

NORTH DAKOTA POTATO COUNCIL
GRAND FORKS, NORTH DAKOTA

Audit Report

For the Fiscal Years Ending
June 30, 2012 and June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

**LEGISLATIVE AUDIT AND FISCAL REVIEW
COMMITTEE MEMBERS**

***Representative Dan Ruby – Chairman
Senator Terry M. Wanzek – Vice Chairman***

Representatives

*Dick Anderson
Tracy Boe
Patrick Hatlestad
RaeAnn G. Kelsch
Keith Kempenich
Gary Kreidt
Joe Kroeber
Andrew Maragos
Corey Mock
David Monson
Chet Pollert
Bob Skarphol
Lonny B. Winrich
Dwight Wrangham*

Senators

*Randel Christmann
Joan Heckaman
Jerry Klein
Judy Lee*

Contents

<i>Independent Auditor’s Report</i>	<i>1</i>
<i>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</i>	<i>3</i>
<i>Financial Statements</i>	<i>5</i>
<i>Comparative Schedule of Revenues and Expenditures (Budgetary Basis)</i>	<i>5</i>
<i>Notes to the Financial Statements</i>	<i>6</i>
<i>Supplementary Information</i>	<i>9</i>
<i>Responses to LAFRC Audit Questions</i>	<i>9</i>
<i>LAFRC Audit Communications</i>	<i>10</i>
<i>Prior Recommendation Not Implemented</i>	<i>11</i>
<i>Governance Communication</i>	<i>12</i>



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

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Potato Council

Diane Peycke, Executive Director

We have audited special-purpose statements of revenues and expenditures of the North Dakota Potato Council, a department of the state of North Dakota as of and for the years ended June 30, 2012 and 2011 as listed in the table of contents. These financial statements are the responsibility of the North Dakota Potato Council's management. Our responsibility is to express an opinion on the 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the 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 Potato Council. They do not purport to, and do not, present fairly the financial position of the state of North Dakota as of June 30, 2012 and 2011, the changes in its financial position or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying special-purpose financial statements are prepared to provide state decision makers, including the Senate and House Agriculture Committees, with a comprehensive overview of the North Dakota Potato Council's operations in accordance with NDCC section 4-24-10. The revenues and expenditures are reported as discussed in the first note to the special-purpose financial statements. The 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 previously present fairly, in all material respects, the revenues and expenditures of the North Dakota Potato Council as of June 30, 2012 and 2011, and the respective changes in financial position thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have issued our report dated October 23, 2012 on our consideration of the North Dakota Potato Council's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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, Legislative Audit and Fiscal Review Committee, the Senate and House Agriculture Committees, and management of the North Dakota Potato Council and is not intended to be and should not be used by anyone other than these specified parties.

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

Robert R. Peterson
State Auditor

October 23, 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

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Potato Council

Diane Peycke, Executive Director

We have audited the special-purpose financial statements of the governmental activities of the North Dakota Potato Council as of and for the two-year period ended June 30, 2012 and have issued our report thereon dated October 23, 2012. Our report was modified to indicate the statements of revenue and expenses were prepared in accordance with NDCC section 4-24-10 and are 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 Potato Council is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the North Dakota Potato Council's internal control over financial reporting as a basis for designing our auditing procedures 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 Potato Council's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the North Dakota Potato Council's internal control over financial reporting.

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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we

identified a certain deficiency in internal control over financial reporting, as described in the accompanying schedule of Prior Recommendation Not Implemented (Prior Audit Finding 08-1) that we consider to be significant deficiencies in internal control over financial reporting. Further we identified another deficiency relating to a lack of segregation of duties, due to the limited size of the North Dakota Potato Council that we consider a significant deficiency in internal control over financial reporting. A recommendation relating to segregation of duties is not being made because we feel the Council is doing an adequate job of mitigating the risk of loss to an acceptable level, based on the use of OMB for entering all transactions, and a BND lockbox to collect revenues. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Potato Council's special-purpose financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of special-purpose financial statements 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*.

We noted certain matters that we reported to management of the North Dakota Potato Council in a separate letter dated October 23, 2012 included in this report under Governance Communication.

This report is intended solely for the information and use of the North Dakota Potato 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. However, this report is a matter of public record and its distribution is not limited.



Robert R. Peterson
State Auditor

October 23, 2012

Financial Statements

Comparative Statement of Revenues and Expenditures (Budgetary Basis)

<u>REVENUES:</u>	<u>FY 2012</u>	<u>FY 2011</u>
Potato Assessments (Net of refunds of \$11,170 and \$7,230)	\$ 436,240	\$ 542,734
Interest on Investments	1,840	3,066
Total Revenues	<u>\$ 438,080</u>	<u>\$ 545,800</u>
<u>EXPENDITURES:</u>		
Operating Fees and Services	\$ 541,000	\$ 491,000
Fees - Professional Services		5,091
IT - Communications	700	545
Insurance	500	780
Travel	694	1,426
Printing	224	
Postage	299	
Office Supplies		284
Total Expenditures	<u>\$ 543,418</u>	<u>\$ 499,125</u>
Revenues Over (Under) Expenditures	<u>\$ (105,337)</u>	<u>\$ 46,674</u>

See Notes to the Special-Purpose Financial Statements.

Notes to the 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 Potato Council. A summary of the significant accounting policies follows:

A. Reporting Entity

For financial reporting purposes, the North Dakota Potato Council includes all funds, programs, and activities over which it is financially accountable. The North Dakota Potato Council does not have any component units as defined by the Government Accounting Standards Board. The North Dakota Potato Council is part of the state of North Dakota as a reporting entity.

The North Dakota Potato Council is composed of one participating producer elected from each of the five districts established in chapter 4.1-10-02 of the NDCC, and the chairman is elected annually from among the members. An assessment of 3 cents per hundredweight is imposed on all potatoes grown in the state or sold to a designated handler. All moneys levied and collected by the North Dakota Potato Council are to be deposited in an account designated "Spud Fund" at the State Treasurer and used for carrying out Council objectives.

The Executive Director of the Council performs the administrative duties and the record-keeping requirements of the North Dakota Potato Council under contract. This related party is further explained in Note 2 to the special-purpose financial statements. The special-purpose financial statements include only activities of the North Dakota Potato Council, which is one department with one division. The North Dakota Potato Council is responsible for and is funded under a continuing appropriation and receives 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 fund 220, the Spud Fund. The comparative statement of revenues and expenditures is a combined statement to give the users an overview of the agency's activity.

C. Basis of Accounting

Revenues and expenditures on the statements 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 a year after fiscal year end. Expenditures are recorded when goods or services are received. Exceptions include: principle 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. Revenue reported on the statements 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.
- B. Certain transfers are sometimes recorded as revenues and expenditures on the state's accounting system.
- C. 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. 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 Potato Council's operations. All revenues and expenditures are included regardless of the nature of the activities.

NOTE 2 – RELATED PARTIES

The Northern Plains Potato Growers Association (NPPGA) located in East Grand Forks, Minnesota, is a related party of the North Dakota Potato Council. The NPPGA is under contract with the Council to provide promotion, advertising, research, and development of Irish potatoes grown in North Dakota. The amount paid under contract was \$525,000 and \$475,000 for each fiscal year ended June 30, 2012 and 2011, respectively.

The Executive Director of the Council, who performs all the administrative duties of the Council, is under contract with the Council as an independent contractor, not as a state employee. Under the contract, the Executive Director was paid \$16,000 for each fiscal year 2012 and 2011. The Executive Director also performs the administrative duties for the NPPGA and for a region of the Minnesota Potato Council.

NOTE 3 – OTHER SIGNIFICANT ITEMS

The North Dakota Potato Council's cash and investments at June 30, 2012 were \$121,253 and \$175,000 and at June 30, 2011 were \$139,162 and \$175,000, respectively. Based on the average monthly expenditures for fiscal year 2012 and 2011 of \$43,450, this amount represents approximately 6.8 and 7.2 months of expenditures, respectively.

Supplementary Information

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?*

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?*

No, the North Dakota Potato Council has not implemented the previous audit recommendation related to conducting a control/fraud risk assessment. See page 11 for additional details.

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

Yes. The Governance Communication on page 13 of this report contains our four informal recommendations related to developing a code of conduct, making timely deposits, expenditure coding, and retention of supporting documentation.

LAFRC Audit Communications

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

The Potato Council implemented the use of a lockbox at the Bank of North Dakota during the current audit period. Other than this, there were no significant changes in accounting policies, management conflicts of interest, contingent liabilities, or significant unusual transactions.

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.*

None.

3. *Identify any significant audit adjustments.*

We increased fiscal year 2012 potato assessment revenue by \$62,006.65 for a miscellaneous receivable closing package adjustment OMB did not make. See Governance Communication section, page 12, for adjustment.

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.*

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.*

None.

Prior Recommendation Not Implemented

No Control/Fraud Risk Assessment (Prior Audit Finding 08-1)

RECOMMENDATION: We recommend the North Dakota Potato Council, with the assistance of the Office of Management and Budget:

- Establish and perform a control risk assessment including a fraud risk assessment on a recurring basis;
- Design and document the necessary control activities to ensure each of the significant control risks and fraud exposures identified during the risk assessment process has been adequately mitigated; and
- Continually monitor control activities to ensure they are functioning properly.

STATUS: Not Implemented

No control/fraud risk assessment was performed during the audit period.

North Dakota Potato Council's Response:

The Executive Director acknowledges the recommendation and will establish a control fraud risk assessment.

Governance Communication

October 23, 2012

Legislative Audit and Fiscal Review Committee

North Dakota Potato Council Board of Directors

We have audited the special purpose financial statements of the governmental activities of the North Dakota Potato Council for the two-year period ended June 30, 2012, and have issued our report thereon dated October 23, 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 Potato Council 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 the year. 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.

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. One of the adjustments made was material, which was due to OMB not making the miscellaneous receivable closing package adjustment. The other adjustment did not have a material impact, but was made in order to make the financial statement presentation more clear to users of the financial statements.

*124001	Accounts Receivable current	\$62,006.65	
421580	Potato Cwt Assessments		\$62,006.65
621305	Misc Contractual Fees	\$ 1,333.33	
521060	Non State Employee Travel		\$ 1,333.33

* This adjustment was made by OMB prior to the audit report being released.

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 23, 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.

The following presents our informal recommendations:

No Code of Conduct (Prior Audit Informal Finding 10-1)

RECOMMENDATION: We recommend the North Dakota Potato Council adopt a code of ethics or code of business conduct. At a minimum, the following issues should be addressed:

- Honest and ethical conduct;
- Full, fair, accurate, timely, and understandable disclosure in reports and documents;
- Compliance with applicable laws;
- The prompt internal reporting of violations of the code;
- Description of what constitutes fraudulent behavior; and
- Accountability for adherence to the code and consequences for breaching it.

STATUS: Not Implemented

The North Dakota Potato Council began writing a Code of Conduct during the audit period, but it was not completed or adopted.

North Dakota Potato Council’s Response:

The Executive Director acknowledges the recommendation will complete and finalize a Code of Conduct.

Timely Deposits (Prior Audit Informal Finding 10-2)

RECOMMENDATION: We recommend the Potato Council take appropriate action to ensure that deposits are made on a timely basis. At a minimum, this means that deposits must be made on a weekly basis or when total funds to be deposited reach \$5,000 or greater, whichever occurs first. If deposits cannot be made timely, handlers should be required to send all payments to the BND directly using the lockbox, so the Potato Council does not receive checks that need to be deposited.

STATUS: Not Implemented

We noted the majority of the payments received by the Potato Council are going directly to a lockbox at BND, but there are a few cases where payments are being mailed directly to the Potato Council. We noted these deposits were not being made on a timely basis, because the client would wait for multiple checks to arrive prior to sending the deposit.

North Dakota Potato Council's Response:

The Executive Director acknowledges the recommendation and will make deposits on a timely basis.

Coding of Expenditures (Informal 12-1)

During our testing of expenditures we noted the following coding errors:

- One payment in the amount of \$1,333.33 made to the Executive Director should have been coded to 621305 - Misc Contract Fees, but was coded to 521060 - Non State Employee Travel; and
- At the beginning of the audit period, board member meeting compensation was being coded to account 511045 - In State Meeting Compensation and mileage was coded to 521030 - In State Vehicle Mileage. Towards the end of the audit period these amounts were combined and coded it to 521060 - Non State Employee Travel.

Good internal controls dictate that accounts are properly coded to ensure financial statements are accurate, consistent, and prepared in accordance with generally accepted accounting principles. Improper use of account codes may lead to misstated financial statements.

Recommendation: We recommend the Potato Council review all transactions at regular intervals to ensure they have used correct account coding for all expenditures and coded like transactions consistently.

North Dakota Potato Council's Response:

The Executive Director acknowledges the recommendation and will review all transaction at regular intervals to ensure they are coded correctly.

Deposit Supporting Documentation (Informal 12-2)

Adequate supporting documentation was not being maintained for deposits made using the lockbox at BND. After a deposit is made, the BND sends a copy of the deposit slip, the Designated Handlers Report, and copies of cancelled checks to the Potato Council. The deposit slip is being attached to a printout showing the receipt recorded in PeopleSoft. The handlers report and copies of cancelled checks are then being kept in a separate file. Due to the fact that the deposits are generally made up of payments from multiple handlers, there is no way to determine which payments make up each deposit. Therefore, deposits could not be traced to the appropriate handlers report.

Good internal controls dictate that an adequate audit trail is maintained. Without an adequate audit trail errors or theft could occur without being discovered on a timely basis or perhaps at all.

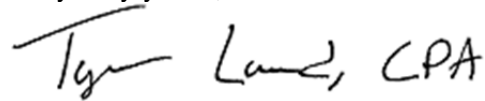
Recommendation: We recommend the Council develop written procedures to provide that copies of cancelled checks that are received back from BND are attached to the deposit slip, so the payments that make up each deposit can be determined and traced to the appropriate Designated Handler's Reports.

North Dakota Potato Council's Response:

The Executive Director acknowledges the recommendation and will create a backup of checks received from BND.

This information is intended solely for the use of the Legislative Audit and Fiscal Review Committee and the North Dakota Potato Council Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Tyson Lund, CPA". The signature is written in a cursive style with a horizontal line above the first name.

Tyson Lund, CPA
Auditor In-charge

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
Bismarck, ND 58505-0060