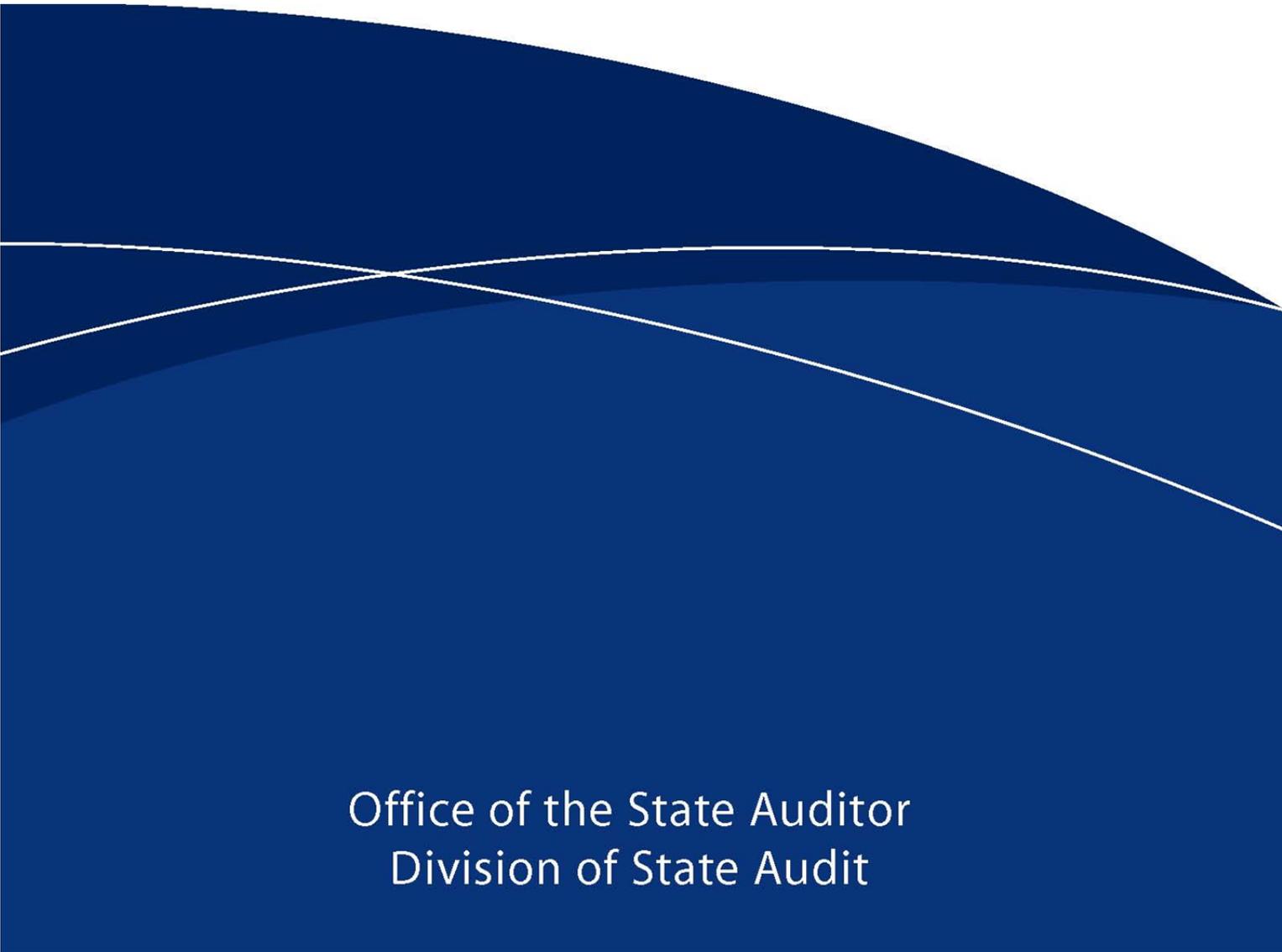


STATE WATER
COMMISSION
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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Transmittal Letter

January 11, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Todd Sando, State Engineer, State Water Commission

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

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

The in-charge auditor for this audit was Kristi Morlock. Lindsey Ulrich and Andrea Wike were the staff auditors. 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, Todd Sando, 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 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.

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 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?

There were no 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 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 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, 2011 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, 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- The central office located in the southeast corner of the Capitol grounds.
- The warehouse located on east Main Street in Bismarck.
- The field office 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. Non-statistical sampling was used and the results were

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

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed 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, 2011, 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 budget.

Financial Summary

The State Water Commission's capital assets include land, buildings, equipment, infrastructure assets, intangibles, easements, 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 \$281 million and \$244 million for fiscal years ended June 30, 2011 and June 30, 2010, 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 \$94 million and \$99 million in revenue bonds outstanding as of June 30, 2011 and June 30, 2010, respectively. The bonds have interest rates ranging from 2.50-5% and maturity dates from calendar years 2009-2048.

Revenues and other sources consisted primarily of federal funds, intergovernmental proceeds, and transfers from the Oil Resources Trust Fund and the Tobacco Settlement Trust Fund. Other revenues during the audited period included loan proceeds, licenses and fees, and interest. Total revenues were \$70,317,374 for the year ended June 30, 2011 as compared to \$73,430,362 for the year ended June 30, 2010. The largest decrease in revenue and other sources for fiscal year 2011 was intergovernmental revenue, which went from \$10,341,301 in fiscal year 2010 to \$4,191,015 in fiscal year 2011 due to a decrease in the amount of revenue from cities. The Northwest Area Water Supply project had construction going on during fiscal year 2010. The State Water Commission pays for the construction and then the City of Minot, who has a cost share relationship, reimburses the State Water Commission for 35% of the expenditures. Transfers In increased from fiscal year 2010 to 2011 by approximately \$2 million due to the Legislature approving the funding for four projects using funds from the Permanent Oil Tax Trust Fund in House Bill 1305 of the 2009 Legislative Assembly. These projects were for the City of Stanley; Burke, Divide, and Williams Water District; Ray and Tioga Water Supply Association; and the City of Wildrose. The State Water Commission also had an increase in transfers from the Oil Resources Trust Fund due to the increase in oil extraction and oil prices. The funds are transferred in accordance with NDCC section 57-51.1-07 to be used for the payment of principal and interest on water project bonds. Other revenues remained fairly consistent.

Total expenditures and other uses for the State Water Commission were \$82,868,843 for the year ended June 30, 2011 as compared to \$72,216,365 for the prior year. The increase in total expenditures for the audited period reflects an increase of approximately \$25 million in Grants, Benefits, and Claims, which makes up approximately 44% of expenditures, due to more payments being made to water resource districts; cities; and municipal, rural and Industrial areas. Other Capital Payments had a significant decrease of approximately \$18 million due to the timing of work being completed for water projects. Utilities increased by approximately \$1 million due to an increase in the number of pumps at the Devils Lake Outlet. All other expenditures remained fairly constant.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The State Water Commission's water and atmospheric resources line item had approximately \$168 million or 54% remaining at the end of the biennium. A lot of the 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 projects 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.

The State Water Commission also had approximately \$8 million remaining in the federal stimulus funds - 2009 line item. This was due to the construction of a new water treatment plant for the Southwest Pipeline project that has not been completed. The funds in this line have been carried forward to the next biennium to complete this project.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$10,721,202	\$10,183,681
Intergovernmental Revenue	4,934,997	10,479,395
Loan Proceeds	434,012	434,012
Miscellaneous Revenue	98,856	172,682
Licenses and Fees	30,900	26,550
Interest Earnings	4,273	3,124
Transfers In	54,093,134	52,130,918
Total Revenues and Other Sources	<u>\$70,317,374</u>	<u>\$73,430,362</u>
<u>Expenditures and Other Uses:</u>		
Grants, Benefits, and Claims	\$46,413,257	\$21,214,234
Other Capital Payments	17,838,665	35,973,210
Salaries and Benefits	6,717,343	6,421,449
Fees – Professional Services	6,414,723	5,663,724
Utilities	1,980,338	828,477
Repairs	755,427	53,833
Land and Buildings	667,559	679,127
Supplies	540,444	283,795
Travel	449,193	413,687
Equipment	314,466	151,185
Operating Fees and Services	215,559	181,880
IT Data Processing / Communications	149,063	151,603
Professional Development	78,714	78,547
Rent	32,849	28,549
Transfers Out	301,243	93,065
Total Expenditures and Other Uses	<u>\$82,868,843</u>	<u>\$72,216,365</u>

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Grants – Local					
Cost–Share	\$ 2,792,000	\$ (265,555)	\$ 2,526,445	\$ 2,413,132	\$ 95,313
Beaver Bay					
Feasibility					
Study	342,000		342,000	83,594	258,406
Admin and Support					
Services	2,977,674	47,115	3,024,789	2,787,360	237,429
Water and					
Atmospheric					
Resources	307,768,034	6,470,009	314,238,043	145,892,399	168,345,644
Federal Stimulus					
Funds – 2009	12,000,000		12,000,000	3,809,550	8,190,450
Totals	<u>\$325,879,708</u>	<u>\$ 6,251,569</u>	<u>\$332,131,277</u>	<u>\$155,004,036</u>	<u>\$177,127,241</u>
Expenditures by Source:					
General Fund	\$ 13,823,899	\$ 300,324	\$ 14,124,223	\$ 13,328,190	\$ 796,034
Other Funds	312,055,809	5,951,245	318,007,054	141,675,846	176,331,207
Totals	<u>\$325,879,708</u>	<u>\$ 6,251,569</u>	<u>\$332,131,277</u>	<u>\$155,004,036</u>	<u>\$177,127,241</u>

Appropriation Adjustments:

The \$265,555 adjustment to the Grants - Local Cost-Share line item was for the Stanley, ND water pipeline construction project. The project was approved within House Bill 1305 by the 2009 Legislative Assembly as an emergency measure and the amount of this adjustment was completed during the prior biennium and is a reduction for the biennium ended June 30, 2011.

The \$47,115 adjustment to the Admin and Support Services line and \$282,885 of the adjustment to the Water and Atmospheric Resources line are market equity increases for classified state employees, administrative personnel, and water development personnel. This adjustment was authorized by House Bill 1015, section 18 of the 2009 Legislative Assembly.

The \$6,186,800 adjustment to the Water and Atmospheric Resources line was additional revenue in the resources trust fund which was provided to the State Water Commission through House Bill 1020, section 5 of the 2009 Legislative Assembly.

The \$324 adjustment to the Water and Atmospheric Resources line was the State Water Commission's allocation from the State Student Internship Program which was authorized through House Bill 1015, section 1 of the 2009 Legislative Assembly.

Expenditures Without Appropriations Of Specific Amounts:

Insurance recoveries has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$81,172 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2011, 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.

Compliance With Legislative Intent

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

- Adherence to payment restrictions for conducting a feasibility study (Senate Bill 2305, sections 1 and 2 of the 2009 Legislative Session).
- Adherence to payment restrictions regarding grants paid from the permanent oil tax trust fund (House Bill 1305, section 1 of the 2009 Legislative Session).
- Proper use of the following legally restricted funds:
 - Water Development Trust fund.
 - NAWS Operation and Maintenance fund.
 - NAWS Project Reserve fund.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapter 20).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of outside bank accounts.
- 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.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the State Water Commission in a management letter dated January 11, 2012.

Operations

This audit did not identify areas of the State Water Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note a certain matter involving operations that we have reported to management of the State Water Commission in a management letter dated January 11, 2012.

Management Letter (Informal Recommendations)

January 11, 2012

Mr. Todd Sando, State Engineer
State Water Commission
900 E. Boulevard Avenue
Bismarck, ND 58505

Dear Mr. Sando:

We have performed an audit of the State Water Commission for the biennium ended June 30, 2011, and have issued a report thereon. As part of our audit, we gained an understanding of the 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.

LEGISLATIVE INTENT

Informal Recommendation 11-1: We recommend the State Water Commission develop tracking procedures in PeopleSoft for projects earmarked by legislation.

Informal Recommendation 11-2: We recommend the State Water Commission fix the salary of the state engineer in accordance with NDCC 61-03-01 to ensure that the state engineer is not setting and approving their own salary.

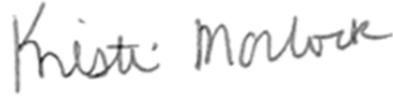
ACCOUNTS PAYABLE / EXPENDITURES

Informal Recommendation 11-3: We recommend the State Water Commission use their P-card as a form of payment to all vendors accepting P-cards.

Management of the 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,

A handwritten signature in cursive script that reads "Kristi Morlock".

Kristi Morlock
Auditor in-charge

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or by contacting the
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