

ND MILL AND ELEVATOR
ASSOCIATION
GRAND FORKS, NORTH DAKOTA

Audit Report

For the Years Ended
June 30, 2011 and 2010

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Contents

<i>Independent Auditor’s Report</i>	<i>1</i>
<i>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</i>	<i>3</i>
<i>Management’s Discussion and Analysis</i>	<i>5</i>
<i>Financial Statements</i>	<i>9</i>
<i>Comparative Statement of Net Assets</i>	<i>9</i>
<i>Comparative Statement of Revenues, Expenses, and Changes in Net Assets</i>	<i>10</i>
<i>Comparative Statement of Cash Flows</i>	<i>11</i>
<i>Notes to the Financial Statements</i>	<i>13</i>
<i>Supplementary Information</i>	<i>25</i>
<i>Responses to LAFRC Audit Questions</i>	<i>25</i>
<i>LAFRC Audit Communications</i>	<i>26</i>
<i>Findings, Recommendations, and Management Response</i>	<i>28</i>
<i>Governance Communication</i>	<i>29</i>



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

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

The Industrial Commission

Vance Taylor, President and General Manager
North Dakota Mill and Elevator Association

We have audited the accompanying financial statements of the business-type activities of the North Dakota Mill and Elevator Association, an agency of the state of North Dakota, as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the North Dakota Mill and Elevator Association's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the North Dakota Mill and Elevator Association are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities of the state of North Dakota that is attributable to the transactions of the North Dakota Mill and Elevator Association. They do not purport to, and do not present fairly the financial position of the state of North Dakota as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the business-type activities of the North Dakota Mill and

Elevator Association as of June 30, 2011 and 2010, and the changes in financial position and its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 23, 2011 on our consideration of the North Dakota Mill and Elevator Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 5-8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the North Dakota Mill and Elevator Association basic financial statements. The accompanying financial information listed as supplementary information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of the North Dakota Mill and Elevator Association. Such information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the financial statements taken as a whole.



Robert R. Peterson
State Auditor

November 23, 2011



STATE OF NORTH DAKOTA
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600 E. BOULEVARD AVENUE - DEPT. 117
BISMARCK, NORTH DAKOTA 58505

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

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

The Industrial Commission

Vance Taylor, President and General Manager
North Dakota Mill and Elevator Association

We have audited the financial statements of the business-type activities of the North Dakota Mill and Elevator Association, an agency of the state of North Dakota, as of and for the years ended June 30, 2011 and 2010, which collectively comprise the North Dakota Mill and Elevator Association's financial statements and have issued our report thereon dated November 23, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the North Dakota Mill and Elevator Association'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 North Dakota Mill and Elevator Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the North Dakota Mill and Elevator Association's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the North Dakota Mill and Elevator Association's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We consider the deficiency described in the accompanying schedule of Findings, Recommendations, and Management Response as item 11-1 to be a significant deficiency in internal control over financial reporting.

We also noted certain matters that we reported to management of the North Dakota Mill and Elevator Association in a separate communication dated November 23, 2011, which is included in this report under Governance Communication.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Mill and Elevator Association'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*.

This report is intended solely for the information and use of management, the Governor, the Industrial Commission, and the Legislative Audit and Fiscal Review Committee and is not intended to be and should not be used by anyone other than these specified parties.



Robert R. Peterson
State Auditor

November 23, 2011

Management's Discussion and Analysis

This section of North Dakota Mill and Elevator Association's annual financial report presents management's discussion and analysis of the Mill's financial performance during the fiscal year that ended June 30, 2011. Please read this information in conjunction with the financial statements that follow this section.

FINANCIAL HIGHLIGHTS Condensed Financial Data

	FY 2011	FY 2010	FY 2009
Current Assets	\$ 78,363,277	\$ 44,822,627	\$ 50,917,643
Noncurrent Assets	302,477	291,221	269,721
Capital Assets	36,087,720	36,726,174	37,288,901
Total Assets	<u>\$ 114,753,474</u>	<u>\$ 81,840,022</u>	<u>\$ 88,476,265</u>
Current Liabilities	\$ 55,587,341	\$ 30,313,895	\$ 43,222,543
Noncurrent Liabilities	787,124	754,526	708,174
Total Liabilities	<u>56,374,465</u>	<u>31,068,421</u>	<u>43,930,717</u>
Invested in Capital Assets, Net of Related Debt	\$ 36,087,720	\$ 36,726,174	\$ 37,282,916
Unrestricted	22,291,289	14,045,427	7,262,632
Total Net Assets	<u>\$ 58,379,009</u>	<u>\$ 50,771,601</u>	<u>\$ 44,545,548</u>
Operating Revenue			
Gross Sales	\$ 272,891,617	\$ 222,354,845	\$ 259,677,920
Sales Deductions	(44,679,188)	(39,130,840)	(35,625,555)
Net Sales	<u>\$ 228,212,429</u>	<u>\$ 183,224,005</u>	<u>\$ 224,052,365</u>
Nonoperating Revenue			
Interest Income	28,853	10,778	27,178
Miscellaneous	88,017	63,529	75,453
Total Revenues	<u>\$ 228,329,299</u>	<u>\$ 183,298,312</u>	<u>\$ 224,154,996</u>
Operating Expenses			
Material Cost	\$ 189,914,884	\$ 149,384,187	\$ 215,321,188
Manufacturing	18,552,692	17,126,344	14,085,938
Selling	1,497,283	1,332,814	1,137,153
General	1,719,910	1,716,942	1,222,999
Nonoperating Expenses (Income)			
Interest Expense	531,852	507,819	2,036,147
Gain on Sales of Assets	-	-	-
Other	24,654	50,296	48,625
Total Expenses	<u>\$ 212,241,275</u>	<u>\$ 170,118,402</u>	<u>\$ 233,852,050</u>
Revenue Over (Under) Expenses	\$ 16,088,024	\$ 13,179,910	\$ (9,697,054)
Transfer to Industrial Commission	(34,404)	(34,404)	(36,254)
Transfer to General Fund	(7,641,811)	(6,260,457)	-
Transfer to Ag Fuel Tax Fund	(804,401)	(658,996)	-
Change in Net Assets	7,607,408	6,226,053	(9,733,308)
Beginning Net Assets	50,771,601	44,545,548	54,278,856
Ending Net Assets	<u>\$ 58,379,009</u>	<u>\$ 50,771,601</u>	<u>\$ 44,545,548</u>

- Gross sales reached \$272,892,000.
- During the fiscal year, the Mill shipped a record 11,489,000 hundredweight of flour.
- The mill made a record profit of \$16,088,000.
- Mill operations provided more than \$208,091,000 to the region and another \$482,771,000 in secondary economic activity for a total economic impact of more than \$690,862,000.

RESULTS OF OPERATIONS

Certain operating information is set forth below, as a percentage of gross sales for the fiscal years ended June 30, 2011, June 30, 2010 and June 30, 2009:

	<u>FY 2011</u>	<u>FY 2010</u>	<u>FY 2009</u>
Gross Margin	14.0%	15.2%	3.4%
Material Costs	69.6%	67.2%	82.9%
Operating Costs	8.0%	9.1%	6.3%
Profits	5.9%	5.9%	-3.7%

Gross sales reached \$272,892,000 for the fiscal year compared to \$222,354,000 last year and \$259,678,000 in fiscal year 2009. These high sales can be attributed to high wheat prices. Sales of spring wheat flour were 10,311,000 hundredweight or 90% of our total sales while sales of durum products were 1,178,000 hundredweight. This compares to sales of 10,041,000 hundredweight of spring wheat flour and 835,000 hundredweight of durum products last year. Bulk flour sales represent 78% of the flour sold. Flour packed in bags accounted for 22% of the flour sold.

As a result of this sales volume and high grain prices, the Mill spent more than \$187,543,000 buying spring wheat and durum. This is up from the previous year purchases of \$143,940,000 and down from purchases in fiscal year 2009 of \$206,952,000. This increase in fiscal year 2011 is due to an increase of \$2.04 in the price of grain delivered to the Mill during the year over the price paid in fiscal year 2010 and the increased number of bushels purchased. The Mill purchased more than 24,868,000 bushels of wheat and durum during the year just ended. The majority of the grain purchased is from North Dakota growers or grain elevators.

In addition to spending over \$187,543,000 on grain, most of which went to North Dakota farmers, the Mill also spent \$8,928,000 with other North Dakota based suppliers. Payroll costs for the North Dakota Mill were \$11,620,000 for the year ended June 30, 2011. These three items when added together show that the Mill provided a direct economic impact to the region of over \$208,091,000. A North Dakota State University study stated that for every dollar in direct economic activity from wheat processing, another \$2.32 was generated in secondary economic activity. Thus, the Mill produced \$482,771,000 in secondary economic activity resulting in a total economic impact of more than \$690,862,000.

Operating costs were \$21,770,000 compared to \$20,176,000 last year and \$16,446,000 in fiscal year 2009. This is an increase of \$1,594,000 from last year. The primary cause for this increase in operating cost is due to the increase in cwts. produced and sold. Operating cost per hundredweight of production increased to \$1.89 from \$1.86 in fiscal year 2010 and \$1.71 in fiscal year 2009.

Gross margins as a percent of gross sales fell to 14.0% from 15.2% in fiscal year 2010 and 3.4% in fiscal year 2009. Reduction in demand and competition is keeping downward pressure on margins. Profits as a percent of gross sales remained unchanged at 5.9% compared

to -3.7% in 2009. The Mill experienced a profit of \$16,088,000 compared to a profit of \$13,180,000 last year.

LIQUIDITY

The North Dakota Mill's cash requirements relate primarily to capital improvements and a need to finance inventories and receivables based on raw material costs and levels. These cash needs are expected to be fulfilled by the Mill through operations and an established operating line of credit with the Bank of North Dakota. The Mill has a \$60,000,000 operating line of credit with the Bank of North Dakota.

CASH FLOWS FROM OPERATIONS

Operating activities for the year ended June 30, 2011 used cash of \$7,557,000 compared to providing cash of \$28,411,000 in fiscal year 2010 and providing cash of \$46,295,000 in fiscal year 2009. Cash was used primarily for increases in the level of accounts receivables and inventories. There was an operating profit for this same period of \$16,528,000 compared to \$13,664,000 in fiscal year 2010 and operating loss of \$7,715,000 in 2009.

CASH FLOWS FROM FINANCING ACTIVITIES

The North Dakota Mill had \$32,500,000 of short-term debt outstanding and payable to the Bank of North Dakota on June 30, 2011 compared to \$13,400,000 last year and \$38,600,000 in fiscal year 2009.

NET ASSETS

Current assets increased \$33,541,000 from last year. This increase from last year is due primarily to large increases in accounts receivables and inventories. Accounts receivables increased \$17,137,000 while inventories rose \$15,328,000 from last year's values. This increase is due to the higher price of wheat.

The carrying value of capital assets decreased \$638,000 to \$36,088,000 for the year ended June 30, 2011. The North Dakota Mill completed several capital projects throughout the year that improved plant efficiencies and/or helped keep operating costs down. For more detailed information regarding capital assets and long-term debt activity see the Notes to the Financial Statements.

Current liabilities climbed \$25,273,000 from last year. The major change occurred in notes payable which increased \$19,100,000. The notes payable is to the Bank of North Dakota. The total net assets increased by \$7,607,000, resulting in an improvement in overall financial position.

COMMODITY PRICE RISK

The North Dakota Mill utilizes futures contracts offered through regulated commodity exchanges to reduce risk. The Mill is exposed to risk of loss in the market value of inventories and fixed purchase and sales contracts. To reduce this risk, opposite and offsetting futures positions are taken. Gains and losses on these positions are recognized for financial reporting purposes when they are realized.

INDUSTRY

U.S. annual wheat flour production increased in 2010 0.4% to 416,200,000 cwts. Production of whole wheat flour in the U.S. increased by 7% to 20,572,000 cwts. Production of durum flour and semolina in the U.S. increased by 3.7% to 32,728,000 cwts. The average rate of flour milling operations in 2010 was 88%. Excess flour milling capacity and high wheat and durum prices continue to put downward pressure on margins. We expect grain and financial markets to continue to be volatile.

North Dakota farmers produced an excellent spring wheat crop despite challenging growing conditions in 2011. Average spring wheat protein is higher this year. Good spring wheat quality has a positive impact on flour quality and contributes positively towards State Mill profitability.

Financial Statements

Comparative Statement of Net Assets

ASSETS	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents	\$ 639,829	\$ 33,614
Notes receivable	966,454	286,545
Receivables, net	45,738,433	28,601,856
Inventories, net	30,568,430	15,240,691
Prepaid expense	450,131	659,921
Total current assets	<u>\$ 78,363,277</u>	<u>\$ 44,822,627</u>
Noncurrent assets:		
Patronage capital credits	\$ 289,327	\$ 278,071
Other assets	13,150	13,150
Capital assets, net (note 6)	36,087,720	36,726,174
Total noncurrent assets	<u>36,390,197</u>	<u>37,017,395</u>
Total assets	<u>\$ 114,753,474</u>	<u>\$ 81,840,022</u>
 LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities (note 7)	\$ 14,641,129	\$ 9,994,442
Due to state general fund	7,641,811	6,260,457
Due to ag fuel tax fund	804,401	658,996
Notes payable	32,500,000	13,400,000
Total current liabilities	<u>\$ 55,587,341</u>	<u>\$ 30,313,895</u>
Noncurrent liabilities:		
Compensated absences	\$ 787,124	\$ 754,526
Total noncurrent liabilities	<u>787,124</u>	<u>754,526</u>
Total liabilities	<u>\$ 56,374,465</u>	<u>\$ 31,068,421</u>
 NET ASSETS		
Invested in capital assets	\$ 36,087,720	\$ 36,726,174
Unrestricted	22,291,289	14,045,427
Total net assets	<u>\$ 58,379,009</u>	<u>\$ 50,771,601</u>

The accompanying notes are an integral part of the financial statements.

Comparative Statement of Revenues, Expenses, and Changes in Net Assets

	2011	2010
OPERATING REVENUES		
Net sales	\$ 228,212,429	\$ 183,224,005
Total operating revenues	<u>\$ 228,212,429</u>	<u>\$ 183,224,005</u>
OPERATING EXPENSES		
Material cost	\$ 189,914,884	\$ 149,384,187
Manufacturing	18,552,692	17,126,344
Selling expense	1,497,283	1,332,814
General and administrative expense	1,719,910	1,716,942
Total operating expenses	<u>211,684,769</u>	<u>169,560,287</u>
Operating income	<u>\$ 16,527,660</u>	<u>\$ 13,663,718</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	\$ 28,853	\$ 10,778
Interest expense	(531,852)	(507,819)
Miscellaneous income	88,017	63,529
Other expense	(24,654)	(50,296)
Total nonoperating expenses	<u>(439,636)</u>	<u>(483,808)</u>
Gain before transfers	<u>\$ 16,088,024</u>	<u>\$ 13,179,910</u>
Transfer to state general fund	\$ (7,641,811)	\$ (6,260,457)
Transfer to ag fuel tax fund	(804,401)	(658,996)
Transfer to Industrial Commission	(34,404)	(34,404)
Change in net assets	<u>\$ 7,607,408</u>	<u>\$ 6,226,053</u>
Total net assets - beginning	<u>50,771,601</u>	<u>44,545,548</u>
Total net assets - ending	<u><u>\$ 58,379,009</u></u>	<u><u>\$ 50,771,601</u></u>

The accompanying notes are an integral part of the financial statements.

Comparative Statement of Cash Flows

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers and users	\$ 255,193,605	\$ 224,865,832
Payments to suppliers	(251,543,376)	(187,304,593)
Payments to employees	(11,206,857)	(9,150,018)
Net cash (used) provided by operating activities	\$ (7,556,627)	\$ 28,411,221
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from noncapital debt	\$ 36,900,000	\$ 10,400,000
Principal paid on noncapital debt	(17,800,000)	(35,600,000)
Note given for other than capital purposes	(1,085,286)	(286,545)
Interest paid on noncapital debt	(531,852)	(507,819)
Ag promotion	(24,654)	(50,296)
Transfer to Industrial Commission	(34,404)	(34,404)
Transfer to state general fund	(6,260,457)	
Transfer to ag fuel tax fund	(658,996)	
Net cash provided (used) by noncapital financing activities	\$ 10,504,351	\$ (26,079,064)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of infrastructure and equipment	\$ (33,944)	\$ (25,000)
Acquisition and construction of capital assets	(2,317,351)	(2,331,046)
Net cash used by capital and related financing activities	\$ (2,351,295)	\$ (2,356,046)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income on investments	\$ 9,786	\$ 10,778
Net cash provided by investing activities	\$ 9,786	\$ 10,778
Net increase in cash and cash equivalents	\$ 606,215	\$ (13,111)
Cash and cash equivalents, beginning	33,614	46,725
Cash and cash equivalents, ending	\$ 639,829	\$ 33,614

(Continued)

Statement of Cash Flows - Continued

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

Operating income	\$	16,527,660	\$	13,663,718
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation and amortization		3,020,712		2,918,773
Sales allowance adjustments		424,444		
Other nonoperating income		57,053		63,529
(Increase) decrease in receivables, net		(17,755,066)		2,447,458
(Increase) decrease in inventories		(15,327,740)		4,723,581
Decrease (increase) in prepaid expense		209,791		(184,101)
(Increase) in patronage capital credits		(11,255)		(21,500)
Increase in accounts payable		5,792,655		3,330,093
Increase in accrued payroll		1,013,570		883,915
(Decrease) increase in other liabilities		(1,542,766)		536,962
Increase in accrued sick and vacation pay		34,314		48,793
Total adjustments		<u>(24,084,288)</u>		<u>14,747,503</u>
Net cash (used) provided by operating activities	\$	<u>(7,556,627)</u>	\$	<u>28,411,222</u>

SUPPLEMENTAL DISCLOSURE ON NON CASH TRANSACTIONS

Assets acquired through derivatives			\$	618,488
Total non cash transactions			<u>\$</u>	<u>618,488</u>

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, as summarized below and the financial statements for the North Dakota Mill and Elevator Association (Mill) are in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) which is the nationally accepted standard-setting body for establishing governmental accounting and financial reporting principles.

A. Reporting Entity

For financial reporting purposes, the Mill has included all of its operations as enterprise funds, and has considered all potential component units for which the Mill is financially accountable and other organizations for which the nature and significance of their relationship with the Mill are such that exclusion would cause the Mill's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. This criteria includes appointing a voting majority of an organization's governing body and (1) the ability of the Mill to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Mill.

Based upon these criteria, there are no component units to be included within the Mill as a reporting entity and the Mill is included within the state of North Dakota as a reporting entity.

B. Basis of Presentation

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Mill's activities are considered to be an enterprise fund, single business-type activity (BTA) and accordingly, are reported within a single column in the basic financial statements.

C. Basis of Accounting

The enterprise fund is accounted for on a flow of economic resources measurement focus. The accrual basis of accounting is utilized by the enterprise fund. Revenue is recognized at the time of shipment from the Mill or from the transloading site. Expenses are recognized at the time goods and services were received and accepted.

In accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, the Mill does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, for business type activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

D. Cash and Cash Equivalents

This classification appears on the Comparative Statement of Net Assets and the Comparative Statement of Cash Flows and includes petty cash and cash on deposit with the Bank of North Dakota. Cash and cash equivalents for reporting purposes includes cash and short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of

changes in interest rates. This includes investments with original maturity of three months or less.

E. Receivables

Accounts receivable represent amounts due from customers for credit sales. Other receivables consist of grain margin accounts, pending railway claims, and derivatives. The grain margin accounts and derivatives are used to buy and sell spring wheat futures contracts on the Minneapolis Grain Exchange. Any activity would be recognized at cost after the settlement period. The allowance method is used to account for estimated uncollectible accounts receivable.

F. Inventories

Grain committed to production is valued at cost. Grain committed to sale is valued at net commitment price. Excess grain inventories are valued at June 30 Minneapolis grain market values less freight costs to Minneapolis. Flour, feed, and resale inventories are valued at ingredient cost plus manufacturing costs incurred in their production. Supplies inventories are valued at cost. The first-in, first-out basis is used for all inventories.

G. Capital Assets

Capital assets are stated at cost. When it is determined that a project consisting of machinery, equipment, or buildings will span more than one year, a "construction in progress" project folder is established to facilitate the accumulation until completion. Upon completion, the completed item is transferred to the applicable asset category. Movable equipment with a cost of \$5,000 or more is capitalized and reported in the accompanying financial statements.

Depreciation is computed on a straight-line basis over the estimated useful life of the assets, generally 10 to 20 years for infrastructure, 30 to 40 years for buildings, 5 to 25 years for plant equipment, 7 to 10 years for office equipment and furniture, and 5 to 10 years for leasehold improvements.

H. Noncurrent Long-Term Liabilities

Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.

I. Compensated Absences

Annual Leave - Union employees earn vacation within a range of 6 days to 30 days per year depending on length of continuous service. Other employees are entitled to earn annual leave, based on tenure of employment, within a range of 12 days to 30 days per year. Individuals may bank earned vacation time to a total accumulation of 30 days payable at retirement or upon severance of employment.

Sick Leave - Union employees earn sick pay at the rate of one day for each two months of continuous employment. Upon termination, union employees shall be paid an amount equal to \$50 times the total unused days of accumulated leave, not to exceed \$5,000. Other employees earn sick pay at the rate of one day per month. Upon termination, these employees are entitled to be paid 10% of their accumulated sick leave, if employed 10 years or longer.

J. Storage Liabilities

Stored grain is treated as a reduction in inventory balances.

K. Net Assets

The Mill's net assets are classified as follows:

Invested in Capital Assets – This represents the Mill's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Unrestricted Net Assets – Unrestricted net assets include resources derived from customer sales.

L. Revenue and Expense Recognition

The Mill presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that use Proprietary Fund Accounting. Operating activities are those activities that are necessary and essential to the mission of the Mill. Operating revenues include all charges to customers. Revenues from interest income, gains on sale of capital assets and bad debt recovery are considered nonoperating since these are either investing, capital or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital, or noncapital financing activities and do not include interest expense and disposal of undepreciated capital assets.

NOTE 2 – BUDGETING AND BUDGETARY CONTROL

The Mill provides its own operating funds. A two-year budget appropriation is approved by the State Legislature. The Mill's budgeting is on the accrual basis. The Mill does not use encumbrance accounting.

NOTE 3 – DEPOSITS

North Dakota Century Code (NDCC) Sections 6-09-07 and 21-04-02 govern the deposit and investment of public funds.

NDCC 6-09-07 states, "All state funds...must be deposited in the Bank of North Dakota...or must be deposited in accordance with constitutional and statutory provisions."

NDCC 21-04-02 provides that public funds belonging to or in the custody of the state shall be deposited in the Bank of North Dakota.

At June 30, 2011 and 2010 the carrying amounts of the Mill's deposits were \$638,829 and \$33,614 respectively, and the bank balances were \$8,879,088 and \$4,611,270, respectively. All deposits are exposed to custodial credit risk because they are not covered by depository insurance and the deposits are uncollateralized. These monies are deposited in the Bank of North Dakota and are guaranteed by the state of North Dakota (North Dakota Century Code Section 6-09-10).

NOTE 4 – RECEIVABLES

The Mill and Elevator entered into a note receivable with a customer in December 2009 and with another customer in September 2010. The total of the note at June 30, 2011 and 2010 was \$966,454 and \$286,545, respectively, with a variable interest rate of 2%, which is the same rate that the Bank of North Dakota charges the Mill and Elevator.

Receivables at June 30, 2011 and 2010 consist of the following:

June 30, 2011	Gross Receivables	Allowance		Net Receivables
		Bad Debts	Billbacks/ Promotional	
Current Receivables				
Accounts	\$ 47,475,607	\$ (1,763,864)	\$ (504,760)	\$ 45,206,983
Margin accounts	531,450			531,450
Total Current Receivables	<u>\$ 48,007,057</u>	<u>\$ (1,763,864)</u>	<u>\$ (504,760)</u>	<u>\$ 45,738,433</u>

June 30, 2010	Gross Receivables	Allowance		Net Receivables
		Bad Debts	Billbacks/ Promotional	
Current Receivables				
Accounts	\$ 29,736,832	\$ (1,266,566)	\$ (486,898)	\$ 27,983,368
Derivative grain futures contract	618,488			618,488
Total Current Receivables	<u>\$ 30,355,320</u>	<u>\$ (1,266,566)</u>	<u>\$ (486,898)</u>	<u>\$ 28,601,856</u>

At June 30, 2011 and 2010, the ages of accounts receivable were as follows:

	2011	2010
Current	\$ 28,290,759	\$ 20,110,868
1-30 Days	14,908,792	7,397,408
31-60 Days	3,370,976.00	1,517,882
61-90 Days	519,550.00	374,723
Over 90 Days	385,530.00	335,951
	<u>\$ 47,475,607</u>	<u>\$ 29,736,832</u>

NOTE 5 – INVENTORIES

At June 30, 2011 and 2010, inventories consisted of the following:

	2011	2010
Grain	\$ 22,553,665	\$ 14,838,306
Flour, Feed, Resale	7,301,988	3,753,586
Supplies	712,777	539,946
Total Inventories	30,568,430	19,131,838
Less Storage Liabilities		(3,491,147)
Total	<u>\$ 30,568,430</u>	<u>\$ 15,640,691</u>

The Mill's net position in the grain market at June 30, 2011 and 2010 was as follows:

	2011 Bushels		2010 Bushels	
	Wheat	Durum	Wheat	Durum
Quantity on Hand	2,105,128	181,109	2,330,883	398,122
Less Storage Liability			(601,507)	(32,298)
Company Owned Grain	2,105,128	181,109	1,729,376	365,824
Open Purchase Contracts				
Cash	(3,848,090)	219,142	3,789,908	105,917
Futures	1,445,000		(1,400,000)	
Total	(297,962)	400,251	4,119,284	471,741
Committed to Production			(3,856,531)	(407,096)
Net Position Long (Short)	(297,962)	400,251	262,753	64,645

Any gains or losses on net open position would only occur if there were changes in the market price of wheat or durum prior to the Mill covering their open position. Losses on open purchase contracts could occur if there was a failure to deliver the commodity. The amount of loss would depend upon the difference between the contract price and the market price at that time.

NOTE 6 – CAPITAL ASSETS

A summary of changes in capital assets for fiscal years ended June 30, 2011 and 2010 is presented as follows:

	Balance 7/1/10	Additions	Deletions	Transfers	Balance 6/30/11
Capital Assets, Non-Depreciable:					
Land	\$ 221,553				\$ 221,553
Construction in Progress		\$ 2,412,851		\$ (1,443,486)	969,365
Total Capital Assets, Non-Depreciable	\$ 221,553	\$ 2,412,851		\$ (1,443,486)	\$ 1,190,918
Capital Assets, Depreciable:					
Infrastructure	\$ 2,716,761				\$ 2,716,761
Buildings	20,393,787				20,393,787
Machinery & Equipment	55,824,718	\$ 28,290	\$ (282,178)	\$ 1,409,710	56,980,540
Furniture & Fixtures	1,034,696	5,654		33,776	1,074,126
Total Capital Assets, Depreciable	\$ 79,969,962	\$ 33,944	\$ (282,178)	\$ 1,443,486	\$ 81,165,214
Less Accumulated Depreciation for:					
Infrastructure	\$ 1,686,724	\$ 77,622			\$ 1,764,346
Buildings	10,264,800	475,335			10,740,135
Machinery & Equipment	30,867,233	2,369,644	\$ (217,642)		33,019,235
Furniture & Fixtures	646,584	98,112			744,696
Total Accumulated Depreciation	\$ 43,465,341	\$ 3,020,713	\$ (217,642)		\$ 46,268,412
Total Capital Assets, Depreciable, Net	\$ 36,504,621	\$ (2,986,769)	\$ (64,536)	\$ 1,443,486	\$ 34,896,802
Capital Assets, Net	\$ 36,726,174	\$ (573,918)	\$ (64,536)		\$ 36,087,720

	Balance 7/1/09	Additions	Deletions	Transfers	Balance 6/30/10
Capital Assets, Non-Depreciable:					
Land	\$ 221,553				\$ 221,553
Construction in Progress	2,377,854	\$ 2,331,046		\$ (4,708,900)	
Total Capital Assets, Non-Depreciable	<u>\$ 2,599,407</u>	<u>\$ 2,331,046</u>		<u>\$ (4,708,900)</u>	<u>\$ 221,553</u>
Capital Assets, Depreciable:					
Infrastructure	\$ 2,467,970			\$ 248,791	\$ 2,716,761
Buildings	19,964,103			429,684	20,393,787
Machinery & Equipment	51,986,907	\$ 25,000		3,812,811	55,824,718
Furniture & Fixtures	840,481		\$ (23,399)	217,614	1,034,696
Total Capital Assets, Depreciable	<u>\$ 75,259,461</u>	<u>\$ 25,000</u>	<u>\$ (23,399)</u>	<u>\$ 4,708,900</u>	<u>\$ 79,969,962</u>
Less Accumulated Depreciation for:					
Infrastructure	\$ 1,614,929	\$ 71,795			\$ 1,686,724
Buildings	9,805,322	459,478			10,264,800
Machinery & Equipment	28,550,746	2,316,487			30,867,233
Furniture & Fixtures	598,970	71,013	\$ (23,399)		646,584
Total Accumulated Depreciation	<u>\$ 40,569,967</u>	<u>\$ 2,918,773</u>	<u>\$ (23,399)</u>		<u>\$ 43,465,341</u>
Total Capital Assets, Depreciable, Net	<u>\$ 34,689,494</u>	<u>\$ (2,893,773)</u>		<u>\$ 4,708,900</u>	<u>\$ 36,504,621</u>
Capital Assets, Net	<u>\$ 37,288,901</u>	<u>\$ (562,727)</u>			<u>\$ 36,726,174</u>

Depreciation expense at June 30, 2011 and 2010 was charged in the following amounts to operating expense:

	2011	2010
Manufacturing	\$ 2,925,182	\$ 2,851,221
General & Administrative	95,530	67,552
Total	<u>\$ 3,020,712</u>	<u>\$ 2,918,773</u>

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2011 and 2010 were as follows:

	2011	2010
Accounts Payable	\$ 12,272,909	\$ 6,048,081
Accrued Gain Sharing	1,813,233	834,328
Accrued Payroll	352,425	317,760
Compensated Absences, Current Portion	41,428	39,712
Grain Contracts Payable		757,009
Accrued Commissions	44,360	15,069
Accrued Payroll Taxes and Benefits		634,555
Margins payable		432,173
Deferred Inflow of Resources		618,488
Other	116,774	297,267
Total accounts payable and accrued liabilities	<u>\$ 14,641,129</u>	<u>\$ 9,994,442</u>

NOTE 8 – SHORT-TERM NOTES PAYABLE

The Mill uses a revolving line of credit to finance current operations. Short-term debt activity for the years ended June 30, 2011 and 2010 was as follows:

	Balance 7/1/10	Draws	Repayments	Balance 6/30/11
Line of credit	<u>\$ 13,400,000</u>	<u>\$ 36,900,000</u>	<u>\$ (17,800,000)</u>	<u>\$ 32,500,000</u>

	Balance 7/1/09	Draws	Repayments	Balance 6/30/10
Line of credit	<u>\$ 38,600,000</u>	<u>\$ 10,400,000</u>	<u>\$ (35,600,000)</u>	<u>\$ 13,400,000</u>

NOTE 9 – LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities for June 30, 2011 and 2010 is presented as follows:

	Balance 7/1/10	Additions	Reductions	Balance 6/30/11	Current Portion	Noncurrent Portion
Net Pension Obligations		\$ 633,230	\$ (633,230)			
Compensated Absences	\$ 794,238	437,784	(403,470)	\$ 828,552	\$ 41,428	\$ 787,124
Total Long-Term Liabilities	<u>\$ 794,238</u>	<u>\$ 1,071,014</u>	<u>\$ (1,036,700)</u>	<u>\$ 828,552</u>	<u>\$ 41,428</u>	<u>\$ 787,124</u>

	Balance 7/1/09	Additions	Reductions	Balance 6/30/10	Current Portion	Noncurrent Portion
Net Pension Obligations		\$ 598,748	\$ (598,748)			
Compensated Absences	\$ 745,447	417,204	(368,413)	\$ 794,238	\$ 39,712	\$ 754,526
Total Long-Term Liabilities	<u>\$ 745,447</u>	<u>\$ 1,015,952</u>	<u>\$ (967,161)</u>	<u>\$ 794,238</u>	<u>\$ 39,712</u>	<u>\$ 754,526</u>

NOTE 10 – BONUS AND OTHER EMPLOYEE AGREEMENTS

The general manager's annual bonus opportunity is based on performance, up to 30% of base salary. The employee's annual bonus opportunity is based on achieving production, safety, and profit goals. Production and safety goals have a 4% bonus potential and if profit before gain sharing expense accrual exceeds \$2 million, the profit bonus would be 1% of base salary for each million in profits (before gain sharing expense accrual), or fraction thereof. The bonus potential was accrued. (See Note 7)

NOTE 11 – LEASE OBLIGATIONS

During the fiscal years ended June 30, 2011 and 2010 the Mill had operating leases with original terms of one to 21 years on 549 to 499 bulk rail and box cars, respectively. Contract rental charges per car varied from \$175 to \$895 per month. The Mill also has an operating lease with Pitney Bowes for a postage machine and GMAC for the general manager's automobile. The annual contract expenses for the years ended June 30, 2011 and 2010 are as follows:

	2011	2010
Bulk rail cars	\$ 4,253,430	\$ 3,928,682
Postage machine	2,774	2,182
Automobile	8,097	9,229
Total operating lease payments	<u>\$ 4,264,300</u>	<u>\$ 3,940,093</u>

The minimum future lease payments for each of the next five years and in the aggregate is as follows:

6/30/2012	\$ 4,072,422
6/30/2013	3,253,472
6/30/2014	2,618,783
6/30/2015	2,095,902
6/30/2016	1,214,125
6/30/2017-2019	1,673,000
	<u>\$ 14,927,704</u>

NOTE 12- PENSION AND POST-RETIREMENT PLANS/BENEFITS

The North Dakota Mill and Elevator Association participates in the North Dakota Public Employees' Retirement System (NDPERS), administered by the state of North Dakota. The following is a brief description of the plans:

A. Description of Pension Plans

1. NDPERS has a cost-sharing multiple-employer defined benefit pension plan covering substantially all classified employees of the Mill. The plan provides retirement, disability, and death benefits. If an active employee dies with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse will be entitled to either a single payment refund, life-time monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, or monthly payments in an amount equal to the employees' accrued 100% joint and survivor retirement benefit, if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the employee's accumulated pension benefits are paid; the balance will be payable to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary, with a minimum benefit of \$100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits beginning when the sum of age and years of credited service equal or exceed 85, or at normal retirement age (65), equal to 2% of their final average salary for each year of service. The plan permits early retirement at ages 55-64, with three or more years of service.

2. NDPERS has a cost-sharing multiple-employer defined contribution pension plan covering selected non-classified employees of the Mill. The employee selects where all mandatory contributions will be invested, from the investment options available through

the plan. The plan provides retirement, disability, and death benefits. An employee gradually vests in the employer contributions as follows: 50% after two years of service; 75% after three years of service; and 100% after four years of service. An employee is always vested in their own contributions. If an active employee dies, the surviving spouse or beneficiary will receive the full market value of the vested portion of the account.

Employees who become disabled are eligible to draw from their account until the funds are gone, subject to income taxes upon withdrawal.

Employees are entitled to their plan benefits at any time upon separation from the state. An early withdrawal penalty may apply, if the employee takes their money before age 59½ without, for example, rolling the money into another qualified plan or IRA.

B. Pension Plan Funding Policy

NDPERS is funded by employee contributions (set by statute) of 4% of regular compensation. During the 1983-1985 biennium the state implemented the employer pickup provision of the IRS code whereby a portion or all of the required employee contributions are made by the employer. The state is paying the full employee contribution. Employer contributions of 4.12% of covered compensation are set by statute. The required contributions are determined using an entry age normal actuarial funding method.

C. State Group Health Plan

Section 54-52.1-03.2 of the North Dakota Century Code establishes a Retiree Health Benefits Fund to provide members who receive retirement benefits from the Public Employees Retirement System a credit toward their monthly health insurance premium under the state health plan based upon the member's years of credited service. The employer contribution for the Public Employees Retirement System is set by statute on an actuarially determined basis (projected unit actuarial cost method) at 1.14% of covered compensation. Employees participating in the retirement plan, as part-time/temporary members are required to contribute 1.14% of their covered compensation to the Retiree Health Benefits Fund.

The North Dakota Retirement Board was created by the state legislature and is the governing authority of NDPERS. Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. The Mill's required and actual contributions to NDPERS for the fiscal years ending June 30, 2011, 2010, and 2009 were \$633,230, \$598,748, and \$460,692, respectively.

NDPERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. The report may be obtained by writing to: NDPERS; 400 East Broadway, Suite 505; PO Box 1657; Bismarck, ND 58502-1657.

NOTE 13 - DEFERRED COMPENSATION PLAN

The state offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits them to defer a portion of their current salary until future years. Participation in the plan is optional. The deferred compensation is not available to the employees until separation of employment, unforeseeable emergency, de minimus distribution or qualified domestic relations orders.

All compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights are held in trust for the exclusive use of the employee or their beneficiary.

The North Dakota Mill and Elevator employee deposits to deferred compensation for June 30, 2011 and 2010 were \$183,066 and \$161,745, respectively.

NOTE 14 – CONCENTRATIONS

The Mill sells a substantial portion of its product to five major customers. Sales to these customers totaled approximately 6,435,667 and 6,089,129 hundredweight for the years ended June 30, 2011 and 2010, respectively. For both June 30, 2011 and 2010, sales to these customers were 56% of total sales.

Approximately 69% of employees are employed under a five-year bargaining agreement that will expire at June 30, 2014. This contract contains a provision that states there shall be no strikes, slowdowns or stoppages of work, picketing, boycotts or other interference with the full operations of the business of the Company by the employees covered by this agreement and there shall be no lockout by the employer.

NOTE 15 - RELATED PARTY TRANSACTIONS

Chapter 54-18 of the North Dakota Century Code provides that the Industrial Commission shall transfer to the state general fund 50% of the annual earnings of the Mill after any transfers to other state agricultural-related programs. The chapter also provides that the Industrial Commission shall transfer 5% of the net income earned by the Mill during that fiscal year to the agricultural fuel tax fund.

As referred to in Note 3, the Mill does all of its banking with the Bank of North Dakota. The Mill established a revolving line of credit with the Bank of North Dakota and as of June 30, 2011 and 2010, there was \$32,500,000 and \$13,400,000 outstanding, respectively. The interest rate is variable at 1.0% over the 3-month LIBOR, adjusted quarterly. As of June 30, 2011, the floor rate was 2.0%.

NOTE 16 – DERIVATIVE INSTRUMENT

The fair value balances and notional amount of derivative instruments outstanding at June 30, 2011 and the changes in fair value of such derivative instruments for the year then ended as reported in the 2011 financial statements are (\$702,058), classified as derivative – grain futures contract (one contract equals 5000 bushels) and (\$702,058), classified as deferred outflow of resources, respectively. The fair value of the grain futures contracts was determined on the Minneapolis Grain Exchange. The margin requirement is \$.60 per bushel, unless the market price changes the limit for two consecutive days, then the margin requirement is \$.90 per bushel. The Mill has entered into futures contracts for spring wheat to lock in a price for a future delivery or settlement period. These contracts are entered into to protect the Mill against price fluctuations of the commodity. The price protection is needed to cover any long or short positions compared to flour sales.

Futures	Brokerage Firm	Number of Contracts	Average Cost	Fair Value	Effective Date
Sept 2011	ADM Investor Services	10	\$8.4530	\$7.9500	June 2011
Sept 2011	MF Global	79	8.1430	7.9500	June 2011
Dec 2011	ADM Investor Services	37	8.4050	7.9225	June 2011
Dec 2011	MF Global	92	8.4430	7.9225	June 2011
Mar 2012	ADM Investor Services	13	8.9230	8.0020	March, June 2011
Mar 2012	MF Global	37	8.7560	8.0025	June 2011
May 2012	ADM Investor Services	10	8.6000	8.0000	June 2011
May 2012	MF Global	6	9.0450	8.0000	June 2011
July 2012	ADM Investor Services	5	8.4460	7.9900	June 2011

The Mill is exposed to credit risk on hedging derivative instruments that are in asset positions. All grain futures trades are completed using two different national brokerage firms on the Minneapolis Grain Exchange. The firms are rated A and BBB by the Standard & Poor's Rating Service.

The Mill is exposed to rollover risk on grain futures trades whenever the hedge ratio (defined in aggregate of the size across all futures months relative to the underlying net cash position) does not equal 1.0. At June 30, 2011, the table below shows the hedge ratio by futures month going forward:

Period	Hedge Ratio
September 2011	0.9
December 2011	0.9
March 2012	0.9
May 2012	1.0
July 2012	1.1
Net Position	0.9

The following table shows the Mill's hedge ratio by futures month going forward for at June 30, 2010:

Period	Hedge Ratio
Sept 2010	0.9
Dec 2010	1.0
Mar 2011	1.1
May 2011	0.9
Net Position	0.9

NOTE 17 - RISK MANAGEMENT

The North Dakota Mill and Elevator Association is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the North Dakota Mill and Elevator Association carries liability insurance and property insurance through the state's Risk Management Fund (RMF) and commercial insurance, respectively.

The 1995 Legislative Session established the RMF, an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of state agencies resulting from the elimination of the state's sovereign immunity. The RMF manages the tort liability of the state, its

agencies and employees. All state agencies participate in the RMF and each fund's contribution was determined using a projected cost allocation approach.

The Mill participated in North Dakota Workforce Safety and Insurance (WSI), an enterprise fund of the state of North Dakota. The WSI is a state insurance fund and a 'no fault' insurance system covering the state's employers and employees financed by premiums assessed to employers. The premiums are available for the payment of claims to employees injured in the course of employment.

The Mill participates in the State Bonding Fund which currently provides blanket fidelity bond coverage in the amount of \$2,000,000 for its employees. The State Bonding Fund does not currently charge any premium for this coverage.

There have been no significant reductions in insurance coverage from the prior years and settled claims resulting from these risks have not exceeded insurance coverage in any of the past three years.

NOTE 18 – COMMITMENTS AND CONTINGENCIES

At June 30, 2011 and 2010, the Mill had committed to purchase -3,848,090 and 3,789,908 bushels of spring wheat, respectively, and 219,142 and 105,917 bushels of durum, respectively.

In addition, at June 30, 2011, construction commitments totaled \$3,125,635; amounts authorized totaled \$4,095,000 and amounts expended totaled \$969,365. There were no construction commitments at June 30, 2010.

Supplementary Information

Responses to LAFRC Audit Questions

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

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

Unqualified.

- 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 significant deficiency included in this report under "Findings, Recommendations, and Management Response".

- 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?*

Yes.

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

Yes, the Governance Communication section of this report contains our informal recommendations.

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, management conflicts or contingent liabilities. However, we noted one relatively unusual transaction. Standards & Poor's Ratings Services lowered its counterparty credit and debt ratings for one of the Mill and Elevator's brokerage companies (MF Global Holdings Ltd.) to "D". On October 31, 2011, MF Global filed for Chapter 11 bankruptcy. The balance in the MF Global account on the Mill and Elevator's general ledger at that time was \$408,000. The Bankruptcy judge ordered 60% of the balance to be paid, or \$244,800. The Mill and Elevator expects to receive an additional 25% for a total recovery of \$346,800.

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 estimate of the useful lives, as described in Note 1, is used to compute depreciation on capital assets. Management's estimate of the allowance for uncollectible receivables is based on aging categories and past history. We evaluated the key factors and assumptions used to develop the allowances in determining that they are reasonable in relation to the financial statements taken as a whole.

3. *Identify any significant audit adjustments.*

None.

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.*

None.

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

None.

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

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

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

None.

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

Microsoft Dynamics GP and CINCH Agri-Suite are the most high-risk information technology systems critical to the North Dakota Mill and Elevator Association. We noted one exception directly related to the operation of an information technology system that related to power user access in Finding 11-1 on page 28 of this report.

Findings, Recommendations, and Management Response

POWER USER ACCESS (Finding 11-1)

The Mill and Elevator went on a new Great Plains Dynamics computer system during fiscal year 2011. During the course of our audit, we noted that five employees have power user access, which gives them access to virtually all components of the system. Three of the individuals were in the information technology department and the other two were in the accounting department, the controller and senior accountant. Since the accounting department is responsible for the financial statements and makes regular entries onto the system, having the ability to change anything in the system is cause for concern.

Computer access rights should be limited to what employees need to perform their duties. The Mill and Elevator should have effective computer access controls to help prevent and detect unauthorized use, damage, loss or modification of programs and data.

Recommendation:

We recommend that the Mill and Elevator restrict power user access to the information technology department by limiting access rights to what is essential for employees to perform their duties.

North Dakota Mill and Elevator's Response:

Power user access will be restricted to those who work in the IT area.



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

Governance Communication

November 23, 2011

Legislative Audit and Fiscal Review Committee
Industrial Commission

We have audited the financial statements of the business-type activities of the North Dakota Mill and Elevator Association for the year ended June 30, 2011, and have issued our report thereon dated November 23, 2011. 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 North Dakota Mill and Elevator Association are described in Note 1 to the financial statements. GASB Statement 53, Accounting and Financial Reporting for Derivative Instruments, was adopted during fiscal year 2010 and the application of existing policies was not changed during fiscal year 2011. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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

- Useful lives of capital assets
- Allowance for uncollectible receivables: \$2,268,624

Management's estimate of the useful lives, as described in Note 1, is used to compute depreciation on capital assets. Management's estimate of the allowance for uncollectible receivables is based on aging categories and past history. We evaluated the key factors and assumptions used to develop the allowances in determining that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. None of the misstatements detected as a result of audit procedures were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 23, 2011.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

The following presents our informal recommendations:

Remittance List (Informal #1):

The Mill and Elevator is not preparing a remittance list when checks are received. The office assistant opens the mail and gives the checks to the administrative assistant to enter into the system.

Proper design and implementation of internal control policies and procedures for segregation of duties, approval, monitoring and verification methods are necessary to ensure management objectives are effectively achieved.

Recommendation:

We recommend that the North Dakota Mill and Elevator Association properly segregate cash receipting by having the office assistance prepare a remittance list upon opening the mail and give the remittance list to the senior accountant to verify the amount deposited was the amount received for the day.

North Dakota Mill and Elevator's Response:

The office assistant will prepare the remittance list requested and forward that list to the Senior Accountant.

Approval of Payroll Register (Informal #2):

Each pay period, the Controller is approving each pay check or direct deposit advice, but there is no indication of the approval on the payroll register.

Proper internal controls require an adequate audit trail be maintained to ensure proper segregation of duties exist over the approval function.

Recommendation:

We recommend that approval be noted on the payroll register for each pay period.

North Dakota Mill and Elevator's Response:

The payroll register will be initialed before each payroll. Currently the payroll batch must be approved by the Controller or Senior Accountant before the payroll checks can be printed.

Walk-in Sales (Informal #3):

Items are sold to walk-in customers by the office assistant. A listing of items sold and the cash is then given to the administrative assistant. The listing of items sold is then given to the customer service representative to remove from inventory by the administrative assistant. The administrative assistant writes a check to the ND Mill and keeps the cash.

Strong internal controls surrounding assets is recognized with a proper accounting trail and segregation of authorization, record-keeping, custody and reconciliation duties; however, the strong internal controls are lost when the same person who has custody of cash (administrative assistant) also has the ability to remove from inventory because of the sale. This weakness could be mitigated by having the office assistant prepare and give a listing of items to both the administrative assistant and the customer service representative and a comparison be done on a daily basis between items sold and items removed from inventory. This will create a better accounting trail for the items sold to walk-in customers, increase the internal controls surrounding assets, and provide a checks and balances for the items sold and amount the check is deposited for - thus reducing the risk of potential loss.

Recommendation:

We recommend that the office assistant prepare a list of items sold for both the administrative assistant and customer service representative.

North Dakota Mill and Elevator's Response:

The mill will no longer be making any cash sales as these of sales were very sporadic and amount to less than an estimated \$300 per year.

Fraud Prevention Policy (Informal #4):

The ND Mill and Elevator has conducted a fraud risk assessment, but does not have a formal written fraud prevention policy in place to establish an anti-fraud culture covering work practices and business ethics; specifically, this policy should include, at minimum, employee responsibility for fraud prevention and detection, reporting channels for suspected instances of impropriety,

procedures to be followed if fraud is suspected, allocation of responsibility for investigating fraud, and actions to be taken in the event of fraud (up to termination and/or legal recourse).

The most important guidance relating to internal control is contained in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework includes discussions about the importance of adequate risk assessment, risk management, code of conduct, and fraud deterrence.

Recommendation:

We recommend the ND Mill and Elevator governing board and management develop and implement a fraud prevention policy to establish an anti-fraud culture covering work practices and business ethics; specifically, this policy should include, at minimum,

- employee responsibility for fraud prevention and detection,
- reporting channels for suspected instances of impropriety,
- procedures to be followed if fraud is suspected,
- allocation of responsibility for investigating fraud, and
- actions to be taken in the event of fraud (up to termination and/or legal recourse).

North Dakota Mill and Elevator's Response:

The mill will develop a fraud prevention policy incorporating the above mentioned items.

Journal Entry Approval (Informal #5)

In our test of 40 journal entries, we noted there was no approval before the entry was posted to the general ledger.

Proper internal controls should not allow the individual who prepares a transaction to approve it.

Recommendation:

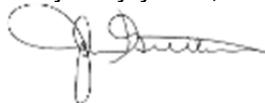
We recommend that the ND Mill and Elevator Association obtain an independent approval on all journal entries prior to entry on the general ledger.

North Dakota Mill and Elevator's Response:

Journal entries will be approved going forward.

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

Very truly yours,



John Grettum, CPA
Audit Manager

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
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Bismarck, ND 58505-0060