



Financial Statements  
December 31, 2016 and 2015

# Beginning Farmer Revolving Loan Fund

## BEGINNING FARMER REVOLVING LOAN FUND

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## **Independent Auditor's Report**

The Industrial Commission  
State of North Dakota  
Bismarck, North Dakota

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Beginning Farmer Revolving Loan Fund (the Fund), an enterprise fund of the State of North Dakota, as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements 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 financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. 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 Fund's preparation and fair presentation of the financial statements 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 Fund'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 statements.

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 statements referred to above present fairly, in all material respects, the respective financial position of the Fund, as of December 31, 2016 and 2015, and the respective changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1, the financial statements of the Fund are intended to present the financial position, the changes in financial position and cash flows of only that portion of the State of North Dakota that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of North Dakota as of December 31, 2016 and 2015, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

**Other Matters****Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated February 17, 2017 on our consideration of the Fund'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.



Bismarck, North Dakota  
February 17, 2017

**BEGINNING FARMER REVOLVING LOAN FUND**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**DECEMBER 31, 2016, 2015 AND 2014**  
**(Dollars in Thousands)**

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The management discussion and analysis of the Beginning Farmer Revolving Loan Fund (the Fund) financial performance provides an overview of the Fund's financial activities for the fiscal years ended December 31, 2016, 2015, and 2014. Please read it in conjunction with the financial statements of the Fund.

**FINANCIAL HIGHLIGHTS:**

*Beginning Farmer Real Estate Loans:*

Beginning Farmer Real Estate loans are funded directly by Bank of North Dakota (BND), with the Fund providing buy down funds, to the extent available, to reduce the borrower's interest rate by 2% for the first five years of the loan. The borrower is limited to \$500 in total loans. There were 78 loans totaling \$20,110 made during 2016 with this program. These loans will require \$1,928 in buy down interest during the life of the loans. There were 70 loans totaling \$19,857 made during 2015 with this program. These loans will require \$1,915 in buy down interest during the life of the loans. There were 79 loans totaling \$23,369 made during 2014, which will utilize \$2,253 in buy down interest during the life of the loans. There are currently 330 loans outstanding totaling \$82,190 made directly by the Bank of North Dakota that are receiving buy down interest from the Fund.

*Beginning Farmer Chattel Loans Originated out of the Fund:*

There are two components to this program. These loans are made in conjunction with a lead lender. BND is required to participate in at least 50% of the total loan, and not more than 80%, with the balance to be retained by the lead lender. These loans are secured by a first security interest on the chattel with a maximum loan to collateral value of 80%. The borrowers are limited to \$500 in total loans. The second component of this program provides for interest buy down on the lead lender's share of the loan. The lead lender's interest rate may not exceed 2% over BND's base rate on variable rate loans and 3.5% over the corresponding Federal Home Loan Bank Advance Rate on fixed rate loans. Interest buy down funds are provided through the chattel loan program, to the extent available, to reduce the borrower's interest rate by up to 4% subject to a minimum rate of 1% to the borrower.

There were 74 loans totaling \$7,925 made during 2016 with this loan program, of which BND participated in \$4,038. These loans will utilize \$620 in buy down interest. There were 57 loans totaling \$5,797 made during 2015 with this loan program, of which BND participated in \$2,898. These loans will utilize \$393 in buy down interest. There were 78 loans totaling \$7,519 made during 2014 with this loan program, of which BND participated in \$3,759. These loans will utilize \$571 in buy down interest.

*Beginning Farmer Revolving Fund Balance Summary:*

Cash available to provide interest buy down to beginning farmers for both chattel and real estate purchases was \$4,553 as of December 31, 2016. There was a \$7,000 appropriation from BND's undivided profits for the biennium July 1, 2015 through June 30, 2017 for interest buy down purposes to beginning farmers, of which \$4,500 had been transferred to the Fund as of December 31, 2016. There was a \$6,000 appropriation from BND's undivided profits for the biennium July 1, 2013 through June 30, 2015 for interest buy down purposes to beginning farmers, of which \$5,200 was transferred to the Beginning Farmer Revolving Loan Fund and \$800 was transferred to the PACE Loan Program for interest buy down commitments.

**BEGINNING FARMER REVOLVING LOAN FUND**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS – CONTINUED**  
**DECEMBER 31, 2016, 2015 AND 2014**  
**(Dollars in Thousands)**

*Envest Loans Funded by BND and a Lead Lender:*

Section 6-09-15.5 of the North Dakota Century Code authorizes the Bank of North Dakota to provide interest buy down on value-added agriculture equity loans (Envest) made for investment in a feedlot or dairy operation. This legislation began August 1, 2007 and states that no more than \$1,000 can be transferred from the Fund during a biennium. There were no new Envest loans made during 2016, 2015, and 2014.

**REQUIRED FINANCIAL STATEMENTS:**

The Fund is an enterprise fund and uses the accrual basis of accounting. The basic financial statements include the statements of net position, statements of revenues, expenses, and changes in fund net position, and statements of cash flows. The statement of net position provides readers the assets and deferred outflows of resources and liabilities and deferred inflows of resources of the Fund, with the differences between the two reported as net position. The statements of revenues, expenses, and changes in fund net position identify the operating performance of the Fund for the calendar year. The statements of cash flows identifies cash flows from operating activities and investing activities and provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

**CONDENSED STATEMENTS OF NET POSITION**  
**DECEMBER 31, 2016, 2015 AND 2014**

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>CURRENT ASSETS</b>			
Cash deposits	\$ 4,553	\$ 4,446	\$ 3,854
Prepaid interest and interest receivable	<u>2,150</u>	<u>2,043</u>	<u>1,816</u>
Total current assets	<u>6,703</u>	<u>6,489</u>	<u>5,670</u>
<b>NONCURRENT ASSETS</b>			
Prepaid interest	<u>3,936</u>	<u>3,754</u>	<u>3,818</u>
Total noncurrent assets	<u>3,936</u>	<u>3,754</u>	<u>3,818</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets and deferred outflows	<u>\$ 10,639</u>	<u>\$ 10,243</u>	<u>\$ 9,488</u>
<b>LIABILITIES</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>	<u>-</u>	<u>-</u>	<u>-</u>
<b>NET POSITION - UNRESTRICTED</b>	<u>10,639</u>	<u>10,243</u>	<u>9,488</u>
Total liabilities, deferred inflows and net position	<u>\$ 10,639</u>	<u>\$ 10,243</u>	<u>\$ 9,488</u>

**BEGINNING FARMER REVOLVING LOAN FUND**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS – CONTINUED**  
**DECEMBER 31, 2016, 2015 AND 2014**  
**(Dollars in Thousands)**

*Net position*

At December 31, 2016, 2015, and 2014, net position was \$10,639, \$10,243, and \$9,488, respectively. The increase in net position from 2015 to 2016 was due to transfers in of \$2,500 and an operating loss of \$2,124. The increase in net position from 2014 to 2015 was due to a net transfer in of \$2,692 and operating loss of \$1,986. As described in Note 1, direct real estate loan and chattel loan interest buydowns are funded directly from the net position of the Fund. The Fund is directed by the North Dakota Industrial Commission. The Bank of North Dakota supervises and administers the Fund and the loans made by the Fund.

**CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**

	<u>2016</u>	<u>2015</u>	<u>2014</u>
OPERATING REVENUES	\$ -	\$ -	\$ -
OPERATING EXPENSES	<u>2,124</u>	<u>1,986</u>	<u>1,870</u>
OPERATING LOSS	(2,124)	(1,986)	(1,870)
NONOPERATING REVENUES	<u>20</u>	<u>49</u>	<u>2</u>
LOSS BEFORE TRANSFERS	(2,104)	(1,937)	(1,868)
TRANSFERS, NET	<u>2,500</u>	<u>2,692</u>	<u>3,200</u>
CHANGE IN NET POSITION	396	755	1,332
TOTAL NET POSITION, BEGINNING OF YEAR	<u>10,243</u>	<u>9,488</u>	<u>8,156</u>
TOTAL NET POSITION, END OF YEAR	<u>\$ 10,639</u>	<u>\$ 10,243</u>	<u>\$ 9,488</u>

*Expenses*

Buy down interest is paid to the banks that participate in the various programs of the Fund. Other expenses are for the independent audit of the financial records and miscellaneous expenditures incurred in connection with loan servicing.

*Nonoperating Revenue*

Nonoperating revenues represent interest earned on the cash balance as well as recoveries of previously charged off loans. Since the Fund no longer carries loans or an allowance, recoveries are recorded as nonoperating revenues.

**BEGINNING FARMER REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS – CONTINUED  
DECEMBER 31, 2016, 2015 AND 2014  
(Dollars in Thousands)**

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*Changes in Net Position*

Net position increased by \$396 or 3.9% for the year ended December 31, 2016; increased by \$755 or 8.0% for the year ended December 31, 2015; and increased by \$1,332 or 16.3% for the year ended December 31, 2014.

**ECONOMIC CONDITION AND OUTLOOK**

Continued soft commodity prices as well as potential interest rate increases are projected for 2017. This combination may slow usage of the Beginning Farmer Revolving Loan Fund this year. If land, machinery cost, and livestock values begin to moderate, opportunities may present themselves for those still seeking to expand.

**CONTACTING THE LOAN FUND'S FINANCIAL MANAGEMENT:**

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Fund's finances and to demonstrate the Fund's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact Bank of North Dakota, P.O. Box 5509, Bismarck, North Dakota 58506-5509.



**BEGINNING FARMER REVOLVING LOAN FUND**  
**STATEMENTS OF NET POSITION**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Current Assets		
Cash deposits at the Bank of North Dakota	\$ 4,553	\$ 4,446
Prepaid interest, current portion	<u>2,150</u>	<u>2,043</u>
Total current assets	<u>6,703</u>	<u>6,489</u>
Noncurrent Assets		
Prepaid interest	<u>3,936</u>	<u>3,754</u>
Total noncurrent assets	<u>3,936</u>	<u>3,754</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	<u>-</u>	<u>-</u>
Total assets and deferred outflows	<u>\$ 10,639</u>	<u>\$ 10,243</u>
<b>LIABILITIES</b>	<u>\$ -</u>	<u>\$ -</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>	<u>-</u>	<u>-</u>
<b>NET POSITION</b>		
Unrestricted	<u>10,639</u>	<u>10,243</u>
Total liabilities, deferred inflows, and net position	<u>\$ 10,639</u>	<u>\$ 10,243</u>

**BEGINNING FARMER REVOLVING LOAN FUND**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**  
**YEARS ENDED DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

	<u>2016</u>	<u>2015</u>
OPERATING REVENUES	<u>\$ -</u>	<u>\$ -</u>
OPERATING EXPENSES		
Buy-down interest	2,119	1,981
Other expenses	<u>5</u>	<u>5</u>
	<u>2,124</u>	<u>1,986</u>
OPERATING LOSS	(2,124)	(1,986)
NONOPERATING REVENUES		
Recovery of charge-off	18	47
Investment income	<u>2</u>	<u>2</u>
LOSS BEFORE TRANSFERS	<u>(2,104)</u>	<u>(1,937)</u>
TRANSFERS		
Transfer from Bank of North Dakota	2,500	2,800
Transfer to Medical Pace Loan Program	<u>-</u>	<u>(108)</u>
TRANSFERS, NET	<u>2,500</u>	<u>2,692</u>
CHANGE IN NET POSITION	396	755
TOTAL NET POSITION, BEGINNING OF YEAR	<u>10,243</u>	<u>9,488</u>
TOTAL NET POSITION, END OF YEAR	<u>\$ 10,639</u>	<u>\$ 10,243</u>

**BEGINNING FARMER REVOLVING LOAN FUND**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

	<u>2016</u>	<u>2015</u>
OPERATING ACTIVITIES		
Payment of buy-down interest to lenders	\$ (2,408)	\$ (2,144)
Payment of other expenses	<u>(5)</u>	<u>(5)</u>
NET CASH USED FOR OPERATING ACTIVITIES	<u>(2,413)</u>	<u>(2,149)</u>
NON-CAPITAL FINANCING ACTIVITIES		
Transfer to Medical Pace Loan Program	-	(108)
Transfer from Bank of North Dakota	<u>2,500</u>	<u>2,800</u>
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES	<u>2,500</u>	<u>2,692</u>
INVESTING ACTIVITIES		
Recovery of charge-off	18	47
Investment income received	<u>2</u>	<u>2</u>
NET CASH FROM INVESTING ACTIVITIES	<u>20</u>	<u>49</u>
NET CHANGE IN CASH	107	592
CASH, BEGINNING OF YEAR	<u>4,446</u>	<u>3,854</u>
CASH, END OF YEAR	<u><u>\$ 4,553</u></u>	<u><u>\$ 4,446</u></u>
RECONCILIATION OF OPERATING LOSS TO		
NET CASH USED FOR OPERATING ACTIVITIES		
Operating loss	\$ (2,124)	\$ (1,986)
Adjustments to reconcile operating loss		
to net cash used for operating activities		
Increase (decrease) in prepaid interest	<u>(289)</u>	<u>(163)</u>
NET CASH USED FOR OPERATING ACTIVITIES	<u><u>\$ (2,413)</u></u>	<u><u>\$ (2,149)</u></u>

**BEGINNING FARMER REVOLVING LOAN FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Operations*

Section 6-09.8 of the North Dakota Century Code (NDCC) established the Beginning Farmer Revolving Loan Fund (Fund). The purpose of the Fund is to make or participate in loans to North Dakota beginning farmers for the purchase of agricultural real estate, equipment, and livestock. The Fund is a revolving fund, and all moneys transferred into the fund, interest upon moneys in the Fund, and payments to the Fund of principal and interest on loans made from the fund are appropriated for the purpose of providing loans and to supplement the interest rate on loans to beginning farmers.

The Bank of North Dakota supervises and administers the Fund and the loans made by the Fund. Four programs have been established under the Fund, including two direct loan programs and two interest buy-down programs.

**Direct Real Estate Loans**

Prior to 1989, most of the loans made by the Fund were made to beginning farmers in conjunction with the Federal Land Bank of St. Paul. These loans are secured by a second mortgage on agricultural real estate and may not exceed the lesser of 35% of the appraised value of the real estate or \$100 per borrower.

Subsequent to 1988, a direct real estate loan may not exceed 75% of the current appraised value of the farm real estate on which the Fund receives a first mortgage as security. The total loan amount was increased from \$100 to \$150 in 1999, to \$250 in 2005, to \$400 in 2009, and to \$500 in 2013. The borrower is restricted to a lifetime cap of \$500 under this program. The term of the loan may not exceed 30 years. The interest rate will be fixed at one percent below the Bank of North Dakota's then current base rate for the first five years of the loan with maximum interest rate of 6% and variable at one percent below the Bank's then current base rate adjusted annually on the anniversary date. For the remaining period of the loan, interest must be charged at the Bank's base rate.

**Interest Buy-downs on Real Estate Loans**

The Bank of North Dakota makes direct loans to beginning farmers for the purchase of farm real estate. The loans are restricted to the same terms as indicated above. The interest rate for the first five years is supplemented by 2% per annum from the Fund.

**Chattel Loans**

A participation loan for the purchase of equipment or livestock may not exceed 80% of the agricultural collateral on which the Fund receives a first security interest as collateral. The Fund is required to participate in at least 50% of the total loan, and not more than 80%, with the balance to be retained by the lead lender. The total loan amount was increased from \$250 to \$400 in 2009, and from \$400 to \$500 in 2013. The borrower is restricted to a lifetime cap of \$500 under this program for the purchase of equipment or livestock. The term of the loan may not exceed seven years. The interest rate on the Fund's share of the chattel loan will be fixed at 1% below the Bank of North Dakota's then current base rate for the first five years of the loan with maximum interest rate of 6% and variable at 1% below the Bank's then current base rate adjusted annually for the next two years.

**Interest Buy Downs on Chattel Loans**

The lead lender's interest rate of the chattel loan will be set according to prevailing market rates, but may not exceed 2% over the Bank of North Dakota's base rate on variable rate loans and 3.5% over the corresponding Federal Home Loan Bank Advance Rate on fixed rate loans. Interest buy down funds, to the extent they are available, are used to reduce the lead lender's rate by 4% subject to a minimum rate of 1% to the borrower.

**BEGINNING FARMER REVOLVING LOAN FUND**  
**NOTES TO FINANCIAL STATEMENTS – CONTINUED**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

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**Interest Buy Downs on Envest Loans**

Section 6-09.8 of the North Dakota Century Code authorizes the Bank of North Dakota to provide interest buy down on value-added agriculture equity loans (Envest) made for investment in a feedlot or dairy operation. This legislation began August 1, 2007 and states that no more than \$1,000 can be transferred from the Fund during a biennium.

*Reporting Entity*

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 61, *The Financial Reporting Entity: Omnibus*, the Fund should include all component units over which the Fund exercises such aspects as (1) appointing a voting majority of an organization's governing body and (2) has the ability to impose its will on that organization, or (3) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Fund.

Based on that criteria, no organizations were determined to be part of the Fund. The Fund is included as part of the primary government in the State of North Dakota's reporting.

*Fund Accounting*

The Fund is an enterprise fund and uses the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

*Basis of Accounting and Measurement Focus*

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All enterprise funds are accounted for using the economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the statements of net position. Net position is segregated into net investment in capital assets, restricted and unrestricted components. The statements of revenues, expenses and changes in fund net position present increases (e.g., revenues) and decreases (e.g., expenses) in total net position. The statements of cash flows present the cash flows for operating activities, non-capital financing activities, and investing activities.

*Use of Estimates*

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of net position and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Significant Group Concentrations of Credit Risk*

All of the Fund's business is with beginning farmers within the State of North Dakota. Concentrations of credit risk are present in the agricultural industry. Due to the pervasive nature of agriculture in the economy of the state, all loans are impacted by agriculture.

**BEGINNING FARMER REVOLVING LOAN FUND**  
**NOTES TO FINANCIAL STATEMENTS – CONTINUED**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

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*Cash and Cash Equivalents*

The Fund considers all cash and time deposits with original maturities of three months or less to be cash and cash equivalents for the purpose of reporting cash flows.

*Credit Related Financial Instruments*

In the ordinary course of business, the Fund has entered into commitments to buy down interest rates on loans. Such financial instruments are recorded when they are funded.

*Operating and Non-operating Revenues*

Operating revenues consist of sales of goods and services, quasi-external operating transactions with other funds, grant revenue for specific activities that are considered to be operating activities of the grantor, receipts from other agencies for reimbursement of operating transactions and other miscellaneous revenue. Grants that would qualify as an operating activity are those that do not subsidize an existing program, rather they finance a program the agency would not otherwise undertake.

All other revenues that do not meet the above criteria are classified as non-operating.

**NOTE 2 - DEPOSITS**

The carrying value and bank balance of the Fund's cash deposits at December 31, 2016 and 2015 was \$4,553 and \$4,446, respectively. Of the bank amounts, none were covered by depository insurance and all are uncollateralized. These monies are deposited in the Bank of North Dakota and are guaranteed by the State of North Dakota (NDCC Section 6-09-10).

*Custodial and Concentration of Credit Risk*

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Fund will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Fund does not have a formal policy that limits custodial credit risk for deposits. None of the Fund's deposits are covered by depository insurance. The Fund's deposits are uncollateralized and all of the deposits are deposited in the Bank of North Dakota and are guaranteed by the State of North Dakota (NDCC Section 6-09-10).

**BEGINNING FARMER REVOLVING LOAN FUND**  
**NOTES TO FINANCIAL STATEMENTS – CONTINUED**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

**NOTE 3 - PREPAID INTEREST AND COMMITMENTS**

A description of the interest buy down programs is included under “Nature of Operations” in Note 1. The monies that are being paid to the Bank of North Dakota and the other lead lenders to buy down the interest rate for qualifying loans is paid in advance. Prepaid interest is amortized over the life of the loans based upon the repayment terms of the loan for chattel and Envest loans. Prepaid interest is amortized over five years based upon the repayment terms of the loan for real estate loans. A summary of the balances of prepaid interest follows:

	<u>2016</u>	<u>2015</u>
Prepaid interest, current portion	<b>\$ 2,150</b>	\$ 2,043
Prepaid interest, noncurrent portion	<b>3,936</b>	3,754
	<u><b>\$ 6,086</b></u>	<u>\$ 5,797</u>

Changes in the balances of prepaid interest follow:

	Real Estate Loans (BND)	Chattel Loans (Other Banks)	Envest Loans	Total Prepaid Interest
Balance, December 31, 2014	\$ 4,041	\$ 1,592	\$ 1	\$ 5,634
Additions, net of returns	1,803	341	-	2,144
Amortization	(1,463)	(517)	(1)	(1,981)
Balance, December 31, 2015	4,381	1,416	-	5,797
Additions, net of returns	1,856	552	-	2,408
Amortization	(1,621)	(498)	-	(2,119)
Balance, December 31, 2016	<u>\$ 4,616</u>	<u>\$ 1,470</u>	<u>\$ -</u>	<u>\$ 6,086</u>

The prepaid interest at the Bank of North Dakota is being utilized to buy down the interest rate on 330 loans with outstanding principal balances of \$82,190 as of December 31, 2016 and 323 loans with a balance of \$75,626 as of December 31, 2015. The prepaid interest at other lead lenders is being utilized to buy down the interest rate on chattel loans made by participating banks involved with the chattel loan program.

**NOTE 4 - RELATED PARTY TRANSACTIONS**

During 2016, \$2,500 was transferred in from the Bank of North Dakota’s undivided profits. During 2015, \$2,800 was transferred in from the Bank of North Dakota’s undivided profits and \$108 was transferred out to the Medical Pace Loan Program.

**BEGINNING FARMER REVOLVING LOAN FUND**  
**NOTES TO FINANCIAL STATEMENTS – CONTINUED**  
**DECEMBER 31, 2016 AND 2015**  
**(Dollars in Thousands)**

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The Fund is supervised and administered by the Bank of North Dakota. All cash accounts are deposited in the Bank of North Dakota. The Fund also has on deposit with the Bank of North Dakota monies used to fund the interest buy downs on real estate and chattel loans, which is included in prepaid interest on the Fund's balance sheet (See Note 3).

**NOTE 5 - RISK MANAGEMENT**

The Fund is exposed to various risks of loss related to torts and errors and omissions. The Fund is administered by the Bank of North Dakota and, therefore, is eligible to the same funds/pools established by the State for risk management issues. These include:

The 1995 Legislative Session established the Risk Management Fund (RMF), an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of State Agencies resulting from the elimination of the State's sovereign immunity. The RMF manages the tort liability of the State, its agencies' employees, and the University System. All State agencies participating in the RMF and their fund contribution was determined using a projected cost allocation approach. The statutory liability of the State is limited to a total of \$250 per person and \$1,000 per occurrence.

The State Bonding Fund currently provides the Fund with blanket employee fidelity bond coverage in the amount of \$2,000. The State Bonding Fund does not currently charge any premium for this coverage.

There have been no significant reductions in insurance coverage from the prior year and settled claims resulting from these risks have not exceeded insurance coverage.



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

The Industrial Commission  
State of North Dakota  
Bismarck, North Dakota

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 statements of the Beginning Farmer Revolving Loan Fund (the Fund), an enterprise fund of the State of North Dakota, as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements and have issued our report thereon dated February 17, 2017.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Fund'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 statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not yet been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Fund's financial statements are 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 Fund'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.

A handwritten signature in black ink that reads "Eide Bailly LLP". The signature is written in a cursive, flowing style.

Bismarck, North Dakota  
February 17, 2017

**Beginning Farmer Revolving Loan Fund  
Auditor's Specific Comments Requested by the North Dakota Legislative Audit and  
Fiscal Review Committee  
Year Ended December 31, 2016**

The Industrial Commission  
State of North Dakota  
Bismarck, North Dakota

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by independent certified public accountants performing audits of state agencies. The items and our responses are as follows:

1. What type of opinion was issued on the financial statements?

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?

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 year audit reports?

There were no prior year findings or recommendations.

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

No

Audit Committee Communications:

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

None

2. Identify any significant accounting estimates and the process used by management to determine those estimates.

Management's estimate of the Amortization of Prepaid Interest is based on the estimated life of the loan for Chattel and Envest loans, but over five years based on repayment terms for Real Estate loans. We evaluated key factors and assumptions used to develop the Amortization of Prepaid Interest in determining that it is reasonable in relation to the financial statements taken as a whole.

3. Identify any significant audit adjustments.

None

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

None

5. Identify any significant difficulties encountered in performing the audit.

None

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

None

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 addressed above are directly related to the operations of an information technology system.

Based on the audit procedures performed, the Fund's critical information technology system is the Fiserv system. There were no exceptions identified that were directly related to this application.

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

*Eide Bailly LLP*

Bismarck, North Dakota  
February 17, 2017

## **Independent Auditor's Communication to the Industrial Commission of North Dakota**

To the Industrial Commission  
State of North Dakota  
Bismarck, North Dakota

We have audited the financial statements of the Beginning Farmer Revolving Loan Fund (the Fund) as of and for the year ended December 31, 2016, and have issued our report thereon dated February 17, 2017. Professional standards require that we advise you of the following matters relating to our audit.

### **Our Responsibility in Relation to the Financial Statement Audit**

As communicated in our engagement letter dated January 16, 2017, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Fund solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### **Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

### **Compliance with All Ethics Requirements Regarding Independence**

The engagement team, others in our firm, as appropriate, our firm, and other firms utilized in the engagement, if applicable, have complied with all relevant ethical requirements regarding independence.

## **Qualitative Aspects of the Entity's Significant Accounting Practices**

### *Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Fund is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2016. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

### *Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimate affecting the financial statements is:

Management's estimate of the Amortization of Prepaid Interest is based on the estimated life of the loan for Chattel and Envest loans, but over five years based on repayment terms for Real Estate loans. We evaluated the key factors and assumptions used to develop the Amortization of Prepaid Interest and determined that it is reasonable in relation to the basic financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

## **Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

## **Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. There were no corrected or uncorrected misstatements.

## **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the financial statements or the auditor's report. No such disagreements arose during the course of the audit.

### **Representations Requested from Management**

We have requested certain written representations from management, which are included in the management representation letter dated February 17, 2017.

### **Management's Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

### **Other Significant Matters, Findings, or Issues**

In the normal course of our professional association with the Fund, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operating plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Fund's auditors.

This report is intended solely for the information and use of the North Dakota Industrial Commission, Legislative Audit and Fiscal Review Committee, Bank of North Dakota Advisory Board and management of the Fund, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Erik Bailly LLP". The signature is written in a cursive, flowing style.

Bismarck, North Dakota  
February 17, 2017