Client Code 601

Department of Commerce

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

LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE MEMBERS

Representative Dan Ruby – Chairman
Senator Terry M. Wanzek – Vice Chairman

Representatives

Dick Anderson
Tracy Boe
Patrick Hatlestad
RaeAnn G. Kelsch
Keith Kempenich
Gary Kreidt
Joe Kroeber
Andrew Maragos
Corey Mock
David Monson
Chet Pollert
Bob Skarphol
Lonny Winrich
Dwight Wrangham

Senators

Randel Christmann
Joan Heckaman
Jerry Klein
Judy Lee

Contents

STATE AUDITOR
ROBERT R. PETERSON

PHONE
(701) 328 - 2241
FAX
(701) 328 - 1406

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

Transmittal Letter

May 21, 2012

The Honorable Jack Dalrymple, Governor

Members of the North Dakota Legislative Assembly

Mr. Al Anderson, Commissioner

We are pleased to submit this audit of the Department of Commerce 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 Michael W. Schmitcke, CPA. Angela Klubberud and Lindsey Ulrich 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 Commissioner Al Anderson and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Department of Commerce has been in existence since July of 2001 and was charged with the task of strengthening and streamlining the state's economic development efforts. Legislation authorized the merger of three former state agencies: Community Services, Economic Development and Finance, and Tourism. Additionally, the Workforce Development Division was created within the Department of Commerce.

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 responses 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?*

   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?*

   Other than our work addressing "increased usage of the purchase card" (page 12) there were no indications of lack of efficiency in financial operations and management of the Department of Commerce.

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

   The Department of Commerce has implemented the recommendation 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 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, 2011 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, 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 Department of Commerce's primary location is its Bismarck office which was included in the audit scope. Two small offices located in Grand Forks and Dickinson were opened to operate the Manufactured Home Program and were not included in the audit scope due to limited activity at those locations.

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 the 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, 2011, 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 in the second half of the biennium due to the amount of stimulus funds received. Transfers for the same time period decreased as a majority of the transfers are received in the first half of the biennium and were from the general fund, Permanent Oil Tax Trust Fund, and the Highway Tax Distribution Fund. 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. These all remained fairly constant for the Department of Commerce. Total revenues were $50,233,631 for the year ended June 30, 2011 as compared to $72,956,289 for the year ended June 30, 2010.

Total expenditures for the Department of Commerce were $69,374,083 for the year ended June 30, 2011 as compared to $79,095,670 for the prior year. The fluctuation of total expenditures for the audited period reflected primarily an increase in grant expenditures including the State Energy Program, Community Development Block Grant, Community Services Block Grant, and Weatherization Grant, and a decrease in transfers out to the Centers of Excellence, and Housing and Finance as these transfers were done in the first half of the biennium. All other expenditures remained fairly constant.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The excess appropriation of federal stimulus funds was the result of less federal stimulus funds being spent during the biennium than was anticipated in the budgeting process.

The excess appropriation in the grants line item was the result of more grants being paid with federal stimulus funds than was anticipated in the budget process.

Unexpended appropriations in the APUC line item were committed but not expended. The Department has carryover authority for these funds.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2011	June 30, 2010
Revenues and Other Sources:		
Federal Revenue	$ 43,467,571	$ 34,104,169
Loan Principle and Interest	1,706,628	1,959,402
Tourism Merchandise Sales	255,122	143,698
Program Income	128,851	230,894
Interest and Investment Earnings	85,987	86,734
Marketing Event Fees	82,030	13,620
Transfers In	4,507,442	36,417,772
Total Revenues and Other Sources	$ 50,233,631	$ 72,956,289
Expenditures and Other Uses:		
Grants	$ 53,238,261	$ 39,298,687
Salaries and Benefits	5,495,666	5,076,521
Operating Fees and Services	4,479,353	6,467,885
Professional Fees and Services	1,028,056	1,155,738
Printing	450,501	317,074
Travel	445,147	437,552
Professional Development	308,841	199,437
Rentals/Leases - Building	303,610	304,894
IT Contractual Services and Repairs	199,434	103,822
Postage	188,309	242,543
IT – Data Processing	109,103	97,857
Supplies – IT Software	70,558	33,163
Miscellaneous Expenses	308,415	277,449
Transfers Out	2,748,829	25,083,048
Total Expenditures and Other Uses	$ 69,374,083	$ 79,095,670

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Benefits	$ 10,020,840		$ 10,020,840	$ 9,355,525	$ 665,315
Operating Expenses	14,498,572		14,498,572	13,564,925	933,647
Capital Assets	25,000		25,000	15,072	9,928
Grants	74,011,058		74,011,058	46,673,885	27,337,173
ND Development Fund	1,299,700		1,299,700	1,299,700	
Discretionary Grants	928,083	$ 535,199	1,463,282	749,589	713,693
Workforce Enhancement Grant	1,000,000		1,000,000	1,000,000	
Economic Development Initiatives	186,846		186,846	173,508	13,338
APUC	2,536,630	897,323	3,433,953	1,641,112	1,792,841
Centers of Excellence – Review	19,500,000		19,500,000	19,464,000	36,000
ND Trade Office	2,064,000		2,064,000	2,000,000	64,000
Partner Programs	2,022,044		2,022,044	2,015,580	6,464
Equine Processing Study	50,000		50,000	24,725	25,275
Federal Stimulus Funds - 2009	68,594,635	873,858	69,468,493	37,327,918	32,140,575
Totals	$196,737,408	$ 2,306,380	$199,043,788	$135,305,539	$ 63,738,249
Expenditures by Source:					
General Fund	$ 58,476,303	$ 994,238	$ 59,470,541	$ 51,115,426	$ 8,355,115
Other Funds	138,261,105	1,312,142	139,573,247	84,190,113	55,383,134
Totals	$196,737,408	$ 2,306,380	$199,043,788	$135,305,539	$ 63,738,249

Appropriation Adjustments:
The increase of $535,199 is unexpended discretionary funds appropriated in the 2007 Legislative Session which were approved as carry over funds in the 2009-2011 biennium pursuant to Senate Bill 2018, section 9 of the 2009 Session Laws.

The increase of $897,323 is unexpended Agricultural Products Utilization Commission grant funds appropriated in the 2007 Legislative Session which were approved as carry over funds in the 2009-2011 biennium pursuant to Senate Bill 2018, section 8 of the 2009 Session Laws.

The increase of $873,858 was approved by the Emergency Commission to accept additional Federal Stimulus funds for the creation and testing of standardized energy assurance and resiliency plans to use during energy emergencies and supply disruptions as well as to provide rebates for consumers purchasing energy star appliances.

Expenditures Without Appropriations Of Specific Amounts:

The Ethanol Production Incentive Fund has a continuing appropriation authorized by NDCC 17-02-05 ($4,105,767 of expenditures for the biennium).

The Workforce Enhancement Fund has a continuing appropriation authorized by NDCC 54-60-23 ($1,410,881 of expenditures for the biennium).

The Centers of Excellence Fund has a continuing appropriation authorized by Senate Bill 2018, section 29 of the 2009 Session Laws ($8,185,471 of expenditure for the biennium).

Internal Control

In our audit for the biennium ended June 30, 2011, 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 relating to compliance with legislative intent.
- Controls related to Inventory.
- Controls related to Investments.
- Controls related to processing of payroll.
- 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 the Department of Commerce in a management letter dated May 21, 2012.

Compliance With Legislative Intent

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

- Compliance with appropriations (2009 North Dakota Session Laws chapters 46, 108, and 631).
- Proper use of the following legislative restricted funds:
  - Alcohol Motor Vehicle Fuel Fund (NDCC section 4-14.1-02).
  - Ethanol Production Incentive Fund (NDCC section 17-02-05).
- Proper administration of the Biofuel Blender Pump Incentive Fund (2009 North Dakota Session Laws chapter 193, section 1).
- Proper establishment of the following legislatively mandated programs:
  - Rural Development Office (2009 North Dakota Session Laws chapter 480, section 14).
  - Energy Policy Commission (2009 North Dakota Session Laws chapter 192).
  - Entrepreneurial Center Awards (2009 North Dakota Session Laws chapter 109, section 3).
- Compliance with requirement to conduct an equine processing facility feasibility study (North Dakota Session Laws chapter 298, sections 2, 3, and 4).
- Grant provided for the construction of the Great Plains Applied Energy Research Center (2009 North Dakota Session Laws chapter 26).
- North Dakota Individual Development Account reporting and matching requirements (2009 North Dakota Session Laws chapter 522, sections 2 and 3).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- 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 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 Department of Commerce in a management letter dated May 21, 2012.

Operations

Our audit of the Department of Commerce identified the following area of potential improvement to operations, as expressed by our operational objective:

- Did the Department of Commerce utilize the purchase card program so as to maximize the amount of applicable purchases made on the purchase card versus making payment through the Accounts Payable module?

Increased Usage of the Purchase Card (Finding 11-1)

Condition:
The Department of Commerce is not utilizing the purchase card (P-card) to the extent possible. Based on an analysis of expenditures during fiscal year 2011 that could have been paid with a P-card, we noted the Department of Commerce only made 15% of payments less than $2,500 with a P-card.

Criteria:

- *OMB Purchasing Card manual* – denotes some of the benefits of using the P-card to include: 1) reducing administrative costs for the state; 2) reducing the amount of paperwork; and 3) reducing the number of checks issued, among other benefits.
- *Government Finance Officers Association (GFOA) Recommended Best Practices* – use of purchasing cards improves the efficiency of purchasing procedures and reduces overall purchase processing costs.
- *National Association of Purchasing Professionals* – estimates that P-cards can save 55% to 90% off the cost of a payment transaction.
- *RPMG Research Corp.* – 2003 Purchasing Card Benchmarking Study demonstrated that P-cards reduce the procurement cycle by 74%.
- *RPMG Research Corp.* – 2005 Purchasing Card Benchmarking Study Highlighted the cost savings of using a P-card ranges from $24 (normal purchase process) up to $67 (making a purchase via a purchase order) per transaction.

Cause:
The Department of Commerce has not monitored purchasing card implementation to ensure P-card usage is increasing as a form of payment.

Effect or Potential Effect:
Administrative efficiency could be increased and check processing costs eliminated by paying eligible expenditures with the P-card.

Operational Improvement:
We recommend the Department of Commerce use their P-card as a form of payment to vendors accepting P-cards.

Department of Commerce Response:

The Department of Commerce agrees with Finding 11-1. Upon notification of this finding, Commerce immediately began determining what accounts payable could be switched over to p-card payment. Commerce is in the process of switching these accounts to p-card payment.

Management Letter (Informal Recommendations)

May 21, 2012

Mr. Al Anderson, Commissioner
Department of Commerce
1600 E. Century Avenue – Suite 2
Bismarck, ND 58503

Dear Commissioner Anderson:

We have performed an audit of the Department of Commerce for the biennium ended June 30, 2011, 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.

CODE OF CONDUCT

Informal Recommendation 11-1: We recommend the Department of Commerce ensure employees acknowledge their receipt and reading of the code of conduct on an annual basis and include the following provisions in their policy:

- A statement that prompts internal reporting of violations of the code to an appropriate person;
- A statement that includes a description of what constitutes fraudulent behavior; and
- A statement of accountability for adherence to the code and the sanctions to be imposed on those who breach it.

INVENTORY

Informal Recommendation 11-2: We recommend the Department of Commerce ensure:

- Inventory record-keeping duties are performed by an individual who does not have access to inventory or the ability to requisition withdrawals;
- Adjustments to inventory records are performed by an individual who does not have access to inventory;
- All reconciliations of sales activity be performed timely and by an individual who does not have access to inventory and the reconciliations are properly approved; and
- Credit card summaries related to inventory sales transactions are reconciled to receipts by an individual who does not have the responsibility to process credit card transactions.

LEGISLATIVE INTENT

Informal Recommendation 11-3: We recommend the Department of Commerce retain documentation in accordance with Information Technology Division's Records Retention Policy.

Management of the 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,

Michael W. Schmitcke

Michael W. Schmitcke, CPA
Auditor in-charge

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241