

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE



Division of Legislative Audit

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March 28, 2012

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 NATURAL RESOURCES  
UNIVERSITY OF ALASKA  
DEPARTMENT OF COMMERCE, COMMUNITY,  
AND ECONOMIC DEVELOPMENT  
VIRUS FREE SEED POTATO PROJECT

March 2, 2012

Audit Control Number  
10-30064-12

The primary objectives of this audit were to report on the Virus Free Seed Potato Project's (seed project) financial activities and determine if the seed project provides a positive monetary or non-monetary return to the State or private entities. Additionally, the audit determines whether continued state involvement in the seed project will yield positive returns and whether seed potato funding has been used for essential state services.

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Fieldwork procedures utilized in the course of developing the findings and recommendations presented in this report are discussed in the Objectives, Scope, and Methodology section of this report.

A handwritten signature in black ink, appearing to read "Kris Curtis".

Kris Curtis, CPA, CISA  
Legislative Auditor



# TABLE OF CONTENTS

	<u>Page</u>
Objectives, Scope, and Methodology .....	1
Organization and Function .....	3
Background Information.....	5
Report Conclusions.....	9
Appendices	
Appendix A .....	15
Appendix B .....	17
Agency Responses	
Department of Natural Resources .....	19
University of Alaska.....	21
Department of Commerce, Community, and Economic Development .....	25



## **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 have conducted a special audit of the State's Virus Free Seed Potato Project (seed project). Specifically, we were asked to perform the following.

1. Identify all state funds appropriated for the seed project by agency and source of funds.
2. Identify seed project funding that was appropriated or allocated to the Department of Natural Resources (DNR), Division of Agriculture's Plant Material Center (PMC), Agriculture Development Allocation, and Agricultural Revolving Loan Fund as well as the University of Alaska's (UA) Matanuska-Susitna experimental farm.
3. Determine whether UA received seed project funding for indirect costs in accordance with an approved allocation rate.
4. Identify the extent UA facilities were used for the seed project.
5. Evaluate seed project expenditures from FY 05 through FY 12 for reasonableness and necessity.
6. Evaluate whether a return, monetary or non-monetary, has been received by the State or private entities as a result of the seed project.
7. Identify the intended outcome of the seed project and evaluate whether continued state participation will yield a positive monetary return or result in a subsidy to farmers.
8. Determine if seed project appropriations were used for essential state services, and evaluate whether there is a benefit for continued State involvement.

### **Scope**

This audit reports state and export certification funding from FY 95 through December 2011. Although funding for the export certification component of the seed project began in FY 95, funding for virus free seed potato certification was already occurring before this date as part of DNR's routine state certification program. Beginning in FY 95, funding was provided for the additional certification costs associated with the international export of seed potatoes. Due to the way funding was appropriated and accounted for in the State's accounting system, seed project funding for state certification and the export certification was not wholly distinguishable.

Evaluation of seed project expenditures includes the period of FY 05 through December 2011. Seed project revenues are calculated for the period of FY 01 through December 2011.

## Methodology

Personnel within the Department of Commerce, Community and Economic Development (DCCED), DNR, and UA whose positions relate, at least in part, to the seed project were interviewed. Interviews were designed to gain an understanding of the seed project's objectives, funding, administration, financial activity, and program outcomes. Additionally, we interviewed staff members of the non-profit organization Alaska Seed Growers, Inc. and several Alaskan seed potato farmers to further develop our understanding.

To identify state funds appropriated and allocated to the seed project, we obtained a schedule of all project funding from each state agency. We also obtained a historical schedule of project funding from the Division of Legislative Finance and verified seed project authorizing legislation.

DNR provided our office with seed project expenditures and revenues from the State's accounting system. We verified the accuracy of the information using the accounting system. UA provided a schedule of seed project expenditures from the UA accounting system. We verified the accuracy and completeness of the data by comparing it to grant agreements and reimbursable service agreements between UA and state agencies. DCCED and the Office of the Governor passed through funding to UA and incurred no direct expenditures.

To estimate the export value of seed potatoes to China and Taiwan, we identified an average value of seed potatoes exported as determined by the United States Department of Agriculture for 2001-2010. The average was applied to the quantities shipped as documented by the export certificates issued by DNR.

Per our request, UA identified the extent their facilities were used for the seed project and identified non-state funding sources.

## ORGANIZATION AND FUNCTION

The key entities involved in the Virus Free Seed Potato Project (seed project) are the Department of Natural Resources (DNR), the University of Alaska (UA), the Department of Commerce, Community, and Economic Development (DCCED), and a non-profit organization, Alaska Seed Growers, Inc. (ASG). Each organization provides differing levels of project support such as grant management, seed testing, seed certification, and seed research.

### Department of Natural Resources

DNR's mission is to responsibly develop Alaska's resources by making them available for maximum use and benefit consistent with the public's interest. DNR's Division of Agriculture (DoAg) promotes and encourages developing agricultural industries within the State. As part of this mission, DoAg conducts field inspections, helps manage disease control, and issues phytosanitary (export) certifications.

DoAg's Northern Latitude Plant Materials Center (PMC) helps test, produce, develop, and distribute materials to promote commercial development. PMC also provides services for growers such as testing and analyzing seeds and soil. PMC provides seed stock that ensures growers are starting out with disease-free seeds. PMC also inspects mature crops for state certification.

### Department of Commerce, Community, and Economic Development

DCCED's mission is to promote a healthy economy and strong communities. DCCED's Division of Community and Regional Affairs (DCRA) reviews community activities, collects and publishes local government information, and assists local governments in managerial functions. DCCED's Division of Economic Development (DED) assists businesses and developers by offering technical assistance and support for start-ups, expansions, and relocations.

DCRA and DED act as funding conduits of state and federally funded appropriations for the seed project. Both of these divisions pass on funding to UA to help fund the seed potato laboratory testing required for international export certification. DCRA and DED have no project oversight or project outcome responsibilities.

### University of Alaska

UA was established as the state university by the Alaska Constitution, Article VII, Section 2, and AS 14.40. UA has three main campuses. Each campus has colleges and schools that are managed by an appointed dean. Within UA's Fairbanks campus is the School of Natural Resources and Agricultural Sciences. This school's Department of High Latitude Agriculture

contains the Plant Pathology and Biotechnology Laboratory. Among other functions, this laboratory performs testing for specific potato diseases.

Alaska Seed Growers, Inc.

ASG is a non-profit corporation that was formed in 1984. It has a seven-member board comprised of four potato growers as well as three grain and grass growers. ASG's purpose is to promote the use of top quality seed stock. Under an agreement that has been in place since 1986, DNR accepts ASG seed certification standards as the standards for seed potatoes in Alaska.<sup>1</sup> Additionally, under the terms of this agreement, ASG performs administrative tasks related to seed certification, has the authority to collect and retain fees, and issues seed certification tags to growers.

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<sup>1</sup>ASG standards govern state certification; however, in order to qualify for export certification, seed potatoes must first be state certified.



## **BACKGROUND INFORMATION**

The request for this audit required a review of the Virus Free Seed Potato Project which encompasses both state and export certification. The activities that support the certification types are similar and often overlap. Within this report, the term *seed project* is used to represent both state and export certification activities. The terms *state certification* or *export certification* are used when the information is specific to the type of certification.

### **Two Types of Alaska Seed Potato Certifications**

Seed potatoes are regulated because diseases can be carried in or on potatoes used for planting. Excluding diseases from seed stock is critical to the success of the potato industry. Growers manage their seed productions to limit possible exposure to diseases, but infections can originate from multiple sources. Certification provides assurance to growers that potato stock is virus free.

Seed potatoes represent approximately twenty percent of the total potato crops grown annually in Alaska. There are two primary purposes of the seed project: (1) certifying seeds for Alaska growers (state certification) and (2) certifying seeds for international export (export certification).

### **State Certification**

State regulation 11 AAC 34.075(j) requires that all seed potatoes sold be certified. State certification provides assurance to growers that the starting seed stock is within disease tolerances; however, certification does not constitute a guarantee or warranty. Since 1986, the Department of Natural Resources (DNR) has delegated the responsibility for state certification to Alaska Seed Growers, Inc (ASG)<sup>2</sup>.

The state certification process begins with the purchase of certified seed by growers. Certified seeds are usually purchased from DNR's Northern Latitude Plant Materials Center (PMC) in Palmer Alaska, although they may also be purchased from other sources. Seeds are derived from plantlets that are determined to be disease free by DNR. Plantlets are planted in the PMC greenhouse to become the basic seed stock of the multi-generational seed program. Seeds are harvested from the greenhouse in the fall and sold to certified seed growers for the following planting season. Once planted in the field, seeds become Generation 1 seeds and are typically replanted each spring until Generation 4 is harvested. Once harvested, Generation 4 seeds are sold to table stock growers to be planted the following spring. After

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<sup>2</sup>ASG is a non-profit corporation whose purpose is to promote the use of top quality seed stock. Under an agreement that has been in place since 1986, DNR accepts ASG seed certification standards as the standards for seed potatoes in Alaska. Additionally, under the terms of this agreement, ASG performs administrative tasks related to seed certification, has the authority to collect and retain fees, and issues seed certification tags to growers.

harvest, table stock growers sell the product to the end customer through retail outlets, farmers' markets, and other means. Per DNR agriculture staff, all table stock is currently sold into the Alaska market. DNR agriculture staff estimate the annual value of the in-state potato industry to be \$2.4 million.

State certification requires semi-annual visual field inspections and annual winter storage inspections. All inspections are performed by DNR personnel. Successful state certification results in the issuance of certification tags by ASG.

According to the PMC:

*The Seed Potato Certification Program is designed to provide growers with potato seed stock that is varietally pure and relatively free from disease causing organisms. These results are achieved by the voluntary compliance of seed growers with certification regulations.*

### Export Certification

Export certification is required for seeds sold for export to other countries. Export certification requirements are determined by the importing country. International export markets have been limited to China and Taiwan. For export to China and Taiwan, certification requires that seeds be state certified and laboratory tested to ensure that diseases of specific concern are not present in the imported seeds. Laboratory testing is conducted during each year of growth, with more testing occurring in earlier years. Samples are typically pulled from the field during the growing season and tested at the UA lab. DNR issues phytosanitary (export) certifications after successful laboratory tests as delegated by the United States Department of Agriculture, Animal and Plant Health Inspection Service.<sup>3</sup> Seed potato export certificates have been issued by the State since 1996.

### Intended Outcome of Export Certification Funding

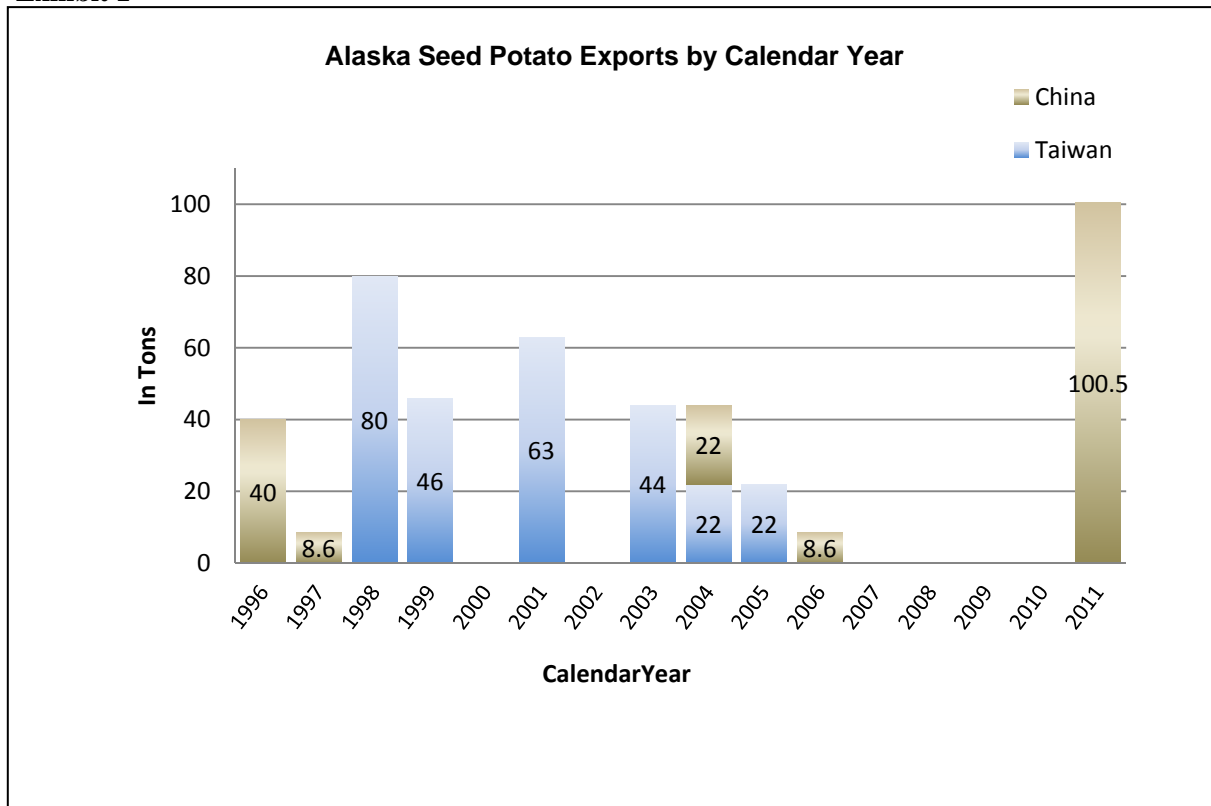
Export certification funding was intended to develop a seed potato export industry with the expectation that the industry would eventually pay for certification costs, including testing, through user fees. In FY 95, the legislature appropriated the first funding to UA “for the Virus Free Seed Potato Project.”

Exhibit 1 (following page) presents the amount of seed, in tons, shipped to Taiwan and China for calendar years 1996 through 2011. As shown in Exhibit 1, there were several years in which no seed potatoes were shipped to either China or Taiwan. Additionally, shipments have not been consistent.

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<sup>3</sup>The import and export of plants and animals are regulated by the federal government.

**Exhibit 1**



Source: Department of Natural Resources- Division of Agriculture

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## **REPORT CONCLUSIONS**

This audit reports on the Virus Free Seed Potato Project's (seed project) financial activities and determines if the seed project provides a positive monetary or non-monetary return to the State or private entities. Additionally, the audit determines whether continued state involvement in the seed project will yield positive returns and whether seed potato funding has been used for essential state services.

Whether or not regulation of seed potato crops is an essential state service is subjective and depends on the definition of *essential*. Diseased seed potatoes may create significant economic losses for producers; however, they do not result in illness or loss of human life. The agriculture industry views the inspection and certification process as essential to the success of the industry.

This audit concludes that no significant monetary or non-monetary returns are being received by the State or private entities as a result of certifying seed potatoes for international export. The export market is stagnant, the number of acres used to grow seed potatoes is not large, and the acreage has not increased. Furthermore, seed potato exports have not provided a positive return in terms of regulation costs compared to revenue generated by export sales. These factors are not expected to change. Consequently, the continued use of state resources to certify seed potatoes for international export will act as a subsidy for seed potato farmers.

The report conclusions, as they relate to export certifications, should not be interpreted as negating the necessity for state certification. Seed potato inspections and certifications have been conducted by the State since the mid-1960s to reduce the risk of disease. This audit does not conclude that continued state certification of seed potatoes is unwarranted or unnecessary.

Detailed conclusions regarding seed project funding, expenditures, administration, and monetary and non-monetary returns are listed below.

A total of \$5.5 million in state and federal funds have been appropriated for the seed project.

Exhibit 2 (following page) shows how \$5.5 million have been appropriated for the seed project from FY 95 through December 2011. Funding came from state general funds, the Agriculture Revolving Loan Fund (ARLF), the Science and Technology Foundation, and the federal government. Funding was either directly appropriated for the purpose of the seed project or departmentally allocated to the project.

Of the total, \$3.4 million (62 percent) were state funds and \$2.1 million (38 percent) were federal funds. Appendix A of this report details seed project funding by recipient, source, and fiscal year.

The majority of the funding appropriated to state departments (\$1.9 million) is passed through to the University of Alaska (UA) through reimbursable service agreements (RSAs).<sup>4</sup> The RSAs between state agencies and UA were generally for laboratory testing of seeds to determine if the seeds were free of specific diseases, as required for export certification. Direct federal grants to UA were for research associated with the seed project and were not specifically designated for export certification testing. UA's total seed project funding is detailed in Appendix B of this report.

## Exhibit 2

Summary of Seed Project Funding State and Federal Funding by Agency FY 95 through December 31, 2011						
Funding Type	DNR	DCCED	Office of the Governor	UA	Total by Type	% of Total
State Funding:						
Direct Appropriations	\$ 250,000	\$ 945,000	\$ - 0 -	\$ - 0 -	\$1,195,000	22%
Agency Allocated	<u>1,313,000</u>	<u>710,000</u>	<u>120,000</u>	<u>56,818</u>	<u>2,199,818</u>	<u>40%</u>
Subtotal State Funds	<u>\$1,563,000</u>	<u>\$1,655,000</u>	<u>\$ 120,000</u>	<u>\$ 56,818</u>	<u>\$3,394,818</u>	<u>62%</u>
Direct Federal Grants	<u>\$1,400,000</u>	<u>\$ 16,000</u>	<u>\$ - 0 -</u>	<u>\$ 689,292</u>	<u>\$2,105,292</u>	<u>38%</u>
Total Funds	<u><u>\$2,693,000</u></u>	<u><u>\$1,671,000</u></u>	<u><u>\$ 120,000</u></u>	<u><u>\$ 746,110</u></u>	<u><u>\$5,500,110</u></u>	<u><u>100%</u></u>

An objective of this audit was to identify seed project funding to the Northern Latitude Plant Materials Center (PMC), the Agriculture Development Allocation, the ARLF, and UA's Matanuska-Susitna experimental farm. In total, approximately \$1.6 million were appropriated to these entities specifically for the seed project as detailed below:

ARLF	–	\$ 200,000
PMC	–	\$ 1,095,000
Agriculture Development Allocation	–	\$ 318,000

Neither state nor federal funds were used for the project at any UA experimental farm – including the Matanuska-Susitna experimental farm.

<sup>4</sup>An RSA is an agreement between two state agencies whereby a one agency enlists the services of another to complete a specified service.

UA charges an indirect rate for overhead costs associated with RSAs and grants.

UA charges granting entities for overhead costs associated with performing laboratory testing and research projects. These indirect costs are in terms of a percentage of the total grant award.

From FY 03 through FY 10, the seed project indirect cost rate negotiated between the federal government and UA ranged from zero to ten percent. For the same period, the export certification indirect rate negotiated between the State and UA ranged from 10.2 to 25 percent. In examining 15 of 42 seed project related RSAs or grant agreements, no additional overhead charges were identified other than the indirect cost rate. As shown in Exhibit 3 (following page), approximately \$94,000 were recovered by UA through indirect charges.

UA's Plant Pathology and Biotechnology Laboratory is the primary UA facility used for the seed project.

The only significant UA facility used for the seed project has been its Plant Pathology and Biotechnology Laboratory. Based on time reports, approximately 56,000 laboratory staff hours were used for the seed project from FY 95 through December 2011. UA greenhouse usage was minimal – 600 square feet for one year. None of the three UA experimental farms were used for the seed project.

A total of \$3.4 million have been spent on the seed project from FY 05 through December 2011.

Exhibit 3 shows that a total of \$3.4 million were expended for the seed project from FY 05 through December 2011. It is important to note that Exhibit 3 includes \$1.2 million of federally funded Department of Natural Resources (DNR) expenditures that were used to purchase and relocate greenhouses. The greenhouse facilities encompass more than seed project activities. However, expenditures were not tracked at a level that would allow seed project expenditures to be specifically identified.

**Exhibit 3**

Seed Project Expenditures Total by Agency FY 05 through December 31, 2011				
Category	DNR	UA	Total	% of Total
Personal Services	\$ 930,039	\$ 795,666	\$ 1,725,705	51%
Travel	28,789	125,079	153,868	5%
Services	93,941	57,313	151,254	4%
Commodities	34,963	218,774	253,738	7%
Capital	957,699	58,739	1,016,438	30%
Other	-0-	5,723	5,723	0%
Direct Total	\$ 2,045,431	\$ 1,261,294	\$ 3,306,725	97%
Indirect Total	-0-	93,640	93,640	3%
Total	\$ 2,045,431	\$ 1,354,934	\$ 3,400,365	100%

Note: Exhibit 3 includes \$1.2 million of federally funded DNR expenditures that were used to purchase and relocate greenhouses. The greenhouse facilities encompass more than seed project activities. However, expenditures were not tracked at a level that would allow seed project expenditures to be specifically identified.

The largest category of seed project expenditures was personal services (51 percent of total expenditures). There were no expenditures by Department of Commerce, Community, and Economic Development (DCCED) or the Office of the Governor because the authorization to expend was passed through to UA in the form of RSAs.

Expenditure activity at DNR and UA includes costs for both the state certification and the export certification. Expenditures are not tracked at a level that would allow these expenditures to be split out between the two types of certification. The expenditures support the intent of the seed project. There is no indication that unreasonable or unnecessary expenditures occurred.

The seed project has resulted in minimal returns to the State and private enterprises.

The seed project has not provided significant monetary returns to state governmental agencies. UA collects no revenues in exchange for the laboratory testing they perform for export certification. Both DCCED and the Office of the Governor do not generate seed project revenues. Minimal revenues are generated by DNR through seed sales and export certification fees. From FY 01 through December 2011, the total DNR seed project revenue was less than \$230,000.

Export certification has produced limited monetary returns to private entities. Using the sales price of seed potatoes published by the United States Department of Agriculture, total revenue generated from exporting seeds to China and Taiwan is estimated to be between \$250,000 and \$750,000 since 1994. These revenues are not significant when compared to additional costs of laboratory testing required for export certification. Even though seed



project regulation costs are not tracked at a level that would allow the direct comparison of export revenues to export certification expenditures, we can conclude that most of UA's expenditures are associated with laboratory testing and these costs, by themselves, outweigh the revenues generated by the seed potato export market.

The lack of monetary returns related to the export of seed potatoes should not be interpreted as negating the necessity for state certification. However, we could not conclude as to monetary return related to state certification due to a lack of domestic price information. DNR staff reported the annual value of the in-state potato industry is \$2.4 million. State certified seed is considered essential to the success of the overall industry.

Non-monetary returns associated with the seed project include expanding Alaska's international market relations and expanding the knowledge base of seed potato diseases. Both of these non-monetary returns may reap some level of benefit to the State of Alaska over the long-term.

Export certification funding provides a subsidy to farmers that is not expected to change over the long-term.

Export certification funding was intended to spark a niche export industry in the State with long-range growth potential. Additionally, it was expected the industry would become self-supporting, paying for the cost of inspection, testing, and certification. To date, this goal has not been realized despite continued state funding. Alaska has not developed a viable, self-supporting seed potato industry. Without significant changes, continued state funding for export certification would be a continued subsidy to potato growers.

Several aspects of seed potato export, as currently managed, make an increase in future returns unlikely. There is a lack of coordination and cooperation between growers. The number of export markets has remained stagnant and current markets have not grown. Furthermore, the long growth cycle for seed potatoes makes the industry highly susceptible to disease and adverse weather.

Although growers do help and assist each other, no industry-wide plan has been developed to ensure the potato seed supply meets demand. Absent some type of industry-wide plan, it is unclear if there is enough supply available to consistently meet demand.

For these reasons, the decision to continue state funding for export certification should be made with the understanding that such funding subsidizes the seed potato export industry.

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## Appendix A

### Seed Project Funding By Department and Funding Source FY 95 through December 31, 2011

Fiscal Year	Department of Natural Resources			Department of Commerce, Community, and Economic Development			Office of the Governor	University of Alaska		Total by Fiscal Year	Percent of Total
	General Fund	Federal Receipts	Agricultural Revolving Loan Fund	General Fund	Federal Receipts	Alaska Science Technology Foundation		University General Fund	USDA Federal Receipts		
1995	-	-	-	-	-	120,000	-	-	-	120,000	2.2%
1996	26,000	-	-	-	-	100,000	-	-	-	126,000	2.3%
1997	-	-	100,000	-	-	-	-	-	-	100,000	1.8%
1998	-	-	100,000	-	-	-	-	-	-	100,000	1.8%
1999	75,000	-	-	-	-	-	-	-	-	75,000	1.3%
2000	-	-	-	120,000	-	-	-	-	-	120,000	2.2%
2001	-	-	-	-	-	-	120,000	-	-	120,000	2.2%
2002	-	1,350,000 *	-	80,000	16,000	-	-	-	-	1,446,000	26.3%
2003	-	-	-	165,000	-	-	-	-	26,392	191,392	3.5%
2004	-	-	-	120,000	-	-	-	-	-	120,000	2.2%
2005	50,000	-	-	-	-	-	-	-	51,400	101,400	1.8%
2006	105,000	50,000	-	120,000	-	-	-	-	526,500	801,500	14.6%
2007	250,000	-	-	-	-	-	-	-	-	250,000	4.5%
2008	-	-	-	-	-	-	-	-	-	-	0.0%
2009	225,000	-	-	-	-	-	-	-	85,000	310,000	5.6%
2010	212,000	-	-	-	-	-	-	-	-	212,000	3.9%
2011	200,000	-	-	230,000	-	-	-	56,818	-	486,818	8.9%
2012	220,000	-	-	600,000	-	-	-	-	-	820,000	14.9%
<b>Total by Source</b>	<b>1,363,000</b>	<b>1,400,000</b>	<b>200,000</b>	<b>1,435,000</b>	<b>16,000</b>	<b>220,000</b>	<b>120,000</b>	<b>56,818</b>	<b>689,292</b>	<b>5,500,110</b>	
<b>Total by Department</b>			<b>2,963,000</b>			<b>1,671,000</b>	<b>120,000</b>		<b>746,110</b>		

\* This funding was for a capital project for facilities that encompass more than potatoes. A break out of funding by program is not available.

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## Appendix B

### UA Seed Project Funding FY 95 through December 31, 2011

<u>Fiscal Year</u>	<u>Issuing Agency</u>	<u>Amount</u>
1995	DCCED	\$ 120,000
1996	DCCED	100,000
1997	DNR	100,000
1998	DNR	100,000
1999	DNR	75,000
2000	DCCED	120,000
2001	Office of Governor	120,000
2002	DCCED	80,000
2003	DCCED	165,000
2004	DCCED	120,000
2005	DNR	50,000
2006	DNR	155,000
2006	DCCED	120,000
2007	DNR	127,400
2008	No Funding	-
2009	No Funding	-
2010	DNR	12,000
2011	DCCED	230,000
2012	DCCED	150,000
<b>Total Pass-Through Funding</b>		<b>\$ 1,944,400</b>
2003	USDA	\$ 26,392
2005	USDA	51,400
2006	USDA	526,500
2009	USDA	85,000
<b>Total Federal Funding</b>		<b>\$ 689,292</b>
<b>Total Funding</b>		<b>\$ 2,633,692</b>

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# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

### COMMISSIONER'S OFFICE

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April 13, 2012

RECEIVED

APR 16 2012

LEGISLATIVE AUDIT

Kris Curtis, CPA, CISA  
Legislative Auditor  
Legislative Budget and Audit Committee  
PO Box 113300  
Juneau, AK 99811-3300

Re: Preliminary Report of Commerce, Community and Economic Development (DCCED),  
Department of Natural Resources (DNR), and University of Alaska (UA), Virus Free Seed  
Potato Project.

Dear Ms. Curtis:

Thank you for the opportunity to provide a written response to the Preliminary Report on the Virus Free Seed Potato Project.

The fundamental issue DNR has with the Preliminary Report is that the Report Conclusions do not provide a clear delineation between the two distinct seed potato programs housed within the Department of Natural Resources and the University of Alaska, Fairbanks. The report does not clearly state that DNR's Certified Seed Potato Program provides assistance to Alaska growers, supports local food production, and contributes to the health of the \$2.4 million dollar in-state potato industry. These are vital benefits to the state.

The preliminary report blends the two programs and references them jointly with the title commonly used for the University program, the Virus Free Seed Potato Project. Over the years there has been a great deal of confusion between the functions of these two programs and DNR believes the blending of the two programs in the audit report will add to the confusion. The DNR program provides virus-free seed to Alaskan seed growers, and provides for inspections of these growers. The UA program is focused on exporting seed potatoes to China and Taiwan.

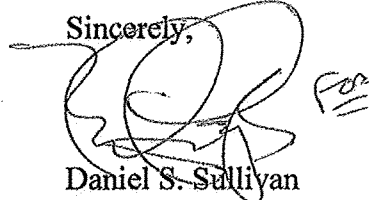
Also not clear throughout the report is the important difference between the DNR state certification portion of our program and the UA testing for export program. We feel the terms "certification" and "testing" were used incorrectly throughout the report. The DNR certification process provides assurance through field inspections that certified seed is relatively free from disease. The UA Virus Free Seed Potato Project provides laboratory testing for diseases of concern identified by the

*"To responsibly develop Alaska's resources by making them available for  
maximum use and benefit consistent with the public interest."*

importing countries of China and Taiwan, and is not conducted as part of the DNR certification process for local potato production.

We note that there were no findings or recommendations for this audit, and concur. If you would like additional information or clarification we would be happy to meet with you; we appreciate the time and effort you and your staff put into this audit.

Sincerely,



Daniel S. Sullivan  
Commissioner



Patrick Gamble, President  
Phone: (907) 450-8000  
Fax: (907) 450-8012  
email: ua.president@alaska.edu



UNIVERSITY  
of ALASKA  
*Many Traditions One Alaska*

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910 Yukon Drive  
P.O. Box 755000  
Fairbanks, AK 99775-5000

April 13, 2012

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APR 17 2012

LEGISLATIVE AUDIT

Kris Curtis, CPA, CISA  
Legislative Auditor  
Alaska State Legislature  
Division of Legislative Audit  
P.O. Box 113300  
Juneau, AK 99811-3300

Dear Ms. Curtis:

This letter is in response to your March 28, 2012, request for comments on the preliminary audit report titled "A Special Report on the Department of Natural Resources (DNR), the University of Alaska (UA), and the Department of Commerce, Community, and Economic Development (DCCED), Virus Free Seed Potato Project, March 2, 2012." We appreciate the effort and professionalism of the work done by you and your staff. This response will cover all report conclusions. Comments and observations will be made only on portions relevant to UA's participation in the project.

REPORT CONCLUSIONS

A total of \$5.5 million in state and federal funds have been appropriated for the seed project from FY95 through December 2011. Of the total, \$3.4 million (62 percent) were state funds and \$2.1 million (38 percent) were federal funds.

UA agrees that the amounts compiled and reported by the Division of Legislative Audit accurately represent the financial activity for this project across the past seventeen years.

Seed Potato Expenditures totaling \$3.4 million from FY05 through December 2011 were reasonable and necessary to carry out the purpose of the project. Expenditure activity includes state certification and export certification costs.

UA concurs that the project expenditures claimed for the UA portion of the project were reasonable and necessary to carry out the purpose of the project.

The only significant UA facility used for the seed project has been the Plant Pathology and Biotechnology Laboratory. UA charged indirect cost rates as part of the seed project grants and agreements.

UA agrees that the single lab identified was the only significant facility used for the program. All indirect rates charged were in accordance with the funding agreements with the respective grant and agreement sponsors.

The seed project has resulted in minimal monetary returns to the State and private enterprises.

UA was not asked to and did not play a role in determining tax revenue or economic benefits to the state or returns to private enterprises from this project. UA did not charge fees for export certification to private enterprises.

Non-monetary returns associated with the seed project include expanding Alaska's international market relations and expanding the knowledge base of seed potato diseases. Both of these non-monetary returns may yield benefits to the State of Alaska over the long-term.

UA concurs with the identified non-monetary benefits but again notes that it was not asked to nor did it play a role in identifying such non-monetary benefits. UA agrees, however, that the non-monetary benefits identified by the auditor will most likely accrue in the long term rather than the near term.

Export certification funding has provided a subsidy to growers. Without significant changes, future state funding for export certification will continue to be a subsidy to potato growers.

UA is not in a position to comment on whether or not the funding for export certification has served as a subsidy to growers.

## FINDINGS AND RECOMMENDATIONS

No comments

\* \* \* \* \*

Kris Curtis, CPA, CISA

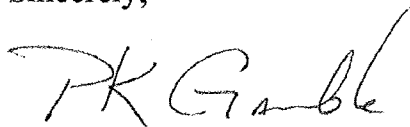
April 13, 2012

Page 3

In closing, UA appreciates the support and partnership of the state, the federal government, and the growers in the seed potato program across the years. Audit results indicate that there are several aspects of the program that have created difficulty in the effort "to spark a niche export industry." Those difficulties remain in place today. UA concurs with the assessment that a coordinated, industry-wide plan is needed in order to achieve different results than were realized in the past.

Again, thank you for the opportunity to comment. Please contact Nichole Pittman, Director of Statewide Audit, at 450-8094 if you have any questions or need to clarify anything in this response.

Sincerely,

A handwritten signature in black ink, appearing to read "PK Gamble". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Patrick K. Gamble

University of Alaska President

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STATE OF ALASKA  
DEPARTMENT OF  
**COMMERCE**  
COMMUNITY AND  
ECONOMIC DEVELOPMENT

Office of the Commissioner

*Sean Parnell, Governor*  
*Susan Bell, Commissioner*

April 18, 2012

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LEGISLATIVE AUDIT

Ms. Kris Curtis, CPA, CISA  
Legislative Auditor  
Alaska State Legislature  
Legislative Budget and Audit Committee  
Division of Legislative Audit  
P.O. Box 113300  
Juneau, AK 99811-3300

Re: Department of Natural Resources, University of Alaska, Department of Commerce,  
Community, and Economic Development Virus Free Seed Potato Project Preliminary  
Report Audit Control Number 10-30064-12

Dear Ms. Curtis:

Thank you for the opportunity to respond to the Preliminary Audit report referenced above.

We concur that the seed project has resulted in minimal returns to the State and that an increase in future returns is unlikely without significant changes to the project. DCCED supports review of potential program changes to provide industry development and export opportunities with investment return potential.

Again, thank you for an opportunity to respond to the audit. If you have any additional questions please contact me at (907)465-2500.

Regards,

Susan K. Bell  
Commissioner

cc: JoEllen Hanrahan, Director ASD, DCCED  
Wanetta Ayers, Director, DED, DCCED

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