

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

## ***Transmittal Letter***

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February 25, 2014

The Honorable Jack Dalrymple, Governor  
Members of the North Dakota Legislative Assembly  
Mr. Al Anderson, Commissioner, Department of Commerce

We are pleased to submit this audit of the Department of Commerce 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 Michael W. Schmitcke, CPA. Jackie Castleberry and Alec Grande 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) 328-2241. We wish to express our appreciation to Commissioner Al Anderson and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Bob Peterson".

Robert R. Peterson  
State Auditor

# ***Executive Summary***

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## ***Introduction***

The North Dakota Department of Commerce has been in existence since July of 2001 and was charged with the task of strengthening and streamlining the state's economic development efforts. Legislation authorized the merger of three former state agencies: Community Services, Economic Development and Finance, and Tourism. Additionally, the Workforce Development Division was created within the Department of Commerce.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's responses are noted below.

## ***Responses to LAFRC Audit Questions***

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

Financial statements were not prepared by the Department of Commerce 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 finding addressing "improper collection of social security numbers" (page 13), the Department of Commerce 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?*

Yes.

### *4. Were there any indications of lack of efficiency in financial operations and management of the agency?*

No.

### *5. Has action been taken on findings and recommendations included in prior audit reports?*

The Department of Commerce has implemented the recommendation included in the prior audit report.

### *6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 15 of this report, along with management's response.

## **LAFRC Audit Communications**

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

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Department of Commerce'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 and Human Resource Management System (HRMS) are high-risk information technology systems critical to the Department of Commerce.

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

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## ***Audit Objectives***

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

## ***Audit Scope***

This audit of the Department of Commerce 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 Department of Commerce's primary location is its Bismarck office. The Department has offsite locations in Medina and Grand Forks. All three locations were included in the audit scope.

## ***Audit Methodology***

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed the Department of Commerce'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 Department of Commerce'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 Department of Commerce were primarily supported by federal funds and appropriations from the state's general fund.

### ***Financial Summary***

Revenues and other sources consisted primarily of federal funds and legislatively mandated transfers. Federal funds decreased in the second half of the biennium due to the amount of stimulus funds received. Transfers for the same time period decreased as a majority of the transfers are received in the first half of the biennium and were from the general fund and Highway Tax Distribution Fund. Other revenues during the audited period included community services loan principle and interest revenue, tourism merchandise sales, mobile home inspection fees, Innovate ND program revenues, and interest and investment earnings. These all remained fairly constant for the Department of Commerce. Total revenues were \$31,923,062 for the year ended June 30, 2013 as compared to \$59,493,909 for the year ended June 30, 2012.

Total expenditures for the Department of Commerce were \$52,655,872 for the year ended June 30, 2013 as compared to \$87,038,881 for the prior year. The decrease in total expenditures for the audited period reflects primarily a decrease in grant expenditures including the State Energy Program, Community Development Block Grant, and Weatherization Grant, and a decrease in transfers out to the Centers of Research Excellence, Internship Fund, and Workforce Enhancement fund as these transfers were done in the first half of the biennium. All other expenditures remained fairly constant.

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

The excess appropriation in the Flood Impact – Loans/Grants line item was the result of the Department of Commerce only being awarded \$11,782,684 through the Community Services Block Grants program. The Department spent approximately \$2.9 million of the amount awarded during the biennium. In the 2013 Legislative Session the Department was given additional authority to expend \$18,358,866 which includes the unexpended funds from the prior program year and the new program year funds.

The excess appropriation in the Grants line item was the result of the following:

- The Community Development Block Grant received less funding than anticipated;
- The Department of Commerce anticipated more turnaround of projects with funding coming back to the Department under the Neighborhood Stabilization Program under the Community Development Block Grant and instead grantees retained the funds and expended them under the Department's direction and review;

- The Department of Commerce did not receive as many economic development loan applications as anticipated;
- The North Dakota HOME program had a number of projects that had not been approved by the end of the biennium;
- The State Energy Program utilized Stimulus funds before their regular allocation was accessed leaving more State Energy Program funds to carry over to the next program year;
- The Blender Pump Incentive program did not receive as much interest as anticipated; and
- Weatherization funding received was significantly lower due to budget cuts at the federal level.

Unexpended appropriations in the APUC line item were committed but not expended. The Department has carryover authority for these funds.

# Financial Statements

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## Statement of Revenues and Expenditures

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<b><u>Revenues and Other Sources:</u></b>		
Federal Revenue	\$ 23,543,142	\$ 38,438,754
Loan Principle and Interest	1,736,564	1,859,391
Tourism Merchandise Sales	188,910	182,609
Mobile Home Inspection Fees	149,357	127,459
Innovate ND Program	16,446	74,720
Interest and Investment Earnings	22,800	48,829
Miscellaneous Income	20,950	40,325
Transfers In	6,244,893	18,721,822
<b>Total Revenues and Other Sources</b>	<u>\$ 31,923,062</u>	<u>\$ 59,493,909</u>
<b><u>Expenditures and Other Uses:</u></b>		
Grants	\$ 37,949,416	\$ 57,670,184
Salaries and Benefits	5,600,273	5,615,635
Operating Fees and Services	4,564,761	5,974,754
Professional Fees and Services	1,772,414	1,019,166
Printing	419,593	422,418
Travel	335,833	409,700
Rent/Leases – Building	303,443	299,700
Professional Development	276,675	245,302
IT Contractual Services and Repairs	251,689	53,853
IT – Data Processing	123,885	119,789
Postage	112,571	150,555
IT – Communications	66,293	70,949
Miscellaneous Expenses	244,050	179,520
Transfers Out	634,976	14,807,356
<b>Total Expenditures and Other Uses</b>	<u>\$ 52,655,872</u>	<u>\$ 87,038,881</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 Benefits	\$ 10,858,251		\$ 10,858,251	\$ 10,302,501	\$ 555,750
Operating Expenses	14,026,650		14,026,650	12,617,068	1,409,582
Capital Assets	70,018		70,018		70,018
Grants	60,027,994	\$ 5,634,636	65,662,630	38,581,762	27,080,868
Discretionary Grants	928,082	713,693	1,641,775	964,117	677,658
Workforce Enhancement Fund	375,000		375,000	375,000	
Economic Development Initiatives	186,846		186,846	167,259	19,587
Flood Impact – Loans/Grants		235,000,000	235,000,000	2,931,627	232,068,373
APUC	2,739,767	1,518,859	4,258,626	1,827,456	2,431,170
Research North Dakota	12,000,000		12,000,000	12,000,000	
ND Trade Office	2,613,400		2,613,400	2,605,944	7,456
Partner Programs	2,072,044		2,072,044	2,063,677	8,367
Federal Stimulus Funds – 2009	24,496,750	7,000,000	31,496,750	29,195,956	2,300,794
<b>Totals</b>	<u>\$130,394,802</u>	<u>\$249,867,188</u>	<u>\$380,261,990</u>	<u>\$113,632,367</u>	<u>\$266,629,623</u>
<b>Expenditures by Source:</b>					
General Fund	\$ 41,759,865	\$ 7,030,421	\$ 48,790,286	\$44,382,976	\$ 4,407,310
Other Funds	88,634,937	242,836,767	331,471,704	69,249,391	262,222,313
<b>Totals</b>	<u>\$130,394,802</u>	<u>\$249,867,188</u>	<u>\$380,261,990</u>	<u>\$113,632,367</u>	<u>\$266,629,623</u>

### Appropriation Adjustments:

The increase of \$5,634,636 in the Grants line item is unexpended grant funds appropriated in the 2009 Legislative Session which were approved as carry-over funds in the 2011-2013 biennium pursuant to Senate Bill 2057, sections 18, 19, 20, 21, and 22 of the 2011 Session Laws.

The increase of \$713,693 in the Discretionary Grants line item is unexpended discretionary funds appropriated in the 2009 Legislative Session which were approved as carry-over funds in the 2011-2013 biennium pursuant to Senate Bill 2057, section 16 of the 2011 Session Laws.

The increase of \$235,000,000 in the Flood Impact – Loans/Grants line item was approved in Senate Bill 2371 of the 2011 Special Legislative Session to accept federal funds for the

purpose of providing loans or grants to flood-impacted individuals, property acquisitions, and infrastructure development grants to flood-impacted communities.

The increase of \$1,518,859 in the APUC line item is unexpended Agricultural Products Utilization Commission grant funds appropriated in the 2009 Legislative Session which were approved as carry-over funds in the 2011-2013 biennium pursuant to Senate Bill 2057, section 15 of the 2011 Session Laws.

The increase of \$7,000,000 in the Federal Stimulus Funds – 2009 line item was approved by the Emergency Commission to accept federal funds from the American Recovery and Reinvestment Act, U.S. Department of Energy, Energy Efficiency Grant program for project grants to increase energy efficiency of buildings, facilities, and processes.

**Expenditures Without Appropriations Of Specific Amounts:**

The Ethanol Production Incentive Fund has a continuing appropriation authorized by NDCC 17-02-05 (\$4,401,806 of expenditures for the biennium).

The Workforce Enhancement Fund has a continuing appropriation authorized by NDCC 54-60-23 (\$1,172,837 of expenditures for the biennium).

The Centers of Research Excellence Fund has a continuing appropriation authorized by NDCC 54-65-05 (\$7,283,164 of expenditures for the biennium).

The Internship Fund has a continuing appropriation authorized by NDCC 54-60-17.1 (\$926,908 of expenditures for the biennium).

The Centers of Excellence Fund has a continuing appropriation authorized by NDCC 15-69-06 (\$12,277,672 of expenditures for the biennium).

## ***Internal Control***

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

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

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls related to inventory.
- Controls related to investments.
- Controls related to processing of payroll.
- Controls surrounding the ConnectND (PeopleSoft) system.

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 adequate.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any significant deficiencies in internal control. However, we noted a matter involving internal control that we have reported to management of the Department of Commerce in a management letter dated February 25, 2014.

## *Compliance With Legislative Intent*

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

- Compliance with appropriations (2011 North Dakota Session Laws chapter 50).
- Proper use of the following legally restricted funds:
  - Agricultural Products Utilization Fund (NDCC section 04-14.1-02)
  - Ethanol Production Incentive Fund (NDCC section 17-02-05)
  - Internship Fund (NDCC section 54-60-17)
- Completeness of Angel Fund applications (House Bill 1057, section 1 of the 2011 North Dakota Session Laws).
- Compliance with law to adopt rules related to inspections of modular residential and commercial structures (Senate Bill 2366, section 3 of the 2011 North Dakota Session Laws).
- Compliance with registration requirements related to agritourism applications (House Bill 1142, section 5 of the 2011 North Dakota Session Laws).
- Compliance of flood related expenditures to individuals, communities, and for property acquisitions (Senate Bill 2371, section 13 of the 2011 North Dakota Session Laws).
- Compliance with requirements for small business technology investments (Senate Bill 2057, section 4 of the 2011 North Dakota Session Laws).
- Compliance with the Centers of Excellence Program requirements (Senate Bill 2057, section 7 of the 2011 North Dakota Session Laws).
- Proper distribution of funds related to the Centers of Excellence (Senate Bill 2057, section 8 of the 2011 North Dakota Session Laws).
- Requirement to develop an electronic portfolio system (Senate Bill 2057, section 11 of the 2011 North Dakota Session Laws).
- Requirement to develop a Centers of Research Excellence Program (Senate Bill 2057, section 12 of the 2011 North Dakota Session Laws).
- Proper accounting of funds donated to the Rural Development Office (NDCC section 54-60-24).
- Proper makeup of the Energy Policy Commission (NDCC section 17-07-01).
- Proper issuance of entrepreneurship awards (NDCC section 10-30.5-12).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper authority for investments.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- 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 one 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 Department of Commerce in a management letter dated February 25, 2014.

### ***Improper Collection of Social Security Numbers (Finding 13-1)***

#### **Condition:**

The Tourism Division of the Department of Commerce is requesting the business owners' social security numbers when registering agritourism businesses even though the Division has no need for the social security numbers. The Division is also not making the required disclosures when collecting the social security numbers.

#### **Criteria:**

The Federal Privacy Act of 1974, 5 U.S.C. 552a requires an entity to tell an individual three things when collecting a social security number:

- whether disclosure is mandatory or voluntary;
- has the statutory or other authority to collect the number; and
- how the government entity will use the number.

#### **Cause:**

The registration form created by the Department was modeled from a form used in a different state that included a field to collect the social security number from registrants. No additional consideration was given by the Department as to whether social security numbers needed to be collected or not.

#### **Effect or Potential Effect:**

Business owners are subjected to an increased risk of identity theft and the program has the possibility of misuse.

#### **Recommendation:**

We recommend the Tourism Division of the Department of Commerce no longer collect social security numbers from agritourism business owners. If the social security number is required for a legitimate purpose the registration form must be in compliance with any applicable federal laws.



***Department of Commerce Response:***

*The Department of Commerce agrees with this recommendation. Commerce has changed the Agri-Tourism registration form and no longer collects the entities SSN.*

## *Operations*

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This audit did not identify areas of the Department of Commerce's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note a certain matter involving operations that we have reported to management of the Department of Commerce in a management letter dated February, 25, 2014.

## ***Management Letter (Informal Recommendations)***

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February 25, 2014

Mr. Al Anderson, Commissioner  
Department of Commerce  
1600 E. Century Avenue – Suite 2  
Bismarck, ND 58503

Dear Commissioner Anderson:

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

### **ACCOUNTS PAYABLE/EXPENDITURES**

Informal Recommendation 13-1: We recommend the Department of Commerce ensure credits to appropriations are processed in accordance with OMB Policy 214.

## **FIXED ASSETS**

Informal Recommendation 13-2: We recommend the Department of Commerce ensure verification of the annual inventory is completed by someone who is not involved with the fixed asset record keeping process in accordance with OMB policy 205.

## **LEGISLATIVE INTENT**

Informal Recommendation 13-3: We recommend the Department of Commerce pay per diem rates based on OMB Policy 505 and account for expenditures using PeopleSoft coding that is consistent with the nature of the expenditures.

Informal Recommendation 13-4: We recommend the Department of Commerce implement a monitoring checklist to be used when performing Centers of Research Excellence onsite monitoring.

Informal Recommendation 13-5: We recommend the Tourism Division of the Department of Commerce ensure:

- Written policies and procedures are developed related to:
  - The registration process used to register agritourism businesses and activities;
  - The steps necessary to ensure the list of registered agritourism businesses is accurate and up to date; and
  - Publishing agritourism business information on the Department's website and travel guide.
- Agritourism businesses have the ability to register their business information through the Department's website.

## **OPERATIONAL IMPROVEMENTS**

Informal Recommendation 13-6: We recommend the Division of Tourism of the Department of Commerce use their purchase cards as a form of payment to all vendors accepting purchase cards.

Management of the Department of Commerce 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,



Michael W. Schmitcke, CPA  
Auditor in-charge

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Division of State Audit

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