

NORTH DAKOTA ETHANOL COUNCIL  
BISMARCK, NORTH DAKOTA

# Audit Report

For the Years Ended  
June 30, 2012 and 2011

ROBERT R. PETERSON  
STATE AUDITOR



Office of the State Auditor  
Division of State Audit

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## *Independent Auditor's Report*

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Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Ethanol Council

Jeff Zueger, Chairman, North Dakota Ethanol Council

We have audited the special-purpose financial statements of revenues and expenditures of the North Dakota Ethanol Council for the two-year period ended June 30, 2012. These special-purpose financial statements are the responsibility of the management of the North Dakota Ethanol Council. Our responsibility is to express an opinion on these special-purpose financial statements based on our audit.

We conducted our audit 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 special-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the special-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall special-purpose financial statements presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, these special-purpose financial statements are intended to present the revenues and expenditures of only that portion of the governmental activities of the state of North Dakota that is attributable to the transactions of the North Dakota Ethanol Council. They do not purport to, and do not present fairly the financial position of the state of North Dakota, in conformity with accounting principles generally accepted in the United States of America.

The accompanying special-purpose financial statements were prepared to provide state decision makers, including the Senate and House Agriculture Committees, with a comprehensive overview of the North Dakota Ethanol Council's operations in accordance with North Dakota Century Code section 4-24-10. The revenues and expenditures are reported as discussed in the first note to the special-purpose financial statements. These special-purpose financial statements are not intended to be a presentation in conformity with generally accepted accounting principles.

In our opinion, the special-purpose financial statements referred to above present fairly, in all material respects, the revenues and expenditures of the North Dakota Ethanol Council for the two-year period ended June 30, 2012, in conformity with the basis of accounting described in Note 1 to the special-purpose financial statements.

In accordance with *Government Auditing Standards*, we have issued our report dated November 29, 2012 on our consideration of the North Dakota Ethanol Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

This report is intended solely for the information of the Governor, North Dakota Ethanol Council, Legislative Audit and Fiscal Review Committee, the Senate and House Agriculture Committees, and management of the North Dakota Ethanol Council, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bob Peterson".

Robert R. Peterson  
State Auditor

November 29, 2012

***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 Standards***

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Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Ethanol Council

Jeff Zueger, Chairman, North Dakota Ethanol Council

We have audited the special-purpose financial statements of revenues and expenditures of the North Dakota Ethanol Council for the two-year period ended June 30, 2012 and have issued our report thereon dated November 29, 2012. Our report was modified to indicate the statement of revenue and expenses was prepared in accordance with NDCC section 4-24-10 and is not intended to be a presentation in conformity with generally accepted accounting principles. We conducted our audit 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.

**Internal Control Over Financial Reporting**

Management of the North Dakota Ethanol Council is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the North Dakota Ethanol Council's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the North Dakota Ethanol Council's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the North Dakota Ethanol Council's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of Findings, Recommendations, and Management Responses, we identified a certain deficiency in internal control over financial reporting that we consider to be material weaknesses.

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 North Dakota Ethanol Council's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of Findings, Recommendations, and Management Responses to be a material weakness (Finding 12-1).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Ethanol Council's special-purpose financial statements are free of 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 special-purpose 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of Findings, Recommendations, and Management Responses as Finding 12-2.

We also noted certain matters that we reported to management of the North Dakota Ethanol Council in a separate letter dated November 29, 2012, included in this report under Governance Communication.

The North Dakota Ethanol Council's responses to the findings identified in our audit are described in the accompanying schedule of Findings, Recommendations, and Management Responses. We did not audit the North Dakota Ethanol Council's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the North Dakota Ethanol Council, Legislative Audit and Fiscal Review Committee, and members of the North Dakota Legislative Assembly, and is not intended to be and should not be used by anyone other than these specified parties.



Robert R. Peterson  
State Auditor

November 29, 2012

## *Comparative Statement of Revenues and Expenditures*

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### **North Dakota Ethanol Council** For the Years Ended June 30, 2012 and 2011

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b><u>Revenues</u></b>		
Ethanol Assessments	\$ 113,476	\$ 114,156
State Energy Program Grants	32,452	15,000
Total Revenues	<u>\$ 145,928</u>	<u>\$ 129,156</u>
<b><u>Expenditures</u></b>		
Professional Services	\$ 70,522	\$ 52,992
Grants	32,452	10,000
Professional Development	2,330	1,022
Travel	1,604	836
IT Communications	396	351
Printing	198	1,229
Postage	119	140
Operating Fees and Services	100	500
Supplies	67	872
Total Expenditures	<u>\$ 107,788</u>	<u>\$ 67,942</u>
Revenues Over/(Under) Expenditures	<u>\$ 38,140</u>	<u>\$ 61,214</u>

*See Notes to the Special-Purpose Financial Statements.*



## *Notes to the Special-Purpose Financial Statements*

### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The responsibility for these special-purpose financial statements, the internal control structure, and compliance with laws and regulations belongs to the management of the North Dakota Ethanol Council. A summary of the significant accounting policies follows:

#### A. Reporting Entity

For financial reporting purposes, the North Dakota Ethanol Council includes all funds, programs, and activities over which it is financially accountable. The North Dakota Ethanol Council does not have any component units as defined by the Government Accounting Standards Board. The North Dakota Ethanol Council is part of the state of North Dakota as a reporting entity. The special-purpose financial statements report all expenditure activity in the administration program.

The North Dakota Ethanol Council was established by North Dakota Century Code (NDCC), chapter 17-06, for funding of research, education programs, promotion, and market development efforts; and the support of state, regional, national, and international entities that promote ethanol utilization. In addition, the North Dakota Ethanol Council shall develop and disseminate information regarding the purpose of the Ethanol assessment and ways in which the assessment benefits Ethanol producers. The North Dakota Ethanol Council receives its funding through an assessment of three one-hundredths of one cent per gallon imposed upon all ethanol produced and sold in North Dakota. The North Dakota Ethanol Council operates on a continuing appropriation and received no funding from the State Legislature.

#### B. Reporting Structure

The special-purpose financial statements include all activities of the reporting entity as defined above. These activities are funded from the North Dakota Ethanol Council's operating fund.

#### C. Basis of Accounting

Revenues and expenditures on the statement of revenues and expenditures are principally reported on the modified accrual basis of accounting which is generally accepted accounting principles (GAAP) for governmental fund types. Because of the unique nature of North Dakota's accounting system and its appropriation laws, there are at times differences between the way expenditures are appropriated and GAAP. These differences are discussed below.

Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., measurable and available). Measurable means the amount can be determined, available means due and collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Revenues are considered available if they are collected within one year after fiscal year end. Expenditures are recorded when goods or services are received. Exceptions include: principal and interest expenditures which are recorded when due; compensated absences which are recorded when paid; and, claims and judgments.

As stated above, there can be differences between revenues and expenditures reported on the state's accounting system and budget basis and those reported by the Office of Management and Budget in the state's CAFR in accordance with GAAP. Basically there are two types of differences: accounting and statutory.

Accounting differences can include:

- A. Loan receipts and loan disbursements are accounted for as revenues and expenditures on the state's accounting system (and at times are budgeted as expenditures).
- B. Revenue reported on the statement of revenues and expenditures can differ from GAAP revenues because certain receivables are accrued for GAAP purposes while they were not recorded as revenue on the state's accounting system when they are received after the apply-back period.
- C. Certain transfers are sometimes recorded as revenues and expenditures on the state's accounting system.
- D. Expenditures recorded on the state's accounting system do not report expenditures relating to capital lease and other financing arrangements.

Statutory differences can occur because of North Dakota Century Code section 54-44.1-11. This section requires the Office of Management and Budget to cancel most unexpended appropriations 30 days after the end of each biennial period. Certain GAAP expenditures are not recorded as budgetary expenditures because the agency does not have the ability to pay the expenditures within 30 days after the end of the biennium. These are relatively rare occurrences, and when significant, will be clearly disclosed.

#### D. Other GAAP Reporting Differences

GAAP financial statements would include a balance sheet by fund type and account group. Revenues, expenditures, and expenses would also be reported by fund type. In addition, a statement of cash flows would have been prepared for proprietary fund type activities. GAAP financial statements would also provide more complete note disclosures. This type of information is available in the state's comprehensive annual financial report and the Office of Management and Budget's combining statements by department.

For this report, revenues and expenditures are reported on a departmental basis to give an overview of the North Dakota Ethanol Council's operations. All revenues and expenditures are included regardless of the nature of the activities (proprietary fund types are included with governmental fund types when applicable).

#### **NOTE 2 – RELATED PARTIES**

The North Dakota Ethanol Council provides funding to the North Dakota Ethanol Producers Association (NDEPA) in order to share costs of research, education programs, promotion, and market development efforts. The NDEPA is considered a related party with one or more common directors, management, or other persons of significant influence. Payments to the NDEPA for the two-year period ended June 30, 2012 totaled \$52,552.

**NOTE 3 – OTHER SIGNIFICANT ITEMS**

The North Dakota Ethanol Council has cash reserves of \$137,810. Based on the average monthly expenditures for fiscal year 2012, this amount represents approximately 15 months of expenditures.

## *Supplementary Information*

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### **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?*

Unqualified.

- 2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?*

Other than our finding addressing “noncompliance with state procurement guidelines” (page 12) the North Dakota Ethanol Council was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

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

Other than our finding addressing the “account coding weakness” (page 11), we determined internal control was adequate.

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

No.

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

There has not been a prior audit of the North Dakota Ethanol Council.

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

Yes, a Governance Communication was issued and is included on page 13 of this report, along with management’s response.

## LAFRC Audit Communications

1. *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, contingent liabilities, or significant unusual transaction were 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.*

The North Dakota Ethanol Council's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Grant revenue was reclassified from Ethanol Assessments in fiscal year 2012 to State Energy Program Grants (\$32,452). Grant expenditures were reclassified from Other Fees and Services in fiscal year 2011 to Grants (\$10,000).

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 special-purpose financial statements.*

We are pleased to report that no significant disagreements arose during the course of our audit.

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.*

ConnectND Finance is the only high-risk information technology system critical to the North Dakota Ethanol Council.

# Findings, Recommendations, and Management Responses

## **Account Coding Weakness (Finding 12-1)**

### **Condition:**

The Ethanol Council had material account coding errors that affected the financial statement presentation.

### **Criteria:**

The Committee of Sponsoring Organizations (COSO) states that internal control should be designed to provide reasonable assurance regarding the reliability of financial reporting.

### **Cause:**

The Ethanol Council was unaware of the proper account code to be used for certain activity.

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

The coding errors required audit adjustments to the Ethanol Council's financial statements in order for them to be fairly presented.

### **Recommendation:**

We recommend the Ethanol Council ensure proper account codes are used for all transactions and consult with the Office of Management and Budget whenever questions arise.

### **North Dakota Ethanol Council Response:**

*The North Dakota Ethanol Council agrees with the finding and will ensure proper account codes are used for transactions. The Office of Management and Budget will be contacted should questions arise.*

## **Noncompliance with State Procurement Guidelines (Finding 12-2)**

### **Condition:**

The Ethanol Council entered into and subsequently renewed a contract for services exceeding \$25,000 without following the state procurement process.

### **Criteria:**

North Dakota Century Code section 54-44.4-02.1 states that all services purchased by any agency or institution in the executive branch of state government must comply with the standards and guidelines for procurement of services established by the Office of Management and Budget.

For purchases over \$25,000, Office of Management and Budget's state procurement guidelines require solicitations by formal sealed bids or proposals with notice to approved bidders on the State Bidders List and posting the notice on the State Procurement website.

### **Cause:**

Client oversight.

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

Noncompliance with state laws.

### **Recommendation:**

We recommend the Ethanol Council comply with state procurement laws.

### ***North Dakota Ethanol Council Response:***

*The North Dakota Ethanol Council agrees with the finding and will review state procurement laws to ensure compliance for future contracts.*

# Governance Communication

November 29, 2012

To: The North Dakota Ethanol Council

The Legislative Audit and Fiscal Review Committee

We have audited the special-purpose financial statements of the governmental activities of North Dakota Ethanol Council for the two-year period ended June 30, 2012, and have issued our report thereon dated November 29, 2012. Professional standards require that we provide you with 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 Ethanol Council are described in Note 1 to the special-purpose financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the period under audit. We noted no transactions entered into by the governmental unit during the audit period for which there is a lack of authoritative guidance or consensus. There was one significant transaction that had been recognized in the special-purpose financial statements in a different period than when the transaction occurred. A payment for contracted services was paid in advance and the financial statements were adjusted to the period in which the services were received.

## 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. Management has corrected all such misstatements. The table below lists material misstatements detected as a result of audit procedures that were corrected by management.

FY 2012 - Ethanol Assessments	\$32,452	
FY 2012 - State Energy Program Grants		\$32,452
FY 2011 - Grants	\$10,000	
FY 2011 - Operating Fees and Services		\$10,000



## **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 November 29, 2012.

## **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. It should be noted that the retention of the State Auditor is a matter of state law and is not under the control of the North Dakota Ethanol Council.

The following presents our informal recommendations.

Informal Recommendation 12-1: We recommend the Ethanol Council obtain, at a minimum, level I and II state procurement training.

Informal Recommendation 12-2: We recommend the Ethanol Council review OMB's fiscal and administrative policy, internal control guidelines, and fraud risk assessment policy and complete a fraud risk assessment at least every biennium.

Informal Recommendation 12-3: We recommend the Ethanol Council ensure transactions are processed in a timely manner at year-end so they can be applied back on the state's accounting system to the proper fiscal year.

Informal Recommendation 12-4: We recommend the Ethanol Council annually elect a member to serve as chairman in accordance with North Dakota Century Code section 17-06-03(1) and document the election in the meeting minutes of the Ethanol Council.

Informal Recommendation 12-5: We recommend the Ethanol Council strengthen internal controls surrounding revenue collections by ensuring:

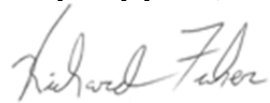
- A) Checks are endorsed immediately upon receipt, recorded on a remittance list, maintained by one individual, and deposited daily if more than \$500 is collected and every Friday regardless of amount collected; or that the Bank of North Dakota's lockbox service is used for collecting remittances.
- B) Individuals are signing off on critical control functions; specifically, the reconciliation of amounts received to assessment forms and the reconciliation of the remittance lists/deposits to amounts recorded on PeopleSoft.

Informal Recommendation 12-6: We recommend the Ethanol Council obtain blanket bond coverage from the State Bonding Fund. We also recommend the Ethanol Council ensure contracts with other entities contain all necessary clauses, including the insurance and indemnity clauses, in accordance with the Office of Attorney General's Contract Drafting and Review Manual.

Management of the North Dakota Ethanol Council agreed with these recommendations.

This information is intended solely for the use of North Dakota Ethanol Council and management of the North Dakota Ethanol Council and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,



Richard Fuher, CPA  
Auditor In-Charge

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