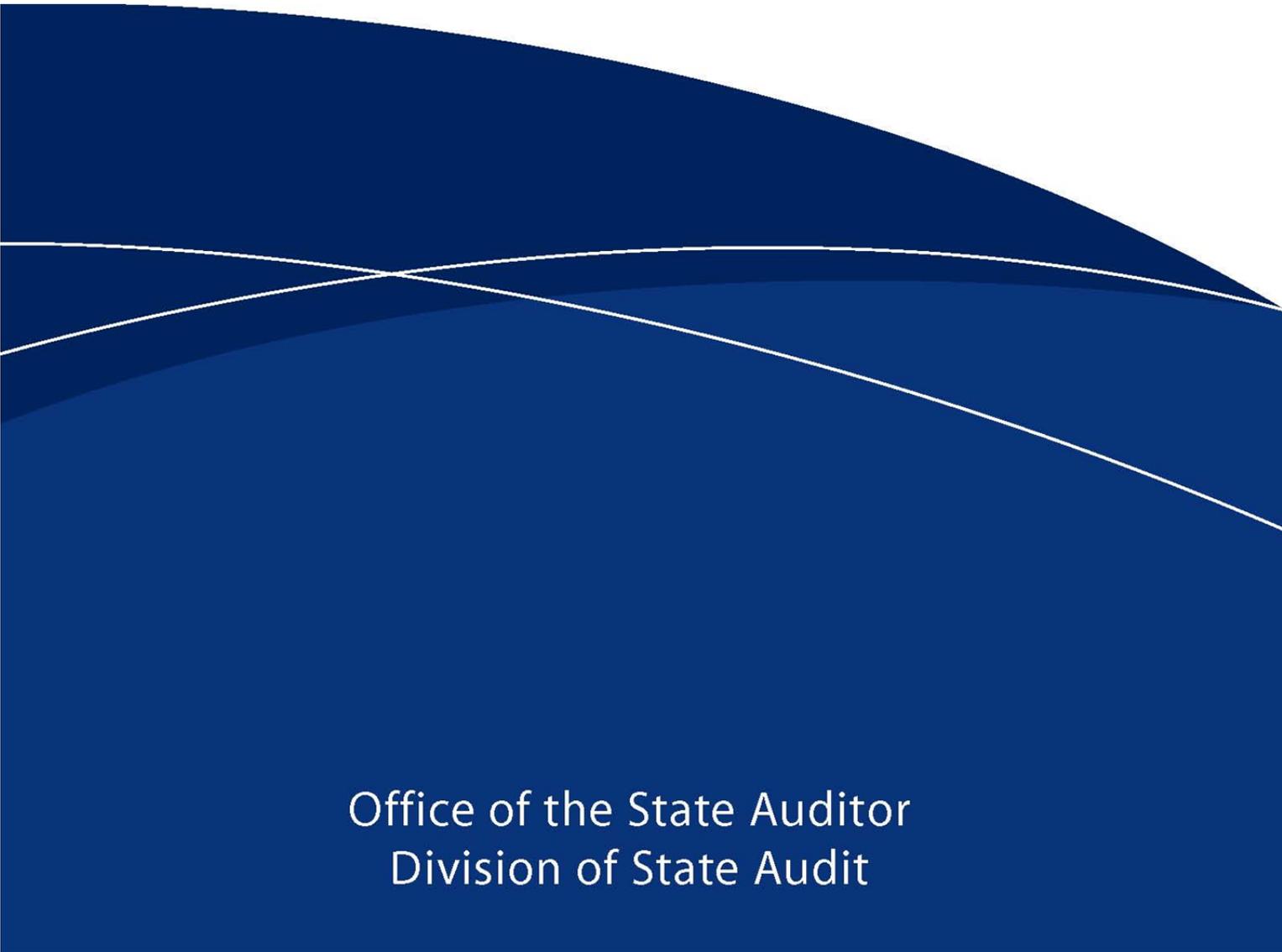


OFFICE OF
STATE TREASURER
BISMARCK, NORTH DAKOTA

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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BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

July 5, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
The Honorable Kelly Schmidt, State Treasurer

We are pleased to submit this audit of the Office of State Treasurer 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 Kevin Scherbenske, CPA. Kristi Morlock and Jacqueline Castleberry were the staff auditors. 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 Treasurer Schmidt and her 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 Office of State Treasurer receives and keeps all monies belonging to the state not required to be received or kept by another state entity. The Office of State Treasurer is responsible for the investment of certain special funds, as well as several trust funds, including the Veteran's Postwar Trust Fund.

Responses to LAFRC Audit Questions

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

Financial statements were not prepared by the Office of State Treasurer 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?

The Office of State Treasurer 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 Office of State Treasurer 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 15 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 Office of State Treasurer'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, Human Resource Management System (HRMS), and Tax Distribution and Outstanding Checks (TDOC) are high-risk information technology systems critical to the Office of State Treasurer.

Audit Objectives, Scope, and Methodology

Audit Objectives

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

Audit Scope

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

The Office of State Treasurer's sole location is its Bismarck office which was included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's 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 Office of State Treasurer'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.

Management's Discussion and Analysis

The accompanying financial statements have been prepared to present the Office of State Treasurer'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).

The following management discussion and analysis was prepared by the Office of State Treasurer's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the biennium ended June 30, 2011, operations of the Office of State Treasurer was supported by appropriations from the state's general fund.

Financial Summary

Revenues consisted primarily of "transfers in" of tax dollars collected by the state then distributed by the Office of State Treasurer. Other revenues include mineral lease royalties, fines and court fees, interest income, profits of the ND mill and elevator, property taxes, and revenues from the federal government. The most significant increase in revenue from fiscal year 2010 to 2011 was from transfers in. Similar to the previous biennium this increase is primarily attributed to increased oil production in North Dakota. The Office of State Treasurer also noticed significant decreases in revenues in the second year of the biennium in a couple of areas. Interest earned on investments declined due to a reduction in interest rates. Further decreases in revenue reflect a decrease in federal dollars for flood control and other grant programs. Total revenues were \$881,360,894 for the year ended June 30, 2011, as compared to \$535,179,938 for the year ended June 30, 2010.

The vast majority of expenditures represent the distribution of state dollars to political subdivisions and transfers out. Expenditures in these areas increased significantly from fiscal year 2010 to 2011 primarily due to increased oil drilling activity and the distributions associated with the distribution of revenues collected as a result of increased oil and gas production. Total expenditures for the Office of State Treasurer were \$1,507,716,009 for the year ended June 30, 2011, as compared to \$1,004,496,163 for the year ended June 30, 2010.

Funds Used to Account for Assets Held by the State in a Trustee Capacity

In accordance with NDCC chapter 57-39.2 the Office of State Treasurer, upon certification of the State Tax Commissioner, distributes funds collected for sales, use, or gross receipts taxes in accordance with NDCC chapter 57-01-02.1 for any incorporated city or county that has adopted the home rule provisions of NDCC chapters 40-05.1 or 11-09.1. These monies are remitted pursuant to the applicable contract with the city or county. City occupancy, restaurant and lodging, and motor vehicle rental taxes are collected by the state pursuant to NDCC chapter 40-57.3. Sales, occupancy, restaurant and lodging, and motor vehicle rental taxes collected pursuant to these chapters were \$151,465,988 for the year ended June 30, 2011, as compared to \$125,695,161 for the prior year.

Analysis of Significant Variances between Final Budgeted and Actual Expenditures

The Office of State Treasurer shows a substantial variance between its original appropriated biennial budget and actual expenditures. The variance stems from a turn back of approximately \$257,000 of funds originally appropriated for in lieu of tax payments. This turn back was the result of the expiration of property tax exemptions given for the first ten years after construction of a carbon dioxide pipeline.

Analysis of Significant Changes in Operations

Tax Distribution System Re-write

During the 2009 legislative session the law governing the distribution of oil and gas tax revenues was significantly amended, making it necessary to re-write the software for the Gross Production Tax distribution in the tax distributions and outstanding checks system (TDOC).

One of the challenges during the biennium came when House Bill 1012 was passed during the 2011 legislative session. This legislation made it necessary for the Office of State Treasurer to perform a distribution of \$35,000,000 in transportation funding to counties, cities, and townships prior to June 30, 2011. The Treasurer's Office staff worked with the Information Technology Department (ITD) to quickly adapt the software written for the weather-related distribution to perform this special transportation funding distribution prior to the legislatively imposed deadline of June 30, 2011.

Accomplishments with Ongoing Projects

Continued Utilization of TDOC

The Office of State Treasurer advanced its goal of adding all of the tax distributions performed by this office to TDOC. During the 2009-2011 biennium, the Office of State Treasurer staff worked with ITD to write, test, and implement distributions of cigarette tax, estate tax, the highway fund, township road and bridge fund, and state aid. Moving forward the Treasurer's Office continues to add distributions to this system as time and funding allows.

Continued Growth of BidND

Certificates of deposit (CD's) are purchased from North Dakota community financial institutions which lend these dollars back into their communities, fostering economic growth. Millions of dollars have been invested in CD's throughout the state. Though the Office of State Treasurer implemented this program several years ago, it has continued to grow through 2009-2011 and is putting dollars back to work in North Dakota communities.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<u>Revenues and Other Sources:</u>		
Mineral Lease Royalties	\$ 18,603,237	\$ 15,246,703
Fines and Court Fees	10,108,408	9,464,979
Interest on Investments	9,429,960	12,080,141
Mill Profits	7,641,811	6,260,457
Flood Control	5,820,710	22,330,490
General Property Tax	2,291,587	2,125,164
Miscellaneous Revenue	399,949	416,131
Transfers In	827,065,232	467,255,873
Total Revenues and Other Sources	<u>\$ 881,360,894</u>	<u>\$ 535,179,938</u>
<u>Expenditures and Other Uses:</u>		
Tax Distributions to Government Units	\$ 371,376,110	\$ 274,592,435
New Jobs Credit Payment	2,235,349	2,617,534
Salaries and Benefits	471,314	451,485
Miscellaneous Expenditures	139,582	175,566
Transfers Out	1,133,493,654	726,659,143
Total Expenditures and Other Uses	<u>\$1,507,716,009</u>	<u>\$1,004,496,163</u>

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 946,507	\$ (10,000)	\$ 936,507	\$ 922,799	\$ 13,708
Operating Expenses	131,478	45,000	176,478	165,648	10,830
Technology Project Carryover		54,000	54,000	54,000	
In Lieu of Tax Payments	1,151,000	200,000	1,151,000	893,573	257,427
Transportation Funding		35,000,000	35,000,000	35,000,000	
Totals	<u>\$ 2,228,985</u>	<u>\$ 35,089,000</u>	<u>\$ 37,317,985</u>	<u>\$ 37,036,020</u>	<u>\$ 281,965</u>
Expenditures by Source:					
General Fund	\$ 2,228,985	\$ 35,089,000	\$ 37,317,985	\$ 37,036,020	\$ 281,965
Totals	<u>\$ 2,228,985</u>	<u>\$ 35,089,000</u>	<u>\$ 37,317,985</u>	<u>\$ 37,036,020</u>	<u>\$ 281,965</u>

Appropriation Adjustments:

The \$10,000 decrease in the Salaries and Benefits line item is the result of two changes. An increase of \$10,000 authorized by the Salary Equity Pool Allocations and a \$20,000 decrease to move appropriation authority from the Salaries and Benefits to Operating Expenses line as noted below.

The \$45,000 increase in Operating Expenses is the result of two changes. A \$20,000 increase is due to Emergency Commission approval to move authority from the Salaries and Benefits line to Operating Expenses line and an additional \$25,000 appropriation request, also approved by the Emergency Commission. The additional \$45,000 as used to update the Oil and Gas Distribution program.

The \$54,000 increase to the Technology Project Carryover was properly approved and used for data processing.

The \$35,000,000 increase in the Transportation Funding line was approved by House Bill 1012 of the 2011 session (emergency clause) and was properly transferred to the appropriate funds.

Expenditures Without Appropriations Of Specific Amounts:

Distributions from the General Fund of the Mineral Management Tax, authorized by NDCC section 15.1-28-03 (\$16,371,240 of expenditures for this biennium).

Distributions from the General Fund to the Lignite Research Fund, authorized by NDCC section 57-61-01.5 (\$2,282,653 of expenditures for this biennium).

Transfers from the General Fund to the Senior Citizen Services and Programs Fund as authorized by NDCC section 57-39.2-26.2 (\$2,710,599 of expenditures for this biennium).

Senior Citizen Services and Programs Fund has a continuing appropriation authorized by NDCC section 57-39.2-26.2 (\$2,710,599 of expenditures for this biennium).

Jobs Training Fund has a continuing appropriation authorized by NDCC section 52-02.1-03(2) (\$4,845,399 of expenditures for this biennium).

Highway Tax Distribution Fund has a continuing appropriation authorized by NDCC section 54-27-19 (\$493,929,127 of expenditures for this biennium).

State Aid Distribution Fund has a continuing appropriation authorized by NDCC section 57-39.2-26.1 (\$124,852,401 of expenditures for this biennium).

Permanent Oil Tax Trust Fund has a continuing appropriation authorized by NDCC section 57-51.1-07.2 (\$15,263,481 of expenditures for this biennium).

Financial Tax Distribution Fund has a continuing appropriation authorized by NDCC section 57-35.3-09 (\$14,475,353 of expenditures for this biennium).

Veterans Postwar Trust Fund has a continuing appropriation authorized by NDCC section 37-14-14 (\$102,924 of expenditures for this biennium).

Coal Severance Tax Fund has a continuing appropriation authorized by NDCC section 57-61-10 (\$22,717,207 of expenditures for this biennium).

Federal Tax Replacement Fund has a continuing appropriation authorized by NDCC section 15.1-27-24 (\$28,152,529 of expenditures for this biennium).

Cigarette Tax Distribution Fund has a continuing appropriation authorized by NDCC section 57-36-31 (\$2,852,423 of expenditures for this biennium).

Telecommunications Tax Distribution Fund has a continuing appropriation authorized by NDCC section 57-34-05 (\$16,800,000 of expenditures for this biennium).

Oil and Gas Production Tax Distribution Fund has a continuing appropriation authorized by NDCC section 57-51-15 (\$783,149,042 of expenditures for this biennium).

Transmission Line Tax Distribution Fund has a continuing appropriation authorized by NDCC section 57-33.1-08 (\$470,162 of expenditures for this biennium).

Township Highway Aid Fund has a continuing appropriation authorized by NDCC section 54-27-19.1 (\$19,072,202 of expenditures for this biennium).

Coal Conversion Tax Fund has a continuing appropriation authorized by NDCC section 57-60-14 (\$49,110,797 of expenditures for this biennium).

Oil Extraction Tax Development Trust Fund has a continuing appropriation authorized by NDCC section 57-51.1-07 (\$777,427,212 of expenditures for this biennium).

Estate Tax Fund has a continuing appropriation authorized by NDCC section 57-37.1-08 (\$13,709 of expenditures for this biennium).

Oil Tax Resources Trust Fund, upon legislative appropriation for the State Water Commission as noted in House Bill 1020 of the 2009 Session, is authorized by NDCC 57-51.1-07 (\$86,000,000 of expenditures for this biennium).

Air Transportation Fee Fund has a continuing appropriation authorized by NDCC section 57-32-04 (\$414,509 of expenditures for this biennium).

Electric Generation, Transmission, and Distribution Fund has a continuing appropriation authorized by NDCC section 57-33.2-19 (\$7,065,609 of expenditures for this biennium).

State Taxes Distribution Fund has a continuing appropriation authorized by Article X, subsection 10, of the North Dakota Constitution (\$4,386,978 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2011, we identified the following areas of the Office of State Treasurer'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 relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the TDOC Distribution 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 the Office of State Treasurer in a management letter dated July 5, 2012.

Compliance With Legislative Intent

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

- Proper distributions from the following funds:
 - * Township Highway Aid Fund (NDCC 57-01-02.1)
 - * State Aid Distribution Fund (NDCC 57-39.2-26.1)
 - * Highway Tax Distribution Fund (NDCC 54-27-19)
 - * Coal Severance Tax Distribution Fund (NDCC 57-62-02)
 - * Oil and Gas Gross Production Tax Distribution Fund (NDCC 57-51-15)
 - * Oil Extraction Tax Development Trust Fund (NDCC 57-51.1-07)
 - * Ethanol Production Incentive Fund (NDCC 39-04-39)
- Distributions from the following funds in accordance with amounts certified by the State Tax:
 - * City Sales Tax Fund (NDCC 27-01-02.1)
 - * Homestead Tax Credits (NDCC 57-02-08.2(2))
 - * Disabled Veterans Tax Credits (NDCC 57-02-08.8(8))
 - * Electric Generation, Transmission, and Distribution Tax Fund (NDCC 57-33.2)
 - * Jobs Training Fund (NDCC 52-02.1)
- Compliance with appropriations and related transfers.
- Compliance with OMB's Purchasing Procedures Manual.
- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

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

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

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 Office of State Treasurer's in a management letter dated July 5, 2012.

Operations

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

Management Letter (Informal Recommendations)

July 5, 2012

The Honorable Kelly Schmidt
State Treasurer
Office of the State Treasurer
600 E. Boulevard Avenue
Bismarck, ND 58505

Dear Treasurer Schmidt:

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

GENERAL

Informal Recommendation 11-1: We recommend the Office of State Treasurer establish and perform a fraud risk assessment on a comprehensive and recurring basis.

Informal Recommendation 11-2: We recommend the Office of State Treasurer perform and maintain documentation of regular reviews of PeopleSoft user access to ensure only personnel authorized to make changes, record transactions, or approve transactions have access to the appropriate areas necessary to perform their assigned duties.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 11-3: We recommend the Office of the State Treasurer comply with the purchase card reconciliation process outlined in Office of Management and Budget policy 300.

Informal Recommendation 11-4: We recommend the Office of State Treasurer develop procedures to approve all ConnectND entries done by other agencies for the Office of State Treasurer.

LEGISLATIVE INTENT

Informal Recommendation 11-5: We recommend the Office of State Treasurer introduce a bill to clarify the legislative intent of NDCC chapter 57-51.2 in regards to the state share of revenue from oil extraction tax from wells on the Fort Berthold Reservation.

Management of Office of State Treasurer 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 black ink that reads "Kevin Scherbenske". The signature is written in a cursive, flowing style.

Kevin Scherbenske
Auditor in-charge

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Division of State Audit

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