

STATE WATER
COMMISSION
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2013

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Contents

<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Introduction</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Audit Objectives, Scope, and Methodology</i>	<i>4</i>
<i>Discussion and Analysis</i>	<i>6</i>
<i>Financial Summary</i>	<i>6</i>
<i>Analysis of Significant Variances - Budgeted and Actual Expenditures</i>	<i>7</i>
<i>Financial Statements</i>	<i>8</i>
<i>Statement of Revenues and Expenditures</i>	<i>8</i>
<i>Statement of Appropriations</i>	<i>9</i>
<i>Internal Control</i>	<i>10</i>
<i>Compliance With Legislative Intent</i>	<i>11</i>
<i>Operations</i>	<i>13</i>
<i>Management Letter (Informal Recommendations)</i>	<i>14</i>

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Transmittal Letter

June 24, 2014

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Todd Sando, State Engineer, State Water Commission

We are pleased to submit this audit of the State Water Commission for the biennium ended June 30, 2013. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Andrea Wike. Jackie Castleberry and Alec Grande were the staff auditors. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Todd Sando, State Engineer, 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 "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota State Water Commission consists of the Governor as chairman; the Commissioner of Agriculture as an ex-officio member; and seven members who are appointed by the Governor to serve six-year terms. The Commission appoints a State Engineer as its executive officer, who employs staff as needed to carry out the aims of the Commission. The State Water Commission is regulated by Title 61 of the North Dakota Century Code. In general, the purpose of the State Water Commission is to regulate the use of water resources and to keep abreast of the water needs of the state of North Dakota while trying to balance the public interest and public trust.

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 State Water Commission 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?

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?

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 14 of this report, along with management's response.

LAFRC Audit Communications

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

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

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

The State Water Commission's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

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

None.

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

None.

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

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

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

None.

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

ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the State Water Commission.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the State Water Commission for the biennium ended June 30, 2013 were to provide reliable, audited financial statements and to answer the following questions:

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

Audit Scope

This audit of the State Water Commission is for the biennium ended June 30, 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The State Water Commission has operations in the following locations. Each location was included in the audit scope:

- The central office located in southeast corner of the Capitol grounds.
- The warehouse located on east Main Street in Bismarck.
- The field office located in West Fargo.

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 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 State Water Commission'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

The accompanying financial statements have been prepared to present the State Water Commission's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2013, operations of the State Water Commission were primarily supported by appropriations from special funds. This is supplemented by general funds, federal funds, and fees credited to the State Water Commission's operating fund.

Financial Summary

The State Water Commission had a significant amount of infrastructure (net of accumulated depreciation) in the amount of \$357 million for the year ended June 30, 2013 compared to \$341 million for the year ended June 30, 2012. Infrastructure assets are major statewide water development projects such as the Southwest Pipeline, Northwest Area Water Supply, and Devils Lake outlet.

The State Water Commission was granted authority to issue bonds to finance various flood control and pipeline projects throughout the state of North Dakota. The State Water Commission has approximately \$85 million and \$91 million in revenue bonds outstanding as of June 30, 2013 and June 30, 2012, respectively. The bonds have interest rates ranging from 2.5-5% and maturity dates from fiscal years 2014-2049.

The loans receivables were approximately \$26.7 million and \$27.3 million at June 30, 2013 and June 30, 2012, respectively. A majority of the loans receivable balance is a result of Sections 1 and 2 of House Bill 1206, which established the Western Area Water Supply Authority and authorized the State Water Commission to provide a zero interest loan to the Western Area Water Supply Authority in the amount of \$25 million.

Revenues and other sources consist primarily of transfers from the Oil Resources Trust Fund and the Tobacco Settlement Trust Fund, federal funds, and intergovernmental revenue for the collection of capital repayments. Other revenues included fines for illegal water use, loan proceeds, licenses and fees, and interest. Total revenues and other sources were \$100,892,743 for the year ended June 30, 2013 in comparison to \$213,175,611 for the year ended June 30, 2012. The decrease in total revenues and other sources consists mainly of transfers in and revenue from the federal government. Significant transfers in from the oil tax resources trust fund were made in fiscal year 2012 to make payments to contractors between August 2011 and June 2012 for the completion of the Devils Lake East End Outlet project. Significant decrease in revenue from the federal government was a result of the State Water Commission receiving American Recovery and Reinvestment Act (ARRA) funding in fiscal year 2012 for the Southwest Pipeline project that was not received in fiscal year 2013. Also, due to a pending lawsuit, work on the Northwest Area Water Supply (NAWS) pipeline project came to a standstill during fiscal year 2012 and therefore, no federal government funding was received in fiscal year 2013.

Total expenditures for the State Water Commission were \$99,086,428 for the year ended June 30, 2013 as compared to \$210,694,363 for the prior year. The decrease in total expenditures for the audited period reflects primarily of grants and capital project payments (which account for 91% of total expenditures in both years). All other expenditures remained fairly constant.

The decrease in grants is a result of more flood control grants given to the cities of Fargo and Minot in fiscal year 2012 compared to fiscal year 2013.

The decrease in the contractor payments and payments to engineers and other professionals is a result of the completion of the Devils Lake Outlet and Control Structure in fiscal year 2012.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The State Water Commission had appropriations over actual expenditures for the biennium ended June 30, 2013 of \$230,707,990 in the water and atmospheric resources line. Chapter 46, section 5 of the 2011 Session Laws states that North Dakota Century Code (NDCC) 54-44.1-11, which cancels all unexpended appropriations after the expiration of the biennial period, does not apply to the funding for grants or water-related projects. The unexpended appropriation will be used for the contracts allocated in the contracts fund.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2013</u>	<u>June 30, 2012</u>
<u>Revenues and Other Sources:</u>		
Intergovernmental Revenue	\$ 8,044,938	\$ 8,550,246
Revenue from Federal Government	5,336,767	18,695,548
Licenses, Fines, and Fees	1,754,021	206,207
Loan Proceeds	624,291	434,012
Interest on Investments	4,207	4,389
Miscellaneous Revenue	6,103	12,485
Transfers In	85,122,416	185,272,724
Total Revenues and Other Sources	<u>\$ 100,892,743</u>	<u>\$ 213,175,611</u>
<u>Expenditures and Other Uses:</u>		
Grants	\$ 52,700,091	\$ 88,920,685
Capital Projects	17,932,654	86,427,654
Bond Repayments	8,393,414	8,366,258
Professional Services	7,341,567	11,985,421
Salaries and Benefits	7,115,769	6,906,677
Electricity and Other Utilities	2,542,863	2,787,044
Right of Way Land Purchases	1,086,572	1,009,652
Travel	486,872	533,857
Repairs	411,032	1,303,337
Supplies	335,030	745,535
Equipment	197,110	191,226
IT Services	167,858	164,916
Operating Fees and Services	137,663	185,053
Transfers Out	100,000	1,034,396
Professional Development	86,398	81,394
Rentals and Leases	51,535	51,258
Total Expenditures and Other Uses	<u>\$ 99,086,428</u>	<u>\$ 210,694,363</u>

Statement of Appropriations

For The Biennium Ended June 30, 2013

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Grants-Local Cost-Share	\$ 500,000		\$ 500,000	\$ 380,777	\$ 119,223
Admin & Support Services	3,229,873		3,229,873	3,072,457	157,416
Water & Atmospheric Resources	448,413,774	\$ 81,350,000	529,763,774	299,055,784	230,707,990
Federal Stimulus Funds - 2009	7,271,773		7,271,773	7,271,773	
Totals	<u>\$ 459,415,420</u>	<u>\$ 81,350,000</u>	<u>\$ 540,765,420</u>	<u>\$ 309,780,791</u>	<u>\$ 230,984,629</u>
Expenditures by Source:					
General Fund	\$ 14,995,199		\$ 14,995,199	\$ 14,253,825	\$ 741,374
Other Funds	444,420,221	\$ 81,350,000	525,770,221	295,526,966	230,243,255
Totals	<u>\$ 459,415,420</u>	<u>\$ 81,350,000</u>	<u>\$ 540,765,420</u>	<u>\$ 309,780,791</u>	<u>\$ 230,984,629</u>

Appropriation Adjustments:

The \$81,350,000 adjustment in the Water & Atmospheric Resources line item was two-fold. First, Senate Bill 2371, Section 19 of the 2011 Special Session appropriated \$50,000,000 from the oil resources trust fund to the State Water Commission for projects approved by the Budget Section. At the September 20, 2012 Budget Section meeting, all \$50,000,000 had been allocated to various projects. Second, House Bill 1269, Section 1 of the 2013 Session was an emergency measure to appropriate \$10,350,000 to the State Water Commission for the purpose of providing grants to advance the following projects: Stutsman County Rural Water, North Central Water Consortium, and McLean-Sheridan Rural Water. This section also appropriated \$21,000,000 to advance additional construction on the Southwest Pipeline project. As of June 30, 2013, neither one of these appropriations under House Bill 1269 were used.

Internal Control

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

Internal Controls Subjected to Testing:

- Controls surrounding the processing of federal revenues.
- Controls surrounding the capital payments and capital reimbursements in accordance with North Dakota Century Code 61-24.3-10.1 and 61-24.3-11, and the reporting of assets for the Southwest Pipeline project.
- Controls surrounding the processing of payroll.
- Controls surrounding the ConnectND (PeopleSoft) system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded internal control was adequate.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: (1) misstatements in financial or performance information; (2) violations of laws and regulations; or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any significant deficiencies in internal control. However, we noted other matters involving internal control that we have reported to management of the State Water Commission in a management letter dated June 24, 2014.

Compliance With Legislative Intent

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

- Compliance with appropriation laws (2011 Session Laws):
 - \$200,000 appropriated from the administrative and support services line for providing grants to the North Dakota Game and Fish Department for law enforcement activities on sovereign lands (chapter 46, section 3).
 - Carryover funds from the \$45,000,000 appropriated in the water and atmospheric resources line item in the 2009-2011 biennium for land purchases and construction for the Fargo flood control projects (chapter 46, section 6).
 - \$30,000,000 appropriated in the water and atmospheric resources line item for Fargo flood control projects, which may only be used for land purchases and construction (chapter 46, section 7).
 - \$500,000 appropriated from the water and atmospheric resources line item. \$250,000 is to provide a grant to wildlife services for animal control and \$250,000 is for flood-related water projects in the Nelson County water resource district (chapter 46, section 8).
 - The reporting of the Garrison Diversion Conservancy District to the State Water Commission (chapter 496, section 3).
- Compliance with appropriation laws with emergency measures (2013 Session Laws):
 - \$10,350,000 from the oil resources trust fund for the purpose of providing grants to advance the following projects: Stutsman County Rural Water, North Central Rural Water Consortium, and McLean-Sheridan Rural Water (chapter 28, section 1).
 - \$21,000,000 in the oil resources trust fund for the purpose of advancing additional construction on the southwest pipeline project (chapter 28, section 2).
- Compensation and expenses of appointive members of the State Water Commission and the weather modification board members in accordance with North Dakota Century Code 61-02-12 and 61-04.1-07, respectively.
- Authorization of the agency's funds.
- Ensure expenditures do not exceed appropriations (2011 Session Laws, chapter 46).
- Changes to appropriations were authorized.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping and surplus property.

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 require 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

Operations

This audit did not identify areas of State Water Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness. However, we did note certain matters involving operations that we have reported to management of the State Water Commission in a management letter dated June 24, 2014.

Management Letter (Informal Recommendations)

June 24, 2014

Mr. Todd Sando, State Engineer
State Water Commission
900 E. Boulevard Avenue
Bismarck, ND 58505

Dear Mr. Sando:

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

INTERNAL CONTROLS

Informal Recommendation 13-1: We recommend the State Water Commission develop a policy to document the procedures as to how the agency will monitor all cost share projects.

Informal Recommendation 13-2: We recommend the State Water Commission strengthen the controls in place to ensure that expenditures coded to miscellaneous grants meet the criteria for grant coding.

Informal Recommendation 13-3: We recommend the State Water Commission develop and document adequate policies and procedures in regards to right of way matters on the Southwest Pipeline project.

OPERATIONAL IMPROVEMENTS

Informal Recommendation 13-4: We recommend the State Water Commission work with the Attorney General's office to:

- Determine whether the cost-share agreement between the state and the grantee should contain verbiage regarding the need of a status report and what is to be included in a status report, and
- Develop a consensus whether a due date should be included in the cost share agreements.

Management of the State Water Commission agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Andrea Wike
Auditor in-charge

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