Client Code 405

INDUSTRIAL COMMISSION

BISMARCK, NORTH DAKOTA

Department of Mineral Resources
Lignite Research Program
Oil and Gas Research Program
Renewable Energy Program
Pipeline Authority
Transmission Authority

Audit Report

For the Biennium Ended
June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

January 10, 2012

The Honorable Jack Dalrymple, Governor

Members of the North Dakota Legislative Assembly

Karlene Fine, Executive Director, Industrial Commission

We are pleased to submit this audit of the Industrial Commission for the biennium ended June 30, 2011. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Richard Fuher, CPA. Kristi Morlock and Andrea Wike were the staff auditors. Fred Ehrhardt, CPA, was the audit supervisor. Inquiries or comments relating to this audit may be directed to the audit supervisor (701) 328-2241. We wish to express our appreciation to Karlene Fine, Lynn Helms, and their staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Industrial Commission was created by the Legislature in 1919 to conduct and manage, on behalf of the state, certain utilities, industries, enterprises, and business projects established by state law. The members of the Industrial Commission are the Governor, Attorney General, and the Agriculture Commissioner of the state.

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

Responses to LAFRC Audit Questions

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

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

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

   Other than our findings addressing "Noncompliance with State Procurement and Contracting Guidelines" (page 15) and "Civil Penalty Collections" (page 17), the Industrial Commission was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

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

   Other than our finding addressing the "Delegation of Authority Weakness" (page12), we determined internal control was adequate.

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?*

   The Industrial Commission has implemented all recommendations included in the prior audit report.

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

   Yes, a management letter was issued and is included on page 19 of this report, along with management's response.

LAFRC Audit Communications

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

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

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

   The Industrial Commission's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

   Significant audit adjustments were not necessary.

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

    None.

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

    None.

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

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

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

    None.

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

    ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the Industrial Commission.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Industrial Commission for the biennium ended June 30, 2011 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Industrial Commission's operations and is internal control adequate in these areas?

2. What are the significant and high-risk areas of legislative intent applicable to the Industrial Commission and are they in compliance with these laws?

3. Are there areas of the Industrial Commission's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Industrial Commission is for the biennium ended June 30, 2011. The scope of our audit included all balances and activities attributed to the following North Dakota Industrial Commission agencies: Department of Mineral Resources, Lignite Research Program, Oil and Gas Research Program, Renewable Energy Program, Pipeline Authority, and Transmission Authority. The Bank of North Dakota, Building Authority, Housing Finance Agency, Public Finance Authority, and Student Loan Trust are audited separately each year and will not be in the scope of our audit. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Industrial Commission has operations in the following locations. Each location was included in the audit scope:

- Administrative office in the State Capitol.
- Department of Mineral Resources office, Bismarck.
- Core and Sample Library, Grand Forks.
- Regional offices in Dickinson, Minot, and Williston.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.

- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively, and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Industrial Commission's processes and procedures.

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

Management's Discussion and Analysis

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

The following management discussion and analysis was prepared by the Industrial Commission's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the biennium ended June 30, 2011, operations of the Industrial Commission were primarily supported by appropriations from the state's general fund and special funds. This is supplemented by interest income and fees credited to the agency's operating fund.

Financial Summary

"Total Revenues and Other Sources" for the Industrial Commission were $9,425,199 in fiscal year 2010 compared to $5,673,932 in fiscal year 2011. Revenues unique to the Commission include revenues from an investment made through the Lignite Research Program with the Dakota Gasification Company (DGC). The provisions of the Investment Agreement state that the annual repayment to the Lignite Research Fund is linked to a formula based percentage of DGC's net income. DGC had profitable years in both 2010 and 2011. The remaining revenues came from federal funds, investment earnings on the research funds, charges for services, permits, and fees. With the increased oil and gas activity in the state, there has been an increase in income from permit fees, charges for sales and services, and other fees.

"Transfers in" were higher in 2010 than in 2011. State law authorizes that 2% of the revenues from the oil and gas gross production tax and oil extraction tax, up to $4 million per biennium, must be deposited monthly in the oil and gas research fund. With the state receiving increased revenues from these two taxes the entire $4 million in revenues was received during fiscal year 2010.

Total expenditures for the Industrial Commission were $13,032,679 for the year ended June 30, 2011 as compared to $15,900,806 for the prior year. Grant expenditures decreased in 2011 as a result of when work was completed under the research programs. Salaries and benefits increased the second year of the biennium reflecting general salary increases and pay adjustments as a result of increased oil and gas drilling activities in North Dakota. The workload impact was discussed in the 2008-2009 audit and we saw it throughout the 2009-2011 biennium. Even with the increased staffing authorized by the 2011 Legislature this will continue through the 2011-2013 biennium. In fact, based on current projections we do not expect it to level off until 2020. There was a decrease in professional services expenditures due to the difficulty we had in hiring contractors to perform reclamation. In 2009 we bid out two large reclamation projects. The expenditures on those projects were disbursed during fiscal year 2010 when the work was completed. In the spring of 2010 we bid out additional reclamation projects and did not receive any bids due to oil industry activity consuming all available services. The remaining expenditures are fairly consistent with prior biennia.

By law the Industrial Commission has responsibility for a number of funds that are listed in this report. Of particular note is the Cash Bond Fund. On June 30, 2010 the balance in the Fund was $5,654,866 and on June 30, 2011 the balance in the Fund was $7,904,395. Monies deposited in this fund are from administrative fees on all moneys held or controlled by the Commission under subdivision d of subsection 1 of Section 38-08-04 (the statute allowing a company to provide a cash bond rather than surety bond when operating in North Dakota). Moneys in this fund are appropriated to the Commission to be used for 1) defraying costs incurred in the plugging of abandoned oil and gas wells and related activities; and 2) defraying costs incurred in the reclamation of abandoned oil and gas drilling and production sites, saltwater disposal pits, drilling fluid pits and access roads, and related activities. Also included in the funds are geophysical exploration accounts, geothermal accounts, coal accounts, and subsurface mineral accounts.

The Commission's oversight also includes the Abandoned Oil and Gas Reclamation Fund. On June 30, 2010 the balance in this Fund was $792,862 and on June 30, 2011 the balance in the Fund was $1,084,569. Revenues to the fund must include:

a. Fees collected by the Oil and Gas Division of the Industrial Commission for permits or other services.
b. Moneys received from the forfeiture of drilling and reclamation bonds.
c. Moneys received from any federal agency for the purpose of this section.
d. Moneys donated to the Commission for the purposes of this section.
e. Moneys received from the State's Oil and Gas Impact Fund.
f. Moneys recovered under the provisions of Section 38-08-04.8.
g. Moneys recovered from the sale of equipment and oil confiscated under section 38-08-04.9
h. Moneys transferred from the Cash Bond Fund under Section 38-08-04.11.
i. Such other moneys as may be deposited in the Fund for use in carrying out the purposes of plugging or re-plugging of wells or the restoration of well sites.

Monies in this Fund are appropriated and must be used and disbursed solely for the purpose of defraying the costs in carrying out the plugging or re-plugging of wells, the reclamation of well sites and all other related activities.

Analysis of Significant Changes in Operations

During the 2009-2011 biennium the Biomass Incentive and Research Fund/Program was rolled into the Renewable Energy Development Fund/Program. Remaining funds in the Biomass Incentive and Research Fund were transferred to the Renewable Energy Development Fund. During the 2009 Legislative Session the Carbon Dioxide Storage Administration Fund was established with special fund and continuing appropriation authority. It is intended that fee income will cover the costs of administering the Carbon Dioxide Storage Program. In the meantime the 2011 Legislature authorized (with an emergency clause) a General Fund one-time transfer of $532,000. This funding will allow the Department to hire staff to resolve the issues that have arisen with the North Dakota law and regulations with what has been proposed at the federal level.

Oil and gas development increased significantly during fiscal years 2010 and 2011. In December 2009 there were 75 drilling rigs and 4,623 producing wells operating in the state—production for calendar year 2009 was 79,736,468 barrels of oil. In December 2010 there were 163 drilling rigs and 5,331 producing wells operating in the state—production for calendar year 2010 was 113,032,814 barrels of oil. Since December of 2010 the rig count, producing well count and oil production has continued to increase. This level of activity creates significant

workload for the Industrial Commission. This will be an ongoing concern for the Commission and its staff.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The Commission continued to see unexpended appropriation authority in its grants line item. This is a result of the timing of payments for Lignite Research Program Projects. Payments are made on projects based on work accomplished. Because of uncertainty at the federal level on energy issues, two lignite projects have been delayed. The Commission has committed Lignite Research Fund dollars in the approximate amount of $14 million for two significant lignite projects. These projects are the Great Northern Power Development Project near South Heart and the American Lignite Energy Project in McLean County. If issues at the federal level are resolved we are hopeful that work could proceed and the funding would be utilized.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2011	June 30, 2010
Revenues and Other Sources:		
Charges for Sales and Services	$ 428,118	$ 252,802
Dakota Gasification Company Loan Revenue	224,700	375,480
Permit Fees	271,555	185,160
Federal Revenue	107,179	143,372
Fines and Forfeitures	126,250	7,167
Interest and Investment Earnings	46,466	72,211
Contributions and Private Grants	32,300	35,800
Miscellaneous Revenue	63,889	119,063
Transfers In	4,373,475	8,234,144
Total Revenues and Other Sources	$ 5,673,932	$ 9,425,199
Expenditures:		
Grants	$ 6,396,982	$ 9,484,697
Salaries and Benefits	5,097,165	4,310,460
Professional Services	320,859	790,164
Travel	339,467	359,926
Rentals/Leases – Building/Land	173,588	385,917
Other Operating Expenses	171,458	173,329
Equipment	167,099	98,559
Data Processing/Communications	139,848	116,001
Supplies	195,461	125,373
Professional Development	30,752	56,380
Total Expenditures	$ 13,032,679	$ 15,900,806

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 9,088,764	$ 503,841	$ 9,592,605	$ 9,249,942	$ 342,663
Operating Expenses	2,498,776	130,659	2,629,435	2,322,958	306,477
Capital Assets	38,000		38,000	37,998	2
Grants	19,971,300		19,971,300	11,112,752	8,858,548
Carbon Dioxide Storage Admin.		532,000	532,000		532,000
State Facility Lignite Project	400,000		400,000	400,000	
Renewable Energy Development	3,000,000		3,000,000	3,000,000	
Totals	$ 34,996,840	$ 1,166,500	$ 36,163,340	$ 26,123,650	$ 10,039,690
Expenditures by Source:					
General Fund	$ 13,800,254	$ 1,157,000	$ 14,957,254	$ 14,132,076	$ 825,178
Other Funds	21,196,586	9,500	21,206,086	11,991,574	9,214,512
Totals	$ 34,996,840	$ 1,166,500	$ 36,163,340	$ 26,123,650	$ 10,039,690

Appropriation Adjustments:

The $503,841 increase in salaries and benefits line item was the result of the following adjustments. The Industrial Commission received $484,500 of the amount appropriated in House Bill 1015, section 18, of the 2009 Session Laws, for market equity adjustments. House Bill 1343, section 1, of the 2011 Session Laws provided $150,000 in additional funding for the purpose of defraying salaries and operating expenses related to oil and gas industry regulatory responsibilities, of which $98,750 was allocated for salaries. The Emergency Commission approved a transfer in the amount of $79,409 to the operating expenses line item.

The $130,659 increase in operating expenses line item consisted of $79,409 transferred from salaries and benefits line item approved by the Emergency Commission to be used for the contracting of professional services to process applications for drilling permits; and $51,250 allocated from the additional funding provided in House Bill 1343, section 1, of the 2011 Session Laws.

The $532,000 increase in the carbon dioxide storage administration line item was pursuant to House Bill 1014, section 18, of the 2011 Session Laws for the purpose of hiring one full-time-equivalent position for up to three years until fee income is sufficient to provide funding for the administration of the provisions of North Dakota Century Code chapter 38-22.

Expenditures Without Appropriations Of Specific Amounts:

Fossil Excavation and Restoration Fund has a continuing appropriation authorized by NDCC section 54-17.4-09.1 ($74,448 of expenditures for this biennium).

Oil and Gas Research Fund has a continuing appropriation authorized by NDCC section 57-51.1-07.3 ($2,864,945 of expenditures for this biennium).

Cash Bond Fund has a continuing appropriation authorized by NDCC section 38-08-04.11 ($372,389 of expenditures for this biennium).

Cartographic Products Fund has a continuing appropriation authorized by NDCC section 54-17.4-10 ($2,958 of expenditures for this biennium).

Global Positioning System Community-Base Station Fund has a continuing appropriation authorized by NDCC section 54-17.4-12 ($4,398 of expenditures for this biennium).

Oil and Gas Reservoir Data Fund has a continuing appropriation authorized by NDCC section 38-08-04.6 ($338,694 of expenditures for this biennium).

Abandoned Oil and Gas reclamation Fund has a continuing appropriation authorized by NDCC section 38-08-04.5 ($9,094 of expenditures for this biennium).

Pipeline Authority Administrative Fund has a continuing appropriation authorized by NDCC section 54-17.7-11 ($174,900 of expenditures for this biennium).

Renewable Energy Development Fund has a continuing appropriation authorized by NDCC section 54-63-04 ($2,407,446 of expenditures for this biennium).

Geo Mineral Coal Exploration Fund has a continuing appropriation authorized by NDCC section 38-21-01 ($175 of expenditures for this biennium).

Geo Data Preservation Fund has a continuing appropriation authorized by NDCC section ($206 of expenditures for this biennium).

Biomass Incentive and Research Fund transferred the unexpended and unobligated balance in the fund at June 30, 2009, to the Renewable Energy Fund pursuant to 2009 Session Laws, chapter 42, section 7 ($1,080,378).

Internal Control

In our audit for the biennium ended June 30, 2011, we identified the following areas of the Industrial Commission's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent, including the authority delegated by the Industrial Commission to the Director of Oil and Gas.
- Controls surrounding the ConnectND (PeopleSoft) system.

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.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control. We also noted other matters involving internal control that we have reported to management of the Industrial Commission in a management letter dated January 10, 2012.

Delegation of Authority Weakness (Finding 11-1)

Condition:
The Industrial Commission has not formally delegated the authority to execute complaints or consent agreements to the Director of the Oil and Gas Division. The Director enters into complaints and consent agreements without an explicit delegation from the Industrial Commission.

Criteria:
North Dakota Century Code section 38-08-04.2 enables the Industrial Commission to delegate all powers the Commission has under the title and under rules enacted under the title to the Director of the Oil and Gas Division.

Cause:
The Director's duties have evolved into including the authority to execute complaints and consent agreements with the implicit permission of the Industrial Commission.

Effect or Potential Effect:
Without a clear delegation of authority, external parties are unable to determine which actions carried out by the Director of the Oil and Gas Division are expressly authorized by the Industrial Commission.

Recommendation:

We recommend the Industrial Commission:

- Reaffirm the authority delegated to the Director of the Oil and Gas Division, and Clarify whether the Director has delegated authority to execute complaints and consent agreements.

Industrial Commission Response:

The Commission agrees in part. It has been a long-standing practice of the Industrial Commission that the Department of Mineral Resources Director/Oil and Gas Director has authority to carry out the statutory provisions of the Industrial Commission as they relate to oil and gas regulation and the Geological Survey. In 2005 the Commission took specific action delegating this authority and identified some exceptions to that authority. Since additional responsibilities have been delegated to the Commission since 2005 the Commission agrees that it is timely that action be taken reaffirming the delegation of authority given to the Department of Mineral Resources Director and Director of the Oil and Gas Division. A new Delegation of Authority Resolution was adopted February 14, 2012.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2011, we identified and tested the Industrial Commission's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Compliance with the Industrial Commission's jurisdiction and authority to enforce the provisions related to the control of gas and oil resources (North Dakota Century Code section 38-08-04).
- Enforcement of flaring of gas requirements (North Dakota Century Code section 38-08-06.4).
- Compliance with the Industrial Commission's authority to impose and compromise civil penalties (North Dakota Century Code section 38-08-16).
- Compliance with requiring reasonable surety bonds (North Dakota Century Code sections 38-12-02, 38-12.1-04, and 38-19-03).
- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapter 42).
- Compliance with the requirements for contingent funding for the Department of Mineral Resources (2009 North Dakota Session Laws chapter 42, section 6).
- Compliance with the Lignite Research, Development, and Marketing Program – Lignite Marketing Feasibility Study (2009 North Dakota Session Laws chapter 42, section 10).
- Compliance with the State Facility Lignite Feasibility Demonstration Project (2009 North Dakota Session Laws chapter 42, section 14).
- Proper use of the following legally restricted funds:
  - Fossil Excavation and Restoration fund.
  - Renewable Energy Development fund.
  - Oil and Gas Research fund.
  - Pipeline Authority Administration fund.
  - Cash Bond fund.
  - Lignite Research fund.
  - Oil and Gas Reservoir fund.
- Application of proper statutory rates relating to revenue.
- Proper use of authorized funds.
- Compliance with Emergency Commission requests and budget changes.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Statutory authority for investments and the proper utilization of the Bank of North Dakota for processing credit card processing.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping and surplus property.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These findings are described below. Other than those findings, we concluded there was compliance with the legislative intent identified above. We also noted certain inconsequential instances of noncompliance that we have reported to management of the Industrial Commission in a management letter dated January 10, 2012.

Noncompliance with State Procurement and Contracting Guidelines (Finding 11-2)

Condition:
The Department of Mineral Resources did not follow state procurement and contracting guidelines for two of their contracts. Formal sealed bids were required for both contracts, but were not obtained. The initial terms of the contracts stated that each contract was not to exceed $24,999, but contained renewal clauses and therefore was subject to formal bidding requirements.

We also noted the contracts did not contain recommended contract clauses, such as, but not limited to:

- Indemnity and Limitations of Liabilities clause;
- Insurance clause;
- Confidentiality clause; and
- State audit clause.

Lastly, the agency did not have its legal counsel or attorney review the contracts.

Criteria:
According to the State Procurement Guidelines, when planning a purchase, you must determine the total estimated purchase price of the needed commodities or services. For services, the entire amount of a service contract includes the initial term and all possible extensions and renewal options. The required level of competition for purchases over $25,000 is to solicit formal sealed bids or proposals.

Guidelines to Managing Contractual Risk Manual created by the Office of Management and Budget Risk Management Division and the State Procurement Office, and the Contract Drafting and Review Manual created by the Office of Attorney General requires contracts to contain certain clauses as noted above. Contracts are also to be reviewed by each agency's legal counsel.

Cause:
The Department of Mineral Resources did not properly follow guidance in writing contracts and improperly followed procurement guidelines when procuring contracts.

Effect or Potential Effect:
Noncompliance with State Procurement and Contracting Guidelines.

Recommendation:

We recommend that the Industrial Commission:

1. Solicit bids using the required level of competition in accordance with State Procurement Guidelines;
2. Ensure contracts contain recommended clauses; and
3. Ensure its contracts are reviewed by legal counsel in accordance with the Office of Attorney General's *Contract Drafting and Review Manual*.

Industrial Commission Response:

The Industrial Commission agrees. Any future contracts will be written to comply with the most current Procurement Guidelines and the Office of Attorney General Contract Drafting and Review Manual.

Civil Penalty Collections (Finding 11-3)

Condition:
The North Dakota Century Code does not specify which fund or funds civil penalties and consent agreement collections related to NDCC section 38-08-16 are to be deposited. Currently, the Industrial Commission is depositing uncontested civil penalties into the State Tuition Fund and consent agreement payments are deposited into the Abandoned Oil and Gas Well Plugging and Site Reclamation Fund.

Criteria:
North Dakota Century Code (NDCC) section 38-08-16 enables the Industrial Commission to impose civil penalties for violations of NDCC, or any rule, regulation, or order of the commission.

NDCC section 15.1-28-01 states that the net proceeds of fines for the violation of state laws must be deposited into the State Tuition Fund. North Dakota Supreme Court case State ex rel. Backes v. A Motor Vehicle Described as a Pawling and Harnishefeger concluded that the phrase "fines for violation of state laws" referred to in the constitution does not encompass civil penalties. Therefore, civil penalty collections should not be treated as fines and deposited into the State Tuition Fund.

Cause:
NDCC section 38-08-16 is silent as to where civil penalty and consent agreement collections should be deposited.

Effect or Potential Effect:

Closely related collections are not being deposited consistently.

Recommendation:

We recommend the Oil and Gas Division seek a formal Attorney General's opinion to determine where to deposit monies received under NDCC section 38-08-16.

Industrial Commission Response:

The Industrial Commission agrees. Because there have been different interpretations over time regarding the deposit of these funds we concur with the State Auditor's recommendation and the Oil and Gas Division Director will seek an Attorney General's opinion.

Operations

This audit did not identify areas of Industrial Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

January 10, 2012

Ms. Karlene Fine, Executive Director
Industrial Commission
600 E. Boulevard Avenue
Bismarck, ND 58505

Dear Ms. Fine:

We have performed an audit of the Industrial Commission for the biennium ended June 30, 2011, and have issued a report thereon. As part of our audit, we gained an understanding of the Industrial Commission's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

CASH

Informal Recommendation 11-1: We recommend the Department of Mineral Resources reconcile the federal funds deposited on PeopleSoft to amounts shown by the federal government as paid to the agency.

FIXED ASSETS

Informal Recommendation 11-2: We recommend the Industrial Commission ensure its capitalized fixed asset records only contain fixed assets that meet the Office of Management and Budget's capitalization policy criteria.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 11-3: We recommend the Industrial Commission ensure coffee provided at Industrial Commission hearings is reimbursed at actual cost and supported by receipts.

Informal Recommendation 11-4: We recommend the Industrial Commission ensure:

- The responsibilities for the approval of vouchers and IDB's are segregated from those for preparation;
- Purchase cardholders submit their monthly statement and receipts to their supervisor for review; and
- Supervisors sign the cardholders' statement certifying that the purchases were made for the use of state business and that they comply with appropriate procurement rules and regulations.

Informal Recommendation 11-5: We recommend the Industrial Commission use their P-card as a form of payment to all vendors accepting P-cards.

LEGISLATIVE INTENT

Informal Recommendation 11-6: We recommend the Department of Mineral Resources comply with records retention laws.

Management of Industrial Commission agreed with these recommendations.

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

Sincerely,

Richard Fuher, CPA
Auditor in-charge

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