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INSPECTOR GENERAL

September 2006

To: George Cannelos, Federal Co-Chair
From: Mike Marsh, Esq., Inspector General
Subject: Inspection of Buckland power plant project

FINAL REPORT

FOR PUBLIC RELEASE

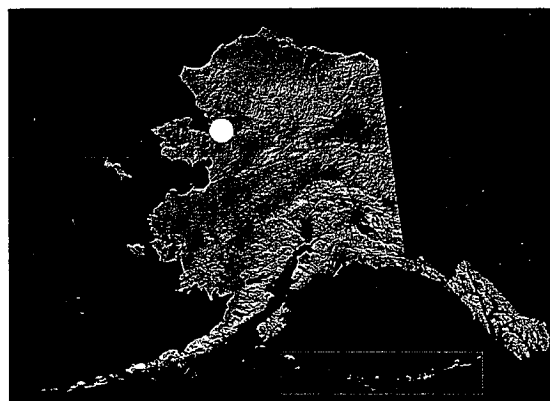
On July 28, 2006, I conducted a routine inspection of the power plant currently under construction at Buckland, Alaska.¹ The purpose of this inspection was to confirm (1) activity at the project site and (2) the traceability of individual expenditures within the total reported to the Commission on OMB Form 269A.

Prior to this inspection, I reviewed records kept at both the Denali Commission and its implementing "program partner," the Alaska Energy Authority (AEA).

This is one of three Denali-funded power plants that AEA was actively constructing in late summer. I have inspected all three (the other two are at Manokotak and Tenakee Springs).

The Buckland project is totally funded by the Denali Commission and anticipated to cost about \$2.26 million. As of late June 2006, AEA reported total expenditures of around \$1.6 million.

During the inspection process, I received exemplary cooperation from AEA, the City of Buckland, and the staff of the Denali Commission.



BASE MAP USGS

¹ Buckland is a small (pop. \approx 400), rural, incorporated settlement with 80 to 90 homes. It is located on the far west coast of northern Alaska, just south of the Arctic Circle. No roads, railroads, or power grids lead to Buckland. A barge delivers fuel once a year, but year-round access is generally by small propeller aircraft. Only the school, clinic, and washeteria (community laundry and shower) have running water.

Conclusions

Nothing in this inspection indicated any need for the Denali Commission to change its selection of a program partner or its continued funding of this particular project. Some opportunities for enhanced monitoring are discussed in my recommendations below.

Expenditure traceability

This power plant project was funded as part of several “lump sum” awards to AEA that cover numerous other projects around the state.² Nevertheless, computerized accounting records at AEA readily enabled a transparent, traceable “roll-up” from individual project expenditures, to project totals, to the cumulative expenditures reported³ on OMB Form 269A. This form has been filed timely with the Commission. Physical records kept at both the Commission and AEA were well-organized and readily reviewable during the inspection.

Project’s physical status

My inspection verified that a facility consistent with AEA’s project records is now under physical construction at the expected site in Buckland. The power plant building has been erected, but considerable interior work, such as the electrical controls, remains to be completed.

As for the facility’s main components, two of the three generators were present inside but unconnected (the third, and smallest, generator had not yet arrived). The day tank and used oil hopper were positioned inside as expected. The two outside step-up transformers had been installed.

My observations at the site were consistent with the photographs that AEA has previously submitted for public display on the Commission’s online project database at *www.denali.gov*.

Control over purchases

In my review of AEA’s accounting records, I judgmentally selected various expenditures of interest for further study. Documentation (e.g., invoices) was readily available and consistently supported the purchases. AEA provided a plausible and acceptable need for the items sampled.

I was able to confirm the existence of the selected items, with the exception of two network webcams (total \$1,620) and a Dell computer (\$2,689). AEA indicates that the two webcams were accidentally diverted to another job site and the computer was destroyed during water damage in AEA’s basement. AEA further indicates that the two webcams are being retrieved and that a new computer will be purchased with insurance proceeds.

Occasional unobserved items are of less concern in the “inspection” of an ongoing construction project, the case here, than they would be in a full “audit” of a completed project. And the minor components of a diesel power plant certainly do not warrant the intense tracking afforded

² Denali Commission award nos. 48-DC-2002-11, 97-DC-2003-111, 165-05.

³ As of the second quarter of federal fiscal year 2006.

prescription drugs and nuclear materials. Nevertheless, given AEA's experience with high-tech remote monitoring, the Commission's management may wish to explore the potential for RFID tracking of palletized materials en route to job sites.⁴

Recommendations

1. Disposition of surplus materials

The Denali Commission has previously funded construction of a tank farm that is now operated by the City of Buckland and two other entities. The city's tank farm operator inquired about the disposition options for a pile of unused piping and fencing from this prior project.

Surplus materials are an expected by-product of construction projects, and some may well occur upon completion of the power plant. However, cost and seasonal transportation can negate the feasibility of returning them to origin during a bush demobilization. Options no doubt exist beyond the defaults of waste, nuisance, and possible conversion to personal use. The Commission's management should develop a grant condition that anticipates this issue in a way that best promotes its mission.

2. Monitoring of litigation

While this inspection was pending, an unsuccessful bidder filed an administrative protest over AEA's procurement of a major component for the project. The procurement manager decided that protest in favor in AEA, and the matter was not appealed further.

However, the same bidder has previously filed the same protest against AEA involving 13 other power plant projects funded by the Commission. AEA indicates that this collection of protests includes every Denali-funded power plant that AEA has started to construct during the past three years.

The protests have been addressed at various levels: the procurement manager, an administrative law judge, and, in one case, the superior court. All decisions so far have been in favor of AEA. However, the bidder is currently appealing the superior court decision further to the Alaska Supreme Court.

The court system, rather than the Commission or its inspector general, is the final authority on the legality of AEA's procurement decisions.⁵ And the court may eventually find that a prior decision has a binding "preclusive effect" that bars repeated relitigating of the same issue between the same parties.

In the meantime, I recommend that the Commission's management develop a grant condition requiring immediate notification of any administrative protests or court cases involving a

⁴ Radio frequency identification (RFID) tracks the progress in transporting goods. The logistics program at the University of Alaska is now studying the potential of this technology. Also, at a recent economic conference underwritten by the Commission, the vice president of transportation from the nation's largest retailer offered his firm's assistance to Alaskan agencies wishing to tap its RFID experience.

⁵ Congress' comptroller general has issued a professional standard that cautions government reviewers to avoid interference with any "legal proceedings." *Government Auditing Standards* (2003) § 7.26.

Commission project. During the annual audit of the Commission's financial statements, it is advisable for the Commission to disclose to the outside auditor any claims or litigation that program partners are defending in funded projects.⁶

The Commission's management should also assess the following: (1) the use of grant funds for the partner's administrative processing⁷ of protests; (2) the use of grant funds for the partner's legal defense; (2) the potential for grant funds to be charged for money judgments; (3) the recovery of costs and attorney fees from unsuccessful litigants; (4) the degree to which a pattern of claims is impeding implementation of the Commission's program.

3. Feasibility of continuing audit requirements

The city manager indicates that small Buckland does not obtain an annual audit from a CPA firm for its city government (no audited financial statements). This is consistent with the "force account" arrangement in which AEA controls expenditures for the power plant.

However, I note that AEA's business plan for this project contains the following provision (p. 9):

The Primary Operator will arrange for an annual financial audit that is conducted by qualified, independent auditors. The Primary Operator will provide an annual report of operations to the Commission that includes a summary description of O&M and R&R projects; annual O&M and R&R budgets, expenditures and account balances; a projection of future O&M and R&R cash flows; and, any other information appropriate to the Facility. The Commission will review the reports and the annual financial audits of Facility operations and will actively monitor the Primary Operator's ability to operate consistent with guidelines outlined in this Plan. . . [emphasis added]

To the extent that this provision is actually being implemented, the Commission's management should carefully review the costs and benefits of requiring tiny settlements to obtain such annual "audits" — as well as placement of the post-construction responsibility for meaningful review of the resulting reports. On the other hand, this continuing boilerplate should be removed if there is no real intention to enforce it.

Ancillary reports

The Commission's prior inspector general visited Buckland's tank farm, but this is the first inspection of the power plant project now under construction.

This project has not been the subject of any audit reports issued by Congress' Government Accountability Office (GAO) or the state's Division of Legislative Audit. AEA does not have an internal auditor.

⁶ Under Financial Accounting Standards Board statement no. 5, the outside auditor assesses the Commission's judgment call as to any claim's probability, remoteness, and materiality in relation to the Commission's financial statements.

⁷ For instance, this might include the time spent by the procurement manager and the administrative law judge in writing their decisions.

Program partner AEA is a state agency and annually obtains a single audit for itself from a CPA firm. Neither the latest audit report (for the state's FY05) nor the associated management letter signal any matters of concern to the Denali Commission. The CPA firm considered AEA to be a low-risk auditee for purposes of federal OMB Circular A-133.

Concept, design, and business plans were prepared for AEA as part of the routine preparation of this project. However, I have not discovered any other reports, reviews, audits, studies, or evaluations of this facility.

Public complaints

AEA's design recognizes Buckland's limited capacity to maintain the facility without outside assistance. Using the Internet, AEA will be able to remotely monitor the vital signs of the three generators. Also through the Internet, zoom-in webcams will allow AEA to track everything from engine sounds to persons approaching the facility. And automated recycling of used oil should reduce the risk of generator damage from neglected oil changes. This state-of-the-art approach is analogous to that employed by the FAA in its remotely-monitored, "minimally-attended" navigation facilities.

To further support Buckland's power plant, the Kotzebue Electric Association (KEA) has signed a five-year management agreement to operate the completed facility for the city. However, correspondence from KEA complained to the Commission last spring about the utility's lack of involvement in planning for a facility that it is entrusted to operate:

One of the expectations KEA was left with after being approached by the AEA and the Denali Commission about managing the Buckland Powerplant was that we would be involved with the design and physical implementation of the new powerplant. To date this has not happened. This puts our utility in the precarious position of having to manage a powerplant that we have had minimal input on for design. . .

During my inspection, the city manager indicated her perception that improved communications were needed between KEA and AEA. And, earlier this month, Buckland's mayor wrote the following to AEA:

We are requesting an update on what type of control system is being planned for our generators. As stated before, we requested for the control system to be adaptable to wind generation. The price of fuel has skyrocketed in the past few years and it is only reasonable to be putting a control system adaptable to wind generation.

As Stakeholders, we request to be involved in decisions for design and capabilities of the new generator plant, as we will be involved in maintenance and operations of the new generator plant.

Expenditures on equipment for remote monitoring need to be compatible with the needs of the utility in Kotzebue as well as those of AEA back in Anchorage. And community preferences need to be balanced with community capacity. However, I did not evaluate these concerns as part

of my inspection, and I note them for the Commission's management to further consider as necessary.

Inspection process

My inspection was conducted in accordance with section 2 of the Commission's standard grant assurances, the project's business operating plan (p. 9), sections 4(a) and 6(a) of the Inspector General Act, and the *Quality Standards for Inspections* issued by the federal Executive Council on Integrity and Efficiency. An "inspection" is narrower in scope and procedures than the classic financial "audit."

Buckland's new power plant was the subject of my July 28 inspection but, to understand the local context of this project, I also visited the clinic, tank farm, and washeteria that have all been funded by the Denali Commission. The city manager, mayor, tank farm operator, and clinic health aide met with me during my visit.

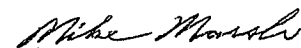
In my "bush" flights between tiny Buckland and regional hub Kotzebue, I appreciated the reassurance of flying with an air service that participates in Alaska's Medallion Foundation safety program.

Response by Denali Commission's management

The Federal Co-Chair was provided a draft of this report and invited to comment on my proposed conclusions and recommendations. He was encouraged to consult his staff, AEA,⁸ and any other parties as desired in the preparation of his response.

The Federal Co-Chair's response is attached as an appendix. The response indicates the general concurrence of the Commission's management with my conclusions and recommendations.

The Commission's implementation of recommendations will be summarized in my semi-annual report filed with Congress under the Inspector General Act.



Mike Marsh, Esq.
Inspector General

⁸ On August 2, I discussed pertinent conclusions and recommendations with AEA's deputy director for rural energy.

Appendix

Federal Co-Chair's Response



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September 11, 2006

Mike Marsh
Inspector General
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Re: Response to draft inspection reports on power plant projects in Buckland,
Manokotak and Tenakee Springs

Dear Inspector General:

Thank you for the recent inspection reports on Denali Commission power plant projects in the communities of Buckland, Manokotak, and Tenakee Springs. Thank you for the insightful review of these important projects. With this letter I am providing a response to several recommendations that were presented in the draft reports for your consideration in drafting of the final public reports on these three projects.

General response to review of Alaska Energy Authority

I was pleased to see from your review that the traceability of expenditures, quarterly programmatic reporting, financial reporting, annual auditing, and photographic documentation provided by Alaska Energy Authority (AEA) to the Commission were all found to be consistent with the Commission's policies and procedures. The Commission is proud to have AEA as a partner to deliver our largest programs and has had a strong and positive relationship with the AEA since our inception. We intend to continue working with AEA into the future in order to complete the Commission's Bulk Fuel and Power Plant Programs and explore other areas to develop Alaska's energy infrastructure. Your reviews provide the Commission many recommendations that will further strengthen this partnership for the future.

Control over purchases

In your selected review of Alaska Energy Authority's expenditures on materials and equipment for the three projects you found several items that had either been delivered to another project or erroneously charged to a project. This equipment was all computers, web cam or other related technology for remotely managed power plants. The Commission understands that AEA is managing multiple projects and purchases equipment for several projects at one time which can lead to difficulty in accounting for equipment by project. In addition the amount and dollar value of items is small comparative to the overall scope of the projects. With this said, Commission management is concerned with this finding and will be working with AEA to ensure future technology equipment is more carefully tracked and accounted for accurately by project.

Appendix
Federal Co-Chair's Response

Response to Draft Inspection Reports (Buckland, Manokotak & Tenakee Springs) - 9/11/2006
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Disposition of surplus material

Your recommendation on clear grant conditions that anticipate excess material that may be left on site is not an issue the Commission has explicitly addressed in the past. Beginning in FY 07 the Commission will work to develop standard financial assistance award language that addresses this issue for all recipients and partners, if monetary effects to the projects can be suitably controlled. Minimizing excess material without increasing project costs is a laudable goal.

Monitoring and expenses of litigation

Although a rare occurrence in the short history of the Commission, litigation and challenges to procurement are an inevitable part of managing the construction of public infrastructure projects. The Commission has not explicitly provided direction to partner agencies or recipients on notification and allowable expenses. Beginning in FY 07 the Commission will develop standard financial assistance award language that addresses this issue for all recipients and partners. We will also pursue your recommendation to assess the use of grant funds in dealing with litigation and claims, since this could lead to an unfunded liability.

Feasibility of continuing audit requirements

The Commission has developed requirements to ensure the useful life of a facility is achieved and projects constructed with Commission funds are generally sustainable into the future. As your review discovered the use of the business plan by AEA is a cornerstone of this requirement. The Commission and AEA are continuously reviewing the standard business plan language for improvement toward this goal. The feasibility of requiring annual audits by communities will be reviewed by the Commission.

Potential for community contributions

The Commission's funding for bulk fuel and power plants in rural communities does not have a specific statutory requirement for cost share funding by recipients like the Commission's health facilities program. The Commission strongly encourages local contribution and funding for these projects while balancing the threat to public safety and the environment by allowing non-code compliant bulk fuel storage facilities and inadequate power infrastructure to remain. It should be noted that both Manokotak and Buckland were required to sign up with an outside electrical utility in a management/mentoring arrangement in order to qualify for the power plant upgrades in their communities. Buckland pays the entire cost of this agreement, while Manokotak pays about half the cost overall (graduated over time). This represents a small, but significant monetary contribution from both communities. The Commission and AEA have received local contributions on several other projects in the past, that were not part of your review, in the form of land donations, labor, materials and direct funding. It is an area that is important to review further. The Commission will be working with Alaska Energy Authority and other program partners to develop strategies for further cost participation by local communities.

Appendix

Federal Co-Chair's Response

Response to Draft Inspection Reports (Buckland, Manokotak & Tenakee Springs) - 9/11/2006
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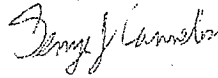
Complaints from Kotzebue Electric Association (KEA) on Buckland Power Plant

The Commission is aware of the concerns of KEA in regards to design of the power plant. This unique model of a regional entity providing operations support for a community power plant designed and constructed by the State was a first for the Commission and

AEA. The Commission will further consider how to approach similar projects in the future with information learned from this project and believes that AEA has adequately addressed the concerns raised at this time for this project.

Please let me know if you have any questions, or need additional information. Thank you again for completing these inspections and for the detailed reviews.

Sincerely,



George J. Canelos
Federal Co-Chair