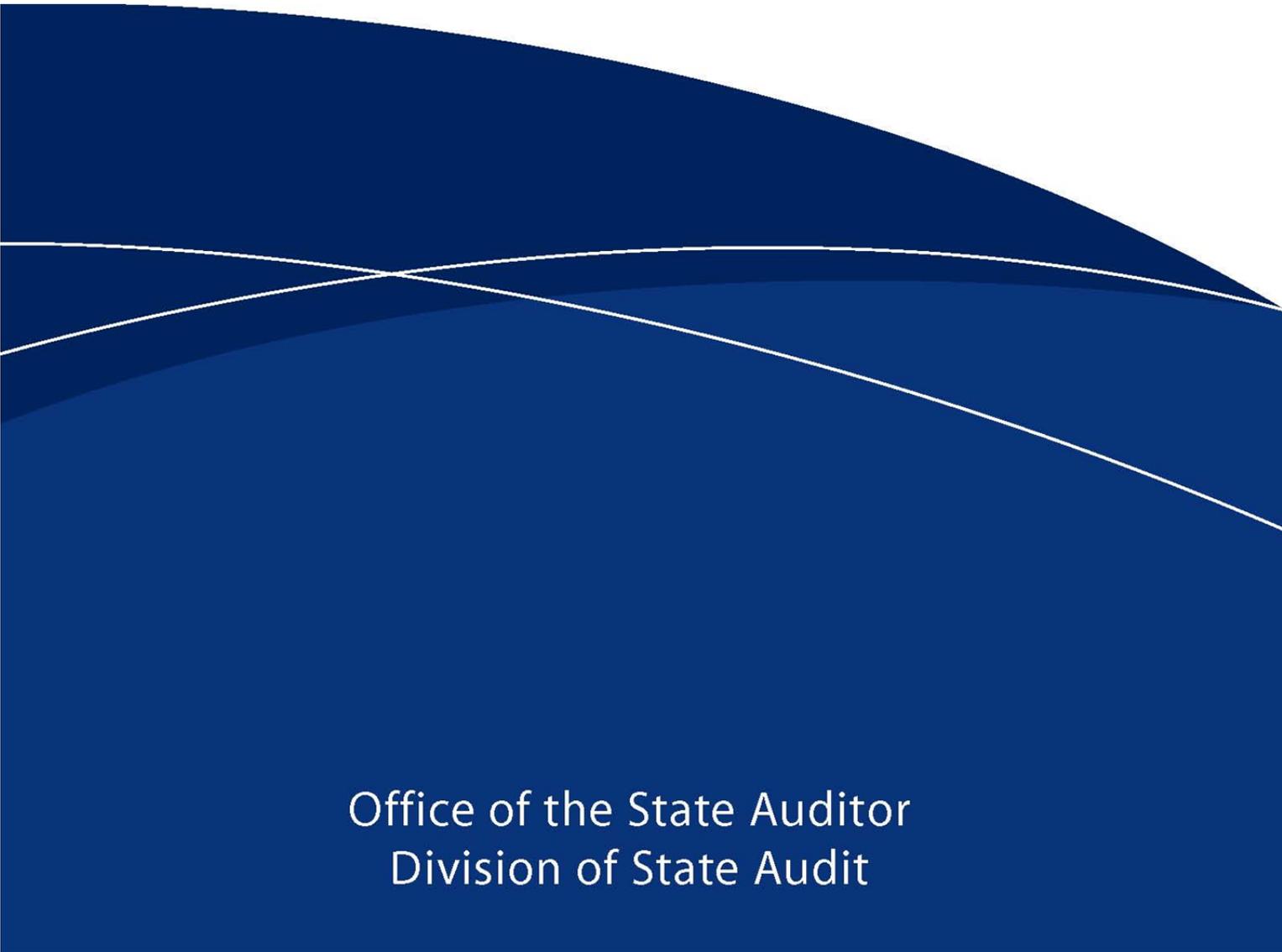


NORTH DAKOTA STATE SEED
DEPARTMENT
FARGO, NORTH DAKOTA

Audit Report

For the Two-year Period Ended
June 30, 2010

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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

Transmittal Letter

June 23, 2011

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Members of the North Dakota State Seed Commission
Mr. Ken Bertsch, State Seed Commissioner, North Dakota State Seed Department

We are pleased to submit this audit of the North Dakota State Seed Department for the two-year period ended June 30, 2010. 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 Robyn Hoffmann, CPA. Cory Wigdahl, CFE and Mary Feltman, CPA were the staff auditors. John Grettum, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7289. We wish to express our appreciation to Commissioner Bertsch 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 "Rob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The Seed Department was established by the North Dakota Legislature in 1931 as the state's designated authority for all seed certification and regulatory matters. The Seed Department is unique by comparison to most state agencies, or seed certification entities, in that it is a self-funded agency of government, and provides inspection, testing, and regulatory enforcement services for all crops, including potatoes. A nine-member seed commission acts as board of directors for the agency. Members are selected to serve by various agriculture industry organizations, including the North Dakota Crop Improvement Association, the North Dakota Certified Seed Potato Growers Association, the North Dakota Agricultural Association, the Northern Plains Potato Growers Association, the North Dakota Potato Council, the North Dakota Grain Dealers Association, the North Dakota Dry Edible Bean Seed Growers Association, and the Director of the North Dakota State University Agriculture Experiment Station. The Commissioner of Agriculture, or his designee, serves as chairman of the Commission. The Commission appoints a State Seed Commissioner, who serves as chief executive officer of the Department.

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 North Dakota State Seed Department 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?

Yes.

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

Yes, a management letter which included three informal recommendations to improve financial operations and internal control was issued and is included on page 11 of this report, along with management's response.

LAFRC Audit Communications

1. *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 or significant unusual transactions were identified.

2. *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 North Dakota State Seed Department's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *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.

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

None.

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

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

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

None.

8. *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 State Seed Administration Software (SSAS) are high-risk information technology systems critical to the North Dakota State Seed Department. No exceptions were noted that directly related to the operations of an information technology system.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the North Dakota State Seed Department for the two-year period ended June 30, 2010 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota State Seed Department'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 North Dakota State Seed Department and are they in compliance with these laws?
3. Are there areas of the North Dakota State Seed Department's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the North Dakota State Seed Department is for the two-year period ended June 30, 2010. 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 North Dakota State Seed Department has operations in the following locations. Each location was included in the audit scope:

- The central office in Fargo.
- A branch office in Grafton

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 North Dakota State Seed Department'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 North Dakota State Seed Department'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 two-year period June 30, 2010, operations of the North Dakota State Seed Department were primarily supported by regulatory fees.

Financial Summary

Revenues consisted primarily of regulatory fees. Other revenues during the audit period included earnings from interest and fees. These all remained fairly constant for the North Dakota State Seed Department, except fees for services which decreased approximately \$99,000. This was primarily due to the Department paying North Dakota State University Research Foundation for excessive fees that were collected in 2005, 2006, and 2007. Total revenues were \$2,439,816 for the year ended June 30, 2010 as compared to \$2,493,193 for the year ended June 30, 2009.

Total expenditures for the North Dakota State Seed Department were \$2,618,219 for the year ended June 30, 2010, as compared to \$2,362,208 for the prior year. The increase in total expenditures for the audited period reflects primarily \$133,000 for the first phase of a new computer program being written over a three year period and approximately \$115,000 for an addition in the Grafton office. All other expenditures remained fairly constant.

Analysis of Significant Changes in Operations

There were no significant changes in operation.

Analysis of Significant Variances - Budgeted and Actual Expenditures

For the fiscal years ended June 30, 2010 and 2009, there were no significant variances between the original and final budgeted amounts or between the final budgeted and actual expenditures.

Financial Statements

Statement of Revenues and Expenditures

Revenues and Other Sources:	June 30, 2010	June 30, 2009
Regulatory Fees	\$ 2,394,168	\$ 2,326,312
Interest & Investment Earnings	28,185	56,579
Licenses, Permits, & Fees	6,838	6,652
Leases, Rents, and Royalties	5,720	0
Fees for Services	4,267	103,148
Miscellaneous General Revenue	638	502
Total Revenues and Other Sources	\$ 2,439,816	\$ 2,493,193
Expenses and Other Uses:		
Salaries and Benefits	\$ 1,747,979	\$ 1,678,396
Travel	146,315	151,721
Other Capital Payments	133,390	0
Land and Buildings	115,036	0
Utilities	80,610	77,361
IT Equipment Over \$5000	40,199	0
Supply/Material-Professional	40,128	32,548
Grants, Benefits & Claims	40,000	90,000
Operating Fees and Services	38,986	33,748
Lab Supplies	37,303	39,816
Postage	28,339	27,874
Professional Development	25,973	28,906
Printing	18,824	21,284
Supplies - IT Software	17,610	62,235
Fees - Professional Services	17,129	22,049
Repairs	16,679	11,220
IT Contractual Services and Repairs	16,220	10,169
IT-Communications	15,370	14,472
Rentals/Leases-Equip & Other	11,023	11,023
Office Supplies	8,205	11,614
Miscellaneous Supplies	7,587	0
IT - Data Processing	6,628	7,349
Insurance	5,892	2,379
Bldg, Grounds, Vehicle Supply	2,794	2,554
Equipment Over \$5000	0	20,428
IT Equip under \$5,000	0	499
Extraordinary Repairs	0	4,563
Total Expenses and Other Uses	\$ 2,618,218	\$ 2,362,204

Statement of Appropriations

For The Biennium Ended June 30, 2009

	Original Appropriation	Adjustments	Adjusted Appropriation	Total Expenditures	Unexpended Appropriation
Seed Operations	\$ 6,166,218	\$ 12,908	\$ 6,179,126	\$ 4,764,333	\$ 1,414,793
Totals	\$ 6,166,218	\$ 12,908	\$ 6,179,126	\$ 4,764,333	\$ 1,414,793
Expenditures by Source:					
Other Funds	\$ 6,166,218	\$ 12,908	\$ 6,179,126	\$ 4,764,333	\$ 1,414,793
Totals	\$ 6,166,218	\$ 12,908	\$ 6,179,126	\$ 4,764,333	\$ 1,414,793

For The Year Ended June 30, 2010

	Original Appropriation	Adjustments	Adjusted Appropriation	FY 2010 Expenditures	Unexpended Appropriation
Seed Operations	\$ 6,805,495	\$ 22,000	\$ 6,827,495	\$ 2,618,218	\$ 4,209,277
Totals	\$ 6,805,495	\$ 22,000	\$ 6,827,495	\$ 2,618,218	\$ 4,209,277
Expenditures by Source:					
Other Funds	\$ 6,805,495	\$ 22,000	\$ 6,827,495	\$ 2,618,218	\$ 4,209,277
Totals	\$ 6,805,495	\$ 22,000	\$ 6,827,495	\$ 2,618,218	\$ 4,209,277

Appropriation Adjustments:

For the biennium ended June 30, 2009, the adjustment was for market equity compensation pursuant to 2007 SB 2189.

For the year ended June 30, 2010, the adjustment was for market equity compensation pursuant to 2009 HB 1015.

Internal Control

In our audit for the two-year period ended June 30, 2010, we identified the following areas of the North Dakota State Seed Department'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.
- Controls surrounding the computer-based financial administrative software.

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 North Dakota State Seed Department in a management letter dated June 23, 2011.

Compliance With Legislative Intent

In our audit for the two-year period ended June 30, 2010, we identified and tested North Dakota State Seed Department's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Members of the Seed Commission received \$135/day and reimbursement for expenses as specified by NDCC 4-09-03.
- The Seed Commission appointed a Commissioner and fixed his salary within legislative appropriation. (NDCC 4-09-03)
- The Commissioner, with the approval of the Seed Commission, established and charged fees for laboratory tests and services. (NDCC 04-09-08)
- Rules and requirements for certification of crop seeds and seed potato certification were published in the department bulletin. (NDCC 4-09-18)
- Fees for making commodity grade inspections determined by the Commissioner, with the approval of the Seed Commission, were established and uniform throughout the state for specified periods of time. (NDCC-4-09.1-03)
- Nonresidents are required to submit an annual application for a nonresident seed dealer license and submit an annual license fee. (NDCC 4-25-04)
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2007 and 2009 North Dakota Session Laws).
- 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, 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 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 North Dakota State Seed Department in a management letter dated June 23, 2011.

Management Letter (Informal Recommendations)

June 23, 2011

Mr. Ken Bertsch
State Seed Commissioner
North Dakota State Seed Department
P.O. Box 5257
Fargo, ND 58105-5257

Dear Mr. Bertsch:

We have performed an audit of the North Dakota State Seed Department for the two-year period ended June 30, 2010, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota State Seed Department'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. 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.

TRAVEL VOUCHERS

For two of the twenty-five travel expenses tested, there was a lack of sufficient documentation for mileage expense being claimed, the expense vouchers were used for multiple months and they were not submitted timely. One of the vouchers was submitted in the next fiscal year.

OMB Policy 505 states that before any allowance for mileage or travel expenses will be made, the official, deputy, assistant, clerk, or other employee will file with the agency, an itemized statement showing mileage traveled, the purpose thereof, and such other information and documentation as may be prescribed by the IRS, or an agency. Statements such as "to attend a meeting", etc., should not be accepted as sufficient documentation for purpose of travel.

When travel expenses incurred in one fiscal year are reported in another fiscal year, not due to the normal accrual basis of accounting, it then becomes a departure from Generally Accepted Accounting Principles, where revenues and expenses should be recognized in the year earned or incurred.

Informal Recommendation 10-1:

We recommend the ND State Seed Department:

- Ensure OMB Policies, specifically Policy 505, is followed and that sufficient and adequate documentation is included for all travel expenses being claimed.
- Employees submitting travel reimbursements complete travel form SFN52785 for each calendar month and submit to the proper person for approval in a timely manner (so travel expenses incurred can be reported in the proper period and fiscal year.)
- Develop a policy on timely travel voucher submission.

North Dakota State Seed Department Response:

We agree with this recommendation and will implement a policy.

FRAUD PREVENTION POLICY

The ND State Seed Department does not have a formal written fraud prevention policy in place; specifically, this would include, at minimum, controls to safeguard assets against theft and loss, establish policies and procedures relating to channels for reporting suspected instances of impropriety, and ensure that financial information is reliable.

The most important guidance relating to internal control is contained in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework includes discussions about the importance of adequate risk assessment, risk management, code of conduct, and fraud deterrence.

Informal Recommendation 10-2:

We recommend the ND State Seed Department governing board and management develop and implement a fraud prevention policy, which would include but not limited to: controls that safeguard assets against theft and loss, establish policies and procedures relating to channels for reporting suspected instances of impropriety, and ensure that financial information is reliable.

North Dakota State Seed Department Response:

NDSSD currently has a code of conduct policy that has been signed by all staff that addresses these issues. Additionally, NDSSD follows a Fraud Risk Assessment that guides administration in managing risk of loss.

Auditor's concluding remarks:

We agree a fraud risk assessment has been completed and reviewed and a code of conduct is implemented, however, detailed fraud prevention policies and physical safeguarding of assets are not in place. Such policies and physical safeguards are an integral part of a fraud prevention system.

SEGREGATION OF DUTIES

The ND State Seed Department has not adequately segregated duties in the check depositing area. There are several departments that checks pass-through along with multiple employees that handle the checks before they are listed and posted to accounts receivable.

The mail should be opened by a person who does not have accounts receivable access and that same person should prepare the deposit and remittance listing. A copy of the remittance listing should be sent to accounts receivable and to the lab staff with that day's batch of mail to be tested. This will mitigate the several departments and multiple employees that handle checks before they are listed and posted to accounts receivable.

Proper internal controls surrounding the custody of assets, initiating the service to be completed, and the preparation of financial statements dictates that there should be sufficient personnel, so duties of employees are properly segregated. Segregation of duties would provide better control over the assets of the ND State Seed Department and protect against loss and financial statement misstatements.

Informal Recommendation 10-3:

We recommend the ND State Seed Department properly segregate the duty of check custody and depositing.

North Dakota State Seed Department Response:

While the Department appreciates the State Auditor Office responsibility in improving internal controls, we have studied and discussed this recommendation and do not believe this process to be feasible or cost effective in our business practices.

This process would require additional staff to implement, particularly in summer months when we have reduced support staff, and during times of heavy receivables throughout the year. All checks are restrictively endorsed immediately upon receipt, which we believe creates necessary security regarding those funds. It is our business practice to work closely with our customers to ensure services are properly rendered and billed prior to accepting and depositing payments. Any shortfall or misapplication of funds would be immediately noticed by customers that have received inspection or testing services from the Department.

Auditor's concluding remarks:

In our opinion additional staff would not be necessary to implement this recommendation. We believe State Seed could implement this recommendation by re-allocating duties and providing for fewer employees handling the deposits. The more people handling deposits, the greater the chance of loss.

I encourage you to call myself or the audit manager at 701-239-7289 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Robyn Hoffmann, CPA
Auditor in-charge

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