

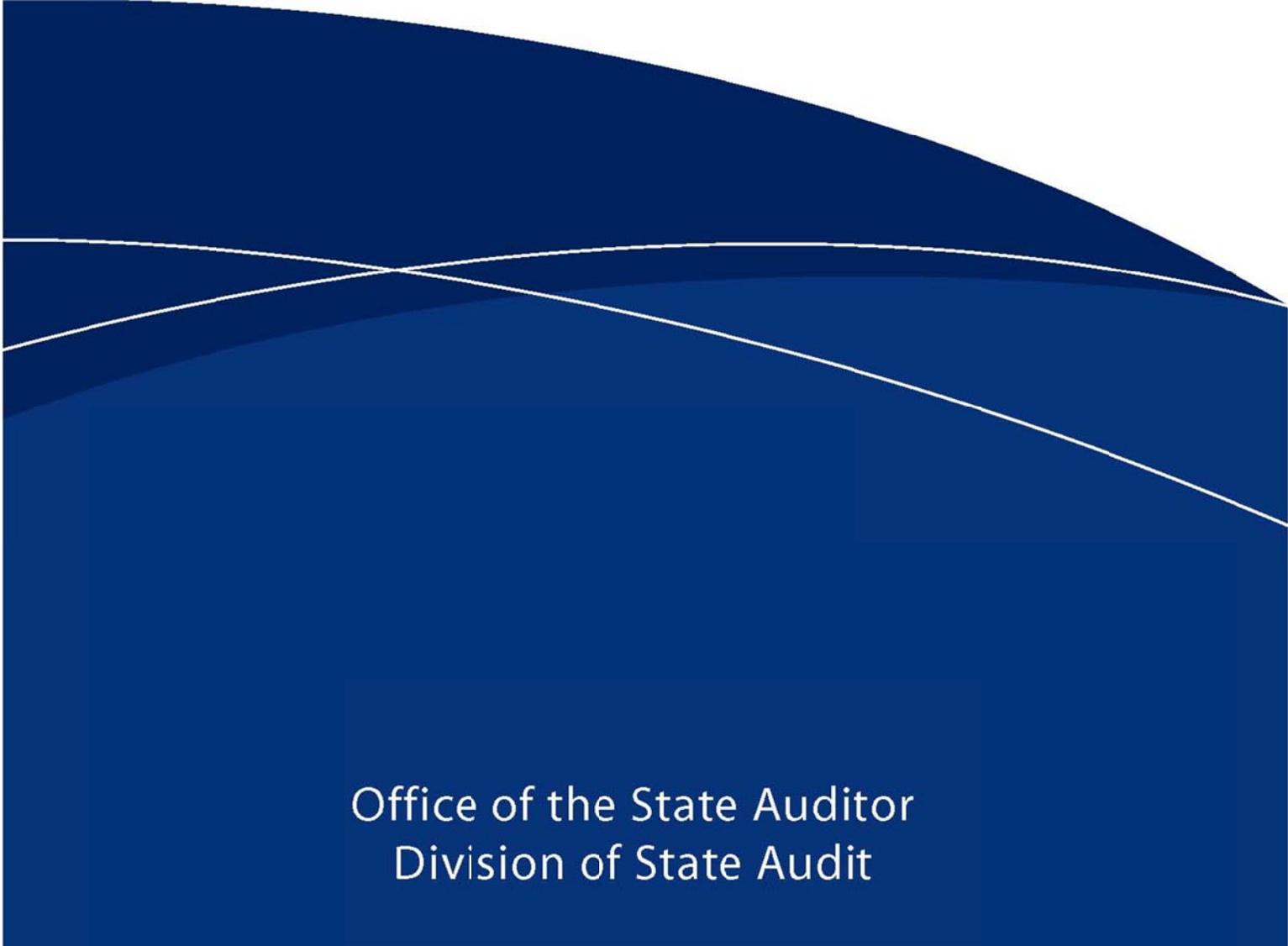


Department of Commerce
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2009

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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Transmittal Letter

May 14, 2010

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Shane Geottle, Commissioner, Department of Commerce

We are pleased to submit this audit of the Department of Commerce for the biennium ended June 30, 2009. 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 Allison Bader. Sarah Kuntz and Kevin Scherbenske, CPA, were the staff auditors. Cindi Pedersen, CPA was the audit supervisor and 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 Commissioner Shane Goettle 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 Department of Commerce is an umbrella agency, through the cooperative effort of several North Dakota state agencies. It operates as a liaison between the public and private sectors in order to enhance the marketability and financial stability of the state. The agency delivers goods and services through seven regional centers located across the state of North Dakota. Through the unique multiparty approach taken by the agency, it is able to provide a better business climate for the state, government, and private businesses alike.

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

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

Other than our finding addressing "noncompliance with appropriation laws" (page 12), the Department of Commerce was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Yes.

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

No.

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

The Department of Commerce has implemented all recommendations included in the prior audit report.

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

Yes, a management letter was issued and is included on pages 13-14 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 Department of Commerce's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

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

None.

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

None.

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

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

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

None.

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

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

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Department of Commerce for the biennium ended June 30, 2009 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Commerce'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 Department of Commerce and are they in compliance with these laws?
3. Are there areas of the Department of Commerce's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Commerce is for the biennium ended June 30, 2009. 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Department of Commerce has operations in its central office located in Bismarck and regional offices which operate the Manufactured Home Program in Dickinson and Grand Forks. The central office was included in the audit scope based on the level of activities performed at this location.

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.
- Interviewed appropriate agency personnel.

- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Department of Commerce'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 Department of Commerce'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, 2009, operations of the Department of Commerce were primarily supported by federal funds and appropriations from the state's general fund.

Financial Summary

Revenues and other sources consisted primarily of federal funds and legislatively mandated transfers. Federal funds increased due to additional federal awards received for weatherization assistance for low-income persons grants and stimulus funds. Legislatively mandated transfers decreased as a result of a lump sum transfer to the workforce enhancement fund pursuant to House Bill 1019, Section 11 of the 2007 Session Laws. Other revenues during the audited period included community services loan principle and interest revenue, interest and investment earnings, marketing event fees, and tourism merchandise sales. Program income consisted of revenue related to the innovate ND, manufactured home, and labor availability study programs. These all remained fairly constant for the Department of Commerce, decreasing slightly. Total revenues were \$22,538,893 for the year ended June 30, 2009 as compared to \$23,594,368 for the year ended June 30, 2008.

Total expenditures for the Department of Commerce were \$37,036,852 for the year ended June 30, 2009 as compared to \$37,159,486 for the prior year. The fluctuation in total expenditures for the audited period reflected primarily an increase in grants for weatherization assistance for low-income persons, stimulus funds, ethanol production incentives, and institutions of higher education workforce training programs. The decrease in operating fees and services reflected radio, television, and newspaper advertising services which are historically purchased during the first year of the biennium. In addition, appropriations to the North Dakota Trade Office pursuant to House Bill 1018, Section 10 were provided during the first year of the biennium. All other expenditures remained fairly constant.

Analysis of Significant Variances Between Final Budgeted and Actual Expenditures

The excess of grant and operating expenses appropriations over actual expenditures was due to \$17.6 million grant appropriation authority and \$1.9 million operating expense authority for the Community Development Block Grant Neighborhood Stabilization Program for which federal funds were not available until the end of the biennium. The remaining unexpended appropriation of the grants and operating expenses lines was a result of turmoil in the U.S. economy and fewer applicants for several economic development related programs.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$17,114,502	\$14,726,080
Loan Principle and Interest	1,689,811	1,847,190
Interest and Investment Earnings	112,261	218,337
Program Income	110,089	143,885
Marketing Event Fees	54,106	64,820
Tourism Merchandise Sales	70,338	81,870
Transfers In	3,387,786	6,512,186
Total Revenues and Other Sources	<u>\$22,538,893</u>	<u>\$23,594,368</u>
<u>Expenditures and Other Uses:</u>		
Grants	\$25,572,013	\$23,883,790
Salaries and Benefits	4,688,869	4,155,815
Operating Fees and Services	3,154,072	5,409,187
Professional Fees and Services	1,039,120	1,212,215
Printing	434,791	338,337
IT - Contracts/Data Processing/Equipment	414,216	316,400
Travel	402,276	401,549
Rentals/Leases – Building	278,087	265,223
Professional Development	229,029	280,617
Postage	222,260	280,017
Supplies/Equipment	218,200	142,243
Miscellaneous Expenses	17,789	21,759
Transfers Out	366,130	452,334
Total Expenditures and Other Uses	<u>\$37,036,852</u>	<u>\$37,159,486</u>

Statement of Appropriations

For The Biennium Ended June 30, 2009

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 8,826,879		\$ 8,826,879	\$ 8,474,761	\$ 352,118
Operating Expenses	14,408,688	\$ 1,960,000	16,368,688	12,653,168	3,715,520
Capital Assets	25,000		25,000	39,765	(14,765)
Grants	48,774,748	17,640,000	66,414,748	37,174,080	29,240,668
ND Development Fund	3,000,000		3,000,000	3,000,000	
Discretionary Grants	1,450,127	630,540	2,080,667	1,491,369	589,297
Economic Develop Initiatives	1,296,846		1,296,846	1,021,578	275,268
APUC	3,008,193	927,669	3,935,862	2,043,213	1,892,649
ND Trade Office Economic Develop Grants	1,500,000		1,500,000	1,500,000	
	50,000		50,000	50,000	
Totals	<u>\$82,340,481</u>	<u>\$21,158,209</u>	<u>\$103,498,690</u>	<u>\$67,447,934</u>	<u>\$36,050,755</u>
Expenditures by Source:					
General Fund	\$26,581,965	\$ 907,525	\$ 27,489,490	\$26,950,620	\$ 538,870
Other Funds	55,758,516	20,250,684	76,009,200	40,497,314	35,511,885
Totals	<u>\$82,340,481</u>	<u>\$21,158,209</u>	<u>\$103,498,690</u>	<u>\$67,447,934</u>	<u>\$36,050,755</u>

Appropriation Adjustments:

An increase in appropriation authority of \$19,600,000 to accept federal funds of the Housing and Economic Recovery Act of 2008 was allocated \$1,960,000 to the Operating Expenses line and \$17,640,000 to the Grants line. These funds are for the Neighborhood Stabilization Program to provide financial assistance for the redevelopment of abandoned and foreclosed homes to benefit low income citizens. Adjustment was approved by the Emergency Commission.

The increase of \$630,540 is unexpended discretionary funds appropriated in the 2005 Session Laws which were approved as carry over funds to the 2008-09 biennium pursuant to House Bill 1018, Section 6 of the 2007 Session Laws.

The increase of \$927,669 is unexpended Agricultural Products Utilization Commission grant funds appropriated in the 2005 Session Laws which were approved as carry over funds to the 2008-09 biennium pursuant to House Bill 1018, Section 5 of the 2007 Session Laws.

Expenditures Without Appropriations Of Specific Amounts:

The Statewide Conference Fund had expenditures that were nonappropriated in accordance with OMB policy 211 (\$918 of expenditures for the biennium).

The Ethanol Production Incentive Fund has a continuing appropriation authorized by NDCC 17-02-05 (\$5,678,464 of expenditures for the biennium).

The Workforce Enhancement Fund has a continuing appropriation authorized by NDCC 54-60-23 (\$1,084,939 of expenditures for the biennium).

Internal Control

In our audit for the biennium ended June 30, 2009, we identified the following areas of the Department of Commerce'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.

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

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded internal control was adequate.

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 did not identify any significant deficiencies in internal control. However, we noted other matters involving internal control that we have reported to management of Department of Commerce in a management letter dated May 14, 2010.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2009, we identified and tested the Department of Commerce's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

- Compliance with appropriations (2007 North Dakota Session Laws chapters 18, 28, and 493).
- Compliance with appropriations (2009 North Dakota Session Laws chapter 46).
- Proper use of the Agricultural Fuel Tax fund to defray the expenses of the ND Agricultural Products Utilization Commission for the enhancement of agricultural research, development processing, technology, and marketing. (NDCC section 4-14.1-02)
- Proper use of the Ethanol Production Incentive fund for use in paying ethanol production incentives. (NDCC section 17-02-05)
- Proper establishment of the following legislatively mandated programs:
 - State Talent Strategy (NDCC section 54-60-09)
 - Beginning Again North Dakota Pilot Program (NDCC section 54-60-20)
 - North Dakota American Indian Business Development Office (NDCC section 54-60-14)
 - North Dakota Women's Business Development Office (NDCC section 54-60-15)
- Compliance with procurement procedures (OMB Purchasing Procedures Manual, ND Administrative Code Chapter 4-12).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper identification of refund credits to appropriations (OMB Fiscal and Administrative Policy 214)

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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*. The finding is described below. Other than this finding, 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 Department of Commerce in a management letter dated May 14, 2010.

Noncompliance With Appropriation Laws (Finding 09-1)

Condition:

The Department of Commerce overspent their capital assets line item by \$14,765 for the 2007-2009 biennium. Expenditures for the purchase of the Weatherization Assistance Program software totaling \$15,000 were not properly recorded to the capital asset line item appropriation at June 30, 2009. The Department had \$235 remaining in their capital assets line prior to the software being appropriately charged to that line.

Criteria:

Section 54-16-03 of the North Dakota Century Code (NDCC) states it is unlawful to expend more than appropriated.

Cause:

Improper application of line item appropriation spending procedures.

Effect:

Noncompliance with NDCC 54-16-03.

Recommendation:

We recommend the Department of Commerce comply with Section 54-16-03 of the North Dakota Century Code by not overspending line item appropriation restrictions.

Department of Commerce Response:

We agree with the recommendation. In this case the Commerce Department Office Manager provided proper instruction to the program manager involved. However, the program manager failed to understand and follow the instruction. The program manager made the expenditure with federal funds and had the appropriate federal fund budget. The program manager did not have enough authority in the equipment line and therefore charged it to the operating line. We have taken corrective action concerning the program manager. We have also implemented additional safeguards designed to prevent this from occurring again.

Operations

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



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

Management Letter (Informal Recommendations)

May 14, 2010

Mr. Shane Goettle, Commissioner
Department of Commerce
1600 E. Century Avenue - Suite 2
Bismarck, ND 58503

Dear Commissioner Goettle:

We have performed an audit of the Department of Commerce for the biennium ended June 30, 2009, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Commerce'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.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 09-1: We recommend the Department of Commerce discontinue the clothing allowance for Tourism employees or obtain proper approval from the Office of Management and Budget. We also recommend the Department of Commerce process any clothing allowances approved by the Office of Management and Budget through the payroll system to ensure proper tax liabilities are addressed.

INVENTORY

Informal Recommendation 09-2: We recommend the Department of Commerce strengthen controls surrounding inventory by ensuring an independent individual performs reviews of:

- Purchases to sales and current inventory balances
- Sales to revenues on ConnectND
- Promotional withdrawals

REVENUE

Informal Recommendation 09-3: We recommend the Department of Commerce only credit appropriations for circumstances authorized by OMB Policy 214.

Informal Recommendation 09-4: We recommend the Department of Commerce properly deposit revenue with the Office of the State Treasurer for online sales of Tourism store inventory in accordance with State Constitution Article X, Section 12.

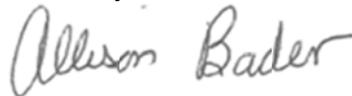
FIXED ASSETS

Informal Recommendation 09-5: We recommend the Department of Commerce properly capitalize the Weatherization Assistance Program software in accordance with OMB Fixed Asset Capitalization Policy.

Management of Department of Commerce 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,



Allison Bader
Auditor in-charge

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