

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



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SUMMARY OF: A Special Report on the Department of Environmental Conservation, Division of Water, Village Safe Water Program, December 5, 2007.

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted an audit of the Village Safe Water Program (VSW) administered by the Department of Environmental Conservation (DEC).

The objectives of the report fall into two categories. The first category involves how the VSW program distributes grant funding to various communities served by the program. Objectives include: (1) assessing the reasonableness of the criteria used to identify and scale sanitation projects for various communities; (2) reviewing how funding priorities are established for construction grant funding; (3) assessing how well the program has done in communicating ranking and assessment criteria to communities seeking grant funding.

The second category of objectives involves reviewing and assessing the changes made by DEC in how the VSW program is administered. Changes have been made primarily in response to a November 2003 Legislative Audit report and concerns by federal funding agencies. Objectives include: (1) assessing the effectiveness of newly established controls over project construction costs; and (2) the impact over how administrative costs being charged to outstanding projects will have on the final cost and design.

REPORT CONCLUSIONS

- Systems selected for communities are consistent with both established DEC criteria and legislative intent.
- Construction and financial controls have improved in recent years, but minor exceptions persist.
- Ranking of applications for construction grant funding is consistent with established criteria.
- VSW program managers did a good job of communicating the changes made to construction grant criteria to affected communities.

- Use of the Rural Utility Business Advisor (RUBA) evaluation process has delayed starting projects already appropriated, and is preventing some rural communities from submitting grant applications.
- VSW's retroactive assessments of administrative costs on past projects and, more significantly, construction material cost increases have an impact on the scope and nature of already appropriated projects.

FINDINGS AND RECOMMENDATIONS

1. The legislature should consider clarifying the eligibility requirements for the Village Safe Water (VSW) in order to better target funding.

The VSW program has historically been used as the primary conduit for funding directed to improve the sanitation conditions in Alaska's remote rural, primarily Native communities. In recent years, the VSW program has provided construction grants for communities that do not fit this profile.

The program has begun receiving interest and applications from neighborhood subdivision organizations or nonprofit corporations representing a group of households rather than being affiliated with a local governing body. VSW managers report they have dealt with organizations that have been specifically formed to apply for sanitation grants. Although managers are uneasy whether such communities meet the central intent of the VSW program, they have been advised by the Department of Law (DOL) that such organizations are eligible for grant funding.

2. DEC's Division of Water Facilities Program Manager should ensure that project application files are complete and provide fully documented support for inclusion the VSW budget request.
3. Managers of the VSW program should require communities to receive a successful utility business assessment as a condition for applying for a construction grant.

VSW requires communities to successfully complete a RUBA assessment prior to releasing appropriated funds necessary to start construction. Currently, there are 17 communities, involving 22 separate appropriations totaling over \$44.7 million, with projects on hold awaiting successful completion of a RUBA essential indication assessment.

We recommend VSW management require a successful RUBA assessment as a condition of applying for a construction grant. Such a requirement would avoid situations where funding is held up over multiple construction seasons and would provide greater assurance the community is administratively capable of sustainably operating the newly built system.

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December 5, 2007

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF ENVIRONMENTAL CONSERVATION
DIVISION OF WATER
VILLAGE SAFE WATER PROGRAM

December 5, 2007

18-30042-08

We reviewed the Department of Environmental Conservation in the construction of water and sewer systems through the Village Safe Water program. The primary emphasis of our review was to assess the procedures followed by program managers in evaluating and ranking applications for construction grant funding. A second objective involved assessing the current status of findings and recommendations made in a prior audit of the program completed in November 2003 (audit control no. 18-30028-04).

The audit was conducted in accordance with generally accepted government audit standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology section.

A handwritten signature in black ink, appearing to read "Pat Davidson".

Pat Davidson, CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

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1. Assessing the reasonableness of the criteria used to identify and scale sanitation projects for various communities;
2. Reviewing how funding priorities are established for construction grant funding; and,
3. Assessing how well the program has done in communicating ranking and assessment criteria to communities seeking grant funding.

The second category of objectives involves reviewing and assessing the changes made by DEC in how the VSW program is administered. Changes have been made primarily in response to a November 2003 Legislative Audit report and concerns by federal funding agencies. Objectives include:

1. Assessing the effectiveness of newly established controls over project construction costs; and,
2. The impact over how administrative costs being charged to outstanding projects will have on the final cost and design.

Scope and Methodology

While VSW staff is ultimately responsible for the oversight of sanitary project appropriations, the day-to-day active oversight of many projects is carried out by the Alaska Native Tribal Health Consortium (ANTHC). The role and background of this organization is discussed further in the Organization and Function section.

When we assessed various controls related to construction oversight of VSW projects, we focused primarily on controls in place at DEC. For some controls, our analysis and evaluation included projects supervised by ANTHC. In other instances, our evaluation was limited to improvements made to systems related only to the projects supervised directly by VSW engineers.

In order to meet the various objectives of the audit, our fieldwork included:

- Analysis of departmental and division policies and procedures related to procurement of goods and services. This was done to evaluate if procurement deficiencies discussed in our prior audit report had been addressed through the adoption and implementation of improved procedures.
- Review of statutes related to the purpose of the program and the eligibility requirements. Since eligibility standards for VSW grants originate in state law, it was necessary to review and understand the program's statutes. This permitted us to evaluate if the criteria used by VSW managers was consistent with the precepts set out in statute.
- Review of the Memorandum of Understanding (MOU) between DEC and the two major federal funding agencies involved, the U.S. Department of Agriculture, and the Environmental Protection Agency. This document sets out measures of program performance, how funding is to be allocated, and what costs are allowable under the terms of the federal programs. This review provided a better understanding of basic program controls required by the federal agencies involved and allowed for consideration of these requirements when evaluating the basis and support for program expenditures.
- Interviews with personnel from the Division of Water; Division of Information and Administrative Services; Department of Community and Economic Development, Division of Community and Regional Affairs; Environmental Protection Agency; and U.S. Department of Agriculture-Rural Development. The interviews provided additional perspective on various aspects of how the VSW program is administered. Additionally, we better understood how the rural utility business assistance program functions and how various aspects of that program affects VSW decision making.
- Review of the MOU between DEC and ANTHC related to supervision of various VSW sanitation projects. We did this to better understand the role ANTHC plays in supervising more than 50 active projects in Alaska.
- Analysis of application files for both planning and construction grants. For the applications received for funding in FY 06 and FY 07, we selected a sample and compared the documentation submitted to the ranking criteria used to establish funding priorities and budget requests. Applications for projects that eventually were supervised either directly by VSW or indirectly through ANTHC were both included. This review allowed us to confirm that VSW program managers were consistently applying the ranking criteria established for assigning priority for inclusion in the department's budget request.
- Evaluation of documents used to support expenditures charged to various construction projects. For a sample of transactions charged to projects in either FY 06 or FY 07, we evaluated the underlying documentation to determine if expenditures were reasonable and allowable under federal funding guidelines. This review also allowed us to assess the

improvements made in how invoiced expenditures were reviewed and approved since DEC assumed responsibility for processing invoices. Expenditures related to projects supervised by ANTHC were included.

- Examination of personnel and payroll records for six projects active during the 2007 construction season. We evaluated these records to determine if payroll charges were reasonable and appropriately supported. Examination of the personnel and hiring records confirmed sufficient employment information had been obtained and kept on file. Another objective of this evaluation was to assess if the controls over payroll processing and labor costs charged to projects had improved since our prior audit in November 2003. We did not review personnel or payroll recordkeeping related to projects supervised by ANTHC.
- Examination of evidence to confirm the appropriateness of procurement procedures followed by construction management firms and project superintendents when obtaining project goods and services. We selected a sample of 25 procurements related to expenditure transactions charged to projects during FY 06 or FY 07. We also reviewed four procurement processes for professional services conducted by VSW in either FY 06 or FY 07. This review assessed the consistency to which preferred, competitive procurement practices were followed by both VSW and agency contractors. Procurement activity carried out by ANTHC for projects supervised by that organization was not reviewed.
- Conducting a survey of communities who submitted construction grant application(s) since FY 04 and consultant engineering firms who assisted communities in the completion of the applications. The survey results provided perspective on how well communities seeking grant funding for VSW projects understood the criteria used to evaluate and rank projects for funding. Communities that received appropriations, whether or not the community's project was supervised directly by VSW or through ANTHC, were included in the survey.

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ORGANIZATION AND FUNCTION

In 1970, the Village Safe Water Act established under Alaska Statute (AS) 46.07 created the Village Safe Water (VSW) program. The Act established “*a program designed to provide safe water and hygienic sewage disposal facilities in villages in the state.*” An eligible village is defined as “*an unincorporated community that has between 25 and 600 people residing within a two-mile radius, a second class city, or a first class city with no more than 600 residents.*”¹

The VSW program was originally administered by the State Department of Health and Welfare but was later transferred to the Department of Environmental Conservation (DEC). The program is currently administered under a separate section within the DEC’s Division of Water.

VSW’s field engineers, financial support staff, procurement specialist, and grants administrator are stationed in DEC’s Anchorage office. The field engineering staff consists of eight engineers, two engineering associates, and one college intern. The VSW program manager, who is assisted by a lead engineer, also works out of DEC’s Anchorage office. The oversight of the VSW program is the responsibility of the facilities program manager, located in Anchorage, with the assistance of a planner from DEC’s Juneau office.

The majority of VSW’s funding is through federal grants from the U.S. Environmental Protection Agency, U.S. Department of Agriculture, Alaska Native Tribal Health Consortium, and Denali Commission. Alaska legislative appropriations for capital budgets provide the remaining funding.

For most VSW construction projects, the workforce is drawn from residents of the community where the sanitation system is being built. This is termed a force account arrangement in the public construction field. A majority of the oversight of the projects is performed by construction management firms and only a couple of projects utilize a superintendent.

Once the legislature has appropriated funds for a specific project, those funds technically belong to the receiving community. However, DEC holds the grant funds “in trust” for each project community.

Alaska Native Tribal Health Consortium

A large segment of the VSW program is carried out through the auspices of the Alaska Native Tribal Health Consortium (ANTHC). The organization was formed in December 1997 to manage statewide health services for Alaska Natives. Alaska Natives, through their tribal governments and regional nonprofit organizations, own the Consortium. ANTHC is one of

¹ AS 46.07.080(2).

22 co-signers of the Alaska Tribal Health Compact, a self-governance agreement with the federal Indian Health Service.

ANTHC employs approximately 1,800 people and had an operating budget of \$322 million in FY 06. ANTHC offers statewide services in specialty medical care, water and sanitation, community health and research, information technology, and professional recruiting.

The Division of Environmental Health and Engineering, ANTHC's second-largest division, provides project management, engineering, construction, and operations support of public health infrastructure in Native communities throughout Alaska.

BACKGROUND INFORMATION

The Village Safe Water (VSW) enabling statute (AS 46.07) authorizes construction of water and sewer systems in the State's villages. The statute defines a village as "an *unincorporated community that has between 25 and 600 people residing within a two-mile radius, a second class city, or a first class city with not more than 600 residents.*"²

Though the Department of Environmental Conservation (DEC) has traditionally focused on sanitation projects in rural Alaskan communities off of the road system, the statute is silent as to any priority among eligible villages or communities. The primary vehicle for implementing the VSW program has been through use of grants to build appropriate, operationally sustainable, water and sewer projects. Grants have been funded by a combination of state and federal funds.

VSW operating procedures have often been driven by policy to promote sense of ownership

Historically, two central principles have had an ongoing impact on how the VSW program has been administered. The first principle involves the role which inadequate water and waste disposal systems, collectively referred to as sanitation systems, have on the public health of many of Alaska's remote, rural communities. These concerns have contributed to both federal and state governments making a substantial funding commitment to the VSW program.

The second principle involves building sanitation systems in such way as to promote a sense of ownership on the part of the communities. This central principle is repeatedly reflected in how VSW management has chosen to administer the program. In particular, this sense of ownership principle has an impact on:

1. How projects are prioritized and selected for funding;
2. What type of project is selected as appropriate for a given community. There is concern to match the cost and scale of the project to a community's capacity to fund and operationally maintain a selected project;
3. How appropriated funds are released for beginning construction;
4. How the funds are accounted for during the construction process; and,
5. How construction projects are managed on a day-to-day basis.

² AS 46.07.080(2).

As the VSW program matured, and increased funding became available from the federal government, many of the administrative choices made based on this core principle have been restructured. This has been done in order to strengthen fiscal oversight over grant funds, while limiting the impact they might have on the ownership principle.

The VSW program makes two types of grants – planning, and design and construction

The VSW program has two categories of grants. Eligible communities wanting to build a sanitation system can apply for a planning grant. Such funding is used to conduct a needs assessment and allow the communities to explore the possible options available to address those needs. Compared to grants for design and construction, these grants are relatively modest, ranging from \$25,000 to \$250,000 in recent years.

The second type of grant involves the funding for design and construction of a sanitation system best suited to meet the sanitation needs of the community. This phase involves the largest funding commitment. The average appropriation in FY 07 for VSW sanitation projects was over \$2.9 million.

Communities seeking first time funding for new systems given priority for planning grants

The criteria used to evaluate and rank applications for planning grants has remained relatively constant from year to year. As set out in Exhibit 1, on the following page, the evaluation criteria used in FY 07 compared to that applied in FY 05 was rescaled, while much of the emphasis remained the same. In both years, points were structured in such a way to give priority to:

1. Communities seeking first time planning funds,
2. New water and sewer systems, rather than upgrading existing facilities; and,
3. Communities who had not received previous federal or state funding for planning.

Key part of planning phase is to match local community capacity and project scope

Communities request funding from VSW in order to document their sanitation needs by completing a feasibility study/master plan. VSW assists the community with procuring and contracting a consulting firm to perform the project planning. During the planning effort, significant communication occurs between VSW, the consultant, and the community in identifying, evaluating, and selecting water and sewer improvement alternatives for the community.

Exhibit 1

Two Examples of Planning Grant Application Scoring Criteria Used in Recent Years

		FY 05 Criteria		FY 07 Criteria	
		Points	Pct.	Points	Pct.
Type of Study		100	15.4%	<i>This FY 05 factor was folded in the Planning Project Need factor below beginning in FY 06.</i>	
Feasibility study or facility plan	100				
Sanitation utility comprehensive study	50				
Planning Project Need				100	20%
Original Sanitation Facilities Plan	100				
Study for an "essential" improvement	75				
Rehabilitation Plan for aging system	50				
Update an obsolete plan	0				
Type of System		100	15.4%	100	20%
Water and/or Sewer Facility	100				
Other Sanitation Facility (FY 05 only)	25				
Solid Waste (FY 07 only)	0				
Purpose of Plan or Study		100	15.4%	<i>This concept of this factor was blended in the Community Development Status criterion beginning in FY 06.</i>	
New System	100				
New level of sanitation service	75				
Upgrade or replace existing system	50				
Community Development Status		100	15.4%	100	20%
25% or less in community presently served	100				
25-50% in community presently served	75				
50-75% in community presently served	50				
More than 75% in community served	25				
25-75% have existing service (FY 07)	75				
More than 75% existing service (FY 07)	50				
Past Federal or State Funding		100	15.4%	100	20%
No planning funding within last 7 years	100				
No planning funding within last 5 years	50				
Funding Received within last 5 years	0				
No planning funding within last 5 years (FY 07)	100				
Previous Planning Documentation		100	15.4%	<i>This factor was incorporated into the overall Past Federal or State Funding above beginning in FY 06</i>	
Never completed a study or plan	100				
No study/ plan of similar scope previously done	50				
Study or plan will update existing study/plan	25				
City Council Resolution		50	7.6%	<i>Factor made part of application quality factor in subsequent years</i>	
Application Quality		<i>Not a specific factor prior to FY 06</i>		100	20%
Total Maximum Points		650	100%	500	100%

Whether the community received planning funds from VSW or another source, the scope of any subsequent funding requests for design and construction must be included in an approved Sanitation Facilities Master Plan.³

For villages seeking first time construction funding, a significant part of the planning process is determining the financial capacity of the community to develop sufficient revenues to cover operation costs for the system selected. An important use of planning funding is to develop a cost estimate for the project selected. Typically, this process requires the community to work with its planning consultant and VSW to choose from four options. Stated in order of construction/operating cost, these options are:

1. Washeteria Model – a single, centralized building in the community, which houses showers, laundry facilities, and toilet facilities, is constructed;
2. Flush and Haul – a system involving a combination of water storage and sewage collection tanks at each residence combined with tank vehicles, either trailer or truck, for transport to/from a watering point or to a sewage disposal lagoon.
3. Septic Tanks and Wells – a system where stand-alone wells and septic tanks are put in place for a residence or group of residences.
4. Piped System – the standard water/sewer setup in the State’s more developed urban areas where water is piped into the residence and sewage is piped out for central treatment.

As part of the village’s master planning process, current conditions are assessed, alternatives are evaluated, and costs are identified. In addition to capital costs, a business plan is developed which details the projected operating revenues and expenses. The VSW project engineer and VSW planner work with the consultant and community during the development of the plan, and may recommend changes necessary for plan approval.

The planner compares the capital and operating costs of the selected system or phased improvements with historical data of similar type and location. The capital cost of \$200,000 per household and a user fee based on 5 percent of median household income are rules of thumb presently used for evaluating affordability and sustainability in determining approval.

To prioritized funding, grant applications are scored using criteria that reflect policy goals

Seventy-five percent of the funding provided for VSW construction grants comes from federal agencies, primarily the Environmental Protection Agency or the U.S. Department of Agriculture.

³ Starting in FY 07, a current and approved plan or study is needed if the amount of the request and all remaining needs was for \$3 million or more. In FY 08, the dollar threshold was reduced to \$2 million. Typically, communities requesting funds less than \$2 million are not for new systems, but components of a system already built. An example would be system upgrades made necessary due to regulatory changes.

Accordingly, VSW sets its overall budget request based on the amount of federal funding available. In recent years, the legislature has provided the 25 percent required matching appropriation from the State's general fund.

The projects included in the annual capital appropriation have been those included in DEC's proposed capital budget.

Demand for funding exceeds available funds, as illustrated in Exhibit 6 on page 28. Accordingly, VSW managers have developed criteria used to evaluate and rank applications for funding. Different sets of criteria are used for planning grants as compared to design and construction grant applications. DEC scoring criteria serve to reflect operational priorities and are designed to provide incentives for communities to conform to established policy.

The selection of factors and how they are weighted is developed through internal policy discussions. VSW consults with federal funding partner agencies in setting the criteria for evaluating applications. Many of the factors reflect the legislative intent that accompanied the FY 06 capital appropriation, as illustrated in Exhibit 2.

Public health factors and local capacity are key factors in evaluating grant applications

In past years, the two primary criteria used to evaluate applications reflected the two central principles that have historically guided VSW operations: addressing public health concerns, and fostering a sense of ownership.

Public health has been the central public policy concern behind the widespread support of the VSW program. In past years, proposed projects that address identified major threats to public health scored higher in the funding application process. In FY 06, this public health emphasis was slightly redirected in the ranking criteria. Rather than tying scoring to specific, documented health events, the department placed emphasis on projects having an overall positive health impact.

This shift in how public health factors were integrated into the application review process reflected studies that concluded a community's general, day-to-day health was consistently

Exhibit 2

Legislative Intent Reflects Central Tenets of the VSW Program

In a statement of legislative intent included with the FY 06 capital budget appropriation, the legislature ratified many of the policies that have historically guided VSW operations. Excerpts from the intent are as follows:

It is the intent of the Legislature that the Department of Environmental Conservation (DEC) will establish guidelines for deciding whether proposed project costs are reasonable and whether proposed projects are sustainable; ensure that projects are limited to systems that are reasonable and sustainable; and exercise final decision authority as to project costs and the types and extent of projects to be constructed.

...

It is the intent of the Legislature that DEC will encourage development of local ordinances that enhance the establishment and collection of user fees which are adequate to pay for the sustained operation of facilities constructed by the program.

better with reliable access to potable water. Accordingly, the emphasis on public health was reflected in the increased weighting assigned to first time service to homes.

As shown in Exhibit 3, on the following page, this criterion became 35 percent of the scoring. Under this rating system, applications involving first time service to homes were accorded higher priority than applications related to upgrading existing service or addressing regulatory compliance exceptions. Criteria that reflect a community's willingness and capability to operate and maintain a facility has remained critical to how a project is prioritized. Referred to as local capacity, evaluative criteria involves such things as the community being able to demonstrate it has the technical and administrative expertise in place to maintain the sanitation project after construction is complete.

For example, a community's application is scored higher if it can demonstrate it has residents that have received training sufficient to keep the system operating. Likewise, a community's application will score higher with demonstrated administrative expertise such as having a trained utility manager and being able to show it has or can develop a business model capable of collecting adequate revenues to maintain and operate the sanitation system. As shown in Exhibit 3, this factor remains at least 40 percent of an application's score, the largest single category for accumulating ranking points.

Construction logistics also play a factor in the score assigned to a project. If the project can be coordinated with other construction that might be going on in the community or if the project provides for consolidation of the sanitation system with other existing systems in the community, the project can receive up to 17.5 percent of the maximum total of available evaluation points.

Rural Utility Business Advisor (RUBA) assessment plays a critical role for communities

The RUBA program is administered by the Department of Commerce, Community, and Economic Development (DCCED). The program assists communities in developing the business skills necessary to run a successful, smaller scale local utility. The program provides training and technical assistance necessary to carry out such fundamentals as, setting rates for services, collecting billings, and making the necessary payroll tax payments. The program gives priority to communities currently having a sanitation system built or is in line to receive funding for new or expanded sanitation system.

Exhibit 3

Two Examples of Construction Grant Application Scoring Criteria Used in Recent Years

	FY 05 Criteria		FY 07 Criteria	
	Points	Pct.	Points	Pct.
Public Health up to a maximum of	300	14.1%	<i>Public health criteria was shifted from being related to specific disease or pollution event into overall health benefits provided by 1st time service to homes below...</i>	
Documented disease event	300			
Potential for disease event	200			
Potential for pollution event	100			
First time service to homes (overall health impact)	200	9.4%	350	35.0%
Project necessary is a subsequent phase to complete already started project	100			
Local capacity factors Points given for certified trained workers, capacity to handle administrative tasks necessary to generate funding to cover operational costs.	900	42.4%	400	40.0%
Project part of state master plan	50	2.4%	<i>Beginning in FY 06, this factor was made a mandatory requirement rather than just ranking item.</i>	
Other project funding is available for use	175	8.2%	<i>Phased out as a factor</i>	
Project can be coordinated with other construction	100	4.7%	75	7.5%
Project will consolidate system with other community systems such as school	200	9.4%	100	10.0%
Economic Feasibility factors	200	9.4%	<i>Phased out as factor, although some precepts incorporated into application quality criterion</i>	
Application Quality	<i>Not a specific factor prior to FY 06</i>		75	7.5%
Total Maximum Points	2,125	100%	1,000	100%

A key part of RUBA’s assistance involves what is termed as an assessment. An assessment involves a documented and structured evaluation of the various operational indicators related to the business of operating a utility. RUBA’s management assessment process identifies what the agency terms essential and sustainable capacity indicators to help identify the technical, managerial, and financial capacity of rural utilities. Essential indicators are defined as those items that are critical for continued operation of the utility. If not accomplished, RUBA projects the utility would fail within three years. Sustainable indicators include factors that are critical to the long-term survival of the local utility.

Under VSW’s construction funding eligibility requirements, if a community has had an assessment performed, they must satisfactorily meet all essential indicators before being even submitting an application. If a community has never had a RUBA assessment performed, it is allowed to follow through with its application, but will have to successfully pass a RUBA assessment before any appropriated construction-related funding is released. Seven

construction projects, with a total of \$13.3 million in appropriations made between FY 01 and FY 03, have not yet been started because communities involved cannot meet RUBA assessment requirements.

In recent years, DEC has made three key changes in how it supervises construction projects

Alaska Statute 46.07.040 authorizes DEC “to provide for the construction by contract or through grants to public agencies or private nonprofit organizations, or otherwise.” The statute further provides that “*workers from the village in which the facility is being constructed shall be utilized to the maximum extent feasible [emphasis added].*”

In 2003, VSW management was supervising construction for most of the sanitation projects under their oversight, using what is termed as the superintendent model. Under this approach, the community receiving the project was primarily responsible for contracting the day-to-day project construction oversight. VSW engineers played a limited role in how superintendents were selected, compensated, and in determining the contractual scope of their duties.

A major reason such an approach was used was to promote the sense of community ownership. Additionally, use of superintendents hired by the village was often seen as a way to maximize the use of “*workers from the village*” as required by state law. However, this approach contributed to weak oversight of projects by VSW engineers. Many of the deficiencies discussed in our agency’s prior audit report⁴ stemmed from the control weaknesses inherent in the superintendent model as it had evolved in recent years.

DEC management made three major operational changes to improve controls over construction project administration. The changes involved:

1. Shifting away from the superintendent model to the construction management model. The village driven superintendent model has been increasingly deemphasized and has been replaced with a more state-agency directed construction management firm model. Rather than allowing or encouraging local communities to select the superintendent to supervise construction, VSW engineers now play a larger role in the selection of construction management (CM) firms.

These CM firms, typically professional engineering firms, have often been involved with the local community during the planning phase of a sanitation project. During the 2006 construction season, there were seventeen independent superintendents working on projects involving VSW engineer oversight. For the 2007 construction season there were only two. VSW managers expect there will be no superintendent model projects for construction they oversee during the next construction season.

2. Development of a more comprehensive standard services contract. In conjunction with changing the model used to supervise project construction, VSW developed a better, more standardized professional services contract for use when dealing with CM firms.

⁴ Division of Legislative Audit report #18-30028-04 dated November 19, 2003.

VSW management cites the development of standard contract terms, detailed, consistent labor rates, and established billing provisions, all as benefits of the new and improved contract.

3. Invoice processing was brought within DEC. A third improvement in controls involved using departmental personnel to supervise and carry out the day-to-day accounting for various projects. This change placed invoice processing in the hands of administrative staff more familiar with cost restrictions attached to federal funding. While the primary oversight responsibility for approving the costs charged to various projects rest with the VSW engineer, state administrative staff better acquainted with federal funding rules provide improved fiscal support. This change helps avoid questioned costs, a significant concern for a program receiving 75 percent federal funding.

To a degree, these changes represent a subtle shift away from the fostering ownership principle. However, the changes were not substantially counterproductive to this core VSW operating principle.

The way administrative costs are budgeted and accounted for has changed in recent years

The budgeting and charging of administrative costs involved with administering VSW construction projects has changed in recent years. Prior to FY 06, DEC received a separate capital appropriation each year to fund the estimated costs of administering all the capital projects appropriated during the same budget year. DEC staff report the budget estimate was based on anticipated costs involved in administering the projects for one year. Since the funding provided was in a capital appropriation, if there was a balance in the administration cost appropriation, it could be carried over from one budget year to the next.

However, there still remains some construction activity related to project appropriations made in the prior years. Accordingly, DEC management has opted to place a retroactive 10 percent administrative allocation against projects appropriated prior to FY 06.

Beginning in FY 06, estimated administrative costs were included in each separate project's funding request, rather than being isolated in a single administrative budget component. This change in how administrative costs were budgeted and accounted for was done primarily at the request of federal funding agencies, who believed such an approach enhanced fiscal accountability over project costs.

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REPORT CONCLUSIONS

We reviewed various issues regarding administration of the Village Safe Water (VSW) program by the Department of Environmental Conservation (DEC). We were directed to assess specific issues related to the effectiveness of: construction administration and financial management controls and the process used to prioritize proposed sanitation systems for construction. We also evaluated the appropriateness of recent changes made in the scoring criteria used to evaluate construction grant applications and how effectively changes in the criteria were communicated to applicant communities.

From our review and analysis, we concluded the following:

- Systems selected in conjunction with communities are consistent with both DEC criteria and the legislative intent attached to the FY 06 capital appropriations for VSW projects.
- Construction and financial controls have improved in recent years, but minor exceptions persist.
- Ranking of applications for construction grant funding is consistent with established criteria. However, documentation in the historical application files is incomplete, making it difficult to confirm an application's ultimate score and rank.
- VSW program managers did a good job of communicating the changes made to construction grant criteria to affected communities.
- Use of the Rural Utility Business Advisor (RUBA) evaluation process has delayed starting projects already appropriated and is preventing some rural communities from submitting grant applications.
- VSW's retroactive assessment of administrative costs on past projects and, more significantly, construction material cost increases has an impact on the scope and nature of already appropriated projects.

Further discussion of these conclusions follows.

Systems chosen in conjunction with communities is consistent with VSW criteria and legislative intent

An important product of the project planning phase, whether funded by a VSW grant or from other sources, is to arrive at a sanitation system appropriate for the community. Factors involved in identifying an appropriate project reflect two major concerns:

1. Technological feasibility given the layout of the community; and,
2. The surrounding geographical area and economic feasibility given the capacity of the community to set up a business structure to charge and collect enough revenue to fund the operations of the selected system.

The trade-off between what is desired and what is affordable is consistent with both stated legislative intent and one of the central operating tenets of the VSW program, building projects scaled in such way so the local community has the capacity to operate the system on a continuing basis. As set out in Exhibit 2, a project is appropriate if the system and costs are consistent with legislative intent that VSW projects be “*reasonable and sustainable*” along with the requirement that adequate user fees be generated to pay for “*the sustained operation of facilities constructed by the program.*”

In our review of projects approved and included in VSW capital budget requests since FY 03, we saw no evidence where the engineers involved scoped projects in a manner inconsistent with cost guidelines. These guidelines were established to best match the cost of a given sanitation project to the operating capacity of the community. The guidelines, recognizing they are considered guidelines and not absolute standards, were consistently applied when evaluating the costs and the most appropriate system for a given community.

Improvement in controls have generally been effective, some minor exceptions persist

Many of the weaknesses identified in the prior audit stemmed from lack of effective oversight of construction management (CM) firms and the widespread use of on-site superintendents with contracts that put them beyond the effective authority and control of VSW engineers. These weaknesses fell into three categories: lack of procurement controls built into construction oversight contracts, deficiencies in invoice review and payment, and inadequate payroll controls.

These deficiencies were addressed in three ways:

1. Utilization of a state procurement specialist. In FY 05, a state position was established to handle various procurement issues rather than leaving such matters to individual VSW engineers.
2. Phasing out the use of working with on-site superintendents. VSW shifted away from relying on a superintendent model approach to supervise day-to-day construction and moved toward a construction management model. This restructuring placed more reliance and responsibility on professional engineering firms.
3. Improved and standardized contract developed to work with CM firms. In addition to shifting to more widespread use of CM firms, DEC management developed standard, more enforceable contracts to be used by VSW engineers.

Despite these improvements, we did identify the following exceptions:

1. Procurement of goods and materials by CM firms was not always done in accordance with contract requirements. Under the new standard VSW contract, CM firms are required to demonstrate they have bought material amounts of goods and services in a manner consistent with VSW procurement policy. We reviewed 25 procurements, all required to be done in accordance with such policy. Adherence to VSW procurement policy could not be determined in three of the procurements due to insufficient documentation. The use of competitive building to purchase items could not be determined.
2. Some personnel files were missing required documentation. Since the prior audit, DEC has issued a new contract to a different accounting firm for the processing of payroll related to various projects being built using the force account approach. In the audit of the payroll charges and related personnel records, isolated documentation errors were identified. More specifically, some required documentation in personnel files maintained by the accounting firm was missing. Payroll expenditures were reasonable and appropriately reviewed and authorized. DEC management was informed of these findings. Accordingly, DEC management intends to specify in a new payroll services contract, that the accounting firm responsible for processing payroll will be also be responsible for working with the communities involved, to be sure personnel files are complete

Projects included in construction grant appropriations consistent with established criteria

Scoring of applications is a collaborative process. In a joint session with representatives from the federal funding agencies, the Department of Commerce, Community, and Economic Development, and the Alaska Native Tribal Health Consortium, VSW management reviews the applications and assigns points based on the established criteria and quality of the application. Communities are then notified of their scores, and if they want to dispute the information in their application they may do so. The scores are adjusted based on any additional information received and the rankings are finalized.

Projects included in the VSW program's capital budget request do reflect the scores assigned during the application evaluation process. Criteria established to reflect various policy objectives of the VSW program were consistently used to identify which applications, and eventually which projects, merited funding. Most grant applicants, those not included in a given year's budget request due to lower scores, continue to work with VSW engineers to improve their scores and increase the probability of receiving funding in future years.

It was difficult to confirm the basis for how some scoring points were assigned. Evaluating and confirming many aspects of a typical application involve consulting data kept on informational databases. These statewide databases are dynamic in nature, constantly changing as they are updated on a regular basis. While information in the database may supply confirmation of an assertion made in an application, a documented record of the information used is not created at the time of access.

As information on the database subsequently changes, it is difficult to confirm what the status of the information was at the time the grant application was scored. With the assistance of VSW management we were able to recreate the information used at the time grant applications were originally evaluated. While documentation of the scoring process should be better maintained, we did confirm that grant applications were consistently funded in accordance with established criteria. Further discussion regarding how to address our concerns about documentation is addressed in Recommendation No. 2.

Ranking criteria generally communicated well to communities

We surveyed 77 of the communities who had submitted applications for VSW grant funding since FY 04. We received 46 responses. More than 80 percent of the responding communities reported they believed VSW officials did a good job of communicating to them the criteria to be used in evaluating their grant applications. These respondents indicated they were consistently made aware of changes made to the scoring criteria. Additionally, 75 percent of respondents reported they either completely understood or somewhat understood why VSW managers were adjusting the application evaluation criteria.

The survey results suggest that the criteria used in the grant application process has been accessible and available to interested communities. Based on survey responses it appears the information has consistently been made available through the VSW website.

Many survey respondents praised the work and communication provided by VSW engineers in keeping their community informed and providing assistance. However, several comments from the surveys indicated that communities are not provided sufficient information regarding their score in order to know where improvements in their applications are needed. One survey respondent stated that a total score amount is received, but includes no detail on the allocation of the points across the scoring criteria. Another respondent replied that due to scoring low in a particular area, additional documentation was provided for the review committee to consider. The respondent was not informed of the committee's decision or the final outcome of the committee's consideration of the additional documentation.

For many villages, the emphasis on management capability is limiting access to funding

In recent years, a community's ability or capacity to demonstrate it can effectively operate a local utility has had a growing impact on some villages' ability to apply for, qualify for, or begin construction of a VSW sanitation project. The State's RUBA assessment process is a key requirement that has substantial impact on both the applying for funds and the release of construction funding.

VSW management is advising communities currently undergoing a RUBA assessment to postpone their application until the village has successfully completed the process. If a community has not begun the RUBA assessment, they can apply for construction funding. However, after receiving an appropriation, the village is expected to successfully complete a RUBA assessment prior to beginning construction.

VSW is aware there are numerous communities that have not submitted an application because they have yet to successfully complete the RUBA assessment. RUBA management reports they are working with more 10 villages who are trying to work through the RUBA process so that they can develop a VSW grant application.

Currently 22 villages, with more than \$44 million in appropriations, have had construction held up due to RUBA assessment requirements. Of these, seven sanitation projects, with more than \$13 million in appropriations made between FY 01 and FY 03, have yet to be started. Construction, and most of the related appropriated funding, has been held up because the communities cannot successfully complete the RUBA essential indicator assessment. The primary reason the communities cannot meet the RUBA test is that they owe back taxes to the Internal Revenue Service.

Retroactive assessment of administrative costs only a portion of the cost factors impacting previously funded projects

DEC has started to assess all active construction projects for administrative costs related to the project oversight. For projects funded before FY 06, this is considered a retroactive assessment because administrative costs were not included in the project specific budgets, but were budgeted and appropriated separately.

The retroactive assessment of administrative costs against active projects is being done at the direction of the federal funding agencies. Even though projects are still active and not yet complete, the federal funding agencies have ended their commitment to fund those costs as non-project specific administrative costs. It appears their reasoning for making such a change is as follows:

1. Three-fourths of the funds in the administrative appropriations come from federal government agencies.
2. The funding agencies will reimburse for project specific cost. Therefore, DEC must develop allocation methodologies to directly associate administrative costs to the specific project driving those costs.

Such a retroactive cost assessment, coupled with the growth in other costs, increases the possibility that some projects, especially those that have yet to start, will have to be restructured, reduced in scope, or a supplemental funding requested in order to complete the project. However, the growth in these other major costs such as goods and materials, are likely to have a more significant impact on the project's budgets than the administrative cost assessment.

Based on information supplied by VSW managers, the cost of various types of pipe used in projects has increased between 40 and 73 percent since 2003. Lumber costs, in the same period, have increased an estimated nine to 18 percent, with fuel costs increasing between 45 and 66 percent. According to the VSW managers, the most likely scenario for completing projects will involve, if necessary, breaking the projects into stages. Staged construction is a

common approach used by VSW engineers for many of the program's larger projects. Projects will most likely remain as previously scoped, but the cost estimate will be revised and a second stage will be identified and cycled into future budgets and appropriations.

It is not a budgetary violation for DEC to charge administrative costs to the projects whether or not those specific types of costs were included in the development of the project estimate as long as those administrative costs are directly associated with that project. However, adding unexpected costs to any project reduces the likelihood the project can be fully completed as planned and for the amount budgeted.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The legislature should consider clarifying the eligibility requirements for the Village Safe Water (VSW) program in order to better target funding.

The VSW program has historically been used as the primary conduit for funding directed to improve the sanitation conditions in Alaska's remote rural, primarily Native communities. Federal funding support, which infused the program with substantial resources, was aimed at what were sometimes called third world sanitation conditions in many of Alaska's villages. Federal law accompanying funding has invariably specified funding is to be used for rural and Native villages in Alaska.

In recent years, the VSW program has provided construction grants for communities that do not fit this profile. Perhaps the most striking examples are two grants totaling more than \$1.7 million made in FY 03 and FY 05, for a sanitation system to be put into a neighborhood subdivision within the larger unincorporated community of Anchor Point. Anchor Point is located in the Kenai Peninsula Borough. It had a 2006 estimated certified population of just over 1,800, albeit spread over a larger expanse than a typical remote Alaskan village.

The grant applicant, which consisted primarily of a neighborhood within Anchor Point, was determined to be eligible to participate in the program. Exhibit 4, on the following page, provides a comparison between how Anchor Point's FY 05 construction funding application was scored compared to Pitkas Point's⁵ application, which did not score high enough to be included that year's budget request.

VSW managers typically deal with recognized governing bodies, such as village or tribal councils, when assisting a community through the grant application process for VSW funds. In recent years, the program began receiving interest and applications from neighborhood subdivision organizations or non-profit corporations representing a group of households rather than being affiliated with a local governing body. At least seven grant applications for five other such communities or housing subdivisions, totaling \$22.6 million, have been received by VSW.

VSW managers report they have dealt with organizations that have been specifically formed to apply for sanitation grants. Although managers are uneasy whether such communities meet the central intent of the VSW program, they have been advised by the Department of Law (DOL) that such organizations are eligible for grant funding.

⁵ See Exhibit 5 on page 26 for a demographic comparison of these two applicants.

Exhibit 4		
How Anchor Point's FY 05 Construction Grant Application Scored Compared to Pitkas Point Unsuccessful Application		
Category/Scoring Criteria	Anchor Point	Pitkas Point
<i>Public Health and Environmental Threats</i>		
Potential for human disease event	200	
Potential for pollution event		100
<i>Project Development Status and Relationship to Other Projects</i>		
Project included in a feasibility study or master plan	50	
<i>Project Coordination</i>		
Project necessary to construct further phases of current project	200	
Coordination with other projects and funding sources		
Consolidation of community and school systems		
<i>Economic Feasibility</i>		
Feasibility score based on costs versus capacity to collect adequate revenues to sustain operations	200	100
<i>Operation & Maintenance</i>		
Primary operator is certified	200	200
Primary operator is trained, but not certified		
Back-up operator is certified	100	100
Utility manager is trained	75	
Rule, fee schedules and user fee ordinance adopted	50	50
Funding for O&M has been identified	50	50
Collection rate is > 90%		350
Collection rate is 80% - 90%		
Collection rate is 70% - 80%	200	
Total Score	1125	950

Definition of the term unincorporated community appears the key eligibility issue

DOL's advice and analysis essentially turns on the lack of a specific definition of unincorporated community in the VSW statutes. Under current law, an applicant community, or village in the language of the law, must be "...an unincorporated community that has between 25 and 600 people residing within a two-mile radius and is not a second or first class city."

However, the statute does not specifically define what is meant by unincorporated community for purposes of the VSW program. Accordingly, DOL looked at how the term is used and defined elsewhere in state law. DOL concluded that unincorporated communities could exist within the boundaries of an organized borough, and by extension, within the boundaries of an unincorporated community. If the applicant group is in an unincorporated

community and the proposed area of service meets the two-mile radius population requirement of the VSW statute, it is eligible to apply for grant funds.

With the definition of unincorporated community interpreted in this way, the geographic dispersion part of the statute's eligibility requirement becomes the primary determining factor. As long as an applicant entity is in an unincorporated community, even if such a community lies within the boundary of an incorporated area, such as borough, and the planned project serves a group of between 25 and 600 people within a two-mile radius, they may apply for a grant. Accordingly, organizations such as homeowner's associations and other non-government related groups involving groups of homeowners in an unincorporated community are now applying for grants. These applicant entities have had an easier time meeting income considerations for system selection and design, and generally do well in the scoring criteria related to having technical expertise in place to operate the designed system.

Legislative history does not indicate VSW program was to exclusively address rural villages

We did not locate any documented legislative history to suggest the VSW program was to be exclusively used to address the sanitation needs of rural, remote villages. While various studies, plans, and task force reports over the years have repeatedly cited the VSW program as being critical to state policy in this area, no direct claim was made as to the exclusivity of the funding just for that purpose. Federal program officials express full confidence that any entity eligible for funding under state law met their standards for receiving funding.

There has been a subtle shift in composition of communities found eligible for the VSW program. This shift could grow more pronounced in future years as a village, with the needs the VSW program was designed to address, may face increasing competition for funds from communities that may have similar needs, but have more options at hand to address them.

As illustrated in Exhibit 5, while the income levels of the communities are fairly equal, factors such as remoteness, existing infrastructure, population, and the number of residences lived in year round, for the two communities reflect very different types of settings. In our view, Pitkas Point is the type of community more commonly thought of as being the type of setting VSW was designed to serve.

Exhibit 5

**Some Demographic Comparisons Between
Anchor Point and Pitkas Point⁶**

	Anchor Point	Pitkas Point
Population	1,803	109
Percent Native	6.4%	93.6%
Total housing units	979	42
Total occupied housing	711	30
Housing vacant due to seasonal use	190 (19.4%)	4 (9.5%)
Median household income	\$41,094	\$41,875
Per Capita Income	\$18,668	\$10,487
Median Value: Owned Homes	\$87,000	\$26,300
Employment	<p>Many residents work in Homer in a variety of positions. The community caters to the sport-fishing industry, and several lodges provide services. Eighty residents hold commercial fishing permits.</p>	<p>Employment is limited to a few year-round enterprises. Subsistence activities provide food sources, including salmon, moose, bear and waterfowl. Two residents hold commercial fishing permits. All supplies are bought in through Saint Mary's. There are no public facilities other than a school and washeteria.</p>
Facilities:		
Current	<p>Most residents have individual wells, septic tanks and complete indoor plumbing. A new well, water treatment plant and water distribution mains were recently installed in an area serving five homes.</p>	<p>Water is supplied by a small stream and infiltration gallery. Residents haul treated water from the washeteria and use honeybuckets. Approximately one-four of homes have running water for the kitchen. A few homes and facilities are connected to a community septic tank, but no homes have complete service.</p>
Future	<p>An expansion of the piped water system to the school, homes, and businesses along the Sterling Highway are underway.</p>	<p>The community wants to develop a piped water and sewer system, and a Master Plan is underway.</p>
Household amenities:		
Lacks complete plumbing (lack sink, bath/shower or flush toilet)	20.9%	84.4%
Lack a complete kitchen (lack stove, fridge or running water)	15.3%	78.1%
Access to community	Located on the Sterling Highway	Airplane to Saint Mary's and then via road. Also, by boat on the Yukon River.

⁶ Information from the Department of Commerce Community and Economic Development, Community Database Online

A confluence of well-intentioned policy choices, such as requiring a successful Rural Utility Business Advisor (RUBA) assessment before beginning construction and DOL's interpretation of statute that seemingly broadened eligibility, has resulted in a situation where grant funding may be less accessible to many rural, remote villages. Accordingly, we suggest the legislature consider reevaluating the scope and purpose of the VSW program. From our perspective, the current circumstances, at a minimum, raise a policy question that may merit legislative consideration and possible restructuring of the VSW statutes.

Recommendation No. 2

The Department of Environmental Conservation's (DEC) Division of Water Facilities Program Manager should ensure that project application files are complete and provide fully documented support for inclusion the VSW budget request.

We were unable to verify the scoring of applications based on the available supporting documentation for VSW construction grant applications. When we attempted to independently recreate and verify the scores assigned to various applications, we could not do so, generally due to the lack of documentation supporting the assigned score.

The primary reason we could not independently recreate and trace the scoring assigned involved the use of support drawn from dynamic informational databases. These databases are updated on a regular basis and information supporting an application at the time it was scored may not be available at a later date. Essentially, information used for scoring an application was not captured to show the documented basis for a scoring committee decision.

The competition for these funds is fierce. As reflected in Exhibit 6, generally less than half of the communities seeking funds receive an appropriation. The criteria used by VSW program managers to evaluate and rank grant proposals are valid and reasonable. The criteria reflect valid policy concerns and allocate available funding in a manner consistent with agency policy and legislative intent.⁷

Most applicant communities report they understand the factors being used to evaluate their application. The process should be fully supportable. VSW managers not providing complete documentation supporting how communities' applications are scored and ranked, brings to question the way funding is allocated. Better documentation of how project applications are considered, scored, and ranked is critical to this effort.

At minimum, we recommend the following changes in procedure:

1. The preliminary, or initial score assigned to an application should be recorded;
2. Information taken from statewide databases should be documented and dated at the time it is used to support an assigned score;

⁷ In the language accompanying the FY 06 capital appropriation, the legislature stated that guidelines should be established to assure projects are reasonable and sustainable. See Exhibit 2 for a portion of the FY 06 intent language.

3. A listing of identified potential errors or requests for additional information should be documented;
4. Community notification of both their preliminary and final scores should be documented and retained;
5. General communication between VSW, including the VSW or ANTHC engineers, and the community should be documented and retained; and,
6. The final assigned score should be clearly documented and evidence retained that all members involved in reviewing the applications approve the final assigned score.

Exhibit 6					
Construction Funding Requests and Appropriated Amounts (FY 04 – FY 08)					
Funding	FY 04	FY 05	FY 06	FY 07	FY 08
<u>Requested Funding</u> <u>(rounded)</u>					
Total requested	\$171,500,000	\$169,000,000	\$310,800,000 ⁸	\$149,000,000	\$ 57,000,000
Number of community applications	112	110	98	47	37
<u>Appropriations</u>					
Total appropriations	\$ 78,327,900	\$ 78,046,800	\$ 78,922,700	\$ 79,121,235	\$ 37,111,580
Number of community projects appropriated	44	44	68	27	11
Total percent of dollar request appropriated	46%	46%	25%	53%	65%
Percent of community projects funded	39%	40%	69%	57%	29%

As designed, the process DEC uses to prioritize and direct grant funding is reasonable and consistent with overarching policy and explicitly stated legislative intent. However, the process is not fully documented. We recommend DEC take steps to better document the basis for how applications for grant funding are ranked for inclusion in the annual VSW budget request.

⁸ The FY 06 figure for the total amount of requested funding increased substantially compared to prior years. This was due to a change in how applications were considered. Beginning in FY 06, the estimated costs involved for each application included **all** estimated project costs, even though the total amount would be appropriated in phases. Prior to FY 06, the phase cost was the only one considered when developing an annual budget request. Beginning in FY 06, budget requests included funding for the current phase of construction applications first received and reviewed for the current budget cycle, and an amount taken from the applications for phase projects pre-approved in earlier budget cycles.

Recommendation No. 3

Managers of the VSW program should require communities to receive a successful rural utility business assessment as a condition for applying for a construction grant.

A central part of fostering a sense of ownership over a sanitation system is to make sure the community involved can carry out the necessary administrative tasks related to running a sustainable system. The community must have the capacity to invoice for the services involved with operating the facility, collect revenues consistently, and meet expenses such as, salaries, supplies, and proper payment of withholding taxes.

The State's RUBA program is designed to provide technical assistance to the small, rural communities in the state as they develop these capabilities. Part of the RUBA program is an evaluation checklist that assesses a community's capabilities and identifies areas requiring improvement. Communities must improve in the areas of identified weakness in order to successfully complete the assessment of essential indicators.

VSW requires communities to successfully complete a RUBA assessment prior to releasing appropriated funds necessary to start construction. Currently, there are 17 communities, involving 22 separate appropriations totaling \$44.7 million, with projects on hold awaiting successful completion of a RUBA essential indication assessment. Most critically, seven projects, involving \$13.3 million in appropriations from FY 01 – FY 03, have now remained dormant for at least four construction seasons. All of these projects are being held pending resolution of unpaid withholding taxes due to the Internal Revenue Service. Proper handling of such taxes is an element of the RUBA assessment instrument.

Linking successful completion of a RUBA assessment to the disbursement of construction funds is an example of where VSW managers are trying to create incentives for communities to develop strong financial controls. However, making it a condition for beginning construction rather than for applying for funds has led to the situation where appropriated funding goes unused, contributing to other interrelated problems, such as:

1. Villages with identifiable needs, and who would likely otherwise qualify for a grant to build a sanitation system to promote better public health, cannot start construction;
2. Project construction estimates are becoming outdated, with the costs involved in the original estimate for goods and materials tending to increase over time;
3. Higher costs require the project to be re-scoped and built in phases, using up future available funding;
4. Federal funding agencies, such as the U.S. Environmental Protection Agency, see funding provided by them not being used, and begin to ask the funding be returned or reallocated.

Requiring a community to obtain a successful RUBA assessment is a good financial control. Currently, if a community planning to apply for a construction grant is in the process of obtaining a RUBA assessment, VSW management requires the community to postpone their grant application until completion of the assessment. If a community has not sought an assessment, they are allowed to apply for a grant. If appropriated, release of grant funds are contingent of completion of the assessment.

We recommend VSW management require a successful RUBA assessment as a condition of applying for a construction grant. Such a requirement would avoid situations where funding is held up over multiple construction seasons and would provide greater assurance the community is administratively capable of sustainably operating the newly built system.

Prior Audit Recommendations

We were directed to follow-up on the recommendations made in the prior special audit conducted in November 2003. Most of the recommendations have been resolved through implementation of new policy and procedures. Resolution of the prior audit recommendations are as follows:

Prior Audit Recommendation No. 1

The governor should, by executive order, place the Village Safe Water program within the public facilities section of the Department of Transportation and Public Facilities (DOTPF).

Both DEC and DOTPF disagreed with this recommendation. DEC did not believe the two rare situations identified in the prior audit warranted reorganization of the program. Instead DEC would have preferred suggestions for other options for correcting the perceived inadequacies.

Legislative Audit's Current Position

This recommendation has not been implemented, as written. However, the circumstances that led us to make this recommendation have been addressed in the various changes made to how the program is administered. Improvements made by DEC in the way in which VSW engineers oversee projects have addressed the concerns and findings that prompted this recommendation.

Prior Audit Recommendation No. 2

The state should mandate that on-site managers be paid with a salary rather than on an open-ended hourly basis.

This recommendation consisted of four components:

1. Excessive wages were being paid to on-site managers or superintendents;

2. Wages were being supplemented by perquisites that could be characterized as abuse under federal funding guidance;
3. Excessive overtime was being paid to on-site superintendents; and,
4. VSW engineers were not effectively overseeing the situation.

Legislative Audit's Current Position

This recommendation has been implemented. Most of the findings that led to this recommendation stemmed from abuses that rose from utilizing on-site superintendents that were largely beyond the control and direction of VSW engineers. VSW has largely discontinued using the on-site superintendent model. With a shift to the construction management firm model, these issues are primarily the responsibility of the firm providing construction oversight.

Prior Audit Recommendation No. 3

The VSW program should institute traditional safeguards to protect the integrity of force account payrolls.

In the prior audit report, we identified various abuses involved with payments made to individuals through the force account payroll process utilized in the construction of many village sanitation projects. We recommended VSW administrators improve fiscal controls over the way force account payrolls were established and administered.

Legislative Audit's Current Position

This recommendation has been partially implemented. The force account payroll process has not been revised since the prior audit. DEC has shifted to utilizing construction management (CM) firms to provide oversight over more projects. The CM firms either have in-house superintendents to provide the day-to-day oversight or a contract for a superintendent under a temporary employment agreement. The use of these firms and the improved contractual relationship between the firms and DEC has resulted to some improvement in the handling of force account payrolls.

Prior Audit Recommendation No. 4

DEC's designated ethics supervisor should, with comprehensive assistance from the Department of Administration, determine the extent of any conflicts of interest among employees and establish clear boundaries.

Some DEC employees are assigned considerable autonomous discretion on VSW projects. Given the scope of discretion, the Executive Branch Ethics Act contemplates that DEC management will carefully screen outside employment for any conflicts of interest. Conflicts

from outside employment may impair employees' eligibility for particular assignments or their impartiality in selecting particular contractors and vendors.

DEC disagreed with this recommendation citing that nothing in the audit suggested evidence of actual conflicts of interest, nor did the audit offer evidence that VSW engineers would be more vulnerable to conflicts of interest than any other state engineering employees.

Legislative Audit's Current Position

This recommendation has been implemented. As recommended, DEC requested the assistance of the Department of Administration to review the conflict of interest identified in the audit. The Division of Personnel found no evidence of an ethics violation or a conflict of interest regarding VSW employees and outside employment or consulting. However, the division did recommend the employees file new ethics disclosure forms.

Since the Division of Personnel's review, only one ethics disclosure form was submitted. This form was reviewed and approved by DEC Ethics Supervisor.

Prior Audit Recommendation No. 5

For force account projects, the VSW program should adopt regulations setting basic business standards for potential conflicts of interest, transaction with project employees, and nepotism.

DEC agreed in part with this recommendation. The nepotism incident should have been prohibited by program guidance. Also, rules governing conflicts of interest would be a valuable addition to VSW program guidance. DEC disagreed with the need for additional rules pertaining to transaction with employees. Also, they stated that all purchases, regardless of who is purchasing, are subject to VSW procurement procedures.

Legislative Audit's Current Position

This recommendation has been implemented. DEC implemented a policy addressing nepotism on force account projects to eliminate actual or potential conflicts of interest, favoritism, and/or weaknesses in internal controls caused by employment of related persons.

This policy is documented in the special grant conditions where force account labor will be used or where a grantee will hire an on-site superintendent. Additionally, the policy is reiterated in the temporary employment agreements between the grantee and the superintendent.

STATE OF ALASKA

DEPT. OF ENVIRONMENTAL CONSERVATION
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December 27, 2007

Pat Davidson
Legislative Auditor
Division of Legislative Audit
Legislative Budget and Audit Committee
P.O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

RE: Preliminary Audit Report
Village Safe Water Program

The Department of Environmental Conservation (DEC) has completed its review of the above referenced report, and we appreciate the opportunity to provide you with our response. As you requested, our responses to each of the recommendations included in the report are provided below.

Recommendation No 1: The Legislature should consider clarifying the eligibility requirements for the Village Safe Water (VSW) in order to better target funding.

The Department agrees there is the opportunity for improving program efficacy by clarifying eligibility requirements. The primary reason cited in the report for such changes is better targeting of project funding. We agree. Another important reason for considering changes to the VSW statute is to recognize the increased emphasis on long-term sustainability of rural water and sewer facilities.

Recommendation No. 2: The Department of Environmental Conservation's (DEC) Division of Water Facilities Program Manager should ensure that project application files are complete and provide fully documented support for inclusion in the VSW budget request.

The Department agrees with this recommendation. The specific changes recommended in the Management Letter will be incorporated into the process of project application evaluation and prioritization. We support any such

measures that will assist in better documenting the basis for the Department's annual budget request to the Legislature.

Recommendation No. 3: Managers of the VSW program should require communities to receive a successful Rural Utility Business Advisor assessment as a condition for applying for a construction grant.

The Department agrees with this recommendation. We have consulted with managers of the Rural Utility Business Advisor (RUBA) program at the Department of Commerce Community and Economic Development (DCCED), and concluded that the program has the capacity to conduct any requested assessments prior to next summer's application process. We agree that such a requirement will help to correct the problems cited in the preliminary audit report. At the same time, DEC and DCCED recognize the need to help communities that struggle to meet the requirements of the assessment. Our goal to develop sustainable water and sewer systems is only partially fulfilled by constructing facilities. Capacity development in small rural communities must also remain a focus for state and federal agencies.

Summary

Through the Village Safe Water Program, the Department of Environmental Conservation is dedicated to working with Alaska rural communities to develop sustainable drinking water and wastewater systems. Since the 2003 Special Legislative Audit we have made concerted efforts to address findings and to make additional improvements in the program. We appreciate the recent efforts of your Division to evaluate the effect of these changes.

The Department is committed to working with the Legislature, other State programs, and federal funding agencies to continually assess and improve program service delivery and compliance with state and federal requirements. The recommendations included in your report will assist our continuing efforts to fulfill this commitment.

Sincerely,



Larry Hartig
Commissioner