment

OMB failed to make an adjustment for tax refunds payable that were reported in Fund 458.

Fund Statement Effect	**Debit**	**Credit**
General Fund		
Tax Refunds Payable	768,228	
Revenue		768,228
Remaining Funds		
Revenue	583,936	
Tax Refunds Payable		583,936
Discretely Presented Component Units		
Revenue	184,292	
Tax Refunds Payable		184,292

3. Passed Audit Adjustment

The NDSU Development Foundation failed to accrue this Receivable.

Entity-Wide Statement Effect	**Debit**	**Credit**
Discretely Presented Component Units		
Pledges Receivable, Net of an Allowance for Uncollectable Accounts and Contribution Receivables for Split-Interest Agreements	8,114,449	
Revenue		8,114,449