

NORTH DAKOTA
BARLEY COUNCIL

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
FARGO BRANCH OFFICE
1655 43rd STREET SOUTH, SUITE 203
FARGO, NORTH DAKOTA 58103

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Barley Council

Steve Edwardson, North Dakota Barley Council Executive Administrator

Report on the Financial Statement

We have audited the accompanying Comparative Statement of Revenues and Expenditures of the North Dakota Barley Council Fund of the state of North Dakota, for the two years ended June 30, 2016 and the related notes as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement 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 statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness

of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

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

Opinion

In our opinion, the financial statement referred to above present fairly, in all material respects, the revenues and expenditures of the North Dakota Barley Council Fund, for the two years ended June 30, 2016, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statement presents only the North Dakota Barley Council Fund's revenues and expenditures, and do not purport to, and do not present fairly the financial position of the state of North Dakota as of June 30, 2016 or 2015, for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the financial statement is presented and audited in accordance with North Dakota Century Code 4-24-10. This financial statement is not intended to be a complete presentation of the North Dakota Barley Council Fund's assets and liabilities. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2016 on our consideration of the North Dakota Barley Council's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the North Dakota Barley Council's internal control over financial reporting and compliance.



Robert R. Peterson
State Auditor

Fargo, North Dakota

October 31, 2016

Financial Statement

Comparative Statement of Revenues and Expenditures

<u>REVENUES</u>	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Barley Assessments (Net of refunds \$39,516 and \$29,172)	\$ 1,018,693	\$ 746,362
Leases, Rents, and Royalties	12,600	7,350
Interest on Investments	4,722	3,905
Miscellaneous Revenue	881	502
Total Revenues	<u>\$ 1,036,896</u>	<u>\$ 758,119</u>
<u>EXPENDITURES</u>		
Grants, Benefits & Claims	\$ 214,909	\$ 285,510
Salaries and Benefits	195,657	183,077
Dues & Memberships	124,307	154,193
Travel	90,542	111,189
Operating Fees and Services	27,336	45,028
Conference Expenses	14,081	9,720
IT - Communications	9,106	8,069
Professional Development	7,977	1,167
Rentals/Leases - Bldg/Land	7,922	8,370
IT Contractual Services and Repairs	5,064	18,555
Office Supplies	5,043	2,049
Miscellaneous Supplies	3,382	3,050
Bldg, Grounds, Vehicle Supply	2,840	3,415
Supplies - IT Software	2,397	445
Postage	1,909	3,032
Office Equip & Furniture-Under	1,800	7,495
Supply/Material - Professional	1,718	3,063
Professional Fees and Services	1,624	9,046
Printing	1,157	2,576
Insurance	1,024	595
IT Equipment Under \$5,000		1,489
Other Equipment Under \$5,000		845
Sponsorships		1,000
Stipends		675
Interior Repairs		788
Total Expenditures	<u>\$ 719,795</u>	<u>\$ 864,441</u>
Revenue Over (Under) Expenditures	<u>\$ 317,101</u>	<u>\$ (106,322)</u>

See Notes to the Financial Statement.

Notes to the Special-Purpose Financial Statement

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Reporting Entity

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

The Council was created by the 1983 Legislature through passage of the "Barley Industry Promotion Act." Per chapter 4.1-02 of the NDCC, the duties of the Council include the funding of research, education programs, market development efforts and support of state, regional, national, and international entities that promote barley utilization.

The Council is composed of one participating grower elected from each of the five districts established in Chapter 4.1-02 of the NDCC. NDCC section 4.1-02-12 states an assessment at the rate of twenty mills per bushel is imposed on all barley grown in the state, delivered into the state, or sold to a first purchaser in the state. The assessment does not apply to barley grown by a producer and used by the producer as livestock feed. Per section 4.1-02-13 of the NDCC, the first purchaser shall collect the assessment from the seller by deducting the assessment from the total price of the barley being purchased by the first purchaser. The Council shall forward all moneys received to the State Treasurer for deposit in the Barley Fund. The Council is responsible for and funded under a continuing appropriation.

B. Reporting Structure

The special-purpose financial statement includes all activities of the reporting entity as defined above. These activities are funded from fund 231, the Barley 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 Presentation

North Dakota Century Code 4-24-10 requires certain commodity promotion groups to prepare a report for the legislative assembly. As part of this report the applicable commodity groups are required to prepare a single-page uniform statement of revenues and expenditures.

Revenues and expenditures on the comparative statement of revenues and expenditures are reported on the modified accrual basis of accounting which is generally accepted accounting principles (GAAP) for governmental fund types.

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: principal and interest expenditures which are recorded when due; compensated absences which are recorded when paid.

D. GAAP Reporting Differences

GAAP financial statements would include a balance sheet. GAAP financial statements would also provide additional note disclosures.

NOTE 2 – RELATED PARTIES

As identified in Note 1 of these financial statements, the Council is an agency of the state of North Dakota; as such, other agencies of the state are related parties. The Council made payments to North Dakota State University (NDSU), and the Northern Crops Institute (NCI). For fiscal year 2016, the Council paid \$ 128,054 and \$7,500 for barley research project contracts, respectively to NDSU and NCI; and for fiscal year 2015, the Council paid \$162,825 and \$30,000 for barley research project contracts, respectively to NDSU and NCI. The Council also has a particularly close working relationship with the North Dakota Grain Growers Association (NDGGA), the US Grains Council (USGC), and the National Barley Growers Association (NBGA). For fiscal year 2016, the Council paid \$98,000, \$57,595, and \$32,903 for promotional marketing and development contracts, respectively to NDGGA, USGC, and NBGA. For fiscal year 2015, the Council paid \$138,750, \$42,500, and \$40,278 for promotional marketing and development contracts, respectively to NDGGA, USGC, and NBGA.

NOTE 3 – OTHER SIGNIFICANT ITEMS

The Council has cash and investment reserves of \$1,656,873 and \$1,308,768 at June 30, 2016 and June 30, 2015, respectively. Based on the average monthly expenditures for fiscal year 2016 and 2015, this amount represents approximately 28 and 18 months of expenditures, respectively.



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Exhibits

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

Independent Auditor's Report

Honorable Jack Dalrymple, Governor

Members of the Legislative Assembly

Members of the North Dakota Barley Council

Steve Edwardson, North Dakota Barley Council Executive Administrator

We have audited, 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, the financial statement of the North Dakota Barley Council, for the two-year period ended June 30, 2016, and the related notes to the financial statement and have issued our report thereon dated October 31, 2016.

Internal Control over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies,

in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we identified a certain deficiency in internal control over financial reporting, as described in the accompany schedule of Findings, Recommendations, and Management's Response that we consider to be a significant deficiency in internal control over financial reporting. Further, we did identify a deficiency in internal control relating to segregation of duties, that we consider a significant deficiency in internal control over financial reporting. Due to the limited size of the North Dakota Barley Council, management is unable to segregate duties to a level that would prevent or reduce the risk of fraud, waste, and abuse. A recommendation relating to segregation of duties will not be made as the Council has taken steps to mitigate the risk of loss.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Dakota Barley Council's financial statement is 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 financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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



Robert R. Peterson
State Auditor

Fargo, North Dakota

October 31, 2016

Responses to LAFRC Audit Questions

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

- 1. What type of opinion was issued on the special-purpose financial statement?*

Unmodified.

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

Yes.

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

No, there is a lack of segregation of duties, however, due to the small size of the Council it is not feasible to implement. For additional commentary see Independent Auditor's Report on Internal Control and Compliance on page 6. Also, there is a recommendation on the use of a lockbox, which is Finding 16-1 on page 10.

- 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, however, due to the small size of the Council it was not feasible to implement. See additional commentary in the Independent Auditor's Report on Internal Control and Compliance on page 6.

- 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 11 of this report contains two informal recommendations related to a classification change of board member compensation and purchasing card approval. The Council disagreed with the classification change of board member compensation and agreed with implementing purchasing card approval.

LAFRC Audit Communications

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

None noted.

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

None noted.

3. *Identify any significant audit adjustments.*

See Governance Communication section, page 12, for adjustments.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the special-purpose financial statement.*

None.

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

None.

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

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

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

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance and Human Capital Management System (HCM) are the most high-risk information technology systems critical to the North Dakota Barley Council. No exceptions related to the operations of an information technology system were noted.

Findings, Recommendations, and Management's Response

Use of a Lockbox (Finding 16-1)

Condition:

Due to its small size and economic realities of the Council, it is not feasible to obtain adequate segregation of duties surrounding the receipting process. To mitigate the risks, we recommend the Council implement the use of the lockbox services at the Bank of North Dakota for quarterly assessments.

Criteria:

The GAO Standards for Internal Control section 10.12 states management consider segregation of duties in designing control activity responsibilities so that incompatible duties are segregated and, where such segregation is not practical, designs alternative control activities to address the risk.

The GAO Standards for Internal Control section 10.14 states if segregation of duties is not practical within an operational process because of limited personnel or other factors, management designs alternative control activities to address the risk of fraud, waste, or abuse in the operational process.

Cause:

The Council is unfamiliar with the process and are not sure how efficient it would be for them.

Effect:

There is an increased potential for loss to occur when there are inadequate segregation of duties surrounding cash collections, whether due to error or fraud.

Recommendation:

We recommend the Council use a lockbox service for their quarterly assessments to strengthen controls over the receipting process.

North Dakota Barley Council's Response:

Disagree. The Council has established procedures for receiving assessments. Council directors regularly review deposits in detail. A lock box will not be utilized because: 1) it creates additional administration for grain buyers in that buyers would send assessments to one location and remittance forms to the Council; 2) separating checks from remittance forms increases risk of losing checks; 3) errors in items 1 and 2 will cause unnecessary administrative burden on the Council in securing and documenting assessments; 4) using a lock box adds steps that reduce efficiency and potentially increase risk. Alternatively, the Barley Council will be implementing procedures in which grain buyers can utilize electronic funds transfer (EFT) to wire the assessments directly to the Barley Council bank account in Bismarck. Grain buyers have requested implementation of this approach to save time in issuing checks.

Auditor Concluding Remarks:

It is our opinion that a lockbox is the best way for the Council to segregate duties for all barley receipts, however we will evaluate the EFT method upon implementation. A lockbox utilizes only a single address and both the assessment checks and forms would be mailed to this single address. The Bank of North Dakota (BND) deposits the funds and sends the owner of the lockbox a detailed check listing of the deposit made and all other items that were received (i.e. an assessment form). This would alleviate the Council from having to prepare and send their deposits to OMB for processing. We encourage the Council to contact BND to clarify the details.

Governance Communication

October 31, 2016

To: The North Dakota Barley Council

The Legislative Audit and Fiscal Review Committee

We have audited the financial statements of the comparative financial statement of revenues and expenditures of the North Dakota Barley Council for the year ended June 30, 2016 and 2015, and have issued our report thereon dated October 31, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated August 1, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

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 Barley 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 years ending June 30, 2016 and 2015. 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. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole. Below are the posted audit adjustments which lists material misstatements detected as a result of audit procedures and were corrected by management.

Posted Audit Adjustments

	<u>Fiscal Year 2016</u>	<u>Debit</u>	<u>Credit</u>
1	Salaries	\$31,995	
	Stipends		\$31,995
	<u>Fiscal Year 2015</u>		
2	Salaries	\$26,865	
	Stipends		\$26,865

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 25, 2016.

Management Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

The following presents our informal recommendations.

Classification of Board Member Compensation (Informal 16-1)

Condition:

The Council board members are being classified as independent contractors rather than as employees; thus compensation paid to the board members was not processed through payroll. Board member compensation was \$31,995 and \$26,865 for fiscal years 2016 and 2015, respectively.

Criteria:

OMB Fiscal Administrative Policy 101, in part states: The State of North Dakota is required by law to withhold payroll taxes on compensation paid where an employer-employee relationship exists. This precludes making payments to individuals from operating expenses where there is an employer-employee relationship. The Internal Revenue Service uses many factors to distinguish independents or independent contractors from employees. Factors such as control over method of doing work, training of new employees, place where work is done, determination of hours, source of tools and supplies, etc., are used as qualification criteria. The approach taken by the IRS varies greatly from job to job, agent to agent, and year to year.

IRS Publication 963, chapter 4, in part states: The term “public official” refers to someone who has authority to exercise the power of the government and does so as an agent and employee of the government. The Internal Revenue Code does not define the term “public official,” but Regulation §1.1402(c)-2(b), explaining the applicability of self-employment tax, indicates that holders of “public office” are not in a trade or business and therefore not subject to self-employment tax. This Regulation states that the performance of the functions of a public office does not constitute a trade or business. Otherwise holders of public office are excepted from self-employment tax and are presumed to be employees receiving wages. The regulations give the following specific examples of positions that constitute “public office” including members of boards and commissions.

Cause:

The Council board members do not agree they are employees.

Effect:

There is non-compliance with OMB policy 101 and potential IRS implications and misstated financial statements.

Recommendation:

We recommend the Council work with OMB to properly set up the board members as employees to have their compensation processed through payroll, in order to comply with OMB policy, IRS rules and to ensure proper coding for financial statement purposes.

North Dakota Barley Council’s Response:

Disagree. Council directors: 1) pay taxes on their stipends when income is reported via a 1099; and 2) retain tax accountants to assist in complying with IRS regulations. The Council will continue with its current procedures for stipends.

Auditor Concluding Remarks:

We conclude the Council board members are misclassified as independent contractors rather than as employees; making the Council in noncompliance with OMB policy and IRS regulations. We encourage the Council to contact OMB to properly setup their board members as employees.

Lack of Purchasing Card Approval (Informal 16-2)

Condition:

The Council does not have adequate controls in place to ensure that expenditures made on the purchasing card are properly approved. It was noted during testing that none of the purchasing card statements selected for testing had a supervisor or other designated employee’s approval.

Criteria:

OMB Purchasing Card Policy states in part: The cardholder should sign the monthly statement and submit it along with the receipts to the designated agency official for approval. The

cardholder's supervisor, card administrator, or another designated employee (other than cardholder) should:

- Review information submitted by cardholder. The reviewer should match receipts to the cardholder statement submitted by the cardholder;
- Verify purchases are for state business use only. Sign cardholder statement to certify that purchases comply with appropriate rules and regulations to the best of the reviewer's knowledge; and
- Verify that no personal transactions are on statement.

Cause:

The Council was unaware that purchasing card statements required individual approval.

Effect:

There is an increased risk of mistakes, erroneous purchases, and/or missing supporting receipts when no approval is received.

Recommendation:

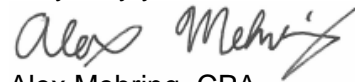
We recommend the Council implement a process to receive signed approval for all purchasing card statements.

North Dakota Barley Council's Response:

Agree. The Barley Council will implement a process in which the chairman and/or vice chairman review and initial all purchasing card statements. The Council currently reviews all purchasing card transactions when reviewing the transaction level detail of Council records (i.e. purchasing card transactions appear in PeopleSoft transaction output).

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

Very truly yours,



Alex Mehring, CPA
Auditor In-charge

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Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060

(701) 328-2241