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STATE OF ALASKA

WILLIAM A. EGAN, GOVERNOR

DEPARTMENT OF ADMINISTRATION

DIVISION OF INTERNAL AUDIT / POUCH C - JUNEAU 99801

November 28, 1973

Mr. Jack Baker, Supervisor
Division of Legislative Audit

Dear Mr Baker:

Coopers and Lybrand's audit report on the Alaska State Development Corporation was reviewed by the Department of Commerce, the agency and the Department of Administration.

The agency concurs with audit recommendations presented in the report. Comments were considered fair and presented in a helpful manner.

The matter captioned, Enabling Legislation, is presented without recommendation or solution. We will review this subject when we examine the agency for effective compliance to other comments. Since the program administrator just changed, we feel it advisable to postpone our action.

Sincerely,

Richard A. Smith

Richard A. Smith
State Internal Auditor

ALASKA STATE DEVELOPMENT CORPORATION

REPORT ON EXAMINATION OF FINANCIAL STATEMENTS
for the year ended June 30, 1973

AND

REPORT TO MANAGEMENT ON ACCOUNTING
AND OPERATING CONTROLS AND PROCEDURES

October 1973

COOPERS & LYBRAND
CERTIFIED PUBLIC ACCOUNTANTS

C O N T E N T S

COOPERS & LYBRAND

CERTIFIED PUBLIC ACCOUNTANTS

IN PRINCIPAL AREAS
OF THE WORLD

Legislative Audit Committee

The Honorable Governor of Alaska

The Board of Directors
Alaska State Development Corporation
Juneau, Alaska

We have examined the balance sheet of Alaska State Development Corporation as of June 30, 1973 and the related statement of changes in fund balances and statement of revenues and expenditures - General Revenue Fund for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The prior year financial statements, which have been restated (Note 7), were not examined by us and are included in this report for comparative purposes only.

In our opinion, the aforementioned financial statements present fairly the financial position of Alaska State Development Corporation at June 30, 1973 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

Anchorage, Alaska
September 28, 1973

ALASKA STATE DEVELOPMENT CORPORATION
COMBINED BALANCE SHEETS - ALL FUNDS

	June 30, 1973					
	General Revenue Fund	Development Loan Fund	Loan Loss Reserve Fund	Principal Reserve Fund	All Funds	June 30, 1972 Combined
ASSETS (Note 2)						
Current assets:						
Cash	$ 8,740				$ 8,740	$ 54,151
Investments, at cost, which approximates market value (Note 6)	270,066	$1,293,465	$515,736	$600,000	2,679,267	2,367,544
Current portion of development loans receivable		335,000			335,000	325,000
Current portion of notes receivable	1,694				1,694	1,600
Accrued interest receivable	62,416				62,416	75,617
Other receivables	4,924				4,924	9,811
Total current assets	347,840	1,628,465	515,736	600,000	3,092,041	2,833,723
Development loans receivable, net of current portion		3,605,204			3,605,204	4,185,386
Notes receivable, net of current portion and allowance for doubtful note of $5,760	6,887				6,887	7,040
Furniture and equipment, at cost, net of accumulated depreciation of $8,347 (Note 1)	827				827	827
Organization costs, net of accumulated amortization of $35,398 (Note 1)	10,080				10,080	20,160
Bond issurance costs, net of accumulated amortization of $99,395 (Note 1)	101,059				101,059	111,139
Interfund accounts		551,650	(551,650)			
	118,853	4,156,854	(551,650	-	3,724,057	4,324,552
	$466,693	$5,785,319	$(35,914)	$600,000	$6,816,098	$7,158,275

See notes to financial statements.

	June 30, 1973					June 30, 1972
	General Revenue Fund	Development Loan Fund	Loan Loss Reserve Fund	Principal Reserve Fund	All Funds	Combined
LIABILITIES						
Current liabilities:						
Note payable (Note 4)	$ 95,000				$ 95,000	
Current portion of Class A revenue bonds payable		$ 600,000			600,000	$ 600,000
Accrued interest payable	87,771				87,771	96,521
Other accrued expenses	834				834	1,296
Foreclosure expenses payable						24,578
Total current liabilities	183,605	600,000	-	-	783,605	722,395
Long-term debt:						
Revenue bonds payable (Notes 2 and 5):						
Class A, net of current portion		2,950,000			2,950,000	3,550,000
Class B		1,500,000			1,500,000	1,500,000
Class C certicates payable (Notes 2 and 3)			$515,736		515,736	515,736
Accrued interest on Class C certificates payable (Notes 2 and 3)			84,411		84,411	74,096
Note payable, State of Alaska (Note 4)	175,000				175,000	270,000
	175,000	4,450,000	600,147	-	5,225,147	5,909,832
	358,605	5,050,000	600,147	-	6,008,752	6,632,227
FUND BALANCES						
Restricted	103,425		(636,061)	$600,000	67,364	(85,132)
Unrestricted	4,663	735,319			739,982	611,180
	108,088	735,319	(636,061)	600,000	807,346	526,048
	$466,693	$5,785,319	$(35,914)	$600,000	$6,816,098	$7,158,275

COMBINED STATEMENT OF CHANGES IN FUND BALANCES - ALL FUNDS
for the year ended June 30, 1973

	General Revenue Fund Unrestricted	General Revenue Fund Restricted	Development Loan Fund	Loan Loss Reserve Fund	Principal Reserve Fund	All Funds Combined
Balance June 30, 1972, as previously reported	$ 23,640	$113,925	$ 671,680	$ (814,600)	$600,000	$594,645
Prior period adjustments:						
1) Cancellation of Class C certificate received in bankruptcy proceeding in 1970, not previously recorded				5,500		5,500
2) Interest on Class C certificates, not previously accrued				(74,097)		(74,097)
3) Adjust unrestricted fund based on 1/12th of budgeted current expenses, as defined, for the year ended June 30, 1973	(17,380)		17,380			-
4) Partial recovery of development loan receivable previously written off, credited to Development Loan Fund instead of Loan Loss Reserve Fund			(84,140)	84,140		-
Balance June 30, 1972 as restated	6,260	113,925	604,920	(799,057)	600,000	526,048
Excess of revenues over expenditures	167,554					167,554
Transfer per Section 505 of the trust indenture	(167,554)				167,554	
Reduction in reserve for payment of principal and interest of Class A revenue bonds for the next six months		(10,500)			10,500	
Payment of Class A revenue bond principal			600,000		(600,000)	
Transfer of unrestricted funds due to the reduction of budgeted current expenses, as defined, for the following month	(1,597)				1,597	
Transfer 1/4 of 1 percent of development loans receivable balance at June 30, 1973 per Section 510 of the trust indenture			(9,850)	9,850		
Transfer 1 percent of development loans receivable balance at June 30, 1973, per Board of Directors' authorization			(39,402)	39,402		
Partial recovery of Seldovia Inn development loan receivable previously written off				20,820		20,820
Reduction of allowance for doubtful notes				83,239		83,239
Reduction of estimated foreclosure expenses				20,000		20,000
Class C certificate interest expense for year ended June 30, 1973				(10,315)		(10,315)
Transfer of funds to meet the next principal payment requirement of Class A revenue bonds			(420,349)		420,349	
Balance June 30, 1973	$ 4,663	$103,425	$735,319	$ (636,061)	$600,000	$807,346

See notes to financial statements.

COMBINED STATEMENT OF CHANGES IN FUND BALANCES - ALL FUNDS
for the year ended June 30, 1972

	General Revenue Fund Unrestricted	General Revenue Fund Restricted	Development Loan Fund	Loan Loss Reserve Fund	Principal Reserve Fund	All Funds Combined
Balance June 30, 1971, as previously reported	$ 26,150	$124,425	$512,286	$(790,399)	$600,000	$472,462
Prior period adjustments:						
1) Cancellation of Class C certificate received in bankruptcy proceeding in 1970, not previously recorded				5,500		5,500
2) Interest on Class C certificates not previously accrued				(63,781)		(63,781)
3) Adjust unrestricted fund based on 1/12th of budgeted current expenses, as defined, for the year ended June 30, 1972	(19,133)		19,133			-
4) Correction of Class C certificates outstanding previously reported as treasury shares				(60,500)		(60,500)
Balance June 30, 1971 as restated	7,017	124,425	531,419	(909,180)	600,000	353,681
Excess of revenues over expenditures	119,642					119,642
Transfer per Section 505 of the trust indenture	(119,642)				119,642	
Reduction in reserve for payment of principal and interest of Class A revenue bonds for the next six months		(10,500)			10,500	
Payment of Class A revenue bond principal			600,000		(600,000)	
Transfer of unrestricted funds due to the reduction of budgeted current expenses, as defined, for the following month	(757)				757	
Transfer of 1/4 of 1 percent of development loans receivable balance at June 30, 1972, per Section 510 of the trust indenture			(11,480)	11,480		
Transfer 1 percent of development loans receivable balance at June 30, 1972, per Board of Directors' authorization			(45,918)	45,918		
Partial recovery of development loans receivable previously written off				84,140		84,140
Class C certificate interest expense for the year ended June 30, 1972				(10,315)		(10,315)
Transfer of funds to meet the next principal payment requirement of Class A revenue bonds			(469,101)		469,101	
Write off of development loans receivable				(21,100)		(21,100)
Balance June 30, 1972	$ 6,260	$113,925	$604,920	$(799,057)	$600,000	$526,048

See notes to financial statements.

STATEMENT OF REVENUES AND EXPENDITURES - GENERAL REVENUE FUND
for the years ended June 30, 1973 and 1972

	1973		1972	
Revenues:				
Interest income from:				
Development loans receivable		$293,133		$332,992
Time certificates of deposit		74,897		63,247
Savings and loan certificates		42,269		32,256
U.S. government securities		15,837		8,347
		426,136		436,842
Other income		543		303
		426,679		437,145
Expenditures:				
Salaries and administrative services		12,693		20,956
Bank service fees		9,653		13,903
Trustee charges		1,772		1,981
Travel and per diem		989		2,273
Insurance and bonding		548		848
Telephone and telegraph		544		705
Payroll taxes		202		786
Legal		-		9,164
Bad debt		-		10,800
Other operating expenses		164		2,525
Amortization of organization costs		10,080		10,082
Amortization of bond issuance costs		10,080		10,080
		46,725		84,103
Interest expense:				
Class A revenue bonds	$136,600		$157,600	
Class B revenue bonds	72,000		72,000	
Note payable	3,800	212,400	3,800	233,400
		259,125		317,503
Excess of revenues over expenditures		$167,554		$119,642

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. The Corporation:

The Alaska State Development Corporation is a tax exempt corporation created by the State of Alaska Legislature to provide development loans to encourage and assist development of new business and industry in Alaska and to rehabilitate and expand existing business and industry in the State.

The significant accounting policies of the Corporation are as follows:

a) Furniture and equipment have been depreciated over their estimated useful lives, to their estimated salvage value, principally by the straight line method. There is no depreciation expense for the year ended June 30, 1973. Depreciation expense for the year ended June 30, 1972 is $454.

b) Organization costs were being amortized over twenty years by the straight line method until June 30, 1971. Beginning July 1, 1971 the remaining balance is being amortized over three years, by the straight line method. The effect of this change is to increase amortization by $7,560 and to decrease excess of revenues over expenses by a like amount for the year ended June 30, 1972.

c) Bond issuance costs are being amortized over twenty years (the original lives of the bond issues) by the straight line method.

2. Funds and Restricted Assets:

The Alaska statutes establish four separate funds to be operated by the Corporation; the bond trust indenture defines more specifically the composition of each fund and its function. These funds are a) the General Revenue Fund, b) the Principal Reserve Fund, c) the Loan Loss Reserve Fund and, d) the Development Loan Fund.

The assets of the General Revenue Fund are restricted to payment of current expenses, as defined by the trust indenture, and the interest on Class A and Class B revenue bonds.

2. Funds and Restricted Assets, Continued:

The assets of the Principal Reserve Fund are restricted to payment of the current maturities of the Class A revenue bonds and, as approved by the Board of Directors, to retire Class B revenue bonds at maturity.

The assets of the Loan Loss Fund are restricted as collateral for the payment, at maturity, of the principal and accrued interest of the Class C certificates. This fund is charged with all development loan receivable losses and is credited with the proceeds of amounts recovered.

The assets of the Development Loan Fund are pledged as collateral for the Class A and Class B revenue bonds payable.

3. Class C Certificates Payable:

Borrowers of development loan funds receive 95 percent of their loans in cash and 5 percent evidenced by Class C certificates payable with interest at 2 percent. The certificates and accrued interest are subordinated to the Class A and Class B revenue bonds and mature on August 1, 1983.

4. Notes Payable:

Notes payable of the Corporation at June 30, 1973 are as follows:

Non-interest bearing note, payable to the State of Alaska at such time as the surplus of the corporation makes reimbursement possible, subordinate to all other debts of the corporation, not collateralized.	$175,000
Note payable to Governmental Statistical Corporation at 4 percent interest, payable annually, due August 1, 1973.	$ 95,000

4. Notes Payable, Continued:

The note payable to Governmental Statistical Corporation was assigned to a third party; the identity of the legal owner of the note at August 1, 1973 is uncertain. A $95,000 escrow account was established on August 1, 1973 for payment of the note upon the determination of the legal owner.

5. Revenue Bonds:

Class A revenue bonds are collateralized by the full resources and credit of the Corporation and take priority in payment of principal and interest to Class B revenue bonds and Class C certificates.

The Class A revenue bonds mature serially from 1973 thru 1983 and bear interest from 3.7 percent to 3.9 percent payable semi-annually. The Class A revenue bonds are redeemable in whole or in part, under certain conditions, on August 1, 1973 and thereafter on interest payment dates at redemption prices declining from 101-3/4 percent of face value to face value on and after August 1, 1977.

The Class B revenue bonds mature August 1, 1983 and bear interest at 4.8 percent, payable semi-annually. The Class B revenue bonds are redeemable in whole or in part, and under certain conditions, on August 1, 1973 at 104 percent of face value and at each interest payment date thereafter at declining redemption prices. The Class B bonds shall not be redeemable, either in whole or in part, unless there shall have first been deposited in the Principal Reserve Fund, an amount equal to the principal amount of the three largest annual maturities of the Class A bonds.

6. Investments:

Investments owned by the corporation are as follows:

6. Investments, Continued:

	June 30, 1973	June 30, 1972
Time certificates of deposit	$1,890,000	$1,500,146
Savings and loan certificates	727,230	689,223
Federal Land Bank bond maturing January 21, 1974	100,044	-
Federal Home Loan Bank bond		50,193
U.S. Treasury note		89,975
	$2,679,267	$2,367,544

7. Restatement and Reclassification of June 30, 1972 Financial Statements:

The June 30, 1972 financial statements have been restated as explained by the adjustments in the statements of changes in fund balances.

Certain amounts have been reclassified in the June 30, 1972 financial statements, principally current assets and current liabilities, to conform to the classifications presented in the June 30, 1973 financial statements.

COOPERS & LYBRAND

CERTIFIED PUBLIC ACCOUNTANTS

IN PRINCIPAL AREAS
OF THE WORLD

October 5, 1973

Legislative Audit Committee

The Honorable Governor of Alaska

Board of Directors,
Alaska State Development Corporation
Juneau, Alaska

Gentlemen:

We have examined the financial statements of Alaska State Development Corporation for the year ended June 30, 1973, and have issued our report thereon dated September 28, 1973. As a part of our examination, we reviewed and tested the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Company's system of internal accounting control for the year ended June 30, 1973, which was made for the purpose set forth in the first paragraph above, would not necessarily disclose all weaknesses in the system. However, such study and evaluation disclosed the following conditions that we believe to be weaknesses. Our detailed findings and recommendations are included in this report which are indexed on the following page.

Should you have any questions concerning the matters in this report or any other matter relating to our examination, we shall be pleased to discuss them at any time.

Coopers & Lybrand

C O N T E N T S

I. Accounting Controls:

A. Controls over cash receipts could be improved.

We recommend that cash receipts by mail should be listed by the person opening the mail. The list should indicate date received, payee and amount. The list should later be compared to the cash receipts book listing and bank deposit slips, by someone independent of the cash receipts functions, to ascertain that all receipts are accounted for by the Company and recorded by the bank on a timely basis. These procedures are recommended to strengthen controls of cash receipts.

B. Vendor's invoices paid are not now being cancelled to indicate payment.

We recommend all invoices be appropriately marked "Paid" and the check number be inserted in an appropriate space on a block stamp imprint, before the check and related invoices are routed to the check signer. All duplicate invoices should be destroyed upon receipt. This procedure should m- .mize the likelihood of duplicate payments.

C. An accounting manual is not now in use.

We recommend an accounting manual be prepared to provide . descriptive analysis of the accounting system and the various accounting functions. The manual should define the various items in the chart of accounts and should interpret the fund accounting regulations and restrictions as set forth in the Company's enabling legislation and trust indenture.

The advantages of such a manual are that operating and management decisions need be made only once. Without such a manual, decisions are often made at a clerical level and with turnover of personnel, the probable result is inconsistency in recording, summarizing and reporting financial data. The manual also provides a written document which can be useful in training new personnel.

I. Accounting Controls, Continued:

D. Internal audit functions performed by corporate personnel are not formalized.

We suggest that certain reviews of clerical accounting and operating functions be made monthly by someone independent of the clerical group, and the reviews be documented by having the reviewer initial and date the documents reviewed. We suggest these reviews include the following:

a) Review of distribution, summarization and posting of cash receipts and cash disbursed to the general ledger and subsidiary ledgers.

b) Review of non-recurring journal entries.

c) Review of computation and posting of standard journal entries.

d) Review of bank reconciliations and investigation of unusual reconciling items.

e) Review reconciliations of subsidiary records to the general ledger for development loans, interest receivable, etc.

f) Review of funded reserves activity.

g) Review of collectibility of receivables, particularly development loans and related interest.

II. Enabling Legislation:

During our review of the development loan portfolio, three violations of the Alaska Statutes Title 44 Chapter 59 (the enabling legislation for Alaska State Development Corporation) were noted. They are:

a) Section 44.59.350; the present terms of the Matanuska Maid development loan results in a maturity date later than the maturity date of the Class B bonds. The

II. Enabling Legislation, Continued:

development loan receivable balance at the maturity date of the Class B Bonds approximates $50,000 providing that Matanuska Maid, Inc. continues to amortize their loan according to the present agreement.

b) Section 44.59.310; the loan to Mr. & Mrs. A. W. Jurgeleit is wholly owned by the Company with no participation by a lending institution.

c) Section 44.59.380; the loans to Fourth Avenue Investments and Matanuska Maid, Inc. had principal balances at June 30, 1973 greater than ten percent of the sum of the principal outstanding on the Class A and Class B Bonds.

Neither the statutes not the trust indenture with Franklin National Bank indicate any remedies that may be available to the holders of the Company's securities when violations of the above type occur. However, these violations are brought to your attention for your further consideration as to any corporate action you may feel necessary.

III. Trust Indenture:

A. The Company's current policy is to carry one-twelfth of total budgeted annual expenditures (including interest) in the unrestricted portion of the General Revenue Fund. The unrestricted portion of the General Revenue Fund should have a balance equal to the ensuing month's budgeted current expenses as defined in the trust indenture. This definition makes no mention of interest on Class A and Class B bonds and Class C certificates as being a part of current expense. The restricted portion of the General Revenue Fund has subaccounts which contain provisions for the Class A and Class B bond interest. The Class C certificate interest is provided for in the Loan Loss Reserve Fund.

Continued

III. <u>Trust Indenture, Continued:</u>

We recommend that accounts in the General Revenue Fund be related to the governing definitions and trust indenture requirements.

B. The trustee is not sending a duplicate copy of a certificate of cremation of all matured and paid bonds to the Company as is required by Section 509 of the Trust indenture.

We recommend that the Company contact the Franklin National Bank and ask them to comply.

IV. <u>Class C Certificate Accrued Interest:</u>

The interest accruing on Class C certificates has not been recorded as a liablility on the books of record of the Company and the current year expense is not included in the annual budget. The Alaska statutes and interpretations thereof by the Alaska Attorney General's Office, indicate that the interest on Class C certificates is a liability of the Company.

We recommend that interest on Class C certificates be accrued and recorded monthly even though it is subordinate to the principal and interest on the Class A and Class B bonds and principal of the Class C certificates.

V. <u>Fund Accounting:</u>

The enabling legislation and trust indenture of the Company establish certain funds and set forth certain accounting requirements and restrictions on the assets of these funds. At present the Company is partially following fund accounting by proper segregation of fund balances and funded reserves.

Continued

V. Fund Accounting, Continued:

We recommend that the assets and liabilities of the Company be identified with their respective funds and the designated amounts be noted in the general and subsidiary ledgers.

The purpose of fund accounting is to insure proper recording and reporting of pledged and trust assets as required by the trust indenture for the holders of the Company's securities.