

NORTH DAKOTA STATE  
SEED DEPARTMENT

FARGO, NORTH DAKOTA

**Audit Report**

For the Two-year Period 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**  
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FARGO, NORTH DAKOTA 58103

## *Transmittal Letter*

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May 17, 2017

Members of the North Dakota Legislative Assembly  
Members of the North Dakota State Seed Commission  
Mr. Ken Bertsch, Commissioner, North Dakota State Seed Department

We are pleased to submit this audit of the North Dakota State Seed Department for the two-year period ended June 30, 2016. 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 Cory Wigdahl, CFE, Mikka Wold, CPA was the staff auditor and Robyn Hoffmann, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7291. We wish to express our appreciation to Commissioner Bertsch and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Joshua C. Gallion".

Joshua C. Gallion  
State Auditor

# *Executive Summary*

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## *Introduction*

The Seed Department was established by the North Dakota Legislature in 1931; as the state's designated authority for all seed certification and regulatory matters. The Seed Department is unique by comparison to most state agencies, or seed certification entities, in that it is a self-funded agency of government, and provides inspection, testing, and regulatory enforcement services for all crops, including potatoes. A nine-member seed commission acts as a board of directors for the agency. Members are selected to serve by various agriculture industry organizations, including the North Dakota Crop Improvement Association, North Dakota Certified Seed Potato Growers Association, North Dakota Agricultural Association, Northern Plains Potato Growers Association, North Dakota Potato Council, North Dakota Grain Dealers Association, North Dakota Dry Edible Bean Seed Growers Association, and the Director of the North Dakota State University Agriculture Experiment Station. The Commissioner of Agriculture, or his designee, serves as chairman of the Commission. The Commission appoints a State Seed Commissioner, who serves as chief executive officer of the Department.

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 North Dakota State Seed Department in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unmodified opinion was issued.

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

Other than our findings addressing "Competition Limited Through Bid Specifications" (page 12) and "State Procurement Guidelines Not Followed" (page 15), the North Dakota State Seed Department was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

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

Other than our findings addressing the "Inadequate Signed Code of Business Conduct and Ethics" (page 8), and "SSAS Security Access and Risk Assessment" (page 10), 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 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, a management letter was issued and is included on page 17 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 or significant unusual transactions were identified.

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 North Dakota State Seed Department'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, ConnectND Human Capital Management (HCM) and State Seed Administration Software (SSAS) are high-risk information technology systems critical to the North Dakota State Seed Department. No exceptions were noted that directly related to the operations of an informational technology system.

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

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## ***Audit Objectives***

The objectives of this audit of the North Dakota State Seed Department for the two-year period ended June 30, 2016 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota State Seed Department'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 North Dakota State Seed Department and are they in compliance with these laws?
3. Are there areas of the North Dakota State Seed Department's operations where we can help to improve efficiency or effectiveness?

## ***Audit Scope***

This audit of the North Dakota State Seed Department is for the two-year period ended June 30, 2016. We conducted our 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 North Dakota State Seed Department has operations in the following locations. Each location was included in the audit scope:

- Central office in Fargo.
- Branch office in Grafton

## ***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 North Dakota State Seed Department'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 North Dakota State Seed Department'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 two-year period June 30, 2016, operations of the North Dakota State Seed Department were primarily supported by regulatory and inspection fees.

### ***Financial Summary***

Revenues consisted primarily of regulatory and inspection fees (93%). Other revenues during the audited period included Fees for Services (4%) and Federal Grants (3%). These all remained constant for the North Dakota State Seed Department, except regulatory and inspection fees decreased \$145,000. This was primarily due to seed numbers, acres of potato field inspections, and seedstock production being down from fiscal year 2015. Total revenues were \$3,283,627 for the year ended June 30, 2016 as compared to \$3,408,216 for the year ended June 30, 2015.

Total expenditures for the North Dakota State Seed Department were \$3,104,049 for the year ended June 30, 2016 as compared to \$2,805,151 for the prior year. The increase in total expenditures for the audited period includes \$113,000 for Salaries and Benefits and \$197,000 for Extraordinary Repairs/Deferred Maintenance. The increase in Salaries and Benefits (which also account for 69% of total expenditures) is due to the general salary increases and the increasing costs of health insurance. The increase in Extraordinary Repairs/Deferred Maintenance was due to a HVAC upgrade at the main Fargo location. All other expenditures remained fairly constant.

### ***Analysis of Significant Changes in Operations***

There were no significant changes in operations.

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

For the fiscal years ended June 30, 2016 and 2015, there were no significant variances between the original and final budgeted amounts or between the final budgeted and actual expenditures.

# Financial Statements

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## Statement of Revenues and Expenditures

<b><u>Revenues and Other Sources:</u></b>	<b><u>June 30, 2016</u></b>	<b><u>June 30, 2015</u></b>
Regulatory and Inspection Fees	\$ 3,039,233	\$ 3,183,836
Fees for Services	123,444	111,854
Federal Grants	99,378	90,270
Cash/Investment Earnings	7,161	6,178
License, Permits and Fees	7,010	7,020
Leases, Rents, and Royalties	5,720	5,720
Miscellaneous General Revenue	1,181	3,338
Fines-Forfeitures-Escheat	500	
<b>Total Revenues and Other Sources</b>	<b>\$ 3,283,627</b>	<b>\$ 3,408,216</b>
<b><u>Expenditures and Other Uses:</u></b>		
Salaries and Benefits	\$ 2,101,592	\$ 1,988,489
Extra Repairs/Deferred Maintenance	197,054	
Travel	169,150	171,670
Professional Fees and Services	136,624	142,900
Utilities	94,788	92,839
Operating Fees and Services	72,917	49,018
Grants, Benefits & Claims	70,000	70,000
Supply/Material - Professional	41,407	44,152
Medical, Dental and Optical	37,859	31,820
Professional Development	32,239	30,923
Postage	29,636	25,751
Repairs	29,162	28,005
IT Contractual Services and Repairs	16,559	29,407
Printing	15,414	12,079
IT - Communications	15,255	13,793
Office Supplies	13,364	12,175
Insurance	8,235	5,142
Rentals/Leases-Equipment & Other	7,439	9,305
Bldg, Grounds, Vehicle Supply	5,422	24,727
Supplies - IT Software	4,639	11,989
IT Equipment under \$5,000	2,598	
Miscellaneous Supplies	2,000	2,218
IT - Data Processing	697	5,852
Other Equipment under \$5,000		2,898
<b>Total Expenditures and Other Uses</b>	<b>\$ 3,104,050</b>	<b>\$ 2,805,152</b>

# *Internal Control*

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In our audit for the two-year period ended June 30, 2016, we identified the following areas of the North Dakota State Seed Department'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 surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the State Seed Administrative Software.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216).

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 that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of North Dakota State Seed Department in a management letter dated May 17, 2017.

***Inadequate Signed Code of Business Conduct (Finding 16-1)***

**Condition:**

During our review of the North Dakota State Seed Department's Code of Business Conduct and Ethics policy, we noted the following:

- 19 out of 72 employees (26%) had not signed the policy, acknowledging that they have read and accept the policy; and
- None of the policies we reviewed (53) were signed by the Seed Commissioner.

**Criteria:**

North Dakota State Seed Department's Code of Business Conduct and Ethics, in-part states: this Code of Business Conduct and Ethics applies to all Seed Department commissioners, managers, and employees, referred to herein collectively as the "Covered Parties."

This Code of Business conduct and Ethics serves to (1) emphasize the department's commitment to ethics and compliance with the law; (2) set forth basic standards of ethical and legal behavior; (3) provide reporting mechanisms for known or suspected ethical or legal violations; and (4) help

prevent and detect wrongdoing. Employees and the Seed Commissioner are to sign the Code of Business Conduct and Ethics acknowledging they read and accepted the Code of Business Conduct and Ethics.

**Cause:**

This was an oversight by North Dakota State Seed Department.

**Effect or Potential Effect:**

Known unethical or illegal behavior could be occurring within the North Dakota State Seed Department, and it could go undetected or unreported because not all employees have acknowledged that they have read and accept the Code of Business Conduct and Ethics to know what constitutes unethical or illegal behavior and how to report it.

**Recommendation:**

We recommend that the North Dakota State Seed Department obtain and retain on file the signed acknowledgement from all employees that they have read and accept the Code of Business Conduct and Ethics. Also, the acknowledgement should be dated when signed by the employee and Seed Commissioner.

**North Dakota State Seed Department Response:**

Agree.

- *The Seed Department is reviewing and updating the Code of Business Conduct and Ethics policy.*
- *The Seed Department will ensure signed acknowledgements are obtained for all employees subject to the policy. Additionally, the policy will be included in an updated employee handbook.*
- *The Seed Commissioner will sign all applicable acknowledgements.*
- *Projected completion: September, 2017*

**SSAS Security Access and Risk Assessment (Finding 16-2)**

**Condition:**

We reviewed the State Seed Administration Software (SSAS) security access levels and noted that the Administrative Officer who is responsible for entering and posting payments to customer's accounts within SSAS also had full administrative access allowing the ability to change anything within SSAS, which does not support proper segregation of duties. We further noted that an additional risk assessment of North Dakota State Seed's computer system encompassing SSAS has not been performed as required by OMB policy 216.

**Criteria:**

OMB Policy 216, states in-part, agency management must establish and maintain effective internal controls within their agency. A guide to effective internal controls is the "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States (Green Book).

ND Office of Management Fraud Risk Assessment Policy, states in-part, agencies that have their own computer systems will need to do additional assessments of their systems.

Standards for Internal Control in the Federal Government, Control Activities, states in-part, management designs control activities for security management of the entity's information system for appropriate access by internal and external sources to protect the entity's information system. Management designs control activities over access to protect an entity from inappropriate access and unauthorized use of the system. These control activities support appropriate segregation of duties. Management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event.

**Cause:**

Administrative access is necessary to troubleshoot SSAS to help keep consulting/programming costs down and a risk assessment has not been performed.

**Effect or Potential Effect:**

There is noncompliance OMB policy 216, and the risk of a material misstatement, whether due to error or fraud, is increased due to the administrative access has not been limited to the programming consultants.

**Recommendation:**  
We recommend the North Dakota State Seed Department perform a risk assessment over their computer system encompassing SSAS, and restrict the administrative level of access to the programming consultants to support adequate segregation of duties.

**North Dakota State Seed Department Response:**

*Agree. The Seed Department will perform a risk assessment over the computer system encompassing SSAS by the end of first quarter, fiscal year 2018.*

*Disagree.*

- The Department currently doesn't have programming consultants available to support the administrative level of SSAS, which involves day-to-day data updates required to meet our specific business needs.*

- *SSAS does not communicate with PeopleSoft. Further, the administrative function only includes employee set-up, hardware set-up and table maintenance.*
- *Due to the Department's size, our Administrative Officer serves the role of our lead IT person as well as our accountant. We do not have any additional IT personnel on staff.*
- *Limiting access would not be efficient or effective. Hiring an additional staff member for this purpose would not be cost effective.*
- *The results of changes to tables (of any type) are reviewed by multiple Department employees in the process of daily customer reporting, providing segregation of duties, and internal control.*
- *Every credit to accounts receivable is documented and approved by the Seed Commissioner.*
- *We believe our internal controls are adequate and necessary to provide good customer service; there has never been a problem with misapplication of fees or revenue detected in this area. Our customers are another layer of control; any mistake in invoicing for service or misapplication of payment to an account would be noticed immediately by customers.*

***Auditor Concluding Remarks:***

*We stand by our recommendation to restrict the administrative access to the programming consultants, without having performed a risk assessment over SSAS, it's inconclusive that adequate control activities have been developed and are in place over the access to SSAS.*

## ***Compliance with Legislative Intent***

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In our audit for the two-year period ended June 30, 2016, we identified and tested North Dakota State Seed Department's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Members of the Seed Commission received \$135/day and reimbursement for expenses (NDCC 4.1-52-06).
- The Commissioner, with the approval of the Seed Commission, can establish and charge fees for laboratory tests and services (NDCC 4.1-52-10).
- 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 use of outside bank accounts, petty cash funds and proper authority for investments outside the Bank of North Dakota.
- 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 two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These findings are described below. Other than these findings, we concluded there was compliance with the legislative intent identified above.

### ***Competition Limited Through Bid Specifications (Finding 16-3)***

#### **Condition:**

While reviewing the competitive bid specifications for the HVAC system, we noted that 2 out of 4 sections where specific manufacturers were listed, an 'approved equal' was not allowed, thereby limiting competition by excluding all other manufacturers. Approved prior written determination of one manufacturer over another was not performed nor provided. It was further noted that there was only one responsive bidder, who was awarded the bid contract and was one of the specific manufacturers listed.

#### **Criteria:**

NDCC 48-01.2-03, states in part that a governing body, in specifying materials to be used for a public improvement or in plans or specifications for a public improvement, may not request bids for product of any one manufacturer, when the requirement will prevent proper competition, unless

the specifications also request bids on other similar articles of equal value, utility, and merit, or unless as provided in section 44-08-01.

NDCC 44-08-01, part 3, states in part, that any state entity in specifying or purchasing any goods, merchandise, supplies, or equipment, may not specify any trademarked or copyrighted brand or name, nor the product of any one manufacturer, when the same will prevent proper competition, unless bidders also are asked for bids or offers upon other articles of like nature, utility, and merit. When it is advantageous that the purchase be a particular product of a particular manufacturer to the exclusion of competitive brands or manufacturers, the entity must document those circumstances and provide written justification for the proprietary specification or purchase.

NDAC 4-12-09-02, part 2, states, whenever limited competitive procurements are to be made, a written determination must include an explanation as to why the competition should be limited, and why a fully competitive procurement method is impracticable, or not in the best interest of the state. The purchasing agency shall provide evidence necessary for an independent examination and determination of the material facts of the procurement.

**Cause:**

North Dakota State Seed Department relied upon NDSU to ensure competitive bidding procedures were followed.

**Effect or Potential Effect:**

There was non-compliance with NDCC and NDAC sections, by limiting the competitive bidding process by specifying certain manufacturers, not allowing an 'approved equal', and not having prior written determination from the state procurement office as required.

**Recommendation:**

We recommend that the North Dakota State Seed Department understand and ensure compliance with NDCC and NDAC surrounding the competitive bidding process.

**North Dakota State Seed Department Response:**

*Agree. Agree with Auditors statement of cause, which indicates that the Seed Department relied upon NDSU to ensure competitive bidding procedures were followed. NDSU provided all bid and construction management services in original construction of the facility under state guidelines and oversight. Administration reasonably assumed a similar level of compliance in this case.*

*Disagree. Disagree with statements surrounding competitive bidding practices. The highest priority of converting HVAC systems to digital controls was enabling connectivity with NDSU central computer systems. Installing independent control systems would have drastically increased project costs and eliminated the opportunity for troubleshooting and diagnostics by NDSU technicians who currently maintain and repair Seed Department HVAC.*

*The Approvals and Substitutions section of the bid proposal summary indicates that “substitution or equivalent items may be approved by the project engineer”, thereby providing some level of flexibility. Specific manufacturers (not brands) were required in order to enable connectivity and integration with NDSU control systems; all potential bidders could reasonably acquire the listed equipment.*

*Regarding the two areas wherein the “approved equal” terminology was absent:*

- All Building Automation System (BAS) specifications requiring either Johnson Control or Trane equipment were critical to the integration with NDSU security, diagnostics, and monitoring systems.*



- *All Variable Frequency Drives (VFD) are also remotely monitored by the NDSU controls system. These drives (listed as ABB or Danfos), are also a known quantity to NDSU Facilities Management in terms of reliability, longevity, and local availability of repair parts.*

*Auditor's reference to NDCC 48-01.2-03 and 44-08-01 both refer to "the product of one manufacturer"; In both cases listed above, two standard commercial commodities/manufacturers and multiple brands were specified. While the list of acceptable manufacturers may be somewhat limited when pursuing the critical objective of connecting to or integrating with NDSU controls systems, no bidders are precluded from incorporating those features into a bid. The distinction of using "approved equal" or "equivalent" language is a semantics argument that is unreasonable, given that NDSU bidding procedures are substantially equivalent to OMB and the objective of upgrading, modernizing, and integrating our controls to the NDSU mainframe was achieved.*

*The Seed Department will have all future projects reviewed and approved by State Procurement.*

***Auditor Concluding Remarks:***

*We stand by our recommendation and conclude, if the highest priority was to enable connectivity with NDSU's central computer system, that a written determination should have been submitted to the state procurement office for approval, as required.*

## **State Procurement Guidelines Not Followed (Finding 16-4)**

### **Condition:**

We noted the following surrounding procurement:

- 4 purchases, totaling \$3,000, were not made from mandatory state contracts and no exemptions were approved from OMB;
- 3 purchases, totaling \$28,376, were indicated as being made by alternate procurement; however, no exemptions approved by OMB could be provided;
- An employee with only level 1 certification procured a level 2 purchase via the purchase card, \$12,817, and split the purchase into two transactions; no documentation existed indicating procurement was performed by a level 2 procurement officer; and
- \$46,044 was spent for janitorial services with one vendor, an estimated purchase price was not determined for janitorial services, and risk for indemnification was not considered.

### **Criteria:**

ND State Procurement Manual, Level 1 and 2, Small Purchases, Chapter 4, part 3 states in-part, the OMB State Procurement Office establishes term contracts for commodities and services commonly used by state agencies. Agencies are required to purchase from state contracts, unless otherwise stated (NDAC 4-12-02-02).

NDAC 4-12-09-03 parts 4 and 5 state in part, the purchasing agency shall approve alternate/noncompetitive procurements within its delegated authority and when the procurement is outside the scope of the agency's delegated authority, prior written approval of the State Procurement Office must be obtained.

The Purchase Card Manual, states in part, all cardholders must follow procurement rules when making purchases. The Certification Program consists of three levels of procurement complexity. Level 1 Certification is for purchases up to \$2,500; Level 2 is for purchases up to \$25,000; and Level 3 Certification is for purchases over \$25,000. The splitting of transactions is prohibited. Split transactions occur when a transaction exceeds the cardholder's limit and the transaction is split into two or more transactions to bypass the limit.

North Dakota State Procurement Manual, Level 1 and 2, Small Purchases, Chapter 6, part 6.3, in-part states, the estimated price is needed to verify that adequate funds are available, determine what level of competition is required, and ensure the procurement officer has delegated purchase authority to make the purchase.

The Risk Management Fund recommends that any person involved in procurement and drafting contracts for the State include these procedures: 1) screening contractors; 2) safety requirements for bid specifications and contracts; 3) contractual risk transfer through indemnification/hold harmless clauses; and 4) insurance requirements.

### **Cause:**

North Dakota State Seed Department:

- Was not aware of the mandatory state contracts;
- Could not locate OMB's approval for the alternate procurements;
- Did not properly increase the cardholder's credit limit and had no documentation to support the proper procurement officer was involved; and
- Choose not to enter into a contract for janitorial services in case the services were not what they expected.

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

There was non-compliance with state procurement practices as noted in the NDAC, the North Dakota State Procurement Manual, Level 1 and 2, Small Purchases, the Purchase Card Manual,

and risk to the state for indemnification has increased, as no formal contract is in place containing the necessary contractual provisions, as established by Risk Management to protect the state.

**Recommendation:**

We recommend that North Dakota State Seed Department review, understand, and adhere to the state procurement practices and work with OMB, as necessary, to properly procure goods and services. We further recommend North Dakota State Seed Department work with OMB, Risk Management, and the Attorney General's Office, as necessary, to evaluate the risk of contractual relationships and to properly include the necessary provisions in contracts to help protect the state, property of the state, and employees from potential harm.

**North Dakota State Seed Department Response:**

Agree.

*However, under Auditor's comments it should be noted:*

- *Of the 4 purchases totaling \$3,000, 3 of the purchases were priced less than state contract prices.*
- *Alternate procurement documentation for the same vendors has been provided to the State Auditor's Office during the past two-plus decades, and cannot be located.*
- *The employee with Level 2 procurement verbally authorized the Level 1 employee to make the purchase. The Level 2 employee does not have a P-card due to internal controls requirements.*
- *Janitorial services were bid and awarded on a monthly cost basis.*

*Seed Department staff is working with Sherry Neas and the State Procurement Office to update exemptions, update procurement training and ensure compliance with state procurement practices in all areas. The review/training process should be complete by September, 2017. The Seed Department will also continue to have all contracts reviewed and approved by the Attorney General's office prior to signing.*

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

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May 17, 2017

Mr. Ken Bertsch  
State Seed Commissioner  
North Dakota State Seed Department  
P.O. Box 5257  
Fargo, ND 58105-5257

Dear Mr. Bertsch:

We have performed an audit of the North Dakota State Seed Department for the two-year period ended June 30, 2016, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota State Seed Department'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.

## **Inappropriate Purchases**

### **Condition:**

We noted 3 of 8 purchases from a North Dakota State Seed Department vendor that were for an employee and not for the North Dakota State Seed Department.

### **Criteria:**

North Dakota State Seed Department's Tax Exempt Certificate, states, "Under the provisions of North Dakota Century Code 57-39.2-04, the organization whose name appears below is certified to be exempt from sales taxes applicable to purchases, rentals and leases of tangible personal property to be used solely and exclusively in the performance of functions by that organization."

North Dakota State Seed's Code of Business Conduct and Ethics forbids conflicts of interest.

North Dakota State Seed's Facility and Computer Technology Security Policy, states in-part, that computer equipment, email and internet access is for normal business activity.

**Effect:**

Purchases made on the North Dakota State Seed's vendor accounts, that are not solely and exclusively used for North Dakota State Seed Department business, in which North Dakota State Seed's tax exempt certificate is associated, would be considered inappropriate use of North Dakota State Seed tax exempt status and non-compliance with North Dakota State Seed's Code of Business Conduct and Ethics. In addition, utilization of North Dakota State Seed's computing and networking resources for non-North Dakota State Seed business, would be considered non-compliance with North Dakota State Seed's Facility and Computer Technology Security Policy.

**Cause:**

Work email was used to sign in to vendor's website to make non-North Dakota State Seed purchases.

**Informal Recommendation 16-1:**

We recommend the North Dakota State Seed Department strengthen its internal controls by ensuring compliance with the policies of the North Dakota State Seed Department and that all employees who are delegated purchasing authority understand the use of North Dakota State Seed's tax exempt status.

**North Dakota State Seed Response/Planned Corrective Action:**

Agree.

*However, under Auditor's comments it should be noted:*

- *These purchases were made by the employee mistakenly logging in to the incorrect account with a vendor used by both NDSSD and the employee personally.*
- *The purchases were made from the employee's home computer.*
- *The purchases were paid for by the employee, who has a tax exemption for the business in question.*

*The error has been corrected and all record of purchases has been transferred to the employee's personal account.*

### **Remittance Listing**

**Condition:**

We noted checks are being restrictively endorsed as mail is being opened; however, there is no remittance listing prepared documenting monies received.

**Criteria:**

OMB policy 216 states in-part, agency management must establish and maintain effective internal controls within their agency. A guide to effective internal controls is the "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States (Green Book).

Standards for Internal Control in the Federal Government, Control Activities, states in-part, management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event.

**Effect:**

There is noncompliance with OMB Fiscal Administrative Policy 216, and without proper segregation of duties surrounding checks and cash, the North Dakota State Seed Department lacks the assurance that all checks and cash may not be accounted for and deposited, increasing the risk of error, misuse, or fraud.

**Cause:**

A remittance listing is not prepared because the North Dakota State Seed Department does not deposit checks where the customer is overpaying and checks that are for applications are not deposited until the application is reviewed and approved, in both of these instances the checks are restrictively endorsed.

**Informal Recommendation 16-2:**

We recommend North Dakota State Seed Department comply with OMB Fiscal Administrative Policy 216 and the Standards for Internal Control in the Federal Government by developing and implementing proper segregation of duties surrounding checks and cash.

**North Dakota State Seed Response/Planned Corrective Action:**

*Disagree*

- *Adequate segregation of duties is accomplished without completing a remittance listing; employees receiving checks immediately restrictively endorse those checks upon arrival, providing for proper safeguarding of payments;*
- *During periods of heavy application, sample receipt, or royalty collections (for example), this process would cause delays in services to our customers due to time spent preparing duplicate recording of checks, and additional support staff dedicated only to managing a remittance list; and*
- *It is our business practice to work with customers to ensure services are properly billed prior to accepting and depositing payments. Any shortfall or misapplication of funds would be immediately noticed by customers and in monthly financial review.*

**Auditor Concluding Remarks:**

*We stand by our recommendation that the North Dakota State Seed Department implement proper segregation of duties surrounding checks and cash. Currently the North Dakota State Seed has the Administrative Officer receipt in the payments, print a list of payments receipted to customer's accounts, creates a receipt tape, and prepares the deposit slip, all of which get reconciled against each other. Having the receipt tape prepared by another individual would provide for better segregation of duties and internal controls surrounding checks and cash.*

**Inadequate Segregation of Duties Surrounding the Clearing Account****Condition:**

We noted the Administrative Officer as having custody of the clearing account checks, as well as, a rubber stamp of the sole authorized signer's signature, the Seed Commissioner, for the clearing account. We also noted that the Administrative Officer is responsible for preparing the monthly bank reconciliations of the clearing account and that a review and approval of the reconciliations is not being documented. These conflicting duties surrounding the clearing account do not support proper segregation of duties.

**Criteria:**

OMB Policy 216, states in-part, agency management must establish and maintain effective internal controls within their agency. A guide to effective internal controls is the "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States (Green Book).

Standards for Internal Control in the Federal Government, Control Activities, states in-part, management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event.

**Effect:**

There is noncompliance with OMB Policy 216 and without proper segregation of duties surrounding the clearing account, there is an increase in the risk of error, misuse, or fraud.

**Cause:**

The Administrative Officer was given the Seed Commissioner's signature stamp so that the monthly sweeps of the clearing account to the Bank of North Dakota could be performed at the end of the month if the Seed Commissioner was traveling. The Seed Commissioner was unaware that someone else having his signature stamp increases risk and leads to improper segregation of duties surrounding the clearing account.

**Informal Recommendation 16-3:**

We recommend North Dakota State Seed Department comply with OMB Policy 216 and the Standards for Internal Control in the Federal Government by developing and implementing proper segregation of duties surrounding the clearing account.

**North Dakota State Seed Response/Planned Corrective Action:**

*Agree. Adding Deputy to bank signatory form; review and confirm clearing account statement and provide signature.*

I encourage you to call me at 701-239-7296 or an audit manager at 701-239-7291 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Cory Wigdahl, CFE  
Auditor in-charge

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