

# Aeronautics Commission

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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## *Transmittal Letter*

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July 18, 2014

The Honorable Jack Dalrymple, Governor  
Members of the North Dakota Legislative Assembly  
Mr. Kyle Wanner, Director

We are pleased to submit this audit of the Aeronautics Commission 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 Allison Bader. Kristi Morlock, Megan Reis, and Elizabeth Rogers were the staff auditors. Cindi Pedersen, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-4743. We wish to express our appreciation to Mr. Wanner and his 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*

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## *Introduction*

The North Dakota Aeronautics Commission was established in 1947 by the State Legislature assigning responsibility for the state aviation functions. The Governor appoints the five members of the Aeronautics Commission to the board for terms of five years. The Commission staff is composed of the Director and three support staff plus two vacant positions.

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 Aeronautics 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?*

Other than our findings addressing "noncompliance with state procurement guidelines" (page 12), the Aeronautics Commission was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

### *3. Was internal control adequate and functioning effectively?*

Other than our findings addressing the "lack of segregation of duties surrounding revenue collections" (page 9), we determined internal control was adequate.

### *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.*

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 Aeronautics 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), and AIMS (Aviation Information Management System) are high-risk information technology systems critical to the Aeronautics Commission.

# ***Audit Objectives, Scope, and Methodology***

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## ***Audit Objectives***

The objectives of this audit of the Aeronautics Commission 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 Aeronautics 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 Aeronautics Commission and are they in compliance with these laws?
3. Are there areas of the Aeronautics Commission's operations where we can help to improve efficiency or effectiveness?

## ***Audit Scope***

This audit of the Aeronautics Commission is for the biennium ended June 30, 2013. We conducted this performance 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 Aeronautics 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 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 Aeronautics 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***

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The accompanying financial statements have been prepared to present the Aeronautics 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, 2013, operations of the Aeronautics Commission were primarily supported by appropriations from the Aeronautics Commission Special Fund. The majority of collections to the Special Fund are from excise taxes and aircraft registration and licensing fees. This is supplemented by federal and general funds.

### ***Financial Summary***

Revenues consisted primarily of aircraft excise tax collections, federal revenue, and aircraft licenses and registrations. Federal revenue increased due to monies received for the airport pavement condition index study conducted throughout the state every three years. Remaining revenues all remained fairly constant for the Aeronautics Commission. Total revenues were \$1,890,315 for the year ended June 30, 2013 as compared to \$1,579,462 for the year ended June 30, 2012.

Total expenditures for the Aeronautics Commission were \$3,363,699 for the year ended June 30, 2013 as compared to \$4,165,859 for the prior year. The majority of the increase in consulting and engineering services expenditures is for the airport pavement condition index study. The decrease in total expenditures for the audited period reflects primarily grants to airports for runway and equipment projects in fiscal year 2012 at Grand Forks, Bismarck, Dickinson, Ashley, and Drayton that received state matching funds. The Aeronautics Commission also purchased a Cessna airplane and de-icing equipment in fiscal year 2012.

### ***Analysis of Significant Variances - Budgeted and Actual Expenditures***

The excess of grants appropriations over actual expenditures was primarily due to the proposed master airport and navigation plans not receiving federal funding to require the state match (approximately \$2.2 million) and airport grants allocated to be paid in the future biennium as projects are completed (approximately \$1.9 million). The Aeronautics Commission had approximately \$2.2 million carryover appropriation for general aviation and air carrier airport grants to the 2013-2015 biennium approved by the Carryover Committee. In addition, the grants line item included approximately \$1 million for the automated weather observation systems national airspace data interchange networks project which the Aeronautics Commission was able to contract statewide within the operating line item rather than provide as grants to airports.

Excess operating appropriations over actual expenditures was mostly due to the State Aviation System Plan and Economic Impact of Aviation in North Dakota projects (approximately \$640,000) which were not started and were included in the 2013-2015 biennium appropriation approved by the Legislative Assembly.

# Financial Statements

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## Statement of Revenues and Expenditures

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<b><u>Revenues:</u></b>		
Aircraft Excise Tax	\$ 1,281,442	\$ 1,389,984
Federal Revenue	495,647	70,047
Aircraft Licenses and Registrations	106,978	105,238
Miscellaneous Revenue	6,248	14,193
<b>Total Revenues</b>	<u>\$ 1,890,315</u>	<u>\$ 1,579,462</u>
<b><u>Expenditures:</u></b>		
Grants to Airports	\$ 2,030,251	\$ 3,025,914
Consulting and Engineering Services	705,918	62,217
Salaries and Benefits	419,803	350,471
Supplies	46,187	71,412
Rentals/Leases of Buildings and Equipment	43,384	41,452
Travel	24,071	25,349
IT Services	21,805	31,759
Professional Development	14,328	12,894
Equipment under \$5,000	9,021	8,344
Repairs	8,785	11,802
Insurance	8,537	9,927
Printing	7,811	8,385
Postage	7,413	5,783
Aircraft Equipment over \$5,000		485,900
Miscellaneous Expenses	16,385	14,250
<b>Total Expenditures</b>	<u>\$ 3,363,699</u>	<u>\$ 4,165,859</u>

## Statement of Appropriations

For The Biennium Ended June 30, 2013

<b>Expenditures by Line Item:</b>	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Wages	\$ 1,005,639		\$ 1,005,639	\$ 768,993	\$ 236,646
Operating Expenses	2,262,549		2,262,549	1,206,909	1,055,640
Capital Assets	780,000		780,000	485,900	294,100
Construction Carryover		\$1,251,645	1,251,645	1,251,645	
Grants	9,040,000		9,040,000	3,816,111	5,223,889
<b>Totals</b>	<u>\$13,088,188</u>	<u>\$1,251,645</u>	<u>\$14,339,833</u>	<u>\$ 7,529,558</u>	<u>\$ 6,810,275</u>
<b>Expenditures by Source:</b>					
General Fund	\$ 554,500		\$ 554,500	\$ 554,500	
Other Funds	12,533,688	\$1,251,645	13,785,333	6,975,058	\$ 6,810,275
<b>Totals</b>	<u>\$13,088,188</u>	<u>\$1,251,645</u>	<u>\$14,339,833</u>	<u>\$ 7,529,558</u>	<u>\$ 6,810,275</u>

### Appropriation Adjustments:

The \$1,251,645 increase in the Construction Carryover line item was approved by the Carryover Committee for airport construction amounts provided to airports throughout the state.

## ***Internal Control***

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

### ***Internal Controls Subjected to Testing:***

- Controls surrounding segregation of duties and reconciliation procedures to ensure proper receipt and deposit of revenue collections.
- Controls surrounding the approval of expenditures and correcting entries in the ConnectND (PeopleSoft) system.
- Controls surrounding the reconciliation and approval of state purchase card expenditures.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the application, award, and monitoring procedures of Air Service Airport grants.
- Controls surrounding the application, award, and monitoring procedures of aerial sprayer licensing.

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 not adequate noting a certain matter involving internal control and its operation that we consider to be a significant deficiency.

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 the following significant deficiency in internal control. We also noted other matters involving internal control we have reported to management of the Aeronautics Commission in a management letter dated July 18, 2014.

### ***Lack of Segregation of Duties Surrounding Revenue Collections (Finding 13-1)***

#### **Condition:**

The Aeronautics Commission has not properly segregated duties of employees with access to revenue collections. Two employees handle revenue collections received through the mail or counter walk-in. These individuals also have access to the Aviation Information Management System (AIMS) in which revenue is recorded; receipts, registrations, and licenses are generated; and, summary reports used for reconciliation purposes are created.

**Criteria:**

The Internal Control Integrated Framework from the Committee of Sponsoring Organizations of the Treadway Commission states that appropriate segregation of duties is achieved when one or more employees or functions acts as a check and balance on the activities of another, such that no one individual has control over conflicting phases of a transaction of activity. Assigning different people responsibilities for authorizing transactions, recording transactions, reconciling information, and maintaining custody of assets reduces opportunity for any one employee to conceal errors or perpetrate fraud in the normal course of his or her duties.

**Cause:**

The Aeronautics Commission has not adequately reviewed the potential risk of fraud surrounding the handling of revenue collections. In addition, the Aeronautics Commission did not implement the prior informal recommendation for reconciliation of aircraft inspected to aircraft registrations awarded be performed by an individual without access to collections and access to make changes in AIMS to mitigate the lack of segregation duties for at least aircraft registration revenues.

**Effect or Potential Effect:**

During fiscal years 2012 and 2013, the Aeronautics Commission received revenue for aircraft registrations, excise taxes, various licenses, and miscellaneous sales totaling approximately \$2.9 million. Any reconciliation procedures to ensure revenue is received and all revenue received is properly deposited are ineffective until access to collections is properly segregated from individuals with access to issue receipts, registrations, and licenses.

**Recommendation:**

We recommend the Aeronautics Commission properly segregate duties surrounding revenue collections. Individuals with access to collections should not have access to the computer system where licenses and registrations are generated and printed. Once this is accomplished, the Aeronautics Commission should implement proper reconciling procedures to ensure all revenue is collected and deposited.

***Aeronautics Commission Response:***

*The Aeronautics Commission agrees with the finding regarding the need to segregate certain duties surrounding revenue collections. The agency will implement the recommended changes immediately by shifting employee responsibilities.*

## *Compliance With Legislative Intent*

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

- Compliance with appropriation laws (2011 Session Laws):
  - \$4,500 from the general fund for establishing a database for anemometer towers (chapter 58, section 2).
  - \$450,000 from special funds and capital asset line item for airplane replacement (chapter 6, section 3).
- Aircraft excise tax of 5% on aircraft or 3% on agricultural aircraft is properly charged on the aircraft purchase price and collected in accordance with NDCC 57-40.5-02.
- Proper deposit of aircraft excise tax to the Aeronautics Commission special fund in accordance with NDCC 57-40.5-09.
- Proper aircraft registration fees charged and deposited to the Aeronautics Commission special fund in accordance with NDCC 2-05-11.
- Proper permanent aircraft registration fees charged and deposited to the Aeronautics Commission special fund in accordance with NDCC 2-05-11.2 and NDCC 2-05-11.3, respectively.
- Proper fee for aerial sprayer license charged and deposited to the Aeronautics Commission special fund in accordance with NDCC 2-05-18.
- Proper fee for aircraft dealer license charged and deposited in accordance with NDCC 2-08-03.
- Proper fee for ultralight vehicle dealer license charged and deposited to the Aeronautics Commission special fund in accordance with NDCC 2-08-04.
- Grants are provided up to 90% of project costs from aviation fuel tax to qualifying political subdivisions or airport authorities and for proper airport construction of improvement projects in accordance with NDCC 57-43.3-06.
- Proper authorization of the Aeronautics Commission special fund (NDCC 57-43.3-06)
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2011 North Dakota Session Laws chapter 6 and Carryover Committee authorizations).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, and capitalization in accordance with OMB policy.
- 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* requires 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*. The finding is described below. Other than this finding, we concluded there was compliance with the legislative intent identified above. We also noted certain inconsequential instances of noncompliance that we have reported to management of the Aeronautics Commission in a management letter dated July 18, 2014.

### ***Noncompliance With State Procurement Guidelines (Finding 13-2)***

#### **Condition:**

The Aeronautics Commission did not follow State Procurement Office guidelines for the purchases of equipment and services. Required bids were not obtained and limited or noncompetitive purchases were not approved. The Aeronautics Commission had 55 purchases requiring compliance with procurement guidelines during the audit period. We identified 6 errors out of the 10 purchases that were tested. The following areas of noncompliance were identified:

- Limited or noncompetitive purchases of airplane equipment totaling \$36,000 and consulting services of \$3,456 were not approved by the State Procurement Office.
- Informal oral or written bids were not documented for purchases of applicator alert mapping, runway crack sealing, and seeding services and supplies totaling \$22,978.
- Informal oral or written bids were not documented for the purchase of computer equipment in the amount of \$5,700 that was provided to an airport authority as a grant.

#### **Criteria:**

Per the State Procurement Office Procurement Manual and North Dakota Century Code 54-44.4-01, it is a state policy that each state agency and institution obtain necessary commodities and services at a competitive cost, consistent with quality, time, and performance requirements with fair and equal opportunity to all persons qualified to sell to the state, except as otherwise provided by law.

Per the State Procurement Office Procurement Manual, prior approval of all limited competitive and noncompetitive purchases over \$2,500 is required, using the Alternate Procurement Request Form. In addition, competitive procurement between \$2,500 and \$25,000 requires at least 3 oral or written informal bids or proposals or written justification if 3 informal bids cannot be obtained.

#### **Cause:**

The Aeronautics Commission is not ensuring employees are following state procurement guidelines.

**Effect or Potential Effect:**

Noncompliance with State Procurement Office purchasing guidelines and North Dakota procurement laws. The Aeronautics Commission may not be ensuring open competition, fairness, and impartiality to vendors or obtaining the most economical commodities and services meeting the needs of the state.

**Recommendation:**

We recommend the Aeronautics Commission follow State Procurement Office guidelines for purchases of equipment and services.

***Aeronautics Commission Response:***

*The Aeronautics Commission agrees with the finding regarding the need to follow state procurement guidelines. The agency will work to ensure that the proper procurement guidelines will be followed and that adequate documentation will be kept regarding each procurement activity.*



## *Operations*

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This audit did not identify areas of Aeronautics Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note certain matters involving operations we have reported to management of the Aeronautics Commission in a management letter dated July 18, 2014.

## *Management Letter (Informal Recommendations)*

July 18, 2014

Mr. Kyle Wanner, Director  
Aeronautics Commission  
PO Box 5020  
Bismarck, ND 58502

Dear Mr. Wanner:

We have performed an audit of the Aeronautics Commission for the biennium ended June 30, 2013, and have issued a report thereon. As part of our audit, we gained an understanding of the Aeronautics 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.

Informal Recommendation 13-1: We recommend the Aeronautics Commission use available ConnectND queries to identify transactions prepared by other agencies for the Aeronautics Commission and develop procedures to approve these transactions.

Informal Recommendation 13-2: We recommend the Aeronautics Commission review and approve the payroll register or payroll changes report each month.

Informal Recommendation 13-3: We recommend the Aeronautics Commission code expenditure transactions to the proper appropriation class.

Informal Recommendation 13-4: We recommend the Aeronautics Commission properly dispose of equipment no longer needed through the Surplus Property Division of the Office of

Management and Budget in accordance with NDCC 54-44-04.06 and properly retain documentation in accordance with the record retention policy 011201.

Informal Recommendation 13-5: We recommend the Aeronautics Commission ensure all employees sign acknowledgment of receipt and compliance with the code of ethics policy.

Informal Recommendation 13-6: We recommend the Aeronautics Commission strengthen controls surrounding travel reimbursements to ensure lodging expenses are paid within per diem rates in accordance with OMB Policy 505 or properly document if per diem rates are not available.

Informal Recommendation 13-7: We recommend the Aeronautics Commission strengthen controls surrounding the purchase card including:

- Restrict the Purchase Card Administrator from being issued a purchase card;
- Ensure effective reconciliation of receipts to purchase card statement with all purchases supported by proper receipts;
- Ensure reconciliation of individual purchase card statements are reconciled to company statement by a non-card holder; and,
- Document the purpose for each purchase of items for evaluation of reasonableness by the approval function.

Informal Recommendation 13-8: We recommend the Aeronautics Commission have signed contracts or agreement for Air Service Grants that contain the following elements:

- Services to be received from the grantor;
- Information and reports the grantee will be required to provide and the grantor's right to verify them;
- Conflict of interest statement and steps to manage or eliminate conflict elements;
- Results expected to be achieved and methods used to measure the results; and
- Consequences for not achieving expected results and any applicable requirements

Informal Recommendation 13-9: We recommend the Aeronautics Commission implement procedures for reviewing the businesses registered with the North Dakota Secretary of State to identify new businesses operating without an aerial sprayer license.

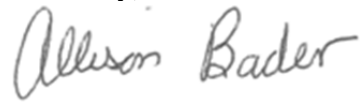
Informal Recommendation 13-10: We recommend the Aeronautics Commission establish documented policies and procedures for the Aerial Sprayer Licensing Program to ensure all complaints are handled appropriately. Specifically, the Commission should ensure that:

- Complaint filing methods and required information is available on the Commission's website;
- Policies and procedures are documented to include receiving and documenting complaints, maintaining confidentiality, investigation processes and results, and timeliness of resolution;
- Investigation processes include contacting landowners to identify businesses and pilots; and,
- A complaint tracking system is developed for consistent documentation and resolution of complaints.

Management of Aeronautics Commission agreed with these recommendations.

I encourage you to call myself 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 cursive script that reads "Allison Bader".

Allison Bader  
Auditor in-charge

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