

North Dakota Office of the State Auditor

Department of Commerce Audit Report For the Biennium Ended June 30, 2019

Client Code 601



North Dakota State Auditor
Joshua C. Gallion



Why We Conducted this Audit

The purpose of this audit was to determine that financial transactions including expenditures were made in accordance with law and appropriation requirements.

What We Found

The Department of Commerce circumvented procurement requirements related to the “Be Legendary” logo and overall brand refresh. We found two temporary employment contracts were used to stay under the purchasing thresholds and continue the work from the original contract.



These contracts should have been treated as one contract for services and bid appropriately following OMB procurement requirements. The total cost of both contracts was \$87,162.50 which would require the Department to follow Level 3 procurement requirements. See pages 2-5.



Violated Appropriation Law

The Department’s procedures did not ensure expenditures were properly charged to appropriations. An additional \$853,908 should have remained in the general fund or Strategic Investment and Improvement fund for the biennium ended June 30, 2019. See pages 5 and 7.



Not Performing Proper Monitoring Procedures

The Department did not monitor procedures of an entrepreneurial contract which resulted in \$123,750 in payments to unapproved subcontractors. See page 6.

KEY PERSONNEL

State Auditor's Office Staff

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Client Staff Contacts

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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

September 17, 2019

The Honorable Doug Burgum, Governor
Ms. Michelle Kommer, Commerce Commissioner

We are pleased to submit this audit of the Department of Commerce for the biennium ended June 30, 2019. 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. 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. Kommer and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion
State Auditor

Cc: Legislative Audit and Fiscal Review Committee
Chris Kadrmas, Legislative Council Fiscal Analyst

Audit Results

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.

Except for the following findings on pages 2-8, no exceptions relating to our statutorily required audit testing were identified.

Circumventing Procurement Guidelines (Finding 19-01)

Conclusion

The Department of Commerce (Department) circumvented procurement requirements related to the “Be Legendary” logo and overall brand refresh. We found two temporary employment contracts were used to stay under the purchasing thresholds and continue the work from the original contract. These contracts should have been treated as one contract for services and allowed for contractor competition following the Office of Management and Budget (OMB) procurement requirements. The total cost of both contracts was \$87,162.50.

Audit Results

In 2001, the State of North Dakota developed the “Legendary” brand and used it through September 2018. This brand was primarily used for the needs of the Division of Tourism at the Department and was not a unified brand across all of state government.

To create a unified brand, the Department entered into a contract (Original Contract) with a Minnesota based business on July 25, 2018, to update the official North Dakota logo into the new “Be Legendary” logo and develop digital and other mediums including a new ND.gov website structure. This contract was set at \$9,500, which only required one fair and reasonable quote, allowing the Department to select the contractor. Once the Original Contract work was underway, the Department claims they underestimated the amount of work that was necessary and, due to a quick timeline, they decided to offer temporary employment contracts to the two individuals who had been working under the Original Contract (Employment Contracts). Executing these Employment Contracts circumvented procurement requirements and did not allow for contractor competition.



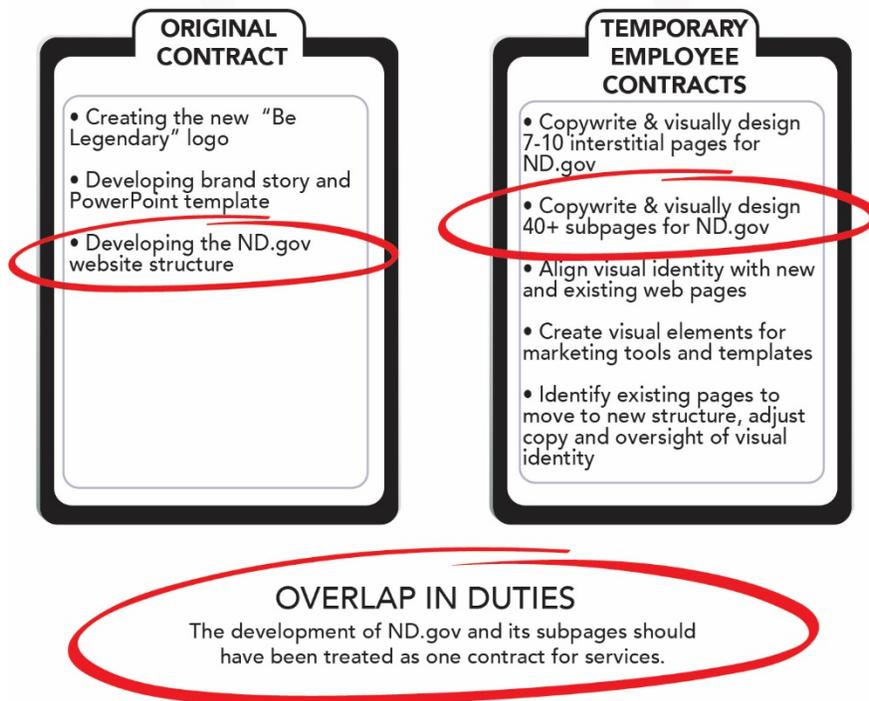
We also found that these two individuals were hired as temporary employees but continued to be treated as contractors. The North Dakota Department of Labor uses the IRS Common Law Test to determine whether an individual is an employee or a contractor. Based on evidence found during our audit, we determined these individuals were treated as contractors and not temporary employees. For example, the following common characteristics of contractors, based on the Common Law Test, that apply to these “temporary employees” include: (1) they were not given set work schedules; (2) they were not required to work on the premises; (3) they were not limited to providing similar services to other clients during this timeframe; and (4) they were not given computers and equipment.

We found the deliverables required from both contracts overlapped and the Employment Contracts were a continuation of the same work in the Original Contract. Interviews with staff confirmed the two temporary employees were continuing to do the same work as they were under the Original Contract.



Office of Management and Budget Purchasing Thresholds

A Level 1 “micro” purchase is defined as a purchase of less than \$10,000 and the agency must obtain at least one fair and reasonable quote.



We also looked at completion dates of deliverables to determine if these contracts were separate projects. We should have been able to confirm that work done under the Original Contract was completed and approved before that contract date ended. However, during testing, we were unable to confirm completion dates.

Based on the determination that the Employment Contracts were a continuation of services, and that there was no clearly defined break in services between the Original Contract and the Employment Contracts, the Department circumvented procurement requirements and should have properly bid the work as one contract for services.

The true cost of this brand refresh to the Department was \$87,162.50 during the 2017-2019 biennium which would have made this a Level 3 procurement according to OMB Purchasing Guidelines effective July 1, 2018. The Department should have solicited informal bids or proposals using the State Procurement Office Online System with the state bidders list. Failure to follow OMB Purchasing Guidelines violates state law pursuant to North Dakota Century Code (NDCC) 54-44.4-02.1.



Office of Management and Budget Purchasing Thresholds

A Level 3 informal written purchase is defined as a purchase of at least \$50,000 and no more than \$100,000. Level 3 purchases require a solicitation of informal bids or proposals using the State Procurement Office Online System with appropriate state bidders list.

Recommendation:

We recommend the Department of Commerce properly follow OMB procurement requirements when making purchases of services.

Department of Commerce Response:

“We disagree with the finding that the Department “violated state law by circumventing procurement requirements related to the ‘Be Legendary’ logo and overall brand refresh”.

As correctly stated in the audit report, the value of this contract was \$9,500, and as such, did not require a competitive bid process under procurement rules.

Contract deliverables were met prior to the contract being completed. Subsequently, temporary workers were hired to perform work that was connected to the brand refresh but was separate from the contract deliverables. We acknowledge there was overlap in the time frame of the contract and the temporary employment as the final contract payment was made in November 2018, and the temporary employees began employment with the Department in October 2018. After the hiring of the temporary employees, the OMB Procurement Office was consulted, and steps were taken to ensure the contract was appropriately terminated after final payment.

The Department will ensure there is a clear separation between contract deliverables and temporary employment arrangements in the future and that all procurement requirements are followed.”

Office of the State Auditor Response:

The Department did not have evidence to support that the services from the Original Contract were completed before the Temporary Employment contracts were negotiated in September 2018

and effective October 1, 2018. Without this evidence and that the duties of both contracts overlapped, the work was a continuation of the same services in the Original Contract. The two individuals providing services under the Original Contract continued to be treated as contractors.

Violation of Appropriation Law (Finding 19-02)

Conclusion

The Department of Commerce (Department) violated their appropriation authorized in the 2017 Session Laws by improperly charging \$853,908 to the wrong biennium.

Audit Results

The 2017 Session Laws, Senate Bill 2018, appropriated \$3 million to the Department for the Enhanced Lease Grant program. The appropriation funding was available for the biennium beginning July 1, 2017 and ending June 30, 2019. In December 2017, the Department entered into a grant agreement with a County. The County submitted reimbursement requests for the work completed. We found the final payment to the County exceeded the reimbursement request by \$458,801. The grant agreement prohibited advance payments by the State. This unsupported advance payment resulted in the Department expending \$2,999,991 of the available \$3,000,000 appropriation at the end of the State's apply back period. The State's apply-back period is open to allow agencies to pay bills received in July when the services occurred prior to June 30.

In addition, the July 2019 supporting invoices of the County's Enhanced Lease Grant included uncompleted construction activity for a billing period with days in June and July. The Department did not require in the County grant agreement that the reimbursement requests match the end of the State's appropriation period or apply reasonable procedures to estimate the July costs. Using the number of days in July in the billing period to estimate the July costs, \$310,931 was improperly charged to appropriations that ended June 30, 2019.

Further testing of payments made in July 2019 identified an additional \$84,176 paid to a vendor that was improperly applied back to appropriations ending June 30, 2019.

Due to these violations, an additional \$853,908 should have remained in the general fund or returned to the Strategic Investment and Improvements Fund for the biennium ended June 30, 2019.

OMB Policy 201 prohibits receiving goods and services in July and charging the cost to the prior biennium.

Recommendation:

We recommend the Department of Commerce comply with all appropriation laws and OMB Policy.

Department of Commerce Response:

The Department of Commerce agrees with the recommendation and acknowledges that these expenditures should have been charged to the 2019-21 biennium rather than the 2017-19

biennium. The Department will strengthen internal controls and implement procedures to ensure in the future expenditures are properly allocated to the correct biennium.

Noncompliance with Contract Requirements (Finding 19-03)

Conclusion

The Department of Commerce (Department) did not monitor contract deliverables of an entrepreneurial contract with a total cost of \$253,921. As a result, contract payments totaling \$123,750 were made to unapproved subcontractors. Further, \$23,448 of these payments were not supported by progress reports.

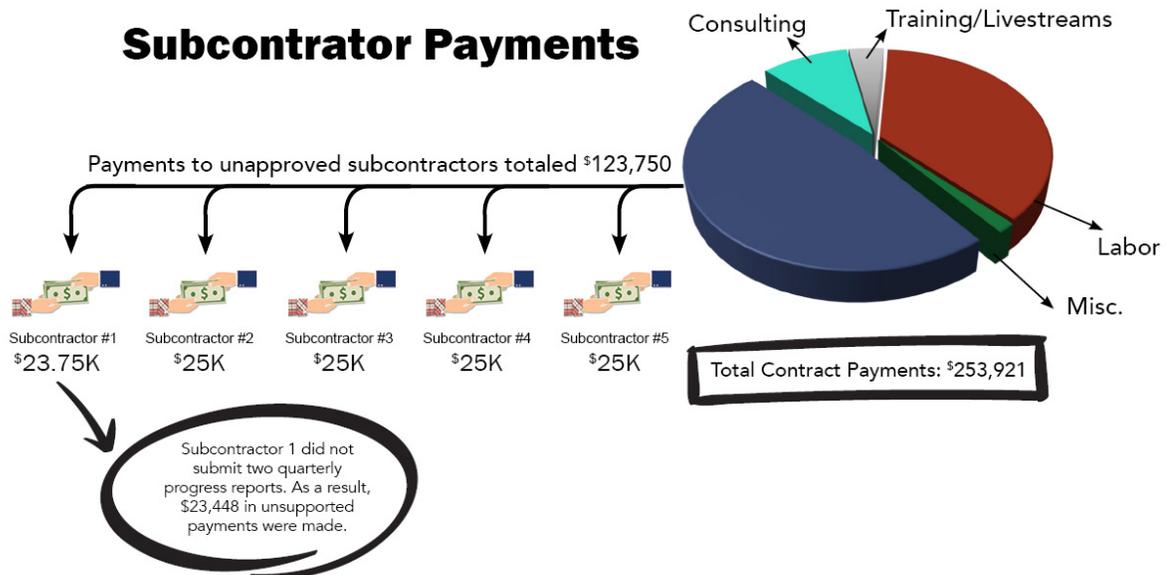
Audit Results

An employee survey identified an entrepreneurial contract as high-risk for potential non-compliance. Due to the nature of the services provided under the contract and turnover of personnel responsible for monitoring the contract, additional testing was performed. We reviewed the contract activity for compliance with the contract deliverables.

The following contract deliverables were not met:

- *CONTRACTOR must submit sub-contractors to state for approval with proof of sustainability of developed programming/positions.*
- *Sub-contractor progress reports must be reported in CONTRACTOR quarterly required reports.*

The Department did not approve subcontractors, which would include a review of proof of sustainability, as required by the contract. Additionally, the Department made unsupported payments to the unapproved subcontractors.



Source: ConnectND Financials and Contract Support

Recommendation:

We recommend the Department of Commerce ensure all contract requirements are performed and supported prior to issuing contract payments.

Department of Commerce Response:

“We disagree with the finding that the Department did not monitor contract deliverables and that contract payments were made to unapproved subcontractors. The auditor’s report indicates that the following contract deliverables were not met:

- *CONTRACTOR must submit sub-contractors to state for approval with proof of sustainability of developed programming/positions.*
- *Sub-contractor progress reports must be reported in CONTRACTOR quarterly required reports.*

The auditor’s report indicates that the “The Department did not approve subcontractors...as required by the contract.” The Department did provide approval for sub-contracts; however, this approval occurred verbally, as verified by the previous contract manager and vendor. The auditor’s report indicates that unsupported payments were made to unapproved subcontractors. As noted, the Department verbally approved subcontractors, hence disagrees payments were made to “unapproved” contractors. The Department has implemented contract monitoring procedures to ensure appropriate documentation is secured in advance of payment for all future contracts.”

Office of the State Auditor Response:

The Department did not obtain proof of sustainability of the sub-contractors to fulfill the work which was required for proper approval of the sub-contractors. At the time of the audit, the Department did not provide evidence of sub-contractor approval. Due to employee turnover within the Department and inability to locate the employee’s records, the Department inquired with the vendor to re-obtain the approval the vendor received for the sub-contractors. The vendor’s response at that time was that the approval was via email but could not be located. Emails of the employee were obtained and researched by the auditor. No approval evidence was identified. Payments totaling \$23,448 also lacked supporting quarterly progress reports. The contract included stipulation that each party acknowledges that all records, regardless of physical form, and the accounting practices and procedures of each party are subject to examination by the State Auditor.

Lack of Internal Control Surrounding Appropriations (Finding 19-04)**Audit Results**

The internal control procedures of the Department of Commerce are not effective to ensure expenditures are charged to the proper biennial appropriations authorized by the Legislature.

Finding 19-02 of this report identified \$853,908 charged to the wrong biennium.

According to “Standards for Internal Control in the Federal Government”, management should design control activities, including accurate recording of transactions. (GAO-14-704G para. 10.01)

Recommendation:

We recommend the Department of Commerce strengthen internal controls to ensure expenditures are charged to the proper biennial appropriations.

Department of Commerce Response:

The Department of Commerce agrees with the recommendation and acknowledges that these expenditures should have been charged to the 2019-21 biennium rather than the 2017-19 biennium. The Department will strengthen internal controls and implement procedures to ensure in the future expenditures are properly allocated to the correct biennium.

Internal Control

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.

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 identified a deficiency in internal control that was significant within the context of our audit objectives and based upon the audit work performed. This deficiency is identified in Finding 19-04.

Scope

This audit of the Department of Commerce was for the biennium ended June 30, 2019.

The Department of Commerce’s sole location is its Bismarck office which was included in the audit scope.

This audit did not include identifying costs incurred by other agencies to rebrand with the “Be Legendary” logo. Expenditures of other agencies were outside the scope of this biennial audit of the Department of Commerce. Possible expenses that other agencies could have incurred include, but are not limited to, road signage, building signage, printing of new letterhead, brochures and business cards, website updates, etc.

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 Department of Commerce's processes and procedures.
- Inspected documentary evidence.
- Tested compliance with appropriation laws and regulations including emergency commission action.
- 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 travel, sponsorships, and restricted funds for further testing.
- Tested job postings applicable to veteran's preference hiring practices to ensure requirements were followed.
- Tested alternate procurements to ensure State Procurement policies and laws were followed.
- Reviewed an entrepreneurial contract and emails of key personnel to identify specific deliverables and evaluate compliance with OMB procurement requirements. Tested payments issued under this contract to ensure they were made for work completed to meet contract deliverables.
- Reviewed contract for services, temporary employment contract and emails of key personnel for the Be Legendary logo and re-branding to ensure compliance with OMB procurement requirements.
- Surveyed employees of the Department of Commerce on the following topics:
 - Efficient and effective utilization of financial and staff resources.
 - Environment free of harassment.
 - Concerns addressed without fear of consequences.
 - Consistent administration of policies, procedures, and processes.
 - Proper application of HRMS and Department policies for hiring, firing, and reduction and force.
 - Compliance with OMB procurement requirements.
 - Knowledge of fraud or non-compliance with laws, policies, or procedures.
 - Instructions outside moral or ethical values.
 - Methods for a better workplace.

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 Department of Commerce 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, 2019</u>	<u>June 30, 2018</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$ 14,381,386	\$ 15,832,727
Loan and Principal Interest	753,009	2,079,191
Program Revenue	449,647	659,594
Tourism Merchandise Sales	196,175	271,062
Interest on Investment	28,348	17,453
Miscellaneous Revenue	583,785	1,267,592
Transfers In	13,453,073	10,999,290
Total Revenues and Other Sources	<u>\$ 29,845,423</u>	<u>\$ 31,126,909</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 5,232,756	\$ 6,515,640
Grants	33,810,201	32,689,190
Operating Fees	8,168,633	6,611,292
Information Technology Services and Supplies	744,623	345,821
Professional Fees and Services	674,512	618,057
Travel	301,960	282,276
Professional Development	294,573	297,088
Building and Equipment Rental and Lease	247,003	301,128
Printing	189,039	317,241
Supplies	103,055	99,318
Postage	100,484	114,380
Miscellaneous Expenditures	17,221	22,407
Transfers Out	3,924	5,051,017
Total Expenditures and Other Uses	<u>\$ 49,887,984</u>	<u>\$ 53,264,855</u>

Source: ConnectND Financials

Statement of Appropriations

For the Biennium Ended June 30, 2019

Expenditures by Line Item:	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Wages	\$ 12,995,788	\$ 11,646,115	\$ 1,349,673
Operating Expenses	15,477,622	13,793,461	1,684,161
Grants	56,260,416	50,389,467	5,870,949
Discretionary Grants	2,849,273	1,107,046	1,742,227
Flood Impact Loans and Grants	5,201,752	351,193	4,850,559
Grants Tribal Colleges	500,000	498,200	1,800
APUC	5,694,769	2,282,513	3,412,256
Unmanned Aircraft System	28,000,000	-	28,000,000
ND Trade Office	2,000,000	2,000,000	-
Partner Programs	1,939,845	1,939,845	-
Entrepreneurship Grants	<u>3,034,383</u>	<u>1,848,612</u>	<u>1,185,771</u>
Totals	<u>\$ 133,953,848</u>	<u>\$ 85,856,452</u>	<u>\$ 48,097,396</u>

Expenditures by Source:	Final Appropriation	Expenditures	Total
General	\$ 63,021,130	\$ 31,035,415	\$ 31,985,715
Other	<u>70,932,718</u>	<u>54,821,037</u>	<u>16,111,681</u>
Totals	<u>\$ 133,953,848</u>	<u>\$ 85,856,452</u>	<u>\$ 48,097,396</u>

Source: ConnectND Financials

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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