

Public Service Commission
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2015

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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

Transmittal Letter

September 21, 2015

The Honorable Jack Dalrymple, Governor

Members of the North Dakota Legislative Assembly

The Honorable Julie Fedorchak, Chairman of the Public Service Commission

We are pleased to submit this audit of the Public Service Commission for the biennium ended June 30, 2015. 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 Kristi Morlock. Jackie Ressler was the staff auditor. 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 Commissioner Fedorchak and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script, reading "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The Public Service Commission is comprised of three Commissioners who are elected on a statewide basis to staggered six-year terms.

The Commission was established before North Dakota became a state. Dakota Territory established a Board of Railroad Commissioners in 1885 to oversee railroads, sleeping car companies, express companies, and telephone companies. The state's constitution retained this board and entrusted it with powers and duties to be prescribed by law. In 1940 the Board's name was changed to the Public Service Commission (PSC). The Legislature has significantly broadened the duties of the PSC. Today, the Commission has varying degrees of jurisdiction over electric and gas utilities, telecommunications companies, energy plant and transmission siting, railroads, grain elevators, auctioneers and auction clerks, weighing and measuring devices, pipeline safety, coal mine reclamation, and abandoned mine lands.

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 Public Service Commission 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?

The Public Service Commission has implemented all 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 15 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 Public Service Commission'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), Weights and Measures, and Grain are high-risk information technology systems critical to the Public Service Commission.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Public Service Commission for the biennium ended June 30, 2015 were to provide reliable, audited financial statements and to answer the following questions:

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

Audit Scope

This audit of the Public Service Commission is for the biennium ended June 30, 2015. We conducted our audit in accordance with generally accepted government auditing standards (GAGAS), except the State Auditor is not independent as required by GAGAS 3.02. 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 GAGAS independence standard was not followed as a result of the Accounting Manager for the Public Service Commission winning his political party's nomination to run for State Auditor. Further, the current State Auditor actively promoted this candidate. This could have affected the audit team's independence of mind (self-interest threat) as well as the independence in appearance (circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised).

The Public Service Commission'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 developed a 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 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 Public Service Commission'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.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Public Service Commission'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).

For the biennium ended June 30, 2015, operations of the Public Service Commission were primarily supported by appropriations from the state's general fund and federal funds. This is supplemented by fees credited to the agency's special funds.

Financial Summary

The Public Service Commission has significant amounts in investments held at the Bank of North Dakota in the Public Service Commission Trustee Account. This account is established in accordance with North Dakota Century Code section 38-14.1-16. The balance of these investments was \$17,921,500 at June 30, 2015 and June 30, 2014.

The Commission has money market accounts and investments held at the Bank of North Dakota in the Credit-Sale Contract Indemnity Fund. The fund is held for the benefit of grain sellers who enter into credit-sale contracts and is made up of private funds. The balances in the fund were \$5,023,280 and \$5,699,955 at June 30, 2015 and 2014, respectively. These investments are authorized in accordance with North Dakota Century Code section 60-10-02.

The Commission has money market and investments held at the Bank of North Dakota in the Abandoned Mine Reclamation Fund. The balances in the fund were \$2,719,508 and \$2,713,909 at June 30, 2015 and 2014, respectively. These investments are authorized in accordance with North Dakota Century Code section 38-14.2-04(3).

Revenues consisted primarily of federal funds, as well as inspection and other regulatory fees, licenses, and permits. Overall revenue increased approximately 41%, which is mainly due to an increase in licenses, permits, fees, and fines for siting applications and prepaid application fees. Federal revenue also increased due to the timing of completing construction work due to weather conditions. Other revenues during the audited period included interest income and miscellaneous income and remained fairly constant. Total revenues and other sources for the Public Service Commission were \$8,873,647 for the year ended June 30, 2015 as compared to \$6,307,447 for the year ended June 30, 2014.

Total expenditures and other uses for the Public Service Commission were \$12,367,307 for the year ended June 30, 2015 as compared to \$8,895,871 for the prior year. The increase in refunds for the audited period is mainly due to the process for siting refunds being changed in fiscal year 2015 to return unused portions of fees to applicants prior to the case being completed and closed. There was also an increase in the number of utility valuation refunds that were given for fees that weren't used. Professional services increased due to the timing of construction work due to weather conditions. All other expenditures remained fairly constant.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The Public Service Commission expended \$15,674,474 of their biennial appropriation, leaving \$4,804,735 of unexpended appropriation. The largest unexpended portion of their appropriation was for the AML Contract Services line in the amount of \$2,459,823. This is due to less funds being received than expected from the Federal Office of Surface Mining.

The Rail Rate Complaint Case line had a significant unexpended balance of \$900,000. This is due to no complaints being received within the audit period. These moneys are exempt from NDCC 54-44.1-11 and may be carried over to the next biennium.

The Reclamation and Grain Litigation line had a significant unexpended balance of \$757,264. This is due to there being more funds appropriated than were needed to process grain insolvencies that closed and reclamation lawsuits that occurred during the biennium.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2015</u>	<u>June 30, 2014</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$ 4,773,481	\$ 4,240,392
Licenses, Permits, Fees, and Fines	4,070,801	2,027,748
Interest and Investment Earnings	13,190	20,594
Miscellaneous Revenue	16,175	13,313
Transfers In		5,400
Total Revenues and Other Sources	<u>\$ 8,873,647</u>	<u>\$ 6,307,447</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 4,290,392	\$ 3,911,747
Professional Services	3,491,751	3,020,241
Refunds	2,860,018	345,099
Grain Insolvency Payments	684,920	870,276
Travel	405,118	323,409
Equipment	192,131	42,011
Supplies	103,602	77,964
Operating Fees and Services	68,667	78,808
Repairs	68,068	5,677
IT – Data Processing	54,374	64,118
Professional Development	46,204	43,593
IT – Communications	38,927	41,133
Rent	35,449	34,154
Other Expenses	19,131	20,796
Transfers Out	8,555	16,845
Total Expenditures and Other Uses	<u>\$ 12,367,307</u>	<u>\$ 8,895,871</u>

Statement of Appropriations

For The Biennium Ended June 30, 2015

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	\$ 8,506,704		\$ 8,506,704	\$ 8,183,723	\$ 322,981
Accrued Leave Payments	168,278		168,278	18,417	149,861
Operating Expenses	1,895,562		1,895,562	1,681,807	213,755
Capital Assets	88,665		88,665	87,614	1,051
Grants	20,000		20,000	20,000	
AML Contractual Services	8,000,000		8,000,000	5,540,177	2,459,823
Rail Rate Complaint Case	900,000		900,000		900,000
Reclamation & Grain Litigation	900,000		900,000	142,736	757,264
Totals	<u>\$ 20,479,209</u>	<u>\$ 0</u>	<u>\$ 20,479,209</u>	<u>\$ 15,674,474</u>	<u>\$ 4,804,735</u>
Expenditures by Source:					
General Fund	\$ 7,091,740		\$ 7,091,740	\$ 6,793,910	\$ 297,830
Other Funds	13,387,469		13,387,469	8,880,564	4,506,905
Totals	<u>\$ 20,479,209</u>	<u>\$ 0</u>	<u>\$ 20,479,209</u>	<u>\$ 15,674,474</u>	<u>\$ 4,804,735</u>

Expenditures Without Appropriations Of Specific Amounts:

PSC Valuation Fund has a continuing appropriation authorized by NDCC sections 49-02-02 and 49-21-01.7 (\$1,451,218 of expenditures for this biennium).

Performance Valuation Fund has a continuing appropriation authorized by NDCC section 49-21-31 (\$5,400 of expenditures for this biennium).

Siting Process Recovery Fund has a continuing appropriation authorized by NDCC section 49-22-22 (\$2,576,890 of expenditures for this biennium).

Credit Sale Contract Indemnity Fund has a continuing appropriation authorized by NDCC section 60-10-02 (\$1,555,196 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2015, we identified the following areas of the Public Service Commission'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 effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the Weights and Measures and Grain Information Systems.

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 that 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 other matters involving internal control that we have reported to management of the Public Service Commission in a management letter dated September 21, 2015.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2015, we identified and tested Public Service Commission's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Development of policies for the assessment of penalties under North Dakota Century Code chapter 49-23 as required by North Dakota Century Code section 49-07-01.1.
- Proper use of the following legally restricted funds:
 - Siting Process Recovery Fund (NDCC 49-22-22(3)).
 - Credit Sale Contract Indemnity Fund (NDCC 60-10-02).
- Application of proper statutory rates relating to the following revenue types:
 - Surface Coal Mining (NDCC 38-14.1-13).
 - Public Service Commission Valuation Fund (NDCC 49-02-02, 49-21-01.7, and 49-05-16).
 - Electric Utility Franchise Fee (NDCC 49-03-02).
 - Public Utility Franchise Fee (NDCC 49-05-04).
 - Public Utility Rate Adjustment Fee (NDCC 49-05-04.2 and 49-05-04.3).
 - Change in Tariff Rates (NDCC 49-05-05).
 - Application fees and refunds (NDCC 49-22-22 (1) & (3)).
 - Auctioneer's License, Fee, and Annual Renewal (NDCC 51-05.1-01.1).
 - Public Warehouse License and Fees (NDCC 60-02-07).
 - Grain Buyer Annual License Fee (NDCC 60-02.1-07).
 - Testing Weighing and Measuring Devices (NDCC 64-02-10).
- Compliance with OMB's Purchasing Procedures Manual.
- Compliance with appropriations and related transfers (2013 North Dakota Session Laws chapter 8).
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Proper authority for investments.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, and annual inventory.

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.

While we did not find any items that were required to be reported in accordance with Government Auditing Standards, we noted a certain inconsequential or insignificant instance of non-compliance that we have reported to management of the Public Service Commission in a management letter dated September 21, 2015.

Operations

This audit did not identify areas of the Public Service Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

September 21, 2015

The Honorable Julie Fedorchak
Public Service Commission
600 E. Boulevard Avenue – Dept. 408
Bismarck, ND 58505

Dear Ms. Fedorchak:

We have performed an audit of the Public Service Commission for the biennium ended June 30, 2015, and have issued a report thereon. As part of our audit, we gained an understanding of the Public Service Commission'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 certain conditions we did not consider reportable within the context of your audit report. These conditions relate 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 recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

FIXED ASSETS

Informal Recommendation 15-1: We recommend the Public Service Commission update their physical inventory policy to include identifying and locating all sensitive items in accordance with OMB Policy 205.

REVENUE

Informal Recommendation 15-2: We recommend the Public Service Commission, at least monthly, reconcile receipts to deposits. The reconciliation should be completed within 10 business days of the period being reconciled.

Informal Recommendation 15-3: We recommend the Public Service Commission reconcile the total licenses issued in the Grain System to the money deposited on the state's accounting system.

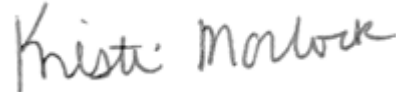
OPERATIONAL IMPROVEMENTS

Informal Recommendation 15-4: We recommend the Public Service Commission, Grain Licensing Division, implement a process to ensure all unlicensed buyers operating in the state of North Dakota are identified.

Management of Public Service Commission agreed with these recommendations.

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

Sincerely,

A handwritten signature in dark ink that reads "Kristi Morlock". The signature is written in a cursive, flowing style.

Kristi Morlock
Auditor in-charge

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Office of the State Auditor
600 East Boulevard Avenue – Department 117
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(701) 328-2241