

# North Dakota Securities

## Department

BISMARCK, NORTH DAKOTA

# Audit Report

For the Two-Year Period Ended  
June 30, 2018

**Joshua C. Gallion**  
State Auditor



Office of the State Auditor  
Division of State Audit



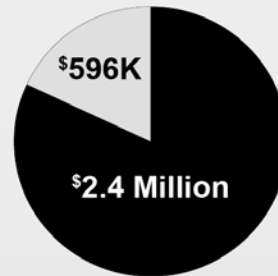
# NEWS

## North Dakota Securities Department Discovers 15-Year Ponzi Scheme by Bismarck Broker

**A** former Questar Capital and Woodbury Financial Services broker plead guilty in March 2018 to mail fraud and money laundering after the North Dakota Securities Department discovers his 15-year ponzi scheme

involving fake CDs and investment funds. Investigators at the Securities Department were paramount in cracking the case and collecting \$3 million in restitution for the victims of the scheme.

### Recouped Dollars



- Woodbury Financial Services
- Questar Capital



Source: ND Governor's Office Press Release

### What We Found

The audit concluded the restitution payments made to the victims of the Ponzi scheme were proper. The North Dakota Securities Department is responsible for the enforcement of the North Dakota securities laws that protect citizens from dishonest investment practices, and regulate the people and companies offering investment opportunities. Hundreds of complaints are investigated annually, and the Department has assisted many North Dakota citizens in recovering money from fraudulent schemes.



*55 OF THE 66 VICTIMS OF THIS SCHEME WERE ELIGIBLE AND HAVE RECEIVED REPAYMENT FROM THE RESTITUTION RECEIVED*

Source: ND Governor's Office Press Release

**LEGISLATIVE AUDIT AND FISCAL REVIEW  
COMMITTEE MEMBERS**

**Senator Jerry Klein – Chairman  
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Patrick Hatlestad  
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Gary Kreidt  
Mike Nathe  
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**Senators**

**Dwight Cook  
Judy Lee  
Richard Marcellais**

**AUDITOR AND AGENCY PERSONNEL**

**State Auditor Personnel**

**Allison Bader, MBA, Audit Manager  
Kevin Scherbenske, CPA, Audit Supervisor  
Amanda Westlake  
Elizabeth Rogers**

**Primary Securities Department Contacts**

**Karen Tyler, Commissioner  
Diane Lillis, Budget Administrator**

# Contents

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<i>Transmittal Letter</i>	<i>1</i>
<i>Statutory Audit Requirements</i>	<i>2</i>
<i>Conclusion</i>	<i>2</i>
<i>Internal Control</i>	<i>2</i>
<i>Scope</i>	<i>3</i>
<i>Methodology</i>	<i>3</i>
<i>Authority and Standards</i>	<i>4</i>
<i>Financial Statements</i>	<i>5</i>
<i>Statement of Revenues and Expenditures</i>	<i>5</i>
<i>Statement of Appropriations</i>	<i>6</i>
<i>LAFRC Responses</i>	<i>7</i>
<i>Responses to LAFRC Audit Questions</i>	<i>7</i>
<i>LAFRC Audit Communications</i>	<i>7</i>



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

## *Transmittal Letter*

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March 22, 2019

The Honorable Doug Burgum, Governor  
Members of the North Dakota Legislative Assembly  
Ms. Karen Tyler, Securities Commissioner

We are pleased to submit this audit of the North Dakota Securities Department for the two-year period ended June 30, 2018. 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.

The primary consideration in determining the contents of these audits is to produce informative audits to improve government. Statutory audit requirements are an important part of these audits and are addressed by our standard audit objective. Additionally, whenever possible additional audit objectives are included to increase responsiveness and effectiveness of state government.

Allison Bader 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 Ms. Tyler and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion  
State Auditor

## **Statutory Audit Requirements**

The objective related to our statutory audit requirements is:

Are there any exceptions to report relating to statutorily required audit testing?

Statutorily required audit testing includes: performing the post audit of financial transactions, detecting and reporting any defaults, determining that expenditures have been made in accordance with law, appropriation acts, and emergency commission action, and evaluating blanket bond coverage. Defaults are defined as failures to do something required by duty or law. Bonding coverage provides insurance to state agencies for any default or wrongful act on the part of any public employee or public official.

### **Conclusion**

No exceptions to our statutorily required audit testing were identified.

Audit procedures included testing compliance with appropriation laws, evaluating the adequacy of blanket bond coverage, performing tests of expenditures, and analysis of revenues collected for license and registration fees.

The North Dakota Securities Department is responsible for the enforcement of the North Dakota securities laws (North Dakota Century Code 10-04) that protect citizens from dishonest investment practices, and regulate the people and companies offering investment opportunities. Hundreds of complaints are investigated annually, and the Department has assisted many North Dakota citizens in recovering money from fraudulent schemes. They also work with local, state, and federal law enforcement agencies to bring perpetrators of fraud to justice. During our audit period, a large Ponzi scheme was discovered by the Department resulting in \$3 million of restitution revenue and \$2.9 million in payments to 55 victims made during the audit period. The audit determined the restitution was properly paid to the victims.

In addition, the Securities Department is required to register franchises, securities, broker-dealers and agents for the offer and sale of a security, and investment advisors and investment adviser representatives. We analyzed the registration fees collected and found that 7,749 securities and 176,069 agents and representatives were registered during the audit period.

### **Internal Control**

We gained an understanding of internal control 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.

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 deficiencies in internal control that were significant within the context of our audit objectives and based upon the audit work performed.

## **Scope**

This audit of the North Dakota Securities Department is for the two-year period ended June 30, 2018.

The North Dakota Securities Department has operations in the following locations. Each location was included in the audit scope:

- The Bismarck office in the State Capitol.
- Satellite office in Grafton, North Dakota

## **Methodology**

To meet this objective, we:

- 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.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system for data analysis. Significant evidence was obtained from ConnectND.
- Observed the North Dakota Securities Department's processes and procedures.
- Inspected documentary evidence.
- Tested compliance with appropriation laws and regulations.
- Reviewed adequacy of blanket bond coverage by comparing coverage to state bonding guidelines.
- Performed an analysis and selected a sample of high-risk transactions, including large restitution payments, for further testing.
- Performed an analysis of revenue sources and trends of revenues.
- Performed a test of receipts from the Blue Express and Electronic Filing Depository (EFD) systems
- Confirmed victim restitution payments were made in accordance with restitution agreements.

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

## ***Authority and Standards***

This biennial performance audit of the North Dakota Securities Department has been conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code Chapter 54-10.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States. 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 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).



# Financial Statements

## Statement of Revenues and Expenditures

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
<b><u>Revenues and Other Sources:</u></b>		
License and Registration Fees	\$10,946,566	\$11,049,388
Restitution Received	3,228,373	124,500
Miscellaneous Sales and Services	175	62
<b>Total Revenues and Other Sources</b>	<b><u>\$14,175,114</u></b>	<b><u>\$11,173,950</u></b>
<b><u>Expenditures and Other Uses:</u></b>		
Restitution Payments	\$ 2,924,202	\$ 193,297
Salaries and Benefits	863,852	816,585
IT Services and Supplies	37,090	36,242
Operating Fees and Services	29,056	26,854
Supplies	22,913	22,184
Travel	19,213	12,830
Professional Development	8,020	7,234
Printing	4,012	3,764
Postage	1,724	1,826
Rental of Buildings or Land	1,415	1,415
Repairs	531	646
Office Equipment and Furniture	435	17,760
Insurance	362	(930)
Professional Fees and Services		83
<b>Total Expenditures and Other Uses</b>	<b><u>\$ 3,912,825</u></b>	<b><u>\$ 1,139,790</u></b>

Source: ConnectND Financials

## Statement of Appropriations

For the Year Ended June 30, 2018

<b>Expenditures by Line Item:</b>	<b>Final Appropriation</b>	<b>Expenditures</b>	<b>Unexpended Appropriation</b>
Salaries and Wages	\$1,848,667	\$863,439	\$ 985,228
Operating Expenses	<u>506,047</u>	<u>125,184</u>	<u>380,863</u>
<b>Totals</b>	<b><u>\$2,354,714</u></b>	<b><u>\$988,623</u></b>	<b><u>\$1,366,091</u></b>

<b>Expenditures by Source:</b>	<b>Original Appropriation</b>	<b>Expenditures</b>	<b>Total</b>
General	\$2,184,714	\$945,809	\$1,238,905
Other	<u>170,000</u>	<u>42,814</u>	<u>127,186</u>
<b>Totals</b>	<b><u>\$2,354,714</u></b>	<b><u>\$988,623</u></b>	<b><u>\$1,366,091</u></b>

Source: ConnectND Financials

For the Biennium Ended June 30, 2017

<b>Expenditures by Line Item:</b>	<b>Final Appropriation</b>	<b>Expenditures</b>	<b>Unexpended Appropriation</b>
Salaries and Wages	\$1,801,279	\$1,713,777	\$ 87,502
Operating Expenses	<u>459,502</u>	<u>258,537</u>	<u>200,965</u>
<b>Totals</b>	<b><u>\$2,260,781</u></b>	<b><u>\$1,972,314</u></b>	<b><u>\$288,467</u></b>

<b>Expenditures by Source:</b>	<b>Original Appropriation</b>	<b>Expenditures</b>	<b>Total</b>
General	\$2,090,781	\$1,919,547	\$171,234
Other	<u>170,000</u>	<u>52,767</u>	<u>117,233</u>
<b>Totals</b>	<b><u>\$2,260,781</u></b>	<b><u>\$1,972,314</u></b>	<b><u>\$288,467</u></b>

Source: ConnectND Financials

# ***LAFRC Responses***

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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?*

This question is not applicable for performance audits. 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.*

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 North Dakota Securities Department'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), Central Registration Depository, Electronic Filing Depository, Blue Express, and the Securities Deposit System are high-risk information technology systems critical to the North Dakota Securities Department.

You may obtain audit reports on the internet at:

[www.nd.gov/auditor](http://www.nd.gov/auditor)

or by contacting the Office of the State Auditor at:

**Email:** [ndsao@nd.gov](mailto:ndsao@nd.gov)

**Phone:** (701) 328-2241

**Office of the State Auditor**

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