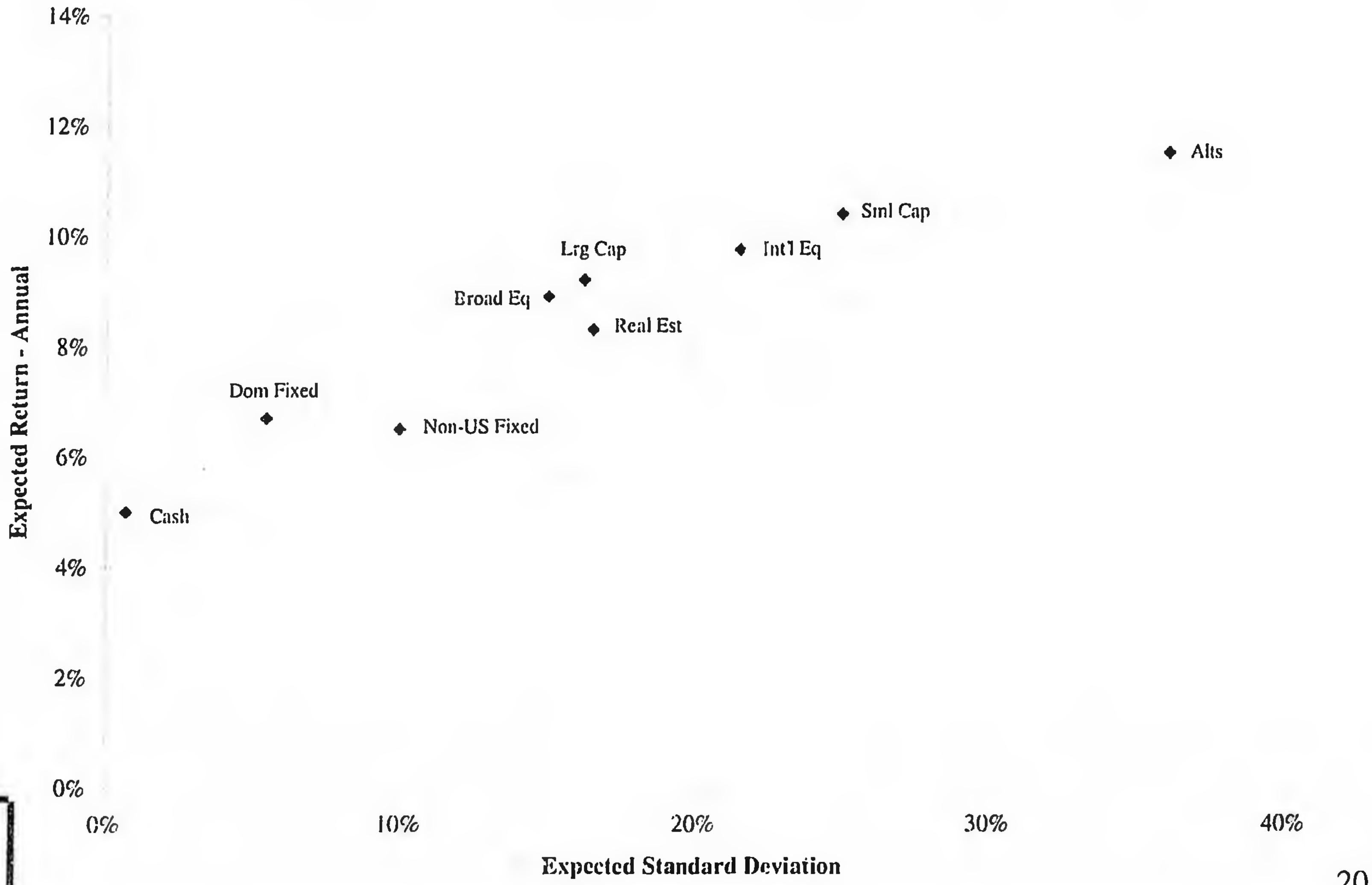
ALASKA LEGISLATURE 1899

HOUSE and SENATE FINANCE COMMITTEE FILES, 1999 - 2000

50

Five-Year Capital Market Projections

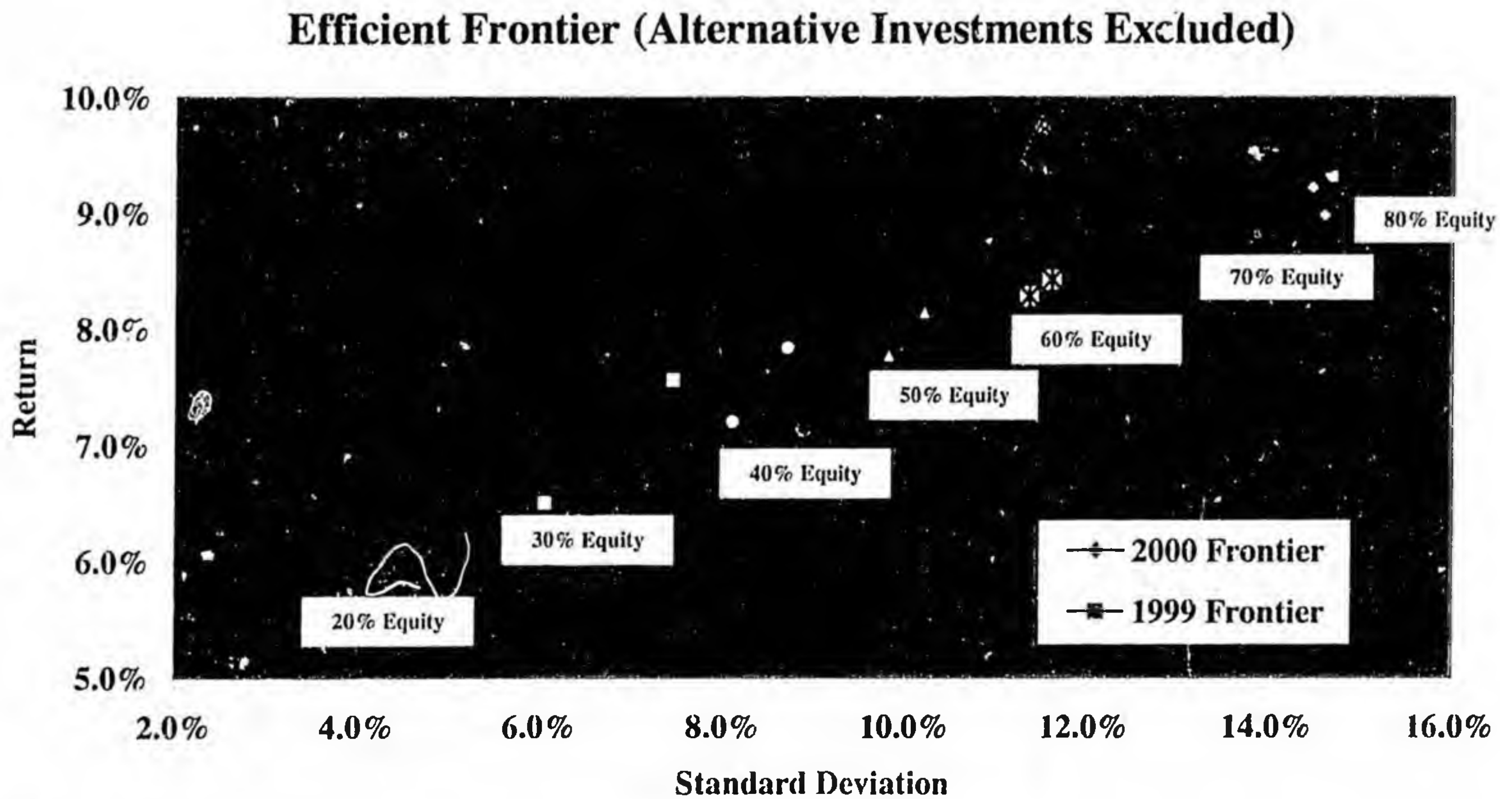
Higher Returns at the Price of Higher Risk



Range of Efficient Alternatives Using Callan's 5 Year Projections

2000	Limits		Asset Mix Alternatives								
Asset Classes	Min	Max	1	2	3	4	5	6	7	8	9
Large Dom Eq	0%	100%	9%	10%	15%	20%	25%	30%	35%	39%	44%
Small Dom Eq	0%	100%	2%	3%	4%	5%	6%	8%	9%	10%	11%
International Eq	0%	100%	5%	6%	8%	11%	14%	16%	19%	22%	24%
Dom Fixed	0%	100%	68%	72%	63%	53%	43%	33%	23%	13%	4%
International Fixed	0%	100%	5%	5%	5%	5%	5%	6%	6%	6%	6%
Real Estate	0%	100%	3%	4%	5%	5%	6%	7%	8%	9%	10%
Cash	0%	100%	9%	0%	0%	0%	0%	0%	0%	0%	0%
Totals			100%	100%	100%	100%	100%	100%	100%	100%	100%
Projected Return			7.00%	7.25%	7.50%	7.75%	8.00%	8.25%	8.50%	8.75%	9.00%
Projected Risk			5.65%	6.36%	7.23%	8.27%	9.44%	10.69%	11.99%	13.33%	14.70%

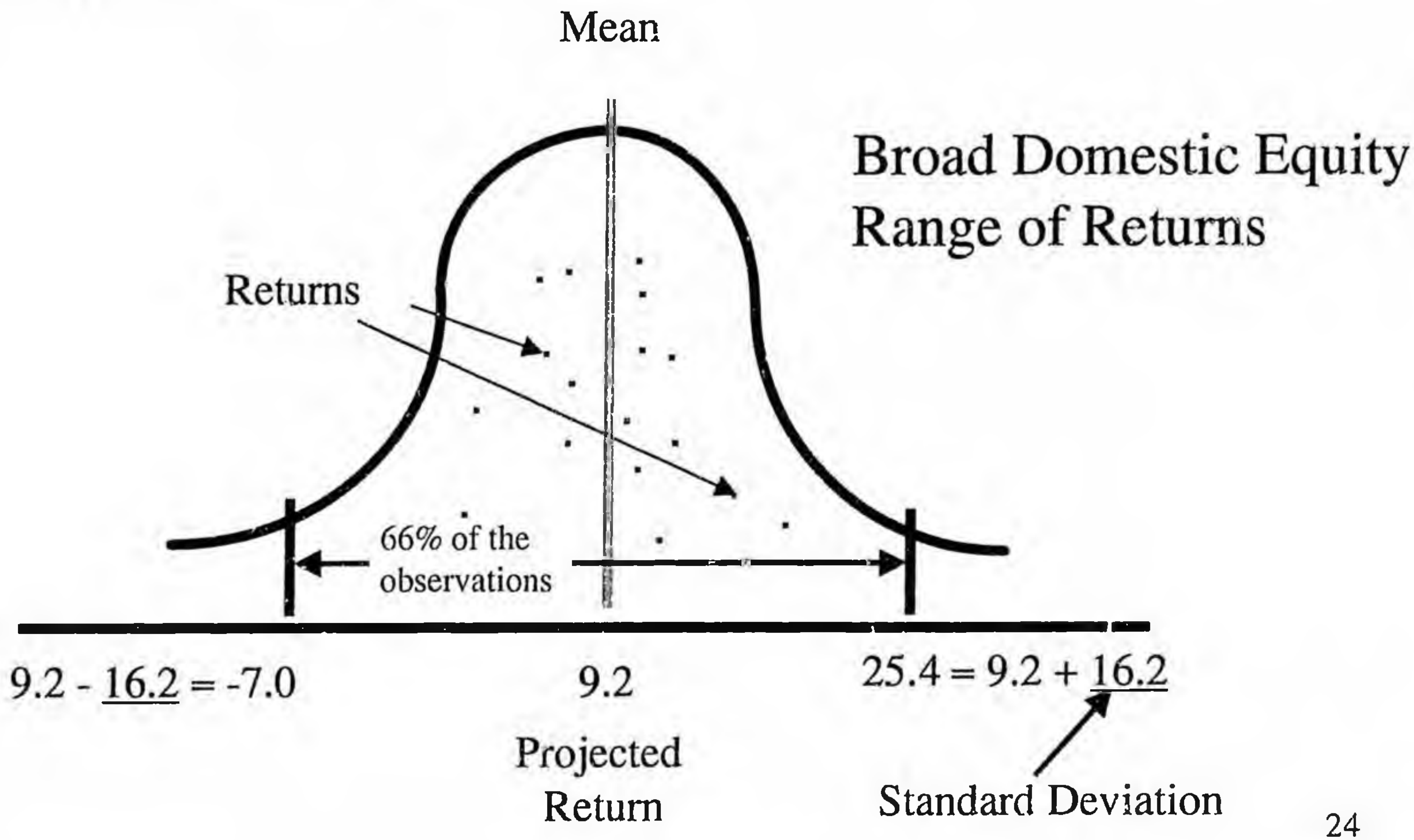
Comparison of Efficient Frontier 2000 vs. 1999 Projections



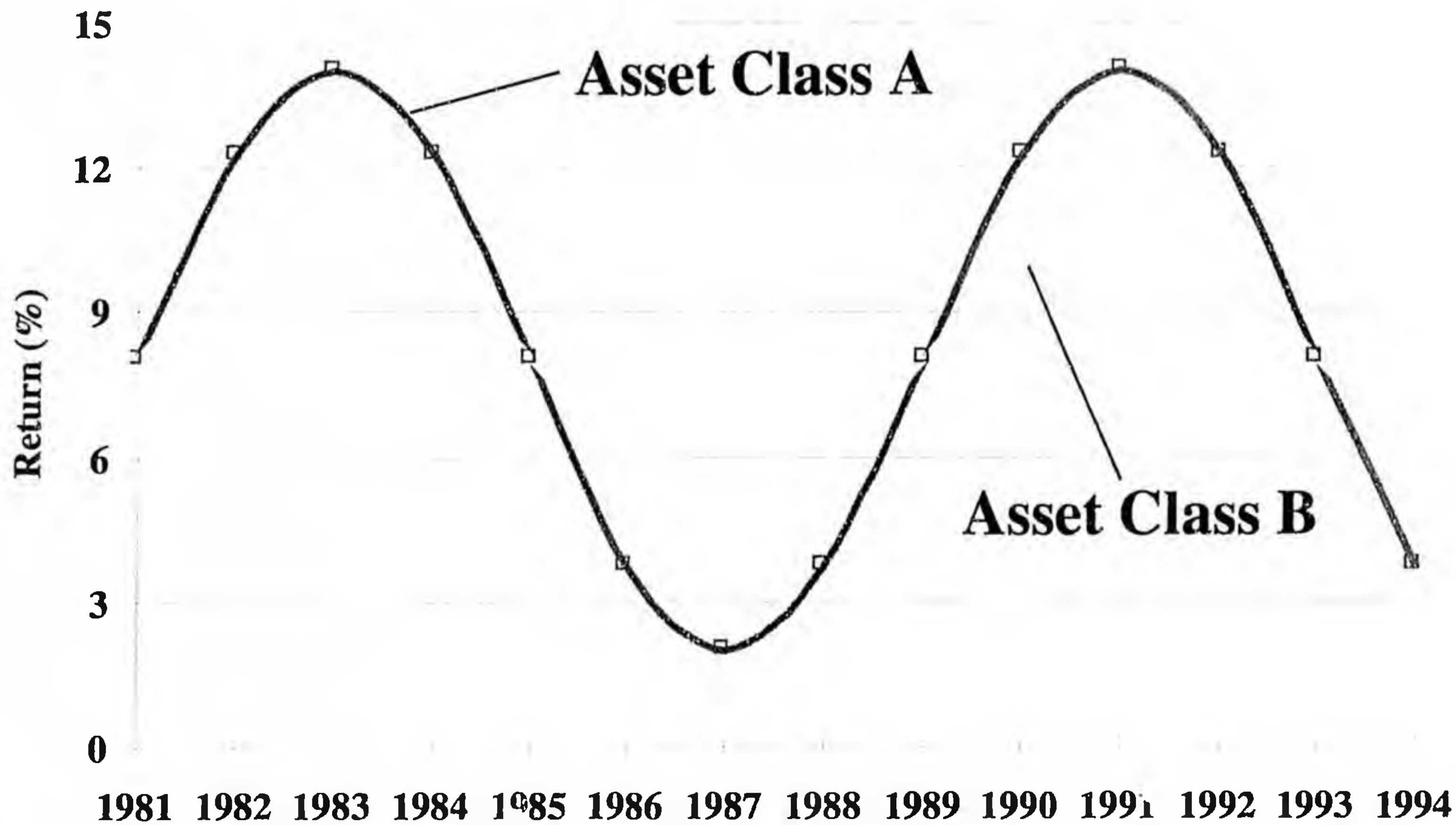
Supplemental Exhibits

Measuring Risk

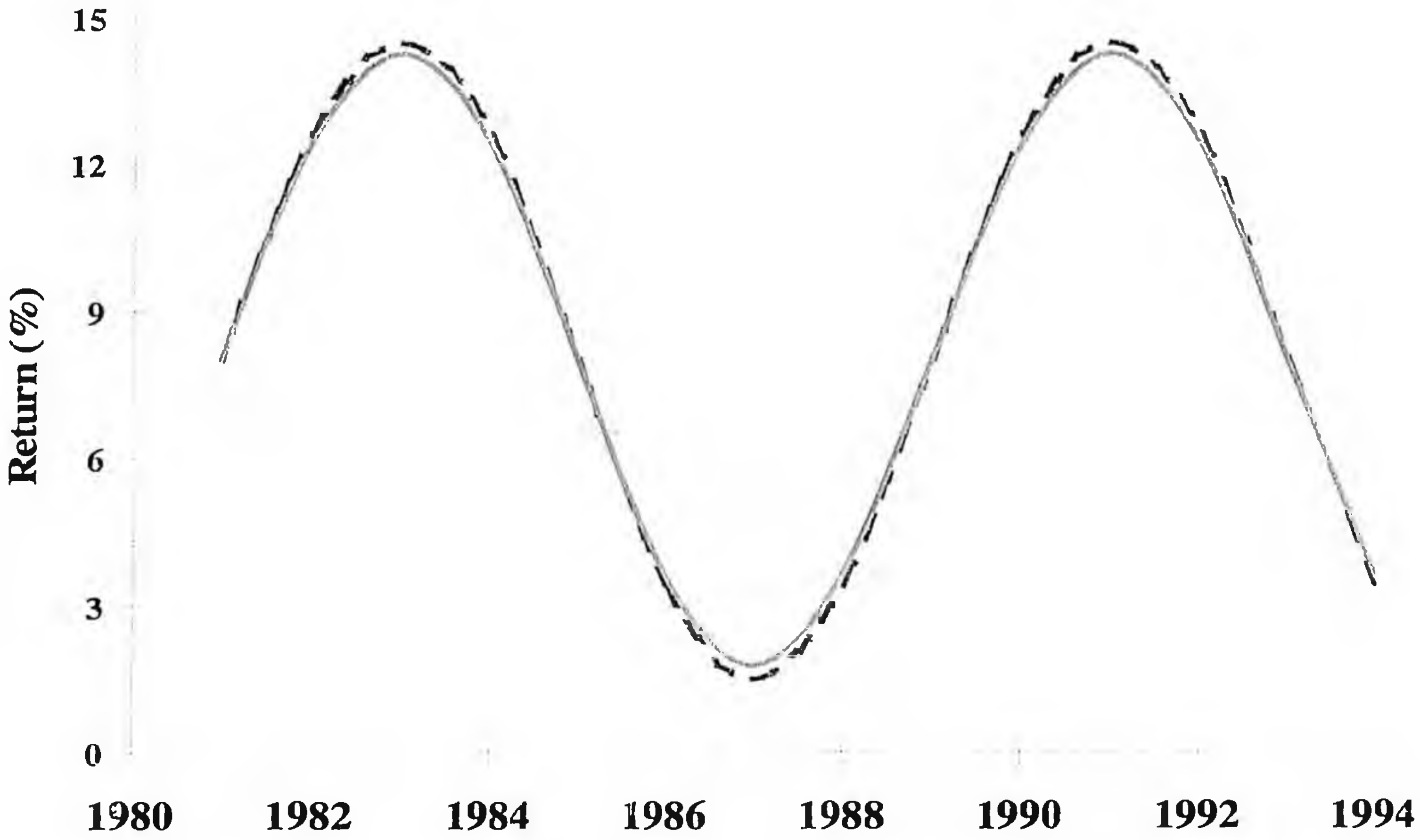
- Standard Deviation - Measures the Variability of Returns from Their Mean



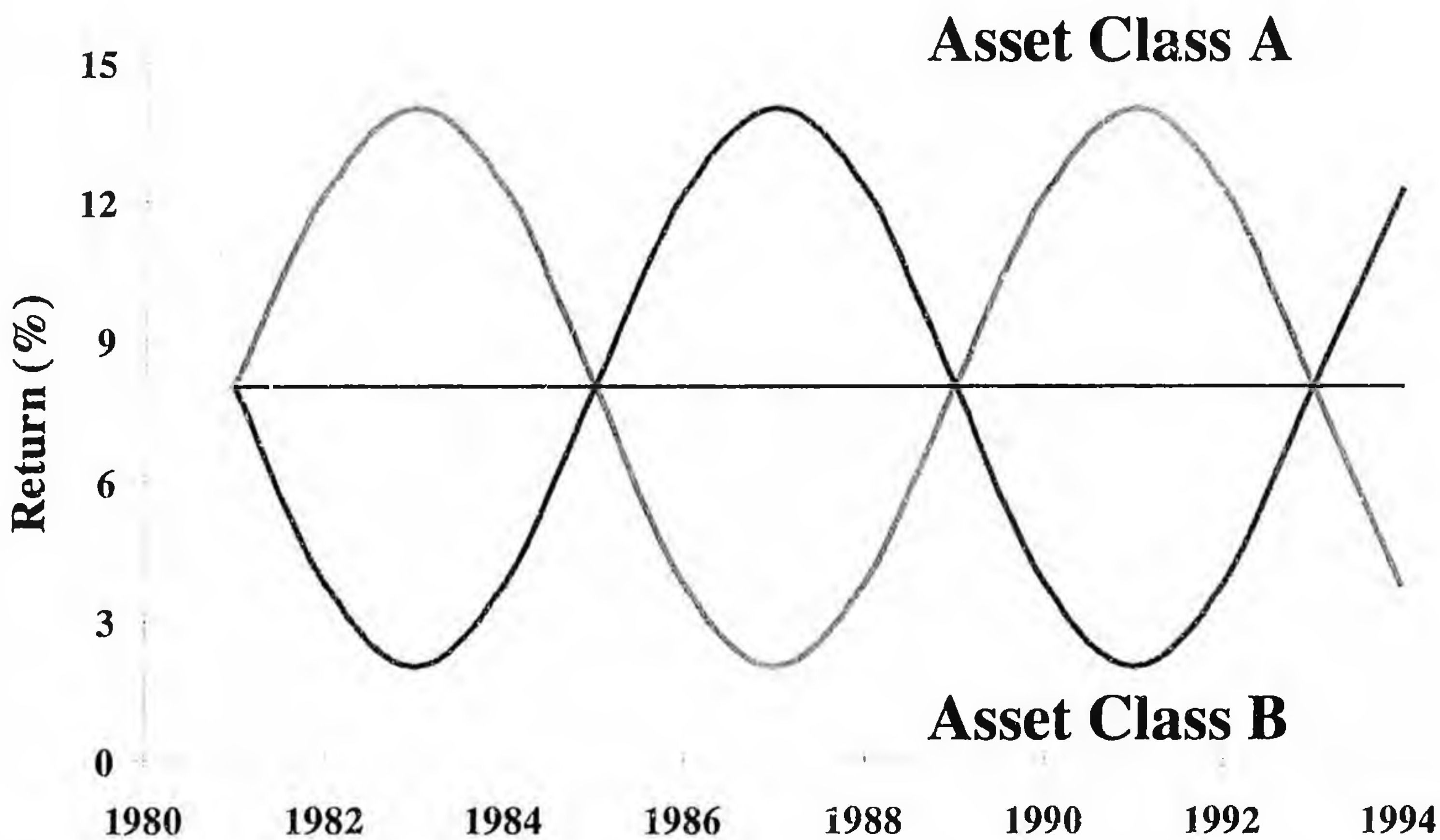
Returns Will Go Up and Down



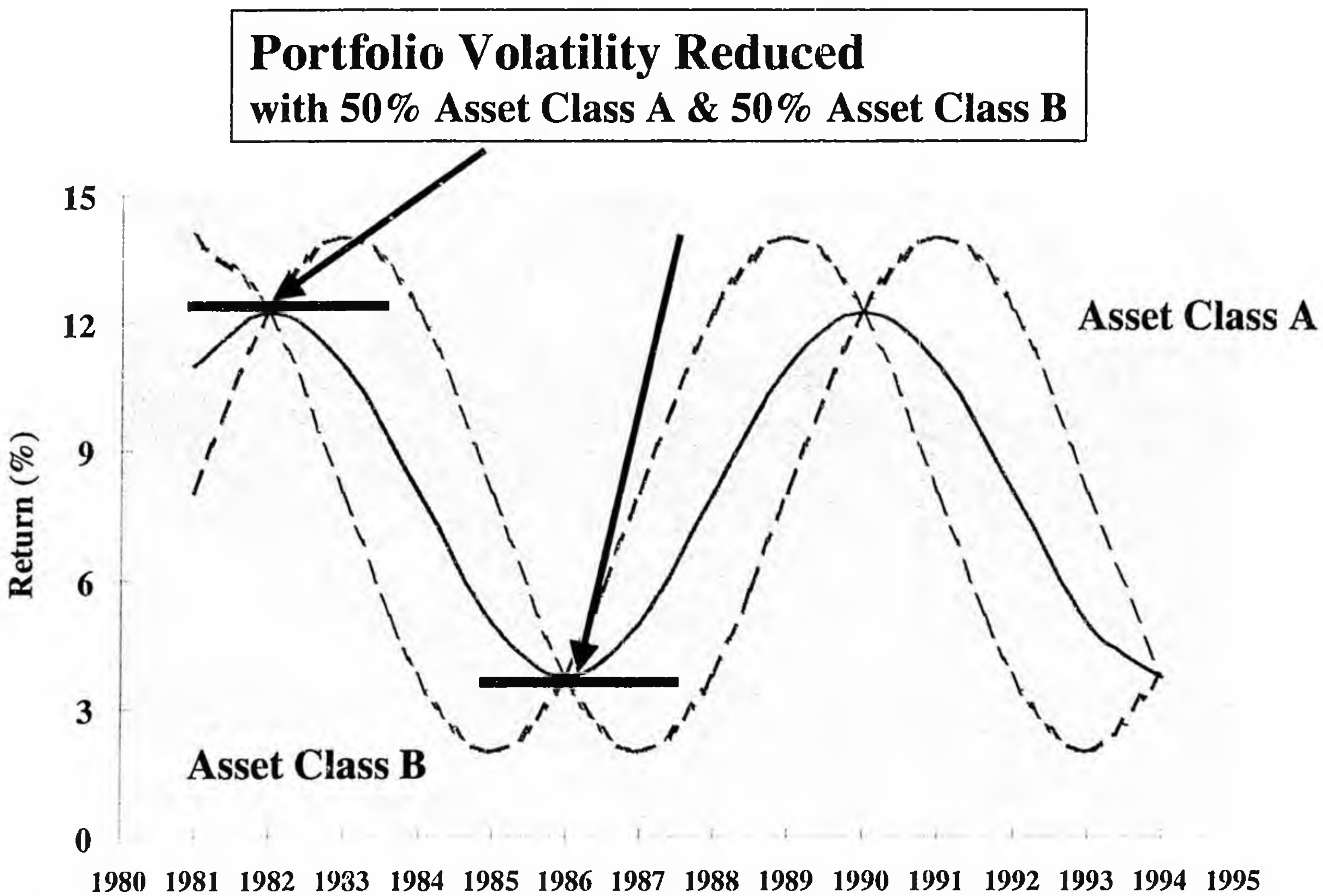
Perfect Correlation (+1)



Perfect Negative Correlation (-1)



Correlation and Diversification



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Section 1: Equity & Fixed Income Performance (post-fees)

	12/31/1999 Market Value	Last Month	Last 3 Months	Fiscal Y-T-D	Last 12 Months	Last 3 Years	Last 5 Years	Last 15 1/2 Years
		--- % return as of 12/31/99 ---					--- % return as of 9/30/99 ---	
FUND SUMMARY								
Unallocated Cash Pool	$ 4.3							
Transition Cash	2.9							
U.S. Equities	9,886.8	6.88	15.44	6.94	18.45	23.48	21.87	16.26
Non-U.S. Equities	5,180.0	12.09	23.25	26.47	34.88	18.50	11.03	
U.S. Fixed Income	9,308.3	(0.54)	(0.30)	0.34	(2.97)	5.30	7.55	9.44
Non-U.S. Fixed Income	594.8	0.41	(1.12)	(1.69)	(3.65)			
Alaska CDs	209.5	0.41	1.24	2.46	5.33	5.37	5.38	
Real Estate	2,424.0	0.24	0.72	1.44	8.47	10.76	9.72	
	$ 27,610.7	**4.37**	**9.02**	**6.95**	**10.98**	**14.09**	**13.09**	**11.52**
U.S. EQUITIES								
S&P 500 Index		5.89	14.88	7.71	21.04	27.56	25.03	17.36
Deutsche Asset Mgt. S&P 500	$ 3,030.1	5.76	14.75	7.74	20.93	27.57	25.03	17.33
Ark Asset	559.3	0.00	(0.47)	(13.07)	(2.67)	9.82	17.12	15.53
Invesco	535.4	2.93	6.03	(8.00)	0.59	14.59	18.72	
Alliance Capital Management	210.6							
McKinley Capital Management	212.7							
Russell 1000 Index		6.02	16.06	8.40	20.90			
Putnam	1,072.8	12.08	25.13	19.08	31.10			
S&P 400 Index		5.94	17.19	7.35	14.73	21.81		
Society Asset	445.5	3.10	8.94	(2.31)	0.07	6.13		
S&P 1000 Index		6.54	15.81	7.20	14.10			
Deutsche Asset Mgt. S&P 1000	759.1	6.54	15.80	7.60	14.29			
NON-U.S. EQUITIES								
MSCI EAFE Index		8.98	16.98	22.12	26.96			
Deutsche Asset Mgt. EAFE	1,386.3	9.41	17.51	22.55	27.66			
MSCI Europe Index		10.25	17.39	18.76	15.90	22.62		
Clay Finlay	907.7	15.61	28.33	27.03	21.94	23.72		

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Section 1: Equity & Fixed Income Performance (continued)

	12/31/1999 Market Value	% return as of 12/31/99 Last Month	Last 3 Months	Fiscal Y-T-D	Last 12 Months	Last 3 Years	% return as of 9/30/99 Last 5 Years	Last 15 1/2 Years
BLENDED EQUITIES								
S&P 500/EAFE Blended Index		7.13	15.72	13.42	23.60	22.89		
Brinson Partners	$ 878.8	4.99	9.20	2.06	9.56	13.32		
Lazard Freres	1,128.8	3.04	7.74	3.61	15.25	17.31		
Russell/EAFE Blended Index		7.91	16.87	10.53	19.92	26.51	23.74	17.15
Dresdner RCM	1,900.6	14.40	31.96	29.43	47.31	40.31	27.46	18.84
Russell/EAFE/EMF Blended Index		10.62	19.53	18.09	26.71	15.61	9.08	
Capital Guardian	1,466.1	15.06	28.40	32.75	72.71	30.96	17.34	
Pacific Basin/EMF Blended Index		9.95	21.51	20.16	59.35	(3.80)	(0.50)	
Schroder	573.0	11.54	25.02	22.61	59.25	(2.92)	(1.59)	
FIXED INCOME								
Lehman Gov/Corp Index		(0.61)	(0.41)	0.13	(2.15)	5.54	7.77	9.64
APFC	$ 8,714.1	(0.55)	(0.33)	0.29	(3.13)	5.28	7.57	9.45
Lehman Aggregate Index		(0.48)	(0.12)	0.56	(0.82)			
APCM	151.3	(0.49)	0.02	0.78	(1.34)			
Brinson Partners	202.7	(0.29)	0.13	1.19	(0.62)			
Sanford Bernstein	240.2	(0.23)	0.30	1.09	0.87			
Short-term Custom Index		0.45	1.30	2.69	5.37			
Unitized Cash Fund	171.9	0.50	1.40	2.78	5.17			
Salomon WGB 50% Hedged Index		0.13	(0.20)	3.09	(6.30)			
Julius Baer	269.9	0.80	(1.33)	(1.55)	(3.34)			
Rogge	325.0	0.09	(0.93)	(1.79)	(3.89)			

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Section 2: Blended Manager Performance Breakdown (post-fees)

	12/31/1999 Market Value	% return as of 12/31/99 Last Month	Last 3 Months	Fiscal Y-T-D	Last 12 Months	Last 3 Years	% return as of 9/30/99 Last 5 Years	Last 15 1/2 Years
BRINSON PARTNERS								
S&P 500 Index		5.89	14.88	7.71	21.04	27.56		
Large Cap Domestic	$ 428.8	0.66	2.54	(12.20)	(3.35)	10.89		
MSCI EAFE Index		8.98	16.98	22.12	26.96	15.75		
Non-U.S. Developed	450.0	9.53	16.32	17.43	22.40	14.79		
	$ 878.8							
LAZARD FRERES								
S&P 500 Index		5.89	14.88	7.71	21.04	27.56		
Large Cap Domestic	$ 573.4	(0.03)	3.74	(7.57)	6.68	15.98		
MSCI EAFE Index		8.98	16.98	22.12	26.96	15.75		
Non-U.S. Developed	555.5	6.41	12.21	18.69	25.84	18.40		
	$ 1,128.8							
DRESDNER RCM								
Russell 1000 Index		6.02	15.06	8.40	20.90	26.85	23.74	17.15
U.S. Large Cap	$ 1,387.2	14.09	30.83	28.41	47.31	40.31	27.46	18.84
Russell 2000 Index		11.32	18.44	10.95				
U.S. Small Cap	293.2	14.38	29.35	19.75				
MSCI EAFE Index		8.98	16.98	22.12				
Non-U.S. Growth	220.3	16.46	43.66	53.61				
	$ 1,900.6							
CAPITAL GUARDIAN								
Russell 2000 Index		11.32	18.44	10.95				
U.S. Small Cap	$ 378.8	11.06	18.24	10.94				
MSCI EAFE Index		8.98	16.98	22.12	26.96	15.75	9.08	
Non-U.S. Developed	694.3	15.49	29.67	41.43	72.71	30.96	17.34	
MSCI Emerging Markets Index		12.72	25.44	18.98				
Emerging Markets	393.0	18.40	37.40	33.63				
	$ 1,466.1							
SCHRODER								
Custom Pacific Index		7.48	17.94	21.54	59.35	(3.11)	(3.80)	
Pacific Rim, Japan 50%-weighted	$ 323.5	7.08	20.07	22.61	59.25	(2.92)	(1.59)	
MSCI Emerging Markets Index		12.72	25.44	18.98				
Emerging Markets	249.5	15.24	29.12	20.65				
	$ 573.0							

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Section 3: Real Estate Performance (post-fees)

	12/31/1999 Market Value	% return as of 9/30/99 Last 3 Months	Last 12 Months	Last 3 Years	Last 5 Years
REAL ESTATE					
Direct					
NCREIF Classic Index		2.65	12.24	14.28	12.37
AEW	$ 187.3	2.15	24.46	27.46	
CB Richard Ellis	291.1	2.21	8.46	13.14	11.39
Heitman	92.5	7.09	15.39	13.94	7.52
Henderson	73.9	2.56	12.40	12.47	14.15
Kennedy	235.7	5.33	14.01	11.04	10.71
L&B	298.7	1.52	9.10	8.83	8.68
LaSalle	169.8	1.98	4.70	6.83	7.21
Raymond James[1]	0.0	2.31	11.69	10.95	10.20
RREEF	46.0	2.24	9.26	14.44	12.31
Sentinel	192.8	2.29	10.05	11.06	11.24
SSR	33.1	1.57	7.61	10.28	11.49
	$ 1,621.0				
Commingled					
NCREIF Classic Index		2.65	12.24	14.28	12.37
Total Commingled	$ 18.5	4.46	15.38	15.40	12.54
REITs					
Morgan Stanley REIT Index		(8.09)	(5.88)	4.36	
AEW REIT	$ 341.1	(6.99)	0.13		
AEW Focus	95.7	(6.00)			
Simon Property Group	54.3	3.16	(8.18)	6.26	6.27
	$ 491.0				
Mortgages					
Lehman Corporate A Index		0.19			
Lend Lease	$ 293.4	0.19			
Total Real Estate					
65 NCREIF/20 MS REIT/15 LB Corp A Index		0.14	6.83	10.39	10.06
Total	$ 2,424.0	0.72	8.47	10.76	9.72

[1] In November, Raymond James' assets were transferred to LaSalle. Separate performance is provided for historical periods.

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Section 4: Asset Allocation

	Market Value	Actual %	Target %	Target Range	Over/ Under
U.S. Equities	$ 9,764.2	35.4	37.0	± 4.0	(1.6)
Value Style	4,751.2	17.2	18.5		(1.3)
Growth Style	5,013.0	18.2	18.5		(0.3)
Non-U.S. Equities	5,124.6	18.6	16.0	± 4.0	2.6
Developed Markets	4,492.0	16.3	13.6		2.7
Emerging Markets	632.6	2.3	2.4		(0.1)
U.S. Fixed Income	9,433.9	34.2	35.0	+7.0,-3.0	(0.8)
Non-U.S. Fixed Income	591.0	2.1	2.0	± 2.0	0.1
Real Estate	2,386.8	8.6	10.0	+2.0,-3.0	(1.4)
Direct	1,621.0	5.9	6.0		(0.1)
Commingled	18.5	0.1	0.0		0.1
REIT's	459.8	1.7	2.0		(0.3)
Mortgages	287.5	1.0	1.5		(0.5)
Opportunistic	0.0	0.0	0.5		(0.5)
Alaska CDs	209.5	0.8	0.0		0.7
Cash & Equivalents	100.5	0.4	0.0		0.4
	$ 27,610.5	100.0	100.0		

Section 5: Turnover

ACTIVE EQUITY	Currnt Mnth	12-Mnth Rate
Alliance Capital Mgmnt	0.0	
Ark	7.8	75.5
Brinson Domestic	3.9	61.8
Brinson International	10.9	74.6
Capital Guardian	2.8	48.1
Cap Guardian Sm Cap	5.2	
Cap Guardian Em Mkts	2.3	
Clay Finlay	4.8	75.8
Invesco	5.9	53.7
Lazard Domestic	2.5	47.4
Lazard International	1.2	29.0
McKinley Capital Mgmt	0.0	
Putnam	5.6	100.7
DRCM Large Cap Dom	5.5	95.2
DRCM Small Cap Dom	11.0	129.2
DRCM International	10.0	183.6
Schroder	1.6	55.6
Schroder Em Mkts	6.6	
Society	4.7	71.9
FIXED INCOME		
APFC	6.5	115.8
APCM	0.0	23.7
Brinson Partners	8.0	87.8
Sanford Bernstein	2.2	275.2
Julius Baer	6.7	294.1
Rogge	1.8	125.9

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Section 6: Unrealized Gain/Loss Analysis

	Cost	Market	Unrealized Gain/Loss
ACTIVE EQUITY			
Value			
Ark Asset	$ 612.0	$ 559.3	$ (52.7)
Brinson Partners	760.4	878.8	118.4
Capital Guardian	1,023.5	1,466.1	442.6
Invesco	452.9	535.4	82.5
Lazard Freres	864.3	1,128.8	264.6
Society Asset	424.4	445.5	21.0
Growth			
Alliance Capital Management	200.0	212.7	12.7
Clay Finlay	625.0	907.7	282.6
Dresdner RCM	1,194.6	1,900.6	706.0
McKinley Capital Management	201.4	212.7	11.3
Putnam	724.6	1,072.8	348.2
Schroders	436.8	573.0	136.1
Total Active Equity	$ 7,520.0	$ 9,893.3	$ 2,373.3
PASSIVE EQUITY			
Deutsche Asset Mgt. S&P 500	$ 1,331.5	$ 3,030.1	$ 1,698.6
Deutsche Asset Mgt. S&P 1000	671.8	759.1	87.3
Deutsche Asset Mgt. EAFE	916.3	1,386.3	470.0
Total Passive Equity	$ 2,919.7	$ 5,175.5	$ 2,255.8
Total All Equity Managers	$ 10,439.7	$ 15,068.8	$ 4,629.1
FIXED INCOME			
APFC Internal	$ 9,057.6	$ 8,714.1	$ (343.5)
Unitized Cash Fund	173.2	171.9	(1.2)
APCM	157.5	151.3	(6.2)
Brinson Partners	212.7	202.7	(10.0)
Sanford Bernstein	246.8	240.2	(6.6)
Julius Baer	278.2	269.9	(8.3)
Rogge	347.4	325.0	(22.4)
Total Fixed Income Managers	$ 10,473.3	$ 10,075.1	$ (398.2)

	Cost	Market	Unrealized Gain/Loss
REAL ESTATE			
Direct			
AEW	$ 113.6	$ 187.3	$ 73.7
CB Richard Ellis	279.8	291.1	11.2
Heitman/JMB	89.2	103.2	14.0
Henderson	66.6	73.9	7.3
Kennedy	223.2	235.7	12.5
L&B	283.7	298.7	15.1
LaSalle	163.8	169.8	6.0
Raymond James	0.0	0.0	0.0
RREEF	42.0	46.0	4.0
Sentinel	181.8	192.8	11.0
SSR	31.0	33.1	2.2
Total RE - Direct	$ 1,474.7	$ 1,631.6	$ 156.9
Commingled			
Allegis	$ 0.0	$ 4.4	$ 4.4
CIGNA	4.4	3.4	(1.0)
Total RE - Commingled	$ 4.5	$ 7.9	$ 3.4
REITs			
AEW	$ 483.2	$ 436.8	$ (46.5)
Simon Property Group	55.8	54.3	(1.5)
Total RE - REITs	$ 539.0	$ 491.0	$ (48.0)
Mortgages			
Lend Lease	$ 301.5	$ 293.4	$ (8.1)
Total All RE Managers	$ 2,319.7	$ 2,424.0	$ 104.2

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Schroders

Alaskan Commodities **Review of 1999 and Outlook for 2000**

Executive Summary

	Outlook
Export Revenues	H2 99 should indicate continued growth in exports, with full year totals exceeding 1998 revenues. 2000 well placed given generally favourable commodity price environment and improving economic growth. Expect at least as good as 1999.
Fish & Fish Products	Unlikely that prices can rise too far from current levels. Further export revenue growth will come from improved volumes.
Oil & Gas	Although oil prices expected to fall from current levels, average annual prices will be up vs. 1999. Possible improvement in LNG export revenues as contract prices rise with a lag.
Wood & Wood Products	Peak prices achieved in 1999. Prices expected to fall, on average, during 2000 as housing starts slow in US and new production capacity reduces prices and margins.
Metals & Mining	Zinc prices to trade higher, although bulk of the gains already achieved in 1999. Lead will rise with other base metals but limited by high and rising inventory profile. Gold expected to remain range bound with limited scope for significant upside surprises.

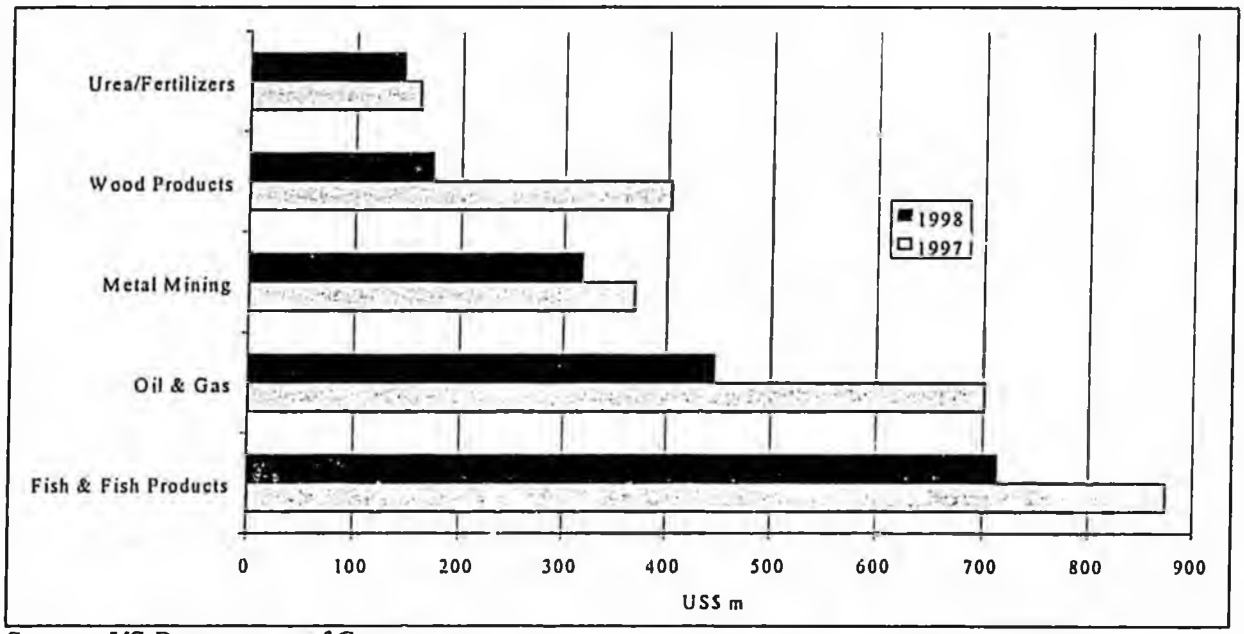
In last year's commodity outlook, we suggested that prices were set for recovery, 'sometime after the first half of 1999'. We, like others, have been shown to be conservative in both the timing and extent of the recovery in most classes of commodity in 1999. Supply restraint was instrumental to stopping prices from sliding further and improved demand growth came from recovery in Asia and from economies elsewhere, which accelerated away from the threat of deflation and recession.

What we have to consider now is the extent to which price recovery can continue from here and whether expected synchronised global growth will lead to another prosperous year for commodities in 2000.

For Alaska, the most significant contribution to export demand growth in 2000 will be growth acceleration in Japan as it accounts for over 40% of all export revenues. Even without substantial growth, Alaskan exports will continue to benefit from a strong Yen. Exports to Asia and Europe should continue to benefit from improved economic fundamentals in those areas although the weak Euro makes US$ priced exports less competitive/attractive. For the price outlook, we will discuss each commodity class in turn.

Although H2 99 data are not available, data for H1 99 suggests that export revenue for the full year should be up on 1998. The major contributing groups of fisheries and oil & gas have both benefited from higher prices, which continued to strengthen during H2 99. Zinc price recovery accelerated in H2 99 and therefore the full year contribution from minerals should increase. Despite weakness in lead and fertilizer prices, total export revenues are expected to have increased year-on-year.

Alaska's Key Exports by Classification



Source: US Department of Commerce

Alaska Export Revenue US$ m January – June 1999 and as % of Full Year 1998

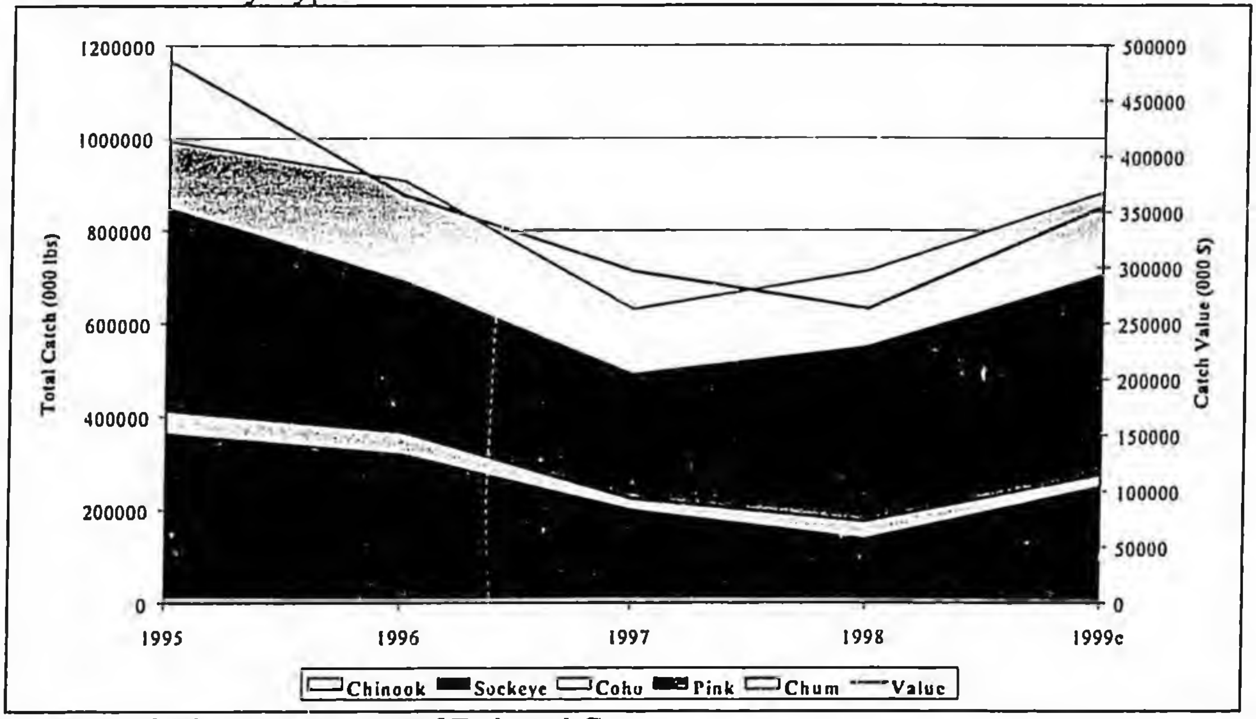
	H1 99 US$ m	% 1998 revenue
Fish & Fish Products	512	77
Oil & Gas	300	79
Metal Mining	45	14
Wood Products	99	53
Urea/Fertilizers	59	35
Total	**1015**	**52**

Source: US Department of Commerce

Fish and Fish Products

In 1998 fishing related exports made up 36% ($713m) of total state export revenues. Data for H1 99 indicate a dramatic increase in revenues, to $512m. Even allowing for seasonality, one would expect full year 1999 revenues to have increased. Exports consist of salmon, fish livers, roes, herring, cod, crustaceans and other fish products. Salmon forms the single most important product group. Based on preliminary salmon catch value data (see chart), the value of salmon caught in Alaskan waters increased 35% to $355m in 1999. The increase came from a combination of price and volume. The average weight of most classes of salmon declined during 1999, but both the number of fish caught and the average price per pound increased. The biggest price improvement came from chinook and the biggest increased catch came from sockeye, reversing the declining trend that began in 1995. The rebound in sockeye salmon (almost double the number of fish) reflects improving health of the salmon population (enhanced ocean survival). As the largest contributor to catch value, this has been the key driver to the improved fortunes of Alaskan fishing during 1999.

Salmon Catch by Type



Source: Alaska Department of Fish and Game

Important to the demand for fish product exports is the health of the Asian economies. Dramatic recovery in Korea and initial signs of recovery in Japan, the two largest importers of fish product from Alaska, have been key to selling on higher volumes of fish at generally higher prices. *Schroder Economics* forecasts growth in Japan to accelerate from 0.7% in 1999 to 1.0% in 2000. Combined with a strong Yen exchange rate, imports from Alaska should increase this year. *Schroder Economics* forecasts for South Korea are a slowdown in growth from 10.1% in 1999 to 7.0% in 2000, still impressive given the economic malaise of 1998. Economic recovery in Euroland should also benefit exports in 2000.

Economic growth will support export earnings, although we would question the extent to which unit prices can rise from current levels. Raising prices significantly will simply result in substitution away from wild salmon to cheaper imports of farmed salmon, especially from Chile. Therefore, revenues will depend on catch volumes and run rates, which are dependent upon the health of the salmon population.

Longer term, the issue facing the fishing industry is competition from cheaper farmed product imports. The US now imports more salmon than it exports as farmed product takes market share from wild salmon. Alaska's wild salmon product is superior but obviously more expensive. The growing trend in organic food may benefit salmon fishermen at the expense of the mass produced variety but such a shift in preferences may take a long time to influence export revenues.

Oil & Gas

1999 was a case study in commodity price volatility as far as hydrocarbons are concerned. New Year predictions suggested that we were entering a period of single digit oil prices. What followed was the re-birth of OPEC influence with a supply-side response to the issue of critically low national budgets. The tri-partite agreement between Venezuela, Saudi Arabia and non-OPEC member Mexico was critical to the success of the output cuts, as indeed were improved relations between Iran and the Saudis. Markets doubted the first two cuts but the third and largest met with increased confidence and prices started to anticipate the draw down in stocks.

Crude Oil Prices ($/bl)

Alaska North Slope (ANS) crude oil prices recovered sharply in 1999, up from $10.70/bl in January to over $24.00/bl at the end of the year. The recovery in prices was instrumental to the improvement in state finances as over 80% of the state budget is sourced from oil & gas revenues. Alaska oil was also in the news during 1999 due to negotiations with BP Amoco over the proposed merger with Arco. The merger will leave the combined entity with a dominant position in oil pipeline exports from Prudhoe Bay to the US West Coast. Agreement within Alaska has now been reached, but final FTC clearance is still pending.

The oil market is now especially tight. Crude oil inventory in absolute terms is at a three year low. Relative to demand crude oil inventories are now below 1996 levels, one of the unofficial benchmarks targeted by OPEC.

With prices still higher than the long-term trading range of $15-20/bl (ANS) one has to consider the prospects for prices remaining at such levels. Y2K appears to have passed largely unnoticed and all that remains in the very short term is Northern Hemisphere winter. To date, it has been warmer than average, although a little colder than last year, the warmest on record. If temperatures do not fall sharply soon, destocking following the non-event of Y2K could put further downward pressure on prices. There is data to suggest that OPEC compliance started to fall during December (as low as 75%) and Iraqi exports have resumed faster than initially expected. Increased supply of crude oil and lacklustre final demand points to downward pressure on prices. Indeed, we expect prices to fall from here.

Crude Oil Price Assumptions

	1998	1999	Q1 00F	Q2 00F	Q3 00F	Q4 00F	2000F	2001F
Brent (spot)	12.76	17.92	21.00	17.00	17.25	17.75	18.25	16.50
WTI	14.35	19.33	22.50	18.75	18.75	19.00	19.75	18.00

Source: Schroder Global Research

Based on the latest GDP forecasts *Schroder Economics* have estimated demand for crude oil. Oil demand is expected to grow 2.2mbd (million barrels per day) in 2000 and 1.5mbd in 2001.

Summary World Crude Oil Demand and Supply

mbl per day	1995	1996	1997	1998	1999(f)	2000(f)	2001(f)
Supply							
OPEC	27.7	28.5	30.0	30.7	29.6	32.3	33.5
Non-OPEC	42.5	43.6	44.4	44.7	44.5	45.1	45.9
Total	***70.1***	***72.0***	***74.4***	***75.3***	***74.1***	***77.5***	***79.4***
% change		2.7%	3.2%	1.3%	-1.6%	4.5%	2.5%
Demand							
OECD	44.9	45.9	46.7	46.9	47.9	48.7	49.9
Non-OECD	25.0	25.7	26.8	27.1	27.3	28.7	29.0
Total	***69.9***	***71.6***	***73.5***	***74.0***	***75.2***	***77.4***	***78.9***
% change		2.4%	2.7%	0.7%	1.6%	2.9%	1.9%
Stock build/(draw)	0.2	0.4	0.9	1.3	-1.1	0.1	0.5

Source: IEA (historic), Schroder Economics, Schroder Global Research (forward estimates)

We assume prices fall further in Q2 2000 as additional supply comes back to the market and seasonal demand falls off. High oil prices in H2 99 are expected to result in increased upstream capital expenditure budgets for 2000 and beyond, although the extent of participation by the Oil Majors in this 'dash for growth' remains to be seen. As such, growth in non-OPEC output may only start to accelerate late 2000/early 2001.

The majority of Alaskan export earnings in oil & gas are derived from crude oil sales. The bulk of the remainder comes from LNG (Liquefied Natural Gas). As volumes are typically fixed via long term take-or-pay contracts it is pricing which determines marginal revenue. LNG prices are typically fixed relative to the competing fuel source (i.e. fuel oil) and will therefore rise as fuel oil prices rise with the oil price. That said, industry dynamics such as the global over supply of LNG limit the extent to which prices can recover. Lower crude oil prices in H1 99 are reflected in lower Alaskan export revenues derived from LNG. For 2000 we would expect the price environment to improve as higher fuel oil prices drive lagged adjustments in LNG prices and as recovery in Asia absorbs the overhang of supply in the region.

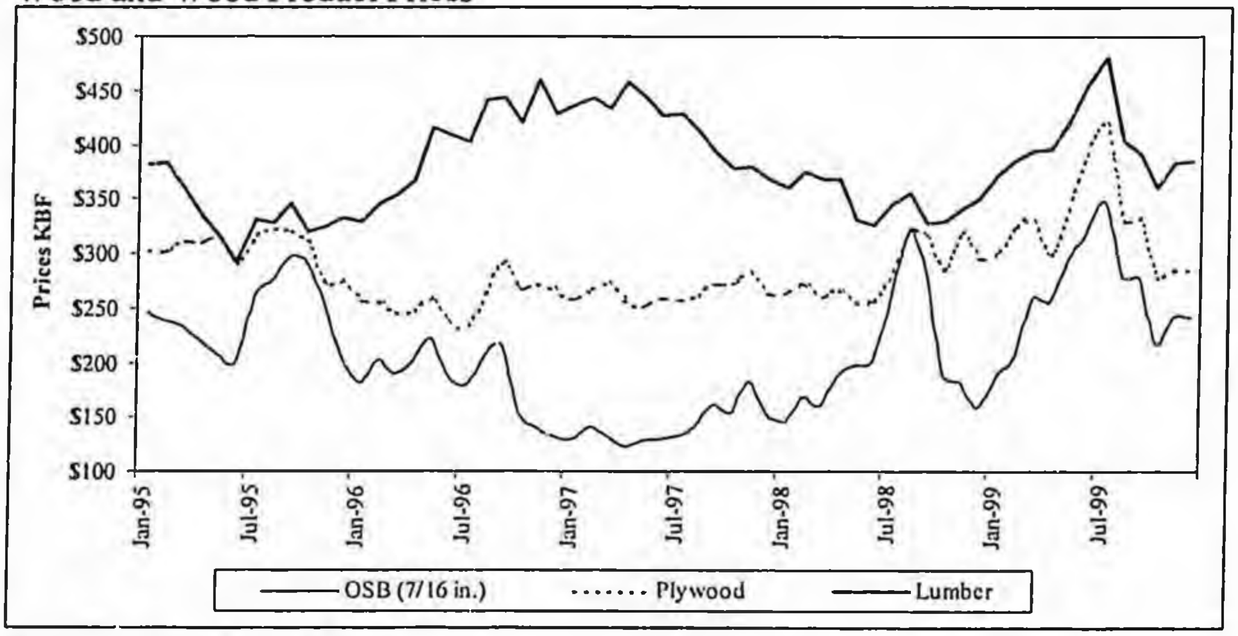
Wood & Wood Products

As markets continued to be surprised by continued strength in construction demand in North America, this was reflected in lumber and panel prices. Recovery in the latter part of 1998 continued well into 1999 with benchmark average framing lumber prices rising over 15% year-on-year. Peak-cycle prices were achieved in July 1999 as US housing markets continued to power ahead and new production capacity additions were limited. This was true for both lumber and plywood. Higher prices are reflected in increased export revenues received during H1 99.

The chart below indicates a sharp fall in prices during the second half of the year. This can be attributed to the slowdown in housing starts. Although growth in commercial property remains relatively strong, that too is showing signs of slowing and is anyway less important to forest product demand.

We continue to expect the US housing market to soften from current levels. New wood product capacity will also act to depress operating rates and reduce prices and margins. Continued recovery in the Asia Pacific region may act to boost export revenues but overall we still expect prices to decline, on average, from peak levels achieved in 1999. For Alaska, sales of chips and scrap wood are material. As such, the forecast rise in pulp prices should lead to higher revenues elsewhere in the production chain.

Wood and Wood Product Prices



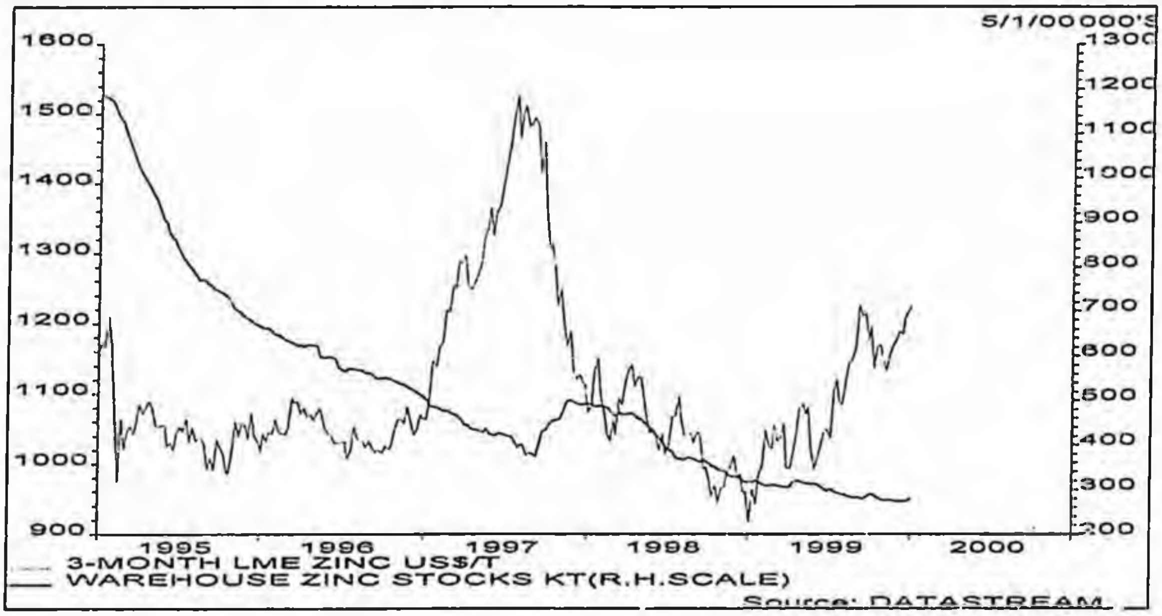
Source: Random Lengths

Metals & Mining

Zinc and lead make up the majority of Alaska's mineral exports, with 81% and 14% respectively. The year started very much where 1998 left off with prices continuing to slide down further as the effects of the Asian crisis continued to be felt.

It then became apparent that Asia was starting to recover and that the US economy was showing few of the expected signs of slow down. As such demand exceeded expectations. With inventories already at low levels, prices started to recover. Benchmark LME zinc prices were up over 30% during the year, although average prices were up only 4% versus 1998. Inventories continued to fall during 1999 especially in Asia, as demand for galvanised steel increased (which accounts for over half of all zinc consumed). The bulk of price increases occurred in H2 99 and this, together with lags in contract prices, meant that H1 99 export revenue fell sharply. We expect H2 99 and H1 00 export revenue to be significantly higher.

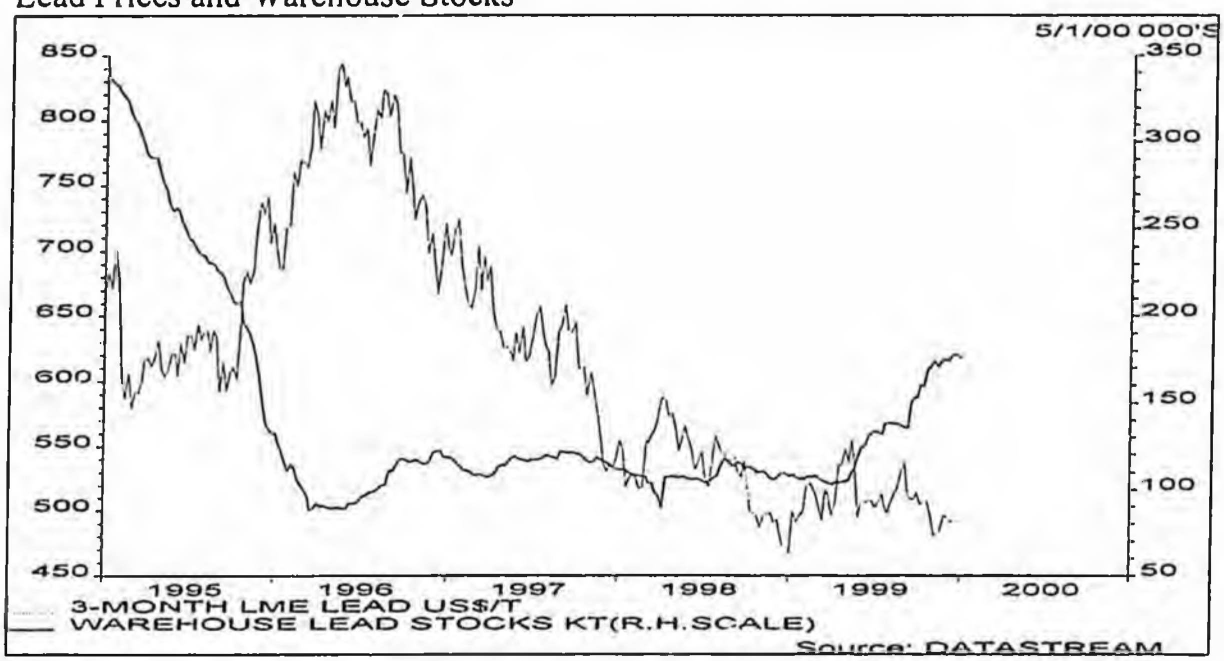
Zinc Prices and Warehouse Stocks



Additional mine supply of zinc is expected from Australia, Mexico, Ireland and Peru during 2000 but demand growth for refined zinc should ensure that the market remains in deficit. This suggests positive price support for the next few years, although scope for significant price appreciation from current levels is limited. We expect prices to trade in the range $1,100-1,250/t.

Like zinc, the price of lead started to recover in Q1 99. However, inventory levels started to turn up and, as such, limited further price appreciation. Benchmark average prices actually declined during the year, by 4.7%. Inventories in 1999 increased by over 60%, a great deal of the increase occurring in Singapore, which reflects increased exports of lead from China.

Lead Prices and Warehouse Stocks



The outlook for lead prices is not particularly exciting. Expansions and start-ups in Australia combined with continued high levels of exports from China should result in continued, if falling, surpluses. As such, we expect prices to recover during the year, but not significantly, to trade in the range $500-520/tonne. Longer term, the environmental lobby to reduce the use of lead in vehicles (which is the key driver for lead demand) will put downward pressure on prices unless capacity is closed down and/or alternative uses are found for the metal.

Briefly on gold, prices recovered dramatically in September last year as European central banks announced that sales and leasing of gold will be limited over the next five years. Over only a few trading days prices shot up from $260/troy oz to over $330/troy oz. The announcement brought to an end speculation regarding multiple sales of central bank reserves, which had sent prices below many producers cash cost level. Since then prices have been volatile, but now appear to have settled into a trading range of $280-300/troy oz as speculative short positions have been unwound. Demand growth is robust and mine supply growth is, at best, flat so prices should rise towards the top end of this range during the year. That said, unexpectedly high demand growth could be met from increased scrap sales or sales from bank reserves not party to the European agreement.

Craig Pennington
Global Commodities Research
Schroder Investment Management
January 2000

Alaska Permanent Fund Forecast Model

January 20, 2000

State of Alaska, Legislative Finance Committees

Gregory C. Allen
EVP, Callan Associates Inc.

Chris Phillips, CFA
Director of Finance, APFC

CAI

Overview of Presentation

- Brief introduction/overview of model.
- Discussion of input assumptions.
- Projections through 2010 for key fund variables.
- Summary observations and conclusions.

CAI

MOMA *(Mother of Models - All)*

- Build a model of the Permanent Fund that:
  - Projects the future for all key dimensions of the fund.
  - Accurately captures the mechanics of the distribution and Inflation-Proofing rules.
  - Allows for the testing of different investment and spending policies.
  - Does all of this across the full range of potential capital market outcomes (taking into account their volatility).

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Primary Assumptions

- Actual Fund results through September, 1999.
- 1999 Callan Associates Inc. capital market assumptions.
- Current APFC Asset Allocation.
- Dividend: Statutory Formula
- Earnings Reserve limitation: Realized Earnings Reserve.
- Oil Revenues: Fall 1999 estimates from Department of Revenue fall forecast.

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Asset Allocation Assumptions

Asset Class	Target
Cash Equivalents	0.0%
Domestic Bonds	35.0%
Active Large Cap Dom Eq	17.0%
Passive Large Cap Dom Eq	13.0%
Small Cap Domestic Equity	7.0%
International Equity	16.0%
Real Estate	10.0%
International Bonds	2.0%
Total	100.00%

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1999 Capital Market Assumptions

Asset Class	Expected Return	Standard Deviation
CPI	3.00%	1.00%
Cash Equivalents	4.40%	0.70%
Domestic Bonds	5.60%	5.30%
Large Cap Domestic Equity	9.00%	15.00%
Small Cap Domestic Equity	11.20%	25.30%
International Equity	10.00%	21.50%
Real Estate	8.00%	16.50%
International Bonds	5.60%	11.00%

Expected Average Total Rate of Return 7.97%

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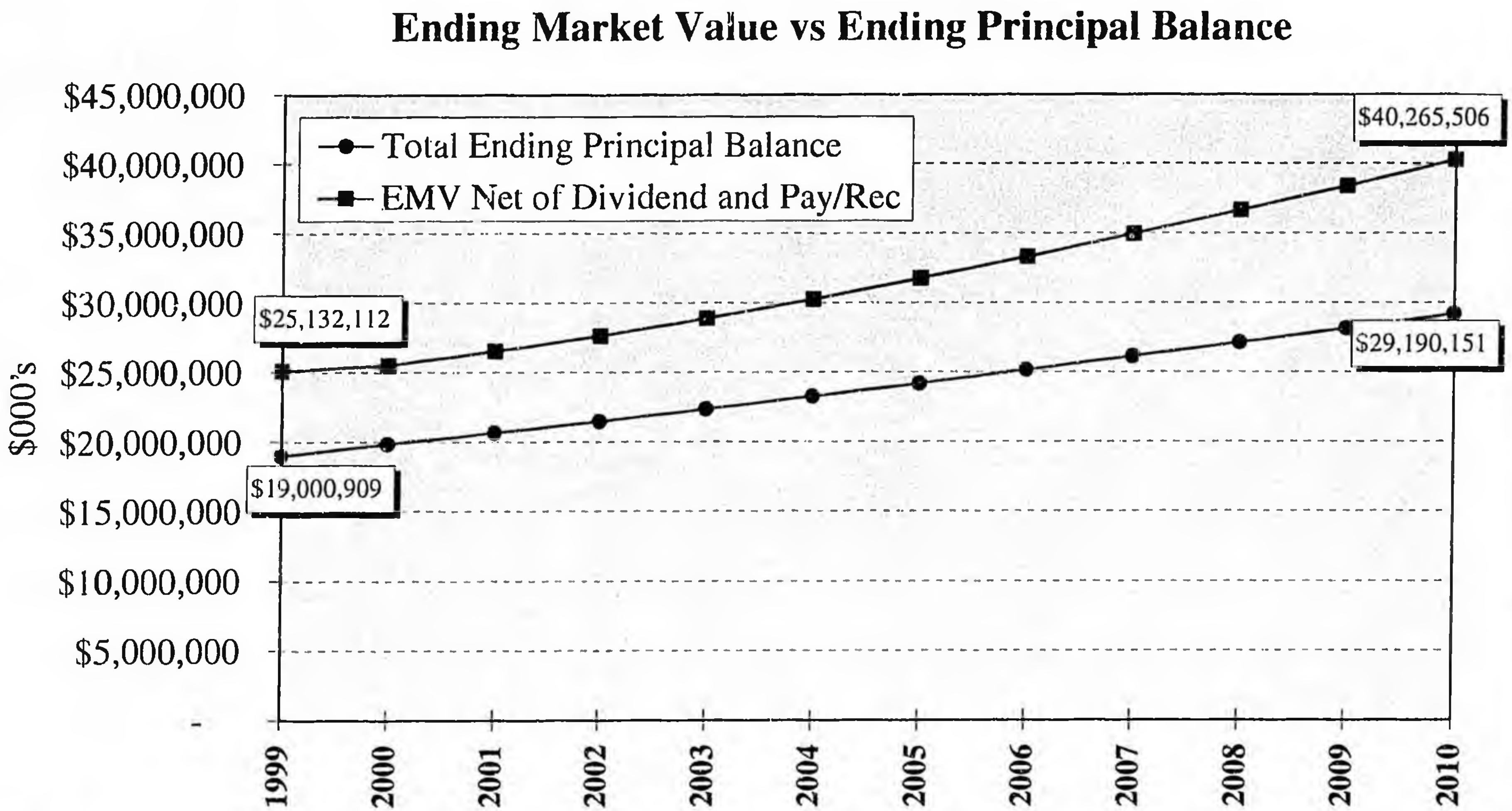
Fund Value vs Principal Balance

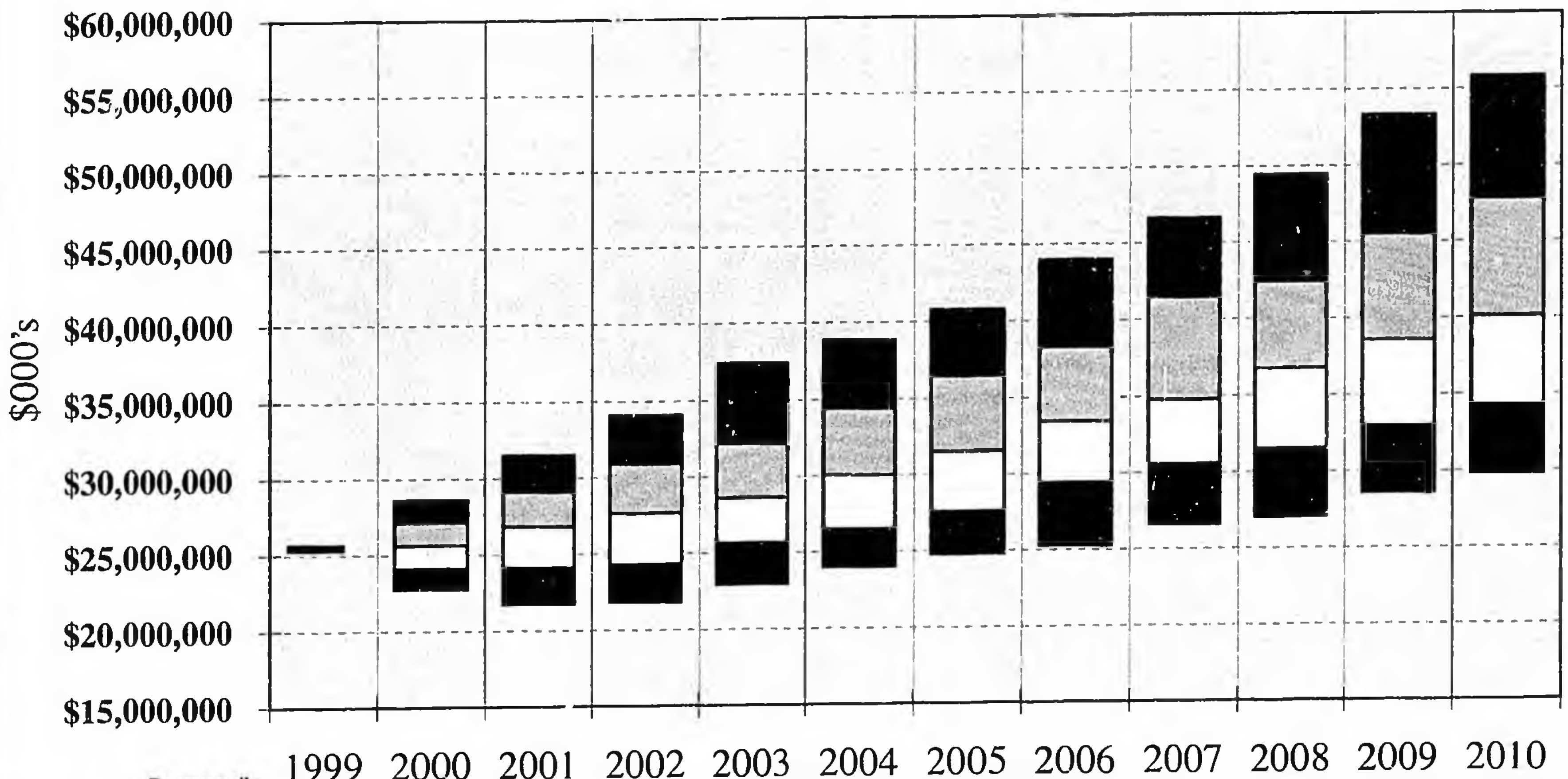


CAI

(Using the median rate of return with no volatility)

Range of Ending Market Value

Range of Ending Market Value



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$25,132	$28,586	$31,503	$34,039	$37,357	$38,823	$40,799	$43,999	$46,636	$49,407	$53,300	$55,796
25th	$25,132	$27,163	$29,122	$30,894	$32,153	$34,367	$36,412	$38,265	$41,474	$42,423	$45,510	$47,822
Median	$25,132	$25,649	$26,835	$27,672	$28,607	$30,026	$31,520	$33,408	$34,766	$36,729	$38,566	$40,110
75th	$25,132	$24,125	$24,120	$24,287	$25,643	$26,465	$27,581	$29,403	$30,552	$31,512	$32,976	$34,310
90th	$25,132	$22,772	$21,765	$21,829	$22,957	$24,043	$24,808	$25,302	$26,610	$27,065	$28,625	$29,804

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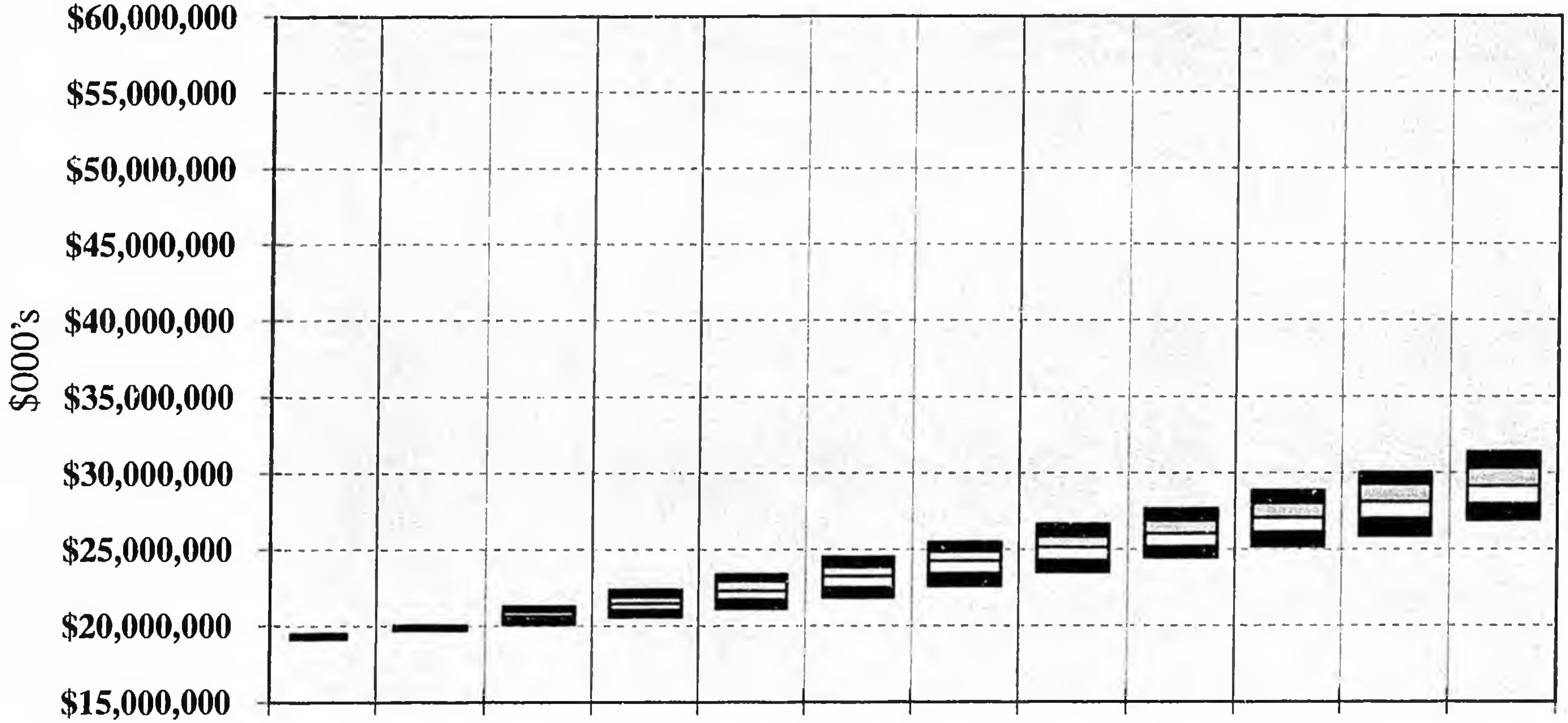
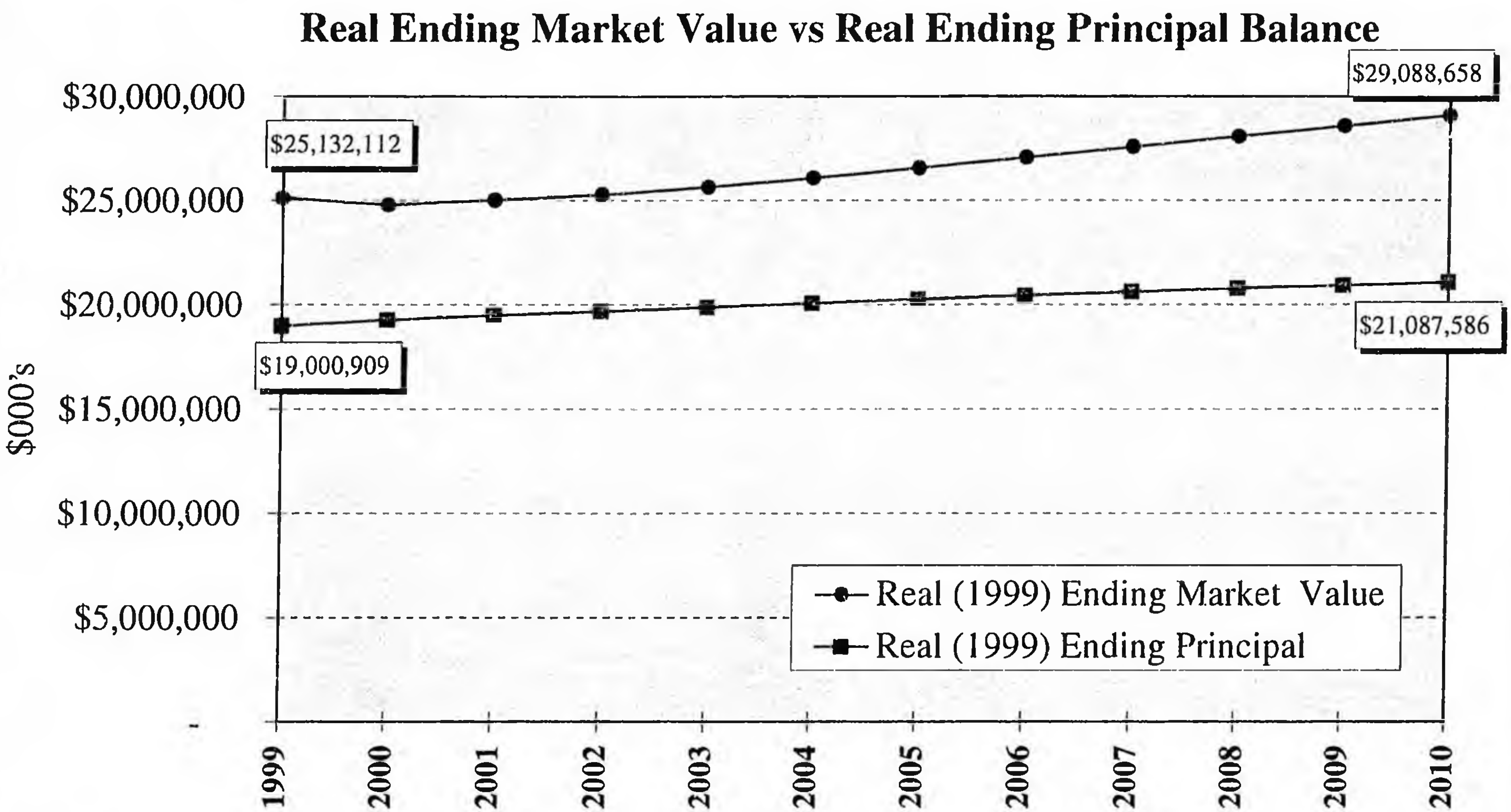
Range of Principal Balance

Range of Principal Balance



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$19,001	$20,023	$21,258	$22,360	$23,372	$24,486	$25,456	$26,638	$27,647	$28,819	$30,016	$31,372
25th	$19,001	$19,961	$20,960	$21,892	$22,923	$23,844	$24,856	$25,816	$26,879	$28,010	$29,247	$30,302
Median	$19,001	$19,868	$20,646	$21,439	$22,309	$23,221	$24,238	$25,143	$26,056	$27,060	$28,098	$29,127
75th	$19,001	$19,780	$20,376	$21,013	$21,716	$22,477	$23,401	$24,270	$25,173	$26,105	$27,010	$27,957
90th	$19,001	$19,731	$20,111	$20,601	$21,142	$21,867	$22,620	$23,516	$24,497	$25,194	$25,879	$26,922

Real Fund Value and Principal

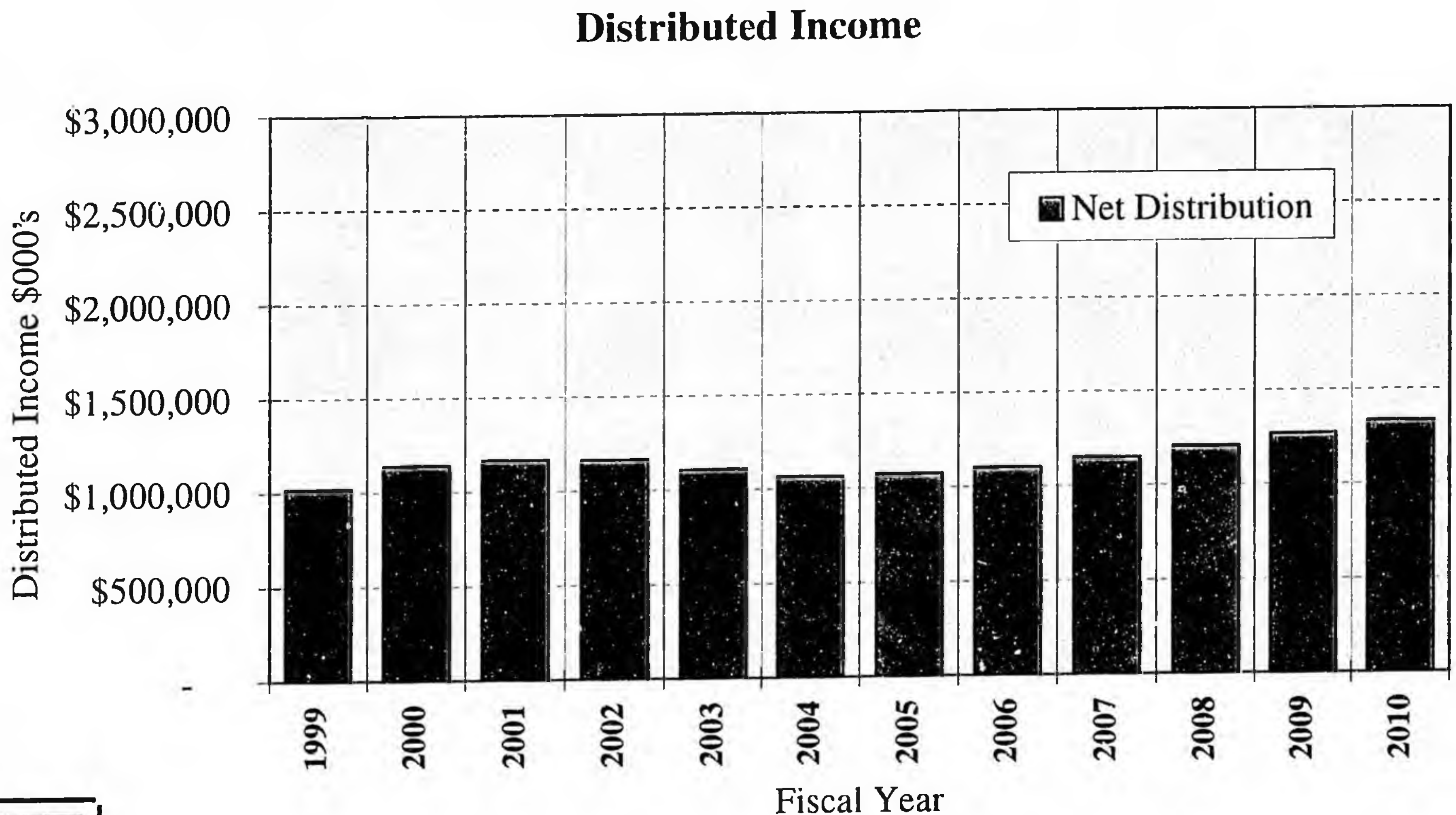


CAI

(Using the median rate of return with no volatility)

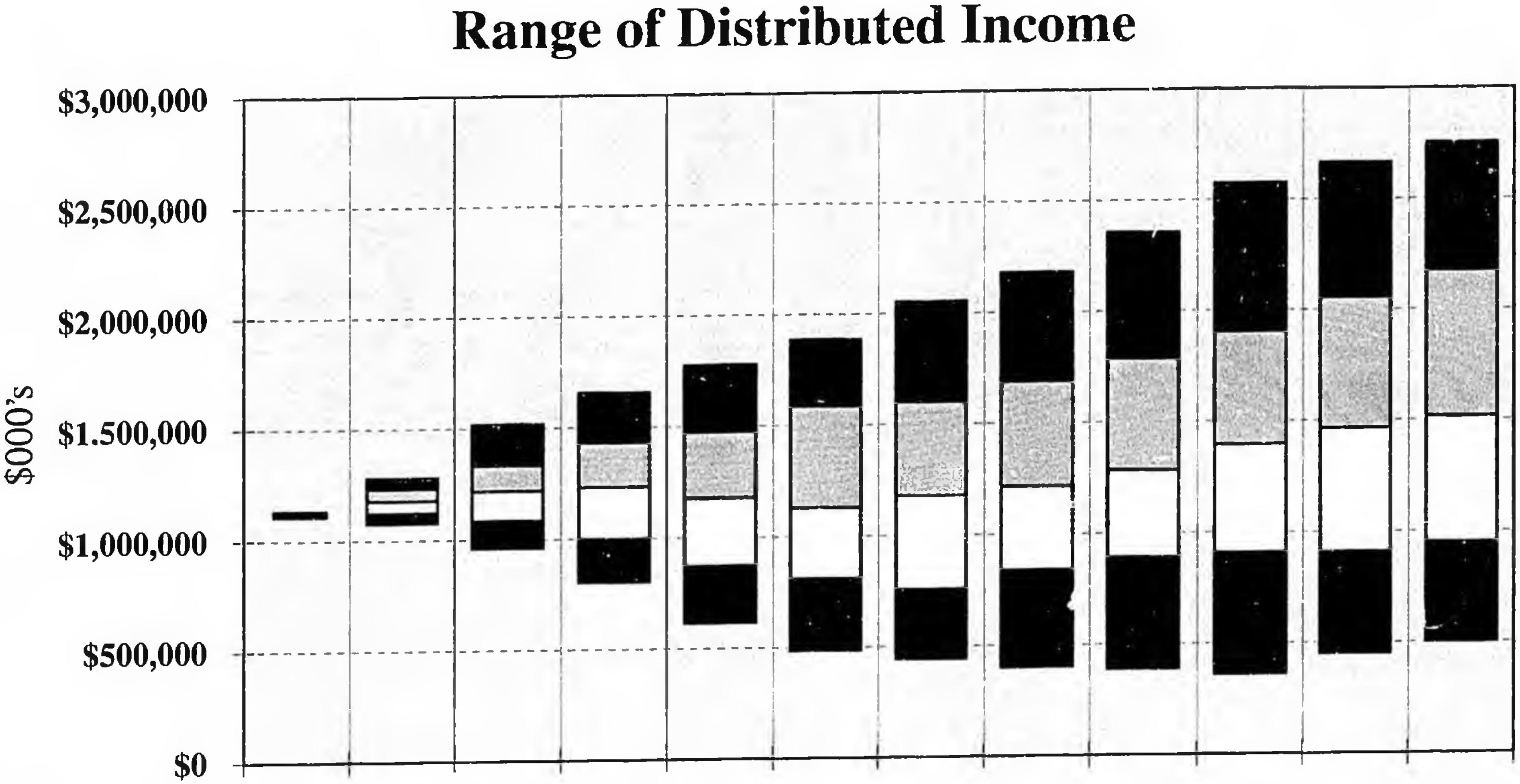
Projected Distribution of Income

(Based on Statutory Income)



(Using the median rate of return with no volatility)

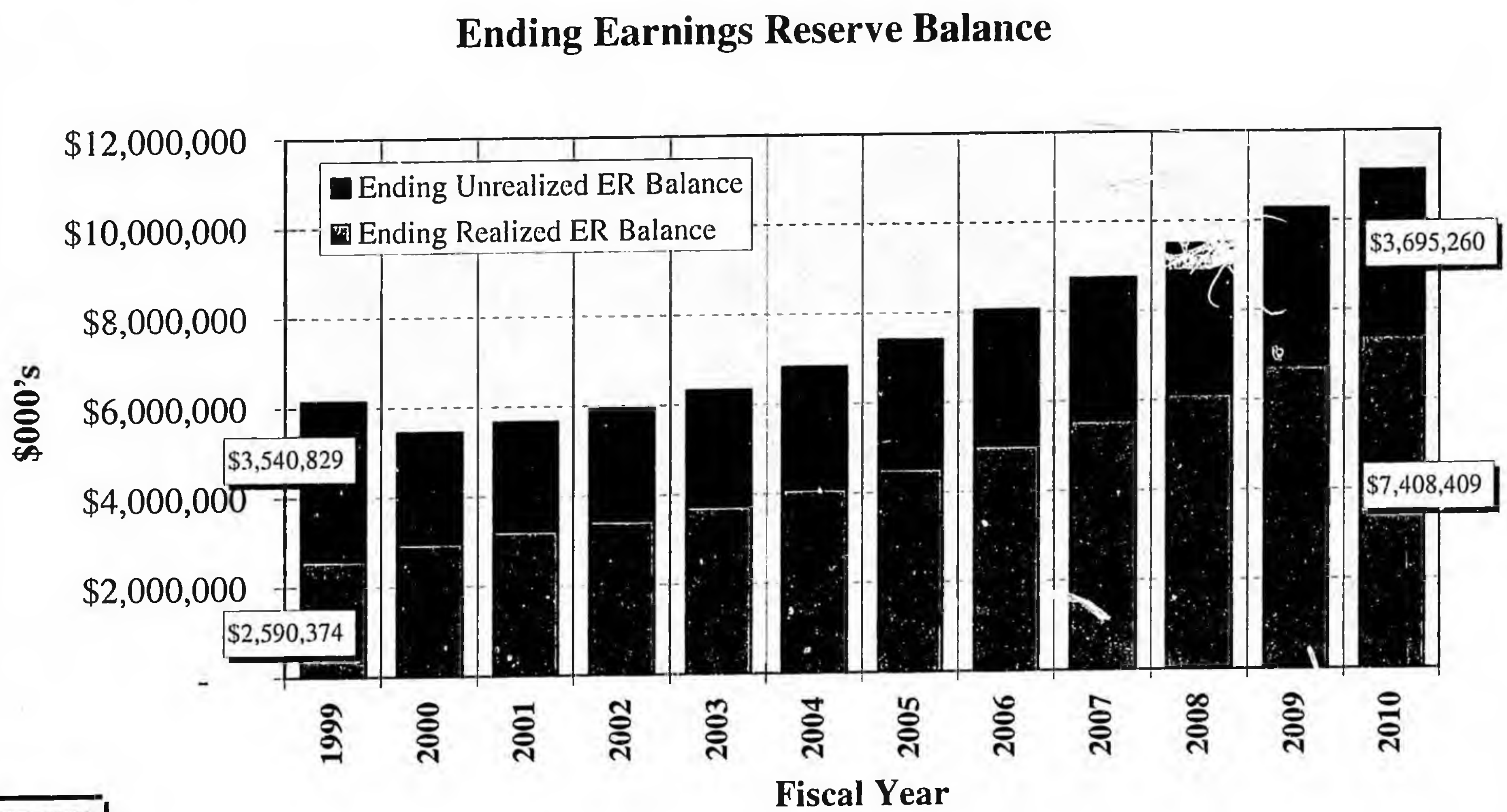
Range of Distributed Income



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$1,045	$1,281	$1,517	$1,657	$1,775	$1,885	$2,052	$2,179	$2,354	$2,572	$2,661	$2,750
25th	$1,045	$1,231	$1,333	$1,431	$1,476	$1,583	$1,600	$1,686	$1,786	$1,905	$2,055	$2,175
Median	$1,045	$1,178	$1,218	$1,232	$1,178	$1,129	$1,178	$1,215	$1,283	$1,395	$1,464	$1,515
75th	$1,045	$1,121	$1,084	$997	$871	$809	$755	$838	$890	$906	$908	$949
90th	$1,045	$1,078	$962	$806	$618	$487	$444	$401	$387	$361	$452	$503

Ending Earnings Reserve Balance

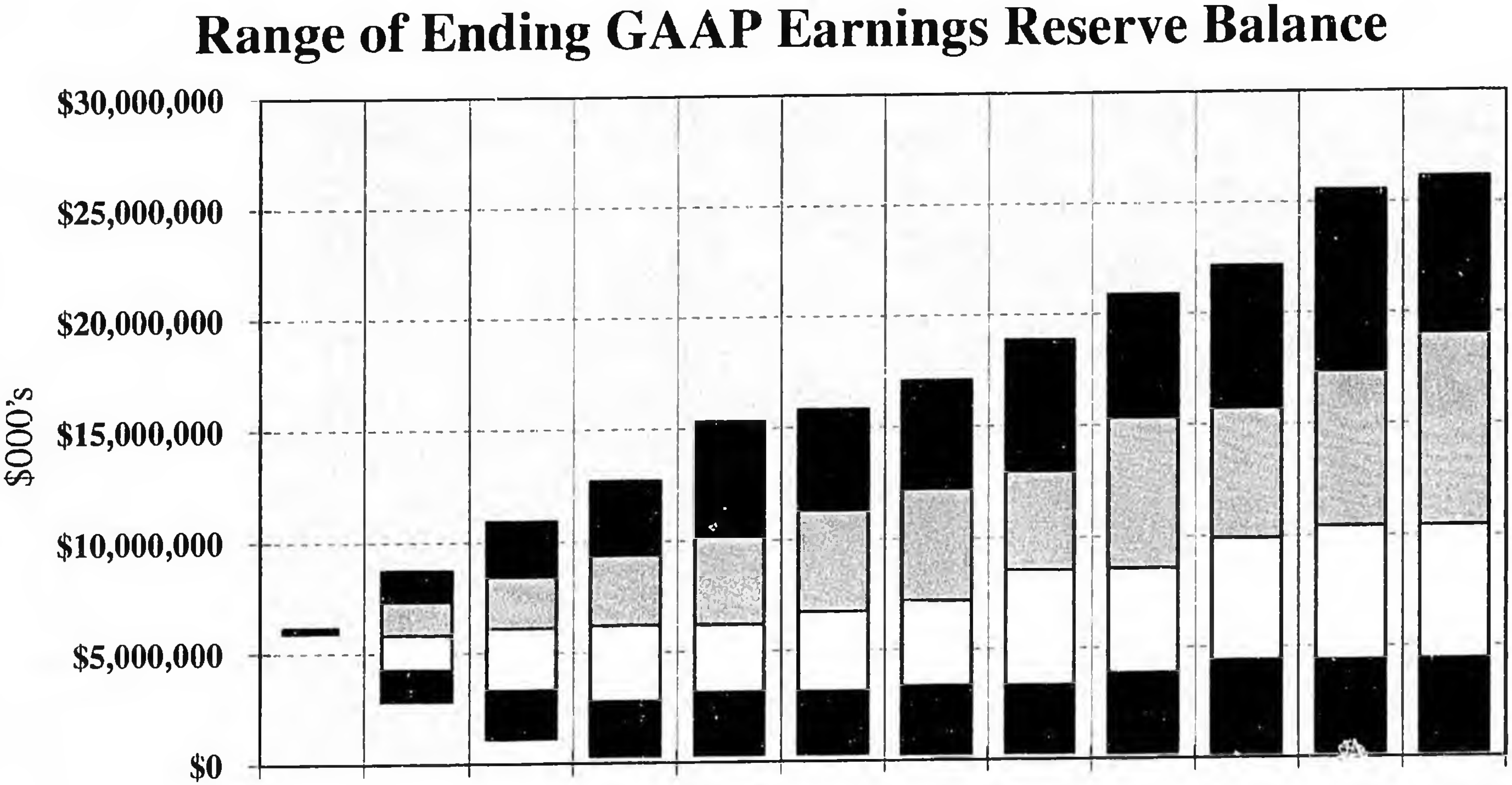
(Both Realized and Unrealized)



CAI

(Using a constant rate of return with no volatility, net of all payables)

Range of Ending Total Earnings Reserve



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$6,131	$8,734	$10,918	$12,712	$15,288	$15,806	$17,078	$18,858	$20,874	$22,137	$25,516	$26,119
25th	$6,131	$7,348	$8,429	$9,376	$10,124	$11,311	$12,241	$12,972	$15,331	$15,741	$17,357	$19,077
Median	$6,131	$5,832	$6,116	$6,224	$6,221	$6,751	$7,195	$8,542	$8,568	$9,897	$10,396	$10,424
75th	$6,131	$4,267	$3,303	$2,784	$3,141	$3,153	$3,360	$3,339	$3,868	$4,386	$4,375	$4,401
90th	$6,131	$2,854	$1,149	$325	$324	$330	$290	$296	$256	$205	$199	$190

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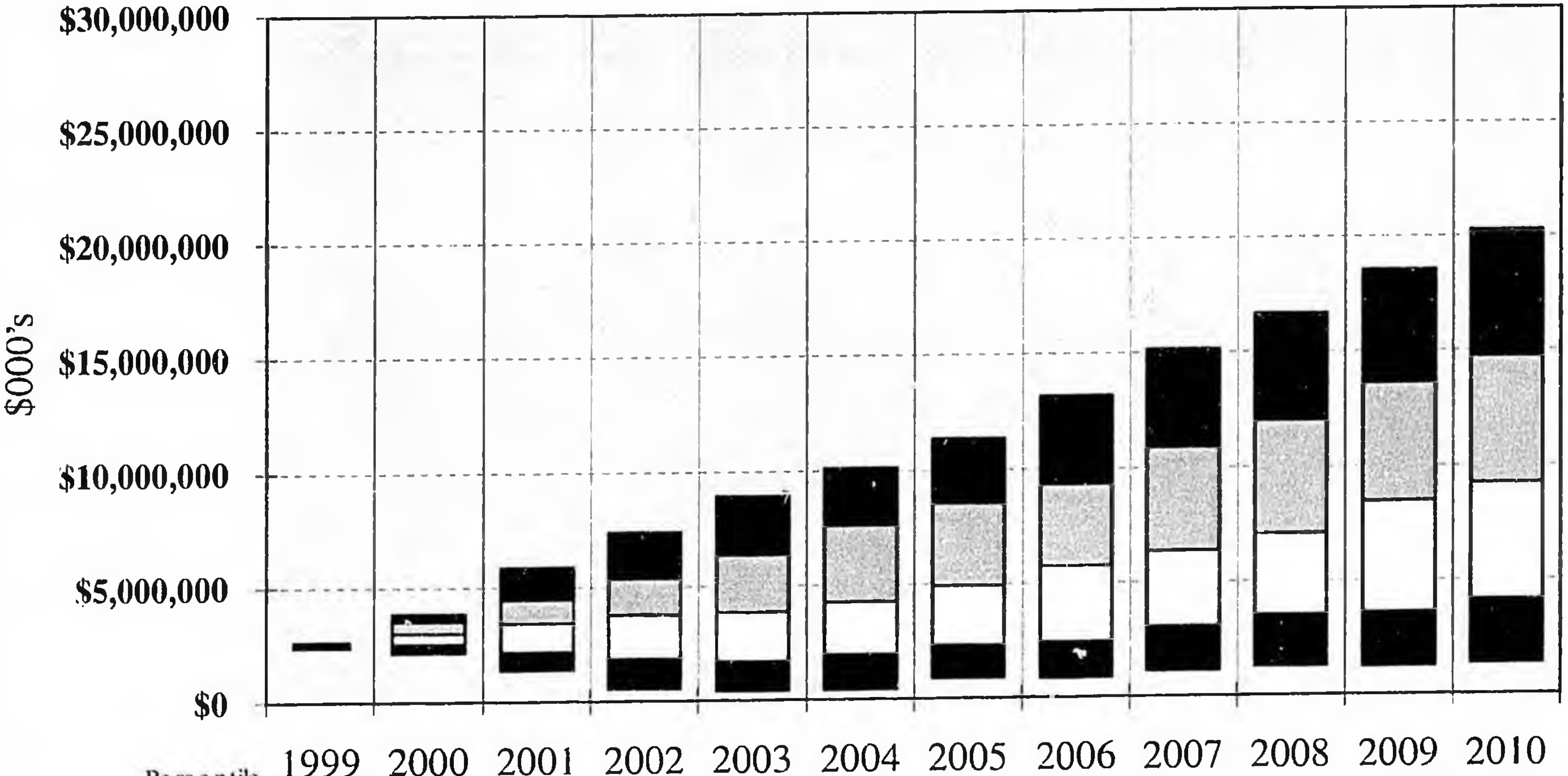
Range of Ending Realized Earnings Reserve

Range of Ending Realized Earnings Reserve Balance



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$2,590	$3,860	$5,873	$7,376	$8,906	$10,102	$11,352	$13,161	$15,139	$16,658	$18,529	$20,237
25th	$2,590	$3,532	$4,471	$5,370	$6,368	$7,611	$8,531	$9,316	$10,893	$12,029	$13,637	$14,722
Median	$2,590	$3,024	$3,421	$3,791	$3,864	$4,254	$4,936	$5,759	$6,378	$7,084	$8,446	$9,218
75th	$2,590	$2,546	$2,184	$1,842	$1,685	$1,961	$2,336	$2,426	$3,051	$3,515	$3,596	$4,112
90th	$2,590	$2,163	$1,413	$572	$421	$448	$905	$873	$1,124	$1,295	$1,252	$1,369

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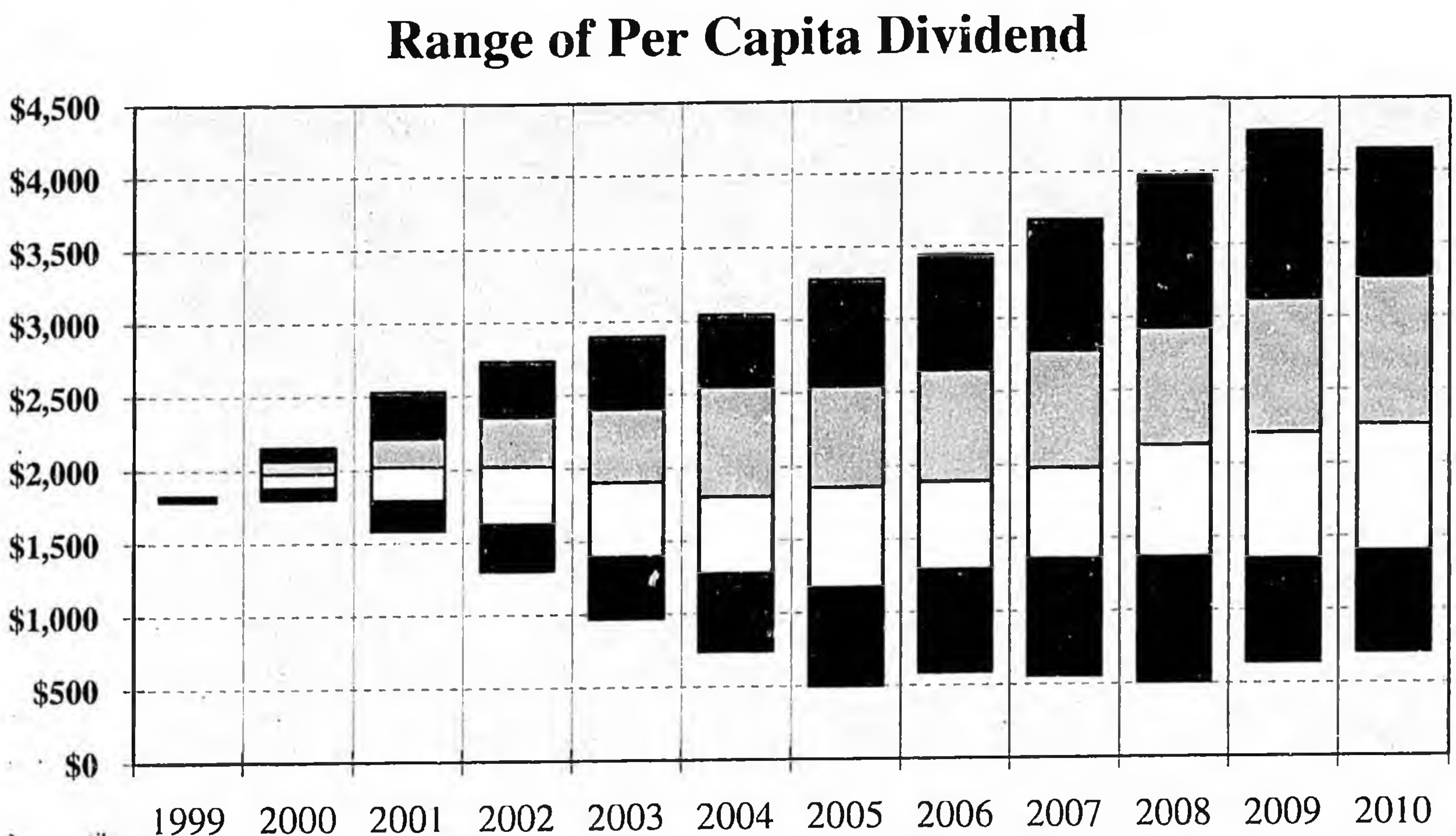
Range of Per Capita Dividend



Percentile	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
10th	$1,770	$2,154	$2,528	$2,731	$2,894	$3,040	$3,273	$3,436	$3,672	$3,968	$4,275	$4,145
25th	$1,770	$2,068	$2,214	$2,352	$2,398	$2,545	$2,541	$2,646	$2,772	$2,925	$3,121	$3,266
Median	$1,770	$1,977	$2,019	$2,018	$1,904	$1,799	$1,857	$1,892	$1,977	$2,128	$2,207	$2,258
75th	$1,770	$1,878	$1,791	$1,624	$1,393	$1,274	$1,171	$1,289	$1,358	$1,362	$1,348	$1,397
90th	$1,770	$1,804	$1,584	$1,302	$973	$747	$501	$590	$561	$510	$643	$713

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Rate of Return Observations

Median expected total rate of return:	7.97%
Estimated fees to manage the Fund:	.17%
Net-of-fee total return:	7.80%
Estimated inflation:	3.00%
Median real growth of the fund:	4.80%

Based on the dividend formula, the current pay-out rate is approximately 3.25% - 4.% of market value.

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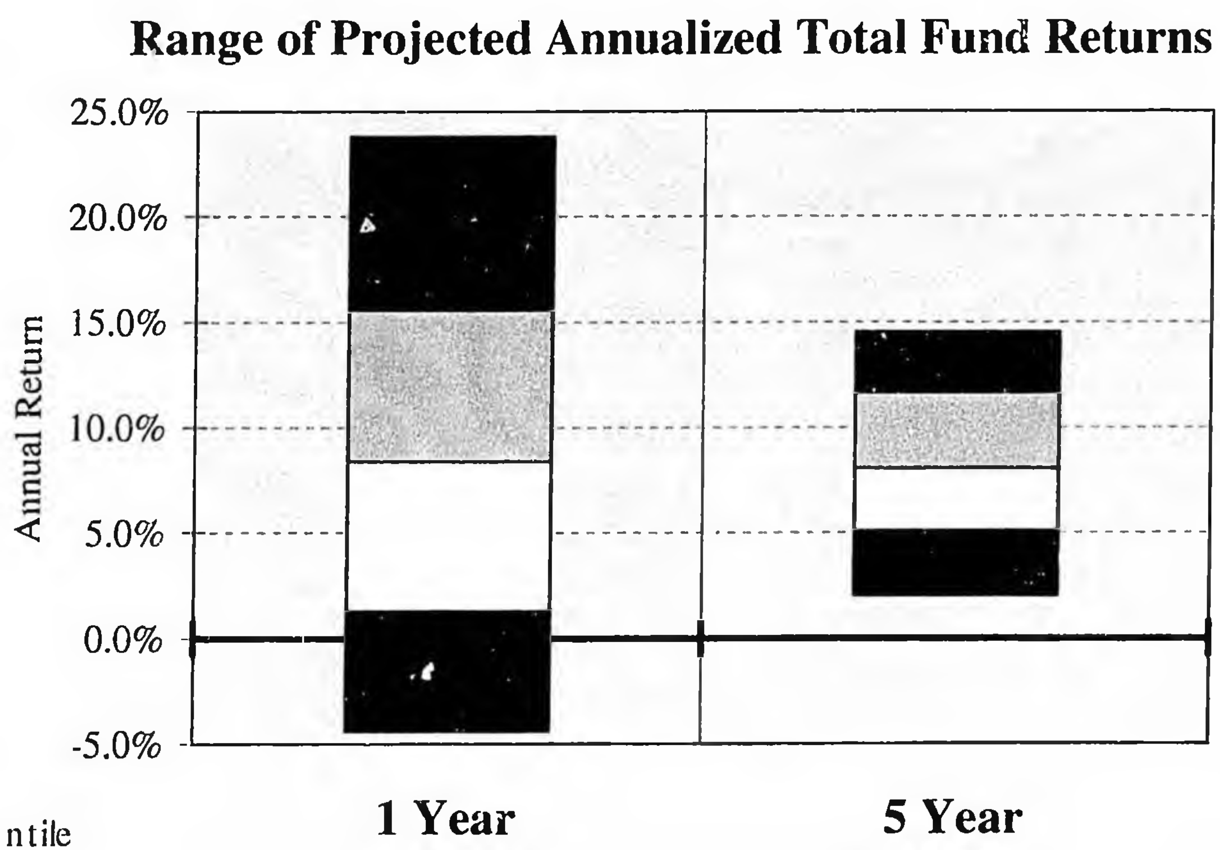
Range of One and Five Year Returns for Total Fund



Percentile	1 Year	5 Year
10th	23.8%	14.5%
25th	15.6%	11.6%
Median	8.4%	8.0%
75th	1.3%	5.1%
90th	-4.4%	2.0%

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Summary Observations

- Given the volatility of the markets, there is a 10% chance that the Fund's total return will be as low as -4.4% and a 10% chance that it will be as high as 23.8% in any given year. Over longer investment time periods volatility is reduced.
- There is approximately a 20% chance that the Fund will generate a negative return in any given year, but over five years the chance of a cumulative negative return is 5%. Over even longer time periods, volatility is reduced.
- Given the simulated interaction of investment performance and Fund mechanics, the model indicates that there is a 75% chance that, over the next 10 years, the Fund will be able to support the dividend every year, with no limitation imposed by the Realized Earnings Reserve balance.
- Given these same interactions, the model indicates that there is an 70% chance that over the next 10 years, the Fund will be able to support inflation-proofing every year, with no limitation imposed by the Realized Earnings Reserve balance.

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Payout as a Percent of Market Value

- Typical pay-out method of large endowment funds and is a preferred method of pay-out by the APFC Trustees.
- The pay-out rate is set below the long-term projected inflation rate, making inflation proofing a priority.
- A percent of the average market value pay-out method of an average total Fund value will result in a more stable distribution stream than the current income based distribution rule.
- Disconnects investment decisions from short-term spending considerations.
- The spending provision becomes a part of the long-term investment strategy rather than a tactical response to market cycles.
- Distributing income in excess of a sustainable real rate of return creates potential shortfalls in future distributions due to the Fund's requirement to preserve principal ("if you payout more today, you must pay out less tomorrow.")

CAI

25 Years

CALLAN ASSOCIATES INC

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1/24/00

Overview

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Audit

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Senate Finance Committee Overviews

January 24, 2000

Prepared by the Division of Legislative Audit

January 24, 2000

Office of the Governor

Expenditures Related to Public Relations or Information Dissemination For FY 97 and FY 98 (01-4574-99)

PURPOSE OF THE REPORT

The purpose of the audit was to develop an estimate of expenditures made by the Office the Governor on public relations or information dissemination. For the purposes of this report public relations and information dissemination is defined as *"the management function that evaluates public attitudes, aligns the policies and procedures of the State with the public interest, and executes a program of action and communication to earn public understanding and acceptance."*

FINDINGS AND CONCLUSIONS

We estimate that personal services costs related to carrying out the aforementioned activities ranged from $1 million to $1.3 million for both FY 97 and FY 98.

Travel related expenses were under $200,000 in both FY 97 and FY 98. Oftentimes the purpose of a trip was for multiple purposes – some of which involved public relations or information dissemination. We did not attempt to allocate the costs of the trip between various purposes, but charged all related costs to our estimate total.

Contractual related costs were approximately $100,000 annually.

Schedules of specific expenditures and activities are set out in the report in order that each reader can review and consider if the activities involved, especially in the area of travel, fit their definition of "public relations."

January 24, 2000

Department of Administration

State of Alaska, Statewide Single Audit for FY 98 (02-6900-99)

PURPOSE OF THE REPORT

This report summarizes our review of the State of Alaska's general purpose financial statements and the State's compliance with federal laws and regulations in the administration of over $1.2 billion of federal financial assistance programs.

FINDINGS AND CONCLUSIONS

The FY 98 General Purpose Financial Statements for the State of Alaska are fairly presented in accordance with generally accepted accounting principles, except for two items. General Fixed assets are reported at replacement or insured value rather than on a historical cost basis as required by generally accepted accounting principles.

With regard to compliance with federal laws and regulations we were unable to obtain sufficient documentation supporting the State's compliance regarding allowable costs for three federal programs:

1. Department of Fish and Game, Pacific Salmon Treaty program;
2. Department of Fish and Game Wildlife Restoration program; and
3. Department of Administration, Aging cluster program.

Additionally, the State of Alaska did not comply with requirements regarding allowable costs for the Public Water System Supervision program administered by the Department of Environmental Conservation or the special tests and provisions applicable to the Child Support Enforcement program administered by the Department of Revenue.

This report also contains 37 recommendations, of which 12 were carried over from the prior year. Many of the recommendations made in this report require significant changes in procedures or a shifting of priorities, and therefore may take more than one year to implement.

A major concern discussed in this report involves an overexpenditure by the Department of Transportation and Public Facilities (DOTPF). We estimate DOTPF overspent its maintenance and operations appropriations by almost $1 million. Rather than reducing actual spending, DOTPF management simply chose not to pay its State Equipment Fleet bills for the last couple of months of the fiscal year. Our recommendation and DOTPF's response involves a somewhat complicated discussion of accounting issues, fleet rates, and replacement credits. However, essentially DOTPF overspent its appropriations.

DOTPF disagrees with this conclusion. We would suggest that as budget discussions occur this legislative session, that the finance committees will wish to assure themselves this does not happen in the future.

January 24, 2000

Department of Administration

A Sunset Review on the Alaska Commission on the Aging (02-1462-99)

PURPOSE OF THE REPORT

We reviewed the activities of the commission in accordance with Titles 24 and 44 of the Alaska Statutes in order to determine whether this commission should continue in existence as provided for under the terms of the State's "sunset" legislation. The commission is currently scheduled to terminate on June 30, 2000.

FINDINGS AND CONCLUSIONS

We believe there is a demonstrated need for this commission, therefore, we recommend the termination date be extended until June 30, 2004.

During our review we did identify some areas for improvement. We made several recommendations addressing improvements that are needed to ensure federal funds are handled in accordance with various federal requirements. Additionally, we reviewed the organizational placement of the Long Term Care Ombudsman LTCO. Part of the commission's responsibility is oversight of the Long Term Care Ombudsman. This set up a potential for a conflict of interest because the Department of Administration also manages the State's Pioneers' Homes.

This became an issue, in part, as a result of the recent investigation in the Anchorage Pioneers' Home by the Long Term Care Ombudsman. The investigation was lengthy and became contentious. The state agency responsible for administering the pioneer homes imposed certain procedures on the Long Term Care Ombudsman. These include:

1. Interviews had to be conducted in the presence of an assistant attorney general from the Department of Law.

2. The Long Term Care Ombudsman was required to notify pioneer home management before conducting interviews with staff regarding complaints.

Widely differing views are held as to the reasons for and the effect of these measures. Regardless, these measures created a situation where state facilities were treated differently by the LTCO than similarly situated private sector facilities.

In recognition of the organizational difficulties the commission is considering organizational alternatives which we expect to be a matter of discussion during legislative hearings on SB 204, which extends the termination date of the board.

January 24, 2000

Department of Administration

Office of Public Advocacy – Public Guardian Program (02-4577-99)

PURPOSE OF THE REPORT

This report evaluated the following:

1. The extent to which recommendations from a prior legislative audit had been implemented.
2. The organizational structure of OPA and the existence of any conflicts of interest.
3. The contractual arrangement for court visitors and the effectiveness of their reviews.
4. The potential for transferring cases from OPA to private guardianship services.

FINDINGS AND CONCLUSIONS

There are over 2,700 guardianships in the State. About 74% of the time, the guardian oversight is carried out by a private, unpaid person – usually a relative. About 20% of the time the oversight services are provided by a public guardian employed by the Office of Public Advocacy, and the remaining 6% of time a private guardianship service fulfills the function.

Private professional guardians must become an important option for dealing with the growth in guardianship services. However, the current private agencies do not yet enjoy the confidence of major participants in the State's guardianship system. The State should encourage responsible growth by this occupational group, such as professional regulation, performance monitoring, or other means of oversight.

Assigning OPA the management responsibilities for the court visitor function created an inherent conflict of interest. The current placement of the court visitor requires them to review the quality of guardianships by OPA, the same agency that has hired, pays and provides training for the court visitor. We recommend that the court visitor function be transferred to the Alaska Court System.

We reviewed concerns by private professional guardians regarding OPA's practice of "spending down" wards' assets to maintain eligibility for public benefits. We find that OPA's practice is analogous to tax planning which is legal, rather than tax evasion – which is illegal.

Findings from reviews conducted by the Office of the Governor, Office of Management and Budget and the McDowell Group confirm that the recommendations from the Division of Legislative Audit's prior audit have been implemented.

January 24, 2000

Department of Administration

Division of Longevity Programs, Alaska Pioneers' Homes (02-4591-00)

PURPOSE OF THE REPORT

The objectives of this audit were:

1. To review internal controls over pharmacy inventories.
2. Evaluate the efficiency of pharmacy operations.
3. To determine if the turnover rates for both residents and direct-care staff are reasonable.
4. To ascertain whether direct-care staffing ratios are adequate.

FINDINGS AND CONCLUSIONS

Controls over some of the Pioneers' Home Pharmacy operations are weak. More specifically we determined that:

1. Physical controls over medications while in transport are lacking.
2. Disposal of controlled substances is in violation of state and federal regulations.
3. The in-house pharmacy program may not be the most efficient alternative.
4. State regulations and divisional policies and procedures are not being followed in personnel matters.

Staffing levels in the homes are adequate, staff turnover is below national averages, and resident turnover is low.

We made seven recommendations to the Department of Administration to address the shortcomings identified in this report. Two of the more critical recommendations addressed concerns we had regarding the backgrounds of certain employees working at the homes. In this area we recommended the following:

1. The Division of Alaska Longevity Programs' human resources officer should assess the risk of employing certain individuals.

   The Pioneers' Home was not assessing the risk associated with certain employees. We noted that several employees had felony convictions for sexual abuse and a pharmacist that had, and may still have, an opiate addiction. We did not conduct a comprehensive review for risks of this nature. We suspect that such a review would reveal additional potential risks to residents, staff, and the State.

2. The commissioners of the Departments of Administration and Health and Social Services should adopt regulations to prohibit employment of certain criminals in assisted living homes.

January 24, 2000

Department of Administration
Department of Community and Economic Development

Regulatory Commission of Alaska and the Alaska Oil and Gas Conservation Commission (02-1466-00)

PURPOSE OF THE AUDIT

This audit was required by Chapter 25, SLA 1999.

The objective of the audit was to evaluate the compatibility of the functions of the Regulatory Commission of Alaska and the Alaska Oil and Gas Conservation Commission. Through a comparative analysis of these functions, we evaluated whether it would be in the State's best interest to combine the two commissions and provide their services through a single agency.

FINDINGS AND CONCLUSIONS

Our central conclusion is that the best interest of the State is served by retaining two separate identities for these commissions.

While both commissions regulate businesses, important differences exist in their missions, the entities being regulated, decisional timelines, technical disciplines, and operating environments. Just as importantly, the agencies' separate identities foster public accountability under some unique Alaska conditions.

January 24, 2000

Department of Administration
Department of Commerce and Economic Development

Selected Compensation Issues Related to Alaska Seafood Marketing Institute (ASMI) and Alaska Industrial Export and Development Authority (AIDEA) (02-4569-99)

PURPOSE OF THE REPORT

This audit reviewed a variety of compensation related issues which involved employees working for various governmental corporations. More specifically, we were requested to identify the basis for setting various rates of pay, and if the governing boards of the entities involved utilized a prescribed pay schedule and plan. A second objective of the review was to assess the comparability of compensation for individuals working at ASMI and AIDEA, paid at range 21 and above, with positions in the private sector and other state agencies.

FINDINGS AND CONCLUSIONS

The report discusses the following findings:

1. Only 5% of executive branch employees are legally required to use the statutory pay plan.

2. Advanced step hire is practiced by both classified and exempt positions.

3. Compensation for most of ASMI positions are within the competitive market range.

4. AIDEA positions fall above, below, and within competitive market range.

We made a recommendation to ASMI that it develop comprehensive personnel policies and have them approved by the board.

Department of Law
Department of Commerce and Economic Development

Issues Relating to World Plus, Inc. (03/08-4590-99)

PURPOSE OF THE REPORT

The purpose of the audit was to review and evaluate the actions of the Division of Banking, Securities, and Corporations and the Department of Law in matters related to the supervision, regulation, and investigation of the Fairbanks-based corporation World Plus, Inc. (WPI). WPI operated an airline ticket discount business. The purported business was underselling travel agents and airlines by marketing discounted airline tickets that had been earned by others through the frequent flyer program. We point out in the report that even this purported business was illegal. All commercial airlines that fly into Alaska allowed frequent flyer tickets to be transferred to only family members or traveling companions. Airlines prohibited participants from selling their mileage to unrelated third parties.

FINDINGS AND CONCLUSIONS

In order to finance the business, the owner developed an investment program. The program essentially consisted of promissory notes guaranteeing interest rates to investors of between 40% to 300% annually. In August 1992, the Division of Banking, Securities and Corporations learned that WPI's owner was selling unregistered securities. When contacted by BSC, the owner of WPI said there were 35 investors with investment contracts totaling $560,000. Actually, the numbers were 500 investors with contracts totaling more than $8.6 million.

In November 1992, the attorney for WPI's owner submitted to BSC 24 letters of endorsement. These letters came from active investors including employees of the Department of Law (DOLaw), Public Defender Agency, and the Alaska Court System. In March 1993 BSC accepted WPI's application for a securities exemption. WPI was limited to 25 investors and a total of $500,000. Later the agency further restricted it to 15 investors and $250,000. However, over this time period the actual number of investors was growing and the total value of investments was approximately $39 million.

Our review made the following conclusions:

1. BSC routinely relies on the representations made by the attorney of the parties seeking approval of a securities exemption. In the case of WPI this reliance was misplaced.
2. BSC examiners overlooked certain inconsistencies in documents submitted to them during the three years that WPI was granted exemptions.
3. Members of the Department of Law's Criminal Division did not adequately communicate with BSC. In addition, certain actions taken by DOLaw interrupted BSC's investigative process.
4. The WPI incident illustrates a weakness in the statutory balance between protecting the public investor and the regulatory burden placed on small businesses.
5. In our view, the attorney general made prudent decisions in deferring the criminal investigation of WPI to the federal government and retaining independent counsel to review the WPI matter for potential state criminal, ethical, and professional violations.

January 24, 2000

Department of Revenue

For the Fiscal Year Ended June 30, 1998 (04-1461-99)

PURPOSE OF THE REPORT

The purpose of this review was to assess the department's compliance with fiscal related laws and regulations. Also, to make an initial assessment to determine if the agency is gathering the data necessary to report back to the legislature regarding the missions and measures included in the FY 99 budget.

FINDINGS AND CONCLUSIONS

We found that the departmental financial statements are fairly presented. We made some general "housekeeping" recommendations to the department regarding the resolution of revenue shortfalls and controlling and accounting for property.

Both the Alcoholic Beverage Control Board and the Child Support Enforcement Division had missions and measures outlined in the FY 99 budget. Both divisions are collecting some, but not all data necessary to provide outcome measure for the areas identified in the FY 99 budget.

January 24, 2000

Department of Education

Lower Yukon School District, Selected Issues (05-4579-99)

PURPOSE OF THE REPORT

The purpose of the audit was twofold: (1) we examined the transactions associated with the implementation of the "Formula 3" reading program; and (2) we analyzed the costs involved with the teacher housing units purchased for Mountain Village and Scammon Bay.

REPORT CONCLUSIONS

The Lower Yukon School District chose to hold training classes for the Formula 3 reading program in San Diego, California, in the summer of 1996, San Francisco, California, in the summer of 1997, and Victoria British Columbia was to be the site for the summer 1998 training. However, the last training session was cancelled and rescheduled to Mountain Village, Alaska.

While these costs were eligible under the grants and approved by the Department of Education, we believe the economy and suitability of the costs are questionable. The department agreed with our analysis and promised to implement procedures to avoid such wholesale out-of-state training in the future.

The school board hired an independent accounting firm to conduct an audit specifically addressing the costs involved in the procurement and construction of the teacher housing units. We reviewed the work of the accounting firm and have included a copy of its report with our report. In summary, a lack of planning and informed oversight led to extensive cost overruns for teacher housing. More specifically, excessive costs were incurred due to:

1. Untimely shipping resulted in substantially high freight costs.

2. Site preparation was not included in the original cost estimate.

3. The original design estimates were reasonable, but overruns resulted in excessive costs. Based on the original budget the cost per square foot was $126, which is consistent with housing cost figures we were able to obtain through the U.S. Department of Housing and Urban Development. However, final costs were approximately $246 per square foot.

We did a cursory visual inspection of the Mountain Village unit and found that it did not appear to be inappropriately lavish in design or construction.

January 24, 2000

Department of Health and Social Services

<u>Division of Family and Youth Services Follow-Up</u> (06-4595-99)

PURPOSE OF THE REPORT

The Division of Legislative Audit has conducted multiple reviews over the years of the agency's operations. We are currently conducting another review of the agency, likely to be released to the public in March 2000. In this review our main objective was to evaluate the impact that new line social worker positions had on the agency's ability to investigate reports of harm (ROH) involving neglect and abuse of children.

FINDINGS AND CONCLUSIONS

The central finding of this particular review was disturbing. Despite receiving funding for 28 new front line social worker positions for FY 99, DFYS investigations declined during the early part of the fiscal year. We reported the number of ROHs investigated by the Division of Family and Youth Services (DFYS) during the first four months in FY 99, decreased by 4% statewide, compared to the same months for the previous year. In Anchorage specifically, the agency responded to 11% fewer ROHs than it had done a year earlier.

Two things were going on that had resulted in this drop off in ROH investigations:

1. <u>Lag time getting new workers trained and in the field</u>. DFYS made reasonable attempts to hire the 28 newly authorized positions, but most were not filled until September or October 1998. Generally, new social workers have a 70 to 90 day orientation before they are required to carry full caseloads. Given the orientation period, at the time we conducted our review, it was too soon to see the impact of these new social workers in the agency's statistics.
2. <u>Internal management decisions</u>. DFYS management made two operational decisions that also resulted in the decrease in the number of investigated ROHs:
   - DFYS adopted procedures that increased the time spent on individual investigations, thus reducing the number of investigations being conducted; and,
   - Internal turnover related to promotions and transfers brought on by the increase in staffing led to inexperienced staff conducting some investigations which contributed to longer investigations and overall inefficiencies.

Given the time constraints of our follow-up review we did not evaluate if the ROH investigations conducted in Anchorage were qualitatively better than those done in the prior year. While children in the aggregate may be better served by improved investigations, it left children who are the subject of uninvestigated ROHs at risk.

CURRENT STATUS

We currently have an on-going audit which addresses the items mentioned above.

January 24, 2000

Department of Health and Social Services

Division of Alcoholism and Drug Abuse (06-4570-99)

PURPOSE OF THE REPORT

The purpose of the audit was to review several aspects of the State's substance abuse prevention and treatment programs. As the legislature discusses missions and measures for agencies – this report highlights some issues that might become common as agencies develop outcome measures.

FINDINGS AND CONCLUSIONS

Prior to 1997 the legislature asked alcohol and drug abuse administrators to develop outcome measures for the agency's programs. The Division of Alcoholism and Drug Abuse (ADA) has worked with the Advisory Board on Alcoholism and Drug Abuse, the Mental Health Trust Authority and many providers to establish outcome based performance measures. The results of this work were incorporated into the FY 98/99 program. However, because historical program results and outcome measures are unavailable so far, the ability to assess impact of agency programs on the incidence of substance abuse is limited.

Minimum outcomes are initially addressed in the FY 98 and FY 99 program years. While it is too early to evaluate these outcomes in our review we criticized the agency for not monitoring the information being submitted by private non-profit organizations who are the primary service providers for the State.

Specifically, we discuss the following issues in the report:

1. The minimum outcomes established in the ADA's request for proposals (RFP) were not always addressed in the provider's responses.
2. Some providers' responses included alternative outcome requirements to those set out in the agency's RFP.
3. When providers did report outcome measures, the information was typically either incomplete or, as state previously, for different measures than those required.

More significantly, is that in many instances the State's alcohol and drug abuse agency was unaware of these reporting inconsistencies. ADA had not instituted a formal process to review or follow-up on reporting by local non-profit service providers.

Accordingly, some of the recommendations we made to the agency are as follows:

1. Amending state regulations so accreditation standards can be updated.
2. Follow-up on the outcome measures being reported by providers.
3. Review funding priorities for the development and approval of alcohol information schools and the new community action grants.
4. Better coordination with the Department of Corrections to obtain outcome measures for inmate substance abuse counseling - particularly for inmates in the Arizona prison system.

Department of Labor

Employment Security Division (ESD) Reorganization and Consolidation of Agency Operations (07-4571-99)

PURPOSE OF THE REPORT

The purpose of the audit was to determine if actual savings were realized from the reorganization of ESD and assess the impact of the use of three centralized "call centers" on operational performance in addition to the service provided to Unemployment Insurance (UI) claimants.

FINDINGS AND CONCLUSIONS

While the division's budget declined by $3.6 million between FY 96 and FY 98, actual expenditures remained relatively stable. The reductions realized in personal services category were in the benefits category.

In terms of operations, the U.S. Department of Labor uses timely first time payments as its primary measure of service. In FY 97 the State paid 90% of its first time claims in a timely manner; this is an improvement over the 79% reported in FY 95.

The department conducted customer satisfaction surveys, in November 1997 and April 1998. In the first survey, customers that were either equally or more satisfied were just over 85%, and in the April 1998 survey increased to 92%.

January 24, 2000

Department of Commerce and Economic Development

Division of Banking, Securities, and Corporations Alaska Native Corporation Issues (08-4572-99)

PURPOSE OF THE REPORT

We reviewed several aspects of how the Division of Banking, Securities, and Corporations (BSC) provided regulatory oversight, specifically when it came to reviewing corporate proxy filings. Our review was developed from an audit request which was very broad in scope. We were limited to reviewing the functions and activities of state agencies. While we discussed the operations of BSC with representatives of various Native corporations we did not conduct any audit work at the corporations.

FINDINGS AND CONCLUSIONS

Our evaluation was done in the context of certain legislative intent developed by the federal government regarding oversight of Native corporations. When congress enacted the Alaska Native Claim Settlement Act it exempted the corporations from federal securities laws. When deciding to exempt these corporations from the Securities Exchange Commission (SEC) regulations, congressional records indicate a concern regarding the importance of accurate and objective communication between corporate management and shareholders. Other than disclosures, which are to be substantially equivalent to SEC reporting, congress left the task of ensuring that management's communications to shareholders regarding corporate affairs and related business activities were without bias to the State of Alaska. Given this background, we were predisposed to hold BSC to a fairly high standard of duty.

Alaska statutes address Native corporations with a minimum asset value of $1 million and 500 shareholders. The State of Alaska, through BSC has the responsibility over proxy solicitation regulations. Any other violations of corporate by-laws, shareholders rights, or corporate statutes fall outside BSC's enforcement umbrella and shareholders must pursue civil redress through the courts.

In this report we make a series of recommendations and observations, primarily to the Department of Commerce and Economic Development, specifically for BSC to:

- Become more proactive in ensuring proxy filings are complete.
- Pursue regulatory changes that would provide for more uniform and detailed disclosures regarding corporate officer and director remuneration.
- BSC should review proxy materials prior to submission to shareholders. If complaints are made, BSC should make a more independent review of verifying the proxy materials in question.

January 24, 2000

Department of Commerce and Economic Development

Alaska Science and Technology Foundation (08-4589-99)

PURPOSE OF THE REPORT

The purpose of this review was to evaluate the Alaska and Science and Technology Foundation's (ASTF) grant selection and monitoring process. In addition, we reviewed ASTF's contract with a public relations firm and the process it follows in determining the disposition of assets purchased with grant funds.

FINDINGS AND CONCLUSIONS

We concluded the following:

- Statutory changes since 1995 have allowed the foundation extraordinarily broad authority to fund a wide variety of grants. Overall, ASTF's grant procedures are generally consistent with that broad authority. The Board of Directors is committed to funding those projects that have potential to generate beneficial results for Alaskans.
- We do have some concerns about the foundations monitoring of ongoing grants and its lack of enforcement of post-grant reporting requirements

In regard to the grant to Alaska Power Systems or its wholly-owned limited liability company Distributed Systems LLC, we determined:

- The foundation did take public testimony prior to awarding the grant.
- There were unresolved questions on existing ASTF grants.
- Prior to awarding the grant the board was aware of many obstacles to achieving success on this project.
- Many of the benchmarks contained in the original grant agreement have not been met, but funding of the grant continued until May 1998.
- In recognition of the additional risk being assumed by ASTF, the grant repayment provisions were enhanced.

In regard to the contract with the public relations firm, while some services were an appropriate use of public funds, other activities could be construed as intending to directly or indirectly influence legislative decisions on funding. This is an inappropriate use of state funds.

Finally, in regards to disposition of assets acquired with grant funds, we found the foundations' methodology to be reasonable. Grantees usually request that title to equipment purchased with grant funds be signed over to the grantee at the completion of the project. In the case of grantees with successful projects, this request is almost always granted.

CURRENT STATUS

Our concerns over small-grant peer reviews and the lack of pursuit of repayments from grantees are addressed in HB117 and SB164. Both bills are currently before the legislature.

January 24, 2000

Department Natural Resources

Matanuska Maid Dairy (10-4545-98)

PURPOSE OF THE REPORT

We evaluated the following aspects related to the operations of the Matanuska Maid Dairy (Mat Maid): (1) its current operational and financial viability; (2) its corporate operating practices; (3) its future role as state-owned asset; and, (4) its future role in the development of Alaska agriculture.

FINDINGS AND CONCLUSIONS

The primary recommendations set out in the report were:

- Development of a strategic plan for Mat Maid's future.
- Retention of a specialized broker to aggressively pursue purchase offers from major dairy corporations.
- Individual sales of Mat Maid's component parts if no purchasers can be found for the intact business.

CURRENT STATUS

The Division of Agriculture (DOAg) continues to advocate for an increase in Alaska's dairy herds. Following resolution of mental health land issues, repossessed Point MacKenzie parcels are now being transferred to the public for agricultural use. DOAg hopes that some of these parcels will be used for increased dairy production.

DOAg acknowledges that Mat Maid can purchase raw milk from the Lower 48 for significantly less than the price that Mat Maid must pay Alaska farmers. Additionally, Alaska milk would eliminate Mat Maid's profits. DOAg still does not have an answer for this dilemma, though the agency suggests the possibilities of federal emergency subsidies and lower prices for new Alaska entrants may be a possibility. DOAg also supports diversification of Mat Maid into nondairy food products.

DOAg considers Mat Maid to be essential infrastructure for the State's commitment to agriculture. The agency envisions that Mat Maid will continue as a state asset.

Since DOAg does not have a specific plan to sell Mat Maid in the foreseeable future, no effort has been made to retain a dairy broker. Nevertheless, from time-to-time, various parties have contacted DOAg and inquired about the possibility of purchasing the facility. DOAg strongly discourages those inquiring by stating that any sale of Mat Maid will be conditioned upon the purchaser's commitment to continue the facility's operation and purchase all available Alaskan milk.

January 24, 2000

Department of Fish and Game

Use of Sport Fish Revenues (11-4585-99)

PURPOSE OF THE REPORT

The central issue of this audit was to review and evaluate how the Department of Fish and Game (DFG) uses designated sport fish revenues. More specifically we considered the nature of the projects that are funded with sport fish revenues and the degree that many of the projects seem to substantially benefit commercial fishing interests.

FINDINGS AND CONCLUSIONS

In addition to the Division of Sport Fish, other DFG agencies that make use of sport fish revenues are:

- Division of Administrative Services - primarily for running the licensing program.
- Division of Habitat and Restoration - fishery habitat protection.
- Commercial Fisheries - primarily for salmon management and assessment projects.
- Wildlife Conservation - shared office space.
- Division of Subsistence - protection of subsistence fisheries .

Overall we found development projects that were funded by sport fish revenues did provide at least some, if not extensive benefit to the recreational angler. DFG cannot measure the benefits to sport fishers in quantitative terms.

Projects promoting the availability of species such as salmon, that benefit multiple fisheries - sport, commercial, personal use - it is currently impossible to determine the extent of benefit received by each competing fishery.

The reason it is not possible to gauge the respective benefits is because, the measurement tools used by DFG for sport fish - angler days - are not comparable to those used for the commercial fishery - number and weight of fish.

In the report we recommended DFG develop a benefit measurement approach with greater commonality in order to better identify and segregate which user groups are benefiting from a given project, and in the case of sport fishers, the source of the revenues being used to fund the projects.

January 24, 2000

Department of Environmental Conservation

<u>Division of Facility Construction and Operation Village Safe Water Program</u> (VSW) (18-4581-99)

<u>PURPOSE OF THE REPORT</u>

There have been substantial appropriations at both the state and federal levels addressing the provision of adequate water and sewer facilities in rural Alaska. In this audit we developed a historical recap of state and federal appropriations over the last ten years and attempted to identify and quantify the related benefits associated with these projects.

<u>FINDINGS AND CONCLUSIONS</u>

The report included the following information and conclusions:

- From 1988 to 1998 state and federal capital appropriations total almost $562 million. During the same time period the State made appropriations of over $37 million for operating costs of VSW projects and other support services such as the remote maintenance workers and rural utility business advisor program.

- As of September 1997 70% of housing units in Alaska's 272 rural communities have adequate water and sewer facilities.

- Benefits of rural water and sewer projects include:
    - Improvement to public health
    - Economic development
    - Economic growth
    - Improvement to quality of life

These benefits are based on professional opinions - primarily from the medical community and anecdotal.

The report made two recommendations to DEC, which are consistent with recent legislative efforts to promote "missions and measures" on the part of state agencies. The recommendations were:

1. DEC take a leadership role in developing documented and quantifiable benefits gained from construction of these projects.

2. DEC should create a statewide inventory of all village sanitation systems for planning and accountability purposes.

January 24, 2000

Department of Corrections

Point MacKenzie Rehabilitation Project (20-4582-99)

PURPOSE OF THE REPORT

This audit was conducted to address allegations of improper use of state assets and inmate labor. We also reviewed the project's mission in terms of offender training, drug counseling programs, farm production, and state-owned property rehabilitation, as well as the controls over property and resources.

FINDINGS AND CONCLUSIONS

The Department of Corrections (DOC) had already conducted an investigation into the alleged misconduct. We reviewed the work by DOC and found it to be sufficiently comprehensive. We noted that better supervision of the project by the deputy director of the Division of Community Corrections would have resulted in earlier identification and resolution of these concerns.

We found that the mission of Point MacKenzie is still evolving. When it started as Project Hope, it was to be a work camp aimed at youths convicted of alcohol and drug-related crimes. In 1993, with adult inmates, one primary goal was to "restore and preserve" the Point MacKenzie farms, which had been repossessed by the Agricultural Revolving Loan Fund.

The counseling, training, and work programs have changed to reflect the project's mission. Currently, its official mission is to:

1. Develop a full spectrum of work programs that will assist offenders in finding future employment.
2. Create working conditions like those in the private sector to ensure that offenders work productively, earn money, and develop good work habits.
3. Provide responsible and productive stewardship of land and facilities owned by the State.
4. Furnish farm products to be used to feed DOC inmates.

We found inventory controls need to be improved. A complete inventory of property and equipment is necessary. It is also a task that could provide some good work experience for offenders.

Department of Corrections

Internal controls over the Offender Financial Accounting (HOFA) System (20-4597-99)

PURPOSE OF THE REPORT

In a prior 1996 audit we made recommendations to the department to improve the internal controls over the HOFA system. Since that time there has been an individual convicted of embezzlement of HOFA funds. We were asked to return to the Department of Corrections (DOC) to again review the internal controls over the HOFA accounts. Our review was conducted at various correctional facilities specifically focusing on cash and negotiable instruments.

FINDINGS AND CONCLUSIONS

We found the internal control system remains very weak.

Fundamental improvements were needed in:

- Ensuring record keeping data entry is accurate.
- Basic cash handling procedures improved
- Critical controls, such as segregation of duties, limiting access, and regular reconciliations.
- Physical controls over assets.

The report includes eight recommendations to the Department of Corrections. By design, we listed and discussed each control deficiency at DOC with a great deal of specificity. This was done to give DOC specific direction regarding the problems that have been identified.

CURRENT STATUS

The department responded to our audit in a very positive and proactive manner. At a meeting with all facility superintendents present, departmental administrators developed a uniform set of procedures for handling cash and negotiable instruments belonging to offenders. The procedures addressed the weaknesses set out in our audit.

January 24, 2000

Department of Community and Regional Affairs

For the Fiscal Year Ended June 30, 1998 (21-1460-99)

PURPOSE OF THE REPORT

The primary purpose of this review was to evaluate the former department's compliance with fiscal-related laws and regulations. Most of our concerns involved the operations and functioning of the Division of Energy (DOE), which is now under the purview of the Department of Community and Economic Development.

FINDINGS AND CONCLUSIONS

DOE administers "grants" to communities for the construction of electrical generation and transmission systems. However, the status of the communities as grantees are somewhat clouded because they typically sign an agreement with DOE for the state agency to act as the community's agent. As a result of this arrangement, DOE retains the right to make virtually all decisions related to project construction. Oftentimes force account labor is used, under the direct supervision of a foreman hired by the community based on a recommendation from DOE. The state agency pays all the bills incurred by the project except payroll. That function is contracted out to a bookkeeper.

DOE has no statutory authority for issuing general fund grants in the manner in which it does. The manner in which DOE runs the grant program raises serious questions regarding the agency's statutory authority and whether there is an employer/employee relationship between DOE and the force account laborers

Administration of the projects needs to be improved, including such things as:

- Excess cash is advanced to the bookkeeper, this cash earns nominal interest. At the end of the project if there is any remaining cash with the bookkeeper, it is returned to DOE and DOE reallocates it to another project. Essentially spending any interest earnings without the benefit of an appropriation. Approximately $160,000 was used this way in FY 98.

- Loans have been made between projects to cover cash shortages, substantially increasing the risk of what amounts to a transfer between appropriations.

The report includes a total of 13 recommendations.

January 24, 2000

Department of Community and Regional Affairs

Pedro Bay Electrification Project (21-4584-99)

PURPOSE OF THE REPORT

The purpose of the audit was to determine the status of the project and whether this project was adequately managed by the Division of Energy. More specifically, we reviewed DOE's approach to developing and implementing grant agreements, construction contracts, and easement acquisitions.

FINDINGS AND CONCLUSIONS

We concluded that DOE had established a clear need for the project; however DOE's poor management of the project led to it being over budget and unfinished.

Specific management problems included:

- Project selection processes was not adequately documented.
- DOE failed to ensure that proper right-of-way easements were in place, resulting in delays.
- DOE selected the contractor with the lowest bid, rather than considering if the proposed amount was the lowest **responsible** bid. The selected bid was unrealistically low for a number of items. This resulted in change orders and increased project costs.
- The absence of comprehensive financial records resulted in a lack of budgetary control.

We recommended that DOE staff or management:

1. Design and implement sufficient policies and procedures for selecting electrical projects.
2. Implement procedures to ensure that enough funds are allocated to a project before contracts are signed or purchase orders obligating payment are placed.
3. Determine that easement requirements are met before proceeding with a project.
4. Implement procedures to insure that construction materials purchased with public funds are used to the most productive extent possible.
5. implement procedures to better monitor the division's contracts and projects.

CURRENT STATUS

DOE's project manager stated that the last phase is 95% complete at the time of the audit. Yet the Pedro Bay Council contends that it is only 80% complete. DOE plans to complete the remaining work by the end of March 2000, while the council has requested that the remaining funds be used for another project.

This project was intended to resolve Pedro Bay's line-loss problem. However, the improvement has been slight. The utility continues to report a high line loss of 35%.

A contractor is reviewing and making recommendations on DOE's contracting, purchasing, and accounting policies and procedures. The new policies and procedures should be implemented by June 2000.

Department of Community and Regional Affairs

Division of Energy, Teller Bulk Fuel Facilities Upgrade (21-4587-99)

PURPOSE OF THE REPORT

The primary purpose of the audit was twofold: (1) to determine if grant funds were properly awarded to for-profit entities that are in direct competition with an established private business; and (2) to determine ownership status of the Teller tank farm and the land.

FINDINGS AND CONCLUSIONS

Our central findings and conclusions were as follows:

1. Regulations allow the State to fund projects that may compete with for-profit entities.

2. The Teller Traditional Council owns the tank farm, while the land is owned by the Teller Native Corporation.

The bulk fuel facility upgrade took longer and cost the State more than originally budgeted. The original budget for the project was $452,000 and final cost for the project was approximately $648,000. The State covered most of the budgetary cost overrun.

January 24, 2000

Department of Transportation and Public Facilities
Department of Education
University of Alaska

Art in Public Places (25-4564-99)

PURPOSE OF THE REPORT

The purpose of the review was to evaluate various state agencies and organizations' compliance with the Art in Public Places (AIPP) program, also often referred to as the State's 1% for art program. In the report we discuss how the program is currently operating. Essentially, we reported the Art in Public Places program is not working as most people believe, primarily due to operational inefficiencies, miscommunication between agencies, and a morass of often conflicting legal opinions generated over the years.

FINDINGS AND CONCLUSIONS

In our view it is time for the legislature to reevaluate this program and decide what it wants to accomplish in subsidizing the arts through public construction, and then develop legislation that is binding on both the executive branch and the university. Specifically, we suggested:

1. Elimination of AS 35.27. This is the statute which sets out the seemingly simple 1% for art concept. We suggest rather than allowing agencies to determine how to apply the statute, the legislature provide for a direct appropriation for artwork to accompany funding provided for various public construction, would improve operational efficiencies.

2. Clarifying in statute which funding sources should be considered when calculating the 1% figure. By making the program applicable to other funding sources, such as federal program monies, financial burden on the General Fund of supporting the program would be reduced.

3. Harmonize AS 35.27 and AS 44.27. Alaska Statute 44.27.060 requires the 1% be deposited into the public art fund if the a publicly-funded construction project is less than $250,000 or is not designed for substantial public use. Currently, state agencies request the commissioner of DOTPF to authorize the purchase of artwork rather than transferring the required 1% to the public art fund. The AIPP program's statute (AS 35.27) permits DOTPF to authorize artwork for buildings or facilities with estimated construction costs of less than $250,000. DOTPF staff reported to us that the authorization is always granted for the state agencies. This statutory language prevents the public art fund from receiving funds to be used for the purpose set out in AS 44.27.060(c). Accordingly, we recommended the legislature consider revising AS 35.27 to clarify which state entities are subject to AIPP requirements and clarify the incongruity between AS 35.27 and AS 44.27.060(b). Clarifying the statutes will assist all state agencies with the implementation of the original state policy and underlying statutes.

4. Re-evaluate which agencies should be covered by the program. Currently all state quasi-corporations are exempt.

Department of Transportation and Public Facilities

Homer Gravel Roads Project (25-4543-00)

PURPOSE OF THE REPORT

The objectives of this review were to determine:

1. If the department reasonably managed these construction projects in accordance with statutes, regulations, contract provisions, and internal policies and procedures.
2. If there was merit to the complaints leveled against the Homer gravel roads project (HGR) by a DOTPF employee.
3. If the extended administrative leave given to this employee was reasonable under the circumstances.

FINDINGS AND CONCLUSIONS

Our audit included an in-depth review the Homer Gravel Roads project and, for comparison purposes, in-depth reviews of three other DOTPF Central Region highway construction projects and limited reviews of 23 additional highway and aviation construction projects. The Homer Gravel Roads project was the target of complaints made by a grade inspector on the project.

We concluded that many of these complaints had merit. Specifically, we felt his concerns regarding placement of various out-of-specification roadway materials, torn geotextile fabric, and placement of out-of-specification material next to culverts did have merit. Although some of the material was out of specification and the fabric was torn, this does not necessarily mean that these roads will prematurely fail. In fact, four years after completion, we understand these roads are holding up well.

We reviewed 27 projects in this timeframe. Our primary concern is the weaknesses in management of the construction process. DOTPF Central Region was responsible for these projects, yet it was not always actively managing them. A number of individual weaknesses brought us to this conclusion.

These included the following:

1. Out-of-specification material accepted by DOTPF.
2. Change orders frequently issued after completion of the work.
3. Some contractors given too much control.

We also made several determinations specific to the HGR investigations. These included the following:

1. Haul of out-of-specification material not effectively halted until FHWA threatens funding.
2. The hiring process used to hire a consultant to review this project was flawed, making independence questionable.
3. The Department of Law may have violated the State Personnel Act by releasing consultant's report.
4. Extended administrative leave considered reasonable under the circumstances.

Department of Transportation and Public Facilities

Anchorage International Airport Terminal Redevelopment Project (25-4576-99)

PURPOSE OF THE REPORT

The report had three primary objectives:

1. Review the major contracts issued on the redevelopment project.
2. Assess the impact of the costs of the project on rates and fees charged by the airport.
3. Provide a status on capital appropriations used to fund the project.

FINDINGS AND CONCLUSIONS

There have been three major contracts issued for the project. We found that DOTPF followed the required statutes and regulations in the bidding and awarding of the contracts. The report included an appendix listing each of the contracts and subsequent contract amendments.

We included a discussion of the passenger facility charge, including the process and the ramifications of such a charge.

Airport rates and fees will increase, but are expected to remain substantially lower than the national average. The report contains a table with the comparisons.

Also included in the report was a listing of capital appropriations, by project and by appropriation, for both the Anchorage International Airport and the Fairbanks International Airport.