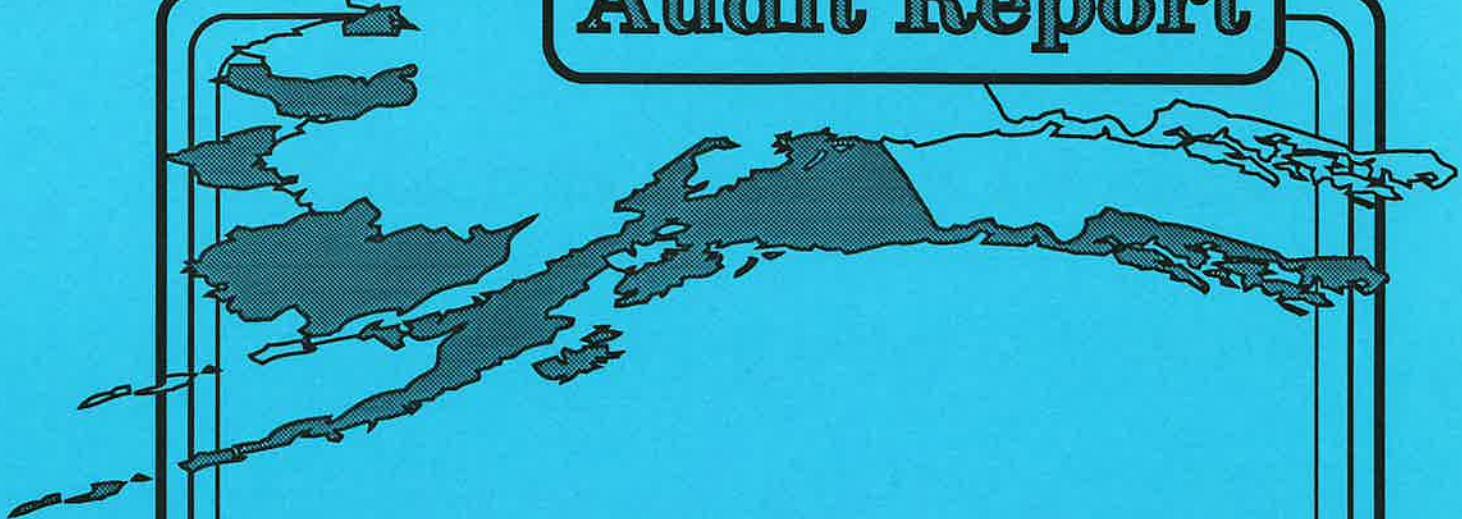
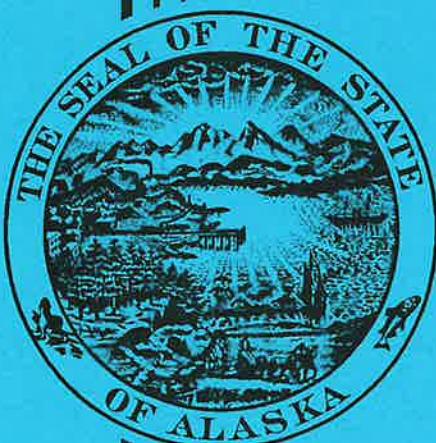


Audit Report



**DEPARTMENT OF COMMUNITY AND
REGIONAL AFFAIRS
DISSOLUTION OF THE ALASKA
ENERGY AUTHORITY AND
TRANSFER OF PROGRAMS**

May 27, 1994



Audit Control Number:

21-4488-94

**Division of Legislative Audit
P.O. Box 113300, Juneau, Alaska 99811-3300**

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DIVISION OF LEGISLATIVE AUDIT

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May 27, 1994

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS DISSOLUTION OF THE ALASKA ENERGY AUTHORITY AND TRANSFER OF PROGRAMS

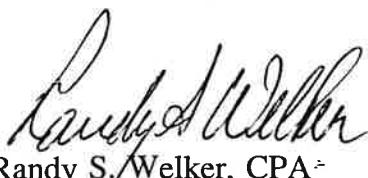
May 27, 1994

Audit Control Number

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The audit addresses the sequence of events and legislation surrounding the dissolution of the Alaska Energy Authority, the identification of the programs and energy assets transferred to the Alaska Industrial Development and Export Authority and the newly created Division of Energy, and the impact the dissolution and program transfer had on the delivery of services.

The audit was conducted in accordance with generally accepted government auditing standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology section on page one.



Randy S. Welker, CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted a review of the transfer of energy related programs from the Alaska Energy Authority (AEA) to other state agencies. The program transfers were a result of legislation (Chapters 18 and 19, SLA 1993) which affected the following Alaska Statutes:

Title 37.05.520	Railbelt Energy fund
Title 42.05	Alaska Public Utilities Commission Act
Title 42.45 (<i>new chapter</i>)	Rural and Statewide Energy Programs
Title 44.47.050	General powers and duties of DCRA
Title 44.83	Alaska Energy Authority
Title 44.88	Alaska Industrial Development and Export Authority

The legislation dismantled AEA, reducing both its responsibilities and duties while also transferring rural and urban energy projects and programs to two different departments. Rural programs are now administered through the new Division of Energy (DOE) within the Department of Community and Regional Affairs (DCRA). Other energy assets were transferred to the Alaska Industrial Development and Export Authority (AIDEA) within the Department of Commerce and Economic Development. The legislation also contained a provision directing agencies to contract with the private sector for service delivery to the maximum extent feasible.

Objectives

The primary objective of the review was to gain an understanding of the impact the new legislation had on the delivery of rural energy program services. A secondary objective was to review the process transferring energy programs from AEA to DCRA.

Specific objectives of the review were to:

1. Review the process leading to the dissolution of AEA.
2. Review the transition process from AEA to the new DOE within DCRA.
3. Determine the impact of the transition from AEA to DOE on the delivery of rural energy program services.
4. Review and report on the status of the Circuit Rider Maintenance Program.

Scope

We focused our review primarily on the management of the former AEA and DCRA relating to the transfer of rural energy programs and the organization of the new Division of Energy. Additionally, we reviewed the transition of other AEA programs that transferred to AIDEA.

Methodology

Our evaluation of the program transfers and the associated impact involved review and analysis of the following documents, interviews, and issues:

1. “Dissolution” legislation and bill history.
2. Pertinent legislative committee minutes.
3. Multiple transitional organizational plans.
4. AEA and AIDEA annual reports.
5. AEA financial statements and management letters.
6. Reading files of, but not limited to:
 - DCRA commissioner
 - DCRA deputy commissioner
 - DCRA/Division of Administrative Services director
 - Former AEA Executive directors
 - DCRA/DOE directors
 - Key energy program staff
7. Personnel files.
8. Accounting issues involved in the transition.
9. AIDEA bond counsel committee minutes.
10. AIDEA board minutes and the development of Joint Action Agencies (JAA).
11. Various AEA sponsored studies regarding strategic energy planning and bulk fuel issues.
12. AEA/DOE project files pertaining to rural projects.
13. Pertinent Department of Law legal opinions.

14. Meetings and discussions with:

- Past AEA executive directors, key program managers, and employees
- Executive director and key program managers of AIDEA
- Bond counsel for the four dam pool committee and the Bradley Power Management Commission (BPMC)
- Former and current Division of Energy directors
- Current DOE staff, including program managers and engineering personnel
- Staff to the Alaska Public Utilities Commission
- Contractors administering the privatized Circuit Rider Maintenance Program
- Members of the Rural Alaska Power Association
- Officials of the Alaska Village Electric Cooperative, Inc.
- Private sector power developer
- Various other rural Alaska power providers
- Various DCRA officials

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ORGANIZATION AND FUNCTION

Prior to enactment of Chapter 18, SLA 1993 (SB 106), both the Alaska Industrial Development and Export Authority (AIDEA) and the Alaska Energy Authority (AEA) were fully structured public corporations. They had the powers of a private corporation and each had its own Board of Directors, yet were agencies which were created to carry out tasks on behalf of the State.

ALASKA ENERGY AUTHORITY

Created in 1976, the original stated purpose of AEA was:

... to promote, develop, and advance the general prosperity and economic welfare of the people of the state by providing a means of constructing, acquiring, financing and operating power projects and facilities that recover and use waste energy.

To meet this objective AEA evaluated, constructed, and operated numerous power projects in addition to providing technical assistance programs, grants, loans, and bond financing. AEA has helped provide electricity to more than 200 communities. AEA owned and operated six hydroelectric dams and more than 420 miles of transmission lines; its assets exceeded \$1 billion.

Upon enactment of the new legislation, the corporate structure of AEA was retained to maintain the integrity of its bonds, however its role in the construction and acquisition of energy projects was repealed. AEA's operating assets and financing abilities were transferred to AIDEA. The legislation also transferred AEA's other programs to the newly established Division of Energy (DOE) within the Department of Community and Regional Affairs (DCRA).

DIVISION OF ENERGY

Located within DCRA, DOE's stated mission is:

... to assist in the development of safe, reliable, and efficient energy systems throughout Alaska, that are financially viable and environmentally sound.

To achieve its mission, DOE has established an energy strategy that emphasizes the following three goals and corresponding objectives:

1. Affordable, safe, reliable, and efficient energy for all Alaskans

DOE's objectives for this goal include addressing issues surrounding the purchase and storage of bulk fuel, developing demonstration projects which use local fuels as an alternative to diesel, development of hydroelectric resources, assessing the feasibility

of incorporating water and waste water system maintenance and operation into the services provided by rural electrical utilities, working with the legislature and Alaska Public Utilities Commission to provide incentives under the Power Cost Equalization program for utilities to invest in energy efficiency and operational cost reductions, and placing emphasis on developing electrical interties.

2. Self-reliant electric utilities

Measures to address this goal include encouraging private investment in rural utilities, developing the skills in rural Alaska to achieve self-sufficiency through operator training and development of utility business strengths, promoting professional utility management, assisting utilities in developing business plans to independently finance and develop generation and transmission systems, performing management audits to ensure rates cover all costs of utility operation, encouraging voluntary consolidation of utilities, and developing an investment plan that qualifies utilities for various levels of state investment.

3. An effective energy policy

Means to achieve this goal include assessment of rural electric utility capabilities and needs; continual examination of trends in energy resources, technologies, distribution systems, energy demand, and state revenue and population forecasts; provide utility management assistance to encourage economies of scale; implementation of Bulk Fuel Task Force recommendations; coordination of energy system investments with housing and sanitation projects; provide statistical information on utility operations; and, review existing state energy programs with attention to coordinating the efforts of other agencies and programs.

With this new mission statement and energy strategy goals and objectives, DOE is placing emphasis on lowering the costs and increasing the safety and reliability of rural power systems. These areas are being addressed by continuing and modifying, as needed, those programs that have been transferred from AEA. However, those programs remain similar in type, nature, and title. Specifically, DOE rural programs include:

OPERATION, TECHNICAL AND EMERGENCY ASSISTANCE (OTE) An "umbrella" program designed to provide a wide range of energy systems assistance to rural communities and utilities. Components of this program are:

- Emergency Prevention (EP): Designed to prevent a potential emergency situation before disasters occur, including standby equipment, procurement of materials, and servicing through the Circuit Rider Maintenance Program.
- Rural Technical Assistance (RTA): Providing technical assistance for rural utilities to aid in the evaluation of the needs and deficiencies of energy systems and facilities within a community.

- Rural Utility Training (RUT): Facilitates formal technical training of rural utility operators.
- Meter Installation and Data Acquisition: Provides for adequate metering of rural utilities and installation of monitoring devices for recording and transmission of time-coded data. This component also facilitates the training of operators to accurately read and record meter data, which provides necessary information for planning purposes.

ELECTRIC SYSTEM LIFE, HEALTH, AND SAFETY IMPROVEMENTS (LHS)
Developed to provide funding for correction and prevention of hazards which may exist or may pose a potential threat to life, health, and safety in rural communities. Whenever possible, funds are leveraged against local matching funds.

RURAL POWER SYSTEMS UPGRADES (RPSU) Provides funds for system upgrades that have been identified through Rural Technical Assistance, the Circuit Rider Maintenance Program, the local community or the legislature. Projects may include efficiency improvements, line assessments, lines to new customers, and other repairs to generation and distribution systems.

RURAL UTILITY REGIONALIZATION, CONSOLIDATION, and BUSINESS MANAGEMENT Promotes achieving the establishment of self-supporting rural utilities without continuous state assistance. This is to be achieved through (1) development of partnerships between utilities, (2) consolidation of small and independent utilities into a regional utility entity, and (3) training of utility business managers and operators.

EMERGENCY BULK FUEL REPAIRS and SPILL PREVENTION Creates incentives and mechanisms to repair bulk fuel systems before a crisis. The program provides for emergency repairs to bulk fuel storage and handling systems in rural communities. Priority is given to those communities where fuel vendors or regulating agencies have threatened to stop delivery of fuel; where conditions have become a life, health, or safety matter; or the environment is threatened.

BULK FUEL SYSTEM UPGRADES Assists private owners in recognizing the need for improving their systems to meet minimum standards. The program funds the design and upgrade of bulk fuel storage and handling facilities in rural communities that are dependent upon seasonal fuel delivery which requires large storage capacity.

ELECTRICAL SERVICE EXTENSION FUND Matching grant program that provides up to 60% of the cost of site preparation and construction for extending electrical service to private residences and small businesses not currently served by an electrical utility and, as a second priority, for making improvements to existing utilities.

STATEWIDE ELECTRIC and POWER PROJECT DEVELOPMENT Provides for the engineering, environmental, and economic analysis of power projects throughout the State. A primary objective is to respond in a timely manner to requests from legislators, utilities,

and communities on power project proposals, and develop a multi-year plan for implementation.

ALTERNATIVE and APPLIED ENERGY TECHNOLOGY DEVELOPMENT Funds provided for development, design, construction, demonstration, and/or operational testing of technological enhancements to energy systems. Such enhancements include coordinating the efforts of energy research groups.

CIRCUIT RIDER/EMERGENCY RESPONSE SERVICES Provides for a preventative maintenance assessment and response service for emergency work required on rural electrical systems. The program is intended to be an "interim fix" until long-term planning can address the problems.

In addition to the operational programs listed above, DOE administers the following loan programs:

POWER PROJECT FUND Provides loans to local utilities and eligible governmental entities for the development of new small-scale power production facilities, and facilities for conservation, bulk fuel storage, transmission and distribution, or potable water supply projects. The amount is based on the borrower's need, its ability to repay the loan, and the balance available in the fund. Loans have a maximum term of 50 years.

RURAL ELECTRIFICATION REVOLVING LOAN FUND At present, this fund services outstanding loans only. The fund was originally established to provide assistance to local utilities for extending electrical service into previously unserved areas.

BULK FUEL REVOLVING LOAN FUND Provides loans in amounts up to \$100,000 to rural communities with populations of under 2,000 for the bulk purchase of petroleum fuels. Loans are to be repaid in one year or less, communities must show a history of loan repayment and credit worthiness, and loans must be repaid in full before another loan is approved.

SOUTHEAST ENERGY FUND A grant fund established by the legislature in 1993. Provides grants to utilities participating in the power transmission intertie between Swan Lake and Tyee Lake hydroelectric projects.

POWER COST EQUALIZATION (PCE) and RURAL ELECTRIFICATION AND CAPITALIZATION FUND This program/fund was established to reduce electric rates by consumers in rural communities where diesel-fired generators provide most of the local electrical needs. The program aims to equalize the power cost per kilowatt hour statewide, at a cost close to the average cost per kilowatt hour in Anchorage, Fairbanks, and Juneau. The fund also makes grants to utilities to improve performance of the utility.

The Division of Administrative Services (DAS) within DCRA provides support for the various functions utilized by other divisions. DOE utilizes support services to handle such

functions as payroll, personnel actions and other personnel matters, contract accounting, procurement, internal auditing, and financial accounting.

With the transfer of AEA programs and employees, DAS received additional positions. These positions will supplement the administrative support already received from DAS by providing specialized services unique to DOE operations. Some of these duties are:

- Administration of PCE program
- Administration of the bulk fuel and other loan and grant programs
- Energy systems specialized capital project accounting
- Procurement services for selection of contractors and for privatization of program services
- Personnel to aid in the process of classification of formerly exempt employees
- Transfer and archiving of all records and property from AEA to DOE

ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY (AIDEA)

Established as a public corporation in 1967, AIDEA's primary mission has been the financing, promotion, and development of various commercial projects. This mission is accomplished by providing and facilitating various means of financing of industrial, manufacturing, export, and business enterprises and facilities within the State. AIDEA's stated purpose is to:

... promote, develop, and advance the general prosperity and economic welfare of the people of Alaska, to relieve problems of unemployment, and to create additional employment.

AIDEA addresses its mission and purpose by:

1. Providing various means of financing of industrial, manufacturing, export, small business and business enterprises, and other facilities in the State;
2. Owning and operating enterprises and other facilities;
3. Fostering expansion of exports of Alaska goods, services, and raw materials;
4. Promotion and advancement of export trade activities in the State;
5. Establishing funding credit guarantees and insurance to support export development; and,
6. Providing and/or participating in financial assistance in support of export transactions.

With the dissolution of AEA and the transfer of rural energy programs to DCRA, the remaining energy assets and operating power projects were transferred to AIDEA. To ensure the integrity of AEA bonds, the Energy Authority continues to exist as a public corporation,

however, it no longer has the authority to acquire and construct projects. The AIDEA board of directors and executive director serve in the same capacity for the Energy Authority.

BACKGROUND INFORMATION

The original purpose of the Alaska Energy Authority (AEA) was to evaluate and, where feasible, construct hydroelectric projects to provide power to the urban areas of the State. In the early 1980s AEA's purpose was expanded to include providing for the energy needs of rural Alaska.

With the large projects nearing completion, AEA increased its attention to rural communities. Many programs were created to aid in various areas of concern which affected rural Alaska. The coordination of these programs, along with the development of alternative and applied technologies, represented a fundamental shift in direction for AEA.

As Bradley Lake, the last of AEA's major hydroelectric projects, neared completion, state policy-makers began to reconsider and reevaluate the role of the agency.

Strategic energy plan proposed a different role and possible dissolution of AEA

In January 1993, a consultant, R.W. Beck and Associates, completed a long-term strategic plan for AEA. The Beck plan noted that AEA performed distinct and different roles in the service it provided to urban areas of the State compared to that of rural Alaska. For urban areas of the State, AEA owned and operated hydroelectric projects and sold energy to various utilities. This power was carried over transmission lines, many of which were also constructed and owned by AEA. In rural Alaska, AEA was responsible for building and maintaining independent power generation facilities. AEA had a major presence in rural Alaska, assisting local communities in acquiring generators, constructing the necessary transmission lines, and training local resident operators.

Anticipating a substantial reduction in future state oil revenues, the Beck strategic plan proposed a shift in responsibility for the future development and maintenance of both rural and urban energy systems. The Beck report presented nine "organizational options" to address Alaska's energy needs. Briefly, those nine options were:

1. Complete dissolution of AEA, with utilities and local communities meeting their own electrical needs without financial or other assistance.
2. AEA becomes a division of the Alaska Industrial Development and Export Authority.
3. Replace AEA with a Joint Action Agency (see following discussion).
4. AEA remains unchanged — maintaining the status quo.
5. AEA organization remains unchanged with expanded board of directors.
6. AEA becomes a member of an Alaskan Joint Action Agency (basic organization of AEA remains unchanged).
7. Move AEA to the Department of Community and Regional Affairs (DCRA).
8. Reduce size and responsibilities for AEA.
9. Separate urban from rural programs.

For rural systems the plan also presented the concept of “regionalization,” to address the lack of economies of scale. The Beck strategic plan discussed the need for regionalization as follows:

One of the most difficult issues facing the provisioning of services in [rural] Alaska is economy of scale. The perpetuation of direct State funded grant and subsidy programs do not provide long term solutions to the problem. An integral part of the new strategic direction should be to use the very subsidy programs that have not encouraged the small systems to be economical as inducements to improve the efficiency of operations¹ in [rural Alaska].

This plan endorses a strategy that would work toward providing [rural Alaska] electric system funding only through regional or local utilities that meet a prescribed standard of performance. [These utilities would be] . . . motivated to reduce future costs by gaining increasing economies of scale. Such regional utilities would add communities to their service areas and be entirely responsible for the operation of the local system.

The strategic plan suggested that a move towards “regionalization” of energy systems can be managed by an agency other than AEA. The Beck strategic plan also suggested that DCRA would be better suited to do so since the department is most concerned with local infrastructure.

The plan proposed shifting management of larger power systems to a group of user utilities

The strategic plan also proposed ownership responsibility for the major hydroelectric projects and transmission lines be conveyed to what are termed “joint action agencies” (JAAs). Under the plan JAAs would be made up of two or more entities participating in construction and operation of generating or transmission facilities as tenants in common. A JAA would be mutually responsible for the operation and maintenance of a given facility or project. Such JAAs would operate under agreed upon provisions for administering their joint responsibilities.

According to the strategic plan, JAAs would be responsible for coordinating and financing the construction of any new facilities. However, the plan recognized that there may be some resistance to the formation of JAAs by the State’s utilities. It was asserted in the plan:

There will be those that will want to perpetuate the status quo for as long as possible — because they may think that their self interests are best served by taking what they can get while they can get it, or because change always entails risk. However, when looking at what would be best for the State and also serve the utility industry, the JAA is the best solution.

¹The Beck strategic plan further suggested the State’s Power Cost Equalization (PCE) program should be modified to recognize and reward efficient operating systems.

Under the Beck strategic plan, AEA's functions would be absorbed either by existing state agencies or by a new JAA consisting of various utilities that served the State's urban areas. The plan felt it was crucial that AEA functions transferred to state agencies complimented the functions and responsibilities of the agency involved, encouraging the reorganization to be accomplished quickly. The estimate of the plan indicated a narrow window of opportunity existed, between 1992 and 1994, for putting all the elements together for implementation.

Legislation directed that AEA be restructured, similar to proposals made in the strategic plan

In 1993, legislation was enacted that resulted in the dismantling of AEA. The legislation reflected some of the tenets discussed in the Beck strategic plan. The legislation included three significant strategic plan concepts:

1. Greater reliance on the private sector — the strategic plan suggested that the State should withdraw from its far-reaching involvement with energy development and production. The legislation directed that DCRA, which was now responsible for AEA's rural energy programs, utilize the private sector. Specifically, the legislation established AS 42.45.410 which requires that "*the department shall, to the maximum extent feasible, carry out its powers and duties by entering into contracts with appropriate entities in the private sector.*"
2. The JAA concept and an accompanying shift of responsibility to urban utilities — the legislation established AS 42.45.300 which states in part:

two or more public utilities may form a joint action agency for the purpose of participation in the design, construction, operation, and maintenance of a generating or transmission facility. . .

The legislation directed that AEA's responsibilities for operating and maintaining various hydroelectric projects and transmission facilities be transferred to AIDEA. In turn, it was AIDEA's objective to utilize the newly recognized JAA entities to carry out AEA's operational responsibilities. AIDEA management felt this approach was consistent with both the overall intent of the legislature² and the proposals set out in the Beck strategic plan.

²In a letter that accompanied the 1993 legislation that dismantled AEA, the legislature stated it was their intent that AEA (which became a much smaller entity under the auspices of AIDEA):

. . . expeditiously implement a plan to reduce the agency's role in providing direct services with state employees, and instead provide those services by contracting with the private sector, regional utilities, or other state agencies.

3. Emphasis on regionalization of small, rural electrical generating facilities — the Beck strategic plan observed that:

Alaska . . . has a large number of isolated communities not connected by electric transmission systems. . . . In rural areas, electric generation and distribution are frequently antiquated and hazardous. . . . There continues to be a need for the development of the basic infrastructure, including electricity.

In order to address these concerns, the legislation's preamble of intent states that the direct participation by the State is necessary to assist in the development of a regional electric transmission infrastructure. Additionally, the legislation permits the department to promote cooperative solutions to problems affecting more than one community or region, including joint service agreements, regional compacts, and other forms of cooperation.

Since these concepts were an integral part of the transition legislation, they had a large impact on the way various AEA programs and responsibilities were transferred or "transitioned." The way in which the Circuit Rider Maintenance Program (CRMP) was "transitioned" best exemplified how these strategic concepts were implemented.

AEA designated the CRMP as a program that could be contracted out to the private sector

AEA's circuit rider program was designed to assist village electric utilities in the routine operation and maintenance of their electrical systems. Prior to transition, the program was staffed with AEA technicians and engineers. AEA staff visited various rural communities as necessary to inspect the condition and operation of powerhouse plants and transmission facilities. These inspections and repairs, termed technical assistance, were provided to various local utilities in addition to allowing AEA staff to train local residents in the operation of their facility.

The strategic plan specifically targeted this activity as being one that should be transferred out of AEA. The Beck plan suggested that the circuit rider program be transferred to designated regional or local utilities. The legislation dismantling AEA offers more direction, but emphasizes the use of the private sector. Under the statute setting terms for assistance to rural utilities, the legislation under AS 42.45.400 (b), states: "*in providing rural utilities with technical assistance and training, the department shall give priority to contracting with the private sector for these services.*"

AEA attempted to structure the CRMP contract to promote regionalization

Since it was statutorily mandated to privatize to the maximum extent feasible, AEA administration developed an invitation to bid (ITB) to solicit contractors to perform the CRMP. However, AEA was also interested in the promotion of the concept of

regionalization. Accordingly, as a means to achieve the regionalization of utilities, AEA attempted to structure the ITB to restrict bidding to regional utilities only.

By this limitation of bidders, AEA intended to promote a working relationship between larger regional utilities in rural Alaska and small isolated community utilities. Such a strategy was consistent with the concept put forth in the Beck strategic plan. However, the Attorney General advised that insufficient justification had been presented to conclude a restriction of bidders was allowable under state procurement laws. The ITB was then widely distributed and three contractors were selected to perform circuit rider services.

During the period the ITB for Circuit Rider services was developed and distributed, the DCRA was wrestling with assimilating the many former AEA rural programs into the department. The approach to organizing the programs into the new Division of Energy was disjointed and, at least in the short term, impacted the delivery of rural energy program services.

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REPORT CONCLUSIONS and RECOMMENDATIONS

Management of the transition of rural energy programs was, at times, haphazard

The legislation requiring the dissolution of the Alaska Energy Authority (AEA) and the transfer of rural programs set a deadline for completion of the transition. In addition, the legislation required that the transition be carried out in an orderly fashion. Specifically, Section 38 of Chapter 18, SLA 1993 required:

... the governor, the Department of Community and Regional Affairs, the Alaska Energy Authority, and the office of management and budget shall implement this Act in an orderly fashion. The transfer of rural programs operated by the Alaska Energy Authority to the Department of Community and Regional Affairs must be completed no later than December 31, 1993 . . .
[emphasis added]

In implementing the transition, the upper management of the Department of Community and Regional Affairs (DCRA) focused on, as its primary goal, meeting the legislatively mandated deadline. However, in our view, DCRA's emphasis on the deadline contributed to the department not meeting the other mandate of this section — to implement the transition in an orderly fashion.

DCRA did not adopt and consistently follow a logical, methodical approach to managing the transition of AEA's rural energy programs. For a period of four to five months DCRA took two different approaches to the reorganization and staffing of AEA's rural energy programs. These two organizational focuses were not well coordinated, often appeared to be developed at cross purposes, and were not consistently communicated between DCRA's upper management and the division directors that were also charged with reorganization. These two focuses collided in October 1993 with the resignation of the Division of Energy (DOE) director and again in February 1994 with the resignation of DOE's third director.³

One organizational plan was under development by the first DOE director. Under the DOE director's approach, interviews were conducted with key program staff and a listing of likely candidates for various positions was developed based upon experience and abilities. In August 1993, the then-DOE director testified to the House Finance Committee regarding desired staffing levels. Based upon his analysis, the minimum number of positions required to continue the mandated energy programs was approximately twenty-five positions within the energy division — provided that all accounting functions were transferred to DCRA.

At the same time, not entirely known by the DOE director, the DCRA commissioner's office was also developing a number of possible organization scenarios. The commissioner's office initial approach to staffing the new division appears to have been based less on an

³There have been four (permanent and acting) directors since July 1, 1993.

assessment of individual qualifications and skills, but rather on an arbitrary "maximum" number of positions — notwithstanding the statutory program requirements and the amount of funding available for personal services. Also, at an August 1993 meeting of DOE and commissioner's office representatives, the DOE director was provided a list of names (which was rejected by the director) who would **not** be retained in the new division — an action which further demonstrates the subjective manner in which the commissioner's office was proposing the new organization.⁴

Despite the DOE director's efforts at establishing an organization and ensuring as smooth as possible transition, in October 1993 the DCRA commissioner's office unilaterally developed an organization plan — a plan which did not have the director's input and one which eliminated the director's personally appointed special assistant. This plan was presented to the director by the DCRA deputy commissioner. After unsuccessfully objecting to the proposed organization, the director resigned effective October 19, 1993.⁵ An acting director was appointed during the interim. On November 19 and 29, 1993, a new DOE director and deputy director, respectively, were appointed.

In our view, the commissioner's office involvement in the structuring of the organization was motivated more by the removal of select individuals, rather than having been based on any objective assessment of programmatic needs or individual qualifications.

The new director and deputy director assessed and evaluated professional and technical staffing requirements necessary to complete the developing backlog of rural energy projects. The director determined that additional positions were necessary to perform the division's duties. On February 4, 1994 a budgetary presentation, detailing the need for additional positions, was made in the commissioner's office by the director. On February 7, for yet unclear reasons, the commissioner dismissed the director and as a result the deputy director resigned in protest.

⁴Corroborating testimonial evidence supports this conclusion, including our discussions with the DCRA deputy commissioner. The deputy commissioner stated, during a lengthy interview, that staffing decisions were based on "people" rather than "positions". The deputy commissioner stated that many names were discussed who did not follow the commissioner's philosophy; that the commissioner and deputy commissioner "selected . . . the people to go;" that if "they didn't buy into the commissioner's objectives they were notified to me and they were added to a list" . . .; and, "the commissioner didn't want certain people - the list was made; we did go that deep [within the organization] right down to the clerks. The commissioner only wanted people who agreed with his philosophy."

⁵According to the deputy commissioner, he presented his organizational plan to DOE staff members left on the organization chart over "working lunches." The deputy commissioner stated that those staff advised of the plan "agreed with it except for the engineering portion of it." On October 15, the deputy commissioner instructed the director to implement the organizational structure as proposed by the commissioner's office. On October 16, the director verbally gave notice of his resignation effective October 19.

We do not take exception to a commissioner level of involvement in the operation and organization of lower levels within a department. We also agree that the mandated time-frame for accomplishing the transition was very aggressive. However, having meeting the deadline as the primary goal was not well advised. Additionally, the disjointed approach to organizing the Division of Energy — with what appears to have been based upon arbitrarily selected or mandated criteria regardless of program requirements — and the commissioner's office finalizing the organizational plan without the involvement of the division director contributed to poor morale, intensified an already difficult personnel situation, and did not provide for the transition **in an orderly fashion**.

Method of transition impacted delivery of rural energy program services

Apart from the impact the DOE organization process had on human resources — both personnel reductions and employee morale — equally significant was the apparent impact on both the planning and delivery of rural energy related program services.

Interviews with numerous individuals — including former directors, engineers, program managers, finance/budgetary personnel, former AEA/DOE employees now in public and private power related service industries in Alaska, and various rural utility operators — shows that there has been an adverse impact on the delivery of rural services. As a result of the transition, the manner in which it was implemented and the resulting reduction in staff, the delivery of rural energy program services — including life, health, safety issues; metering and data acquisition; technical assistance; bulk fuel repair and upgrade; rural utility training; emergency prevention; and capital project planning — have diminished.

However, degree of impact on rural energy programs in general uncertain

At this point in the evolution of DOE the magnitude of the program delivery impact due to the transfer of programs from the former AEA is indeterminate.

DOE is entering its first construction season. The confusion and ensuing "down time" resulting from successive changes in management over a very short period of time temporarily stymied DOE planning and program activity. During this time of minimal management direction and decision making, energy program planning and implementation was, at times, on hold. The impact on two of the more significant programs — Circuit Rider Maintenance (CRMP) and Bulk Fuel Repair/Upgrade — has been estimated at a loss of community contact and program delivery of two months. The effect of this in the immediate and future construction seasons has yet to manifest itself.

Long-term impact of the transition on CRMP also indeterminate

With the exception of the bulk fuel repair/upgrade program (which addresses the significant policy and environmental issues of rural bulk fuel delivery and storage), we believe CRMP

is essential as it best protects the State's sizeable investment in rural energy production facilities.

In addition to providing operator training and routine preventative maintenance on rural power generation facilities, CRMP acts as the "eyes" of DOE for identifying life, health, and safety issues and emergency conditions which may interrupt power production.

Significant questions have been raised regarding the CRMP and its service delivery. We believe that the transition process and the privatization of CRMP did impede service delivery in the short term. However, whether CRMP services have been impacted in the long-term is uncertain at this time.

The "new privatized" CRMP is presently only in the third quarter of a one-year contract (with a possible one-year renewal, subject to appropriation). It is premature to determine whether a privatized circuit rider program is cost effective (see discussion of related issues that follow). However, we do have the following concerns about the CRMP:

- DOE should establish standardized CRMP site visit reports, requiring contractors to separately identify life, health, and safety (LHS) and emergency prevention (EP) issues apart from basic technical information. In addition, DOE should establish criteria for prompt submission by contractors of LHS and EP issues.

DOE receives quarterly reports from contractors through the CRMP program. These CRMP reports, which vary in format between contractors, report areas reviewed, training provided, problem areas encountered, describes conditions that the contractor observed, and maintenance services provided.

However, the notification of DOE staff of LHS and EP issues has been hampered by non-standardized reporting formats and because reporting by all contractors for all regions occurs simultaneously, at quarter end. We reviewed a sample of CRMP reports which showed that there was an inconsistency in the classification (LHS/EP versus routine) of conditions found. A LHS/EP situation had been reported at one utility where a similar situation had been determined routine on another. Discussions with DOE staff pointed out that this has been a problem since contracting of circuit rider maintenance services.

To facilitate DOE's review of contractors' site reports and to highlight significant LHS/EP conditions, these issues should be addressed separately and promptly communicated to DOE staff apart from other standard report information.

Also, we have been informed that direct community contact with DOE staff has been curtailed substantially since contractors now represent DOE through CRMP visits. Decreased communication with the rural communities has eliminated a valuable source of information available to DOE with respect to present conditions and overall awareness of the communities needs and prospective plans.

With the privatization of CRMP, we have been informed that these direct community contacts have been reduced to a "trickle" of what they once were. Furthermore, with the transfer of programs to DOE and privatization of CRMP, many communities do not know whom to contact at the agency when assistance is needed.

We believe that DOE should make every effort to re-establish these crucial contacts with rural communities. The additional information provided by the utilities themselves could help in avoiding potential problems between regular CRMP visits.

- DOE should assess rural power facilities needs and establish a circuit rider visitation schedule based on that assessment.

When rural energy programs were under AEA, the circuit rider program was essentially "needs based." Circuit rider visits were scheduled based upon the program manager's knowledge of a utility. If the utility in general, and the powerhouse in particular, were well managed and maintained by a reliable utility operator, oftentimes fewer visits were required to ensure its continued operation. Conversely, some utilities may have required more visits because of historical operating performance problems.

Under the current CRMP all rural utilities requesting participation in the circuit rider program receive four visits annually, regardless of the condition of the utility or historical performance of its operators. The requirement for scheduled quarterly visits was part of the Invitation to Bid (ITB) for circuit rider services and was incorporated into the successful bidders contracts. We were unable to ascertain why the pre-determined number of visits was required, and why engineers and program managers were not consulted prior to the development of the ITB.

Under AEA, at any given point in time, the number of communities served by the CRMP ranged between twenty and thirty. Beginning in October 1993, more than 65 communities were served by contractors on a quarterly basis. The contract has been in place for approximately eight months, and is therefore only two-thirds through the first year of completion.

The CRMP under DOE's privatized mandate for FY 94 is budgeted (subject to amendment) in excess of \$550,000. Under AEA the cost of circuit rider services for the three previous fiscal years has been identified as:

<u>Fiscal Year</u>	<u>Cost (unaudited)⁶</u>
1991	\$362,810
1992	355,023
1993	130,180

⁶Fiscal years 1991 through 1993 circuit rider expenditures were provided by the DOE manager of Accounting and Administration and are unaudited.

We believe circuit rider services should be provided where needed. Those utilities that have achieved a satisfactory level of operation and operator ability should not receive state financed maintenance services based upon an arbitrarily determined number of visits. CRMP expenditures should be based upon an assessment of the needs of the rural utility.

- DOE should adopt a formal policy prohibiting CRMP contractors in particular, and agency contractors in general, from marketing goods and services while performing under DOE contracts.

Concern has been expressed regarding the selling of goods and services in rural areas by DOE contractors while performing services under DOE contracts. Transportation to rural Alaska is a significant expense for both individuals and businesses. Those businesses conducting state-financed services in rural Alaska — in which the State paid the contractor's transportation expenses — have an unfair advantage over others should they wish to market additional goods or services beyond that specified in their contract.

We believe that DOE should formally adopt a policy, incorporated as a contract condition with penalty provisions, that prohibits contractors from pursuing additional business ventures while "on state time." Such a policy would ensure that DOE does not endorse providing existing contractors with an unfair competitive advantage when considering future potential contracts and contractors.

What is DOE's mandate for privatization?

Chapter 18, SLA 1993 drastically revamped the State's energy programs, basically dissolving AEA and creating DOE. The legislation also contained language regarding dealings with the private sector. Specifically, the legislation stated:

Sec. 42.45.400(b) *In providing rural utilities with technical assistance and training, the department shall give priority to contracting with the private sector for these services.*

and,

Sec. 42.45.410 *The department shall, to the maximum extent feasible, carry out its powers and duties under this chapter by entering into contracts with appropriate entities in the private sector.*

In response to this legislation, the former AEA initiated (and DCRA pursued) the privatization of circuit rider maintenance services. Some have characterized the speedy transfer of providing circuit rider services to the private sector as hasty. We also believe that implementing the privatization concept was hasty, but perhaps for different reasons. It is

unclear what DOE's "privatization" mandate is. It is likewise unclear as to the meaning of "*maximum extent feasible*."

We believe that before the privatization of state sponsored programs, the State should perform formal feasibility studies to determine the potential costs and benefits that would result from privatization. The study should also determine the costs and benefits of the work if performed by state employees. The decision to privatize should be based on the ultimate costs and benefits. In determining whether to perform or contract out services, the State should consider the costs and what is in the best interest of the State and the people the programs are intended to serve. Such an analysis was not performed in the decision to contract out circuit rider services. It is not known whether privatization of those programs serves the best interest of the State and program recipients.

We recommend that DOE define its responsibilities under the legislation and establish criteria or guidelines in defining "*maximum extent feasible*." We also recommend that in following the "privatization" mandate that DCRA and DOE conduct the necessary analyses to determine whether the contracting of any services is in the best interest of Alaskans.

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STATE OF ALASKA

DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS

DIVISION OF ADMINISTRATIVE SERVICES

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July 19, 1994

Mr. Randy Welker
Legislative Auditor
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

RECEIVED
JUL 19 1994
LEGISLATIVE AUDIT

Dear Mr. Welker:

RE: Preliminary Report
Department of Community and Regional Affairs
Division of Energy - Transfer of AEA energy programs

The Department of Community and Regional Affairs appreciates the opportunity to provide our written comments concerning the matters discussed in the above referenced preliminary audit report. The Department vigorously disagrees with the content and tone of the preliminary report and would like to use this opportunity to set forth the facts involved in this matter.

The Department of Community and Regional Affairs (DCRA) understands and appreciates the benefits and constructive results which an independent review of the Department's programs and activities can provide. However, we must question the independence and motivation of the Division of Legislative Audit in conducting the review, because the majority of the conclusions and comments identified in your preliminary report are based upon inaccurate and subjective information, and, as a result, are inappropriate.

The major conclusion of the preliminary report is that the Department's "Management of the transition of rural energy programs was, at times, haphazard." Based upon the information provided in the report, the Department believes your conclusions are unsupported, unwarranted and patently biased.

As noted on page 17 of the report, the Department did have the goal guiding its actions of meeting the legislative mandate that the transition be accomplished by December 31, 1993. This mandate was the primary focus to actions taken by the Department and, as a result, the transition was completed by the deadline.

Mr. Welker

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As I am sure you can appreciate, the deadline of December 31, 1993 was very short for accomplishing the many tasks required for the completion of the transition. This is probably the shortest period of time ever provided in which to transfer programs and operation responsibilities from one state agency to another. For example, the transfer of DCRA's housing programs to the Alaska Housing Finance Corporation took between one and one-half to two years to complete.

There were a great number of issues to be dealt with during the transition phase. In addition, the process involved at least six different agencies, each of which had their own priorities and concerns. Additional problems were encountered through unclear and sometimes contradictory transition legislation.

The third paragraph on page 17 of the report states: "For a period of four to five months DCRA took two different approaches to the reorganization and staffing of AEA's rural energy programs." This is factually incorrect, as there never were two transition or organizational efforts.

Only the Director of DOE led the transition and organization effort. However, that effort was subject to my approval. This means that each draft organizational plan and each major detail of the transition was to receive my approval. I required and received periodic briefings on the transition and tracked progress towards meeting the goals of the transition.

You should be aware that in situations like this, I have the authority to assess various issues and concerns, and if in my judgement, they are not adequately addressed or are going in a direction contrary to my approval, I can make decisions based upon the information at hand. In some cases, these decisions may be contrary to the desires of a director.

The last paragraph on page 17, continuing on page 18, implies that the DCRA Commissioner's Office was developing possible organization scenarios and that these were based on "an arbitrary 'maximum' number of positions." Again, this is an incorrect statement. The only organizational structures proposed were those made by the DOE Director and those proposed were for the transition. The DOE Director did not propose a structure for the FY 95 budget. The Commissioner's Office was not concurrently creating any separate organizational structures; however, there were on-going discussions with the DOE Director concerning the structures. It is clearly within the authority of the Commissioner to establish such plans when setting up a new division.

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The above referenced paragraph indicates that the DOE director was provided by the Commissioner's Office with "a list of names ... who would not be retained in the new division -- an action which further demonstrates the subjective manner in which the commissioner's office was proposing the new organization." This was not the case and there was never such a directive. There were discussions between the Commissioner's Office and the DOE Director regarding the retention of certain positions, however, this was without regard to the person filling the position.

In support of your conclusion in the previous paragraph, the Division of Legislative Audit has included as a footnote on page 18 several quotes purported to have been made by the Deputy Commissioner during discussions with DLA staff. The following addresses these purported quotations.

"The deputy commissioner stated, during a lengthy interview, that staffing decisions were based on 'people' rather than 'positions'." This is a false statement as the Deputy Commissioner never stated this and would not attest to something that was not part of the process.

"The deputy commissioner stated that many names were discussed who did not follow the commissioner's philosophy." This is another false statement and never occurred.

"... that the commissioner and deputy commissioner 'selected ... the people to go'." This is also a false statement. "People" never entered our consideration of the class and number of positions necessary to fulfill the statutory tasks.

"[T]hat if 'they didn't buy into the commissioner's objectives they were notified to me and they were added to a list' ... " This is out of context and is an inaccurate reconstruction. What the Deputy Commissioner had said was there were third parties who believed certain employees of AEA did not (and in some cases did) agree with the commissioner's objectives and that these third parties expressed their beliefs to the Deputy Commissioner. That the Deputy Commissioner took note of these third party viewpoints and passed them on to the director of the division, does not imply there was a significant "list" of any nature used as a basis for the organizational structure of the energy division.

"[A]nd, 'the commissioner didn't want certain people - the list was made'." This is a false statement. I never generated any "list" nor did the Deputy Commissioner or I make a statement in this context regarding any AEA employee.

Mr. Welker

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"[W]e did go that deep [with the organization] right down to the clerks." This is a true statement, but is stated in a context meant to mislead and convey meaning that is contrary to the truth, and, therefore, is false. "We" means the Deputy Commissioner, the Director and the Director's Deputies, who examined staff requirements at every level, and conveyed this information to me on a regular basis.

"The Commissioner only wanted people who agreed with his philosophy." Again, the Deputy Commissioner has indicated he did not make such a statement. The audit interview with the Deputy Commissioner dealt primarily with hypothetical situations, because the interviewers admitted they had never before done an audit of this nature, and they asked what the Deputy Commissioner thought the likelihood of similar audits being necessary in the future. In this context, the Deputy Commissioner did make comments relating to "a commissioner's" fundamental right to hire individuals into exempt positions, who hold similar management or government philosophies as he or she.

The second paragraph on page 18 states "the DCRA commissioner's office unilaterally developed an organization plan -- a plan which did not have the director's input and which eliminated the director's personally appointed special assistant." The DOE director did not propose a structure for the FY 95 budget. The Commissioner's Office did make a decision on the FY 95 organizational structure when it became apparent the Director was either unable to do so or did not ever intend to meet the December 31, 1993 deadline. Furthermore, it was apparent the director was not going to meet the Office of Management and Budget October 25, 1993 deadline for draft operating budget submissions, necessary to meet the December 15, 1993 deadline for submission to the Legislature.

The organizational structure proposed by the Deputy Commissioner, which I approved, was based on information from the director, his deputies, staff of the Energy Division, and information provided by the previous Executive Director of AEA. This information was provided to the Commissioner's Office beginning in May 1993.

Prior to my approval, I required the Deputy Commissioner to review the proposal with the Division Director. We then discussed the proposal with energy program managers in the presence of the Director. The product of these meetings was a collective understanding that the organizational structure would work. This allowed budgets to be prepared, work plans constructed, space requirements finalized, and many other details could be brought to closure within the legislative deadline of December 31, 1993. Therefore, your statement that this was "a plan which did not have the director's input" is not correct.

Mr. Welker

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On page 18, several comments attributed to the Deputy Commissioner are included in the second footnote. These are also discussed in the following.

The footnote states: "According to the deputy commissioner, he presented his organizational plan to DOE staff members left on the organization chart over 'working lunches'." This is an inaccurate reconstruction of fact. The Deputy Commissioner, the Director of the division, and I, met with DOE program managers regarding the organizational plan proposed by the Deputy Commissioner and that had previously been discussed with the Director. These meetings were during what was termed a "working lunch," even though no one was eating, because they took place during the lunch hour. We did not meet with all "DOE staff members left on the organization chart." The purpose of the meetings was to get an honest assessment from the program managers if they could do their job given the resources we were proposing.

The footnote continues: "The deputy commissioner stated that those staff advised of the plan agreed with it except for the engineering portion of it." Again, this is inaccurate. The engineering section voiced the only concern, and it was not with the structure of the section, the number of engineers, or the number of support staff. They expressed concern that they not become "rubber stamp engineers, basically approving contract engineers work."

"On October 15, the deputy commissioner instructed the director to implement the organizational structure as proposed by the commissioner's office." This is correct.

"On October 16, the director verbally gave notice of his resignation effective October 19." This is incorrect. On October 16, the Director verbally resigned. I accepted the Director's resignation at that time and stated I wanted a letter to that effect. The Director asked if Tuesday morning would be sufficient for receiving the letter, as October 16 was a Saturday and the following Monday was a state holiday. As there would be no staff to type the resignation letter until Tuesday, October 19, I agreed. The Director resigned effective immediately on October 16 at approximately 6:00 p.m.

In the second complete paragraph on page 18, your report states: "the commissioner's office involvement in the structuring of the organization was motivated more by the removal of select individuals, rather than having been based on any objective assessment of programmatic needs or qualifications." As we have indicated throughout this letter, this conclusion is incorrect and, apparently, primarily based upon incorrect and false statements attributed to the Deputy Commissioner.

Mr. Welker

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The third complete paragraph on page 18 states, in part, that on February 4, 1994, the director made a budgetary presentation detailing the need for additional positions and on February 7, "for yet unclear reasons" the Director was dismissed and the Deputy Director resigned in protest. The meeting with the Director on February 4 did take place, however the Director never provided any detailed documentation. In fact, the Director provided no written materials to the Commissioner or Deputy Commissioner, nor to any others in attendance at the meeting. During this meeting, the Director either could not answer or refused to answer direct questions of the Deputy Commissioner related to the Director's investigation, or assessment of alternatives to additional staff.

During the February 4 meeting, I asked the Director whether or not he had discussed any of his ideas regarding staff with the other Division Directors to take advantage of their experience managing government organizations. The Director indicated that he had not done this, nor had his Deputy Directors. I then expressed my concern regarding the impacts to the other divisions of the department should I approve energy staff increases at that particular time.

During the entrance conference to the review, I clearly told your auditors the reasons why I had requested the Director's resignation. Therefore, your statement that this was for "unclear reasons" is misleading and is also inappropriate.

On page 19, the first paragraph states, in part: "We do not take exception to a commissioner level of involvement in the operation and organization of lower levels within a department." In our view, the preceding pages of the report have done just that --- take exception to a commissioner level of involvement.

You continue in that paragraph: "However, having meeting the deadline as the primary goal was not well advised." The Department does not agree with this conclusion by the Division of Legislative Audit. Yes, the Department did have a legislative mandate to make the transition in as orderly of a manner as possible. The word "orderly" is much more subjective than the very real and mandated deadline of December 31, 1993. Consequently, the Department focused upon meeting the December 31, 1993 deadline and conducted the transition towards that end in as orderly of a manner as possible.

Mr. Welker

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The paragraph continues: "Additionally, the disjointed approach to organizing the Division of Energy -- with what appears to have been based upon arbitrarily selected or mandated criteria regardless of program requirements -- and the commissioner's office finalizing the organizational plan without the involvement of the division director contributed to poor morale, intensified an already difficult personnel situation, and did not provide for the transition in an orderly fashion."

In response to this, several comments are in order. First, the Department's approach was focused and aggressive, and that may have bothered some individuals. But, we saw no other way to accomplish the transition between August 19 and December 31.

Second, the criteria I selected was based upon program needs, rural resident needs, community needs, and the necessity of planning a budget. Please don't forget that I sat on the AEA Board of Directors for three years.

Third, as previously stated, Commissioner's Office did not develop the organizational plan without the involvement of the Division Director. The plan that was subsequently adopted was based, in part, on information provided by the Director and was discussed with the Director and other DOE staff prior to implementation.

Fourth, the morale at AEA was extremely poor after passage of SB 106 and SB 126. We made every effort to raise that morale, without raising individual employee job expectations, while attempting to accomplish a major legislative shift in policy and provide rural energy services with minimal impact. The personnel situation was made difficult by the legislation that transferred the programs. It is obvious that any reorganization is going to impact upon the individuals involved and this problem was compounded by the short December 31, 1993 deadline. Had more time been available, it is likely that the impact upon the human resources involved might have been eased.

The preliminary report starting with the second paragraph on page 19 indicates that there have been impacts upon the planning and delivery of rural energy program services and the remainder of the report attempts to describe those impacts. However, we believe the report falls far short of offering definitive evidence to support the conclusion that the program services have been impacted.

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The fact is program delivery was not curtailed. Delivery of services continued to be carried out despite any perception that services and programs were in danger. At no time were life, health, safety issues; metering and data acquisition; technical assistance; bulk fuel repair and upgrade; rural utility training; emergency prevention; and capital project planning ever diminished. In fact, at the request of Governor Walter J. Hickel, a number of bulk fuel storage repair projects were speeded up.

With respect to this, we admit there is always some confusion during a transfer of programs. For a time there was confusion, but it did not affect the delivery of programs. Nothing was put "on hold." We agree that the effect, if any, of the transition in the immediate and future construction seasons has yet to manifest itself. However, given the planning taking place within the Division, the Department is more than comfortable stating that programs and assistance will continue to be provided to the constituents of the division in a timely and professional manner.

The management letter next turns to the Circuit Rider Maintenance Program (CRMP). With respect to the discussion concerning privatization of a portion of the program, it should be stated that privatization was planned before the transfer legislation was adopted. Any time a new program is initiated, there is a period of time necessary to make changes in order to carry out the program objectives. The new privatization of CRMP has had some difficulties, but they are being worked out within the Division.

CRMP site visits reports are being developed. Indeed, they were developed in response to the transfer legislation prior to the management letter. The same is true of the format of the quarterly reports.

The last paragraph on page 20 refers to what is called decreased communication with rural communities. Any time a service previously provided by a state agency is contracted out to a private party, it will necessarily result in the reduction of division staff visiting affected communities. There may well be a decreased visibility on the part of division personnel; however, it should be noted we continue to be in constant contact with every participating community in the CRMP in order to monitor the work of the various contractors. We have not withdrawn from the communities that we serve.

We must take exception to the first full paragraph on page 21, which asserts many communities do not know whom to contact at the agency when assistance is needed. The communities are aware of division personnel who have assisted them in the past and continue to do so in the present.

Mr. Welker

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The third paragraph on page 21 refers to the number of visits made to rural utilities under the CRMP. We have begun to assess the number of visits made to each community and will initiate procedures that will cover the needs of those communities.

On page 22, you recommend the Division adopt a formal policy on contractors marketing goods and services while performing DOE contracts. It should be noted that there was legislative intent language adopted during the last session that will cover this area of concern for all CRMP contractors.

On pages 22 and 23, the report contends DOE's mandate for privatization is unclear. Again, it should be stated that the Division has only recently been organized and programs placed within DCRA. We will continue to look at the manner in which we provide programs within the Division of Energy. Our concerns have been echoed by recent legislative action which provided intent language to provide one year CRMP contracts, and that contracts be awarded to a greater number of contractors. The State Legislature also this year provided funding as well as travel money within the Division's budget to hire additional personnel to provide CRMP services.

The management letter asked a question concerning the Division's mandate for privatization. Section 42.45.400(b) and Section 42.45.410 are quite clear in the direction given the division in order to carry out its programs. Your recommendation that the Division define its responsibilities under the legislation and establish criteria or guidelines in defining "maximum extent possible" is inappropriate. There is no possible way to develop such criteria. This is, and rightfully so, a matter to be determined by the department and the Division of Energy.

Your recommendation to conduct analyses to determine whether the contracting of any services is in the best interest of Alaskans flies in the face of Sections 42.45.400(b) and 42.45.410 cited earlier.

On the basis of this discussion, the Department concludes that the preliminary report is based upon inaccurate and misleading information and does not reflect all of the information available to you. The Department is concerned that the Division of Legislative Audit has not considered the comments provided in response to the Management Letter in preparing this Preliminary Report. We cannot help but conclude that the review was not conducted in the fully independent manner required by professional audit standards.

Mr. Welker

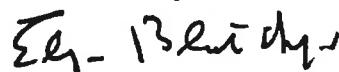
RE: PRELIMINARY REPORT RESPONSE

July 19, 1994

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If we can provide you with any additional facts regarding the transition of the rural energy programs to DCRA, please let me know.

Sincerely,



Edgar Blatchford
Commissioner

STATE OF ALASKA

DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS

OFFICE OF THE COMMISSIONER

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July 6, 1994

RECEIVED
JUL 7 1994

Randy S. Welker
Legislative Auditor
Legislative Budget and Audit Committee
P.O. Box 113300
Juneau, AK 99811-3300

Dear Mr. Welker:

Please include this letter as a part of the Department's response to the preliminary audit report on: *Department of Community and Regional Affairs, Dissolution of the Alaska Energy Authority and Transfer of Programs, May 27, 1994.*

This letter does not constitute the departments response to the preliminary report. You will be receiving that response for inclusion in the final report and transmittal to the Committee by your deadline of July 19, 1994.

The purpose of this letter is to point out my disappointment and surprise that comments attributed to me are contained in the footnotes on page 18.

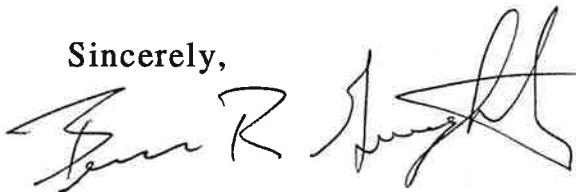
I'm disappointed from the stand point that I expect a higher standard of professionalism from the staff of the Legislative Budget and Audit Committee. It is inconsequential at this point that the quotes attributed to me are in part statements I never made, are as a whole inaccurate reconstructions and are taken entirely out of the context of the interview I had with two of your audit team. The consequential aspect of this method of justifying your report conclusion, is that it calls into question the credibility of all the reports conclusions and recommendations.

Mr. Randy S. Welker
July 6, 1994
Page 2

One can argue that the workmanship exhibited in the last seven pages of the preliminary report is more characteristic of tabloid journalism rather than what is expect in an objective audit.

I seriously recommend you consider the departments response to the management letter and to the preliminary report, which will follow this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Bruce R. Geraghty".

Bruce R. Geraghty
Deputy Commissioner

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Finance



July 27, 1994

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Members of the Legislative Budget
and Audit Committee:

We have reviewed the responses from the Commissioner and Deputy Commissioner of the Department of Community and Regional Affairs (DCRA), and have the following comments.

On page 1 of DCRA's response the commissioner wrote:

... we must question the independence and motivation of the Division of Legislative Audit in conducting the review, because the majority of the conclusions and comments identified in your preliminary report are based upon inaccurate and subjective information ...

and,

Based upon the information provided in the report, the Department believes your conclusions are unsupported, unwarranted and patently biased,

and on page 9,

We cannot help but conclude that the review was not conducted in the fully independent manner required by professional audit standards.

The department takes exception to the use of interviews as a basis for determining past events and making judgement on issues. The use of interviews (testimonial evidence) as a basis for development of audit conclusions is an important element in the accumulation of audit evidence. Testimonial evidence must be complete and consistent. Corroborating testimonial evidence is central to a review. A number of interviews were held with individuals who could speak freely, without fear of retribution, and these statements were corroborated by those who had to temper their comments because of that fear.

Interviewing is a widely used and accepted evidence gathering technique. Competency of evidence refers to the degree to which evidence is considered believable or trustworthy. If evidence is competent, it is persuasive. We believe the testimonial evidence obtained during the course of this review (from no fewer than thirty individuals both within and outside the

agency), to the extent it was corroborated by other documentation and evidence, is competent and sufficient.

In regard to specific responses made by DCRA, we offer the following:

On page 1 of the response the commissioner noted:

. . . the Department did have the goal guiding its actions of meeting the legislative mandate that the transition be accomplished by December 31, 1993. This mandate was the primary focus to actions taken by the Department and, as a result, the transition was completed by the deadline.

We take exception to the department's assertion that the transition was completed by the deadline cited in statute. Many significant issues remained outstanding to effect the transition, most notably as late as Spring 1994:

- the department was continuing to wrestle with which appropriations, and how much of each, could be expended for transition and operating purposes;
- AKSAS accounting system journal entries had not been processed to record the allocation of transition expenses;
- significant procurement issues concerning authority and the procedures to be followed remained outstanding;
- former Alaska Energy Authority warehouse inventories had not been performed; and,
- accounting and project manager information needs and reporting systems had not been resolved.

The fact that the transition was not effected by December 31, 1993 notwithstanding, it remains our opinion that having that date as the department's "primary focus" was ill advised as evidenced by the resulting turmoil and impact on delivery of program services.

In regard to the organization of the new Division of Energy (DOE), it remains clear to us that while the first DOE director was attempting to forge an organization and staffing level based on program requirements and individuals' experience and abilities, the commissioner's office did in fact develop an organizational structure quite apart from that of the director's.

On page 5 of the department's response the commissioner noted our statement regarding the resignation of the director effective October 19, 1993 was incorrect and stated "*The Director resigned effective immediately on October 16 at approximately 6:00 p.m.*" As noted in our report, the director, as a result of the imposition of an organizational plan apart from the

structured approach undertaken by the director, did in fact resign on October 16, 1993 **effective** October 19, 1993. This is further evidenced by the director's resignation letter dated October 19, 1993 effective 4:30 pm that day **and** an Attorney General's memorandum citing the fact that the director was performing the duties of the director's position on October 19, and that he had "*color of authority*" to perform those duties. One of the issues discussed in this memorandum dealt with whether DCRA was bound by severance agreements offered by the outgoing director. DCRA's honoring of those agreements testifies to the authority of the director through day's-end on October 19, 1993.

On pages 3 - 5 of the department's response the commissioner and deputy commissioner take exception to comments in our report attributed to the deputy commissioner. The Division of Legislative Audit follows the highest of professional standards, and enjoys a well received reputation in that regard. This agency does not manufacture evidence nor report "*purported quotations*." The comments attributed to the deputy commissioner were made during the course of an interview by members of our staff and were reported as stated and in the proper context. In regard to this, the commissioner has stated that the auditors conducting the interview were speaking in terms of hypothetical situations and "*... admitted they had never before done an audit of this nature.*" The auditors were not discussing the real-life events surrounding the dissolution of the Alaska Energy Authority in hypothetical terms, nor was this the first audit of this nature ever undertaken by the staff in question. The two team leaders on this review have combined experience in excess of 30 years in this type of auditing and program review. Both team leaders are Certified Public Accountants and one a Certified Fraud Examiner. As such, these individuals are bound by the standards adopted by the American Institute of Certified Public Accountants, the Association of Certified Fraud Examiners, governmental auditing standards, and internal procedures regarding the documentation of evidence, its extent, and credibility.

On page 4 of the response in regard to the statement made by the deputy commissioner that "*we did go that deep [within the organization] right down to the clerks*", the commissioner responded:

This is a true statement, but is stated in a context meant to mislead and convey meaning that is contrary to the truth, and, therefore, is false. "We" means the Deputy Commissioner, the Director and the Director's Deputies, who examined staff requirements at every level, and conveyed this information to me on a regular basis.

Once again, our reporting of this discussion is accurately presented and not in a fashion to mislead or convey an untruth. The context of this discussion was in regard to a list of AEA employees that was presented to the first DOE director at an August 1993 meeting with the commissioner's office representatives. At this meeting the director was informed people on that list would not be retained in the new Division of Energy. The director rejected that list. It was in this context the deputy commissioner commented how "deep" within the organization the "list" went.

On page 5 of the response, the commissioner states "*As we have indicated throughout this letter, this conclusion is incorrect and, apparently, primarily based upon incorrect and false statements attributed to the Deputy Commissioner.*" Our observations and conclusions are not based primarily on any one source — but rather based on a variety of sources and pieces of corroborating evidence.

On page 8 the commissioner responded:

The fact is program delivery was not curtailed. Delivery of services continued to be carried out despite any perception that services and programs were in danger. In fact, at the request of Governor Walter J. Hickel, a number of bulk fuel storage repair projects were speeded up.

Based upon numerous discussions with engineers, fiscal and budgetary personnel, and our observations, it is clear that the transfer of programs to DCRA in a very short time frame coupled with successive changes in management (four directors in seven months) did impact the planning and delivery of services. It has been estimated that the transition and rapidity in changes of management caused six to ten fewer bulk fuel repair/upgrade projects in that program alone to be addressed in the immediate construction season.

Finally, on page 9 of the response in regard to our recommendation that the department define its responsibilities under its statutory guidance to privatize to the maximum extent feasible and determine whether privatization is in the best interest of Alaskans, the commissioner responded "*Your recommendation to conduct analyses to determine whether the contracting of any services is in the best interest of Alaskans flies in the face of Sections 42.45.400(b) and 42.45.410 . . .*"

As cited on page 22 of the report, Alaska Statute states that the department shall give priority to contracting with the private sector and to the maximum extent feasible enter into contracts with the private sector. We recommended that prior to blanket privatization the department determine whether privatization is in the best interest of Alaskans. We do not believe it is in the best interests of Alaskans when there may be decreased program services at a much higher cost to Alaskans. Only a proper analysis will tell.

The department asserts it must follow the privatization guidance in statute regardless of cost. We do not believe it "*flies in the face*" of statute to determine how to achieve program delivery at the least cost.

In 1989, the Department of Administration dealt with similar legislation governing its procurement of telecommunications services. Alaska Statute 44.21.310(a)(6) stated that the department shall "*whenever feasible*" procure telecommunication services from private enterprise. In an opinion from the Department of Law, the Attorney General's office stated that the section of statute encouraging privatization whenever feasible was "*. . . little more than a hard-to-read, vague, general policy directive that adds little regarding actual*

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*telecommunications procurement procedures beyond the procedural requirements of AS 36.30
that apply to nearly all state procurements."*

We believe that DCRA should, while considering the guidance of AS 42.45.400(b) and AS 42.45.410, also consider the cost of following that guidance compared to alternative means of program delivery.

Sincerely,


Randy S. Welker, CPA
Legislative Auditor