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Audit Report

DEPARTMENT OF COMMERCE AND
ECONOMIC DEVELOPMENT
ALASKA TOURISM MARKETING COUNCIL

January 21, 1992

Audit Control Number:

08-4413-92

Division of Legislative Audit

P.O. Box 113300, Juneau, Alaska 99811-3300



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DIVISION OF LEGISLATIVE AUDIT

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DIVISION OF LEGISLATIVE AUDIT

Randy S. Welker, CPA
Legislative Auditor
Merle R. Jenson, CPA
Deputy Legislative Auditor

P.O. Box 13300
Juneau, Alaska 99811-3300

(907) 465-3830, Juneau
(907) 561-1445, Anchorage

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



P. O. Box W
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

March 26, 1992

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 COMMERCE AND ECONOMIC DEVELOPMENT ALASKA TOURISM MARKETING COUNCIL

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This report reviews the production methodology and costs of the two recently produced commercials -- Explorers Wanted and Adventures Wanted -- by the Alaska Tourism Marketing Council and its advertising contractors. In addition, we reviewed the contractual and financial relationship between the Alaska Visitor's Association and Department of Commerce and Economic Development.

The audit was conducted in accordance with generally accepted governmental performance auditing standards. Audit scope and methodology are discussed in the Report Objectives, Scope, and Methodology section of the report. Audit results may be found in the Auditor's Conclusions section and the Findings and Recommendations section of this report.

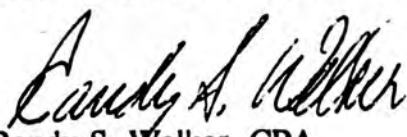

Randy S. Welker, CPA
Legislative Auditor

TABLE OF CONTENTS

	<u>Page</u>
Objectives, Scope, and Methodology	1
Organization and Function	3
Issues and Background	5
Auditor's Conclusions	7
Findings and Recommendations	13
Agency Responses:	
Department of Commerce and Economic Development	23
Alaska Tourism Marketing Council	28
Legislative Audit's Additional Comments	31

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 an audit of the Alaska Tourism Marketing Council (ATMC). The primary objectives of our audit were to determine whether the television commercials -- Explorers Wanted and Adventures Wanted -- were produced economically and were effective in bringing visitors to Alaska.

The policy and audit approach utilized by the Division of Legislative Audit for performance reports can best be described as "audit by exception." This methodology focuses audit effort on areas of an agency's operation that have been identified by a preliminary survey as having a high degree of probability for needing improvements.

Therefore, by design, finite audit resources are used to identify where and how improvements can be made and little attention is devoted to reviewing efficient operations or programs. Consequently, this report highlights those areas needing improvement and does not emphasize those operations and programs that are properly functioning.

Discussion of the Objectives, Scope and Methodology of our audit follows.

Objectives

The objectives of our audit were to:

1. Determine that the methodology for producing the two commercials was performed in an economic and efficient manner and that ATMC complied with state procurement laws and regulations.
2. Assess the commercials' effectiveness for bringing visitors to Alaska.
3. Ascertain ATMC's funding sources and compliance with Alaska Statutes regarding the receipt of the required industry contribution.

Scope and Methodology

The scope of this audit is divided into three sections: effectiveness of the two commercials, reasonableness of the production costs, and ATMC and Division of Tourism's compliance with Alaska laws and regulations. Due to the distinct subject matter of each section, varying approaches were developed for each area. The methodology for addressing each section is as follows:

1. Reasonableness of the Production Costs. We obtained and reviewed the commercials' production expenditures incurred by ATMC and the procurement procedures utilized

by ATMC and its advertising contractors. However, due to the procurement method utilized by the advertising contractor, we were unable to review the related costs incurred by the production company to ascertain reasonableness.

2. Effectiveness of the Two Commercials. We analyzed various research studies provided by the ATMC that were performed throughout the commercials' production. Secondly, the advertising agency provided us a listing of awards achieved by the commercials.
3. Compliance with Alaska Laws and Regulations. We reviewed the joint management agreement and associated accounting activities between Alaska Visitor's Association (AVA) and Department of Commerce and Economic Development for compliance with Alaska statutes. This included pertinent accounting information from unaudited financial schedules provided to us by AVA.

ORGANIZATION AND FUNCTION

The Alaska Tourism Marketing Council (ATMC) was established on July 1, 1988 as an instrumentality of the State in the Department of Commerce and Economic Development (DCED). It is a quasi-state corporation that has a legal existence independent of and separate from the State. The DCED commissioner has statutory authority on how to manage ATMC. Since the inception of ATMC, the commissioner has determined it is in the State's best interest to contract with a qualified trade association for joint management. Alaska Visitor's Association (AVA) is the trade association the department has an agreement with.

ATMC's statutory responsibilities include the following:

1. To conduct a tourism marketing program which promotes the State as a world class tourist destination.
2. To prepare and implement marketing plans for the promotion of Alaska tourism and perform necessary research on all tourism marketing plans.
3. To provide advice on tourism programs developed and performed by the Division of Tourism (DOT).

To accomplish its statutory mission ATMC consists of council members, a number of committees, and staff. ATMC is required to meet at least four times a year.

ATMC is governed by a 21 member board with 10 members appointed by the Governor, 10 members appointed by AVA, and the remaining member is the director of DOT, who is the presiding officer. Statutes require that all board members have business or government experience that would materially contribute to the planning, execution, or evaluation of the visitor industry promotional campaign.

Underlying the ATMC membership are six standing committees: planning, advertising, collateral, public relations, research, and fall/winter/spring. The planning committee oversees and coordinates other committees' activities with the overall ATMC marketing plan goals and objectives. The planning committee consists of all other committee chairs and the ATMC's presiding officer.

ATMC members are required to sit on at least one committee but are limited to two committees with the exception of the presiding officer. Other tourism industry professionals may sit on a committee with approval by the ATMC.

A periodical called the Vacation Planner is produced yearly by ATMC. The Vacation Planner includes editorial information about Alaska by region and advertising by Alaska tourism businesses. AVA sells the advertising space to all interested tourism-related

businesses to raise the required industry contribution and their pro rata share of the production costs. For the 1992 Vacation Planner, advertising rates ranged from \$200 for a five line narrative ad to \$165,000 for a two page display ad with a business reply card inserted.

Executive Director and Staff

Alaska Statutes limit ATMC staff to an executive director and no more than two other employees. The executive director of ATMC is selected by the council members. Currently, the administrative assistant position is filled and the marketing coordinator position is vacant.

ATMC's Funding Sources

Part of ATMC's funding includes a statutorily established 15% industry matching contribution based on total operating expenses of the council. The contributed revenue is transferred to ATMC and deposited into the State's general fund. The revenues are appropriated by the legislature annually to ATMC. The balance of ATMC's funding is derived from the general fund and DOT appropriations.

DCED, Division of Administrative Services and DOT

Both of these divisions provide assistance to ATMC in the areas of accounting, procurement, personnel, and budgeting. The DOT director is statutorily responsible for overseeing all ATMC procurement documents and procedures of the tourism marketing council to ensure compliance with applicable laws and regulations. Currently, ATMC has two different types of contracts. The joint management agreement between AVA and DCED and the advertising services contract with Bradley Communications (BC), a private contract.

The joint management agreement outlines the management responsibilities for AVA and DCED, the appointment process of AVA members to the council, the calculation for the required 15% industry contribution, and other administrative matters.

The advertising services contract with BC is a professional service contract. This contract is a five year contract not to exceed \$30,030,000. All advertising services requested by DOT and ATMC are procured by this contract. McCann-Erickson is BC's primary subcontractor.

ISSUES AND BACKGROUND

We were requested to review the methodology used to create two television commercials produced by the Alaska Tourism Marketing Council (ATMC) and the Department of Commerce and Economic Development (DCED), Division of Tourism (DOT) - Explorers Wanted and Adventures Wanted - and the composition of the commercials' total costs. In addition, we reviewed the contract administration procedures and the statutory funding scheme that related to these commercials.

Background

ATMC felt that new commercials were needed to assist in advertising Alaska as a world class travel destination. Commercials produced in prior years were found to be ineffective because of the number of times they had been shown on national television. Consumer research tests, conducted by ATMC's advertising contractors, indicated that travelers wanted to visit Alaska, but were not confident they could experience its natural wonders and participate in its activities. These test results influenced ATMC when developing the commercials' content. The commercials included scenery pictures with people performing various activities and enjoying Alaska's wildlife.

A plan was formulated into various production stages which included determination of activities, locations, schedules, and other production steps. During the planning and creative stage, February 1989 through August 1990, ATMC designed the commercials to include many activities performed in several locations around the State.

Bradley Communications (BC) and McCann Erickson (ME) are ATMC's advertising contractors. Their total cost to produce these commercials was \$734,005. The original cost estimate for the two commercials was approximately \$500,000, with the major components consisting of production and director services which were originally estimated at \$383,918.

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AUDITOR'S CONCLUSIONS

The major objective of our review was to evaluate the Alaska Tourism Marketing Council's (ATMC's) administration and supervision of the two promotional commercials filmed in 1991. A primary aspect of our assessment involved a review of ATMC's cost effectiveness in administering the contract with the subcontracting advertising agency. We also reviewed other aspects of ATMC's administrative activities such as the original design of the commercials and supporting rationale for any creative changes made during production. Based on our review of these factors, we make the following observations and conclusions.

Advertising agency production costs and procurement activities were not reviewed, controlled, and monitored by ATMC

McCann Erickson (ME) solicited project proposals from three production companies for the two commercials' production and director services. ME's creative director selected GMS, Inc. to perform these services. Though GMS, Inc. was the more costly proposal, the creative director's decision was based on subjective factors on staff qualifications such as cinematographer expertise, experience in complex location filming, national reputation, and originality.

The first bid of \$304,918 received from GMS, Inc. was for seven anticipated location filming days and contained a provision for weather contingency days at \$39,500 per day. The ATMC budget included the bid amount and two weather contingency days, maximizing the potential production costs to \$383,918. Filming was to occur between June 16, 1990 and June 25, 1990.

Though we were told by ME that this contract was to be conducted under the Association of Independent Commercial Producers (AICP) national guidelines and it was of a "firm bid" nature, ATMC could not provide us with a signed agreement. Under AICP standards, if production is postponed because of a contingency situation and is rescheduled for a later date, the client is required to pay all non-recoverable out-of-pocket expenses, full director's cost as bid, and a service charge.

The initial location filming was scheduled in Juneau on June 16, 1990. The weather on this day was rainy which prevented filming and a weather contingency day was called. On June 17, 1990 filming was successful in Ketchikan. The production team was able to accomplish scheduled location scenes. On June 18, 1990 the production crew flew to Anchorage, accomplished necessary filming, and flew to Homer. The weather in Homer was overcast and raining, so June 19, 1990 was the second weather contingency day. Due to future weather forecasts, all personnel agreed to postpone the filming until August 1990.

For the services received in June 1990, ME paid GMS, Inc., \$288,588 of the \$383,918 production budget. To complete the commercials' filming in August 1990, ME negotiated

a second contract of \$199,097. Since GMS, Inc. received approximately 75% of the initial budget for spending four out of nine days on location or 44% of their professional time, we requested an explanation on how the \$288,588 was determined. In addition, since industry standards provide for out-of-pocket reimbursement, we asked for detailed financial data supporting the amount paid. Neither ATMC nor ME could provide us with the details requested, claiming that since the bid was of a "firm bid" nature, they had no legal right to request the information from GMS, Inc. In addition, they could not provide us with financial detail supporting the negotiations of the second contract and how the \$199,097 was arrived at.

In our opinion, ATMC and DOT should be fully aware of contracts and related negotiations. They should review all financial data that has been utilized in making the decision to pay postponement costs and renewal amounts. (See Recommendation No. 3.)

The commercials that were designed were expensive

The commercials were designed to include the top ten activities rated in a market research study of Alaska tourists contracted by ATMC. To film these activities, the council wanted to include as many Alaska locations as possible. The original production schedule included filming in Juneau, Haines, Skagway, Anchorage, Homer, and Ketchikan. To accomplish all location filming, five days of production time were added to the commercials' location filming schedule. The daily professional rates per the original firm contract for the production crew ranged from \$150 for a production assistant to \$6,000 for the director. Total costs for the additional five days was approximately \$85,125. In addition, increased travel and per diem costs were incurred because of the many locations visited.

According to ME personnel, all filming for the two commercials could have been accomplished within two locations and on two days. However, according to ME, when they discussed this cost saving issue with ATMC and DOT, the state agencies opted to retain the initial planned locations rather than consider any cost savings.

ATMC requested changes in the commercials throughout the filming which resulted in additional production costs

A pre-production meeting was held on June 15, 1990 at BC's office. At this meeting, the day before location filming was to occur, the former ATMC executive director and an ATMC member added additional activities to the commercials. Adjustments to the production schedule had to be made in order to accomplish these added activities.

In addition, the original production plan did not include location filming in Fairbanks. An ATMC member inquired why Fairbanks was not considered when weather problems were encountered in Southeast Alaska and Homer. This member stated that Fairbanks' weather conditions were warm and sunny and felt the filming could have been accomplished. As a result of this council member's inquiry, the advertising agency had the wildlife photographer

perform services in Fairbanks. The original contract between the photographer and the advertising agency was \$7,000. Traveling to Fairbanks changed the original agreement that resulted in an increased contract price to \$11,899.

In our opinion, ATMC could have produced these commercials, at a lesser cost, if: (1) they had insisted that BC enforce the project's contract, monitored the advertising agency's activities, and reduced the number of filming locations; and (2) changes were not made by ATMC to the original creative plan.

Commercials' effectiveness cannot be determine until after the 1992 tourist season

We were asked to determine the effectiveness of the two commercials produced in bringing visitors to Alaska. These commercials were first shown on national television during January through April and in the fall months of 1991. The commercials televised during this time schedule are predicted, by Bradley Communications, to increase the visitor rate during the summer of 1992 peak tourism period. Due to this time frame, advertising research on the effectiveness of these commercials cannot be performed until after the completion of the summer season. Therefore, we are unable to determine the effectiveness of the commercials. However, ATMC did perform market research during the commercials' development stage. Secondly, during October 1991 a 1-800 number study was commenced to test the commercials. In addition, the advertising contractor reported to us that the two commercials have won several advertising awards.

Market research test results

ATMC conducted several research studies on the two commercials produced - Adventures Wanted and Explorers Wanted - throughout their creative development stages. The purpose was to verify that the final product would meet the commercials' pre-established goals and objectives. Additionally, information obtained from research studies was used to assist ATMC and the advertising contractor in refining the commercials.

Prior to showing the commercials on national television, an advertising research study called Audience Survey, Inc. (ASI) -- a generic industry term for research testing -- was performed during October 1990. The objectives of this study were to determine the commercials' ability to penetrate through all television advertising and to communicate messages to the consumer in an in-home viewing situation. In addition, it was used to make refinements to the commercials.

Market research using "recall" methods was performed on the completed commercials. This entails contacting potential respondents and requesting them to watch cable television on a given night and channel. The next day the participating respondents were called and asked various questions about commercials they viewed the night before. According to the research group, the number of respondents able to recall the specific commercial being tested directly relates to its ability to penetrate the market.

Explorers Wanted was tested October 1, 1990 in Riverside, CA and October 4, 1990 in St. Louis, MO. Adventures Wanted was tested on October 2, 1990 in Phoenix, AZ and October 3, 1990 in Oakland, CA. According to The Research Department, the company who performed the ASI tests, the results indicated that the majority of respondents liked the two commercials and found them enjoyable to watch. Attitude measures showed that key strategy points -- Alaska's scenery and activities -- were clearly interpreted by the respondents. Additionally, people's impressions were favorably changed with better climate, scenery, and activities which overall increased the potential visitors' interest.

According to the market research tests results interpreted by the research company, ATMC and its advertising contractors believe that these commercials will assist in increasing Alaska as a travel destination.

1-800 Test Results

During October 1991, ATMC added a 1-800 number to the end of the commercials. The idea was to have consumers located in a predetermined city, after viewing the commercials call the 800 number displayed and request information on Alaska. The caller would hear a recording asking 12 questions that related to various demographics. Additionally, the participant would be requested to give their name and address. In turn, they would be mailed a copy of the Vacation Planner.

For this one month research test, 10,000 calls were received with 4,875 calls completed. (Calls were determined to be completed when all demographic questions were answered.) The information obtained from these calls will be used to perform other research tests on the 1992 tourism season and to develop statistics on what the potential visitors' interests are.

According to the advertising agency, the research to be performed in 1992 will be to determine; (1) how many of the 4,875 callers actually visited Alaska, (2) if providing a telephone number at the end of the commercial increases the visitor rate, and (3) if that increase is cost effective advertising. The cost to have this service performed was \$7,500. If it is cost permissible the ATMC will consider including telephone numbers in future advertising.

Commercials have won national advertising awards

ATMC's advertising agency reported to us that the commercials' Explorers Wanted and Adventures Wanted have won the following national awards.

1. International Film and TV Festival of New York Finalist Award

The New York Festivals offer a professional evaluation of creative work provided by some of the most talented and experienced advertising practitioners from around the world.

2. Creativity '91 - Certificate of Distinction

The Creativity Show is the major international awards show for visual professionals. Judging is based on creative excellence.

3. Adweek Magazine Top Ten Creative Spots

This monthly industry magazine rates all new national commercials. During April 1991 the commercials were listed as one of their top ten spots.

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FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The joint management agreement between Department of Commerce and Economic Development (DCED) and the Alaska Visitor's Association (AVA) should be re-negotiated in order to comply with Alaska Statutes.

The commissioner of DCED has determined that it is in the State's best interest to contract with AVA to jointly manage Alaska Tourism and Marketing Council (ATMC). An agreement is formally negotiated between the DCED commissioner's office and AVA. Several stipulations within the FY 92 joint management agreement do not comply with the ATMC statutes.

- a. The management agreement limits AVA's matching contribution towards ATMC's operating expenses.

The management agreement states that if supplemental appropriations are received by ATMC, AVA is not obligated to match these funds. The agreement also states that AVA is not required to provide matching contribution for ATMC's expenditures relating to reimbursable services agreements (RSAs).

AS 44.33.705(b) states "...before the end of the fiscal year that the contract covers, the association will contribute at least 15% of the total operating expenses of the council for that fiscal year."

The statute is very specific about the required industry contribution. Operating expenditures incurred by ATMC regardless of the funding source or RSA activity should be matched by AVA. During FY 90, ATMC incurred \$406,000 of unmatched RSA expenses. Due to the agreement's provision, AVA did not contribute \$60,900 (\$406,000 x 15%) to match these valid operating expenses. Limiting the contribution based on the source of funding and the method of expenditure does not comply with the Alaska Statute.

- b. The management agreement improperly provides for a "ceiling" on the required industry contribution.

The management agreement states, "AVA shall provide an annual cash contribution to ATMC of at least (1) 15% of the total operating expenses of the Council or (2) \$1,070,000, ..., whichever is less." As stated above, the statute requires 15% of all ATMC's operating expenses be matched by AVA. The statute does not limit the amount of the contribution, but requires a percentage of matching funds based on

actual expenditures. Placing a ceiling on the contribution and not considering the actual expenditures is not in compliance with Alaska Statutes.

- c. The management agreement allows state funds to remain within AVA accounts rather than be deposited into the State's general fund.

The management agreement states that funds raised by AVA from any source remain the sole property of AVA until contributed to the council. AS 44.33.727 requires "*All funds obtained by the qualified trade association from the sale of space in publications and promotional materials and the sales of the mailing list, less the association's expenses related to those sales and leases, shall be transferred to the council for deposit in the general fund.*" AVA generates their required industry contribution from the sales of advertising in the Vacation Planner and the labels created from ATMC's mailing list. The net profit from these revenue sources are state funds and, therefore, should be transferred on a timely basis to ATMC for deposit in the general fund. Currently, AVA collects the revenues and only transfers the required amount of their contribution. The balance of the funds remain within AVA's interest bearing bank accounts. Allowing AVA to retain all remaining state funds does not comply with Alaska Statutes. (See Recommendation No. 5.)

- d. The method to calculate AVA's pro rata share of the Vacation Planner does not include all production costs.

The agreement states that AVA will pay its pro rata share of the actual production costs for the publication or promotional material. AVA has defined their pro rata share to include the actual costs incurred by ATMC for paper and printing of the actual pages used by AVA in the publication or promotional material.

AS 44.33.715(13) states "...[AVA] pays its pro rata share of the production costs for the publication." In our opinion, the statute provision refers to total planner production costs and should not be limited to the cost of paper and printing. The 1992 Vacation Planner's production cost is approximately \$600,000 which includes \$484,179 of printing and paper costs. The 1992 Vacation Planner consists of 126 pages (including the front and back covers) of which AVA used 63.5 pages. AVA was billed \$244,011 ($[\$484,179 / 126] \times 63.5$). However, if the total production costs were used, the State would have been reimbursed for the Vacation Planner expenses totaling \$302,381. The result is that the State has incurred \$58,370 more than their pro rata share.

- e. The agreement should be reviewed and formally approved by the attorney general.

The agreement between AVA and DCED can be defined as a contractual relationship. The agreement is very technical in substance and not a state standard form contract. Due to its complexity, a contract of this nature should be approved by the attorney

general as to form and content. We were unable to obtain supporting evidence that the attorney general approved the agreement.

The legislative intent behind creating ATMC was to form a partnership between the tourism industry and state government. This partnership was to combine the government and private sector efforts to enhance the Alaska tourism market within the statutory framework established by law. However, the agreement, as written, does not comply with the intent of the legislature. Specifically, the matching concept is not working as envisioned, state funds and related interest earnings are not being transferred in a timely manner, and the State is incurring more than its share of publication expenses.

For these reasons, we recommend that the joint management agreement between DCED and AVA be renegotiated and reviewed by the attorney general.

Recommendation No. 2

DCED should require provisions in the management agreement to better protect the State's interest.

In addition to the changes noted in Recommendation No. 1, DCED should include the following items in the joint management agreement to ensure the State's interest is protected.

- a. The agreement should require an annual financial compliance audit of AVA's cooperative marketing program funds.

An annual financial compliance audit of the cooperative marketing program funds, preferably procured by DCED, would ensure that revenues received and expenditures incurred were properly accounted for and activities conducted were in compliance with state laws and regulations. The current agreement is silent on this issue. AVA's cooperative marketing program is audited annually. It appears that this audit's primary emphasis is on proper financial reporting. The audit does not include compliance reporting procedures relating to state laws and regulations, nor the proprietary determination of the fund's recorded revenues and expenditures related to AS 44.33.727 and AS 44.33.715 (13). (See Recommendation No. 5.)

- b. The agreement should address the disposition of interest earnings on the revenues generated from the sale of advertising space and label sales.

Currently, AVA invests revenues received in an interest bearing bank account. The interest is recorded in the cooperative marketing fund and is retained by AVA. In similar situations, the attorney general's office has opined that interest earnings belong to the State. In our opinion, since the interest was earned on state funds, the interest income should also be transferred to the State in a timely manner.

- c. The agreement is silent on the definition of selling and administrative expenses for the advertising space and label sales.

Alaska Statutes allow AVA to deduct their selling and administrative expenses incurred for procuring the advertising space in the Vacation Planner and the label sales. However, the agreement does not provide any explanation of what are valid selling and administrative expenses. In our opinion, during FY 91, AVA incurred \$416,321 of expenses in the cooperative marketing program (see Recommendation No. 5) that do not appear to be related selling and administrative expenses.

Defining allowable expenses will assist the trade association in their accounting for state revenues and the timely transfer of the appropriate amounts to ATMC.

Recommendation No. 3

DOT and ATMC should establish administrative procedures to monitor advertising firms for contractual compliance.

In February 1988, DOT signed a five-year contract for advertising services with Bradley Communications (BC), an Alaskan firm and BC's subcontractor, McCann-Erickson (ME), a national firm.

Currently, BC is responsible for the day-to-day contact, administration, and billing to state agencies. ME is responsible for the marketing plan's creative development and design, and the purchase of national cable air time. Both BC and ME utilize subcontractors. Expenditures incurred by ME and other subcontractors are billed to BC. In turn, BC requests payment from ATMC and DOT.

ATMC's yearly advertising program is designed to generically promote Alaska as a world class travel destination. For FY 91, BC and its subcontractors received at least \$5,159,000 from ATMC for advertising services. The advertising services are performed on a project basis. Specifically, commercials are developed, the Vacation Planner is created, and Alaska is advertised in national magazines.

During our review of the expenditures related to the commercials, we determined the following contractual stipulations were not enforced.

- a. No formal documentation exists that indicates DOT and ATMC formally approved the use of subcontractors for the two commercials reviewed.

The contract contains a provision that states "*...The State will approve whether a contract should be subcontracted. All subcontracts will be subject to state approval.*"

Certain advertising services are specialized and are not performed by BC. Therefore, the advertising firm subcontracts these services to industry professionals. For instance, for the commercials being reviewed, production and director services were subcontracted to GMS, Inc., a California based company. This firm received \$497,776 for their services. From our review of records filed in DOT and ATMC, there is no evidence that either agency formally approved the use of this subcontractor.

b. Alaska vendor preference was not enforced for the two commercials.

During the location filming for the television commercials, all travel arrangements for personnel were procured through a Jackson, Wyoming travel agency. Alaska travel agents were not considered for these services, nor did BC or ME require the use of Alaskan vendors by GMS, Inc.

The advertising contract contains a provision for use of subcontractors: *"All subcontractors which are necessary for the execution of this contract will utilize a competitive bid process and favor Alaska Vendors to the maximum legal extent."* We recommend that DOT and ATMC develop procedures to monitor BC's subcontracts to ensure that all contractual provisions are followed. (See Auditor's Conclusions section.)

Though its questionable whether the procurement code applies to subcontractors of subcontractors, to ensure Alaska vendors have an opportunity to be considered, we feel Alaska vendor preference and competitive principles should be followed.

Recommendation No. 4

DOT should establish procedures to oversee ATMC's contracting activities to ensure compliance with Alaska Statute.

The director of Tourism is statutorily responsible for ATMC's procurement activities. AS 44.33.120(b)(3) states, *"The Alaska division of tourism shall review and approve the procurement documents and procedures of the tourism marketing council to ensure compliance with applicable laws and regulations."*

Current monitoring procedures include DOT's review of BC's billings (which include subcontract expenditures) and supporting documentation for propriety and compliance with state laws and regulations. However, supporting documentation relating to subcontractors' invoices is retained in BC's office and is not submitted to DOT and ATMC. Rather, they rely on BC to monitor subcontractors' expenditures for state compliance and contractual provisions. Due to these procedures, DOT does not have access to the supporting documentation which is essential for proper disbursement of state funds.

DOT staff does not receive adequate supporting documentation for processing contract billings.

Invoices reviewed in BC's billing files indicated that at various times BC paid for former ATMC personnel travel expenses. On one occasion we noted that the State's standard per diem allowance was also paid during the same time period. Since DOT does not receive adequate supporting documentation, these expenditures were paid twice.

In addition, we noted that it was DOT's and ATMC's intent to fund the commercials' expenditures from the DOT supplemental appropriation received in March 1990. However, DOT staff did not receive adequate supporting documentation to properly record all the expenditures to the correct funding source.

Total production and director expenditures obligated during June 1990 were \$288,588. However, the DOT supplemental appropriation only reflects \$250,000. The balance of the commercials' costs were recorded to ATMC's FY 91 authorization, with services received in FY 90. The posting error to the incorrect authorization could potentially violate the Legislative Budget Act.

For these reasons, we recommend that DOT and ATMC receive all subcontractor supporting documentation. Prior to payment, the state agency personnel should review the billings for compliance with contractual provisions and state laws.

Recommendation No. 5

DOT and ATMC, after consulting with the attorney general, should initiate a compliance audit and, if determined necessary, pursue collection for any state funds held by AVA or related to unallowable expenditures.

AVA sells advertising space to Alaska businesses in the Vacation Planner published yearly and sells mailing labels to qualified tourism businesses. The revenues collected by AVA, less the related selling and administrative expenses incurred, are statutorily required to be transferred to ATMC for deposit in the State's general fund. Additionally, AVA is required to pay its pro rata share of the Vacation Planner.

AS 44.33.727 states:

All of the funds obtained by the qualified trade association from the sale of space in publications and promotions materials and from the sale or lease of tourism mailing lists, less the association's expenses related to those sales and leases, shall be transferred to the council for deposit in the general fund. The amount of the funds turned over to the council under this section shall be applied to the required contribution of the association.

Furthermore, AS 44.33.715 (13) states:

...[AVA] pays it pro rata share of the production costs for the publications or promotional material; payment under this paragraph is not part of the association's required contribution.

Currently, ATMC and DOT do not ensure that the State's general fund receives all the revenues it is statutorily entitled to.

- a. AVA only transfers the required 15% contribution and their pro rata share of the Vacation Planner.

Revenues received for advertising and label sales are deposited in AVA's restricted cooperative marketing fund. All financial activity, including revenues and expenditures related to the cooperative marketing program, is accounted for within this separate fund.

AVA provided the Division of Legislative Audit with a detailed FY 91 financial schedule of the revenues and expenditures accounted for within the cooperative marketing fund.

It appeared from the financial information provided that current AVA practice is to transfer funds to ATMC for the 15% contribution and their pro rata share of the Vacation Planner expenses. Other expenditures that appear not to be related to qualified selling expenses are not paid to the State but recorded against state revenues received. Secondly, all excess proceeds including related interest earned remain within AVA's accounts. Furthermore, ATMC and DOT personnel do not request AVA to transfer the fund balance at the fiscal year-end.

For FY 91, in addition to those expenses not qualified as "related" to revenues generated, excess funds totaling \$129,132 were retained by AVA. According to Alaska law, these funds should be transferred to ATMC for deposit into the State's general fund.

In addition to the excess funds remaining within AVA accounts, we question whether the following expenditure items that were paid by state funds were related to the advertising and label sales as required by AS 44.33.727.

- b. AVA incurs additional expenditures within the cooperative marketing fund that appear to be unallowable.

As stated above, AVA is allowed to deduct selling and administrative expenses related to advertising and label sales. However, from the FY 91 AVA financial schedule presented to us, they incurred expenses within the cooperative marketing

fund that are not directly related to the selling of advertising and labels. For instance, AVA received a grant from a private corporation totaling \$746,880. The related grant expenses totaled \$1,026,880 (print campaign). The excess expenditures, \$280,000, was funded with the revenue received from the advertising and label sales.

Additionally, AVA is recording private contract fees and other expenses totaling \$94,629 and \$38,692, respectively against the cooperative marketing funds. These expenditures combined total \$133,321 and do not appear to directly relate to the selling and administrative expenses for advertising and label sales.

Overall, for FY 91, the State's general fund did not receive approximately \$542,453 it was statutorily entitled to. Therefore, we recommend that DOT and ATMC, in conjunction with the attorney general's office, determine what is legally owed the State and collect any state money held by AVA.

In addition, during FY 91 AVA reimbursed ATMC \$277,300 for their pro rata share of the Vacation Planner expenses. This payment was funded by advertising revenues received. Alaska Statutes specifically state that AVA may deduct their related selling and administrative expenses and their required 15% contribution from the advertising sales. However, the statutes do not allow the Vacation Planner's production costs to be funded with these revenues. Secondly, Alaska Statutes state that the payment received for the pro rata share of the Vacation Planner is not part of the association's required 15% contribution. In our opinion, these expenses may be due the State. We recommend that DOT and ATMC consult with the attorney general's office regarding the funding of AVA's production costs for the Vacation Planner.

We recommend that ATMC improve their monitoring procedures for AVA by ensuring that all revenues received less the "related" selling and administrative expenses are transferred to the general fund. If DOT and ATMC required a separate compliance audit on the cooperative marketing fund this would provide more assurance that unrelated expenditures were not applied to state revenues and that all funds were appropriately transferred to the State. (See Recommendation No. 2.)

Recommendation No. 6

DOT and ATMC should improve their efficiency in accounting and reporting systems to support advertising projects' actual expenditures, to account for revenue sources, and to maintain budgetary control over financial transactions.

Accurate accounting records are needed to provide current budgetary status and to historically reflect the actual financial activity that occurs during the fiscal year. Currently, the accounting practices of DOT do not provide an accurate financial history of DOT and ATMC's activities. During our review of the expenditures related to the television commercials we noted instances of inaccurate recording of financial transactions.

- a. Advertising project expenditures are not properly recorded on the State's accounting system.

DOT and ATMC utilize AKSAS program structure to account for a specific advertising project's cost. Project accounting should enable users of the system to obtain an AKSAS audit trail of all specific advertising project costs listed either by detailed transactions or in summary form.

We obtained an AKSAS audit trail for the two television commercials' production costs. Total expenditures reflected for the television commercials totaled \$835,159. The actual expenditures reported to us were \$734,004, according to DOT's manual accounting records. The difference of \$101,155 consists of unrelated expenditures recorded to the television commercials' established program code.

Current accounting procedures in DOT are to reserve funds by establishing an encumbrance for a project's estimated cost. As project expenditures are incurred, the transactions are recorded to the program account and the encumbrance is subsequently reduced by that amount. Theoretically, when the project is completed if costs were lower than estimated the encumbrance balance should be released and the funds made available for other projects. However, current procedures within DOT are to record other advertising project expenditures against the remaining encumbrance balance. As a result, the actual project costs on all projects become inaccurate.

- b. State accounting records do not clearly reflect the revenue source to efficiently ascertain contract compliance.

DOT and ATMC receive revenues from AVA for two purposes. AVA is required to contribute 15% of ATMC's operating expenses and to pay their pro rata share of the Vacation Planner's costs.

During our fieldwork, we attempted to determine how much revenue was received from the two sources. We obtained FY 90 and FY 91 AKSAS audit trails of all revenues received by ATMC. The revenue sources were not identifiable on the audit trail, but could be determined by a manual accounting system maintained by DOT. Specific identification of revenue sources would assist management in verifying that the 15% industry contribution was received. We recommend that DOT and ATMC record revenues so that specific identification can be determined by source.

- c. Financial transactions between AVA and DOT are not recorded on AKSAS.

During FY 91, DOT granted a credit of \$50,000 to AVA against their pro rata share of the Vacation Planner. This credit was granted because AVA provided services on behalf of DOT. However, this credit transaction was not recorded on AKSAS resulting in understated revenues and understated expenditures of \$50,000.

The importance of using the State's accounting system to record financial transactions is noted within Alaska Statutes. Specifically, AS 37.05.140(a) states, "*Duplicate accounting records may not be maintained, except in the office of the Department of Administration as it directs.*" Additionally, AS 37.05.150 states:

The accounting system must be in accordance with accepted principles of governmental (fund) accounting and must include both budgetary and property accounts. The system must provide records showing at all times by funds, accounts, and together pertinent classifications the amounts appropriated, the estimated revenue, actual revenue or receipts, the amounts available for expenditures, the total expenditures, the unliquidated obligations, actual balances on hand, and the unencumbered balances of appropriations for each state agency.

Using manual records to reflect nonsystem-generated transactions prevents recording of accurate financial information in the State's underlying accounting records. Accurate financial records are needed for management information and history of actual financial transactions. In addition, a manual accounting system does not comply with Alaska laws and regulations and should be discontinued.

We recommend that DOT comply with Alaska Statutes and record all financial transactions on the State's accounting system. Recording all transactions on AKSAS will provide accurate and historical financial information to assist ATMC and DOT management in monitoring AVA for financial and statutory compliance.

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

P.O. BOX D
JUNEAU, ALASKA 99811-0800
PHONE: (907) 465-2500

May 1, 1992

MAY 1992

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

Dear Mr. Welker:

Thank you for the opportunity to respond to the preliminary audit report prepared by your division on the Department of Commerce and Economic Development and the Alaska Tourism Marketing Council.

I appreciate the work done by you and your staff to assure that the cooperative marketing program established by the Legislature is conducted efficiently and in compliance with the statutes.

With regard to the Auditor's Conclusions, I have enclosed a letter that reflects the views of both the Alaska Tourism Marketing Council (ATMC) and the Department of Commerce and Economic Development.

As for the Findings and Recommendations of the auditor, I will address them in the format they were presented:

Recommendation #1: The joint management agreement between DCED and the Alaska Visitors' Association (AVA) should be renegotiated in order to comply with Alaska Statutes.

A. The management agreement limits the AVA's matching contribution toward ATMC's operating expenses.

Response: I agree. The current management agreement excludes supplemental appropriations and RSA's from the required 15% match. These terms were agreed upon after a great deal of negotiation between the Department of Law, this department, and the Alaska Visitors' Association (AVA).

However, due to the issues raised in this recommendation, the FY 93/FY 94 management agreement now provides a mechanism for AVA to match supplemental appropriations. In addition, I agree with the auditor that reimbursable services agreements (RSAs) should be matched. Language regarding RSAs has been removed from the FY 93/FY 94 management agreement.

- B. The management agreement improperly provides for a "ceiling" on the required industry contribution.

Response: I agree. A cash ceiling is provided for in the current management agreement. After consulting with the Department of Law, we have removed the ceiling clause from the new management agreement.

- C. The management agreement allows state funds to remain within AVA accounts rather than be deposited into the state's general fund.

Response: I disagree. Funds raised by the AVA are being deposited in the general fund to meet the qualified trade associations's match of 15% of the total operating expenses of the council (AS 44.33.705(b)) and to satisfy their pro rata share of the production costs of the vacation planner (AS 44.33.715(a)(13)). However, I agree with the auditor that these are state funds. The new management agreement that covers the next two fiscal years no longer states the funds are the "sole property of the AVA until contributed to the council." In addition, the new management agreement requires AVA to transfer all funds raised by AVA for the cooperative marketing program, including interest, to the general fund should the AVA and the Department of Commerce and Economic Development no longer have a management agreement.

- D. The method to calculate AVA's pro rata share of the vacation planner does not include all production costs.

Response: I agree. The new agreement states that AVA's pro rata share will be based on the total production costs of the vacation planner.

- E. The agreement should be reviewed and formally approved by the Attorney General.

Response: I agree. The new agreement has been reviewed and formally approved by the Department of Law.

Recommendation #2: DCED should require provisions in the management agreement to better protect the state's interest.

- A. The agreement should require an annual financial compliance audit of AVA's cooperative marketing program funds.

Response: I agree. The new agreement requires AVA to provide the department with portions of AVA's annual audit relating to the cooperative marketing program. In addition, the new agreement provides the department access to all of AVA's records that relate to the cooperative marketing program.

- B. The agreement should address the disposition of interest earnings on the revenues generated from the sale of advertising space and label sales.

Response: I agree. Future agreements will discuss the disposition of interest earnings.

- C. The agreement is silent on the definition of selling and administrative expenses for the advertising space and label sales.

Response: I agree. Specific language defining allowable expenses will be included in all future agreements.

Recommendation #3: DOT and ATMC should establish administrative procedures to monitor advertising firms for contractual compliance.

A. No formal documentation exists that indicates DOT and ATMC formally approved the use of subcontractors for the two commercials reviewed.

Response: I agree that no formal documentation exists. The ATMC uses the committee process in monitoring its contracts. In this case, the advertising committee reviewed and approved GMS Inc. Their decision was then presented to the entire ATMC in the advertising committee's verbal report.

However, GMS Inc. is a subcontractor of the primary subcontractor, McCann Erickson. According to the department's policy on subcontractor approval, no formal approval documentation is required for subcontractors of subcontractors.

B. Alaska vendor preference was not enforced for the two commercials.

Response: I disagree. As required by AS 36.30.250(b), Alaska Vendor Preference was used in the selection of the advertising contractor, Bradley Communications. In addition, pursuant to AS 36.30.210(a), all subcontractors are required to have Alaska business licenses. However, the firms in question, GMS Inc. and a Wyoming travel agency, are not subcontractors. They are subcontractors of the subcontractor, McCann Erickson, who is a subcontractor to the prime contractor, Bradley Communications. In accordance with AS 36.30.250(b), there are no vendor preference requirements for subcontractors of subcontractors.

Recommendation #4: DOT should establish procedures to oversee ATMC's contracting activities to ensure compliance with Alaska Statute.

DOT staff does not receive adequate supporting documentation for processing contract billings.

Response: I agree. Adequate documentation was not being forwarded to the ATMC during the audit period. Procedures were established by ATMC in October 1991 requiring Bradley Communications to submit all the backup from their subcontractor, McCann Erickson, with their invoices.

The specific travel incident referred to, per the copy received from the auditor, resulted from the existing and current departmental travel procedures not being followed. The previous Executive Director's travel was approved only by Anchorage staff and not by the Commissioner or his designee as the department requires. This was, and is, inappropriate.

Recommendation No. 5: DOT and ATMC, after consulting with the Attorney General, should initiate a compliance audit and, if determined necessary, pursue collection for any state funds held by AVA or related to unallowable expenditures.

- A. AVA only transfers the required 15% contribution and their pro rata share of the vacation planner.

Response: This recommendation restates the concerns stated in Recommendation No. 1(b) and 1(c). Please refer to our responses to those recommendations.

- B. AVA incurs additional expenditures within the Cooperative Marketing Fund that appear to be unallowable.

Response: It is not possible to respond to the specifics of this recommendation because we have not had access to the information the auditor used in developing this recommendation. However, as stated in the response to Recommendation No. 2(a), the department will be requiring financial audits in future management agreements with AVA. In addition, as stated in the response to Recommendation No. 2(c), allowable expenses will be defined in future management agreements.

Also, the department has consulted with the attorney general's office regarding the funding of AVA's pro rata share of the vacation planner. The new management agreement for FY 93 and FY 94 will allow the AVA to use revenue raised under AS 44.33.715 (a)(13) and (14) to satisfy their pro rata share of the vacation planner.

Recommendation # 6: DOT and ATMC should improve their efficiency in accounting and reporting systems to support advertising projects actual expenditures, to account for revenue sources, and to maintain budgetary control over financial transactions.

- A. Advertising project expenditures are not properly recorded on the state's accounting system.

Response: I disagree. Expenditures are posted to the agency's appropriation or allocation through the use of collocation codes. As required by Section 12, Article IX, of the state constitution and as discussed in AAM 35.010 and AAM 25.020 of the state Administrative Manual, financial information is required at the appropriation, allocation and collocation code level. The information is available and correct.

State agencies use manual systems, separate data bases and/or AKSAS's lower levels to help capture additional financial data for management purposes. All methods are purely optional and may be used in whatever way best serves the needs of the agency.

The use of the subsidiary levels, i.e., project accounting, within AKSAS is also optional. DOT and ATMC use project accounting to distinguish the budget of each project being performed by the contractor. Staff then monitors each project for possible overexpenditures. Once a project is complete, and if funds are remaining, payments for other projects are applied to those funds.

The system used by staff was never intended to track actual expenditures on a long-term basis but rather was used to monitor for overexpenditures while a project is in process. The "manual" system referred to by the auditor is financial information extracted from AKSAS which was reformatted using Lotus 1-2-3 to meet the needs of management. Spreadsheet

May 1, 1992

and reformatting capabilities are not available in AKSAS. Across the departments, agencies extract and download AKSAS financial information and reformat it using spreadsheet tools such as Lotus 1-2-3, Excel, Multiplan, etc. This includes the Division of Finance.

In summary, expenditures are recorded correctly in AKSAS, the use of subsidiary ledgers is strictly optional, and the project accounting used by staff was designed to track budget allocations and not actual expenditures. It is generally recognized that AKSAS cannot do everything, so the use of PC capabilities is encouraged.

B. State accounting records do not clearly reflect the revenue source to efficiently ascertain contract compliance.

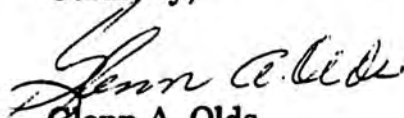
Response: I disagree. There is ONE revenue source, the AVA, and revenue is posted correctly to the ATMC appropriation using a restricted revenue account code. The further breakdown of this revenue source between the 15% match and the vacation planner is optional. The agency chose to identify them by using Lotus 1-2-3. This is perfectly acceptable, especially in light of how few deposits are made, four (4) annually.

C. Financial Transactions between AVA and DOT are not recorded on AKSAS.

Response: I agree. The financial transactions referred to are the credits toward AVA's pro rata planner share expenditures AVA incurred on behalf of DOT and/or ATMC. The precedent of allowing credits was established in the original Settlement Agreement which was signed by the Department of Law. In addition, the inability to record the credits in AKSAS was discussed with the Department of Administration. The consensus at the time was that it was not possible to record the credits in AKSAS as revenue and that the department needed to keep track of them in a separate system.

In conclusion, the Department of Commerce and Economic Development appreciates the opportunity to work with you to assure that the state's best interests are being advanced in the tourism cooperative marketing program. If there are other ways that my department can be of assistance, please let me know.

Cordially,


Glenn A. Olds
Commissioner

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Enclosures

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

DIVISION OF TOURISM

WALTER J. HICKEL, GOVERNOR

P. O. BOX E
JUNEAU, ALASKA 99811-0800
PHONE: (907) 465-2010

MAY - 1992

April 23, 1992

The Honorable Glenn A. Olds
Commissioner
Department of Commerce and
Economic Development
PO Box 110800
Juneau, AK 99811-0800

Dear Commissioner Olds:

RE: Preliminary Audit Report on Alaska Tourism Marketing
Council, January 21, 1992.

The following response to the auditor's conclusions and recommendations are submitted jointly by the Alaska Tourism Marketing Council and the Division of Tourism. We believe it adequately answers the questions posed by the auditors, provides solutions to indicated problems, and charts a course for a productive future for Alaska's tourism marketing efforts. We sincerely hope that after review, both you and the Division of Legislative Audit concur with these observations.

Conclusion 1. Advertising agency production costs and procurement activities were not reviewed, controlled, and monitored by the ATMC.

At the instruction of the ATMC, McCann Erickson (ME) developed a creative platform matching our marketing plan and then solicited proposals from three companies for the production of two commercials. ME's creative director selected GMS, Inc. to perform these services based on the terms of its proposal and consideration of other important criteria such as staff qualifications, overall experience, national reputation, and the abilities of the cinematographer and director. A standard industry contract was signed with GMS, Inc. which provided for the cost to be calculated on the basis of time and labor and made an allowance for two weather contingency days. Unfortunately, this contract did not address the unique challenges of film production in Alaska, where standard industry practices are both difficult and costly to maintain.

When the worst summer weather in Alaska's history forced first the alteration, and later the cancellation of the shoot, there was no alternative except to negotiate the best terms possible for settlement of the problem which ATMC ultimately did.

ATMC's efforts resulted in a reduction of cancellation penalties by approximately \$95,000 and also avoided the likelihood of costly litigation. In view of past production experience, both the price and the terms of the contract appeared reasonable at the time the contract was negotiated. However, based on this experience, the ATMC will, in the future, exercise more direct control over the budgeting, awarding and monitoring of such contracts.

Conclusion 2. The commercials designed were expensive.

The initial estimate of approximately \$500,000 for two commercials seemed not to be out of line when viewed in the context of (a) the projected amortization of costs over a three to five year period, (b) comparative prices of other national commercials shot in Alaska, including Miller Beer (\$1,500,000), McDonalds (\$1,600,000), Jeep, Toyota, Postal Service and Ruffles and others, all budgeted at \$750,000, and (c) the fact that both marketing and political considerations called for shooting locations throughout the state, a practice which substantially increased the cost estimate. In the future we will make sure that certain contract provisions such as weather days will be greatly altered, since this factor alone accounted for virtually all of the cost overruns. While we regret that there were cost overruns during the production of the commercials, we are nevertheless pleased that we did produce two commercials which match our marketing objectives, have earned national recognition, and, when amortized over a three to five year period, should prove cost effective.

Conclusion 3. ATMC requested changes in the commercials throughout the filming which resulted in additional production costs.

The fact that we were able to obtain sufficient footage to produce the commercials we are now using is due to the fact that we did request changes. In Alaska, flexibility is the key to successful production, since adverse conditions in one area may force last minute changes to avoid downtime. In film production, as in many other endeavors, non-productive time is the most expensive time. Numerous changes were made--admittedly not always successfully--in attempts to shoot "around the weather." Had we been completely successful, cost overruns would have been greatly reduced or eliminated altogether. But even as it was, we were able

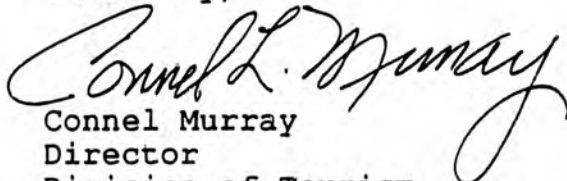
page 3

to produce two national award-winning commercials. We respectfully suggest that we should not be faulted for our serious efforts at damage control--particularly since these actions precisely answer the concerns expressed in Conclusion 1 (i.e. a lack of monitoring and control of the subcontractor by the ATMC).

In Summary

We have taken steps to see that any future film shoots and related procedures are conducted in as responsible and efficient a manner as possible, with appropriate management and oversight throughout. We acknowledge that our former staff did not inform the council of the full scope of problems. New procedures and new staff and management should prevent such occurrences in the future. The Commissioner is intent on fostering stronger policy interaction with the Council to ensure close collaboration on these matters in the future. Finally, recent action by the council returns primary responsibility for creative and production work to our prime contractor, thus permitting more control over subcontractors while also meeting the "Alaska Vendor Preference" recommendation made by the audit committee. ATMC has always operated with the goal of giving the State of Alaska the best value possible for its promotional dollar. We will continue to pursue this goal fervently in the future.

Sincerely,


Connel Murray
Director
Division of Tourism


Tina Lindgren
Executive Director
A.T.M.C.

CM/nbm

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



P. O. Box W
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

May 11, 1992

Members of the Legislative Budget and Audit Committee:

We have reviewed the Department of Commerce and Economic Development's (DCED) responses to our preliminary report. The following are points which, in our opinion, require further clarification.

Recommendation No. 1 C

DCED's response states that "In addition, the new management agreement requires Alaska Visitor's Association (AVA) to transfer all funds raised by AVA for the cooperative marketing program, including interest, to the general fund should the AVA and the Department of Commerce and Economic Development no longer have a management agreement." This clause continues to allow AVA to retain state funds within their interest bearing accounts until such time AVA and DCED cease their contractual relationship. This does not resolve the issue raised in the audit recommendation regarding timely revenue transfers to the State's general fund.

Therefore, we recommend that the legislature amend AS 44.33.727 to clarify that excess funds be transferred at the end of the fiscal year. We believe a statutory timeline would assure that state revenues and interest are properly deposited into the general fund. Furthermore, the timely deposit would negate any arguments that the state funds collected by AVA are dedicated for a special purpose in violation of Article IX, Section 7, of the Alaska Constitution.

Recommendation No. 3 B

DCED states that Alaska's procurement code does not extend to subcontractors of a subcontractor. DCED's advertising contract with Bradley Communication (BC) is a five year, 30 million dollar contract and contains a clause that states "All subcontractors which

are necessary for the execution of this contract will utilize a competitive bid process and favor Alaska Vendors to the maximum legal extent."

The two television commercials, procured under BC's advertising contract, cost the State of Alaska \$734,005. Of this amount, \$701,979 was remitted to McCann Erickson (ME), BC's subcontractor. However, ME procured specialized advertising services (creating the subcontractor of a subcontractor relationship) outside their business. The commercials production and director services were subcontracted to GMS, Inc by ME for \$497,776. DCED states that this subcontract, which represents 68% of the total costs of the commercials, is not subject to the procurement code.

We believe that in order to ensure that state money is being spent in a cost effective manner and follows the spirit of the procurement code, DCED should require all subcontractors to conform, as much as possible, to AS 36.30 and the advertising contract's stipulations.

Recommendation No. 5 A and B

DCED's response states "It is not possible to respond to the specifics of this recommendation because we have not had access to the information the auditor used in developing this recommendation." Their response to this recommendation is indicative of inadequate control and monitoring by the DCED and the ATMC staff regarding AVA's collection and use of state revenues. As stated in the recommendation, due to this lack of control and monitoring by state agencies, AVA has incurred additional expenditures that appear to be unallowable. These expenditures are reflected in AVA's accounting records without DCED staff's knowledge nor were they subject to legislative authorization.

Therefore, we believe DCED and the Attorney General's office should defined the parameters of qualifying expenditures to ensure that the intent of AS 44.33.700 through AS 44.33.735 are being complied with by AVA.

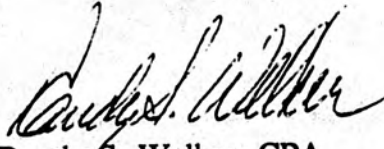
Subsequent to our audit fieldwork, DCED has negotiated a new management agreement with AVA for fiscal years 1993 and 1994. The new management agreement limits related selling and administrative expenses to 15% of the total revenues generated, excluding AVA's pro rata share of the Vacation Planner and actual costs to AVA for producing the tourism mailing lists, and provides a provision that states "... including but not limited to expenses for administration, research, solicitation, mailing, and data entry."

Members of the Legislative
Budget and Audit Committee

-3-

May 11, 1992

In our opinion, this provision significantly broadens qualifying expenses, especially research items, which do not appear to be within the intent of the statute.

A handwritten signature in cursive script, appearing to read "Randy S. Welker".

Randy S. Welker, CPA
Legislative Auditor