

# State Water Commission

BISMARCK, NORTH DAKOTA

## **Audit Report**

For the Biennium Ended  
June 30, 2015



Office of the State Auditor  
Division of State Audit

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

## *Transmittal Letter*

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May 4, 2016

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, 2015. 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. Megan Reis and Holly Robak 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 his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Bob Peterson".

Robert R. Peterson  
State Auditor

# *Executive Summary*

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## *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.*

No.

## **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 Capital Management (HCM) are high-risk information technology systems critical to the State Water Commission.

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

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## **Audit Objectives**

The objectives of this audit of the State Water Commission for the biennium ended June 30, 2015 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, 2015. 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 Bismarck office located in the southeast corner of the Capitol grounds.
- The warehouse located on east Main Street in Bismarck.
- Field offices located in West Fargo, Devils Lake, and Minot.

## **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 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***

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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, 2015, operations of the State Water Commission were primarily supported by appropriations from the special funding in the oil resources trust fund and water development trust fund. This is supplemented by federal funding and fees credited to the agency's operating fund.

### ***Financial Summary***

The State Water Commission had a significant amount of infrastructure (net of accumulated depreciation) in the amount of \$402 million for the year ended June 30, 2015 compared to \$370 million for the year ended June 30, 2014. Infrastructure assets are major statewide water development projects such as the Southwest Pipeline, Northwest Area Water Supply, and the 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 had approximately \$54 million and \$79 million in revenue bonds outstanding as of June 30, 2015 and June 30, 2014, respectively. The significant decrease in bonds payable was due to the State Water Commission paying off defeased bonds at the beginning of fiscal year 2015. The bonds have interest rates ranging from 4.25-5% and maturity dates from fiscal years 2016-2025.

The loans receivables were approximately \$55.6 million and \$26.4 million at June 30, 2015 and June 30, 2014, respectively. A majority of the loans receivable balance is a result of the 2011 Legislative Session, 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. The increase is mainly due to the State Water Commission authorizing an additional \$19.5 million loan to the Western Area Water Supply Authority in fiscal year 2015.

Revenues and other sources consist primarily of transfers from the Oil Resources Trust Fund and the Tobacco Settlement Trust Fund and intergovernmental revenue for the collection of capital repayments. Other revenues included loan related revenues, intergovernmental revenue, and miscellaneous general revenues. Total revenues and other sources were \$231,405,399 for the year ended June 30, 2015 in comparison to \$100,210,191 for the year ended June 30, 2014. The increase in total revenues and other sources consists mainly of transfers in, intergovernmental capital repayments, and loan related revenues. Transfers In from the oil tax resources trust fund significantly increased based on more grants for water-related project and studies approved by the State Water Commission in fiscal year 2015 compared to fiscal year 2014. Increases in the loan related revenues were a result of receiving loan interest income from the Western Area Water Authority on loans provided by the State Water Commission. The increase in intergovernmental capital repayments is due to the State Water Commission paying off Southwest Pipeline Project bonds at the beginning of fiscal year 2015. As such, the revenues collected from the Southwest Water Authority are directly deposited into the State Water Commission fund and are no longer used for bond payments.

Total expenditures and other uses for the State Water Commission were \$230,007,843 for the year ended June 30, 2015 as compared to \$96,363,134 for the prior year. The increase in total expenditures and other uses for the audited period is primarily reflected in grants, bond and other capital payments, and transfers out. Grants increased as a result of providing funding during fiscal year 2015 for the Fargo flood control project and also the Western Area Water Supply project. Bond and other capital payments increased as a result of the State Water Commission making a payment in fiscal year 2015 to pay off Southwest Pipeline Project bonds. Transfers out increased as a result of the agency receiving loan payments from the Western Area Water Authority in fiscal year 2015, which were transferred to the Bank of North Dakota. All other expenditures remained fairly constant.

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

The State Water Commission had appropriations over actual expenditures for the biennium ended June 30, 2015 of \$533,018,993 in the water and atmospheric resources line. Chapter 20, section 6 of the 2013 Session Laws excludes the State Water Commission from North Dakota Century Code 54-44.1-11 in that the agency is allowed to carry over any unexpended funds from the resources trust fund for grants or water-related projects included the water and atmospheric resources line. The unexpended appropriation will be used for contracts allocated in the contracts fund.

# Financial Statements

## Statement of Revenues and Expenditures

	<u>June 30, 2015</u>	<u>June 30, 2014</u>
<b><u>Revenues and Other Sources:</u></b>		
Intergovernmental Capital Repayment	\$ 8,081,855	\$ 4,811,977
Loan Related Revenue	2,896,665	391,172
Intergovernmental Revenue	805,964	1,911,663
Water Rights Filing Fees	169,200	53,250
Interest on Investments	3,078	3,358
Mineral Lease Royalties	108,466	2,845
Miscellaneous Revenue	531,628	716,885
Transfers In	218,808,543	92,319,041
<b>Total Revenues and Other Sources</b>	<b><u>\$ 231,405,399</u></b>	<b><u>\$ 100,210,191</u></b>
<b><u>Expenditures and Other Uses:</u></b>		
Grants	\$ 115,951,814	\$ 40,596,891
Bond and Other Capital Payments	52,886,441	31,453,379
Professional Fees and Services	9,655,008	4,924,319
Salaries and Benefits	8,596,713	7,942,445
Utilities	4,223,316	3,237,746
Repairs	695,152	457,582
Travel	597,894	544,003
Equipment	515,715	217,308
Supplies	480,343	400,949
Operating Fees and Services	407,654	251,859
Rentals and Leases	276,121	361,634
Information Technology Services	193,736	195,031
Buildings and Right of Way Land Purchases	143,361	329,559
Professional Development	104,647	87,498
Transfers Out	35,279,928	5,362,931
<b>Total Expenditures and Other Uses</b>	<b><u>\$ 230,007,843</u></b>	<b><u>\$ 96,363,134</u></b>

## Statement of Appropriations

For The Biennium Ended June 30, 2015

	Original		Final		Unexpended
<b>Expenditures by Line Item:</b>	<u>Appropriation</u>	<u>Adjustments</u>	<u>Appropriation</u>	<u>Expenditures</u>	<u>Appropriation</u>
Accrued Leave Payments	\$ 325,774		\$ 325,774	\$ 117,121	\$ 208,653
Admin and Support Services	4,761,665		4,761,665	4,602,121	159,544
Water and Atmospheric Resources	853,958,366	\$ 546,106	854,504,472	321,485,479	533,018,993
<b>Totals</b>	<u>\$ 859,045,805</u>	<u>\$ 546,106</u>	<u>\$ 859,591,911</u>	<u>\$ 326,204,721</u>	<u>\$ 533,387,190</u>
<b>Expenditures by Source:</b>					
Other Funds	\$ 859,045,805	\$ 546,106	\$ 859,591,911	\$ 326,204,721	\$ 533,387,190
<b>Totals</b>	<u>\$ 859,045,805</u>	<u>\$ 546,106</u>	<u>\$ 859,591,911</u>	<u>\$ 326,204,721</u>	<u>\$ 533,387,190</u>

### Appropriation Adjustments:

The \$546,106 increase in the Water and Atmospheric Resources line was approved by the Emergency Commission to hire five positions within the Water Appropriations Division to conduct hydrological reviews of permits, inspections, and compliance.

### Expenditures Without Appropriations Of Specific Amounts:

Insurance Recoveries Property Fund has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$166,257 of expenditures for this biennium).

## ***Internal Control***

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In our audit for the biennium ended June 30, 2015, we identified the following areas of the State Water Commission's internal control as being the highest risk:

### ***Internal Controls Subjected to Testing:***

- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the grants given under the cost-share program for the Fargo Flood Control Project, Stutsman Rural Water System, Southeast Cass Wild Rice River Dam Study, and the Mouse River Snagging and Clearing Project.

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) and, for programs receiving federal funds, the Code of Federal Regulation as set forth by the federal Government (2 CFR 200.303).

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.

## *Compliance With Legislative Intent*

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In our audit for the biennium ended June 30, 2015, 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 (2013 North Dakota Session Laws):
  - \$135,000 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 in the state (chapter 20, section 3).
  - Requirements on the Fargo Flood Control Project (chapter 20):
    - Limitations of the construction of the project (section 7).
    - Funding available only for levee and dike protection until stated requirements are met (section 8).
    - Requirements of entering into a cost-share agreement (section 9).
    - Requirements that the state shall provide one-half of the local cost-share for the project not to exceed \$450,000,000, with \$275,000,000 yet to be designated by the state over the next four bienniums (section 10).
    - \$100,000,000 appropriated from the water and atmospheric resources line for the project for the biennium beginning July 1, 2013 and ending June 30, 2015. Any funds unspent must be continued into the next or subsequent bienniums (section 11).
    - Requirements of reporting to the budget section biannually on the impacts of the project (section 15).
  - \$11,000,000 appropriated from the water and atmospheric resources line for the Red River valley water supply project (chapter 20, section 12).
  - \$60,000,000 appropriated from the water and atmospheric resources line for the purpose of paying off or defeasing outstanding bond issues (chapter 20, section 13).
  - \$10,350,000 appropriated from the oil resources trust fund for the purpose of grants to advance the Stutsman County rural water, North Central rural water consortium, and McLean-Sheridan rural water projects (chapter 28, section 1).
  - \$21,000,000 appropriated from the oil resources trust fund for the purpose of advancing additional construction on the southwest pipeline project (chapter 28, section 2).
- Compliance with appropriation laws with emergency measures (2015 North Dakota Session Laws)
  - \$30,000,000 appropriated from the water and atmospheric resources line from funds available in the resources trust fund for Fargo interior flood control projects (chapter 54, section 12).
  - \$414,000,000 appropriated from the water and atmospheric resources line designated as follows: (chapter 54, section 17)
    - \$113,000,000 for flood control projects;
    - \$61,000,000 for general water projects;
      - \$50,000,000 is available for providing grants; and
      - \$11,000,000 from the infrastructure revolving loan fund is available for providing loans;

- \$130,000,000 for rural water projects;
  - \$85,000,000 for municipal water projects; and
  - \$25,000,000 for providing loans from the infrastructure revolving loan fund for rural and municipal water projects.
- Development of a comprehensive water development plan (NDCC section 61-02-01.3).
- Disclosures from members of the state water commission who have a direct or indirect personal or pecuniary interest in a matter and non-participation in or vote on that particular matter (NDCC section 61-02-04.1).
- Proper use of the water development fund, which is used to pay for bonds issued and for other water projects (NDCC section 61-02.1-05).
- Contractual obligations of the state water commission, excepting salaries and expenses of the commission employees and the cost of any office supplies, materials, and equipment must be paid from the contract fund (NDCC section 61-02-64.1).
- Establishment of payments for water service to be paid by water user entities for the purchase of water from the southwest pipeline project (NDCC section 61-24.3-11).
- Money received from water user entities for capital costs of the southwest pipeline project not pledged for the repayment of bonds issued for the construction of the southwest pipeline project may be expended for planning for and construction of water-related projects (NDCC section 61-24.3-18).
- Establishment of payments for water service to be paid by water user entities for the purchase of water from the northwest area water supply project (NDCC section 61-24.6-06).
- Proper use of the northwest area water supply project operation and maintenance fund, which is used only for paying for costs and expenditures for operation and maintenance of the northwest area water supply project (NDCC section 61-24.6-07).
- Revenues from water user entities or otherwise for replacement and extraordinary maintenance of the northwest area water supply project not held pursuant to the terms of a resolution or trust indenture must be deposited into the northwest area water supply project reserve fund (NDCC section 61-24.6-08).
- Authorization of the agency's funds.
- Authorization of changes to the agency's appropriations (NDCC sections 54-16-03 and 54-10-01.1).
- Compliance with OMB's Purchasing Procedures Manual on the Red River valley water supply project.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions in accordance with directives.
- Compliance with investments, including statutory authority of investments and proper deposits of interest (NDCC section 54-27-16).
- Proper use of the Bank of North Dakota surrounding credit card transactions (NDCC section 54-06-08.2).
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including annual inventory (NDCC section 44-04-07) and use of surplus property (NDCC section 54-44-04.6).

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*

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This audit did not identify areas of the State Water Commission's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

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[www.nd.gov/auditor/](http://www.nd.gov/auditor/)

or by contacting the  
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