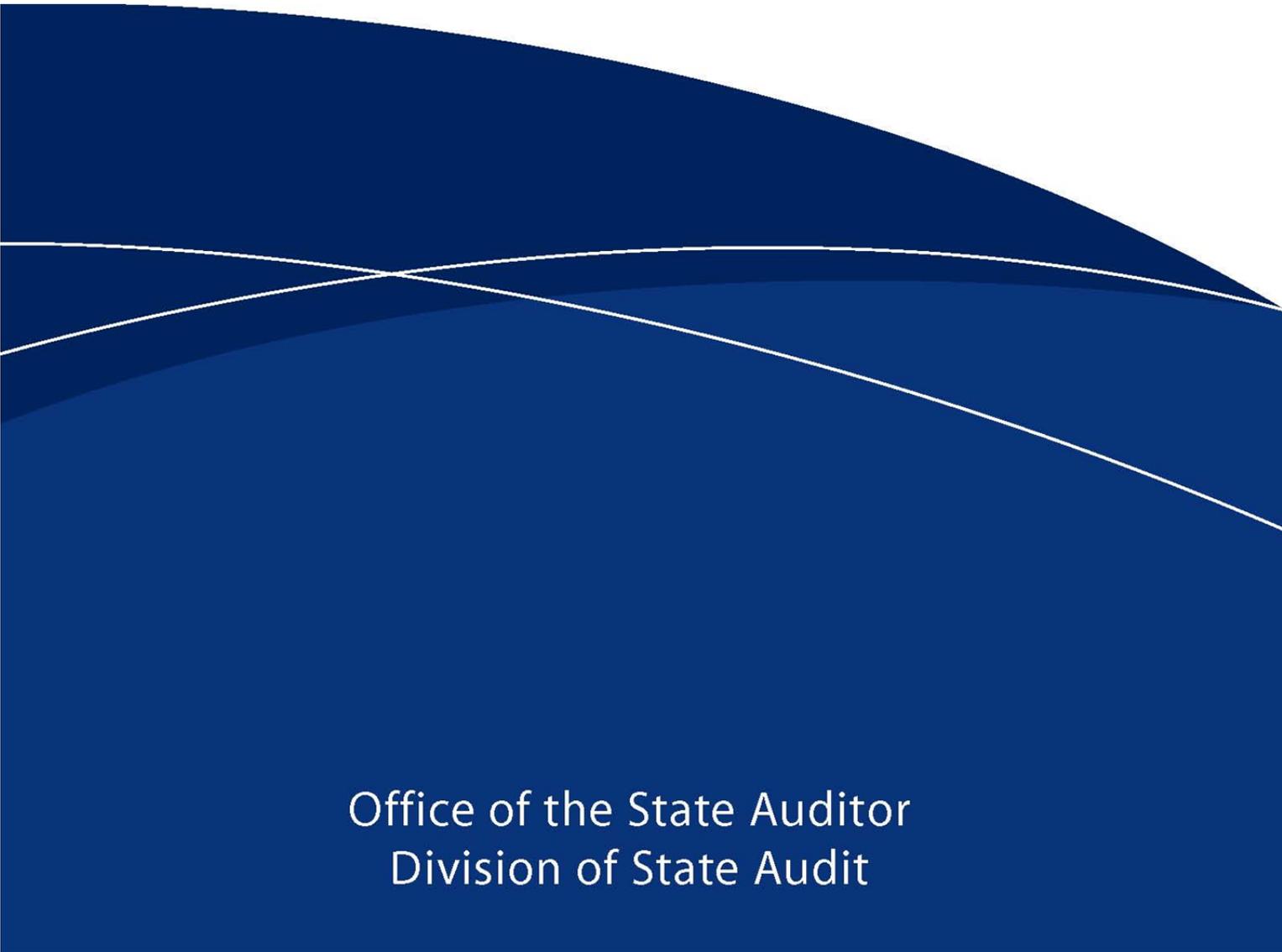


AERONAUTICS COMMISSION
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium
June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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STATE AUDITOR
ROBERT R. PETERSON



PHONE
(701) 328 - 2241
FAX
(701) 328 - 1406

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

Transmittal Letter

June 13th, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Larry Taborsky, Director, North Dakota Aeronautics Commission

We are pleased to submit this audit of the Aeronautics 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 Crystal Hoggarth. Paul Welk, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to director Larry Taborsky and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Aeronautics Commission was established in 1947 by the State Legislature assigning responsibility for the state aviation functions. The Governor appoints the five members of the Aeronautics Commission to the board for terms of five years. The Commission is composed of the Director and three support staff plus two vacant positions.

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 Aeronautics 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?

Yes

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "fraud risk assessment" (page 9), we determined internal controls were adequate.

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

There were not any indications of a lack of efficiency in financial operations and management of the Aeronautics Commission.

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

The prior recommendation "Fraud Risk Assessment" (page 9) has not been implemented.

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 14 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 Aeronautics' Commissions 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, Human Resource Management System (HRMS), and AIMS (Aviation Information Management System) are high-risk information technology systems critical to the Aeronautics Commission.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Aeronautics 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 Aeronautic 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 Aeronautics Commission and are they in compliance with these laws?
3. Are there areas of the Aeronautic Commission's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Aeronautic Commission is for the biennium ended June 30, 2011. 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 Aeronautics Commission's sole location is its Bismarck office which was included in the audit scope.

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 developed a 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 Aeronautics 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.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Aeronautics 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).

For the biennium ended June 30, 2011, operations of the Aeronautics Commission were primarily supported by appropriations from the Aeronautics Special fund. The Special Fund has moneys collected from excise taxes, motor fuel taxes, and registration and licensing fees credited to the agency's special fund. This is supplemented by federal and general funds.

Financial Summary

Revenues consisted primarily of aircraft excise tax collections, federal revenue, and registrations and licensing fees. These all remained fairly constant for the Aeronautics Commission except for the aircraft excise taxes which increased due to more aircrafts being purchased, and an increase in federal revenue due to more contract activity for airports resulting in more Federal Aviation Administration reimbursements for fiscal year 2011. Total revenues were \$2,418,062 for the year ended June 30, 2011 as compared to \$982,584 for the year ended June 30, 2010.

Total expenditures for the Aeronautics Commission were \$3,449,637 for the year ended June 30, 2011 as compared to \$3,432,416 for the prior year. Expenditures remained fairly constant.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The excess of the salary and wages appropriations over the actual expenditures was due to a vacant FTE and turnover during the audit period. The excess appropriation on the capital assets line was due to a planned terminal and fencing project at the International Peace Garden airport that did not happen. The variance in the grants line was caused by numerous projects that did not take place which included: a \$900,000 ADBS Navigation project; \$500,000 PCI Study; \$1,610,000 Master Plan Studies; and a \$1,350,000 AWOS study.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$1,194,283	\$379,611
Aircraft Excise Tax	1,047,356	478,353
Aircraft Licenses and Registrations	97,433	94,145
Aircraft Services	77,457	28,073
Miscellaneous Revenue	1,533	2,402
Total Revenues and Other Sources	<u>\$2,418,062</u>	<u>\$982,584</u>
<u>Expenditures and Other Uses:</u>		
Grants to State Airports	\$1,799,257	\$1,967,790
Consulting and Engineering Fees	980,756	744,546
Salaries and Benefits	371,720	376,889
Aircraft Repairs and Fuel/Oil	66,055	108,081
Travel	46,343	34,736
Rental/Leases of Buildings and Equipment	39,967	40,114
Printing	22,765	16,297
Aircraft Repair Services	21,386	52,421
Professional Development	17,667	17,654
IT Expenses	34,640	30,830
Insurance	9,249	9,971
Utilities	4,897	
Postage	5,442	6,904
Miscellaneous Expenses	29,493	26,183
Total Expenditures and Other Uses	<u>\$3,449,637</u>	<u>\$3,432,416</u>

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 887,234	\$ 14,000	\$ 901,234	\$ 746,861	\$ 154,373
Operating Expenses	1,841,432		1,841,432	1,698,670	142,762
Capital Assets	400,000		400,000	75,081	324,919
Grants	9,790,000		9,790,000	4,361,442	5,428,558
Totals	<u>\$ 12,918,666</u>	<u>\$ 14,000</u>	<u>\$ 12,932,666</u>	<u>\$ 6,882,053</u>	<u>\$ 6,050,613</u>
Expenditures by Source:					
General Fund	\$ 550,000		\$ 550,000	\$ 550,000	
Other Funds	12,368,666	\$ 14,000	12,382,666	6,332,053	\$ 6,050,613
Totals	<u>\$ 12,918,666</u>	<u>\$ 14,000</u>	<u>\$ 12,932,666</u>	<u>\$ 6,882,053</u>	<u>\$ 6,050,613</u>

Appropriation Adjustments:

The increase to the Salaries and Benefits line was for the market equity raises provided in House Bill 1015 of the 2009 Session Laws.

Internal Control

In our audit for the biennium ended June 30, 2011, we identified the following areas of the Aeronautics 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.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer-based Aviation Information Management System (AIMS).

The criteria used to evaluate internal controls are 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 Aeronautics Commission's management in a management letter dated June 13, 2012.

Fraud Risk Assessment (Finding 11-1)

Condition:

The Aeronautics Commission has not established a fraud risk assessment to identify possible instances of fraud or fraudulent activities at the Aeronautics Commission. No control activities are in place or documented to ensure significant fraud exposures are identified and mitigated.

Criteria:

The Office of Management and Budget policy 216 states that all agencies need to complete a fraud risk assessment at least every biennium for each function and division.

Cause:

The Aeronautics Commission was aware of the requirement but did not develop a fraud risk assessment. This was a prior formal recommendation in the 2008-2009 biennial audit.

Effect or Potential Effect:

Fraud and fraudulent activities could occur and not be identified.

Recommendation:

We recommend the Aeronautics Commission establish a fraud risk assessment on a comprehensive and recurring basis. We recommend that control activities be designed and documented to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated.

Aeronautics Commissions Response:

The Aeronautics Commission agrees with the finding. Since this auditing period, an additional staff member has been hired. His duties will include making an objective assessment from the perspective of a new person who is not directly involved in the financial transactions of the office. His recommendations, and those of the auditor, will be compiled, addressed, and documented for the next audit.

Compliance With Legislative Intent

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

- Collection and allocation of aircraft excise tax (NDCC 57-40.5-02 and 57-40.5-09).
- Collection and allocation of aircraft registrations fee (NDCC 2-05-11).
- Anemometer towers locations (Senate Bill 2206, section 1 - emergency measure from the 2011 session).
- Funding of Airport authorities (House Bill 1132, section 7 - emergency measure from the 2011 session).
- Application of proper statutory rates relating to revenue.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapter 34).
- Compliance with OMB's Purchasing Procedures Manual.
- 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, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, 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 Aeronautics Commission in a management letter dated June 13, 2012.

Operations

This audit did not identify significant areas of the Aeronautics Commission's operations to help to improve efficiency or effectiveness that were required to be reported in accordance with Government Auditing Standards, however, we did note a less significant matter involving operations that we have reported to management of the Aeronautics Commission in a management letter dated June 13, 2012.

Prior Recommendations Not Implemented

The recommendation from the prior audit as shown below has not been implemented.

Fraud Risk Assessment (Finding 09-01)

Recommendation:

We recommend the Aeronautics Commission:

- Establish and perform a control risk assessment including a fraud risk assessment on a recurring basis; and
- Design and document the necessary control activities to ensure that each of the significant control risks and fraud exposures identified during the risk assessment process has been adequately mitigated.

Status:

Not implemented - see Finding 11-01 on page 9.

Management Letter (Informal Recommendations)

June 13, 2012

Mr. Larry Taborsky, Director
Aeronautics Commission
PO Box 5020
Bismarck, ND 58502

Dear Mr. Taborsky:

We have performed an audit of the Aeronautics 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 Aeronautics 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 Aeronautics Commission:

- Deposit cash in a timely manner.
- Ensure that cash received in June is recorded on ConnectND in the correct fiscal year or included on the Cash and Investments closing package for the state's CAFR.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 11-2: We recommend the Aeronautics Commission charge expenses to appropriate account and class codes.

Informal Recommendation 11-3: We recommend the Aeronautics Commission strengthen controls surrounding the purchase card including:

- Reconciling individual purchase card statements to the agency-wide statement.
- Consistently reviewing and approving all reconciliations of the individual purchase card statements to receipts.
- Closing purchase cards upon termination of employment.
- Restricting the Purchase Card Administrator from using the purchase card.

Informal Recommendation 11-4: We recommend the Aeronautics Commission strengthen controls surrounding travel reimbursements to include:

- Proper support to justify hotel expenses exceeding allowable rates, justifications for rental car expenses, and starting and ending travel times for meal reimbursements;
- Limiting mileage reimbursement in the city of employment to travel from the employees normal workstation;
- Reimbursing travel expenses in accordance with the amount on the receipt;
- Properly reviewing travel expense reimbursements claims to ensure allowable reimbursements; and,
- Properly accounting for taxable meals.

Informal Recommendation 11-5: We recommend the Aeronautics Commission establish controls to ensure meals are provided on a reimbursement basis to individuals in travel status within per-diem allowances in accordance with OMB policies 217 and 505. In addition the Aeronautics Commission should only reimburse meals for employees not in travel status when a necessary working lunch occurs.

General Ledger

Informal Recommendation 11-6: We recommend the Aeronautics Commission develop procedures to approve all ConnectND entries prepared by other agencies for the Aeronautics Commission on a monthly basis.

Legislative Intent

Informal Recommendation 11-7: We recommend the Aeronautics Commission establish controls to ensure that purchases are sales tax exempt in accordance with NDCC 57.39.2-04.

Informal Recommendation 11-8: We recommend the Aeronautics Commission establish controls to ensure that proper procurement guidelines are followed including:

- Ensuring purchases are properly bid or required emergency purchase documentation is completed;
- Properly utilizing state contracts;
- Obtaining adequate levels of procurements training for purchases over \$2,500; and
- Maintaining proper support to validate that services were properly bid.

Informal Recommendation 11-9: We recommend the Aeronautics Commission establish a documented inventory policy to set an accountability dollar threshold and identify sensitive inventory items in accordance with OMB policy 505. In addition, we recommend the Aeronautics Commission perform a physical inventory on an annual basis in accordance with NDCC 44-04-07.

Informal Recommendation 11-10: We recommend the Aeronautics Commission not exceed 75% of their appropriation for the operating line during the first 18 months of the biennium in accordance with NDCC 54-27-10.

Informal Recommendation 11-11: We recommend the Aeronautics Commission consistently recalculate the tax amounts submitted by the aircraft owner to ensure that aircraft excise taxes are collected in accordance with the NDCC 57-40.5-02.

Informal Recommendation 11-12: We recommend the Aeronautics Commission strengthen controls surrounding aircraft registrations to include:

- Ensuring the reconciliation between the aircraft inspected for registrations and the aircraft registered in AIMS is performed by an individual independent of access to cash and access to make changes in AIMS;
- Evidence of the reconciliation;
- Charging aircraft registration fees in accordance with NDCC 2-5-11; and
- Documenting policies for aircraft registration penalties and pro-rations.

Operational Improvement

Informal Recommendation 11-13: We recommend the Aeronautics Commission establish controls and procedures surrounding grants by:

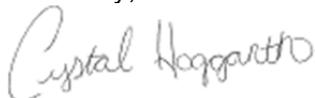
- Entering into contracts with the grantee that specify the requirements and expectations of the grant award;
- Communicating to the grantee in writing the consequences for noncompliance upon the grant award; and
- Establishing a corrective action plan for reimbursements granted on unallowable expenses.

Informal Recommendation 11-14: We recommend the Aeronautics Commission increase their usage of the purchase card as a form of payment

Management of the Aeronautics Commission agreed with these recommendations.

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

Sincerely,



Crystal Hoggarth
Auditor in-charge

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www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241