

Department of Commerce

BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2017



Office of the State Auditor
Division of State Audit

Office of the State Auditor

Department of Commerce Report Highlights

Internal Control: We evaluated and tested high-risk areas including: revenue, expenditures (including correcting entries and purchase card transactions), inventory, investments, and payroll.

- We did not note any deficiencies that were required to be reported, or warrant the attention of those charged with governance.

Legislative Intent: We evaluated and tested high-risk areas including: required transfers, proper use of restricted funds and appropriation laws.

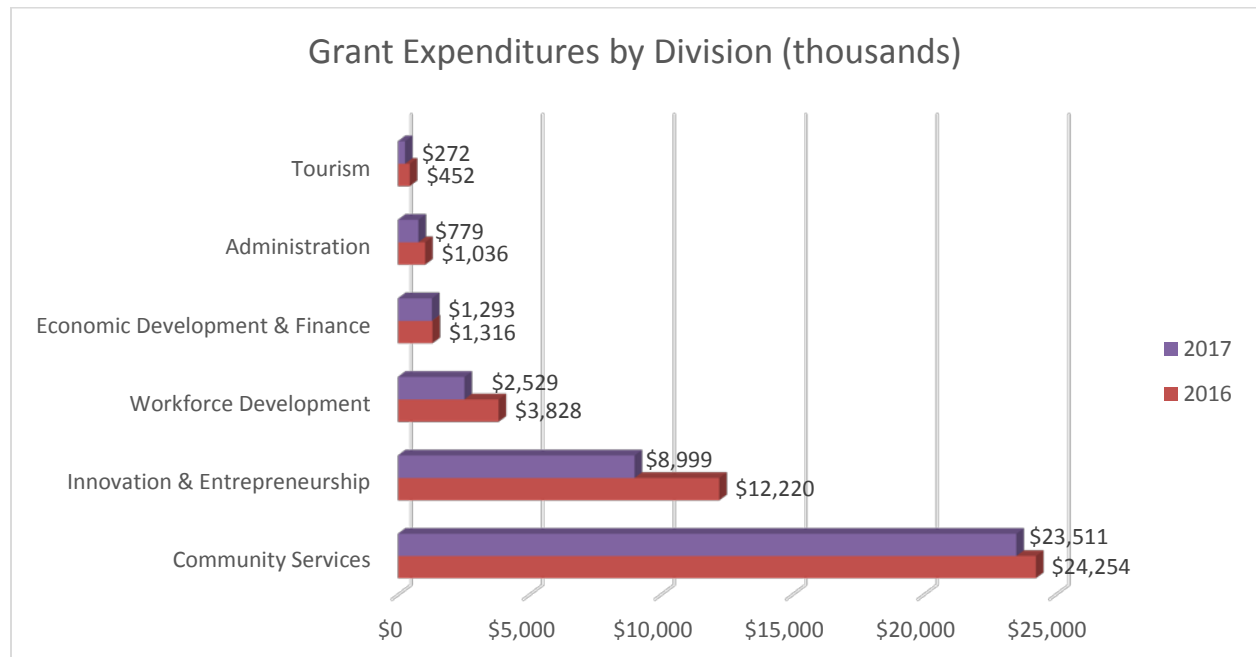
- We concluded there was compliance with the legislative intent.

Operations: We evaluated the following operational areas of the Department of Commerce. We did not note any deficiencies that were required to be brought to the attention of those charged with governance:

- Ethanol Production Incentives
- Early Childhood Education Grants

Financial:

- The decrease in Federal Revenue during fiscal year 2017 was due to the timing of drawing down federal funds and receiving less Federal Revenue for flood grants.
- The decrease in Transfers In during fiscal year 2017 was due to the timing of transfers. Most transfers, such as funding for Domestic Violence Grants and the Enhanced Use Grant, were made in the first year of the biennium.
- The decrease in Grants during fiscal year 2017 was mainly due to the timing of when grant funds were given out and the majority of the decrease is due to the Enhanced Use Grant that was given to Grand Forks County in fiscal year 2016.
- The decrease in Operating Fees and Services during fiscal year 2017 was mainly due to over 90% (\$2.4 million) of the contract with the ND Trade Office being paid during the first year of the biennium.
- Other revenues and expenditures remained fairly consistent between fiscal year 2016 and fiscal year 2017.



Source: ConnectND amounts.

**LEGISLATIVE AUDIT AND FISCAL REVIEW
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AUDITOR AND AGENCY PERSONNEL

State Auditor Personnel

**Cindi Pedersen, CPA, CM, Audit Manager
Kristi Morlock, MBA, In-Charge
Ryan Bear, CISA, Auditor
Jackie Ressler, Auditor
Krista Lambrecht, CPA, M. Acc., Auditor
Liz Rogers, Auditor**

Department of Commerce Contacts

**Jay Schuler, Commissioner
LaVonne Stair, Office Manager
Celeste Engelhard, Account/Budget Manager**

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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
STATE CAPITOL
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BISMARCK, NORTH DAKOTA 58505

Transmittal Letter

January 31, 2018

The Honorable Doug Burgum, Governor
Members of the North Dakota Legislative Assembly
Mr. Jay Schuler, Commissioner

We are pleased to submit this audit of the Department of Commerce 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 Schuler 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 Department of Commerce has been in existence since July 2001 and is charged with the task of strengthening and streamlining the state's economic development efforts. Legislation authorized the merger of three former state agencies: Community Services, Economic Development and Finance, and Tourism. Additionally, the Workforce Development Division was created within the Department of Commerce.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's responses are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Department of Commerce in accordance with generally accepted accounting principles, so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an 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?

Yes.

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 Department of Commerce's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

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

None.

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

None.

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

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

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

None.

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

ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the Department of Commerce.

Audit Objectives, Scope, and Methodology

Audit Objectives

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

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

Audit Scope

This audit of the Department of Commerce is for the biennium ended June 30, 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 Department of Commerce'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.
- 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 Commerce’s processes and procedures.
- Performed a detailed review of the following Department of Commerce Programs:
 - Ethanol Production Incentive
 - Early Childhood Education Grant
- Performed follow-up on recommendations from the prior audit for the following Department of Commerce Programs:
 - Manufactured Home Installation Program
 - Workforce Development Grant for Tribally Controlled Community Colleges

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 and Other Sources:</u>		
Federal Revenue	\$ 13,980,815	\$ 17,993,948
Loan Principal and Interest	1,348,092	1,312,776
Innovate ND Program	181,660	144,196
Tourism Merchandise Sales	138,176	217,234
Mobile Home Inspection Fees	63,531	64,795
Interest on Investment	18,448	20,835
Miscellaneous Revenue	287,220	60,844
Transfers In	9,770,353	15,387,521
Total Revenues and Other Sources	\$ 25,788,295	\$ 35,202,149
<u>Expenditures and Other Uses:</u>		
Grants	\$ 37,383,800	\$ 43,106,124
Operating Fees and Services	7,331,716	9,680,412
Salaries and Benefits	6,524,149	6,437,671
Professional Fees and Services	652,445	776,176
Information Technology	401,167	470,629
Rentals/Leases	372,101	397,900
Printing	322,711	328,493
Travel	304,960	379,115
Professional Development	265,958	340,723
Supplies	148,579	174,087
Postage	110,265	117,953
Equipment	51,730	30,271
Miscellaneous Expenditures	5,532	10,220
Transfers Out	1,785	209,435
Total Expenditures and Other Uses	\$ 53,876,898	\$ 62,459,209

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	\$ 13,090,346		\$ 13,090,346	\$ 12,566,586	\$ 523,760
Operating Expenses	18,339,438		18,339,438	16,802,524	1,536,914
Grants	66,238,453	\$ 3,419,009	69,657,462	55,061,034	14,596,428
Discretionary Grants	784,152	649,679	1,433,831	784,558	649,273
Workforce Enhancement Fund	960,068		960,068	960,068	
Flood Impact – Loans/Grants	12,859,869		12,859,869	5,379,900	7,479,969
APUC	3,118,611	2,500,467	5,619,078	2,999,661	2,619,417
Research North Dakota	4,353,542		4,353,542	4,353,542	
ND Trade Office	2,556,694		2,556,694	2,556,694	
Partner Programs	2,173,829		2,173,829	2,173,829	
Entrepreneurship Grants	3,216,830		3,216,830	2,132,447	1,084,383
Totals	<u>\$127,691,832</u>	<u>\$ 6,569,155</u>	<u>\$134,260,987</u>	<u>\$105,770,843</u>	<u>\$ 28,490,144</u>
Expenditures by Source:					
General Fund	\$ 52,522,359	\$ 4,288,095	\$ 56,810,454	\$ 51,655,103	\$ 5,155,351
Other Funds	75,169,473	2,281,060	77,450,533	54,115,740	23,334,793
Totals	<u>\$127,691,832</u>	<u>\$ 6,569,155</u>	<u>\$134,260,987</u>	<u>\$105,770,843</u>	<u>\$28,490,144</u>

Expenditures without Appropriations of Specific Amounts:

The Statewide Conference Fund has a continuing appropriation in accordance with OMB Policy 211 (\$16,505 of expenditures for this biennium).

The Centers of Research Excellence Fund has a continuing appropriation authorized by NDCC 54-65-05 (\$1,486,838 of expenditures for this biennium).

The Internship Fund has a continuing appropriation authorized by NDCC 54-60-17.1 (\$1,125,208 of expenditures for this biennium).

The Workforce Enhancement Fund has a continuing appropriation authorized by NDCC 54-60-23 (\$1,546,376 of expenditures for this biennium).

The Energy Conservation Grant Fund has a continuing appropriation authorized by NDCC 54-44.5-05.1 (\$1,125,618 of expenditures for this biennium).

The Centers of Excellence Fund has a continuing appropriation authorized by NDCC 15-69-06 (\$7,657,286 of expenditures for this biennium).

The Research North Dakota Fund has a continuing appropriation authorized by NDCC 54-65-08 (\$7,334,582 of expenditures for this biennium).

The Ethanol Production Incentive Fund has a continuing appropriation authorized by NDCC 17-02-05 (\$4,776,462 of expenditures for this biennium).

Internal Control

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

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls related to inventory.
- Controls related to investments.
- Controls related to payroll.
- Controls surrounding the ConnectND (PeopleSoft) 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 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: 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 did not identify any significant deficiencies in internal control.

Compliance with Legislative Intent

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

- Compliance with appropriations and related transfers (2015 North Dakota Session Laws chapter 18).
- Compliance with the enhanced use lease grant program requirements (House Bill 1018, section 4 of the 2015 North Dakota Session Laws).
- Compliance with the entrepreneurship grants and voucher program requirements (House Bill 1018, section 6 of the 2015 North Dakota Session Laws).
- Compliance with the unmanned aircraft systems program requirements (House Bill 1018, section 7 of the 2015 North Dakota Session Laws).
- Compliance with the tribal college grants program requirements (House Bill 1018, section 8 of the 2015 North Dakota Session Laws).
- Compliance with the domestic violence shelter grant program requirements (House Bill 1285, section 1 of the 2015 North Dakota Session Laws).
- Compliance with the early childhood education provider grants program requirements (Senate Bill 2151, Section 7 of the North Dakota Session Laws).
- Compliance with the ethanol production incentive grant program requirements (NDCC section 17-02-03 and NDCC section 39-04-39).
- Proper allocation of state funds to community action agencies to provide matching funds for eligible individual development accounts (NDCC section 54-62-02).
- Compliance with reporting requirements of the Research North Dakota Grant Program (NDCC section 54-65-06).
- Proper use of the following legally restricted funds:
 - Agricultural Products Utilization Fund (NDCC section 54.60.3-06)
 - Centers of Research Excellence Fund (NDCC section 54-65-05)
 - Internship Fund (NDCC section 54-60-17.1)
 - Workforce Enhancement Fund (NDCC section 54-60-23)
 - Energy Conservation Grant Fund (NDCC section 54-44.5-05.1)
 - Community Service Fund (NDCC section 54-44.5-05)
 - Centers of Excellence Fund (NDCC section 15-69-06)
 - Research North Dakota Fund (NDCC section 54-65-08)
 - Unmanned Aircraft Systems Fund (NDCC section 54-60-29)
 - Ethanol Production Incentive Fund (NDCC section 17-02-05)
- Proper authorization of the Department's funds.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper authority for investments and investment interest.
- Adequate blanket bond coverage of employees (NDCC section 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.
- Compliance with payroll-related laws including statutory salaries for applicable appointed positions.

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

Our audit of the Department of Commerce included reviewing operations surrounding the Ethanol Production Incentive and the Early Childhood Education Grant.

Ethanol Production Incentive

Background

The Ethanol Production Incentive program is within the Community Services Division of the Department of Commerce. This division was established to provide technical assistance to local governments and state agencies in the areas of community and rural planning and development, policy research and development, and grant program implementation. The Ethanol Production Incentive program was approved by the 2003 Legislative Session to provide incentive funding for new ethanol plants built in North Dakota. The Ethanol Production Incentive is a counter-cyclical program that helps producers during adverse times when ethanol prices are unusually low and/or corn prices are unusually high. When these prices are normal or better than normal, the incentive is phased out and market conditions are allowed to prevail.

Our audit of the Department of Commerce's Ethanol Production Incentive program procedures was designed and conducted to meet the following objectives:

- Are policies and procedures in place to ensure that necessary information is adequately conveyed to the grantee?
- Were performance measures properly developed?
- Has a process been developed that ensures the integrity and validity of the selection process?
- Do grant requirements, including such items as grant contract, work plans, and/or status and financial reports facilitate accountability?
- Do monitoring efforts validate financial status, outputs/outcomes, results and continued compliance with grant provisions?
- Does management compile data/information from the grant program operations to be able to assess program performance versus expectations?

We did not identify any significant issues related to the objectives noted above and all objectives were met.

Early Childhood Education Grant

Background

The Early Childhood Education Grant program is within the Workforce Development Division of the Department of Commerce. This division partners with other state agencies and the public-sector industry to deliver specialized programs and services to assist in enhancing the workforce of North Dakota. Early Childhood Education Grant program was established by the 2015 Legislative Session to provide funding for public and private Early Childhood Education programs serving four-year-old children that are eligible for free or reduced lunches according to the National School Lunch Act.

In order to be eligible facilities must:

- Be a participating member in a local Early Childhood Education coalition or on the governing board,
- Be approved by the North Dakota Department of Public Instruction to provide Early Childhood Education,
- Incorporate within its curriculum at least ten hours of research-based parental involvement, and
- Has documented willingness to admit children of all learning abilities.

Our audit of the Department of Commerce's Early Childhood Education Grant program procedures was designed and conducted to meet the following objectives:

- Are policies and procedures in place to ensure that necessary information is adequately conveyed to the grantee?
- Were performance measures properly developed?
- Has a process been developed that ensures the integrity and validity of the selection process?
- Do grant requirements, including such items as grant contract, work plans, and/or status and financial reports facilitate accountability?
- Do monitoring efforts validate financial status, outputs/outcomes, results and continued compliance with grant provisions?
- Does management compile data/information from the grant program operations to be able to assess program performance versus expectations?

We did not identify any significant issues related to the objectives noted above and all objectives were met.

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