

ND MILL AND ELEVATOR
ASSOCIATION
GRAND FORKS, NORTH DAKOTA

Audit Report

For the Year Ended
June 30, 2016

Office of the State Auditor
Division of State Audit

**LEGISLATIVE AUDIT AND FISCAL REVIEW
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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
FARGO BRANCH OFFICE
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FARGO, NORTH DAKOTA 58103

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Industrial Commission

Vance Taylor, President and General Manager
North Dakota Mill and Elevator Association

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the North Dakota Mill and Elevator Association, an agency of the state of North Dakota, as of and for the year ended June 30, 2016, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not

for the purpose of expressing an opinion of the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the North Dakota Mill and Elevator Association as of June 30, 2016, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America required the management's discussion and analysis on pages 4-7 and the Schedule of Employer's Share of Net Pension Liability and the Schedule of Employer Contributions on page 27 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries with management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the North Dakota Mill and Elevator Association's basic financial statements. The Schedule of Appropriations is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Schedule of Appropriations is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United

States of America. In our opinion, the Schedule of Appropriations is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Emphasis of Matter

As discussed in Note 1, the financial statements of the North Dakota Mill and Elevator Association are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities of the state that is attributable to the transactions of the Mill and Elevator Association. They do not purport to, and do not present fairly the financial position of the state of North Dakota as of June 30, 2016, the changes in its financial position, or where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the state of North Dakota adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application* and GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 1, 2016 on our consideration of the North Dakota Mill and Elevator Association's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the North Dakota Mill and Elevator Association's internal control over financial report compliance.



Robert R. Peterson
State Auditor

Fargo, North Dakota

November 1, 2016

Management's Discussion and Analysis

This section of the North Dakota Mill and Elevator Association's annual financial report presents management's discussion and analysis of the Mill's financial performance during the fiscal year that ended June 30, 2016. Please read this information in conjunction with the financial statements that follow this section.

FINANCIAL HIGHLIGHTS

Condensed Financial Data

	Fiscal Year 2016	Fiscal Year 2015
Current Assets	\$ 61,831,940	\$ 69,441,887
Noncurrent Assets	435,716	382,535
Capital Assets	73,706,792	52,631,575
Total Assets	<u>\$ 135,974,448</u>	<u>\$ 122,455,997</u>
Deferred Outflow of Resources	\$ 1,264,422	\$ 741,813
Current Liabilities	\$ 41,439,856	\$ 30,787,291
Noncurrent Liabilities	6,845,619	6,098,697
Total Liabilities	<u>\$ 48,285,475</u>	<u>\$ 36,885,988</u>
Deferred Inflow of Resources	\$ 673,042	\$ 2,423,431
Invested in Capital Assets	\$ 73,706,792	\$ 52,631,575
Unrestricted	14,573,561	31,256,816
Total Net Position	<u>\$ 88,280,353</u>	<u>\$ 83,888,391</u>
Operating Revenue		
Gross Sales	\$ 273,637,401	\$ 305,574,444
Sales Deductions	(57,514,059)	(57,639,983)
Net Sales	<u>\$ 216,123,342</u>	<u>\$ 247,934,461</u>
Nonoperating Revenue		
Interest Income	2,217	2,743
Miscellaneous	88,672	70,605
Total Revenues	<u>\$ 216,214,231</u>	<u>\$ 248,007,809</u>
Operating Expenses		
Material Cost	\$ 179,460,488	\$ 203,632,762
Manufacturing, Selling, General	27,047,530	27,375,789
Nonoperating Expenses		
Interest Expense	301,000	302,294
Other	68,595	21,616
Total Expenses	<u>\$ 206,877,613</u>	<u>\$ 231,332,461</u>
Revenue Over Expenses	\$ 9,336,618	\$ 16,675,348
Transfer to Industrial Commission	(42,931)	(35,803)
Transfer to General Fund	(4,434,894)	(3,408,600)
Transfer to Ag Fuel Tax Fund	(466,831)	(833,767)
Change in Net Position	4,391,962	12,397,178
Beginning Net Position as restated in FY15	83,888,391	71,491,213
Ending Net Position	<u>\$ 88,280,353</u>	<u>\$ 83,888,391</u>

- Gross sales reached \$273,637,000.
- During the fiscal year, the Mill shipped a record 12,993,000 hundredweight of flour.
- The Mill made a profit of \$9,337,000.
- Mill operations provided more than \$195,584,000 to the region and another \$453,755,000 in secondary economic activity for a total economic impact of more than \$649,339,000.

RESULTS OF OPERATIONS

Certain operating information is set forth below, as a percentage of gross sales for the fiscal years ended June 30, 2016 and June 30, 2015:

	<u>FY 2016</u>	<u>FY 2015</u>
Gross Margin	13.4%	14.5%
Material Costs	65.6%	66.6%
Operating Costs	9.9%	9.0%
Profits	3.4%	5.5%

Gross sales reached \$273,637,000 for the fiscal year compared to \$305,574,000 last year. The lower sales can be attributed to the lower cost of grain during the year. Sales of spring wheat flour were 11,922,000 hundredweight or 92% of our total sales while sales of durum products were 1,071,000 hundredweight. This compares to sales of 11,554,000 hundredweight of spring wheat flour and 996,000 hundredweight of durum products last year. Bulk flour sales represent 79% of the flour sold. Flour packed in bags accounted for 21% of the flour sold.

As a result of this increased sales volume, the Mill spent more than \$152,206,000 buying wheat and durum. This is down from the previous year purchases of \$194,819,000. This decrease in fiscal year 2016 is due primarily to a decrease of \$1.52 in average price paid per bushel for grain purchased by the Mill during the year. However, the Mill did purchase 660,000 bushels less wheat and durum during the year than in the previous year. The majority of the grain purchased is from North Dakota growers or grain elevators.

In addition to spending over \$152,206,000 on grain, most of which went to North Dakota farmers, the Mill also spent \$29,114,000 with other North Dakota based suppliers. Payroll costs for the North Dakota Mill were \$14,264,000 for the year ended June 30, 2016. These three items when added together show that the Mill provided a direct economic impact to the region of over \$195,584,000. A North Dakota State University study stated that for every dollar in direct economic activity from wheat processing, another \$2.32 was generated in secondary economic activity. Thus, the Mill produced \$453,755,000 in secondary economic activity resulting in a total economic impact of more than \$649,339,000.

Operating costs were \$27,048,000 compared to \$27,376,000 last year. This is a decrease of \$328,000 from last year. The primary cause for this decrease in operating cost is due to the decrease in energy costs. Operating cost per hundredweight of production were unchanged at \$2.21.

Gross margins as a percent of gross sales decreased to 13.4% from 14.5% in fiscal year 2015. Profits as a percent of gross sales decreased to 3.4% compared to 5.5% last year. The Mill experienced a profit of \$9,337,000 compared to a profit of \$16,675,000 last year.

LIQUIDITY

The North Dakota Mill's cash requirements relate primarily to capital improvements and a need to finance inventories and receivables based on raw material costs and levels. These cash needs are expected to be fulfilled by the Mill through operations and an established operating line of credit with the Bank of North Dakota. The Mill has a \$70,000,000 operating line of credit with the Bank of North Dakota.

CASH FLOWS FROM OPERATIONS

Operating activities for the year ended June 30, 2016 provided cash of \$17,653,000 compared to \$19,841,000 in fiscal year 2015. Cash was used primarily for capital projects at the Mill. There was an operating profit for this same period of \$9,615,000 compared to \$16,926,000 in fiscal year 2015.

CASH FLOWS FROM FINANCING ACTIVITIES

The North Dakota Mill had \$20,000,000 of short-term debt outstanding and payable to the Bank of North Dakota on June 30, 2016, compared to \$9,000,000 last year.

NET POSITION

Current assets decreased \$7,610,000 from last year. This decrease from last year is due primarily to decreases in inventories. Grain inventories declined \$4,958,000 from last year's values and the finished goods inventories and work in process inventories declined \$1,617,000.

The carrying value of capital assets increased \$21,075,000 to \$73,707,000 for the year ended June 30, 2016. The North Dakota Mill is in the process of completing a 30% flour milling capacity expansion project. In addition, the Mill completed other capital projects throughout the year that improved plant efficiencies and/or helped keep operating costs down. For more detailed information regarding capital assets and long-term debt activity see the Notes to the Financial Statements.

Current liabilities increased \$10,653,000 from last year. The major change occurred in notes payable, which increased \$11,000,000. The notes payable is to the Bank of North Dakota. The total net position increased by \$4,392,000, resulting in an improvement in overall financial position.

COMMODITY PRICE RISK

The North Dakota Mill utilizes futures contracts offered through regulated commodity exchanges to reduce risk. The Mill is exposed to risk of loss in the market value of inventories and fixed purchase and sales contracts. To reduce this risk, opposite and offsetting futures positions are taken.

INDUSTRY

U.S. annual wheat flour production decreased slightly in 2015 to 424,900,000 cwts. or a 0.01% decrease from 2014. Production of whole wheat flour in the United States was estimated at 24,115,000 cwts. The average rate of flour milling operations in 2015 was 86%. Excess flour milling capacity and high wheat and durum prices continue to put downward pressure on margins.

Per capita flour consumption decreased to 133 pounds in 2015. We expect grain and financial markets to continue to be volatile.

The growing season was difficult for some North Dakota farmers. While some farmers produced a large, good quality spring wheat crop in 2016, others had experienced poor growing conditions and a poor quality harvest. Average spring wheat protein is the same as last year at 14.2%. Good spring wheat quality has a positive impact on flour quality and contributes positively towards State Mill profitability. North Dakota is now the largest wheat producing state in the United States.

Financial Statements

Statement of Net Position

ASSETS	<u>June 30, 2016</u>
Current assets:	
Cash and cash equivalents	\$ 226
Receivables, net (note 4)	38,456,880
Inventories (note 5)	22,632,769
Prepaid expense	742,065
Total current assets	<u>\$ 61,831,940</u>
Noncurrent assets:	
Patronage capital credits	\$ 422,566
Other assets	13,150
Capital assets, net (note 6)	73,706,792
Total noncurrent assets	<u>74,142,508</u>
Total assets	<u>\$ 135,974,448</u>
 DEFERRED OUTFLOW OF RESOURCES	
Accumulated decrease in fair value of hedging derivatives	\$ 149,387
Derived from pensions	1,115,035
Total deferred outflows of resources	<u>\$ 1,264,422</u>
 LIABILITIES	
Current liabilities:	
Checks issued in excess of cash	\$ 1,928,041
Accounts payable and other liabilities (note 7)	14,460,703
Due to state general fund	4,434,894
Due to ag products utilization fund	466,831
Derivative instruments	149,387
Notes payable	20,000,000
Total current liabilities	<u>\$ 41,439,856</u>
Noncurrent liabilities:	
Compensated absences	\$ 943,836
Net pension liability	5,901,783
Total noncurrent liabilities	<u>6,845,619</u>
Total liabilities	<u>\$ 48,285,475</u>
 DEFERRED INFLOWS OF RESOURCES	
Derived from pensions	\$ 673,042
Total deferred inflows of resources	<u>\$ 673,042</u>
 NET POSITION	
Invested in capital assets	\$ 73,706,792
Unrestricted	14,573,561
Total net position	<u>\$ 88,280,353</u>

The accompanying notes are an integral part of the financial statements.

Statement of Revenues, Expenses, and Changes in Net Position

	June 30, 2016
OPERATING REVENUES	
Sales (net of sales deductions of \$57,514,059)	\$ 216,123,342
Total operating revenues	\$ 216,123,342
OPERATING EXPENSES	
Material cost	\$ 179,460,488
Wages and benefits	14,264,026
Repairs and maintenance	2,078,888
Operating supplies	810,351
Utilities	3,399,814
Insurance	883,589
Outside services	586,043
Office supplies	163,168
Computer expense	229,832
Communications	59,777
Travel and entertainment	260,787
Employee expense	69,171
Safety expense	54,467
Postage and mailing	24,564
Advertising	136,460
Dues and subscriptions	149,629
Legal and professional	34,207
Depreciation	3,842,757
Total operating expenses	206,508,018
Operating income	\$ 9,615,324
NONOPERATING REVENUES (EXPENSES)	
Interest income	\$ 2,217
Interest expense	(301,000)
Miscellaneous income	88,672
Other expense	(68,595)
Total nonoperating expenses	(278,706)
Gain before transfers	\$ 9,336,618
Transfer to state general fund	\$ (4,434,894)
Transfer to ag products utilization fund	(466,831)
Transfer to Industrial Commission	(42,931)
Change in net position	\$ 4,391,962
Total net position - beginning of year	83,888,391
Total net position - ending	\$ 88,280,353

The accompanying notes are an integral part of the financial statements.

Statement of Cash Flows

	June 30, 2016
CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers and users	\$ 272,199,723
Payments to suppliers	(239,781,614)
Payments to employees	(14,764,676)
Net cash provided by operating activities	\$ 17,653,433
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Proceeds from noncapital debt	\$ 20,000,000
Principal paid on noncapital debt	(9,000,000)
Interest paid on noncapital debt	(301,000)
Ag promotion	(58,939)
Transfer to Industrial Commission	(42,931)
Transfer to state general fund	(3,408,600)
Transfer to ag products utilization fund	(833,767)
Net cash used by noncapital financing activities	\$ 6,354,763
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	\$ (24,917,974)
Net cash used by capital and related financing activities	\$ (24,917,974)
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest income on investments	\$ 2,217
Net cash provided by investing activities	\$ 2,217
Net increase in cash and cash equivalents	\$ (907,561)
Cash and cash equivalents, beginning	907,787
Cash and cash equivalents, ending	\$ 226

(Continued)

Statement of Cash Flows - Continued

**RECONCILIATION OF OPERATING INCOME TO NET
CASH PROVIDED (USED) BY OPERATING ACTIVITIES**

Operating income	\$	9,615,324
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization		3,842,757
Pension expense		634,443
Other nonoperating income		79,016
Increase in receivables, net		(1,516,693)
Decrease in inventories		6,645,896
Decrease in prepaid expense		162,021
Increase in patronage capital credits		(53,181)
Decrease in accounts payable		(767,680)
Decrease in accrued payroll		(537,200)
Increase in other liabilities		146,623
Increase in accrued sick and vacation pay		32,908
Decrease in deferred outflows for pension		(630,801)
Total adjustments		<u>8,038,109</u>
Net cash provided by operating activities	\$	<u><u>17,653,433</u></u>

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies, as summarized below and the financial statements for the North Dakota Mill and Elevator Association (Mill) are in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard-setting body for establishing governmental accounting and financial reporting principles.

A. Reporting Entity

For financial reporting purposes, the Mill has included all of its operations as enterprise funds, and has considered all potential component units for which the Mill is financially accountable and other organizations for which the nature and significance of their relationship with the Mill are such that exclusion would cause the Mill's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. This criteria includes appointing a voting majority of an organization's governing body and (1) the ability of the Mill to impose its will on that organization; or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Mill.

Based upon these criteria, there are no component units to be included within the Mill as a reporting entity and the Mill is included within the state of North Dakota as a reporting entity.

B. Basis of Presentation

The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Mill's activities are considered to be an enterprise fund, single business-type activity (BTA) and accordingly, are reported within a single column in the basic financial statements.

C. Basis of Accounting

The enterprise fund is accounted for on a flow of economic resources measurement focus. The accrual basis of accounting is utilized by the enterprise fund. Revenue is recognized at the time of shipment from the Mill or from the transloading site. Expenses are recognized at the time goods and services were received and accepted.

D. Cash and Cash Equivalents

This classification appears on the Statement of Net Position and the Statement of Cash Flows and includes petty cash and cash on deposit with the Bank of North Dakota.

E. Receivables

Accounts receivable represents amounts due from customers for credit sales. Other receivables consist of grain margin accounts, derivatives, and a promissory note from an employee. The grain margin accounts and derivatives are used to buy and sell spring wheat futures contracts on the Minneapolis Grain Exchange. Any activity would be recognized at cost after the settlement period. The allowance method is used to account for estimated uncollectible accounts receivable.

F. Inventories

Grain committed to production is valued at cost. Grain committed to sale is valued at net commitment price. Excess grain inventories are valued at June 30 Minneapolis grain market values, less freight costs to Minneapolis. Flour, feed, and resale inventories are valued at ingredient cost plus manufacturing costs incurred in their production. Supplies inventories are valued at cost. The first-in, first-out basis is used for all inventories.

G. Capital Assets

Capital assets are stated at cost. When it is determined that a project consisting of machinery, equipment, or buildings will span more than one year, a "construction in progress" project folder is established to facilitate the accumulation until completion. Upon completion, the completed item is transferred to the applicable asset category. Movable equipment with a cost of \$5,000 or more is capitalized and reported in the accompanying financial statements.

Depreciation is computed on a straight-line basis over the estimated useful life of the assets, generally 10 to 20 years for infrastructure, 30 to 40 years for buildings, 5 to 25 years for plant equipment, 7 to 10 years for office equipment and furniture, 3 to 8 years for intangibles, and 5 to 10 years for leasehold improvements.

H. Noncurrent Long-Term Liabilities

Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.

I. Compensated Absences

Annual Leave - Union employees earn vacation within a range of 6 days to 30 days per year depending on length of continuous service. Other employees are entitled to earn annual leave, based on tenure of employment, within a range of 12 days to 30 days per year. Individuals may bank earned vacation time to a total accumulation of 30 days payable at retirement or upon severance of employment.

Sick Leave - Union employees earn sick pay at the rate of one day for each two months of continuous employment. Upon termination, Union employees shall be paid an amount equal to \$50 times the total unused days of accumulated leave, not to exceed \$5,000. Other employees earn sick pay at the rate of one day per month. Upon termination, these employees are entitled to be paid 10% of their accumulated sick leave, if employed 10 years or longer.

J. Scale Accrued Purchases

Grain received/unloaded at the Mill that has not yet been settled by the Mill.

K. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the North Dakota Public Employees Retirement System (NDPERS) and additions to/deductions from NDPERS' fiduciary net position have been determined on the same basis as they are reported by NDPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

L. Net Position

The Mill's net position is classified as follows:

Invested in Capital Assets – This represents the Mill's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets. However, there are no outstanding debt obligations.

Unrestricted Net Position – Unrestricted net position include resources derived from customer sales which may be used to meet the Mill's ongoing obligations.

M. Revenue and Expense Recognition

The Mill presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the Mill. Operating revenues include all charges to customers. Revenues from interest income, gains on sale of capital assets, and bad debt recovery are considered nonoperating since these are either investing, capital, or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital, or noncapital financing activities and do not include interest expense and disposal of non-depreciated capital assets.

N. New Accounting Pronouncements

During fiscal year 2016, the Mill adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application* and GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

The Mill will implement the following new pronouncements for fiscal years ending after 2016: GASB Statement No. 74, *Financial Reporting for Postemployment Benefits Plans Other than Pension Plans*, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, GASB Statement No. 77, *Tax Abatement Disclosures*, GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, GASB Statement No. 80, *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*, GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, and GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, 68, and 73*. The effect that these GASB Statements will have on future financial statements has not yet been determined.

NOTE 2 – BUDGETING AND BUDGETARY CONTROL

The Mill provides its own operating funds. A two-year budget appropriation is approved by the State Legislature. The Mill's budgeting is on the accrual basis. The Mill does not use encumbrance accounting.

NOTE 3 – DEPOSITS

North Dakota Century Code (NDCC) Sections 6-09-07 and 21-04-02 govern the deposit and investment of public funds.

NDCC 6-09-07 states, "All state funds...must be deposited in the Bank of North Dakota...or must be deposited in accordance with constitutional and statutory provisions."

NDCC 21-04-02 provides that public funds belonging to or in the custody of the state shall be deposited in the Bank of North Dakota.

At June 30, 2016 the carrying amount of the Mill's deposits was \$226 and the bank balance was \$3,627,597. All deposits are exposed to custodial credit risk because they are not covered by depository insurance and the deposits are uncollateralized. These monies are deposited in the Bank of North Dakota and are guaranteed by the state of North Dakota (NDCC 6-09-10).

NOTE 4 – RECEIVABLES

Receivables at June 30, 2016 consist of the following:

June 30, 2016	Gross Receivables	Allowance		Net Receivables
		Bad Debts	Billbacks/ Promotional	
Current Receivables				
Accounts	\$ 40,205,283	\$ (1,584,938)	\$ (723,081)	\$ 37,897,264
Margin accounts	554,616			554,616
Other	5,000			5,000
Total Current Receivables	<u>\$ 40,764,899</u>	<u>\$ (1,584,938)</u>	<u>\$ (723,081)</u>	<u>\$ 38,456,880</u>

At June 30, 2016, the ages of gross accounts receivable were as follows:

	2016
Current	\$ 25,545,368
1-30 Days	9,007,659
31-60 Days	3,199,587
61-90 Days	1,759,575
Over 90 Days	693,094
	<u>\$ 40,205,283</u>

NOTE 5 – INVENTORIES

At June 30, 2016, inventories consisted of the following:

	2016
Grain	\$ 17,311,806
Flour, Feed, Resale	4,626,259
Supplies	694,704
Total Inventories	<u>\$ 22,632,769</u>

The Mill's net position in the grain market at June 30, 2016 was as follows:

	2016 Bushels	
	Wheat	Durum
Company Owned (Priced) Grain on Hand	2,417,048	112,460
Open Purchase Contracts		
Cash	4,023,789	299,124
Futures	1,135,000	
Subtotal	<u>7,575,837</u>	<u>411,584</u>
Bushel Equivalent of Flour Inventory	981,469	60,317
Committed to Production	<u>(8,614,726)</u>	<u>(352,736)</u>
Net Position (Short) Long	<u>(57,420)</u>	<u>119,165</u>

Any gains or losses on net open position would only occur if there were changes in the market price of wheat or durum prior to the Mill covering their open position. Losses on open purchase contracts could occur if there was a failure to deliver the commodity. The amount of loss would depend upon the difference between the contract price and the market price at that time.

NOTE 6 – CAPITAL ASSETS

A summary of changes in capital assets for fiscal year ended June 30, 2016 is presented as follows:

	Balance July 1, 2015	Additions	Deletions	Transfers	Balance June 30, 2016
Capital Assets, Non-Depreciable:					
Land	\$ 387,126				\$ 387,126
Construction in Progress	10,493,364	\$ 24,927,632		\$ (4,827,832)	30,593,164
Total Capital Assets, Non-Depreciable	<u>\$ 10,880,490</u>	<u>\$ 24,927,632</u>		<u>\$ (4,827,832)</u>	<u>\$ 30,980,290</u>
Capital Assets, Depreciable:					
Infrastructure	\$ 2,772,503				\$ 2,772,503
Buildings	21,932,931			\$ 122,997	22,055,928
Machinery & Equipment	70,856,921		\$ (990,371)	4,359,805	74,226,354
Intangibles	734,311			206,915	941,226
Furniture & Fixtures	671,967			138,115	810,082
Total Capital Assets, Depreciable	<u>\$ 96,968,633</u>		<u>\$ (990,371)</u>	<u>\$ 4,827,832</u>	<u>\$ 100,806,093</u>
Less Accumulated Depreciation for:					
Infrastructure	\$ 2,011,250	\$ 55,124			\$ 2,066,374
Buildings	12,593,870	605,605			13,199,475
Machinery & Equipment	39,684,020	3,032,606	\$ (980,551)		41,736,074
Intangibles	403,553	111,473			515,026
Furniture & Fixtures	524,856	37,786			562,642
Total Accumulated Depreciation	<u>\$ 55,217,549</u>	<u>\$ 3,842,594</u>	<u>\$ (980,551)</u>		<u>\$ 58,079,591</u>
Total Capital Assets, Depreciable, Net	<u>\$ 41,751,084</u>	<u>\$ (3,842,594)</u>	<u>\$ (9,820)</u>	<u>\$ 4,827,832</u>	<u>\$ 42,726,502</u>
Capital Assets, Net	<u>\$ 52,631,574</u>	<u>\$ 21,085,038</u>	<u>\$ (9,820)</u>		<u>\$ 73,706,792</u>

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2016 were as follows:

	<u>2016</u>
Accounts Payable	\$ 7,250,128
Scale Accrued Purchases	4,973,762
Accrued Gain Sharing	1,528,024
Accrued Payroll	355,304
Other	217,788
Accrued Payroll Taxes and Benefits	22,295
Accrued Commissions	49,835
Compensated Absences, Current Portion	63,567
Total accounts payable and accrued liabilities	<u>\$ 14,460,703</u>

NOTE 8 – SHORT-TERM NOTES PAYABLE

The Mill uses a revolving line of credit to finance current operations. Short-term debt activity for the year ended June 30, 2016 was as follows:

	Balance July 1, 2015	Draws	Repayments	Balance June 30, 2016
Line of credit	<u>\$ 9,000,000</u>	<u>\$ 20,000,000</u>	<u>\$ (9,000,000)</u>	<u>\$ 20,000,000</u>

NOTE 9 – LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities for June 30, 2016 is presented as follows:

	Balance July 1, 2015	Additions	Reductions	Balance June 30, 2016	Current Portion	Noncurrent Portion
Compensated Absences	\$ 974,495	\$ 722,072	\$ (689,164)	\$ 1,007,403	\$ 63,567	\$ 943,836
Total Long-Term Liabilities	<u>\$ 974,495</u>	<u>\$ 722,072</u>	<u>\$ (689,164)</u>	<u>\$ 1,007,403</u>	<u>\$ 63,567</u>	<u>\$ 943,836</u>

NOTE 10 – BONUS AND OTHER EMPLOYEE AGREEMENTS

The general manager's annual bonus opportunity is based on performance, up to 30% of base salary. The employee's annual bonus opportunity is based on achieving production, safety, and profit goals. Production and safety goals have a 4% bonus potential and if profit before gain sharing expense accrual exceeds \$2 million, the profit bonus would be 1% of base salary for each million in profits (before gain sharing expense accrual), or fraction thereof. The bonus potential was accrued. (See Note 7)

NOTE 11 – LEASE OBLIGATIONS

During the fiscal year ended June 30, 2016 the Mill had operating leases for bulk rail and box cars with original terms of 2 to 21 years on 836 cars. Contract rental charges per car varied from \$425 to \$897 per month. The Mill also has an operating lease with Pitney Bowes for a postage machine

and Chrysler Capital for the general manager's automobile. The annual contract expenses for the year ended June 30, 2016 are as follows:

	<u>2016</u>
Bulk rail cars	\$ 7,073,849
Postage machine	1,722
Automobile	<u>8,232</u>
Total operating lease payments	<u>\$ 7,083,803</u>

The minimum future lease payments for each of the next five years and in the aggregate is as follows:

6/30/2017	\$ 7,193,830
6/30/2018	6,601,614
6/30/2019	5,648,817
6/30/2020	4,164,272
6/30/2021	2,540,915
6/30/2022-2026	<u>1,112,810</u>
	<u>\$ 27,262,258</u>

NOTE 12- PENSION PLAN

The Mill participates in the North Dakota Public Employees' Retirement System (NDPERS), administered by the state of North Dakota. The following brief description of NDPERS is provided for general information purposes only. Participants should refer to NDCC Chapter 54-52 for more complete information.

A. Description of Pension Plans

NDPERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all employees of the state of North Dakota, its agencies, and various participating political subdivisions. NDPERS provides for pension, death, and disability benefits. The cost to administer the plan is financed through the contributions and investment earnings of the plan.

Responsibility for administration of the NDPERS defined benefit pension plan is assigned to a Board comprised of seven members. The Board consists of a Chairman, who is appointed by the Governor; one member appointed by the Attorney General; one member appointed by the State Health Officer; three members elected by the active membership of the NDPERS system; and one member elected by the retired public employees. Effective July 1, 2015, the Board was expanded to include two members of the legislative assembly appointed by the chairman of the legislative management.

B. Pension Benefits

Benefits are set by statute. NDPERS has no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Member of the Main System are entitled to unreduced monthly pension benefits beginning when the sum of age and years of credited service equal or exceed 85 (Rule of 85), or at normal retirement age (65). For members hired on or after January 1, 2016 the Rule of 85 will be replaced with the Rule of 90, with a minimum age of 60. The monthly pension benefit is equal to 2.00% of their average monthly salary,

using the highest 36 months out of the last 180 months of service, for each year of service. The plan permits early retirement at ages 55-64 with three or more years of service.

Members may elect to receive the pension benefits in the form of a single life, joint and survivor, term-certain annuity, or partial lump sum with ongoing annuity. Members may elect to receive the value of their accumulated contributions, plus interest, as a lump sum distribution upon retirement or termination, or they may elect to receive their benefits in the form of an annuity. For each member electing an annuity, total payment will not be less than the members' accumulated contributions plus interest.

C. Death and Disability Benefits

Death and disability benefits are set by statute. If an active member dies with less than three years of service for the Main System, a death benefit equal to the value of the member's accumulated contributions, plus interest, is paid to the member's beneficiary. If the member has earned more than three years of credited service for the Main System, the surviving spouse will be entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the member's accrued normal retirement benefit, or monthly payments in an amount equal to the member's accrued 100% Joint and Survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the member's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

Eligible members who become totally disabled after a minimum of 180 days of service, receive monthly disability benefits equal to 25% of their final average salary with a minimum benefit of \$100. To qualify under this section, the member has to become disabled during the period of eligible employment and apply for benefits within one year of termination. The definition for disabled is set by the NDPERS in the North Dakota Administrative Code.

D. Refunds of Member Account Balance

Upon termination, if a member of the Main System is not vested (is not 65 or does not have three years of service), they will receive the accumulated member contributions and vested employer contributions, plus interest, or may elect to receive this amount at a later date. If the member has vested, they have the option of applying for a refund or can remain as a terminated vested participant. If a member terminated and withdrew their accumulated member contribution and is subsequently reemployed, they have the option of repurchasing their previous service.

E. Member and Employer Contributions

Member and employer contributions paid to NDPERS are set by statute and are established as a percent of salaries and wages. Member contribution rates are 7% and employer contribution rates are 7.12% of covered compensation.

The member's account balance includes the vested employer contributions equal to the member's contributions to an eligible deferred compensation plan. The minimum member contribution is \$25 and the maximum may not exceed the following:

- 1 to 12 months of service – greater of one percent of monthly salary or \$25
- 13 to 24 months of service – greater of two percent of monthly salary or \$25
- 25 to 36 months of service – greater of three percent of monthly salary or \$25
- Longer than 36 months of service – greater of four percent of monthly salary or \$25

F. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016, the Mill reported a liability of \$5,901,783 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Mill's proportion of the net pension liability was based on the Mill's share of covered payroll in the Main System pension plan relative to the covered payroll of all participating Main System employers. At June 30, 2015 the Mill's proportion was 0.867931 percent, which was an increase of 0.050928 from its proportion measured as of June 30, 2014.

For the year ended June 30, 2016 the Mill recognized pension expense of \$620,901. At June 30, 2016, the Mill reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$171,218	
Changes of assumptions		\$525,821
Net difference between projected and actual earnings on pension plan investments	681,940	806,526
Changes in proportion and differences between employer contributions and proportionate share of contributions	313,016	22,635
Employer contributions subsequent to the measurement date	630,801	
Total	\$1,796,975	\$1,354,982

\$630,801 reported as deferred outflows of resources related to pensions resulting from Employer contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016.

Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended June 30:	
2017	(\$101,485)
2018	(101,485)
2019	(101,485)
2020	155,957
2021	(40,400)
Thereafter	0

Actuarial assumptions. The total pension liability in the July 1, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.50%
Salary increases	4.50% per annum
Investment rate of return	8.00%, net of investment expenses
Cost-of-living adjustments	None

For active members, inactive members, and healthy retirees, mortality rates were based on the RP-2000 Combined Healthy Mortality Table set back two years for males and three years for females, projected generationally using the SSA 2014 Intermediate Cost scale from 2014. For disabled retirees, mortality rates were based on the RP-2000 Disabled Mortality Table set back one year for males (no setback for females) multiplied by 125%.

The actuarial assumptions used were based on the results of an actuarial experience study completed in 2015. They are the same as the assumptions used in the July 1, 2015, funding actuarial valuation for NDPERS.

As a result of the 2015 actuarial experience study, the NDPERS Board adopted several changes to the actuarial assumptions effective July 1, 2015. This includes changes to the mortality tables, disability incidence rates, retirement rates, administrative expenses, salary scale, and percent married assumption.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense, and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Fund's target asset allocation are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic Equity	31%	6.90%
International Equity	21%	7.55%
Private Equity	5%	11.30%
Domestic Fixed Income	17%	1.52%
International Fixed Income	5%	0.45%
Global Real Assets	20%	5.38%
Cash Equivalents	1%	0.00%

Discount rate. The discount rate used to measure the total pension liability was 8% as of June 30, 2015. The projection of cash flows used to determine the discount rate assumes that member and employer contributions will be made at rates equal to those based on the July 1, 2015, Actuarial Valuation Report. For this purpose, only employer contributions that are intended to fund benefits of current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs of future plan members and their beneficiaries, as well as projected contributions from future plan members,

are not included. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments for current plan members as of June 30, 2015. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability as of June 30, 2015.

Sensitivity of the Employer's proportionate share of the net pension liability to changes in the discount rate. The following presents the Employer's proportionate share of the net pension liability calculated using the discount rate of 8%, as well as what the Employer's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7%) or 1-percentage-point higher (9%) than the current rate:

	1% Decrease (7%)	Current Discount Rate (8%)	1% Increase (9%)
Employer's proportionate share of the net pension liability	\$9,050,088	\$5,901,783	\$3,325,899

Pension plan fiduciary net position. Detailed information about the pension plan's fiduciary net position is available in the separately issued NDPERS financial report.

NOTE 13 – POST RETIREMENT BENEFITS

Section 54-52.1-03.2 of the NDCC establishes a Retiree Health Benefits Fund to provide members who receive retirement benefits from the Public Employees Retirement System a credit toward their monthly health insurance premium under the state health plan based upon the member's years of credited service. The employer contribution for the Public Employees Retirement System is set by statute on an actuarially determined basis (projected unit actuarial cost method) at 1.14% of covered compensation. Employees participating in the retirement plan, as part-time/temporary members required to contribute 1.14% of their covered compensation to the Retiree Health Benefits Fund.

NOTE 14 - DEFERRED COMPENSATION PLAN

The state offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits them to defer a portion of their current salary until future years. Participation in the plan is optional. The deferred compensation is not available to the employees until separation of employment, unforeseeable emergency, de minimis distribution, or qualified domestic relations orders.

All compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights are held in trust for the exclusive use of the employee or their beneficiary.

The Mill employee deposits to deferred compensation for June 30, 2016 was \$246,180.

NOTE 15 – CONCENTRATIONS

The Mill sells a substantial portion of its product to five major customers. Sales to these customers totaled approximately 6,747,252 hundredweight for the year ended June 30, 2016, respectively. For June 30, 2016, sales to these customers were 52%.

Approximately 69% of employees are employed under a five-year bargaining agreement that will expire at June 30, 2019. This contract contains a provision that states there shall be no strikes, slowdowns, or stoppages of work, picketing, boycotts, or other interference with the full operations of the business of the Company by the employees covered by this agreement and there shall be no lockout by the Employer.

NOTE 16 - RELATED PARTY TRANSACTIONS

Chapter 54-18-19 of the NDCC provides that the Industrial Commission shall transfer to the state general fund, 50% of the annual earnings and undivided profits of the Mill after any transfers to other state agricultural-related programs. The moneys must be transferred on an annual basis in the amounts and at the times requested by the director of the Office of Management and Budget. For the year ended June 30, 2016, the Mill had a due to state general fund of \$4,434,894.

Chapter 54-18-21 of the NDCC provides that the Industrial Commission shall transfer 5% of the net income earned by the Mill during that fiscal year to the Agricultural Products Utilization Fund. For the year ended June 30, 2016, the Mill had a due to Ag Products Utilization Fund of \$466,831.

As referred to in Note 3, the Mill does all of its banking with the Bank of North Dakota. The Mill established a revolving line of credit with the Bank of North Dakota and as of June 30, 2016, there was \$20,000,000 outstanding. The interest rate is variable at 1.0% over the 3-month LIBOR, adjusted quarterly. As of June 30, 2016, the floor rate was 1.75%.

The Mill also paid the Northern Crop Institute and the Industrial Commission, both state of North Dakota agencies, \$25,000 and \$42,931, respectively, in fiscal year 2016.

NOTE 17 – DERIVATIVE INSTRUMENT

Fair value measurements are used to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures.

During the year ended June 30, 2016, the Mill adopted GASB Statement No. 72 – *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. This statement provides guidance for determining fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to disclosures related to all fair value measurements.

Fair Value Hierarchy

In accordance with GASB Statement No. 72, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of assumptions used to determine fair value. These levels are:

- Level 1 - Valuation is based upon quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

- Level 2 – Valuation is based upon quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Determination of Fair Value

In accordance with GASB Statement No. 72, fair values are based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is the Mill's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurement in accordance with the fair value hierarchy.

The following is a description of valuation methodologies used for liabilities recorded at fair value.

Derivative Instruments

Fair values of the grain future contracts are determined on the Minneapolis Grain Exchange.

Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the balance of liabilities measured at fair value on a recurring basis at June 30, 2016.

	2016			
	Total	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
LIABILITIES				
Derivative Instruments	\$ 149,387	\$ 149,387		
Total	\$ 149,387	\$ 149,387		

The fair value balances and notional amount of derivative instruments outstanding at June 30, 2016 and the changes in fair value of such derivative instruments for the year then ended as reported in the 2016 financial statements are (\$149,388), classified as Derivative Instrument (one contract equals 5000 bushels) and (\$149,388), classified as Deferred Outflows of Resources – Accumulated increase in fair value of hedging derivatives. The fair value of the grain futures contracts was determined on the Minneapolis Grain Exchange. The margin requirement is \$.60 per bushel, unless the market price changes the limit for two consecutive days, then the margin requirement is \$.90 per bushel. The Mill has entered into futures contracts for spring wheat to lock in a price for a future delivery or settlement period. These contracts are entered into to protect the Mill against price fluctuations of the commodity. The price protection is needed to cover any long or short positions compared to flour sales. The table below shows the cost and market values of these spring wheat futures.

Fiscal Year 2016

Month	# Contracts	Average	Quoted Prices	Average Cost	Market Value
	Long/(Short)	Cost	in Active Mkts		
Sep-16	(339)	5.3905	5.0825	\$ (9,136,938)	\$ (8,614,838)
Dec-16	340	5.5081	5.2375	9,363,838	8,903,750
Mar-17	115	5.6112	5.3825	3,226,438	3,094,938
May-17	89	5.6377	5.4750	2,508,788	2,436,375
July-17	22	5.6281	5.5600	619,088	611,600
				\$ 6,581,214	\$ 6,431,825

The Mill is exposed to credit risk on hedging derivative instruments that are in asset positions. All grain futures trades are completed using two different national brokerage firms on the Minneapolis Grain Exchange. ADM Investor Services is rated A by the Standard & Poor's Rating Service. RJ O'Brien is a privately held business and is not rated by the Standard & Poor's Rating Service.

The Mill is exposed to rollover risk on grain futures trades whenever the hedge ratio (defined in aggregate of the size across all futures months relative to the underlying net cash position) does not equal 1.0. On June 30, 2016, the table below shows the hedge ratio by futures month going forward:

Period	Hedge Ratio
September 2016	1.0
December 2016	1.1
March 2017	1.0
May 2017	1.0
July 2017	1.0
Net Position	1.1

NOTE 18 - RISK MANAGEMENT

The North Dakota Mill and Elevator Association is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the North Dakota Mill and Elevator Association carries liability insurance and property insurance through the state's Risk Management Fund (RMF) and commercial insurance, respectively.

The 1995 Legislative Session established the RMF, an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of state agencies resulting from the elimination of the state's sovereign immunity. The RMF manages the tort liability of the state, its agencies, and employees. All state agencies participate in the RMF and each fund's contribution was determined using a projected cost allocation approach.

The Mill participated in North Dakota Workforce Safety and Insurance (WSI), an enterprise fund of the state of North Dakota. The WSI is a state insurance fund and a 'no fault' insurance system covering the state's employers and employees financed by premiums assessed to employers. The premiums are available for the payment of claims to employees injured in the course of employment.

The Mill participates in the State Bonding Fund which currently provides blanket fidelity bond coverage in the amount of \$2,000,000 for its employees. The State Bonding Fund does not currently charge any premium for this coverage.

There have been no significant reductions in insurance coverage from the prior years and settled claims resulting from these risks have not exceeded insurance coverage in any of the past three years.

NOTE 19 – COMMITMENTS AND CONTINGENCIES

At June 30, 2016, the Mill had committed to purchase 4,023,789 bushels of spring wheat and 299,124 bushels of durum.

In addition, at June 30, 2016, construction commitments totaled \$18,541,838, amounts authorized totaled \$49,135,000, and amounts expended/construction in progress totaled \$30,593,164.

Required Supplementary Information

Schedule of Employer's Share of Net Pension Liability

ND Public Employees Retirement System Last 10 Fiscal Years*

	2016	2015
Employer's proportion of the net pension liability (asset)	0.867931%	0.817003%
Employer's proportionate share of the net pension liability (asset)	\$5,901,783	\$5,185,693
Employer's covered-employee payroll	\$7,732,208	\$6,882,262
Employer's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	76.33%	75.35%
Plan fiduciary net position as a percentage of the total pension liability	77.15%	77.70%

*Complete data for this schedule is not available prior to 2015.

Schedule of Employer Contributions

ND Public Employees Retirement System Last 10 Fiscal Years*

	2016	2015
Statutorily required contribution	\$587,323	\$490,017
Contributions in relation to the statutorily required contribution	(\$560,143)	(\$490,017)
Contribution deficiency (excess)	\$27,180	\$0
Employer's covered-employee payroll	\$7,732,208	\$6,882,262
Contributions as a percentage of covered-employee payroll	7.60%	7.12%

*Complete data for this schedule is not available prior to 2015.

Supplementary Information

Schedule of Appropriations

OBJECT	2015-17 Original Appropriation	Appropriation Adjustments	2016 Expenses/ Transfers	Balance 6-30-16
Salaries and wages	\$ 36,278,898		\$ 14,264,026	\$ 22,014,872
Operating expenses	27,327,000		8,931,009	18,395,991
Agriculture promotion	210,000		58,939	151,061
Contingency	500,000			500,000
TOTAL	<u>\$ 64,315,898</u>	<u>\$ -</u>	<u>\$ 23,253,974</u>	<u>\$ 41,061,924</u>
SOURCE				
Special fund authority	\$ 64,315,898		\$ 23,253,974	\$ 41,061,924
TOTAL	<u>\$ 64,315,898</u>	<u>\$ -</u>	<u>\$ 23,253,974</u>	<u>\$ 41,061,924</u>

2015-17 Appropriation amounts come directly from the North Dakota Session Laws, Chapter 14, House Bill 1014.

The following is a reconciliation of the GAAP expenses from the Statement of Revenue, Expenses, and Changes in Net Position to the Schedule of Appropriations:

Total operating expenses	<u>2016</u> \$ 206,508,018
Less:	
Material cost	(179,460,488)
Depreciation	(3,842,757)
Add:	
Demurrage	(9,738)
Agriculture promotion	58,939
Expenses per schedule of appropriations	<u>\$ 23,253,974</u>

Appropriation Adjustments:

None



STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
FARGO BRANCH OFFICE
1655 43rd STREET SOUTH, SUITE 203
FARGO, NORTH DAKOTA 58103

Exhibits

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standard

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Industrial Commission

Vance Taylor, President and General Manager
North Dakota Mill and Elevator Association

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the business-type activities of the North Dakota Mill and Elevator Association, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the North Dakota Mill and Elevator Association's basic financial statements, and have issued our report dated November 1, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the North Dakota Mill and Elevator Association's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the North Dakota Mill and Elevator Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the North Dakota Mill and Elevator Association's internal control.

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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable

possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Mill and Elevator Association's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Mill and Elevator Association's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Robert R. Peterson
State Auditor

Fargo, North Dakota

November 1, 2016

Responses to LAFRC Audit Questions

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

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

Unmodified.

- 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.*

Yes, the Governance Communication on pages 33 of this report contain one informal recommendation relating to maintaining adequate support for procurement transactions. Management of the Mill agrees with and plans on implementing the recommendation.

LAFRC Audit Communications

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

None noted.

2. *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.*

Management's estimate of the useful lives, as described in Note 1, is used to compute depreciation on capital assets. Management's estimate of the allowance for uncollectible receivables is based on aging categories and past history. We evaluated the key factors and assumptions used to develop the useful lives and allowances in determining that they are reasonable in relation to the financial statements taken as a whole.

3. *Identify any significant audit adjustments.*

No significant audit adjustments.

4. *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.

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

None.

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

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

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

None.

8. *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.*

Microsoft Dynamics GP and CINCH Agri-Suite are the most high-risk information technology systems critical to the North Dakota Mill and Elevator Association.



STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
FARGO BRANCH OFFICE
1655 43RD STREET SOUTH, SUITE 203
FARGO, NORTH DAKOTA 58103

Governance Communication

November 1, 2016

Legislative Audit and Fiscal Review Committee

Industrial Commission

We have audited the financial statements of the business-type activities of the North Dakota Mill and Elevator Association for the year ended June 30, 2016, and have issued our report thereon dated November 1, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 23, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the North Dakota Mill and Elevator Association are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during fiscal year 2016. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Useful lives of capital assets
- Allowance for uncollectible receivables: \$2,308,019

Management's estimate of the useful lives, as described in Note 1, is used to compute depreciation on capital assets. Management's estimate of the allowance or uncollectible receivable is based on aging categories, past history, and an analysis of the collectability of individual accounts. We evaluated the key factors and assumptions used to develop the useful lives and allowances in determining that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. None of the misstatements detected as a result of audit procedures were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 20, 2016.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

The following presents our informal recommendation:

INADEQUATE SUPPORTING DOCUMENTATION FOR PROCUREMENT

Condition:

We noted the Mill and Elevator was not maintaining adequate supporting documentation for all procurement transactions, including phone quote documentation and alternative procurement forms.

Criteria:

The GAO Internal Control Standards state in Principle 10.03 that management should design appropriate types of control activities for the entity's internal control system. This includes documentation for all transactions, which is readily available for examination. Documentation and records should be properly managed and maintained.

Cause:

The Mill employees did not maintain the adequate supporting documentation when they procured services.

Effect:

The lack of supporting documentation increases the risk of misstated financial statements and allow for fraud, waste and abuse to occur without detection.

Recommendation:

We recommend the Mill and Elevator maintain adequate supporting documentation for all procurement transactions.

Mill Response/Planned Corrective Actions:

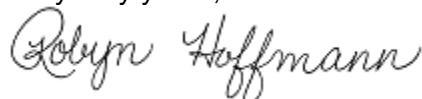
Agree. The Mill will obtain and maintain the supporting documentation for procurement transactions. The department heads will be responsible for their respective areas to ensure that the documentation is obtained and maintained. The Mill will have in place a method to maintain the documentation within the next 90 days.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of Industrial Commission and Legislative Audit and Fiscal Review Committee and management of the North Dakota Mill and Elevator Association, is not intended to be, and should not be used by anyone other than these specified parties.

Very truly yours,



Robyn Hoffmann, CPA
Audit Manager

You may obtain audit reports on the internet at:

www.nd.gov/auditor/

or by contacting the
Division of State Audit

Office of the State Auditor
600 East Boulevard Avenue – Department 117
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