

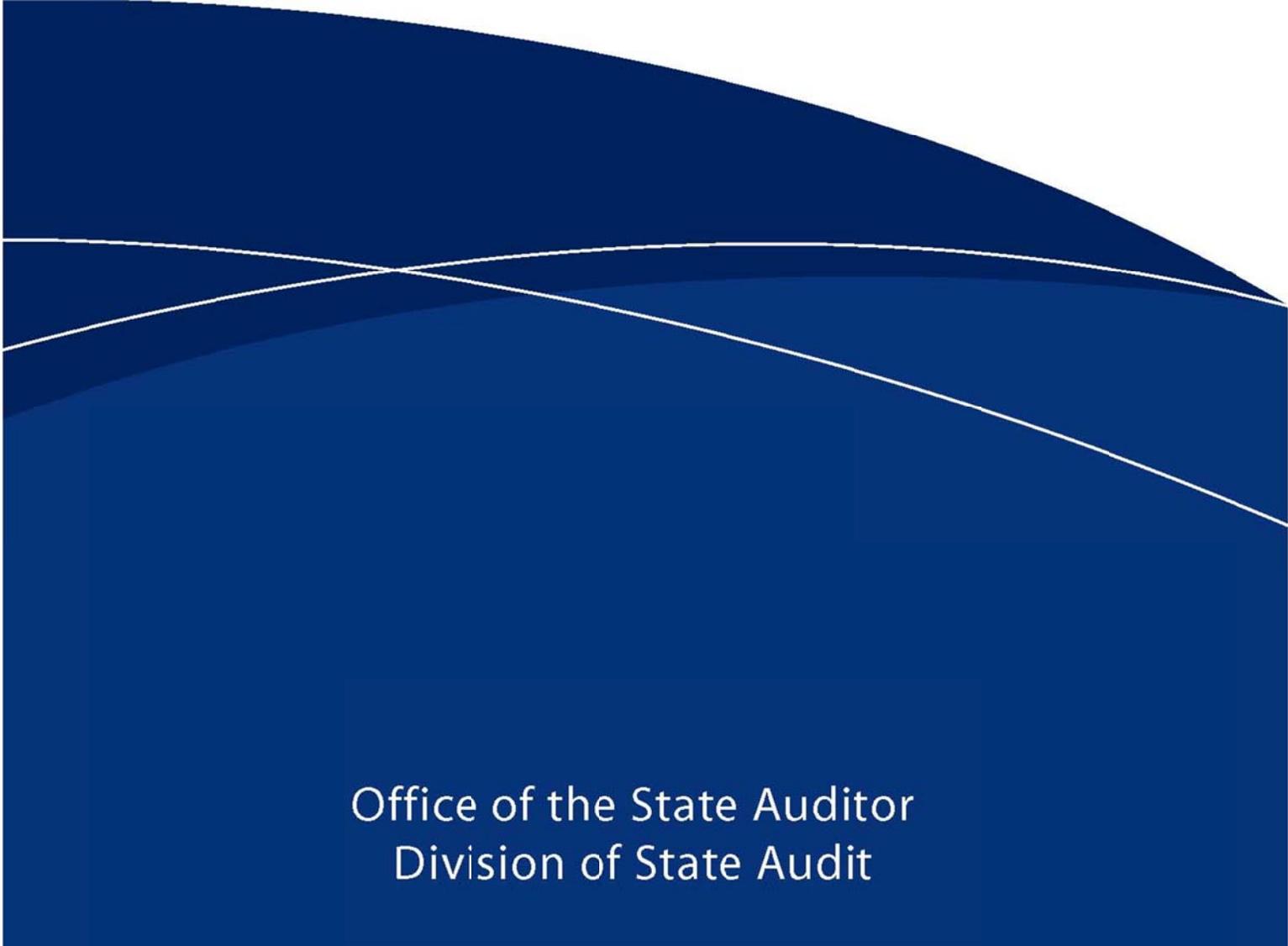


STATE WATER
COMMISSION
BISMARCK, NORTH DAKOTA

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

February 2, 2010

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Dale Frink, State Engineer, State Water Commission

We are pleased to submit this audit of the State Water Commission 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 senior auditor for this audit was Orlin Bensen, LPA. Andrea Wike was the staff auditor. Fred Ehrhardt, 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 supervisor or audit manager by calling (701) 328-2241. We wish to express our appreciation to State Engineer, Dale Frink 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 State Water Commission consists of: the Governor as chairman; the Commissioner of Agriculture as an ex-officio member; and seven members who are appointed by the Governor to serve six-year terms. The Commission appoints a State Engineer as its executive officer, who employs staff as needed to carry out the aims of the Commission. The State Water Commission is located primarily in the State Office Building in Bismarck, North Dakota. In addition, the State Water Commission has a field office in West Fargo. The State Water Commission is regulated by Title 61 of the North Dakota Century Code. In general, the purpose of the State Water Commission is to regulate the use of water resources and to keep abreast of the water needs of the state of North Dakota while trying to balance the public interest and public trust.

Responses to LAFRC Audit Questions

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

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

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

Yes.

3. Was internal control adequate and functioning effectively?

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 State Water Commission has implemented all recommendations included in the prior audit report.

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

Yes, a management letter was issued and is included on page 13 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 State Water Commission's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

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

None.

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

None.

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

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

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

None.

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

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

Audit Objectives, Scope, And Methodology

Audit Objectives

The objectives of this audit of the State Water Commission 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 State Water Commission's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the State Water Commission and are they in compliance with these laws?
3. Are there areas of the State Water Commission's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the State Water Commission 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- The central office is located in the southeast corner of the Capitol grounds.
- The warehouse is located at east Main Street in Bismarck.
- The field office is located in West Fargo.

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. Nonstatistical sampling was used and the results were projected

to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate State Water Commission personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed State Water Commission's processes and procedures.

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

Discussion and Analysis

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

For the biennium ended June 30, 2009, operations of the State Water Commission were primarily supported by appropriations from special funds. This is supplemented by general funds, federal funds, and fees credited to the State Water Commission's operating fund.

Financial Summary

The State Water Commission's capital assets include land, buildings, equipment, infrastructure assets, and construction in progress - all of which are initially capitalized at historical cost. All capital assets with an original cost of \$5,000 or more per unit and an estimated useful life in excess of one year are capitalized. The State Water Commission's total assets before deducting accumulated depreciation were approximately \$244 million and \$222 million for fiscal years ended June 30, 2009 and June 30, 2008, respectively. The largest capital asset category the State Water Commission has capitalized is infrastructure. Infrastructure assets are major statewide water development projects such as the Southwest Pipeline, Northwest Area Water Supply, and Devils Lake flooding, including the Devils Lake outlet.

The State Water Commission was granted authority to issue bonds to finance various flood control and pipeline projects throughout the state of North Dakota. The State Water Commission has approximately \$107 million and \$109 million in revenue bonds outstanding as of June 30, 2009 and June 30, 2008, respectively. The bonds have interest rates ranging from 2.50-5.50% and maturity dates from calendar years 2009-2048.

Revenues and other sources consisted primarily of federal revenue, intergovernmental proceeds, and transfers from the Oil Resources Trust Fund, the Tobacco Settlement Trust Fund, and General Fund. Other revenues during the audited period include the loan proceeds, permits, fees, interest, and mineral lease royalties. These all remained fairly constant for the State Water Commission, increasing slightly. Total revenues and other sources were \$41,842,302 for the year ended June 30, 2009 as compared to \$48,084,481 for the year ended June 30, 2008.

The largest increase in revenue and other sources for fiscal year 2009 was federal revenue. The increase in federal funding was primarily for the Northwest Area Water Supply project and for the Southwest Pipeline Project. The increase in intergovernmental revenue from \$5,037,661 for fiscal year 2008 to \$6,586,243 for fiscal year 2009 was the result of increased revenue received from the Southwest Water Authority and from cities for the Northwest Area Water Supply Project. Transfers In decreased from fiscal years 2008 to 2009 by \$15,511,154. The two largest transfers in were from the Tobacco Settlement Fund and the Oil Resources Trust Fund. The tobacco settlement funds for fiscal years 2009 and 2008 were \$11,256,444 and \$16,416,485, respectively. Tobacco settlement funds are transferred to the State Water Commission in accordance with NDCC section 54-27-25 and are to be used to address the long-term water development needs of the state of North Dakota. The Oil Resources Trust Fund's transfers to the State Water Commission decreased from \$17,850,000 to \$7,250,000

from fiscal year 2008 to fiscal year 2009. The funds are transferred in accordance with NDCC section 57-51.1-07 to be used for the payment of principal and interest payments on water project bonds.

Total expenditures and other uses for the State Water Commission were \$43,964,333 for the year ended June 30, 2009 as compared to \$44,621,102 for fiscal year ended June 30, 2008. The decrease in total expenditures and other uses was primarily the result of decreases in Grants, Benefits, and Claims from fiscal years 2008 to 2009 due to less payments being made to water resource districts. The decrease in expenditures is offset by increase in bond principal and interest payments from fiscal years 2008 to 2009. All other expenditures remained fairly constant.

Analysis of Significant Variances Between Final Budgeted and Actual Expenditures

The State Water Commission's water and atmospheric resources budget line item had \$99,469,854 or 54% remaining at the end of the biennium. The State Water Commission and the Water Coalition discuss and prioritize the water projects for the next biennium. A lot of water projects take longer than a biennium to complete and sometimes several years to complete. In addition, it is not uncommon to encounter project delays due to lawsuits, condemnations, permit issues, and federal or local funding problems. The state has obligated all of the funding needed to complete the State Water Commission's share of the water project approved by the legislature. At the end of the biennium, the State Water Commission had a large balance of unexpended authority of which a large portion is carried forward into the next biennium to complete the projects.

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	\$15,500,717	\$8,096,821
Intergovernmental	6,586,243	5,037,661
Loan Proceeds	856,309	510,313
Interest Earnings	15,029	14,617
Permits and Fees	14,450	30,700
Other Revenue	20,889	34,550
Transfers In	18,848,665	34,359,819
Total Revenues and Other Sources	<u>\$41,842,302</u>	<u>\$48,084,481</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 5,800,297	\$ 5,257,012
Major Operating Expenditures		
Fees – Professional Services	4,995,516	4,018,946
Travel	423,089	339,817
Equipment	455,190	27,226
IT Data Processing/Communications	172,516	132,467
Operating Fees and Services	136,616	137,323
Utilities	130,326	67,640
Supply/Material-Professional	116,668	123,632
IT Equipment	76,166	113,745
Professional Development	91,645	100,040
Buildings/Grounds/Vehicle Supplies	88,533	40,929
Supplies	62,903	78,938
Other Operating Expenditures	135,465	180,547
Capital Payments	22,393,683	21,160,752
Grants, Benefits, Claims	8,191,761	12,621,374
Land and Buildings	451,639	175,603
Transfers Out	242,320	45,111
Total Expenditures and Other Uses	<u>\$43,964,333</u>	<u>\$44,621,102</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>
Grants-Local					
Cost-Share		\$ 265,555	\$ 265,555		\$ 265,555
Administration & Support					
Service	\$ 2,454,866	10,640	2,465,506	\$ 2,420,228	45,278
Water & Atmospheric Resources	173,544,397	12,090,664	185,635,061	86,165,207	99,469,854
Totals	<u>\$ 175,999,263</u>	<u>\$ 12,366,859</u>	<u>\$ 188,366,122</u>	<u>\$ 88,585,435</u>	<u>\$ 99,780,687</u>
Expenditures by Source:					
General Fund	\$ 13,877,247	\$ 93,402	\$ 13,970,649	\$ 11,958,986	\$ 2,011,663
Other Funds	162,122,016	12,273,457	174,395,473	76,626,449	97,769,024
Totals	<u>\$ 175,999,263</u>	<u>\$ 12,366,859</u>	<u>\$ 188,366,122</u>	<u>\$ 88,585,435</u>	<u>\$ 99,780,687</u>

Appropriation Adjustments:

The \$265,555 adjustment to the Grants-Local Cost Share line item was for the Stanley North Dakota water pipeline construction project. The project was approved within House Bill 1305 by the 2009 Legislative Assembly.

The \$10,640 adjustment to Administration and Support Services and the \$90,664 for the Water and Atmospheric Resources line items are market equity increases for classified state employees. The adjustment was authorized within Senate Bill 2189 by the 2007 Legislative Assembly.

The \$12,000,000 adjustment to Water and Atmospheric Resources is funding from the American Recovery and Reinvestment Act of 2009. The funding was approved within House Bill 1020 by the 2009 Legislative Assembly.

Internal Control

In our audit for the biennium ended June 30, 2009, we identified the following areas of the State Water Commission's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.

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 State Water Commission in a management letter dated February 2, 2010.

Compliance With Legislative Intent

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

- Determined the State Water Commission was in compliance with NDCC section 61-03-05.1 by properly depositing fees and using the funding to address the water development and water management needs of the state of North Dakota.
- Application of proper statutory rates relating to revenue.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2007 North Dakota Session Laws chapter 46).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of bank accounts outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

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

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

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

Operations

This audit did not identify areas of State Water Commission'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)

February 2, 2010

Mr. Dale Frink, State Engineer
State Water Commission
900 E. Boulevard Avenue
Bismarck, ND 58505-0850

Dear Mr. Frink:

We have performed an audit of the State Water Commission for the biennium ended June 30, 2009, and have issued a report thereon. As part of our audit, we gained an understanding of the State Water Commission's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

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

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

The following present our informal recommendations.

RECONCILIATION OF DEPOSITS

Informal Recommendation 09-1: We recommend the State Water Commission obtain remittance documentation from a federal source stating the amount of federal funds that have been given to the State Water Commission and reconcile it to the deposit receipts by someone independent of federal draws.

ACCOUNTS PAYABLE APPLYBACKS

Informal Recommendation 09-2: We recommend the State Water Commission record expenditures in the proper accounting period.

PURCHASE CARDS TRANSACTIONS AND AUTHORIZATION

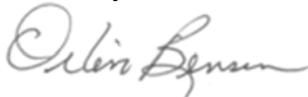
Informal Recommendation 09-3: We recommend the State Water Commission:

- Reconcile purchase card receipts to individual statements and sign off on the statement denoting a reconciliation has been completed;
- Have the appropriate level of management review the purchase card transactions and sign off certifying the purchases were made for the use of state business;
- Ensure the Purchase Card Administrator sign on the agency wide statement denoting reconciliation has been completed;
- Ensure purchase card holders inform vendors that the purchase is for state purposes and therefore is exempt to sales tax; and
- Review the current purchasing and disbursement process, where applicable, increase the use of the purchase card purchases and payments.

Management of State Water Commission agreed with these recommendations.

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

Sincerely,



Orlin Bensen
Senior Auditor

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