

OFFICE OF
STATE TREASURER
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2013

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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STATE AUDITOR
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BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

July 8, 2014

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

We are pleased to submit this audit of the Office of State Treasurer for the biennium ended June 30, 2013. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Kristi Morlock and Krista Lambrecht were the staff auditors. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Treasurer Schmidt and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

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

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The Office of State Treasurer receives and keeps all monies belonging to the state not required to be received or kept by another state entity. The Office of State Treasurer is responsible for the investment of certain special funds, as well as several trust funds, including the Veteran's Postwar Trust Fund.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests 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 Treasurer in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an 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?

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?

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.

Yes, a management letter was issued and is included on page 17 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Office of State Treasurer's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

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

None.

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

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

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

None.

14. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

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

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Office of State Treasurer for the biennium ended June 30, 2013 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Office of State Treasurer's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Office of State Treasurer and are they in compliance with these laws?
3. Are there areas of the Office of State Treasurer's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Office of State Treasurer is for the biennium ended June 30, 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.

- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Office of State Treasurer's processes and procedures.

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

Management's Discussion and Analysis

The accompanying financial statements have been prepared to present the Office of State Treasurer's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

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

For the biennium ended June 30, 2013, operations of the Office of State Treasurer were entirely supported by appropriations from the state's general fund.

Financial Summary

Revenues and other sources consisted primarily of "transfers in," tax dollars collected by the state then distributed by the Office of State Treasurer (OST). Other revenues include mineral lease royalties, fines and court fees, interest income, profits of the North Dakota Mill and Elevator, and property taxes.

Interest earned on investments increased despite a continued decrease in interest rates. This increase was attributable to improved cash management practices as well as the growing cash balance being realized under the continued strong economic position North Dakota is experiencing. This strong economic position also attributed to the increase in North Dakota Mill and Elevator profits during the biennium.

The most significant decrease in revenue and other sources from fiscal year 2012 to 2013 was from transfers in. This decrease was solely due to the elimination of the permanent oil tax trust fund and the transfer of its balance to the general fund as spelled out in House Bill 1451, section 12 of the 2011 Legislative Session. This transfer activity increased both transfers in and transfers out for the year ended June 30, 2012 by \$689,935,590. Without regard to this permanent oil tax trust fund transfer, the transfers in activity remained relatively constant from fiscal year 2012 to 2013. The OST also noticed a significant decrease in revenues in the second year of the biennium in regards to mineral lease royalties as there were large rental/bonus payments received in October 2011.

Total revenues and other sources were \$1,300,372,047 for the year ended June 30, 2013, as compared to \$2,015,803,754 for the year ended June 30, 2012.

The vast majority of expenditures and other uses represent the distribution of state dollars to political subdivisions and transfers out. Distributions of state dollars to political subdivisions increased significantly from fiscal year 2012 to 2013 primarily due to increased oil drilling activity and the distributions associated with the revenues collected as a result of increased oil and gas production. Without regard to the permanent oil tax trust fund transfer mentioned above, transfers out increased significantly from fiscal year 2012 to 2013. This increase can also be attributable to the increased oil activity and the subsequent increase in trust fund deposits.

Total expenditures and other uses for the State Treasurer's Office were \$3,144,288,873 for the year ended June 30, 2013, as compared to \$3,080,961,086 for the year ended June 30, 2012.

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

In accordance with NDCC chapter 57-39.2 the Office of State Treasurer, upon certification of the State Tax Commissioner, distributes funds collected for sales, use, or gross receipts taxes in accordance with NDCC chapter 57-01-02.1 for any incorporated city or county that has adopted the home rule provisions of NDCC chapters 40-05.1 or 11-09.1. These monies are remitted pursuant to the applicable contract with the city or county. City occupancy, restaurant and lodging, and motor vehicle rental taxes are collected by the state pursuant to NDCC chapter 40-57.3. Sales, occupancy, restaurant and lodging, and motor vehicle rental taxes collected pursuant to these chapters were \$201,287,042 for the year ended June 30, 2013, as compared to \$200,861,257 for the prior year.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The Office of State Treasurer shows a substantial variance between its original appropriated biennial budget and actual expenditures. The variance stems from a turn back of approximately \$150,000 of funds originally appropriated for one-time ITD costs relating to the Tax Distribution System re-write project, which was under budget at the completion of the biennium.

The remainder of the variance stems from a turn back of approximately \$128,000 of funds originally appropriated for coal severance tipple reimbursement payments. This variance was due to a change in the interpretation of the law. The initial appropriation was based on amounts related to coal severed for all of calendar year 2011. After further discussion with legal counsel it was determined that the effective date language in the bill made it clear that only coal severed after July 1, 2011 was eligible. This change in interpretation decreased the amount of reimbursement payments significantly and resulted in the turn back of funds.

Analysis of Significant Changes in Operation

Tax Distribution System Re-write

During the 2011 legislative session the law governing the state aid distribution was amended making it necessary to re-write the software in the tax distributions and outstanding checks system (TDOC). The change in the law also called for the Office of State Treasurer to withhold a portion of the distribution from any county not in compliance with agricultural property valuations based on soil survey. This ability was also programmed into TDOC to eliminate the need for manual intervention.

A re-write was also completed in the Oil and Gas Tax Distribution/Allocation to include the implementation of the Legacy Fund and incorporate the allocation and distribution changes. This also included modification of the Oil and Gas Flow Charts posted on the Office of State Treasurer website.

Accomplishments with Ongoing Projects

Continued Utilization of TDOC

The Office of State Treasurer advanced its goal of adding all the tax distributions performed by this office to TDOC. During the 2011-13 biennium, Treasurer's Office staff worked with ITD to write, test, and implement distributions of coal conversion tax and coal severance tax. Moving forward the Treasurer's Office continues to add distributions to this system as time and funding allows.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<u>Revenues and Other Sources:</u>		
Mineral Lease Royalties	\$ 56,640,018	\$ 63,251,014
Fines and Court Fees	12,170,941	11,465,795
Investment Earnings	8,517,110	7,270,961
Mill Profits	5,625,933	3,822,989
General Property Tax	2,807,557	2,397,716
Miscellaneous Revenue	79,884	76,178
Transfers In	1,214,530,604	1,927,519,101
Total Revenues and Other Sources	<u>\$1,300,372,047</u>	<u>\$2,015,803,754</u>
<u>Expenditures and Other Uses:</u>		
Tax Distributions to Government Units	\$ 624,123,079	\$ 524,029,353
New Jobs Credit Payment	1,768,112	2,135,729
Salaries and Benefits	544,723	504,455
IT – Data Processing	63,290	112,446
Professional Services	34,727	25,425
Other Operating Expenditures	30,860	27,684
Transfers Out	2,517,724,082	2,554,125,994
Total Expenditures and Other Uses	<u>\$3,144,288,873</u>	<u>\$3,080,961,086</u>

Statement of Appropriations

For The Biennium Ended June 30, 2013

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	\$ 1,054,524	\$ 18,840	\$ 1,073,364	\$ 1,049,177	\$ 24,187
Operating Expenses	398,066	(15,000)	383,066	229,333	153,733
Transportation Funding	25,000,000	124,105,000	149,105,000	149,105,000	
Coal Severance Payments	252,800		252,800	125,012	127,788
Totals	<u>\$ 26,705,390</u>	<u>\$124,108,840</u>	<u>\$150,814,230</u>	<u>\$150,508,522</u>	<u>\$ 305,708</u>
Expenditures by Source:					
General Fund	\$ 26,705,390	\$124,108,840	\$150,814,230	\$150,508,522	\$ 305,708
Totals	<u>\$ 26,705,390</u>	<u>\$124,108,840</u>	<u>\$150,814,230</u>	<u>\$150,508,522</u>	<u>\$ 305,708</u>

Appropriation Adjustments:

The \$18,840 increase for the Salaries and Benefits line is made up of \$15,000 transferred from the Operating Expenses line for payment of annual and sick leave upon retirement of a long time agency employee as approved by the Emergency Commission. The remaining \$3,840 increase was for the state internship stipend program.

The \$124,105,000 increase in the Transportation Funding line is made up of the following:

- \$23,000,000 general fund moneys authorized by the 2011 Special Legislative Session - Senate Bill 2371, section 27 for providing transportation funding distributions.
- \$100,000,000 general fund moneys authorized by the 2013 Legislative Session - Senate Bill 2176, section 2 for providing transportation funding distributions declared an emergency measure.
- \$720,000 general fund moneys authorized by the 2013 Legislative Session – Senate Bill 2012, section 6 for transportation funding declared an emergency measure.
- \$385,000 general fund moneys authorized by the 2013 Legislative Session – Senate Bill 2012, section 7 for providing transportation funding distributions declared an emergency measure.

Expenditures Without Appropriations Of Specific Amounts:

Distributions from the General Fund of the Mineral Management Tax, authorized by NDCC section 15.1-28-03 (\$35,675,202 of expenditures for this biennium).

Distributions from the General Fund to the Lignite Research Fund, authorized by NDCC section 57-61-01.5 (\$2,363,981 of expenditures for this biennium).

Transfers from the General Fund to the Senior Citizen Services and Programs Fund as authorized by NDCC section 57-39.2-26.2 (\$3,517,179 of expenditures for this biennium).

Senior Citizen Services and Programs Fund (255) has a continuing appropriation authorized by NDCC section 57-39.2-26.2 (\$3,517,179 of expenditures for this biennium).

Jobs Training Program Fund (384) has a continuing appropriation authorized by NDCC 52-02.1-03(2) (\$3,903,840 of expenditures for this biennium).

Highway Tax Distribution Fund (400) has a continuing appropriation authorized by NDCC section 54-27-19 (\$648,447,105 of expenditures for this biennium).

State Aid Distribution Fund (401) has a continuing appropriation authorized by NDCC section 57-39.2-26.1 (\$185,994,138 of expenditures for this biennium).

Financial Institution Tax Distribution Fund (405) has a continuing appropriation authorized by NDCC section 57-35.3-09 (\$22,323,319 of expenditures for this biennium).

Veterans Postwar Trust Fund (410) has a continuing appropriation authorized by NDCC section 37-14-14 (\$65,036 of expenditures for this biennium).

Coal Severance Tax Distribution Fund (412) has a continuing appropriation authorized by NDCC section 57-61-10 (\$21,551,267 of expenditures for this biennium).

Federal Tax Replacement Fund (416) has a continuing appropriation authorized by NDCC section 15.1-27-24 (\$38,728,074 of expenditures for this biennium).

Cigarette Tax Distribution Fund (420) has a continuing appropriation authorized by NDCC section 57-36-31 (\$3,192,236 of expenditures for this biennium).

Telecommunications Carriers Tax Distribution Fund (424) has a continuing appropriation authorized by NDCC section 57-34-05 (\$16,800,000 of expenditures for this biennium).

Oil and Gas Production Tax Distribution Fund (427) has a continuing appropriation authorized by NDCC section 57-51-15 (\$1,910,147,267 of expenditures for this biennium).

State Taxes Distribution Fund (430) has a continuing appropriation authorized by Article X, subsection 10, of the North Dakota Constitution (\$5,205,026 of expenditures for this biennium).

Transmission Line Tax Distribution Fund (431) has a continuing appropriation authorized by NDCC section 57-33.1-08 (\$58,970 of expenditures for this biennium).

Permanent Oil Tax Trust Fund (432) has a continuing appropriation authorized by NDCC section 57-51.1-07.2 (\$690,054,160 of expenditures for this biennium).

Township Road and Bridge Fund (444) has a continuing appropriation authorized by NDCC section 54-27-19.1 (\$29,362,516 of expenditures for this biennium).

Coal Conversion Tax Trust Fund (454) has a continuing appropriation authorized by NDCC section 57-60-14 (\$50,490,655 of expenditures for this biennium).

Electric Generation, Transmission, and Distribution Fund (455) has a continuing appropriation authorized by NDCC section 57-33.2-19 (\$15,444,120 of expenditures for this biennium).

Oil Extraction Tax Development Trust Fund (458) has a continuing appropriation authorized by NDCC section 57-51.1-07 (\$2,135,991,510 of expenditures for this biennium).

Estate Tax Distribution Fund (468) has a continuing appropriation authorized by NDCC section 57-37.1-08 (\$1,112 of expenditures for this biennium).

Oil Tax Resource Trust Fund (469), upon legislative appropriation for the State Water Commission as noted in Senate Bill 2020 – Section 4 of the 2011 Legislative Session, is authorized by NDCC section 57-51.1-07(1) (\$251,500,000 of expenditures for this biennium).

Air Transportation Fund (494) has a continuing appropriation authorized by NDCC section 57-32.04 (\$407,541 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2013, we identified the following areas of the Office of State Treasurer's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls surrounding the processing and tracking of investment activities.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the TDOC information 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 a certain matter involving internal control that we have reported to management of the Office of State Treasurer in a management letter dated July 8, 2014.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2013, we identified and tested Office of State Treasurer's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Properly distributed \$23,000,000 of general fund moneys to political subdivisions (2011 North Dakota Special Legislative Session, Senate Bill 2371, section 27).
- Properly distributed \$25,000,000 of general fund moneys to political subdivisions (2011 North Dakota Legislative Session, House Bill 1012, section 6).
- Properly distributed \$100,000,000 of general fund moneys to political subdivisions (2013 North Dakota Legislative Session, Senate Bill 2176, section 2).
- Properly distributed \$720,000 of general fund moneys to political subdivisions (2013 North Dakota Legislative Session, Senate Bill 2012, section 6).
- Properly distributed \$385,000 of general fund moneys to political subdivisions (2013 North Dakota Legislative Session, Senate Bill 2012, section 7).
- Proper distributions from the following funds:
 - Highway Tax Distribution Fund (NDCC 54-27-19).
 - Oil and Gas Gross Production Tax Distribution Fund (NDCC 57-51-15).
 - Oil Extraction Tax Development Trust Fund (NDCC 57-51.1-07).
 - State Aid Distribution Fund (NDCC 57-39.2-26.1).
- Ensure funds transferred to the Oil and Gas Research Fund from the Oil and Gas Production Tax Fund and Oil Extraction Tax Fund did not exceed \$4,000,000 (NDCC 57-51.1-07.3).
- Properly deposited the state share of oil and gas taxes between the state general fund, property tax relief sustainability fund, strategic investment and improvement fund, and state disaster relief fund (NDCC 57-51.1-07.5).
- Compliance with appropriations and related transfers (2011 North Dakota Legislative Session, Senate Bill 2005 and NDCC 54-27-10).
- Proper legislative approval for all funds and non-appropriated expenditures (NDCC 54-44.1-09).
- Proper legislative approval concerning the deposit of all investment interest.
- Compliance with OMB's Purchasing Procedures Manual.
- Proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

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

Government Auditing Standards 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 State Treasurer's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

July 8, 2014

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

Dear Treasurer Schmidt:

We have performed an audit of the Office of State Treasurer for the biennium ended June 30, 2013, and have issued a report thereon. As part of our audit, we gained an understanding of the Office of State Treasurer's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted a certain condition we did not consider reportable within the context of your audit report. This condition relates 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 recommendation to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if this recommendation has been implemented, and if not, we will reconsider its status.

The following presents our informal recommendation.

GENERAL

Informal Recommendation 13-1: We recommend the Office of State Treasurer perform and maintain documentation of regular reviews of PeopleSoft user access to ensure only personnel authorized to make changes, record transactions, or approve transactions have access to the appropriate areas necessary to perform their assigned duties.

Management of Office of State Treasurer agreed with this recommendation.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of the recommendation included in this letter.

Sincerely,

A handwritten signature in cursive script that reads "Kevin Scherbenske".

Kevin Scherbenske
Auditor in-charge

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or by contacting the
Division of State Audit

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