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SEMIANNUAL REPORT TO THE CONGRESS

FY 2011 – SECOND HALF

OFFICE OF THE INSPECTOR GENERAL

DENALI COMMISSION

ANCHORAGE, ALASKA



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Memo

To: Mike Marsh, Inspector General, Denali Commission
From: Joel Neimeyer, Federal Co-Chair, Denali Commission
Subject: FY2011 (Second Half) Semi-Annual Report to Congress
Date: January 9, 2012

A handwritten signature in black ink, appearing to read "Joel Neimeyer".

This memo is written in response to the above referenced document that was provided to me for review and comment on December 4, 2011. The following is offered.

A. General comments

1. This response is guided by the Inspector General Act of 1978, as amended. In particular, Section 5(b) of the Act outlines the responsibilities of the head of the agency in responding to Semi-Annual reports. In large part, the Semi-Annual Report (First Half) for FY2011 was my first substantive effort, in collaboration with you, to address my responsibilities set forth in Section 5(b). In particular, the Appendix for the 2011 First Half report provides a summary table of 159 recommendations made by you to me, or to my predecessor (Mr. George Cannelos) over the past five years. I appreciate all the time and attention you put forth in preparing the table, which includes the results of each recommendation: accepted or declined by the Federal Co-Chair, still under consideration, or effectively tabled to Congress (i.e. recommendations for Commission reauthorization).
2. Although we spent considerable time together, going over each recommendation prior to you publishing the 2011 First Half report, I believe we will need to revisit some of the recommendations. Given the \$15 Million rescission in FY11 of Commission unobligated funding (from FY10) we now know that Congress is not supportive of carrying over unobligated funds from one year to the next (despite the funds classification as "no year" funding).
3. I view this Congressional action as a "wake-up" call to the agency to improve our administrative and programmatic procedures. Consequently, I have challenged agency staff to consider two broad actions in FY12. First, we must improve project and program data gathering to demonstrate outcomes of Commission investments (i.e. the impact of Commission projects in addressing needs) – not just outputs (e.g. how many clinics were built). Second, the agency must improve our administrative procedures to demonstrate that Commission funded projects are well managed and completed as intended. The first improvement is about effectiveness of Commission investments and the second is about efficiency in delivery of Federal resources to address rural Alaska needs. I ask that you review the full list of recommendations for those that may address these two desired

improvements – whether the recommendations have been implemented or declined. I imagine that throughout 2012 we will be discussing these points and identifying those that may have the most impact in achieving these goals.

B. Comments to the FY2011 Second Half Semi-Annual Report

1. I appreciate your thorough and thoughtful review of the Commission's Private Enterprise policy. Once the report is published, I will forward it on to the Commissioners and schedule appropriate time with them to consider the recommendation to suspend the policy for all past, current and future grants.
2. I applaud your approach of working with senior management so that the agency can avoid future problems with potential vulnerabilities with Commission administrative and program procedures. I point to your work on the annual FISMA review of computer security as one example. In addition, your efforts to identify subject matter experts on other Commission matters is also appreciated such as putting agency staff in contact with representatives of the CEAR review panel that reviews the agency's annual Performance and Accountability Report (PAR). I am hopeful that the 2011 PAR will be better received and will be the model for the Commission to better tell the story of the needs in rural Alaska.

MEMORANDUM FOR FEDERAL CO-CHAIR NEIMEYER

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

Subject: Semiannual report to agency head and Congress for second half of FY 2011

The Inspector General Act requires the Office of Inspector General (OIG) at the Denali Commission (Denali) to prepare a semiannual report to the agency head and Congress. The discussion below constitutes this report for the second half of FY 2011.

OIG'S SUPERVISION OF THE ANNUAL
AUDIT OF THE AGENCY'S FINANCIAL RECORDS

Federal law requires that OIGs conduct an annual audit of their agencies' financial statements, with the results publicly published in the agency's *Performance and Accountability Report* (the "PAR") that is required by OMB. Like most of the 73 OIGs created by Congress, Denali's OIG contracts to have this audit performed by a CPA firm experienced in the requirements of the Beltway.

The annual audit's bottom line

For readers that want the short version, the contract auditor issued an unqualified opinion that Denali's FY 2011 financial statements are fairly stated under the applicable professional standards. The actual opinion is included within the agency's PAR at www.denali.gov.

OIG's monitoring of the annual audit

For readers that want more detail on the monitoring and larger context of the annual audit, OIG will start by noting that at 1 FTE — that is, the inspector general himself with no staff — we are the very smallest of the OIGs that Congress has created around the federal system. While contracts to retain auditors (as well as for investigators and experts) are certainly authorized by the Inspector General Act,¹ this does not eliminate the need for OIG to monitor the contractor's performance and encourage a meaningful interaction with the agency's management² — the player with the actual ability to implement corrections and improvements.

¹ See Inspector General Act sections 6(a)(9), 8G(g)(2).

² See OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, sec. 12.

Some remember that a prior auditor issued a “disclaimer” when that meaningful interaction did not occur some years back.³

This legal mandate — and the others that Congress requires of OIGs — are concentrated in the Beltway, where the vast majority of the appointed inspector generals (but not Denali’s) maintain their permanent duty stations. Regardless of the small size of Denali’s OIG and the agency itself (less than 20 FTEs), the same legal mandates apply and Denali’s OIG must spend considerable time in the Beltway to satisfy these requirements in a meaningful manner. Every year, Denali OIG devotes around 25% of its time to the mandatory audit. Another 10% is devoted to participation in the training that Congress requires agencies to fund for OIGs.⁴ And yet another 10% is devoted to the weekly videoconferences and other meetings that Denali OIG has with the agency head and CFO to prevent problems before they necessitate inspections with critical findings⁵ (that management has historically sometimes been slow to address⁶).

Though Denali’s funding targets Alaska, readers seldom realize that all nine of the following key activities for Denali (and its OIG) are actually located within federal service centers in the eastern Lower 48: (1) accounting records, (2) payroll, (3) procurement, (4) personnel function, (5) OIG’s financial auditor, (6) the agency’s “business board” of expert advisors, (7) oversight agencies (GAO, OMB, CIGIE, OPM, and congressional committees), (8) mandatory legal counsel for OIGs,⁷ and last but not least, (9) the specialized federal training to understand all of this that Congress requires the agencies to fund for OIGs.⁸ The dispersal of these activities around the federal system is simply the norm in the modern cost-conscious federal world, rather than some hidden revelation peculiar to Denali.

Though the annual audit of the agency’s finances could be minimized as a required ritual, Denali OIG attempts to leverage its impact through several associated activities that we describe next.

Annual FISMA review of computer security

A further statutory mandate requires that OIGs conduct an annual FISMA review of their agencies’ computer security, with online reporting of selected data to OMB. Denali OIG thus contracted with its auditor to assess the agency’s IT system for FY 2011 and gather the information needed for this reporting.

³ See Denali OIG, *Semiannual Report to the Congress* (May 2009) at www.denali-oig.org.

⁴ See Inspector General Act sec. 6(f).

⁵ See Inspector General Act sections 4(a)(3), 4(a)(5), 6(a)(6).

⁶ See Denali OIG, *Semiannual Report to the Congress* (May 2011) at www.denali-oig.org.

⁷ See Inspector General Act sec. 8G(g)(4).

⁸ See Inspector General Act sec. 6(f).

OIG recommended that Denali's management go further and contract for a more specialized technical assessment of its system's vulnerabilities. Management took our advice, and its study from a security consultant reported that past weaknesses have now been effectively addressed.

OIG has in the past been concerned about the lack of a backup server as a component in Denali's disaster planning. But four developments have now mooted our concern: (1) the transfer of all functions except email and the home page to servers maintained by federal providers in the Lower 48; (2) arrangements under a new federal law which requires agencies to enhance their employees' capacity to remotely "telework;"⁹ (3) routine use of cellular texting as a substitute for email; (4) the limited harm from disruptions of the routine public information available on the agency's home page.

The larger federal audit of controls at Denali's contractor

Denali's management contracts out the small agency's accounting, payroll, procurement, and personnel functions to a Treasury Department franchise fund¹⁰ that provides such services to numerous federal agencies. And OIG's contract auditor examines this contractor's records as part of Denali's annual audit. However, the franchise fund's controls are also reviewed by both the Government Accountability Office (Congress' auditor) and a CPA firm retained by Treasury's OIG. The latter audit by a CPA is annually published as a report known in accounting jargon as the SSAE 16 review of a service organization.

Since Denali relies heavily on the franchise fund's systems, Denali OIG and its contract auditor study the annual SSAE 16 report for any pertinent findings. The report issued in 2011 described 20 categories of control testing, with only a single exception detected among the many transactions sampled. However, to better understand the limitations of this very technical study, OIG recently invited Denali's CFO and the franchise fund's accounting manager to a consultation with GAO's chief accountant (a significant "booth referee" of federal accounting requirements). OIG now appreciates that the scope of this SSAE 16 report does not include controls at the franchise fund's numerous subcontractors.

An expert panel's critique of Denali's PAR

The annual audit of an agency's financial statements is a key component in the OMB-required *Performance and Accountability Report* (the "PAR").

The PAR is one of those federal mandates that seemed like a good idea at the time. However, particularly at larger agencies, annual production of the voluminous document has over the years taken on a life of its own — where the ritual of requirements can overshadow the reassurance of readers. Cynics stereotype it as yet another expensive government study in which seldom has so much, meant so little, to so few.

⁹ The Telework Enhancement Act of 2010, P.L. 111-292, 5 USC 6501-6506.

¹⁰ The Bureau of the Public Debt franchise fund in the U.S. Department of the Treasury.

OMB itself publicly acknowledges the need to re-examine the hopes for the PAR. And each year the national trade association for federal accountants¹¹ offers agencies the antidote of its CEAR¹² review process, in which a blue-ribbon panel of CPAs will critique an agency's PAR as a meaningful public product. Though the Denali Commission may be smallest agency to volunteer for such a review, Denali OIG pays for it in hopes of enhancing public confidence in the agency's audit.

But one must, of course, always be careful what one asks for. When the judges have their scores on the CEAR review panel, their pages of critique pull no punches — as Denali saw last year in this frustrated observation:

We also want to point out that the CEAR program provides many useful recommendations for improving Performance and Accountability Reports and Agency Financial Reports. Many of these recommendations have not been reflected in the reports that Denali submits for review each year. Denali might want to examine why, absent addressing the matters identified in the recommendations, it is continuing to participate in the program.

And since Denali OIG requested (and paid for) the panel's review, the following comment seems well taken:

[W]e assume that the OIG also wants to improve Denali's accountability and transparency. Hence, by providing the recommendations to the Inspector General (and the auditor), and that Denali's response to the comments submitted with its FY 2011 report will reflect his actions in regard to those comments [sic].

With this in mind, Denali OIG arranged for staff from the CEAR review program to directly confer with the agency head, the CFO, and OIG's contract auditor. Based on these meetings and the panel's critiques over several years, three recurring themes emerge that OIG will attempt to paraphrase: (1) management needs to publicly disclose program-by-program spending in the financial statements; (2) management needs to demonstrate its results through meaningful performance metrics; (3) management's PAR narratives need to tell an inspiring story of maximized public benefit from diminished congressional funding.

The PAR is largely a book authored by the agency's management. However, OMB reserves one of the final sections for the inspector general's perspective:

The PAR shall include a statement prepared by the agency's Inspector General (IG) summarizing what the IG considers to be the most serious management and

¹¹ The Association of Government Accountants (AGA) in Alexandria, Virginia.

¹² The Certificate of Excellence in Accountability Reporting (see www.agacgfm.org/performance/cear/).

*performance challenges facing the agency and briefly assess the agency's progress in addressing those challenges.*¹³

The three key criticisms of the CEAR review panel offered a useful framework for this discussion in the PAR concerning OIG perspectives on the most significant challenges facing Denali's management. OIG's section of the PAR is available at www.denali-oig.org.

OIG'S PURSUIT OF AUTHORITATIVE DETERMINATIONS FOR PERSISTENT FUNDING ISSUES

The specific programs entrusted to Denali have varied over the agency's life span with changing congressional priorities and support. Denali started in the late 1990s with only around \$20 million and a mission to replace leaking fuel tanks. In the agency's heyday, it had annual congressional support of well over \$100 million for clinics, training, housing, community centers, waste disposal, broadcasting, transportation, and rural electrification. Congressional support today has dwindled down close to the startup funding, and now only the latter two programs receive new money.

Federal agencies work within a legal norm that limits their spending to such appropriations as Congress decides to send them. Efforts to circumvent the congressional limits by going elsewhere are prohibited "augmentations" unless Congress gives the statutory blessing. While regional commissions are intended as federal, state, and tribal collaborations, Denali currently has questionable legal authority to diversify its funding from non-federal sources.¹⁴

OIG is responsible for monitoring Denali's compliance with congressional funding limitations. And both the Inspector General Act¹⁵ and GAO's legislation¹⁶ encourage OIGs to seek any needed interpretations from the comptroller general as Congress' "booth referee" of appropriation law.

Denali's OIG has thus sought several authoritative determinations as to the legal boundaries of the agency's efforts to preserve and conserve its funding.

Congressional rescission of \$15 million from Denali's prior funding

At the macro level, Congress and the President struggled long and hard to reach final agreement on the nation's FY 2011 appropriations. At the micro level, one of many compromises was for Denali to return some unused funding to the Treasury:

¹³ See OMB Circular A-136, sec. II.5.5.

¹⁴ See Denali OIG, *Semiannual Report to the Congress* (May 2011), pages 8-10, at www.denali-oig.org, and GAO, *Denali Commission—Authority to Receive State Grants*, # B-319246 (Sept. 1, 2010) at www.gao.gov.

¹⁵ See Inspector General Act sections 4(a)(4) and 6(a)(3).

¹⁶ See 31 USC 3526(d) and 31 USC 3529.

Of the unobligated balances from prior year appropriations available for "Independent Agencies, Denali Commission", \$15,000,000 is rescinded.¹⁷

In effect, Congress sent Denali an FY 2011 base appropriation of just under \$11 million — which Congress neutralized with the \$15 million rescission. OMB attempted to comply with Congress' direction and collect the rescinded amount from Denali. However, Denali's management insisted that, as of the date of the rescission's enactment, only a fraction of the \$15 million still remained from prior years.

In other words, Denali claimed that it had already obligated most of the \$15 million that Congress assumed was still available to reclaim. OMB and Denali then struggled for some time with the uncertain mechanics of how the full amount of this "debt" could be extracted from the agency in practice.

On one hand, Congress certainly has the authority to recoup unused funding and apply it differently as national needs change. On the other hand, Congress would not lightly expect an agency to cancel awarded grants¹⁸ and negate the annual public process for the agency's "work plan" that Congress has entrusted to a panel of statewide leaders under the enabling act.¹⁹ At some point, that panel and grantees need finality to effectively plan what the agency can do with what's been given.

Given OIG's responsibility to report to Congress on any violations of appropriation laws, OIG ultimately sought the safe harbor of a comptroller general's determination as to how the rescission legislation should be legally implemented. The comptroller general ruled that Congress meant what it said and that Denali owed the full \$15 million, regardless of how much the agency actually had available at the moment that the rescission was enacted.²⁰

The comptroller general's ruling found that time payments over future years would be consistent with the rescission legislation. But Denali was able to arrange the return of some unused funding from its grantees, and sufficient money was accumulated to retire the debt by the end of FY 2011.

Suffice it to say, Denali's meaningful planning was frustrated for much of FY 2011 — including public confidence in the annual "work plan" that the enabling act envisions as a blueprint for the best use of available funding.

¹⁷ See P.L. 112-10, sec. 1477.

¹⁸ See *Lynch v. United States*, 292 U.S. 571 (1934).

¹⁹ See Denali Commission Act (P.L. 105-277, 42 USC 3121 note), sec. 304.

²⁰ See GAO, *Denali Commission—Fiscal Year 2011 Rescission*, # B-322162 (Sept. 19, 2011) at www.gao.gov.

Availability of transportation funding under SAFETEA-LU extensions

Transportation remains as one of the two programs that Congress continues to fund at the Denali Commission. And that transportation funding for Denali arrives through the appropriations enacted for two other agencies: the Federal Transit Administration (FTA) and the Federal Highway Administration (FHWA).

A previous *Semiannual Report to the Congress* described a persistent uncertainty concerning the availability of Denali's funding identified in FTA's appropriations.²¹ OIG ultimately sought an authoritative determination from the comptroller general, who reached the following conclusion:

*Funds appropriated to FTA for the Denali Commission should be transferred to the Commission as a nonexpenditure transfer. FTA does not have an oversight role in administering the funds and should not delay transferring the funds in order to prepare an IAA [interagency agreement] to facilitate monitoring of their use. Funds become available to the Commission when Treasury transfers the funds to the Commission's account.*²²

Denali received just under \$5 million from FTA during FY 2011.

But uncertainty has now arisen concerning the availability of Denali's transportation funding that arrives through FHWA. Denali's agency head and FHWA apparently have differing interpretations as to the funding that Denali has a right to receive under recent congressional extensions of SAFETEA-LU (P.L. 111-147 and P.L. 112-5). A labyrinth of arcane funding laws must be reconciled to resolve this for both agencies, and Denali OIG has a pending request for a further determination from the comptroller general.²³

Board member waivers of their statutory compensation

Perhaps OIG's most unique request for a comptroller general determination concerns the ability of Denali's part-time board members to conserve resources by waiving their statutory compensation.

Section 306(a) of the agency's enabling act²⁴ provides in pertinent part as follows:

Each member of the Commission who is not an officer or employee of the Federal Government shall be compensated at a rate equal to the daily equivalent of the

²¹ See Denali OIG, *Semiannual Report to the Congress* (May 2010), pages 8-9, at www.denali-oig.org.

²² See GAO, *Denali Commission—Transfer of Funds Made Available through the Federal Transit Administration's Appropriations*, # B-319189 (Nov. 12, 2010) at www.gao.gov.

²³ See GAO, *Denali Commission—SAFETEA-LU Funding*, # B-322481 (pending for decision).

²⁴ See Denali Commission Act (P.L. 105-277), sec. 306(a).

annual rate of basic pay prescribed for level IV of the Executive Schedule under section 5315 of title 5, United States Code, for each day (including travel time) during the time such member is engaged in the performance of the duties of the Commission. . .

While this provision gives board members the right to be paid for their time, most of them (but not all) have historically offered to perform their services as volunteers and waive the statutory compensation. Most have full-time, compensated “day jobs” at their sending organizations, and a few have situations that may even legally bar outside compensation. In any event, anyone’s preference to *decline* government money would on its face seem to be public-spirited and uncontroversial.

But, as the lore suggests, no good deed seems to go unpunished in the federal bureaucracy. Based on informal consultation with GAO and well-established appropriations law,²⁵ the agency’s CFO has assumed for some time that the inflexible language of the enabling act requires the payments and prohibits their waiver.

On one hand, section 305(c) states that the agency “*may accept, use, and dispose of gifts or donations of services or property [emphasis added].*” On the other hand, the language of section 306(a) includes neither an explicit blessing of waivers nor any relief from the fixed level of pay (no words such as “up to,” “not more than,” or simply “may be compensated”).

However, we appreciate that the CFO needs to diplomatically defuse three landmines in this situation: (1) conflicts with well-meaning volunteers, (2) any spectre that she is flaunting Congress’ clear direction in the statute (perception of a forbidden “impoundment”²⁶), and (3) any test of the ethics regulation that requires federal employees to respect the tax laws.²⁷ She has thus in good faith attempted to signal her intent to obey the legal mandate by obligating the compensation in the agency’s accounting records, a form of “holding pattern” until the issue can be resolved with authoritative determinations — or Congress simply amends the enabling act.

Unfortunately, the short-term fix of an ever-increasing “reserve” of unpaid obligations, accrued expenses, and potential claims is problematic as a permanent solution. Ignoring the issue to keep the peace could be a Faustian bargain, given certain nuances of the tax laws.

While OIG has the duty to monitor the agency’s compliance with federal laws, OIG has over the years suggested some possible interpretations of section 306(a) that could offer management more flexibility. But the authoritative “safe harbor” in this situation is a published determination by the comptroller general,²⁸ which OIG has now requested.

²⁵ See GAO, *Principles of Federal Appropriations Law, Third Edition*, vol. II, pages 6-97 to 6-102, at www.gao.gov.

²⁶ See GAO, *Principles of Federal Appropriations Law, Third Edition*, vol. I, pages 1-32 to 1-35, at www.gao.gov.

²⁷ See 5 CFR 2635.809.

²⁸ See 31 USC 3526(d).

REQUESTED INSPECTION OF THE
AGENCY'S "PRIVATE ENTERPRISE POLICY"²⁹

Denali's agency head and counsel asked if OIG could take a hard look at the agency's "private enterprise policy." This is certainly fair game, given Congress' direction³⁰ that inspector generals do the following:

recommend policies for . . . relationships between such establishment and other Federal agencies, State and local governmental agencies, and nongovernmental entities with respect to (A) all matters relating to the promotion of economy and efficiency in the administration of . . . programs and operations administered or financed by such establishment . . .

The Denali Commission was scarcely a year old when a Member of Congress worked the "constituent casework" that triggered the agency's "private enterprise policy." A corporation complained that a proposed Denali grant was threatening its investment in a small town that wasn't big enough for two fuel retailers. On the other side, a local tribe sought to open a competing tank farm in hopes of lowering prices.

The dispute was a classic showdown over economic regulation, rather than actual competition for a grant. While the newborn Denali Commission was hardly equipped to regulate the economy, it nevertheless responded with the policy in question.³¹

The agency has over the past decade functioned as a congressional experiment — a form of northern field station — and its management should be commended for taking a critical look back at the "lesson learned" from its early policies.

A candid question, of course, deserves a candid answer. OIG has concluded that this is an instance of a little agency that tried to do too much for too many. OIG recommends that the agency head suspend the application of Denali's private enterprise policy for both new grants and the policing of old ones.

An agency's process for grants isn't subject to the formal rulemaking requirements of the Administrative Procedure Act. However, OIG still recommends that Denali use the *Federal Register* to alert the public of the agency's desire to revisit this issue. Denali should then contract

²⁹ This section of the *Semiannual Report to the Congress* constitutes OIG's interim public report on this issue (no separate report has been published). OIG's inspection has been conducted pursuant to the CIGIE professional standards for inspections.

³⁰ See Inspector General Act sec. 4(a)(4).

³¹ While bureaucrats understandably lack enthusiasm for "constituent casework," it's an important form of congressional oversight over federal agencies. The public may under-appreciate the wisdom of Solomon that a Member of Congress must apply in fielding a complaint over the distribution of grants. Informal congressional intervention is sometimes symptomatic that a grant-making agency needs a more sophisticated appeals process that decides competitor protests on a transparent record. Denali could potentially contract with a larger agency for the services of a hearing officer to decide such appeals.

with the experienced Federal Mediation and Conciliation Service (FMCS) to convene stakeholders in a process analogous to negotiated rulemaking.³²

In fact, OIG has itself retained FMCS to mediate a four-level conflict over a tank farm grant in which the parties are debating roles, working relationships, and the applicability of Denali's policies. This is an appropriate use of OIG resources under the Inspector General Act,³³ and we will use care not to frustrate the mediator's efforts by commenting on the matter at this time. To the extent that FMCS discloses any resulting settlements to OIG, the mediator understands that OIG plans to report that progress to the public in the next *Semiannual Report to the Congress*.

In the meantime, OIG recommends suspension of the private enterprise policy based on the following five concerns that appear on the face of the policy itself.

Concern 1: economic development versus economic regulation

Antitrust laws at both the federal and state levels discourage arrangements to restrict business competition, including attempts to block the entry of new competitors into the market. However, there are times when the government itself limits competition through complex regulatory systems that evaluate whether more providers, increased capacity, and price changes (rates) are in the public "interest," or "convenience," or "necessity." For instance, a regulator may allow only one utility company to serve a given area. The number of hospitals, or hospital beds, may be limited through a certificate of need. Only one broadcaster will be licensed for a given frequency.

The regulatory agencies that make such determinations do so through formal adjudicatory proceedings that weigh the economic analyses of financial experts. Well-known examples would be the Federal Energy Regulatory Commission, the Federal Communications Commission and, at the state level, utility commissions such as the Regulatory Commission of Alaska.

While Denali decisions obviously involve comparisons of the need in applicant communities, those decisions are not made by economic regulators. Subject matter experts on advisory committees work with Denali's handful of generalists in selecting the funded projects. But the private enterprise policy represents to the public that Denali has the more specialized capacity to evaluate whether a community needs more competition or lower prices:

Funding decisions must take into account existing private enterprise in the community. Funding should not generally be used to create new or additional competition with existing private enterprise in the community. However in cases where an unregulated monopolistic or otherwise inefficient condition exist in which current services are not available at fair and reasonable rates the

³² See www.fmcs.gov.

³³ See Inspector General Act sections 4(a)(4), 6(a)(9), 8G(g)(2).

Commission, after appropriate consultation, may consider funding projects that would contribute to more competitive rates. . .

The existing market share balance among retail fuel suppliers within a community may be significantly altered as a result of a Denali Commission funding only if all of the affected retail fuel suppliers currently operating in the community agree to it or if such alteration is deemed necessary to facilitate competitive conditions in the community. . .

In other words, the policy asserts that Denali will assess whether an existing monopoly (or oligarchy) should be protected, reinforced, or challenged through subsidized infrastructure. But Congress has given Denali neither the mandate nor the resources to perform this type of regulatory analysis. While economic development is certainly within the province of the agency,³⁴ crossing the line into economic regulation is not. To put it another way, grants are not tariffs.

Concern 2: the consequences of control

A major factor in business planning is the need to avoid, defend, and insure against lawsuits, an aspect of “risk management.” For private firms, this cost is factored into the prices charged to customers. However, Congress and legislatures protect the public treasury by limiting the extent to which the government can be sued for alleged wrongs (torts).

For instance, the Alaska Legislature has by statute³⁵ given state agencies immunity from suits when they are executing a “discretionary” function,” that is, planning and adjudicatory activities versus day-to-day operations.³⁶ The statute also immunizes state agencies from suits for “interference with contract rights.” The Alaska Legislature has also immunized local governments from suits based on “approvals,” as well as the performance of discretionary functions.³⁷

Congress and the federal courts have similarly given federal agencies a large dose of immunity. Federal agencies that make grants are not normally liable for any harm caused by their grantees, or by sub-grantees down the funding chain.³⁸ Nor can federal agencies normally be joined as

³⁴ See Denali Commission Act (P.L. 105-277), sec. 302.

³⁵ See Alaska Statutes sec. 09.50.250.

³⁶ See *Plancich v. State*, 693 P.2d 855 (Alaska 1985).

³⁷ See Alaska Statutes sec. 09.65.070(d)(2), (d)(3). If the state conditions its sub-award to a city on the latter’s appointment of the state as the city’s agent for a project’s construction, section 09.65.070(d) may potentially shield both entities. That subsection provides that “[a]n action for damages may not be brought against a municipality or any of its agents, officers, or employees if the claim . . .” (emphasis added).

³⁸ See *United States v. Orleans*, 425 U.S. 807 (1976); *Thompson v. United States*, 504 F. Supp. 1087 (D.S.D. 1980); *D.R. Smalley & Sons, Inc. v. United States*, 372 F.2d 505 (Ct. Cl. 1967).

parties with the state officials that are frequently sued under the federal civil rights law for interference with property rights.

However, the immunity of federal agencies can be compromised under certain circumstances. For instance, federal officials who join with state officials in misbehavior may be included when the latter are sued under the federal civil rights law.³⁹ And while rigorous monitoring of grants is desirable, immunity can disappear if the federal agency's zeal for compliance crosses the line into daily management of a grantee's operations. One training manual for federal grant officials puts it bluntly:

*When lines of authority and responsibility blur, the [grant] recipient may be viewed as an agent of the federal government, acting at its direction, thereby exposing the federal government to lawsuits for injury or wrongful action actually conducted by the recipient. When attorneys are seeking financial benefit, restitution, or to exact a penalty on behalf of their clients, they look for the deepest pockets, and the federal government has deeper pockets than any of its recipients. Remember, under grants the lines of responsibility are clear: the recipient is responsible for the conduct of the project. That is why the courts have held that federal grant sponsors are not liable for actions taken by recipients. . . .*⁴⁰

Denali should thus carefully consider any grant agreements or memoranda of understanding that label the recipient as Denali's "fiduciary agent," "partner," or similar designations that may erode federal immunity. While the federal government as a whole may have a very deep pocket, lawsuits can still seriously disrupt the day-to-day work of a tiny agency with less than 20 employees.

Regardless of Denali's private enterprise policy, the agency retains a continuing federal interest that allows it to reclaim a funded facility that ceases use for the intended public purpose.⁴¹ However, the policy in question goes farther and requires — for the life of the facility — that any change in tenants be blessed by Denali (or its successor). Denali should carefully consider the potential impact on federal immunity if it uses its private enterprise policy to justify intensive involvement in a grantee's business decisions during the decades after construction has been completed and the grant closed out.

Local leadership will obviously come and go over the years in the many settlements where Denali's grantees have made their sub-awards to construct specific facilities. Denali should be wary of mediating local disputes that request interventions such as lease cancellations or tenant lockouts ("taking the keys away"). Even if interventions that rise to the level of a de facto

³⁹ See *Merritt v. Mackey*, 827 F.2d 1368 (9th Cir. 1967).

⁴⁰ See Management Concepts Inc., *Cooperative Agreements and Substantial Involvement* (Vienna, Va., 2011) at page 3-6.

⁴¹ See Denali OIG, *Semiannual Report to the Congress* (May 2010), page 25, at www.denali-oig.org.

“receivership” might save a forgotten facility, the price tag for the federal rescue may include a loss of federal immunity.

Concern 3: the problem of perpetuity

Under Denali’s private enterprise policy, grantees are committed to operate the funded project for the rest of its natural life:

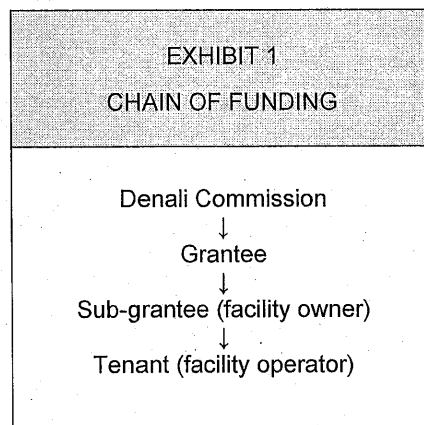
[T]o ensure that long-term benefits flow through to the public, such new or improved fuel storage and dispensing facilities will generally be owned by a local government entity which may lease the facilities to the private sector fuel supplier at a nominal cost or contract with the private sector fuel supplier for facility operation. The term of such lease or contract will be for the life of the assets, and is not transferable as an asset of the leaseholder without express written approval of the Denali Commission or its successor agency. [emphasis added]

Recording a notice of federal interest that promotes the intended use for a decade or so would seem a reasonable public expectation.⁴² However, the leases and business plans that grant applicants promise to Denali may commit them for 20, 40, or even 100 years. Given that such long-term agreements are made several levels below Denali in the chain of funding (see Exhibit 1), expecting Denali to police them in perpetuity does not seem realistic.

In fact, Denali has so far not adopted some significant tools that OMB has offered agencies over the years to strengthen their enforcement of grant conditions. For instance, OMB has recommended that agencies adopt a codified “common rule” of grant requirements, a “compliance supplement” of expected audit procedures, a process for identifying grantees as “high risk,” and a regulation for “debarment” of the unfit from future awards. Such tools could assist Denali in monitoring the long-term use of funded facilities.

While tough conditions may be tough to enforce, they may still have symbolic value in overcoming the cynical public lore of an “entitlement culture” that abuses funded facilities and then demands replacements from the American taxpayer. The more likely scenario is that the original need for a facility will quietly fade away with the arrival of new technology or the departure of a remote population — like the ghost towns left along the way as the Lower 48 expanded westward.

Diesel fuel may be the best solution for the moment in much of bush Alaska. However, a “private enterprise policy” that locks this costly technology in place may represent promises made to be broken. The same generation of Alaskans has seen the disappearance of the DEW



⁴² See Denali OIG, *Semiannual Report to the Congress* (May 2010), page 25, at www.denali-oig.org.

line and fallout shelters, followed by the arrival of cell phones, laptops, GPS, and the Internet. A Denali policy that protects existing providers from new competition may also frustrate the local incentives to offer new breakthroughs for old problems.

A sensitive issue is the private enterprise policy's passing references to "*the Denali Commission or its successor agency*." Given the steady congressional decrease in both the scope and funding of Denali's programs, the optimistic time horizons of the private enterprise policy strain meaningful commitments. Equally unrealistic is the assumption that any inheriting "successor agency" will aggressively police small grants that were closed out decades ago in remote places served by an agency that no longer exists.

Concern 4: the problem of participation

The private enterprise policy emphasizes a perspective that existing businesses should be protected from the displacement that can result from subsidies to new competitors. However, the policy fails to address the corollary that government funding should not displace the mechanisms through which private enterprise has historically been expected to finance its own development.

While Denali certainly serves very impoverished hamlets that lack alternatives for private funding, there is a wide spectrum in the degree of affluence across the geography of Alaska. Denali continuously grapples with differing public perceptions as to whether Congress envisions a focus on the state's "third world" bush poverty or, rather, on the broader goal of universalization of basic "infrastructure" for all Americans, no matter where they live.

For example, under the latter assumption, Denali may serve Alaskan communities with concentrations of pensioned retirees, weekend homes, or seasonal tourists (cruise ships, national parks).

Since the federal government is itself the largest employer in the state, there is a further issue as to the degree that Congress

EXHIBIT 2 TRADITIONAL NON-DENALI FUNDING POSSIBILITIES FOR PRIVATE DEVELOPMENT
Special assessments during property taxation
Taxes levied by special use districts
Homeowner association assessments
Subdivision fees during initial platting
User fees for local services
Loan guarantees
Federal facility impact payments in lieu of taxes
Remediation costs at closed federal sites
Historical preservation grants
Neighborhood "barn-raising" with in-kind
Neighborhood pooling of permanent fund dividends
Alaska Municipal Bond Bank Authority
Alaska Industrial Development & Export Authority

should pay for the local impacts — past and present — of federal facilities that dominate adjacent communities. Military sites, environmental remediation, and popular national parks all present this situation. Such non-Denali impacts should be addressed through the appropriations of other federal agencies — behemoths that dwarf the Denali Commission in the federal system.

Denali's private enterprise policy emphasizes preservation of the first business on the scene, that is, respect for the needs of existing businesses to avoid displacement by Denali. But the policy under-emphasizes the equally important question as to whether other resources are available to displace the need for Denali subsidies in the first place. Funding through any of the traditional *non-Denali* alternatives in Exhibit 2 may be a possibility in some communities.

Concern 5: the challenge of serviceable size

One of Denali's most difficult and uncomfortable issues has always been the size of community that warrants public support (versus self-support). While national lore may abstractly decry construction to "nowhere," the choices are very real — and very serious — for rural families in remote places that must go without what most of America takes for granted.

Denali's private enterprise policy was a product of its early optimism. The agency's original strategic plan idealistically aspired that "[a]ll Alaska, *no matter how isolated*, will have the physical infrastructure necessary to protect health and safety and to support self sustaining economic development [*emphasis added*]."

The private enterprise policy implicitly assumes that the key issue is whether an existing business should be grandfathered as the single provider in a small settlement — whether there's room enough in town for two of something. And OIG's reports over the years have indeed noted Denali's serious efforts to fund facilities in remote places with less than 200 people.

For instance, OIG's *Semiannual Report to Congress* (May 2010) found that 43 of the 139 projects in Denali's transportation program had been for improvements in locations with a population of less than 200 (examples were Elfin Cove and False Pass, pop. 30 and 39).

The same report listed 13 power plants and tank farms that Denali had installed in hamlets with a population of 100 or less (examples were Lime Village and Nikolski, est. pop. of 28 and 31). OIG further listed eight clinics built in places with a population of 100 or less (examples were Alatna and Beaver, pop. of 41 and 64).

In the same report to Congress, OIG further noted that Denali's program for rural electrification (power plants and tank farms) sent most of its funding to a state agency and a utility cooperative that served only a fraction of the state's population. For instance, the cooperative served around 50 of the most challenging locations that together represented less than 4% of Alaska's population.

But the policy's paradigm of grandfathered providers doesn't fit current federal realities. Denali is now in the process of retooling itself to emphasize the "coordination" of funding, rather than its distribution. Support for the economies of scale from enhanced arrangements in Alaska's regional hubs regional hubs may be the best that Denali can offer with its diminished appropriations.⁴³

In short, while Denali's private enterprise policy no doubt seemed like a good idea at the time (a decade ago), the policy has now outlived its usefulness.

EPILOGUE

Congress has sent mixed messages over the years as to what it expects Denali to accomplish. To the extent that the goal has been universalization of the nation's "infrastructure," Denali's counts of construction in the colorful bar charts of its home page may be a fair performance measure.

In contrast, proof that life is good remains elusive if Congress intends the "Other Alaska" to vanish from the ranks of the "Other America" (which inspired creation of regional commissions in the first place). Those mixed messages continue to frustrate Denali's development of performance measures, that is, management's ability to measure like they mean it.

A sidebar in OIG's *Semiannual Report to Congress* (May 2010) detailed the continuing uncertainty over outcomes as "key questions from Denali's decade and a billion." The answers remain uncertain in the public conversation, and that chart is repeated here verbatim as Exhibit 3.

EXHIBIT 3 KEY QUESTIONS FROM DENALI'S DECADE AND A BILLION

Are better clinic buildings resulting in better health care?

Are Denali-provided power plants resulting in cheaper "bush" electricity?

Are Denali-provided tank farms resulting in cheaper "bush" fuel?

Is training for construction projects resulting in long-term careers?

Are Denali-provided facilities reducing — versus extending — the dependence on future federal funding?

Has Denali pioneered "silver bullet" solutions applicable to other states?

Do projects function as capacity-building "barn raisings" (versus mere short-term cash infusions)?

Has Denali leveraged rural schools as the major local facility?

Has Denali effectively partnered with the military as the state's largest employer?

Has Denali effectively leveraged federal single audits as a grants monitoring tool?

Has Denali strengthened regional hubs as an alternative to urban migration?

Has Denali pioneered interventions for troubled projects (versus just adding money)?

Is Denali helping coastal communities benefit from the opening of new arctic shipping routes?

Have Denali projects preserved "priceless" qualities of Alaska that are valued by the rest of the nation?

⁴³ See Denali OIG, *Semiannual Report to the Congress* (May 2010), pages 15, 19, at www.denali-oig.org.

Denali's management has consistently and persistently argued (1) the great need in bush Alaska, (2) the tough logistics of building out there, and (3) the tougher challenge of continuing to do it when Congress no longer sends the money. Management's public report on *Sustainable Rural Communities in Alaska*⁴⁴ is an excellent discussion of the complications of extending America's basic facilities into rural Alaska. That publication shows Denali's maturing role in Alaska "government coordination" — the diplomatic magic of applying Denali's lessons-learned to help better funded agencies do their best in the bush.

Nevertheless, while Denali's management has more effectively told its story in recent years, Congress has still decided to send its money elsewhere.

Since Denali's new funding has effectively declined to approximately its startup level, Congress may simply be signaling that the experiment has run its life cycle and shouldn't expect perpetual appropriations. If that be the case, Congress should leave Denali with the unmistakable statutory authority to diversify its funding from nonfederal sources and from reimbursement for services to other agencies. In short, if Congress decides from a policy perspective not to fund the Denali Commission, Congress should equip the agency with the legal ability to fend for itself.

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DENALI COMMISSION

⁴⁴ See Denali Commission, *Sustainable Rural Communities in Alaska*, Parts I and II (July 2010, June 2011), published online at www.denali.gov (link to "government coordination").