

Office of the
State Tax Commissioner

BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2017

Joshua C. Gallion
State Auditor

Office of the State Auditor
Division of State Audit

Office of the State Auditor

State Tax Commissioner Report Highlights

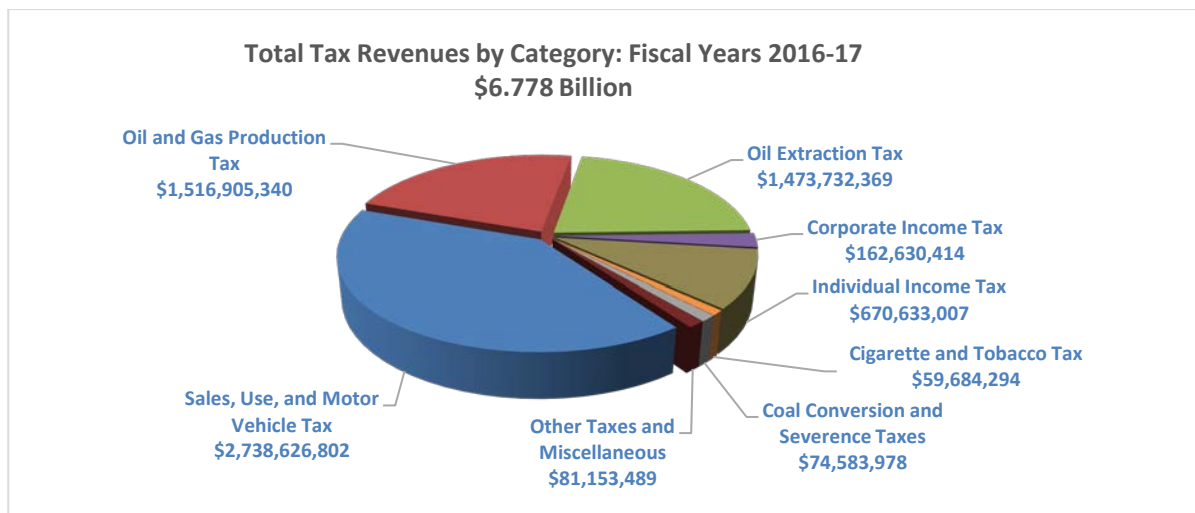
Financials, Legislative Intent, Internal Control:

We evaluated and tested high-risk areas of internal control and legislative intent.

- The Office of the State Tax Commissioner is not ensuring supervisors complete a timely review of GenTax system access privileges. The GenTax system contains significant taxpayer information including confidential records.

Office of the State Tax Commissioner Revenues by Category

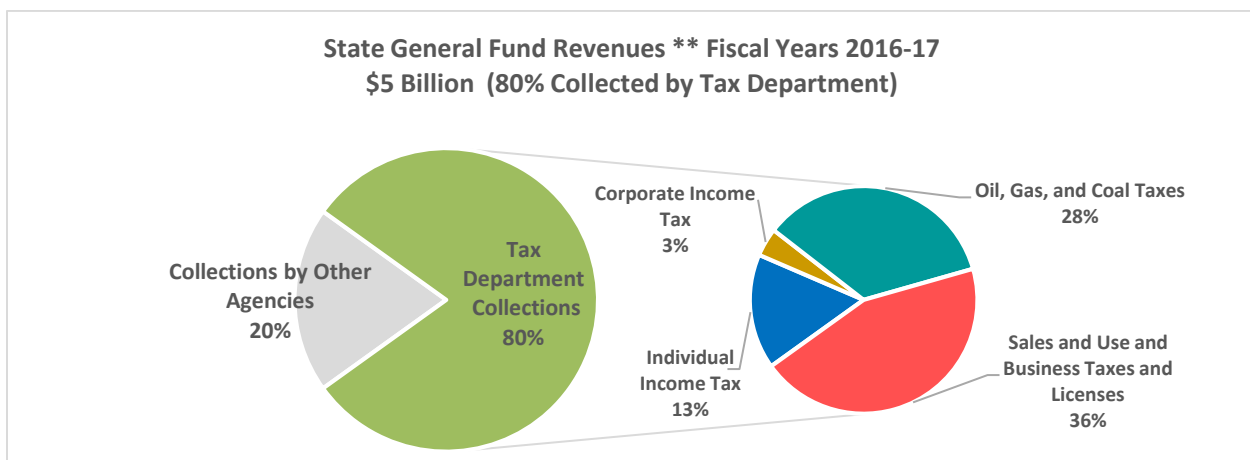
Tax revenues decreased \$264 million between fiscal years 2016 and 2017 and over \$4 billion compared to the 2013-15 biennium mainly due to the overall economic slowdown in North Dakota related to declined commodity prices for oil, natural gas, and agricultural products.



Source: ConnectND Financials

State General Funds Revenues:

The Office of the State Tax Commissioner collected 80% of the state's total general fund revenues for the fiscal years 2016 and 2017. General, non-dedicated tax revenues are deposited into the general fund. Appropriations from the general fund provides for the operation of general government services.



Source: Comprehensive Annual Financial Report and ConnectND Financials agency detail.

* The General fund includes refund reserves, Tax and Disaster Relief funds, ND Legacy fund, and Budget Stabilization fund.

** Majority of collections by other agencies include motor vehicle excise tax collected by the Department of Transportation and interest and investment earnings of the ND Legacy fund.

**LEGISLATIVE AUDIT AND FISCAL REVIEW
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AUDITOR AND AGENCY PERSONNEL

State Auditor Personnel

Cindi Pedersen, CPA, CM, Audit Manager
Allison Bader, MBA, MSM, In-Charge
Rob Sipes, CPA, CISA, Auditor
Kristi Morlock, MBA, Auditor
Holly Robak, Auditor
Erin Maslowski, Auditor

State Tax Commissioner Contacts

Ryan Rauschenberger, Tax Commissioner
Glenda Anderson, Director, Fiscal Mgmt. Div.

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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

April 25, 2018

Members of the North Dakota Legislative Assembly
The Honorable Ryan Rauschenberger, Tax Commissioner

We are pleased to submit this audit of the Office of the State Tax Commissioner for the biennium ended June 30, 2017. 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.

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 Rauschenberger and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion
State Auditor

Executive Summary

Introduction

The North Dakota Office of the State Tax Commissioner is responsible for collecting tax revenue required to be paid by law and necessary to fund the operations of the state and local government.

More information can be obtained from the Office of the State Tax Commissioner's website at <http://www.nd.gov/tax/>.

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 Office of State Tax Commissioner 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 unmodified 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?

Other than our finding addressing the "approval of GenTax access" (page 9), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

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

There were no recommendations included in the prior audit report.

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

No, a management letter was not issued.

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, management conflicts of interest, contingent liabilities, or significant unusual transactions identified.

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 Tax Commissioner'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 GenTax System are high-risk information technology systems critical to the Office of the State Tax Commissioner.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Office of the State Tax Commissioner for the biennium ended June 30, 2017 were to provide reliable, audited financial statements and to answer the following questions:

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

Audit Scope

This audit of the Office of the State Tax Commissioner is for the biennium ended June 30, 2017. We conducted our 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 the State Tax Commissioner has operations in the following locations. Financial transactions of ConnectND and the Human Resources Management System (HRMS) for all locations were included in the audit scope.

- The central office in the State Capitol.
- Remote offices in Dickinson, Fargo, Grand Forks, Minot, and Williston.

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.
- 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 Office of the State Tax Commissioner's processes and procedures.
- Surveyed employees of the Office of the State Tax Commissioner for evaluation of employees' response to the following:
 - Actual, suspected, or allegations of fraud.
 - Non-compliance with laws or regulations.
 - Inappropriate or unusual financial corrections or accounting adjustments.
 - Management's communication of the importance of ethical behavior and appropriate business practices.
 - Management's oversight over financial reporting, operational compliance, and internal control procedures.
 - Timely corrective action by management of internal control deficiencies.
 - Reporting lines, authorities, and responsibilities assigned to knowledgeable individuals.
 - Individuals held accountable for internal control responsibilities.
 - Process for information on fraud, waste, or abuse to be submitted in an anonymous or confidential manner.
 - Contingency plans with proper knowledge and assignment of responsibilities to allow for uninterrupted services to the public.

In aggregate, there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

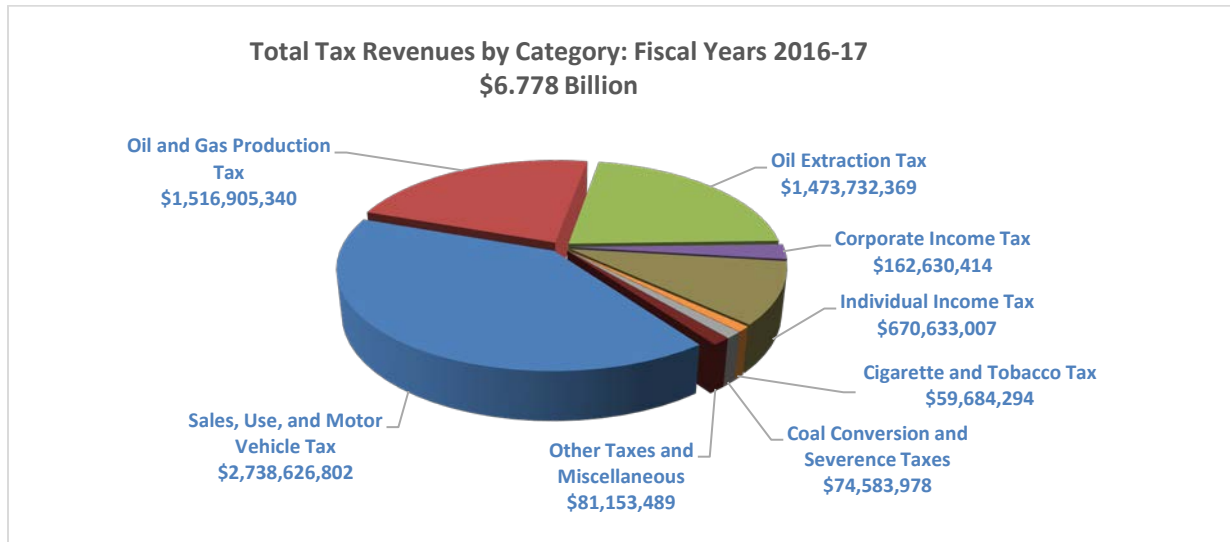
Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
<u>Revenues:</u>		
Natural Resource Taxes	\$1,516,117,524	\$1,549,104,164
Sales and Use Tax (Net of Refunds)	1,328,979,643	1,487,228,940
Income Taxes (Net of Refunds)	380,378,447	454,194,331
Business Taxes	19,289,258	16,972,788
Telecommunication Taxes (Net of Refunds)	10,989,515	12,293,973
Pre-Paid Wireless Emergency 911 Fees (Net of Refunds)	948,485	984,497
Alcohol License Fees	82,700	80,695
Other Revenues	127,609	177,123
Total Revenues	<u>\$3,256,913,181</u>	<u>\$3,521,036,511</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 10,621,785	\$ 10,555,055
Homestead Tax Credit	7,690,317	6,868,225
Disabled Veterans Tax Credit	3,757,225	3,950,884
Information Technology	2,147,164	2,263,611
Postage	377,099	483,307
Supplies	221,690	180,848
Professional Services	209,601	207,286
Equipment Under \$5,000	128,162	23,052
Professional Development	75,457	81,066
Printing	72,906	80,091
Travel	54,113	120,377
Equipment Over \$5,000	24,947	10,009
Other Operating Expenditures	165,697	162,770
Transfer to Medical Center Fund	39,420	36,871
Total Expenditures and Other Uses	<u>\$ 25,585,583</u>	<u>\$ 25,023,452</u>

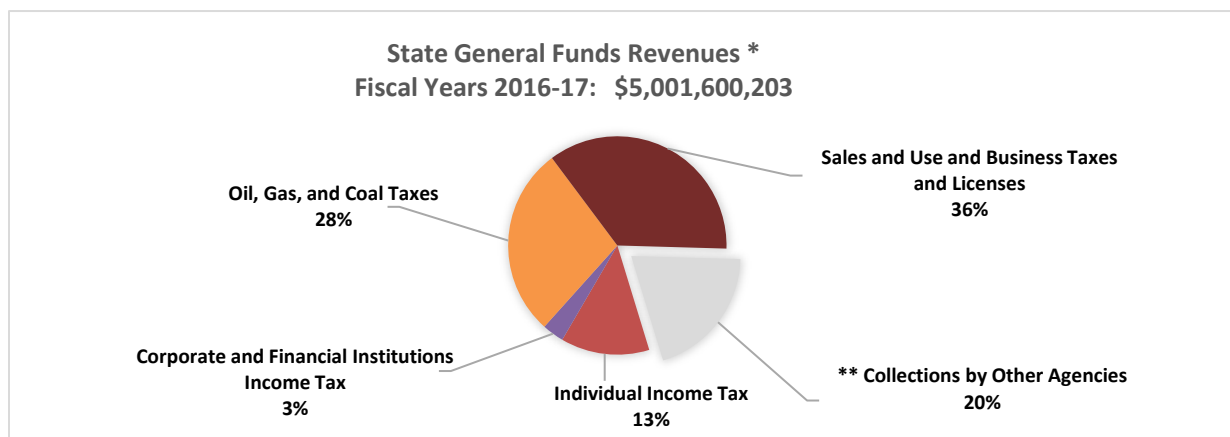
Analysis of Revenues

Revenues decreased \$264 million between fiscal years 2016 and 2017 and over \$4 billion compared to the 2013-15 biennium mainly due to the overall economic slowdown in North Dakota related to declined commodity prices for oil, natural gas, and agricultural products.



Source: ConnectND Financials

The Office of the State Tax Commissioner collected 80% of the state's total general fund revenues for the fiscal years 2016 and 2017. General, non-dedicated tax revenues are deposited into the general fund. Appropriations from the general fund provides for the operation of general government services.



Source: Comprehensive Annual Financial Report and ConnectND Financials agency detail.

* The General fund includes refund reserves, Tax and Disaster Relief funds, ND Legacy fund, and Budget Stabilization fund.

** Majority of collections by other agencies include motor vehicle excise tax collected by the Department of Transportation and interest and investment earnings of the ND Legacy fund.

Statement of Appropriations

For the Biennium Ended June 30, 2017

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	\$ 21,528,135	\$ 26,767	\$ 21,554,902	\$ 21,176,840	\$ 378,062
Operating Expenses	7,628,262		7,628,262	7,054,299	573,963
Capital Assets	24,000	16,000	40,000	34,956	5,044
Homestead Tax Credit	18,690,000	(750,000)	17,940,000	14,583,580	3,356,420
Disabled Veteran Credit	7,175,091	750,000	7,925,091	7,759,361	165,730
Totals	<u>\$ 55,045,488</u>	<u>\$ 42,767</u>	<u>\$ 55,088,255</u>	<u>\$ 50,609,036</u>	<u>\$ 4,479,219</u>
Expenditures by Source:					
General Fund	\$ 54,920,488	\$ 42,767	\$ 54,963,255	\$ 50,580,824	\$ 4,382,431
Other Funds	125,000		125,000	28,212	96,788
Totals	<u>\$ 55,045,488</u>	<u>\$ 42,767</u>	<u>\$ 55,088,255</u>	<u>\$ 50,609,036</u>	<u>\$ 4,479,219</u>

Internal Control

In our audit for the biennium ended June 30, 2017, we identified the following areas of the Office of State Tax Commissioner's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues including reconciliation of tax returns validated and receipted to the Great Plains accounting software, GenTax, and ConnectND (Peoplesoft) system.
- Controls surrounding taxes accounts receivable including credit adjustments.
- Controls surrounding the processing of expenditures including state purchase card transactions.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the GenTax System.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216) and for programs receiving Federal funds, the Code of Federal Regulation as set forth by the Federal Government (2 CFR 200.303).

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 that internal control was not adequate, noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

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 misstatements in financial or performance information, violations of laws and regulations, or impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiency in internal control.

Approval of GenTax Access (Finding 17-1)

Condition:

The Office of the State Tax Commissioner is not ensuring supervisors complete a timely review of the GenTax system access privileges. The GenTax system is the tax processing software. During the audit period, 8 of 19 supervisors approved outdated access listings that were generated 6-19 months prior to their review. In addition, approval of access privileges on at least an annual basis was not required.

Criteria:

"Standards for Internal Control in the Federal Government" (Green Book) states that management design control activities which include verifications, approvals and supervisory control activities

and document corrective actions on a timely basis. Control activities for security management of information systems include safeguards of unauthorized access to data, files, and programs through access rights. The Green Book also provides guidance that internal controls be evaluated annually. (GAO-14-704G para. OV3.04, 10.10, 11.12, 17.06)

Cause:

Proper procedures have not been developed to document an annual review and approval of access to the GenTax system.

Effect or Potential Effect:

Individuals may have improper and unauthorized access to confidential taxpayer information.

Recommendation:

We recommend the Office of the State Tax Commissioner document approval of the GenTax system access privileges timely and on an annual basis at a minimum.

Office of the State Tax Commissioner Response:

The Office of State Tax Commissioner concurs with the recommendation.

The Agency takes the security for system access rights seriously. In addition to the access listings mentioned in the audit finding, the Department had in place weekly status reports reflecting access right changes but these were not available to be used as supporting documentation for the audit. In addition to the weekly status reports, the Department has developed a more automated process to ensure current access roles are identified and reviewed at least annually by appropriate personnel.

Compliance with Legislative Intent

In our audit for the biennium ended June 30, 2017, we identified and tested the Office of the State Tax Commissioner's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Proper transfer of motor vehicle fuel tax revenue to the general fund (Senate Bill 2006, section 3, of the 2015 Legislative Session).
- Compliance with minimum taxpayer refunds laws (House Bill 1133, section 4, of the 2015 Legislative Session).
- Compliance with renter's refund homestead tax credit eligibility (NDCC 57-02-08.1(2)).
- Certifications to the State Treasurer's Office for distributions to local subdivisions and restricted funds were completed for the proper amounts for the following certifications:
 - City Sales Tax (NDCC 57-01-02.1).
 - Homestead Tax Credit (NDCC 57-02-08.2).
 - Property Tax (NDCC 57-20-07.2).
 - Senior Citizens Services and Programs (NDCC 57-39.2-26.2).
 - Oil and Gas Production Tax (NDCC 57-51-15).
 - Oil Extraction Tax (NDCC 57-51.1-06).
- Deposit of taxes to the proper funds, including:
 - Telecommunications Tax (NDCC 57-34-05).
 - Cigarette Tax (NDCC 57-36-32).
 - Income Tax (NDCC 57-38-55).
 - Sales and Use Tax (NDCC 57-39.2-12(3), 57-39.2-20, and 57-39.2-26).
 - Motor Vehicle Excise Tax (NDCC 57-40.3-10).
 - Motor Fuels Cash Bond (NDCC 57-43.1-14, 57-43.2-07, and 57-43.3-09).
 - Motor Fuels Tax (NDCC 57-43.1-28).
 - Special Fuels Tax (NDCC 57-43.2-19).
 - Aviation Fuels Tax (NDCC 57-43.3-02, 57-43.3-04, 57-43.3-06, and 57-43.3-07).
 - Oil Extraction Tax (NDCC 57-51.1-06).
 - Coal Severance Tax (NDCC 57-61-10).
- Proper use of legally restricted funds, including:
 - Sales and Use Tax Deposit Fund (NDCC 57-39.2-12(3)).
 - Motor Fuels Cash Bond Deposit Fund (NDCC 57-43.3-14(5)).
 - Prepaid Wireless Emergency 911 Fee Fund (NDCC 57-40.6-15).
 - Cigarette Tax Distribution Fund (NDCC 57-36-31(2)).
 - Gas Tax Collection and Refund Fund (NDCC 57-43.1).
 - Aviation Tax Collection and Refund Fund (NDCC 57-43.3-03).
 - Corporate Income Refund Reserve Fund (NDCC 57-38-40.1).
 - Individual Income Refund Reserve Fund (NDCC 57-38-40.1).
 - Special Fuels Tax Collection and Refund Fund (NDCC 57-43.2-20).
 - City Lodging Tax Suspense Fund (NDCC 57-01-02.1).
 - City Motor Vehicle Rental Tax Fund (NDCC 57-01-02.1).
 - Electric Generation, Transmission, and Distribution Tax Fund (NDCC 57-33.2-18).
 - Oil Extraction Tax Development Trust Fund (NDCC 57-51.1-07).

- Proper authorization of the Office of State Tax Commissioner's funds.
- Compliance with OMB's Purchasing Procedures Manual.
- Compliance with appropriations and related transfers (2015 North Dakota Session Laws, chapter 40).
- Compliance with adjustments to appropriation (Senate Bill 2006, section 4, of the 2015 Legislative Session; House Bill 1006, section 4, of the 2017 Legislative Session, emergency clause; and Emergency Commission appropriations).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Adequate blanket bond coverage of employees (NDCC 26.1-21-08).
- Proper use of the Bank of North Dakota as a depository for credit card revenue in accordance with NDCC 54-06-08.2.
- Compliance with fixed asset requirements including record-keeping, annual inventory, and lease analysis requirements.
- Compliance with payroll-related laws including statutory salaries for elected 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.

Operations

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

You may obtain audit reports on the internet at:

www.nd.gov/auditor

or by contacting the Office of the State Auditor at:

Email: ndsao@nd.gov

Phone: (701) 328-2241

Office of the State Auditor

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