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INSPECTOR GENERAL

January 2007

To: George Cannelos, Federal Co-Chair

From: Mike Marsh, Esq., Inspector General

FINAL REPORT

FOR PUBLIC RELEASE

Subject: Inspection of Unalakleet tank farm

On September 15, 2006, I conducted a routine inspection of the tank farm currently under construction at Unalakleet, Alaska. The purpose of this inspection was to confirm (1) activity at the project site and (2) the traceability of expenditures within the total reported to the Denali Commission on OMB Form 269A.

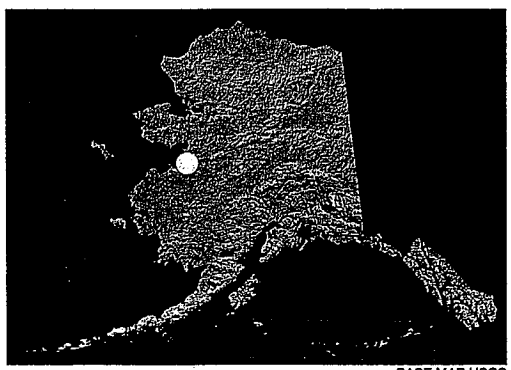
PROJECT BACKGROUND

Unalakleet is a small (pop. ≈ 700), rural, incorporated city on the far west coast of Alaska — about 150 miles southeast of Nome. The public school has around 175 students.

No roads, railroads, or power grids lead to Unalakleet. Year-round access is by the scheduled airlines that serve Nome and Anchorage.

The new tank farm is totally funded by the Denali Commission and anticipated to cost about $10 million. It is owned by the city government, who will lease portions to the local electric utility, the school district, the Unalakleet Native Corporation, and West Coast Aviation Services (a private corporation). Each of these four entities will have its own, physically separate set of four to eight tanks within the facility. Each will share the facility's operating costs.

The Commission's implementing "program partner" is the Alaska Energy Authority (AEA). With over a million gallons of fuel storage, this is the largest tank farm that AEA has built so far. As of December 2006, AEA had reported total expenditures of around $7.4 million for the project.



BASE MAP USGS

While this inspection concerns the new tank farm, the Denali Commission has other projects at Unalakleet. A new $9 million clinic has been completed, with the major funders being USDA ($4 million) and the Denali Commission ($3.6 million). The Denali Commission is also contributing $1.5 million toward teacher housing at the local school.

EXPENDITURE TRACEABILITY

This project was funded as part of two "lump sum" awards to AEA that cover numerous other projects around the state.[1] Nevertheless, computerized accounting records at AEA readily enabled a traceable "roll-up" from AEA's project payments, to project totals, to the cumulative expenditures reported[2] on OMB Form 269A.

PROJECT'S PHYSICAL STATUS

My inspection verified that a facility consistent with AEA's project records is now under physical construction at the expected site in Unalakleet.

The completed facility will have 26 tanks, each set on a concrete foundation ("ringwall"). At the time of my inspection, 22 of the foundations had been completed and nine of the tanks had been installed.

During my day in Unalakleet, I watched as some tanks were moved from the beach and lifted on to their foundations. Fourteen tanks were either waiting on the beach or actually en route to the construction site. The three largest tanks will not arrive by barge until 2007.

Each of the four leasing entities has a separate compartment that is defined by wooden containment walls to control any spills. All but 70 feet of these walls had been installed at the time of my inspection.

Preservation of the underlying permafrost is critical to the design, and I noted that all 19 thermotubes had been installed to accomplish this.

My observations were consistent with the photographs that AEA has previously submitted for public display on the Commission's online project database at *www.denali.gov*.

CONCLUSIONS: ANALYSIS OF THREE CONFLICTS

1. Change orders

AEA selected its contractor for this project through competitive bidding. The original contract was let for $8,374,000. Two change orders totaled $369,862 and increased the contract amount to $8,743,862. These two change orders reflect minor scope revisions and, taken together,

[1] Denali Commission award nos. 48-DC-2002-I1 and 165-05.

[2] As of the second quarter of federal fiscal year 2006.

amount to less than a 5% increase in the contract price. They appear to have been amicably negotiated by mutual agreement and with little fanfare.

However, a third issue has not been successfully resolved through a change order. This conflict concerns an attempt by one of the project's beneficiaries to charge the contract for access to a beach used for unloading materials.

The Unalakleet Native Corporation (UNC) is a primary beneficiary of this project. Almost a third of the tank farm's capacity (31%) lies in the section that the city will lease to UNC. Yet the Denali Commission is totally funding this $10 million project, with no contribution by UNC.

Barges unloaded the new tanks along UNC's beachfront last summer, and they sat there awaiting transport to the city-owned construction site. In August, UNC sent the contractor a proposed land use permit that would require it to pay UNC approximately $40,000 for that access.

The contractor did not expect UNC to, in effect, charge the contractor for building something intended to benefit UNC. The contractor's lawyer wrote UNC's lawyer that this charge is AEA's problem.

AEA, on the other hand, asserts that any needed permits are the contractor's responsibility, and that this charge is thus the contractor's problem.

And, amidst all this finger-pointing, the inspector general says this charge for an intangible is symptomatic of some larger issues that are the Commission's problem.

As I note below in Recommendation No. 3, I think it will be more productive for a team of commissioners to directly mediate this than for the parties to continue brandishing their lawyers.

First, it is important to recognize from the start that AEA's grantee — the City of Unalakleet — is no bystander to this dispute. The city selected and provided the construction site, but failed to provide the access implicitly needed to install tanks on it. This would seem contrary to the following provision in its grant agreement:

> *The Grantee is responsible for securing the real property interests necessary for the construction and operation of the Project, through ownership, leasehold, easement, or otherwise. The grantee also is responsible for obtaining the required permits and approvals. . .*[3]

Further, the city's operating agreement with its four tenants specifies that *"[a]ll unresolved land issues will be resolved prior to startup of Facility construction."*[4]

The arriving fuel tanks were the very essence of the project. Charging AEA (or its contractor) for access to bring them to the site seems the antithesis of the promised cooperation. In fact, this

[3] AEA grant agreement no. 2195236 (City of Unalakleet), section B(6)(a).

[4] *Access, Occupancy, Operations and Maintenance Agreement* (Feb. 2006), section 11.

implicit treatment of the Denali Commission as an outsider could arguably constitute "commercial frustration" under the law of contracts.[5]

Second, federal law provides the public with easements across Native land selections in certain circumstances. Access from navigable water and marine coastline is prescribed in some locations under section 17(b) of the Alaska Native Claims Settlement Act. Historically-used transportation routes may be continued under the former federal law known as R.S. 2477.

BLM records and the state's easement atlas show a 17(b) easement at points along the beach between the city and the general area where the tanks were unloaded.[6] Recommendation No. 2 thus suggests that the Commission's management ask the state to ascertain the proximity of any public easements to the precise spot on the beach where the tanks were unloaded.

Third, AEA's grant agreement recognizes the importance of local effort:

> *The Authority [AEA] requires in-kind contributions to demonstrate that the grantee and the community are committed to and invested in the proposed project. Typical in-kind contributions include, but are not limited to: land for the tank farm, the use of heavy equipment as available, lodging, etc. The Authority encourages the grantee and the community to support this project with in-kind contributions to the greatest extent possible.*[7]

The grant agreement reflects that AEA arranged for the city to contribute shop space and some heavy equipment.[8] However, AEA failed to negotiate the issue of beach access to unload the tanks that are the very essence of the project.

In the Commission's enabling act, the very first purpose listed by *Congress* was *"[t]o deliver the services of the Federal Government in the most cost-effective manner practicable by reducing administrative and overhead costs."* And the Commission's strategic plan provides that *"[p]riority will generally be given to projects with substantial cost sharing."*[9]

As I note below in Recommendation No. 1, the Commission should implement these fundamentals by focusing on communities whose local contributions emphasize "grant leveraging" rather than "grant harvesting." Reasonable local efforts enable the Commission to spread its funding farther and help more communities.

The City of Unalakleet now seems to recognize the troubling message in its tenant's implicit treatment of the Denali Commission as an outsider — an outsider who apparently needs to buy its access to build the tenant a multimillion dollar tank farm. Earlier this month, the city administrator wrote the following to AEA:

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[5] See *Division of Agriculture Loan Fund v. Carpenter,* 869 P.2d 1181 (Alaska 1994).

[6] In these records, the public easement of interest is designated as EIN 31 on the Unalakleet D-4 USGS topographic quadrangle.

[7] AEA grant agreement no. 2195236, excerpt from section B(6)(c).

[8] See AEA grant agreement no. 2195236, Appendix 3.

[9] *Denali Commission Five Year Strategic Plan (2005-2009)*, p. 4.

> *The Unalakleet City Council has agreed unanimously to waive the dock fees for the future Alaska Energy Authority projects that may occur in the City.*

Again, the city is no bystander to this project, and this post-inspection offer does not obscure the failure of both the city and AEA to negotiate any access issues before the project was ever approved.

This type of anecdote can erode long-term national support for this program. In Recommendation No. 3, I suggest that a mediation team from the Commission intervene before any other communities perceive that this anecdote translates as a precedent for yet another way to charge the grant.

2. Multiple federal reviews of AEA's accounting records

Most of AEA's funding comes from the Denali Commission. AEA appropriately retains a local CPA firm to conduct the annual "single audit" of federal funding required by law. AEA is also subject to "inspections" of its projects (such as this one) and other reviews under the Inspector General Act.

While this inspection was pending, AEA found itself subject to yet another source of federal financial inquiry. USDA Rural Development sent a staff CPA from the Lower 48 to review AEA's use of USDA money passed through the Denali Commission.

Contrary to some popular lore, the Single Audit Act doesn't prohibit scrutiny by multiple federal agencies. OMB Circular A-133 clearly states:

> *The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits.*[10]

Under the concept of a "single audit," grantees are only protected from having to pay for multiple audits of their federal funding. Though A-133 encourages federal reviewers to *"rely upon and use such audits"* and to *"build upon work performed by other auditors,"*[11] multiple reviews remain a reality of federal assistance so long as recipients aren't billed for the extra oversight.

USDA's accountant reportedly found it necessary to visit AEA in order to understand the use of funding passed through the Denali Commission. An apparent lack of precision in the Commission's accounting system necessitated this resort to the grantee's records.

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[10] Section 215.

[11] Section 215.

Such multiple reviews are not only burdensome for the program partners, but they also may call into question the public value that the Commission is contributing as an intermediary. Recommendation No. 4 suggests corrective action that should reduce the need for auditors from other federal agencies to visit the Commission's program partners.

3. Coordination with state funding for rural schools

The local school district is another of the city's tenants that is receiving a dedicated section of this $10 million tank farm. The school district's share will consist of 14% of the total tankage. The Denali Commission is also contributing $1.5 million toward the district's housing for its teachers in Unalakleet.

This school district is one of three that have jointly filed a public interest lawsuit alleging a constitutional requirement that the state spend more on their schools.[12] The case has been pending since 2004, with closing arguments heard last month. The plaintiffs are asking for a court-supervised determination of the required funding level, with an order that the state then supply the money.

So, in effect, the Commission is funding the state (through AEA) to assist a school district that is suing the state over the latter's funding decisions. And this, of course, is not the first such suit in Alaska. For instance, back in 1999, the court ruled that rural school districts were indeed disadvantaged by a disproportionate system of state funding.[13]

It remains to be seen whether the court will order the state to increase the money sent to Unalakleet's school district. However, the Commission's grants should always be carefully rationed to fill the gaps left by other funders — rather than displace their need to contribute. If another entity is potentially going to fund, whether by choice or compulsion, the Commission needs to coordinate with the state education department so as to not supplant that effort.

Recommendation No. 5 addresses the need for enhanced coordination with the state education department.

RECOMMENDATIONS

Recommendation No. 1

Priority should be given to communities that emphasize grant leveraging rather than grant harvesting.

The extent to which the Commission's projects should be a shared effort — versus just provided — is a sensitive policy decision that currently varies with the type of facility. Nevertheless, long-run national support for this program may be encouraged to the extent that projects are perceived more as innovative partnerships and community "barn raisings" — and less as seasonal cash injections and entitlements.

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[12] *Moore, et al v. State of Alaska,* 3AN-04-9756 Civil.

[13] *Kasayulie, et al v. State of Alaska,* 3AN-97-3782 Civil.

In the Commission's enabling act, the very first purpose listed by *Congress* was *"[t]o deliver the services of the Federal Government in the most cost-effective manner practicable by reducing administrative and overhead costs."* And the Commission's strategic plan provides that *"[p]riority will generally be given to projects with substantial cost sharing."*[14]

However, a recurring theme in my inspections of AEA projects has been the assumption that Denali Commission grants involve local purchases rather than local contributions. Communities have grown to expect that they will get both the facility itself and a seasonal cash injection from charging anything available to the grant.

In Exhibit 1, I list various in-kind contributions that the Commission could insist upon in deciding which selection of projects will allow it to build the most facilities in the most communities. Without meaningful local contributions, one community's "harvest" translates as another community's "famine."

Such contributions may not be the historical norm for bush capital projects. But the commissioners need to confront this tough issue head-on and decide whether the Denali Commission will be different.

EXHIBIT 1
EXAMPLES OF POTENTIAL IN-KIND CONTRIBUTIONS TO DENALI PROJECTS

- Permission to cross private land to access the construction site
- Access to docks and beaches for unloading materials
- Gravel from local beaches
- Gravel from local gravel pits
- Use of heavy equipment
- Use of local garages, workshops, and tools
- Local transportation, such as pickup trucks, four-wheelers, and boats
- Fuel for heavy equipment and vehicles
- Travel on project owner's aircraft
- Housing for itinerant construction workers (such as vacant homes)
- Fuel and utilities for itinerant construction housing
- Punch list tasks by grantee's regular employees with technical skills
- Volunteers for post-construction cleanup

And, as I've said before, agreements for local contributions need to be negotiated before the commissioners vote to approve a project. Once the Commission has committed to construct, it's unrealistic to expect program partners — or anyone else — to be able to negotiate serious contributions.

If a program partner is unable to negotiate the desired in-kind, the Commission should hire a specialized contractor to handle that aspect of the grant application process. I've previously noted that it may be difficult for the same agency to simultaneously negotiate both local contributions and local cooperation.

[14] *Denali Commission Five Year Strategic Plan (2005-2009)*, p. 4.

Response by Denali Commission's management:

The full response of the Federal Co-Chair is attached as an appendix. He asserts the limited capacity of small places to contribute and notes the commissioners' April 2005 decision to not adopt a *"mandatory cash match to all Commission funded projects."*

Further comment by inspector general:

I have reviewed records of the April 2005 quarterly meeting held in Kodiak, including the verbatim transcript. Staff proposed in writing that it be *"the policy of the Denali Commission that a cash match of at least 10% be provided for all infrastructure projects funded by the Commission."*[15] The commissioners' vote was in support of their verbal motion, *"Shall we reject the cash match policy and leave the current situation status quo?"*[16]

The transcript makes it clear that a mandatory, across-the-board, minimum cash contribution was at issue — not negotiation of local in-kind. Asking cash-poor settlements to find local money is a different matter than asking them to contribute non-cash items that they already have.

The issue is not the comparative resources of a village and the U.S. Treasury. Rather, Congress has authorized the Commission through September 2008,[17] and the agency's available funding simply must be spread as far as possible in helping rural Alaska.

I note again that the extent to which the Commission's projects should be a shared effort — versus just provided — is a sensitive policy decision. In the Commission's enabling legislation, Congress directly specified minimum matches for clinics that range from 20% to 50%.[18] Congress can further address this issue to the extent it deems necessary when it considers reauthorization.

Recommendation No. 2

The state's department of natural resources should be asked to ascertain the status of any public easements pertinent to the beach access at issue.

Land specialists in the state's department of natural resources monitor the status of public easements under both R.S. 2477 and section 17(b) of the Alaska Native Claims Settlement Act. The Governor functions as the Commission's State Co-Chair, and the Federal Co-Chair should request her to ascertain from the department whether any such easements coincide with the beach where barges unloaded the tanks for this project.

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[15] Emphasis added.

[16] Emphasis added.

[17] See P.L. 108-7, 117 Stat. 158, sec. 504.

[18] See Denali Commission Act., sec. 307(c).

Response by Denali Commission's management:

The response of the Federal Co-Chair is attached as an appendix. He responds, *"If the issue has not been resolved shortly we will suggest this option to AEA."*

Recommendation No. 3

A team of commissioners should mediate the important precedent concerning local charges to access the job site.

I describe above the pending dispute over whether AEA's contractor should pay the Unalakleet Native Corporation (UNC) for access to bring the tanks to the job site. This is troubling given UNC's role as a major beneficiary that will control 31% of the completed tankage.

The City of Unalakleet is the project owner — and no bystander to this transaction. The city selected and provided the construction site, but failed to arrange the access implicitly needed to install tanks on it. As detailed above, this conflict seems contrary to promises in both AEA's grant agreement with the city and the operating agreement between the city and its four tenants.

I recommend that the Federal Co-Chair intervene at this point and encourage the city administrator to negotiate a settlement with his tank farm tenants — a settlement that treats the Commission as a welcome partner rather than an outsider.

The operating agreement between the city and its tenants has a clause indicating that, *"[i]f a dispute arises between the parties to this agreement, the parties will attempt to attempt to resolve the dispute through mediation."*[19] I thus further recommend that the Commission dispatch a mediation team to Unalakleet to review with UNC the importance of local effort.

That team should ideally include the commissioners from AFN and AGC, as well the Commission's CFO. The latter should be present for any questions concerning allowable costs under OMB Circular A-87 and federal spending laws.

Response by Denali Commission's management:

The full response of the Federal Co-Chair is attached as an appendix. He indicates that *"[s]o long as the parties involved in the dispute continue to work toward a resolution, to consider intervention in a dispute over access is premature."* He further asserts the following:

> *The Denali Commissioners are charged with the responsibility for due diligence in exercising their voting rights to obligate federal funds. That duty does not reach to determining rights and responsibilities between third parties, nor should it. . .*

[19] *Access, Occupancy, Operations and Maintenance Agreement* (Feb. 2006), section 10.

Further comment by inspector general:

As I've stated in the Commission's latest *Performance and Accountability Report,* the agency's most untapped resource is the commissioners themselves. They're no ordinary board. In the enabling act, Congress has assembled the most esteemed "dream team" of statewide experts since the drafting of the Alaska Constitution.

However, the enabling act actually says very little about Congress' envisioned role for this panel of experts. Literally read, that legislation only specifies that the commissioners as a group will recommend an annual work plan, with projects and funding priorities, to the Federal Co-Chair, who acts on behalf of the Secretary of Commerce.

By institutional custom over the past eight years, the commissioners as a group have considered each grant application and voted their approval at a public meeting. Also, by adopted custom, subsets of the seven commissioners have chosen to function as "subcommittees" that screen categories of applications before they get consideration at meetings of the group as a whole. (Under federal spending law, though, the actual "obligation" of federal funds probably does not occur until the Federal Co-Chair communicates his approval to the grantee.)

While Congress explicitly assembled this blue-ribbon panel of state experts as the "commissioners," Congress appears to have left them considerable discretion to evolve their role. Mediation of a novel, precedent-setting dispute by a commissioner or two would seem an opportunity for the new agency to demonstrate its "value added" in the chain of federal funding. It might also reduce the need for AEA to charge the grant for legal expenses as the dispute continues to fester.

Nevertheless, the Federal Co-Chair should consult his legal counsel if he has concerns about the evolving roles and authority of the other commissioners.

Recommendation No. 4

The Commission's CFO should refine its accounting system to reduce the need for multiple reviews of program partner financial records.

The basic requirement of federal spending law is that agencies transparently track what happens to money from a specific "appropriation." And a specific appropriation is identified in terms of both its congressional source (a subcommittee specifying a purpose) and its year of origin (e.g., "FY06 energy and water").

Transparency is impaired when funds from different appropriations get blended together in an agency's accounting records. The ability to track the end use of specific funding is obscured.

As discussed above, AEA was subjected to an additional review of its financial records when a federal accountant was unable to ascertain the use of his agency's funds from the Commission's own tracking system.

CFOs from AEA and the Commission should coordinate the refinements in the Commission's accounting system that will reduce the need for pass-through funders to obtain their information from program partners. This transparent tracking may require that the Commission limit individual awards to funding from a single appropriation.

AEA has in recent years developed considerable in-house expertise with software that tracks the use of grants. While the Commission tends to shop for solutions within the federal bureaucracy, I encourage the Commission's CFO to explore a potential collaboration that draws upon AEA's local experience.

The inquiries from USDA's field accountant suggested some ambiguity as to the Commission's relationship to AEA for purposes of USDA pass-through funding. Since most of AEA's funding is from the Denali Commission, the latter's CFO should formally clarify with OMB that the Commission is regarded as AEA's *"cognizant agency for audit responsibilities"* under Circular A-133. The agency with that designation should proactively take the lead in coordinating the monitoring needs of other contributors.[20]

Response by Denali Commission's management:

The full response of the Federal Co-Chair is attached as an appendix. He indicates that *"new controls in the accounting system . . . now limit funding and expenditures against only one account and one year, for FY 2007 and beyond."* He indicates that *"[t]his will eliminate the need for auditors to review the records of our program partners per the reference in this inspection."*

Recommendation No. 5

The Commission's program managers should semiannually coordinate school-related projects with the state's school finance director.

The school is always a major institution in Alaska's small rural cities. Some Commission projects have a direct relation to the local school, such as generators, fuel tanks, and teacher housing. Other types of projects, such as community centers, could potentially be physically joined to the school if properly coordinated.

The Commission's program managers should semiannually meet with the state's school finance director to review the following five coordination issues:

- Potential economies of scale from simultaneous mobilization for separate projects in the same community.
- Potential collocation of Commission projects within new or remodeled schools.
- School consumption of electricity or fuel from Commission-funded facilities for the community.

[20] Circular A-133, section 400.

- Schools with less than 15 students that risk closure from discontinued state funding.
- Coverage of any anticipated court-ordered funding increases.

The Federal Co-Chair should arrange these meetings (1) when the school finance division is planning its upcoming construction season and (2) shortly after the legislature has passed the capital budget.

Response by Denali Commission's management:

The full response of the Federal Co-Chair is attached as an appendix. He indicates that *"[w]e have conferred with Eddy Jeans, the State's school finance director, and will continue regular coordination with him in planning future energy projects, and considering collocating schools with other community projects."*

Recommendation No. 6

Commission grants should include a provision for visiting engineers to inspire science careers through talks at the schools in project communities.

Alaska recently applauded its first homegrown astronaut as he piloted the space shuttle. And Alaska's homegrown director at the National Science Foundation[21] recently urged the Commission to partner with schools in promoting science careers.

The Commission uses program partner AEA to tackle rural energy needs in some of the most challenging locations in America. In my inspections this fall, I've watched AEA build on a mountainside, over frozen ground that must never be allowed to thaw, and in the interior where winter can drop to –50° F. And, using the Internet, engineers can diagnose the vital signs of AEA generators — even their engine sounds — from anywhere in the world.

The technical ingenuity applied in these settings can rival that seen on popular television's *Modern Marvels.*

The Commission should require that AEA's "hard bids" include a provision that the contractor send an engineer to inspire a local science class at some point in the project. For AEA's "force account" projects, its own engineer should do the honors during a field visit. This will be comparable in spirit — but far less costly than — the requirement by the Municipality of Anchorage that capital projects include a work of public art.

The Denali Commission provides rural settlements with basic facilities that the rest of the nation has long taken for granted. But the real, long-term future of the "other Alaska" lies in education — not the harvesting of grants or the buildings they fund. The precise form that bush education should take is perhaps Alaska's toughest policy question.

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[21] Former Alaskan Anna Kerttula is now the program director for arctic social sciences at the National Science Foundation in Washington, D.C.

While those long-term solutions evolve, the Commission can take this small, but meaningful, step to acquaint rural students with the possibility of a career in the sciences.

Response by Denali Commission's management:

The full response of the Federal Co-Chair is attached as an appendix. He indicates that he *"will discuss this issue with staff and our major partners."*

ANCILLARY REPORTS

This is the first inspection of this project by the Commission's inspector general.

This project has not been the subject of any audit reports issued by Congress' Government Accountability Office (GAO) or the state's Division of Legislative Audit. AEA does not have an internal auditor.

Three years ago, GAO issued an audit report concerning nine Alaskan communities threatened by floods and erosion. Unalakleet was one of the rural cities that GAO studied:

> *Unalakleet experiences both coastal and river flooding, which, when combined with shoreline erosion, have created an access problem at the harbor. Eroded land has piled up at the harbor mouth, creating six distinct sandbars. These sandbars pose a serious problem for barge passage; barges and fishing boats must wait for high tide to reach the harbor, delaying the delivery of bulk goods, fuel, and other items, which increases the costs of the cargo and moorage. . .*[22]

GAO noted the need for federal agencies to consider any relocation plans before making grants to build in rural Alaska. However, Unalakleet was not in "imminent danger" and the residents were not planning to move the city to another location.

Program partner AEA is a state agency and annually obtains a single audit for itself from a CPA firm. Neither the latest audit report (for the state's FY06) nor the associated management letter signal any matters of concern to the Denali Commission. The CPA firm considered AEA to be a low-risk auditee for purposes of federal OMB Circular A-133.

INSPECTION PROCESS

My inspection was conducted in accordance with section 2 of the Commission's standard grant assurances, section C(1) of the subgrantee's agreement with AEA, sections 4(a) and 6(a) of the Inspector General Act, and the *Quality Standards for Inspections* issued by the federal Executive Council on Integrity and Efficiency. An "inspection" is narrower in scope and procedures than the classic financial "audit."

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[22] GAO, *Alaska Native Villages: Most Are Affected By Flooding and Erosion, but Few Qualify for Federal Assistance,* GAO-04-142 (Dec. 2003), page 39.

During this inspection, I was accompanied by the city's public works director and the contractor's on-site superintendent.

The city's new tank farm was the subject of this inspection. However, to understand the project's context, I also visited the local school and the new clinic (the Commission contributed $3.6 million toward the latter's construction).

I visited the mayor and city administrator at the city hall. The operations manager for the health corporation showed me the new clinic.

One of the Commission's prior inspector generals also accompanied me during my inspection, and I appreciated the insights derived from his many years of experience.

On December 21, 2006, the Federal Co-Chair was provided a draft of this report and invited to comment on my proposed conclusions and recommendations. He was encouraged to consult his staff, AEA, and any other parties as desired in the preparation of his response. AEA was provided a copy of my draft report for this purpose.

The Federal Co-Chair's response was received on January 16, 2007 and is attached as an appendix.

The Commission's implementation of recommendations will be summarized in my semiannual report filed with Congress under the Inspector General Act.

Mike Marsh

Mike Marsh, Esq.
Inspector General

Appendix

Federal Co-Chair's Response

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January 17, 2007

Mike Marsh
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Re: Response to draft inspection report of Unalakleet bulk fuel storage facility

Dear Mr. Marsh:

Thank you for your recent inspection report on the Denali Commission funded Unalakleet bulk fuel storage facility. This important project serves 700 rural residents who depend on this infrastructure for power and to heat their homes and businesses year round.

The initial earthwork for this project was performed in late summer and fall of 2005 and final design documents were prepared for issuing an Invitation for Bid (IFB) for a "hard-bid" contract award. While Hankal Construction was the low bidder, all bids exceeded the government estimate, and in April 2006, Hankal was awarded a Firm Fixed Price Contract.

As noted in your Draft Report, your inspection had a dual purpose which the Commission enthusiastically supports, namely, "to confirm (1) activity at the project site and (2) the traceability of expenditures with the total reported" on OMB Form 269 to the Denali Commission. I am pleased that both were apparently satisfactory.

In preparing this response we met with Alaska Energy Authority (AEA) staff to discuss and consider the issues you raise. AEA is our major program partner in delivering our largest program, energy, and we are proud of our relationship with them. An obvious advantage to this partnership is the desire by both sides to look for ways to improve our collaboration so that rural Alaska benefits in a measurable way. (As a side note, we are particularly pleased with your assessment that the challenges presented by building on permafrost were noted, and in the case of Unalakleet, were met successfully.)

I offer comments on your six draft recommendations:

Recommendation No 1. Priority should be given to communities that emphasize grant leveraging rather than grant harvesting.

The Commission, in coordination with other federal funding agencies and our program partners, works actively to encourage community contributions. Our partners have made

Appendix

Federal Co-Chair's Response

stronger efforts in recent years to find in-kind community match or other sources of contributed funds for projects. For example, King Cove (administered by AEA) has provided a cash match on the bulk fuel project planned for their community, and Alaska Village Electric Cooperative (AVEC) has successfully acquired partial project funding from Alaska Community Development Quota Program (CDQ) organizations and others.

However, few small communities have substantial cash resources to contribute to a project, and may not own heavy equipment or local housing to be contributed on an "in kind" basis. Owners of privately owned equipment are often reluctant to forfeit the use of their equipment to a project for the "Public Benefit."

The Commissioners wrestled with this issue in January 2005 when they considered a mandatory cash match to all Commission funded projects. After remanding the discussion to public input, the issue was put to a vote at the quarterly meeting April 28, 2005 in Kodiak: the motion to **not** adopt the match policy was approved.

We will give additional thought to the role of the Denali Commissioners, the staff, and our program partners in ensuring the right mix of local contributions. Sometimes, by necessity, the Commission votes to approve a project subject to numerous conditions unresolved at the time, but to be worked out by the parties. Other times, detailed local contributions are outlined, for example in a business plan, and brought to the commission as a fait accompli.

I do not fault a private equipment owner, or even a land owner for charging for the use of a particular asset. There is growing consensus among researchers, for example, that a Native Elder should be paid for providing insightful cultural information. Why should his knowledge differ from any other consultant? We need to review each case on its merits.

Recommendation No 2 The state's Department of Natural Resources should be asked to ascertain the status of any public easements pertinent to the beach access at issue.

If the issue has not been resolved shortly we will suggest this option to AEA.

Recommendation No 3 A team of commissioners should mediate the important precedent concerning local charges to access the job site.

You have recommended the Denali Commissioners themselves should intervene in the post-award grant process to personally mediate disputes between third parties. In the present case, Unalakleet Native Corporation, a beneficiary to the bulk fuel project, is attempting to charge the contract for beach access to off load materials for construction of the bulk fuel facility.

The Denali Commissioners are charged with the responsibility for due diligence in exercising their voting rights to obligate federal funds. That duty does not reach to determining rights and responsibilities between third parties, nor should it. A better approach would be for grantees to include a professional mediation clause in their sub-grant and/or contract award documents with the parties agreeing to split the associated costs.

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I would note that construction on this project continues. The Unalakleet Bulk Storage Facility Award is not fully completed (there are 17 additional storage tanks yet to be installed, 9 were completed as of your inspection). So long as the parties involved in the dispute continue to work toward a resolution, to consider intervention in a dispute over access is premature.

Recommendation No 4 The Commission's CFO should redefine its accounting system to reduce the need for "tag team" reviews of program partner financial records.

It would not be appropriate for the Commission to offer public comment on the decision by another federal agency to audit a particular grantee's books and records. Furthermore, the USDA-RD auditor was not reviewing his agency's funding of this project, so this issue does not seem germane to your review.

The Director of Administration, who you refer to inaccurately as CFO, has implemented new controls in the accounting system. These controls now limit funding and expenditures against only one account and one year, for FY 2007 and beyond. This will eliminate the need for auditors to review the records of our program partners per the reference in this inspection.

Recommendation No 5 The Commission's program managers should semiannually coordinate school-related projects with the state's finance director.

Coordination with state government is essential to the successful collaboration for which the Commission is well-known. The Department of Education has a capital projects list available to the Commission and its program partners. Evaluation of planned infrastructure or other new projects anticipated in a community are part of the assessment and design process.

We have conferred with Eddy Jeans, the State's school finance director, and will continue regular coordination with him in planning future energy projects, and considering co-locating schools with other community projects. Because the school construction project priority list is provided by the Education Department to the Legislature, who decides which projects to actually fund, dates of funding availability and project construction in a specific community may not always mesh with other project priorities. Mr. Jeans also confirmed the state does not consider pending lawsuits when updating the priority list. At the time this project was proposed for funding, neither we nor AEA was aware of the pending case you reference; but I do not believe it should be a normal consideration of the Commission in granting project funds if we are not party to such a suit.

As Federal Co-Chair, I will be meeting with the Commissioner of Education in the near future, and will emphasize the need to work more closely together.

Recommendation No 6 Commission grants should include a provision for visiting engineers to inspire science careers through talks at the schools in project communities.

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I have long believed that professionals who work throughout Alaska have an obligation to share their knowledge and talents with local students. I will discuss this issue with staff and our major partners.

I appreciate the opportunity to comment on your observations and recommendations from your site visit to Unalakleet this past September. Your candor and obvious desire to assist the Denali Commission in making a positive and measurable difference in the lives of rural Alaskans benefits all Alaskans.

Sincerely,

George Cannelos
Federal Co-Chair