

# Office of the State Auditor

*Division of State Audit*

## North Dakota Securities Department Bismarck, North Dakota

Audit Report for the  
Two-Year Period Ended June 30, 2008  
Client Code 414

*Robert R. Peterson*  
*State Auditor*



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## *Transmittal Letter*

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June 15, 2007

The Honorable John Hoeven, Governor  
Members of the North Dakota Legislative Assembly  
Ms. Karen Tyler, Commissioner

We are pleased to submit this audit of the North Dakota Securities Department for the two-year period ended June 30, 2008. 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. Allison Bader, Al Stroklund, and Fred Ehrhardt, CPA were the staff auditors. Cindi Pedersen, CPA was the audit supervisor and Paul Welk, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to Commissioner Tyler and her 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*

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## ***INTRODUCTION***

The North Dakota Securities Department was created as a result of the Securities Act of 1951 with statutory authority under Chapters 10-04, 43-10.1, 51-19, and 51-23 of the North Dakota Century Code. The function of the North Dakota Securities Department is to protect the public and private sector in matters involving the issuance and sale of securities, sale of franchises, sale or execution of pre-need funeral service contracts, and registration of salesmen, brokers, or dealers handling the sale of securities. The North Dakota Securities Department also issues cease and desist orders to individuals and corporations attempting to sell securities without approval; provides exemptions for companies who meet the stated requirements; and investigates and prosecutes violators of the state's securities laws. In an effort to achieve uniformity in securities legislation, the North Dakota Securities Department cooperates with the administrators of federal and state securities laws.

## ***RESPONSES TO LAFRC AUDIT QUESTIONS***

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

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

Financial statements were not prepared by the North Dakota Securities Department in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified 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?***

Other than our findings addressing the "fraud risk assessment" (page 15), "lack of employee evaluations" (page 16), and "revenue segregation of duties" (page 17), we determined internal control was adequate.

4. *Were there any indications of lack of efficiency in financial operations and management of the agency?*

Other than our work addressing "securities applications and renewal receiving procedures" (page 20) there were no indications of lack of efficiency in financial operations and management of the North Dakota Securities Department.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

The North Dakota Securities Department has implemented all 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 22 of this report, along with management's response.

#### **LAFRC AUDIT COMMUNICATIONS**

1. *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.

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

The North Dakota Securities Department's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

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

None.

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

None.

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

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

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

None.

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

ConnectND Finance, Human Resource Management System (HRMS), and the Securities Deposit System are high-risk information technology systems critical to the North Dakota Securities Department.

# *Audit Objectives, Scope, and Methodology*

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## *Audit Objectives*

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The objectives of this audit of the North Dakota Securities Department for the two-year period ended June 30, 2008 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Securities Department's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Securities Department and are they in compliance with these laws?
3. Are there areas of the North Dakota Securities Department's operations where we can help to improve efficiency or effectiveness?

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## *Audit Scope*

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This audit of the North Dakota Securities Department is for the two-year period ended June 30, 2008. 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The North Dakota Securities Department has operations in the following locations. Each location will be included in the audit scope:

- The central office in the Capitol.
- Securities Investigators office in Grand Forks.

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## *Audit Methodology*

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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 reviewed management's 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. Nonstatistical sampling was used and the results were projected to the population. Further 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) ERP system.
- Observed North Dakota Securities Department's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

## ***Management's Discussion and Analysis***

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

The following management discussion and analysis was prepared by North Dakota Securities Department's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the two-year period ended June 30, 2008, operations of the North Dakota Securities Department were primarily supported by appropriations from the state's general fund.

### ***FINANCIAL SUMMARY***

Licenses, permits, and fee revenue increased \$699,119 from fiscal year 2007 to fiscal year 2008. The financial services industry continued to experience expansion during this half of the 07-08 audit period, as broker dealers and investment advisors continued to hire new employees. This growth had a positive impact on Department revenue. Note: the industry has since experienced a significant contraction and revenues can be expected to decrease accordingly.

Fines and forfeitures revenue decreased \$639,058 from fiscal year 2007 to fiscal year 2008. Revenue collections in this category will fluctuate significantly from year to year based on the number, nature, and scope of the Department's enforcement cases and the resulting resolutions thereto. In 2007 the Department settled a number of large cases involving wide-spread conduct and a large number of investor victims that resulted in the assessment of significant penalties. However, as stated earlier, the priority objective of our enforcement mandate is the return of money to harmed investors. In enforcement cases where firms self report wrong doing and/or generally cooperate with the agency in reaching a resolution, fines and penalties will be adjusted accordingly. Note: the enforcement matters detailed in the "Agency Activities" section of this report were investigated during the audit period, but the cases were settled after the audit period therefore the penalties assessed and collected are not reflected in this data.

## **AGENCY ACTIVITIES**

### **ENFORCEMENT**

The primary objective of the Department's enforcement mandate is the return of money to harmed investors. Investigations of fraud and misconduct and subsequent enforcement actions result in monies returned to North Dakota Investors through rescission, recovery, and restitution. Enforcement actions protect the integrity of our capital markets and investor confidence therein. In some cases, enforcement actions generate revenue as a result of the assessment of civil penalties against wrongdoers.

The Department's enforcement caseload is tracking approximately 10% higher than the previous audit period. The sale of securities by unregistered individuals, Ponzi schemes, unsuitable product recommendations, and the lock-up of the Auction Rate Securities market represent the types of cases the Department dealt with most frequently during the 07-08 audit period.

Auction Rate securities are variable rate debt instruments issued primarily by municipalities and student loan entities. They behaved like short-term debt because the rate reset weekly or monthly through an auction process. They were sold to investors as an alternative to a money market account or other cash equivalent. The growth of this market exploded from 1995 through 2007 ultimately reaching \$300 billion at its peak. Growth in the underwriting and auction management fees collected by investment banks exploded along with it. What investors did not know was that as the market grew, the auctions became less and less viable and ultimately, they were not true auctions. The investment banks (Goldman Sachs, Citigroup, Merrill Lynch, UBS, Morgan Stanley, and JP Morgan, etc.) had to perpetually support the auctions to make them work. As the credit crisis evolved and the financial condition of the firms continued to deteriorate, the firms became less inclined to commit capital to the ARS auctions, and in February 2008 the firms, en mass, walked away from the auctions leaving thousands of investors and billions of dollars locked in what had been represented to be a safe, liquid, cash-equivalent investment.

Investor complaints flooded in to regulators across the country. In North Dakota, the Department had numerous investor complaints from individual investors, businesses, and foundations. Because ARS were sold as a safe, liquid, money market alternative, the consequences for investors were exceedingly damaging. Home purchase down payments, general living expenses for retirees, business operating, and payroll funds were inaccessible.

In the Securities Commissioner's capacity as president of the North American Securities Administrator's Association, the Security Commissioner participated in settlement negotiations along with the New York Attorney General and the SEC. Regulators ultimately secured settlements with 11 firms and the largest repayment of funds to investors in the history of our capital markets – approximately \$50 billion.

While "Ponzi" is now a household word as a result of the Bernard Madoff fraud, Ponzi schemes are not new to the department and in fact represent one of the most common types of frauds the Department deals with on an on-going basis. As an example, during the audit period the Department investigated a ponzi scheme to which 20 North Dakotans fell victim, losing approximately \$3 million. This particular scheme, fronted with Arizona real estate, was run by David Skjerven, an insurance agent in the Fargo market, who at one time had held a securities license. After a comprehensive 18-month investigation, the Department secured repayment to investors of losses plus 6% interest. The Department made a criminal referral to Cass County and Skjerven ultimately plead guilty to numerous securities related violations and was sentenced to two years in prison.

The importance of the Department's investor protection mandate cannot be over-emphasized. Financial crime can have devastating consequences for our residents – economically, socially, and emotionally.

#### FINANCIAL EDUCATION

The delivery of financial education to North Dakota residents of all ages continues to be a priority objective of the Department. The Department views financial education as a preventative mechanism, and a critical component of the Department's Investor Protection mandate. The Department views investor education as the first and best defense against investment fraud. The Department maintains the position that there is a direct correlation between financial decision-making aptitude and the economic health of families, communities, and the state overall.

The Hallmark of the Department's various education programs is the Invest North Dakota Teacher Training Academy held every summer at the University of Mary. The Academy, which was held for the 11th and 12th year during the audit period, provides teachers with the training and resources they need to integrate financial education into the classroom curriculum. Over 1700 North Dakota teachers have participated in this event since its inception.

The Department also devotes education resources to helping investor constituents recognize and avoid investment fraud. In December 2007, the Securities Commissioner testified before the US Senate Banking Committee about the vital role education plays in the fight against investment fraud, and the on-going and dedicated efforts by state securities regulators to deliver this education and arm investors against fraud.

#### CORPORATION FINANCE

The Department experienced a significant number of securities filings involving alternative energy companies, specifically in the Wind and Ethanol space, during the audit period. Registered offerings by alternative energy companies totaled \$9.5 million; however, a total dollar amount for all related securities offerings is not available due to the fact that several companies utilized the federal Regulation D, Rule 506 exemption from registration.

# *Financial Statements*

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## **STATEMENT OF REVENUES AND EXPENDITURES**

|  | <u>June 30, 2008</u> | <u>June 30, 2007</u> |
|--|----------------------|----------------------|
| <b><u>Revenues and Other Sources:</u></b>  |                      |                      |
| Licenses, Permits, and Fees                | \$ 8,622,329         | \$ 7,923,210         |
| Fines and Forfeitures                      | 39,350               | 678,408              |
| Conference Registration Fees               | 4,000                | 5,550                |
| Miscellaneous Revenue                      | 5,271                | 552                  |
| <b>Total Revenues and Other Sources</b>    | <u>\$ 8,670,951</u>  | <u>\$ 8,607,720</u>  |
| <br>                                       |                      |                      |
| <b><u>Expenditures and Other Uses:</u></b> |                      |                      |
| Salaries and Benefits                      | \$ 606,852           | \$ 562,996           |
| Operating Fees, Services, and Supplies     | 40,561               | 117,153              |
| Supply/Material-Professional               | 32,015               | 38,795               |
| Travel                                     | 31,799               | 27,263               |
| IT Services                                | 29,314               | 27,335               |
| Professional Development                   | 25,660               | 27,521               |
| Professional Services                      | 16,913               | 27,837               |
| Rentals/Leases                             | 10,330               | 10,518               |
| Equipment and Software                     | 8,416                | 8,165                |
| <b>Total Expenditures and Other Uses</b>   | <u>\$ 801,860</u>    | <u>\$ 847,583</u>    |

**STATEMENT OF APPROPRIATIONS**

**For The Fiscal Year Ended June 30, 2008**

| <b>Expenditures by<br/>Line Item:</b> | <u>Original<br/>Appropriation</u> | <u>Adjustments</u> | <u>Final<br/>Appropriation</u> | <u>Expenditures</u> | <u>Unexpended<br/>Appropriation</u> |
|---------------------------------------|-----------------------------------|--------------------|--------------------------------|---------------------|-------------------------------------|
| Salaries and<br>Benefits              | \$ 1,265,243                      | \$ 5,040           | \$ 1,270,283                   | \$ 606,134          | \$ 664,149                          |
| Operating<br>Expenses                 | 575,311                           |                    | 575,311                        | 195,726             | 379,585                             |
| <b>Totals</b>                         | <u>\$ 1,840,554</u>               | <u>\$ 5,040</u>    | <u>\$ 1,845,594</u>            | <u>\$ 801,860</u>   | <u>\$ 1,043,734</u>                 |
| <b>Expenditures by<br/>Source:</b>    |                                   |                    |                                |                     |                                     |
| General Fund                          | \$ 1,623,355                      | \$ 5,040           | \$ 1,628,395                   | \$ 712,598          | \$ 915,797                          |
| Other Funds                           | 217,199                           |                    | 217,199                        | 89,262              | 127,937                             |
| <b>Totals</b>                         | <u>\$ 1,840,554</u>               | <u>\$ 5,040</u>    | <u>\$ 1,845,594</u>            | <u>\$ 801,860</u>   | <u>\$ 1,043,734</u>                 |

**Appropriation Adjustments:**

The \$5,040 increase in the Salaries and Benefits line item was allotted by the Office of Management and Budget from the statewide salary equity pool appropriated pursuant to Senate Bill 2189 of the 60<sup>th</sup> Legislative Assembly for market equity compensation adjustments for classified employees.

**Expenditures Without Appropriations Of Specific Amounts:**

Investor Restitution Fund has a continuing appropriation authorized by NDCC section 10-04-03(5). There were no expenditures this year.

## STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

| <b>Expenditures by<br/>Line Item:</b> | <u>Original<br/>Appropriation</u> | <u>Adjustments</u> | <u>Final<br/>Appropriation</u> | <u>Expenditures</u> | <u>Unexpended<br/>Appropriation</u> |
|---------------------------------------|-----------------------------------|--------------------|--------------------------------|---------------------|-------------------------------------|
| Salaries and<br>Benefits              | \$ 1,105,588                      |                    | \$ 1,105,588                   | \$ 1,075,562        | \$ 30,026                           |
| Operating<br>Expenses                 | 570,855                           |                    | 570,855                        | 477,946             | 92,909                              |
| <b>Totals</b>                         | <u>\$ 1,676,443</u>               | <u>\$ 0</u>        | <u>\$ 1,676,443</u>            | <u>\$ 1,553,508</u> | <u>\$ 122,935</u>                   |
| <b>Expenditures by<br/>Source:</b>    |                                   |                    |                                |                     |                                     |
| General Fund                          | \$ 1,459,244                      |                    | \$ 1,459,244                   | \$ 1,370,950        | \$ 88,294                           |
| Other Funds                           | 217,199                           |                    | 217,199                        | 182,558             | 34,641                              |
| <b>Totals</b>                         | <u>\$ 1,676,443</u>               | <u>\$ 0</u>        | <u>\$ 1,676,443</u>            | <u>\$ 1,553,508</u> | <u>\$ 122,935</u>                   |

### Appropriation Adjustments:

There were no appropriation adjustments during the 2005 – 2007 biennium.

### Expenditures Without Appropriations Of Specific Amounts:

Investor Restitution Fund has a continuing appropriation authorized by NDCC section 10-04-03(5). (\$71,108 of expenditures for this biennium).

## *Internal Control*

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In our audit for the two-year period ended June 30, 2008, we identified the following areas of the North Dakota Securities Department's internal control as being the highest risk:

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### Internal Controls Subjected To Testing

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- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer based Securities Program.
- Controls surrounding the application and renewal process.

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

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of North Dakota Securities Department in a management letter dated April 15, 2009.

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## **FRAUD RISK ASSESSMENT**

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Finding 08-1

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The North Dakota Securities Department does not have a system in place to identify possible instances of fraud or fraudulent activities in their state's financial and operational areas.

The most important guidance relating to internal control is contained in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This guidance dictates that a Fraud Risk Assessment program be established and practiced to identify risks of fraudulent type activities, including when special circumstances arise, when changing operating environments, and for restructuring. In addition, the ND Securities Department does not have the necessary control activities designed/documentated to ensure significant fraud exposures are identified and mitigated. Management must design the necessary internal controls to ensure that each of the significant fraud exposures identified during the risk assessment process are adequately mitigated and that the system of control activities addressing each of the identified fraud risks has been adequately tested by management.

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Audit Recommendation and  
Agency Response

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### **Recommendation:**

We recommend the North Dakota Securities Department:

- Establish and perform a fraud risk assessment on a recurring basis.
- Design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated, including background investigations, and that each of the identified fraud risks has been adequately tested by management.

### **North Dakota Securities Department Response:**

*The Department agrees and will act on the recommendation. The Department understands that this recommendation has been made to all agencies and that guidance will be forthcoming from OMB regarding the appropriate structuring of a fraud risk assessment system.*

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Finding 08-2

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### **LACK OF EMPLOYEE EVALUATIONS**

The North Dakota Securities Department is not conducting formal performance reviews on an annual basis for all employees.

Section 4-07-10-04 of the Administrative Code requires that annual performance reviews be completed by management. The evaluations should serve as documented support for salary increases based on merit, employee performance, and equity adjustments.

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Audit Recommendation and  
Agency Response

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**Recommendation:**

We recommend the North Dakota Securities Department complete annual evaluations on all personnel in accordance with Section 4-07-10-04 of the Administrative Code.

**North Dakota Securities Department Response:**

*The Department agrees with the recommendation. Formal employee reviews, including a peer review process, have been conducted by the Commissioner and the Division Supervisor, but the review cycle has varied. Reviews have been completed for the July 08-June 09 timeframe. It should be noted that the Department is a small agency with 9 employees, 8 of whom are located in the same facility in Bismarck. The Department's employees interact with each other and with the Commissioner on a daily or near-daily basis. The 1 employee in the agency's satellite office interacts with the Supervisor on a daily or near-daily basis. As such, the opportunity for the Commissioner, Deputy Commissioner and Supervisor to provide performance feedback is regular and on-going, and any personnel issues are handled as they arise and in a timely manner.*

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## **REVENUE SEGREGATION OF DUTIES**

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### Finding 08-3

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The North Dakota Securities Department does not have proper controls surrounding the collection of revenue. The individual responsible for opening the mail and restrictively endorsing checks has access on the Securities Program to enter deposits and create letters of effectiveness (certifications) for all types of licensing managed by the system. In addition, the backup to this individual also has access to the money and has access on the Securities Program to create letters of effectiveness. It was noted that there was approximately \$3.1 million in revenues in fiscal year 2008 and approximately \$3.3 million in revenues in fiscal year 2007 that are processed through the deposit system.

The most important guidance relating to internal control is contained in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This guidance dictates proper segregation of duties is an integral requirement of internal control. Proper segregation of duties requires access to approval registrations and licenses be restricted to individuals with duties independent of custody of revenue collections.

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### Audit Recommendation and Agency Response

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#### **Recommendation:**

We recommend the North Dakota Securities Department segregate duties to ensure revenue collections are posted to company records by an individual with duties independent of custody of revenue.

#### **North Dakota Securities Department Response:**

*We agree with the recommendation. The Department has implemented changes to segregate the revenue related functions identified in Finding 8-3. The Securities Department employee responsible for revenue collection no longer has access to functionality in the Securities Program that provides for the ability to create Letters of Effectiveness.*

## *Compliance With Legislative Intent*

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In our audit for the two-year period ended June 30, 2008, we identified and tested North Dakota Securities Department's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

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### Legislative Intent Included In Our Audit Scope

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- Application of proper statutory rates relating to revenue.
- Proper registration and collection of fees required for the sale of securities and renewal applications.
- Proper rates charged for the licensing of those selling securities.
- Proper regulation of and proper fees charged for the sale of franchises.
- Proper use of the Investor Restitution Fund for repaying defrauded investors and the Investor Education and Technology Fund mainly used for investor education and technology equipment.
- Proper use of one-time funding for the Document storage and retrieval system. (2007 North Dakota Session Laws chapter 38, section 4).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2005 North Dakota Session Laws chapter 11 and 2007 North Dakota Session Laws chapter 38).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping and surplus property.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

*Government Auditing Standards* requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or

grant agreements, and significant abuse that have occurred or are 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.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the North Dakota Securities Department in a management letter dated April 15, 2009.

# Operations

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Our audit of the North Dakota Securities Department identified the following area of potential improvement to operations, as expressed by our operational objective:

- Is the North Dakota Securities Department using best practices for their application and renewal process?

The criteria used for this operational improvement is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. (Information and Communication – Quality and effectiveness of information and communication.)

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Operational  
Improvement 08-1

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## **SECURITIES APPLICATIONS, REPORTING, AND RENEWAL PROCEDURES**

The Securities Department provides various application, reporting and renewal forms for securities and franchise filing requirements. North Dakota application forms are not online fillable and do not consistently identify proper fees to be paid or fee calculation methods. Fillable forms in PDF format increase user friendliness allowing applicants to complete the forms online, save, print or email the forms to the Securities Department. Fillable forms that calculate fees ensure proper amounts due are identified to the applicant.

Ultimately the Securities Department should consider migrating toward a web-based filing system to receive applications, reporting documents, renewals and exhibits including online payment of applicable fees by credit card.

### **Operational Improvement:**

We recommend the Securities Department provide online fillable application, reporting and renewal forms which identify or calculate applicable fees due.

We recommend the Securities Department consider the cost benefits of providing an online filing system including the ability to receive online payment of fees by credit card.

### **North Dakota Securities Department Response:**

*While we agree that advances in technology should be deployed when prudent in order to improve operational efficiencies for the Department, the Department faces a number of constraints that may prevent it from implementing the above operational improvement in the near term.*

- *Funding for such an improvement is not in the Department's 09-11 budget*
- *Uniformity between jurisdictions is key concern for filers. Other jurisdictions must be surveyed by the Department to ensure preservation of uniformity to the extent possible.*
- *Filing processes may start at the federal level and are then pushed out to the states. For example, the Securities and Exchange Commission is currently developing an electronic system for Reg D filings. The states, through NASAA, are building a compatible state filing system. As such, the Department will utilize this electronic filing system when complete instead of expending resources to build its own.*

*To the extent fiscally possible, the Department will research the recommended improvements. The Department will take steps to improve existing forms utilized by filers, including updating forms to ensure information pertaining to various filing fees is consistently disclosed.*

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

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April 15, 2009

Ms. Karen Tyler, Securities Commissioner  
North Dakota Securities Department  
600 E. Boulevard Avenue  
Bismarck, ND 58505

Dear Commissioner Tyler:

We have performed an audit of the North Dakota Securities Department for the two-year period ended June 30, 2008, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Securities Department's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

### **LEGISLATIVE INTENT**

Informal Recommendation 08-1: We recommend the Securities Department properly reimburse travel expenses only once.

Informal Recommendation 08-2: We recommend the Securities Department have someone independent of posting entries into the GL approve all entries. This approval must be done after the entry has been posted and is necessary until workflow is fully implemented for GL entries.

Informal Recommendation 08-3: We recommend the Securities Department follow the purchasing procedures outlined by OMB in the Purchasing Procedures Manual.

## GENERAL

Informal Recommendation 08-4: We recommend the Securities Department provide adequate evidence of the reconciling procedures of state procurement card supporting documents.

Informal Recommendation 08-5: We recommend the Securities Department obtain proper level II state procurement training for purchases of items between \$2500 and \$25,000.

Informal Recommendation 08-6: We recommend the Securities Department expand the code of ethics/code of business conduct to include:

- Full, fair, accurate, timely, and understandable disclosure in reports and documents;
- Compliance with applicable governmental laws, rules, and regulations; and
- The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code.

We recommend the Securities Department ensure employees acknowledge receipt of the code of ethics/code of business conduct on an annual basis.

Management of North Dakota Securities Department 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