

DEPARTMENT OF
AGRICULTURE
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 24, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
The Honorable Doug Goehring, Agriculture Commissioner

We are pleased to submit this audit of the Department of Agriculture 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. Sarah Kuntz was the staff auditor. Cindi Pedersen, 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 Goehring and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Department of Agriculture was originally established as the Commissioner of Agriculture and Labor by the North Dakota Constitution in 1889. In 1964, voters approved dividing the office into two separate offices – Commissioner of Labor and Commissioner of Agriculture.

The responsibilities of the Department of Agriculture include: a leadership role in the formulation of policies affecting the state's agricultural industries; the advocacy of the needs and concerns of farmers and ranchers in the state and national level; the administration of fair and timely mediation services to farmers and ranchers; the promotion and marketing of North Dakota products; and the dissemination of information concerning agricultural issues to the Governor, Legislature, and the general public.

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 Agriculture 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 Department of Agriculture 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 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 Department of Agriculture'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 Agriculture.

Audit Objectives, Scope, and Methodology

Audit Objectives

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

Audit Scope

This audit of the Department of Agriculture 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 Department of Agriculture'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 Department of Agriculture'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 Department of Agriculture'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 Department of Agriculture'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 Department of Agriculture were primarily supported by appropriations from the state's general fund. This is supplemented by federal funding and fees credited to the agency's operating fund.

Financial Summary

Revenues consisted primarily of federal funds from a variety of federal grants and other revenues derived mainly from licenses, registrations, interagency transfers, and user fees. Total revenues were \$5,116,093 for the year ended June 30, 2011 as compared to \$9,048,634 for the year ended June 30, 2010. This decrease is due to pesticide registrations and commercial feed registrations on a two-year cycle with registrations due the first year of the biennium.

Total expenditures for the Department of Agriculture were \$9,987,384 for the year ended June 30, 2011 as compared to \$8,495,320 for the prior year. The increase in total expenditures for the audited period reflects primarily grants to associations and colleges related to an increase in federal expenditures for the Specialty Crop Grant program and grants to counties for noxious weeds. All other expenditures remained fairly constant.

The increase in expenditures for salaries and benefits reflected the general salary increases as well as an increase in filled FTE's.

Analysis of Significant Changes in Operations

The Department of Agriculture implemented a number of significant changes during the 2009-2011 biennium.

In February, 2010, the Department of Agriculture signed a five-year lease and moved ten FTEs out of the State Capitol Building to improve working conditions on the sixth and fourteenth floors.

The Department received more than \$275,000 of federal grants to provide cost-share assistance for organic producer and handler certifications. The program reimbursed qualified individuals and entities up to \$750 of their annual certification costs.

The Pesticide, Feed, and Fertilizer Division entered into an agreement with Kelly Registration Systems to dramatically increase productivity and efficiency in handling pesticide, feed, and fertilizer inspection and registration processes.

This Pesticide, Feed, and Fertilizer Division also added a new FTE to provide outreach and compliance assistance to the regulated pesticide community. This resulted in reaching 2,000 individuals with non-regulatory assistance programs. This Division also added a new FTE to the fertilizer program to focus more attention on anhydrous ammonia and other fertilizer regulatory issues.

The Department conducted additional Project Safe Send pesticide collections in areas impacted by flooding. The Department also prepared information for individuals on the safe handling and storage of pesticide in flood impacted areas.

The Department received federal grants to enhance the competitiveness of specialty crops. Specialty crops now grown commercially in North Dakota include dry beans, dry peas, lentils, potatoes, grapes, honey, and various vegetables. Over \$700,000 was distributed to enhance research, promotion, marketing, trade enhancement, education, and product development.

The Department added a new FTE to the Board of Animal Health to increase the number of health permit inspections on livestock entering North Dakota.

Analysis of Significant Variances Between Final Budgeted and Actual Expenditures

The Department of Agriculture had excess appropriations over actual expenditures in the Board of Animal Health line. This line item variance (\$2,808,825 appropriated compared to \$1,640,653 actual expenditures) is due to over-estimated federal revenue.

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	\$2,369,511	\$2,074,465
Pesticide Registration	366,450	3,819,681
Fertilizer Registration	483,569	455,337
Commercial Feed Registration	260,198	723,895
Conference Registration Fees	173,594	152,168
Apiary Licenses	96,357	88,559
Inspection Fees	46,404	49,588
Turkey Assessments	17,057	19,356
Other License, Permits, and Fees	100,527	113,364
Miscellaneous Revenue	30,055	41,059
Transfers In	1,172,371	1,511,162
Total Revenues and Other Sources	<u>\$5,116,093</u>	<u>\$9,048,634</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$4,476,920	\$4,093,310
Grants:		
Associations	756,795	287,067
Cities/Counties	682,754	451,495
State Colleges	240,484	31,775
Individuals	5,399	152,289
Wildlife Services	660,819	606,581
Livestock Pollution Prevention Program	637,359	571,678
Travel	555,495	517,509
IT-Data Processing/Equipment/Service	283,772	275,613
Project Safe Send	243,296	239,868
Building – Rent/Repairs	241,045	104,854
Operating Fees	240,578	311,666
Contractual Fees	167,642	169,883
Radio/TV/Newspaper	142,825	112,920
Miscellaneous Expenditures	557,158	516,368
Transfers Out	95,043	52,444
Total Expenditures and Other Uses	<u>\$9,987,384</u>	<u>\$8,495,320</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	\$ 8,566,196	\$ 177,000	\$ 8,743,196	\$ 7,508,077	\$ 1,235,119
Operating Expenses	6,094,603		6,094,603	5,090,455	1,004,148
Capital Assets	5,000		5,000		5,000
Grants	2,969,825		2,969,825	2,532,348	437,477
Board of Animal Health	2,808,825		2,808,825	1,640,653	1,168,172
Wildlife Services	1,067,400	200,000	1,267,400	1,267,399	1
Crop Harmonization Board	50,000		50,000	43,815	6,185
Totals	<u>\$ 21,561,849</u>	<u>\$ 377,000</u>	<u>\$ 21,938,849</u>	<u>\$ 18,082,747</u>	<u>\$ 3,856,102</u>
Expenditures by Source:					
General Fund	\$ 7,467,383	\$ 90,000	\$ 7,557,383	\$ 7,488,728	\$ 68,655
Other Funds	14,094,466	287,000	14,381,466	10,594,019	3,787,447
Totals	<u>\$ 21,561,849</u>	<u>\$ 377,000</u>	<u>\$ 21,938,849</u>	<u>\$ 18,082,747</u>	<u>\$ 3,856,102</u>

Appropriation Adjustments:

The \$177,000 adjustment to the Salaries and Benefits line item was for salary equity funds of \$167,000 and for the State Government Internship Stipend Program of \$10,000 per House Bill 1015 of the 2009 Session Laws.

The \$200,000 adjustment to the Wildlife Services line item was an emergency clause from Senate Bill 2009, section 3 of the 2011 Session Laws.

Expenditures Without Appropriations Of Specific Amounts:

Pesticide civil penalties authorized by NDCC section 4-35-28 (\$29,710 of expenditures for this biennium).

Turkey Promotion Fund has a continuing appropriation authorized by NDCC 4-13.1-05 (\$61,049 of expenditures for this biennium).

Honey Promotion Fund has a continuing appropriation authorized by NDCC 4-12.1-03 (\$30,041 of expenditures for this biennium).

Minor Use Pesticide Fund has a continuing appropriation authorized by NDCC 4-35-06.3 (\$171,174 of expenditures for this biennium).

Anhydrous Ammonia Storage Inspection Fund expenditures were authorized by House Bill 1010, section 8 of the 2009 Session Laws (\$107,989 of expenditures for this biennium).

Internal Control

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

- Limited use of funds from the Environment and Rangeland Protection Fund to \$3,888,578 (2009 Session Laws, House Bill 1009, section 2).
- Limited use of funds from the Anhydrous Ammonia Storage Inspection Fund to \$40,000 (2009 Session Laws, House Bill 1009, section 3).
- Limited use of funds from the Game and Fish Department to \$968,800 (2009 Session Laws, House Bill 1009, section 4).
- Compliance with required increase by the Board of Animal Health of the number of health permit inspections on livestock entering the state (2009 Session Laws, House Bill 1009, section 7).
- General funds used by the Department of Agriculture for additional office space limited to \$120,000 (2009 North Dakota Session, House Bill 1009, section 8).
- Proper expenditures of \$40,000 from the environment and rangeland protection fund for the collection of damaged pesticides from the 2009 flood (2009 North Dakota Session, House Bill 1009, section 9).
- Proper deposit of money received or generated by the Pride of Dakota program into the Agriculture Department operating fund (NDCC 4-01-19).
- Proper deposit of fees collected for pesticide registrations into the Environment and Rangeland Protection Fund (NDCC 19-18-04).
- Proper development of distribution methods for noxious weed control (NDCC 4-33-11).
- Limited use of funds from the Game and Fish Fund to \$200,000 (2011 North Dakota Session, Senate Bill 2009, section 3).
- Limited use of funds from the Environment and Rangeland Protection fund for controlling invasive species to \$50,000 (2009 North Dakota Session, Senate Bill 2371, section 5).
- Proper use of the following legally restricted funds:
 - Turkey Fund (NDCC 4-13.1-02).
 - Honey Promotion Fund (NDCC 4-12.1-01).
 - State Waterbank Fund (NDCC 61-31-05).
 - Minor Use Pesticide Fund (NDCC 4-35-06.3)
 - Anhydrous Ammonia Storage Inspection Fund (NDCC 19-20.2-08.1).
 - Environment and Rangeland Protection Fund (NDCC 19-18-02.1).
- Application of proper statutory rates relating to revenue.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- 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 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. However, we noted a certain matter involving compliance that we have reported to management of the Department of Agriculture in a management letter dated January 24, 2012.

Operations

This audit did not identify areas of the Department of Agriculture's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we noted a certain matter involving operations that we have reported to management of the Department of Agriculture in a management letter dated January 24, 2012.

Management Letter (Informal Recommendations)

January 24, 2012

The Honorable Doug Goehring
Agriculture Commissioner
Department of Agriculture
600 E. Boulevard Avenue
Bismarck, ND 58505

Dear Commissioner Goehring:

We have performed an audit of the Department of Agriculture 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 Agriculture'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 Department of Agriculture perform annual performance reviews on all employees.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 11-2: We recommend the Department of Agriculture use their purchase card as a form of payment to all vendors accepting purchase cards.

Management of Department of Agriculture 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, slightly slanted style.

Kevin Scherbenske
Auditor in-charge

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