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INSPECTOR GENERAL

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To: George Canelos, Federal Co-Chair

From: Mike Marsh, CPA, MPA, CFE, Esq., Inspector General

FINAL REPORT

FOR PUBLIC RELEASE

Subject: Inspection of McGrath city hall
(grant 94-DC-2003-I9, state sub-award 85-0261)

The City of McGrath (pop. \approx 320) lies deep in Alaska's interior between the Bering Sea and the mountains of the Alaska Range. No roads, railroads, or power grids connect McGrath with the rest of the state. It lies near the upriver, barge-accessible end of the long Kuskokwim River,¹ which might be considered analogous to a rural "Route 66" in the Lower 48. Routine access is by small propeller airliners. It is a stop on the annual Iditarod dog sled race. The local school now has about 45 students.

The Denali Commission provided grant funding of \$50,375 for McGrath to renovate its little city hall (\approx 10,000 square feet) that was built 30 years ago. The city matched this with \$16,791 of its own. More technically, Denali provided its funding to the State of Alaska which then administered McGrath's project as a state sub-award.

In May 2009, Denali's Office of Inspector General (OIG) reviewed the state's records concerning the McGrath sub-award. In June 2009, we physically inspected the resulting facility while in McGrath for other matters.

We found the city hall's renovation to be a success story that illustrates what committed local leadership can do with a grant that is quite small by federal standards. Though Denali no longer issues grants for "multi-use" facilities, we noted some lessons worth considering in its continuing programs.

WHY WE INSPECTED THIS PROJECT

We recognize that few inspector generals would visit a location as remote as McGrath, Alaska to inspect the use of only \$50,000. However, occasional spot-checking of small grants is desirable since they may easily stay beneath the radar of the four main oversight safeguards.

¹ The popular History Channel television program, *Tougher in Alaska*, has a "Frozen Freeway" episode about the challenge of using the frozen Kuskokwim River to truck fuel to a Denali-funded tank farm at Kwethluk, Alaska.

First, a small grant may be neither material nor sampled by OIG's contract auditor during the routine annual audit of Denali's own financial statements. Second, though the State of Alaska is Denali's largest grantee,² an individual grant may not be significant in the state's annual audit of its overall federal funding (not a "major" program for audit purposes). Third, local audits are not required when small towns (like McGrath) receive less than \$500,000 in annual federal assistance. Fourth, both a state's department and a small town may lack the benefit of an internal auditor (the case here).

More specifically, Denali's experiment with "multi-purpose" (or "multi-use") buildings has been a controversial program in the agency's short history of only a decade. In 2007, Denali's CFO notified OIG that she was suspending grant no. 94-DC-2003-I9 to the State of Alaska. The CFO's letter to the state government indicated the following reasons for this administrative action:

The reasons for the suspension of funds are due to lateness of financial reporting, inaccuracy of financial reporting, no submissions of quarterly estimates, expenses for grants being charged to other grants, inaccuracy on cash versus accrual on financial reports, and inconsistent information from financial versus program staff at [state's department].

The CFO further notified OIG that construction of the buildings for at least two of the 12 locations had been started but never completed.

In fact, this was only one of seven grants to the State of Alaska that Denali's CFO suspended. While she has the authority do this under the grant agreements, it seemed to OIG to be an atypical scenario in federal-state relations.

OIG recommended that Denali's CFO contract with a federal franchise fund's internal auditor to assist her staff in reviewing the state's accounting procedures for grant no. 94-DC-2003-I9. In March 2009, this internal auditor issued a brief report to the CFO.³ His sample included four of the funded multi-use facilities, but not the one at McGrath. He did not attempt to physically inspect any of the facilities, but he noted aspects of the state's monitoring practices which OIG felt warranted further review.

Denali's management also contracted with a local 8(a) corporation for a program evaluation of multi-use facilities. The firm employed a well-respected university researcher, who looked in depth at four facilities that were successfully completed (but not the one at McGrath) and issued broad advice for the future.⁴ OIG's recent inspections involved different facilities and a more focused look at some specific state monitoring issues.

² For instance, the State of Alaska received over a third of Denali's funding in FY 2007.

³ OIG has reviewed this internal auditor's workpapers. We see no reason to duplicate his fieldwork in Juneau concerning the state's bookkeeping procedures for recording Denali funding in the state's accounting system. Rather, OIG has focused on the state's project monitoring records in Fairbanks and visited the facility itself in McGrath.

⁴ NANA Pacific, *Multi-Use Facility Program Evaluation*, April 30, 2008.

Finally, OIG received a referral from the federal OMB concerning Denali's accounting for another grant to the same state department that administered grant no. 94-DC-2003-I9. OIG ultimately requested a formal determination from the U.S. Comptroller General, which was published last fall (GAO # B-316372, Oct. 21, 2008).⁵ In discussing the facts, the Comptroller General noted that the problem began with an error by the state government as grantee:

In August 2005, Commission staff sent a Financial Assistance Award document to the Alaska Department for signature. The Alaska Department misplaced the award document and, consequently, never returned it to the Commission. After following up with the department in October 2005, Commission staff transmitted a second award document to the department, dated December 2, 2005.

Given that this additional grant involved the same state department, small sub-awards ("mini-grants"), another suspension by Denali's CFO, and a misplaced grant award for \$400,000, OIG considered it among the factors that suggested further review of the state's monitoring procedures would be beneficial.

CONCLUSIONS

The state's desk monitoring satisfied Denali's grant conditions

Congress provided two appropriations to Denali for "multi-purpose community facilities." Denali passed this money on to Alaska's state government as grant #94-DC-2003-I9 for \$7.3 million. The McGrath renovation was one of 12 projects across Alaska for which the state issued sub-awards under this Denali grant.

Congress attached no specific monitoring conditions to its appropriations for this purpose. Denali's grant to the state incorporated OMB's standard grant circulars by reference, since Denali has never issued grant regulations of its own in the Code of Federal Regulations. In the grant agreement, Denali required that the state submit quarterly progress reports for each project plus periodic photos taken by the sub-awardees.

The state monitored this grant from its office in Fairbanks. OIG reviewed the extensive file maintained there for the McGrath sub-award (literally 7 pounds in weight and approximately 300 pages of paper). The state charged Denali only \$1,008 for all of this administration. OIG appears to be the first federal official that has examined this state monitoring file.

McGrath's city manager submitted 10 progress narratives to the state, including around 40 photos. Pertinent parts of these narratives were electronically forwarded to Denali. And the photos appear within the public database portion of Denali's website at www.denali.gov. OIG noted that the city manager charged the sub-award only \$2,799 for her administrative work (certainly reasonable).

OIG reviewed McGrath's progress narratives in the state's file and found them to contain detailed descriptions of specific construction activities as well as supporting invoices. We noted

⁵ See www.gao.gov.

that the state's grant administrator rigorously reviewed each narrative and assured adherence to the sub-award's budget. While three time extensions (grant amendments) were accommodated during construction, the file reflects a continuous stream of meaningful, timely communication (and documentation) between the two officials.

OIG also found that the state's grant administrator had an adequate system for documenting the internal policies and procedures that she applied in monitoring this grant. This included the state's own grant conditions that were far more detailed than those specified by Denali. The state's internal guidance for Denali's multi-use program was physically a two-inch binder of memos documenting institutional knowledge, rather than a formal codification. However, OIG found this to be an adequate and efficient solution for a specialized federal program of such limited size and duration. A cosmetic codification seems unnecessary.

The state's monitoring did not include any site visits

The state's grant administrator did not physically visit the funded facility to confirm implementation of the grant. Denali's grant conditions neither required it nor provided the state with the travel funding to do it. We again note that the state charged Denali only \$1,008 for administration of McGrath's sub-award (including the state's 7-pound file of monitoring paperwork).

Our June 2009 visit appears to be the first time that any Denali official has inspected the renovated facility. OIG observed that the remodeled city hall was consistent with McGrath's grant application, progress narratives, and photos.

Given the small amount of Denali's grant and the remoteness of McGrath, the travel costs of periodic site visits would in this case be disproportionate to the risks and benefits. And the city manager's detailed narratives, invoice copies, and numerous photos provided the state with important verification of the use of the grant. And we again note that the city manager charged the sub-award only \$2,799 for her administrative work.

Nevertheless, this is the common "bush" reality in which a project's success hinges on the efforts of a single key local who must wear multiple hats out of necessity. For instance, the grant application shows one person as McGrath's combined city clerk, treasurer, and city administrator. Other small Alaskan towns are able at best to spread the governance tasks among relatives — still an inherent limit on the optimal "segregation of duties" found in larger bureaucracies. And, to further compound the scenario, neither multi-tasking officials nor the public have the reassurance of an outside audit when the funding is so limited (it's not legally required for federal support less than \$500,000).

While these are unavoidable realities of rural Alaska (and McGrath was a successful project), we still see a practical alternative to simply relying upon the recipient's own remote representations.

Recommendation: When a grant is too small to warrant site visits, Denali should include a grant condition for periodic, informal "walk-throughs" by a credible local third-party. For instance, both the local state trooper and a state magistrate occupy the McGrath city hall. In such a scenario, the state's grant administrator could conceivably ask either to walk through the

two-story building (only 10,000 square feet) every few months during construction. Either could then offer informal (non-engineering) observations that confirm the remodeling progress.⁶ Simple documentation of these phone calls in the state's file would provide some outside reassurance in the absence of site visits.

Recommendation: As broadband Internet coverage expands across bush Alaska, live walk-throughs with portable webcams may be the best alternative to site visits.

This sub-award reflects an efficient use of federal funding

Our past OIG reports have cautioned Denali's management about the need to leverage federal funding with local effort. For instance, our May 2007 *Semiannual Report to the Congress* stated:

The extent to which the Commission's projects should be a shared effort — versus just provided — is a sensitive policy decision that currently varies with the type of facility. Nevertheless, long-run national support may be encouraged to the extent that projects are perceived more as innovative partnerships and community "barn raisings" — and less as seasonal cash injections and entitlements.

Though we've been critical of this aspect elsewhere in the region,⁷ renovation of McGrath's city hall reflected a "barn raising" of community involvement. Unless a task required a specialty contractor, the city manager successfully scheduled local people to accomplish the work. We recognize her talents in coordinating this under the conditions — and without a budget increase (her narratives reflect work in temperatures between 85°F above zero and 51°F below zero).

Key persons at McGrath showed OIG their renovated city hall with great pride. This included the local nurse practitioner,⁸ the mayor, and the president of the tribal corporation.⁹ Instead of requesting a new \$1 million+ stand-alone building, the community used less than \$70,000 to extend the life of its existing facility and reduce its fuel bills.

While Congress left the boundaries of "multi-purpose" and "multi-use" to Denali's discretion, the continued consolidation of this small town's city council, police, fire, laundromat, water treatment, and even its jail,¹⁰ unquestionably offers efficiencies of scale in this remote setting. And our physical inspection enabled us to verify that — two years after completion of repairs — the facility was being used for the asserted public functions that were the basis for approving the grant application.

⁶ OIG is not suggesting that rural law enforcement officials double as "building inspectors" or "auditors." But there is a long history of miscellaneous public service courtesies by Alaska's rural police that extend beyond the apprehension of criminals.

⁷ See OIG's inspection reports for Denali projects at Takotna, Sterling Landing, and Red Devil at www.denali-oig.org.

⁸ The nurse-practitioner is the lead medical provider in McGrath.

⁹ MTNT, Limited.

¹⁰ One of Alaska's historical bush challenges has been humane confinement of the dangerous until state troopers can transport them by plane to a state correctional center. See John E. Angell, *Public Safety and the Justice System in Alaskan Native Villages* (Pilgrimage Inc., 1981, ISBN 0-932930-35-2), pages 46-50.

Though McGrath (pop. \approx 320) is a very small city by Lower 48 norms, it serves as the regional center for a historical constellation of much smaller settlements. Schools are the primary publicly-funded institution in the latter, and their populations move as the schools disappear with their associated support services.

For instance, most residents of Telida (pop. now 3) moved down the river to Nikolai (pop. 90) with the departure of the school, clinic, telephone service, and subsidized mail planes.¹¹ And if Nikolai's school closes, the residents will probably move further down the river to McGrath.

Other area examples with discontinued schools are Lime Village (pop. now 32) and Lake Minchumina (pop. now 17). Takotna's school continues but with only 12 students (10 is the critical threshold for state funding). Even McGrath as the regional center now has only about 45 students, compared to the 130 of a prior decade.

Federal investment in regional hubs like McGrath offers an efficient alternative to migrations from tiny settlements into the urban centers at Anchorage (pop. 285,000) and Fairbanks (pop. 98,000). Public preservation of Alaska's rural hubs is a more reasonable expectation for the long term than the continuation of government services in 200+ isolated settlements.

Ironically, this small-project success story at McGrath would not have occurred had Congress not left Denali some flexibility in the selection of project locations. Denali's staff interpreted the appropriations and associated congressional records as encouraging the construction of multi-purpose facilities in some specific named communities that did not include McGrath.

Recommendation: Denali should consider convening one of its quarterly meetings in McGrath to assure that the needs of this remote interior region are considered in the agency's annual statutory work plan. Alternatively, less than a quorum of the commissioners could conduct a public hearing in McGrath concerning the work plan.

The delay in fire marshal approval delayed the project

McGrath's facility included its fire department and state trooper, and a further irony was the project's delay due to problems in obtaining approval from the state fire marshal (another state law enforcement official).

Construction work on public buildings cannot begin until the state fire marshal has approved the plans. The McGrath project was delayed for around six months due to problems with an incomplete application to the fire marshal. This is significant given that the city's original grant application optimistically projected that construction itself would only take six months (July to December 2004).

We did not see the fire marshal's approval in the state's file for the McGrath sub-award (though the state's grant administrator obtained a copy at our request). The grant administrator correctly noted that monitoring for fire marshal approval was not a condition of Denali's grant to the state.

¹¹ Telida's story was told nationally as one segment of the 1996 PBS/Reader's Digest television program *Incredible Journeys Around the World: From the Amazon to the Arctic*.

The fire marshal's linkage to Denali grants is important at several levels that make approval more than just another bureaucratic hurdle.

Destruction of public buildings by fire is now unusual in the Lower 48, where running water and sprinkler systems are the expected norm. But such tragedies are still too common in the remote areas of Alaska off the road system. At least three of the 12 funded multi-purpose facilities serve uses displaced by burned buildings.

Also, widespread summer wildfires are the rule rather than the exception in rural Alaska. We observed two active wildfires from the air during our trip to the McGrath area. One expanse of burned timber ran between the nearby settlements of Nikolai and Telida. The latter, though spared this time, had been almost completely encircled. Summer haze from far distant wildfires is an accepted fact of life in Anchorage on the other side of the Alaska Range.

From the perspective of managing financial risks, destroyed public buildings often trigger replacement at public expense. Further, the state has committed to review public construction plans for fire prevention, and any neglected review may thus subject the state to liability.¹² While the federal government is generally not liable for grantees' mistakes, suits against grantees may raise the disruptive issue as to whether Denali's grants can be charged for grantees' defense costs and court judgments.

Both metaphorically and literally, it's obviously better to prevent fires than to put them out.

Recommendation: Denali should include an explicit condition in its grants that the grantee will document the fire marshal's plan approval before construction starts.

Recommendation: Denali should coordinate technical assistance from the Cooperative Extension Service when a community has difficulty in meeting the fire marshal's requirements. As an alternative, Denali should include the position of "rural ombudsman" within its staff as OIG has previously recommended.¹³

HOW WE REVIEWED THIS PROJECT

A project "inspection," such as this one, is narrower in scope and procedures than the classic financial "audit." One prominent originator of this type of inspector general review described it as follows:

The idea is to prevent problems before they occur and to avoid vulnerabilities from becoming permanent features of programs. We usually initiate these reviews ourselves, but sometimes senior program managers request that we find out what is happening as grantees or government agencies struggle with the complex tasks of starting a new program — what seems to be working, what is not, what barriers grantees are facing, what, if anything, any of them have been able to do

¹² See *Angnabooguk v. State*, 26 P.3d 447, 453 n.24 (Alaska 2001); *R.E. v. State*, 878 P.2d 1341 (Alaska 1994).

¹³ See OIG's inspection report for Red Devil, Alaska at www.denali-oig.org.

*about problems which arise, what innovative practices grantees are experimenting with, and whether and how they are measuring progress, etc. . .*¹⁴

Our review was conducted in accordance with section 2 of Denali's standard grant assurances, 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.

The agency head was provided a draft of this report. He informally provided us with his thoughtful feedback by email, and we carefully considered his comments before publication.

Mike Marsh

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INSPECTOR GENERAL

¹⁴ George F. Grob, "Inspections and Evaluations: Looking Back, and Forward Too," *Journal of Public Inquiry* (spring/summer 2004), page 11.