

# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE



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SUMMARY OF: A Special Report on the Department of Natural Resources, Division of Agriculture, November 29, 2002.

### PURPOSE OF THE REPORT

In accordance with a Legislative Budget and Audit Committee special request and Title 24 of the Alaska Statutes, we have conducted an audit of the Department of Natural Resources (DNR), Division of Agriculture (DOAg). The purpose of this audit was:

- To evaluate DOAg's human resource management.
- To evaluate the use of DOAg assets, including expenditures for operations and management of physical resources.
- To evaluate the effectiveness of the working relationship among DOAg, the new Board of Agriculture and Conservation, and other entities involved in Alaska agriculture.

### REPORT CONCLUSIONS

Since our last audit, the division has made very little progress in advancing agriculture. In fact, we found that the lack of innovative leadership is actually hindering the expansion of Alaska agriculture. We also found problems with the management of human resources and physical resources at the division.

### FINDINGS AND RECOMMENDATIONS

1. The legislature should statutorily restructure services to agriculture for a more aggressive pursuit of distinctive Alaskan opportunities.
2. DNR should consult the attorney general concerning state oversight of Mat Maid.

**RECOMMENDED STATUTORY RESTRUCTURING TO REDIRECT AND REVITALIZE  
INNOVATIVE ALASKAN AGRICULTURAL DEVELOPMENT**

<b><u>Function</u></b>	<b><u>Current Placement</u></b>	<b><u>Most Feasible Reassignment</u></b>
State's top agricultural official  <i>Currently responsible for a "micro-division" of less than 30 permanent full-time employees</i>	DOAg director	DNR deputy commissioner  <i>Niche discovery and promotion, corporate relations, regulations, Alaska Grown program, Lower 48 publicity, industry liaison to Denali Commission</i>
Inspection of farms and farm products to protect consumers (quality) and public health (disease) (including federal contracts)	DOAg	DEC Environmental Health
Sales and leases of state land with agricultural covenants (AS 38)	DOAg	DNR Mining, Land and Water
Farm loans	DOAg (BAC)	DCED Investments  <i>Approval and servicing of ARLF loans, management and custody of ARLF funds</i>
Oversight of farm-related industrial facilities (non-research)	DOAg (BAC)	AIDEA board of directors and staff
Agricultural research	DOAg Plant Materials Center  Cooperative Extension Service (UAF College of Rural Alaska)  UAF School of Agriculture (including experiment stations)  Alaska Science & Tech. Found.  Federal agencies: NRCS, ARS, FSA	Plant Materials Center statutorily reconstituted under DNR as the Alaska Agricultural Research Consortium (AARC)  Cooperative Extension Service statutorily moved into AARC  ⌈ Applied research work statutorily linked to AARC, consultation with BAC for all agricultural research projects ⌋  MOUs negotiated with federal agencies for consortium participation
Farmer participation in state agricultural policies	DOAg (BAC)	BAC statutorily redefined as an advisory board to the Alaska Agricultural Research Consortium and the DNR's deputy commissioner for agriculture  <i>No BAC role in operations (loan approvals, land sales, or facilities oversight)</i>
Export niche discovery	DOAg	DCED International Trade and Market Development
Game farming regulation	DOAg	DF&G Wildlife Conservation
Livestock identification branding	DOAg	DNR State Recorder's Office
<i>Abbreviations:</i> DCED = Department of Community and Economic Development; BAC = Board of Agriculture and Conservation; MOU = memorandum of understanding; UAF = University of Alaska Fairbanks; DEC = Department of Environmental Conservation; AIDEA = Alaska Industrial Development and Export Authority; ARLF = Agricultural Revolving Loan Fund; NRCS = Natural Resource Conservation Service; ARS = Agricultural Research Service; FSA = Farm Service Agency		

December 10, 2002

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 NATURAL RESOURCES  
DIVISION OF AGRICULTURE  
SELECTED ISSUES

November 29, 2002

Audit Control Number

10-30017-03

The objectives of this audit were to evaluate: (1) the Division of Agriculture's human resource management; (2) the use of division assets, including expenditures for operations and management of physical resources; (3) the effectiveness of the working relationship among Division of Agriculture, the new Board of Agriculture and Conservation, and other entities involved in Alaska agriculture.

The audit was conducted in accordance with generally accepted government auditing 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.

Pat Davidson, CPA  
Legislative Auditor

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## OBJECTIVES, SCOPE, AND METHODOLOGY

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 Department of Natural Resources, Division of Agriculture (DOAg).

### Objectives

The objectives of the audit were as follows:

- To evaluate DOAg's human resource management.
- To evaluate the use of DOAg assets, including expenditures for operations and management of physical resources.
- To evaluate the effectiveness of the working relationship among DOAg, the new Board of Agriculture and Conservation (BAC), and other entities involved in Alaska agriculture.

### Scope and Methodology

Field work for the audit included the following:

- Review of statutes, regulations, board activities, and DOAg documents since our prior audits.<sup>1</sup>
- Interviews with state agencies,<sup>2</sup> federal agencies,<sup>3</sup> and affected members of the public.
- Attendance at meetings of the BAC and the Creamery Corporation board of directors, as well as a review of selected minutes since our prior audits.
- Review of supporting documentation for 294 judgmentally-selected, high-risk DOAg expenditures in the time period of FY 00 through FY 02.
- Visits to various government supported agriculture projects.

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<sup>1</sup> Special Audit of Agricultural Revolving Loan Fund, Audit Control No. 10-4557-98 (March 31, 1998); Special Audit of Matanuska Maid, Audit Control No.10-4545-98 (September 30, 1998).

<sup>2</sup> DOAg staff (all offices and facilities); BAC board members; Creamery Corporation board members; personnel of DNR, Department of Law, Department of Administration, Department of Environmental Conservation, and the University of Alaska.

<sup>3</sup> Farm Service Agency; Natural Resources Conservation Service; Agriculture Research Service; Cooperative State Research, Education, and Extension Service; and Agriculture Statistics Service.

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## ORGANIZATION AND FUNCTION

The Division of Agriculture (DOAg) is organized within the Department of Natural Resources (DNR).

The division's FY 03 operating budget consists of three components: \$1,495,400 for agriculture development; \$2,527,200 for the plant materials center; and \$743,900 for Agriculture Revolving Loan Program administration. Approximately 43% of the division's operating budget is funded by federal receipts and 44% by the Agriculture Revolving Loan Fund. There are 31 permanent full-time and 24 permanent part-time budgeted positions.<sup>4</sup> Except for two exempt positions, the employees are represented by three labor unions.

DOAg's main office is located in Palmer. The plant materials center (PMC) is an industrial/laboratory complex consisting of several buildings located on a tract in the rural Mat-Su Valley near Pioneer Peak. Also located in the rural Mat-Su Valley on Trunk Road is the division's nursery that consists of a building and two large greenhouses. DOAg also has a northern region satellite office located in a state office building in Fairbanks.

The functions of DOAg are divided as follows:

- Sales and leases of state land with agricultural covenants. The division is responsible for selling and administering Title 38 (Public Land) property with agricultural covenants.
- Institutional advertising. The division administers the Alaska Grown program and provides assistance to producers in getting their products sold.
- Inspections. This division provides inspections and grading of agriculture products. It also provides field inspections for seed certification and disease control.
- Alaska Natural Resource and Conservation & Development Board. The board's enabling legislation is codified in AS 41.10. The board represents the State for the Alaska Soil and Water Conservation District.
- Board of Agriculture and Conservation (BAC). Alaska Statutes 03.09 and 03.10 establishes the Board of Agriculture and Conservation and defines the powers of the board. This citizen board has seven members<sup>5</sup> appointed by the governor who serve

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<sup>4</sup> Twenty-five permanent full-time positions and 17 permanent part-time positions were filled.

<sup>5</sup> AS 03.10.050(b) provides, in pertinent part, as follows:

*Members shall have the following qualifications: (1) one member shall have general business or financial experience; (2) one member shall be a member of a statewide agriculture promotion organization; (3) one member shall be a member of a soil and water conservation district established under AS 41.10.130(a) who is also engaged in commercial production agriculture; (4) four members shall be engaged in commercial production agriculture; each shall represent a different agriculture enterprise from the others, such as livestock production, dairy, vegetable production, grain production, horticultural production, and greenhouse and hydroponic production.*

staggered three-year terms. The board currently is responsible for loan approvals, agriculture policy discussions, and overall oversight of state-owned agriculture facilities.

- Farm loans. The division currently processes and services Agriculture Revolving Loan Fund (ARLF) loans, which are approved by the BAC board. The servicing of ARLF loans includes collections and the sales of repossessed property and collateral.
- Oversight of farm-related industrial facilities. The division owns farm-related industrial facilities that are the aftermath of failed private sector projects. Some of these are operated by the division while others are made available to the private sector under various arrangements.
- Applied research. PMC's enabling legislation is codified in AS 03.22. PMC is to provide for the production and development of plant materials. PMC is basically the state repository for Alaska seed and is responsible for encouraging the development of the seed industry.
- Miscellaneous. Two specialized functions of the division are livestock identification branding and game farming regulation (e.g., elk).



# REPORT CONCLUSIONS

Since our last audit, the Division of Agriculture (DOAg) has made very little progress in advancing agriculture. In fact, we found that the lack of innovative leadership is actually hindering the expansion of Alaska agriculture. We also found problems with the management of human resources and physical resources at the division.

Our detailed conclusions follow.

## Lack of innovative leadership hinders Alaska agriculture expansion

### *Top DOAg management*

Our previous audits<sup>6</sup> reported on the need for DOAg to refocus its strategy from dairy farming to the discovery of specialties (niches) that capitalize on the distinctive Alaska strengths. These strengths and others we list in Exhibit 1. There has been no significant progress in these areas.

In fact, DOAg views its primary role as to emulate the commodity farming of the Lower 48 (dairy, red meat, grain).<sup>7</sup> Under a philosophy of “import substitution,” the current director considers his major accomplishment to be the substantial sales of state land for further experimentation with Alaskan “meat and potatoes” farming.

The placement of land in the private sector is treated as an end in itself. There is no vision as to how this would translate into profitable farm businesses, versus mere expansion of government benefits,<sup>8</sup> subsidies, entitlements, and litigation from those who claim DNR has failed them.<sup>9</sup>

<b>EXHIBIT 1</b>
<b>DISTINCTIVE ALASKA STRENGTHS NEGLECTED BY DOAg's CURRENT STRATEGY</b>
<ul style="list-style-type: none"><li>• Tourism (European, Asian, Lower 48)</li><li>• Air cargo (world's fifth busiest)</li><li>• Worldwide mystique and image of Alaska</li><li>• Federal financial support (nation's highest per capita)</li><li>• Alaska Native heritage</li><li>• Extensive in-state military presence</li><li>• Key military logistics position for Pacific Rim readiness</li><li>• Cultural diversity (second only to Hawaii)</li><li>• Major portion of the nation's freshwater supply</li><li>• Availability of federal Denali Commission funding for programs that benefit Rural Alaska</li></ul>

<sup>6</sup> Special Audit of Agricultural Revolving Loan Fund, Audit Control No. 10-4557-98 (March 31, 1998); Special Audit of Matanuska Maid, Audit Control No.10-4545-98 (September 30, 1998).

<sup>7</sup> In the case of dairy farming, there is little genuine economic justification for the State to perpetuate this tradition. See Special Audit of Agricultural Revolving Loan Fund, Audit Control No. 10-4557-98 (March 31, 1998); Special Audit of Matanuska Maid, Audit Control No. 10-4545-98 (September 30, 1998).

<sup>8</sup> Those favoring further projects traditionally expect that the State will hand out the costly infrastructure that a private subdivider would include in the price of the lot. See S.J. Komarnitsky, “State looks at opening more land for farming projects: Thousands of acres in Mat-Su among areas considered,” *Anchorage Daily News*, Dec. 2, 2002, pp. A-1, A-6.

In short, DOAg’s unfocused approach simply emphasizes the volume of “farmland” that has been re-privatized. Such nearsightedness is reminiscent of the unquestioned “jungle” in the popular business leadership example of Exhibit 2.

The lack of innovation is particularly troubling since small-scale commodity farms are no longer considered viable even in the Lower 48. Even the academicians that, decades ago, advocated Alaska dairy and grain farming have retreated to espouse “differentiated” specialties (distinctive niches).<sup>10</sup> Though the reaction of DOAg since our last audit has been continued efforts to protect the occupational preferences of a handful of Railbelt commodity farmers, the rest of Alaska, particularly the “bush,” still continues to be largely ignored.

<b>EXHIBIT 2</b>
<b>EXCERPT FROM MICHIGAN DAIRY REVIEW</b>
<p><i>Consider this analogy from Stephen Covey’s “The 7 Habits of Highly Effective People.” Envision a group of people cutting their way through the jungle with machetes. They’re the producers, the problem solvers. They’re cutting through the undergrowth, clearing it out.</i></p> <p><i>The managers are behind them, sharpening their machetes, writing policy, and bringing in improved technology.</i></p> <p><i>The leader is the one who climbs the tallest tree, surveys the entire situation, and yells, “Wrong jungle!”</i></p> <p><i>But how do the busy, efficient producers and managers often respond? “Shut up! We’re making progress.”</i></p> <p>Source: Michigan State University, <i>Michigan Dairy Review</i>, May 1999, p. 1.</p>

However, whether the strategy is the status quo or untried niches,<sup>11</sup> DOAg has failed to actively pursue a substantial potential source of federal funding. The Denali Commission,

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<sup>9</sup> The State has no obligation to provide every service to every location in Alaska. However, an expectation of expanded state services would accompany another “Point MacKenzie” type project in an inaccessible area. Once DNR agrees to extend a service to an area, the State assumes liability for negligence in providing that service. See *Angabooguk v. State Dept. of Natural Resources*, 26 P.3d 447 (Alaska 2001) (homeowners claiming that DNR was negligent in fighting the Big Lake fire).

<sup>10</sup> See Carol E. Lewis and Roger W. Pearson, “Alaska’s agricultural industry,” *Agroborealis* (summer/fall 1996), p. 23 (“*Alaska must penetrate national and international niche markets. Entering the commodity markets is unlikely.*”); James V. Drew, *A Tale of Two Agricultures*, plenary lecture to Fourth Conference of the Circumpolar Agricultural Association, Aug. 27-29, 2001, Akureyri, Iceland (“*[T]he near term success of agricultural development in Alaska . . . will depend on the ability of Alaska farmers to develop and supply specialty markets.*”); Carol E. Lewis, Roger W. Pearson, and Charles W. Knight, “Agriculture in Alaska,” report for the Alaska Science and Technology Foundation, 1998, pp. 2, 13 (“*[There] has been expanding interest by [Alaska] producers in products that can add value or be sold in niche markets*”; “*Premium prices can be obtained . . . in specialty markets where products are differentiated.*”).

<sup>11</sup> Potential niches have not been adequately explored due to the lack of collaboration among researchers. For instance, the popular national market for herbal remedies could recognize the contributions of Alaska’s Native heritage. See Ann Garibaldi, *Medicinal Flora of the Alaska Natives* (University of Alaska, 1999). Neglected linkages among DNR, Native organizations, and rural Alaska would, of course, need to be pursued. Another potential niche could be distinctive products added to the military logistics flights that pass through Alaska en route to Pacific Rim readiness forces. DNR may wish to consult the University for assistance, given its new business logistics program and the recently retired generals now serving as university president and business school dean. A third little-explored niche is the development of brewing hops that capitalize on the mystique of Alaska. Some niches may profit from partnerships with major agribusiness in the Lower 48. For instance, such businesses may contract with farmers for production of specialized seeds not found elsewhere.

Unlike the large scale production of generic commodities, profitable niche products can be supplied from a wide diversity of small “alternative” farms (farms with orientations that are organic, lifestyle, commuter, hobby, religious, or therapeutic). We agree with a recent Oregon extension service publication in which a faculty member opines that such alternative farms “*bring an awareness of agriculture and land management to urban life*” and that “*there is room for everyone in [his state’s] agriculture today.*”

which serves Alaska exclusively, provides millions of dollars in federal grants for projects that benefit rural Alaska. While each year the commission plans its funding around a particular rural need, DOAg has not aggressively sought a year dedicated to farming projects or even offered the commission an individual to serve as the agricultural industry's liaison.

DOAg's efforts to "market" Alaska farm products, while well-intentioned, have similarly lacked vision. Signs, hats, bumper stickers, and media ads are intended to convince consumers to purchase available Alaska products. With a few successful exceptions, Alaska farmers simply wait to see what is actually available for harvest and then offer it to a local outlet, an extremely basic, small-scale approach.

Under the true consumer-driven "marketing" strategy that drives mainstream America, DOAg would take a different approach. DOAg would spend less time networking with other states' officials and more time discovering new products that major distributors<sup>12</sup> would like Alaskans to start supplying for the rest of the world.<sup>13</sup>

Once again, the disappointing performance is in DOAg's failure to find new products that distributors want and Alaska producers can readily produce. The growth-stunting assumption is that Alaskans will buy whatever local farmers produce.

Further evidence of the lack of a genuine consumer orientation is found in the narrow focus of DOAg inspection programs. Although inspections are identified with consumer protection, inspections are actually limited to a few interested parties. For example, DOAg is to provide inspection of fresh fruits and vegetables in accordance with a federal agreement. These inspections are mainly provided for federal purchase contracts, and upon request for a service charge, to distributors, wholesalers, or retailers that usually question shipments. There are no routine inspections of retail businesses that sell directly to Alaska consumers.

We see no reason why inspection services, including inspecting potatoes for quality and disease, cannot be performed within the context of the more routine Department of Environmental Conservation's (DEC) health inspections to protect consumers. Thus, in Recommendation No. 1 we suggest refocusing agriculture inspections to better protect retail consumers by moving the function to DEC.

The State of Alaska can no longer afford to subsidize a perceived "right to farm." Affluent corporate farmers need to coordinate their annual cash flow, like other successful businesses,

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<sup>12</sup> When approaching the marketing executives of major distributors, state officials should think beyond the handful of existing distributors that currently service Alaska grocery stores. For instance, profitable Alaska niches may be found through contact with major Lower 48 chains that manufacture and retail specialty items to the gourmet, health food, physical fitness, and alternative remedy markets. An example would be the Wild Oats Markets, a publicly-traded corporation with 102 natural food grocery stores in 23 states and Canada (see [www.naturesnorthwest.com](http://www.naturesnorthwest.com)). In short, under a true modern "marketing" approach, a feasible market is discovered before the item is produced.

<sup>13</sup> Iowa State University has reported that the average U.S. grocery store now stocks items from over 100 countries. For this reason, we recommend that the more aggressive discovery of new farm products for export be entrusted to the Department of Commerce and Economic Development's Division of International Trade.

through a visit to their local banker. Perpetually failing farmers need to be weaned from the entitlement culture and find something else to do. True entrepreneurs with a vision for promising niches should be encouraged in accountable ways.


Unfortunately, the current DOAg structure has become so strongly identified with the status quo that it is incapable of the leadership required for the redirection of Alaska agriculture over the coming decades, see Exhibit 3. There is a meaningful role for Alaska agriculture, but the current structure is unlikely to ever find it. To reverse this trend, a major reassignment of DOAg functions is necessary. This reassignment will be consistent with Governor Murkowski's recently-issued Administrative Order No. 202, which encourages performance audit recommendations "for consolidation and reorganization of departments, divisions, and duties." See Recommendation No. 1.

*Fragmented, disjointed research facilities*

Despite agriculture's minor presence in Alaska, a considerable variety of researchers of the subject are stationed in various agencies around the state, see Exhibit 7, page 16. Also, as we observed with DOAg's management, the efforts of these individual scientists have so far not resulted in any profitable niches that have prevailed as a fixture in the Alaska economy.

In states with major agribusiness, the federally-funded cooperative extension service has historically been the vital link between theoretical research and farmers that need to earn a living. However, unlike in the Lower 48, neither DOAg nor the University (current organizational home of cooperative extension) has actively sought to focus Alaska's extension agents on traditional problems like dairy herds, crop diseases, and failing farm waste treatment systems.

In fact, unlike other states, Alaska's cooperative extension service is not even associated with an agricultural school or an agricultural agency. Rather, it continues to reside in the university's College of Rural Alaska, where its handful of well-meaning agents service Railbelt hobby gardeners more than working farms.

<b>EXHIBIT 3</b>	
<b>OUTMODED ASSUMPTIONS THAT HINDER AGRICULTURAL PROGRESS</b>	
<ul style="list-style-type: none"><li>• Farmers need the government to take care of them</li><li>• Government can run a business better than the private sector</li><li>• Customers need to buy whatever farmers grow</li><li>• Real farmers serve generic commodity markets (not niches)</li><li>• Waste byproducts are someone else's problem</li><li>• Waste byproducts are some other agency's problem</li><li>• Produce it now, worry about "marketing" later</li><li>• Rules are for private businesses; government businesses are free to do whatever they want</li></ul>	

DOAg itself has a sizeable, but little-known, research facility known as the Plant Materials Center (PMC). Despite the statutory direction to work with other agencies, we found the scientists at this laboratory to be conscientious but disconnected from other research agencies within even the same community. The losers from all of this fragmented research are those who farm for a living today, as well as those who might do it tomorrow if profitable niches were discovered. Even the statute's requirement for a joint DOAg-University appointment of the PMC's administrator has been circumvented by DOAg over the past decade.

This lack of collaboration among agencies is certainly not the norm for scientists from state agencies, the university, or the federal government. Researchers from all three have successfully worked together for years in Alaskan consortiums that directly benefit the public in tangible ways. Six examples would be the Alaska Volcano Observatory, Alaska Earthquake Information Center, Tsunami Warning Network, Geologic Materials Center, Moose Research Center, and ARLIS<sup>14</sup> reference library. While participating agencies share facilities, projects, and personnel in such consortiums, all agencies retain their individual identities.

Research with genuine value to the public would be best promoted by establishment of an Alaskan Agriculture Research Consortium that consists of mandatory participation by all state-funded researchers and negotiated memoranda of understanding with federal agencies, see Recommendation No. 1. To assure maximum utility of the consortium's work-product, it is essential that Alaska's cooperative extension service be directly administered by the new consortium rather than the College of Rural Alaska.

Despite the long-term benefit to Alaska agriculture, it is not realistic to expect, after decades of separatism, that the existing personalities from autonomous groups such as DOAg and the university will ever voluntarily initiate such a consortium.<sup>15</sup> Therefore, the legislature needs to directly, formally, and explicitly mandate it through amendments to the statutes that govern the PMC and the university system.

*A more meaningful role for the  
new Board of Agriculture and Conservation*

Monitoring the consortium's research would be a more significant role for the new Board of Agriculture and Conservation (BAC) than being enmeshed like a bankers' loan committee in the minutia of ever-dwindling DOAg loans. As we note in Recommendation No. 1, the details of approving and servicing loans belong, not with an agricultural policy board, but rather with the financial specialists that administer other state loans to businesses.

More specifically, the BAC should on a regular basis review the consortium's proposed research projects and the progress on existing ones. In an advisory capacity to consortium scientists, the

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<sup>14</sup> Alaska Resources Library and Information Services.

<sup>15</sup> Governor Murkowski, in his recently-issued Administrative Order No. 202, encourages performance audit recommendations "for consolidation and reorganization of departments, divisions, and duties."

BAC should prioritize proposals based on their anticipated utility to Alaska farmers and the potential for discovering profitable niches. The consortium's annual budget request should include a BAC report to the legislature on the following: (1) progress on research projects that the board considers to have direct value to existing farmers; (2) progress on research projects that are exploring potential new niches that capitalize on particular Alaskan strengths; and (3) new niches that have been profitably implemented by Alaskan farmers as a result of consortium research.

#### Human resources mismanaged

Although there are noteworthy accomplishments,<sup>16</sup> overall we found that human resource management at DOAg is plagued by numerous problems, see Exhibit 4.

The commissioner's office acknowledges there is a general problem, but attributes it to a lack of strong decisive leadership at the division level and to inherent diseconomies of scale for a small division. We note however, the division director is an appointed executive and subject to direction by the commissioner and the governor. There is authority to remedy the leadership void at the division if the commissioner or governor so chooses to direct their efforts to this situation.

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<sup>16</sup> In 2001, the Plant Materials Center staff asked Occupational Safety and Health to conduct a safety and health evaluation of its program and facilities. Although the inspection found numerous safety and health hazards, PMC staff not only worked diligently to fix the hazards, but held safety meetings and trainings to address the concerns.

#### EXHIBIT 4

### PROBLEMS IN HUMAN RESOURCE MANAGEMENT THAT DEGRADE DOAg's ADVANCEMENT OF ALASKA AGRICULTURE

- Uncertainty as to employer expectations for performance and professional behavior (sporadic formal evaluations, infrequent coaching and mentoring, no action plans to correct specific deficiencies, no use of progressive discipline system)
- Careless screening of job applicants for any criminal background or dangerous driving records (incomplete applications, little verification, lax follow-up of disclosures to assess risk to public and coworkers)
- Inadequate safeguards for accurate communication of pay rates and benefits to hires
- Ambiguity as to employee accountability and chain of command
- Employee confusion over Ethics Act boundaries between official and private behavior
- Neglect of escalating reclassification disputes (duties have expanded to do more with less)
- Lack of routine positive "one-on-one" feedback for employee achievement and innovation
- No professional development plans to inspire senior career employees
- Frustrated career advancement for long-timers (few promotions due to small division size)
- Lack of continuing, proactive professional intervention in the publicly-embarrassing office "civil war"
- No referrals of troubled workers to the Employee Assistance Program (festering personal issues that risk stress-related workers' compensation claims, hostile workplace disputes, OSHA complaints, and labor grievances)
- Neglected personal safety of employees with custody of cash
- Work assignments hindered by unresolved personal safety issues about toxic substances (reasonable use of pesticides)
- Continuous drain of DOAg resources to ongoing employment disputes

#### Physical resources mismanaged

We found several deficiencies in the management of assets. We placed these deficiencies into the following four categories.

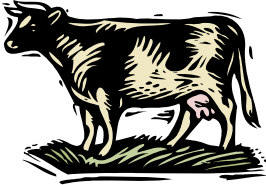
##### *1. Environmental stewardship*

Responsible planning for waste is an important aspect of every industry. Here in Alaska, the State does not hesitate in holding local industries such as mining, petroleum extraction, and cruise ships responsible for unpleasant byproducts of their successes. The obvious byproduct of the livestock industry is manure, which is heavily monitored by the federal Environmental Protection Agency in the Lower 48. In Alaska, there is very little animal waste monitoring. Exhibit 5 explains why animal waste is of concern.

Despite claims Alaska is the land of “*eco-friendly agricultural practices*,”<sup>17</sup> we found otherwise. We observed, and had confirmed by DEC’s professionals, extensive, uncontained<sup>18</sup> stockpiling of manure that threatens the area’s watershed. In fact, neglected manure at one Mat-Su dairy compelled the state’s veterinarian to suspend the dairy’s operating permit out of fear of local water contamination.

DOAg and BAC’s approach to developing agriculture is placing state agriculture lands into the private sector and granting loans and leases for agriculture purposes. Planning for animal waste management is not treated as an integral part of this promotion. Environmental concerns involving animal waste apparently are regarded as someone else’s or some other agency’s problem, which is inconsistent with the governor’s overall position concerning the environment.<sup>19</sup> Additionally, we note that the State as a landlord may be liable for uncorrected hazards such as pollution that harms neighbors.

Although technically called the Board of Agriculture *and Conservation*, the board’s potential in conservation matters has so far been unrealized. Since DOAg and its board have neglected the waste treatment aspect of environmental stewardship, DEC with the assistance of the cooperative extension service will need to spearhead the responsibility<sup>20</sup> in

<b>EXHIBIT 5</b>	
<b>LIVESTOCK WASTE: A WATER QUALITY CONCERN</b>	
<ul style="list-style-type: none"> <li>▪ <i>Runoff from livestock operations enters water bodies when poor maintenance of waste lagoons, improper design of storage structures, improper storage of animal waste, and excessive rainfall result in spills and leaks of manure-laden water.</i></li> <li>▪ <i>Overapplication of manure to cropland is another source of animal waste runoff.</i></li> <li>▪ <i>When livestock manure and other animal waste spills or leaks into surface or ground water, it can create an immediate threat to public health and water resources.</i></li> </ul>	
<ul style="list-style-type: none"> <li>▪ <i>This runoff has nutrients, such as nitrogen and phosphorus, that in excess cause algae and other microorganisms to reproduce in waterways, creating unsightly and possibly harmful algae blooms. Explosive algae populations can lower the level of dissolved oxygen, which can cause fish and other aquatic organisms to die.</i></li> <li>▪ <i>Spills from ruptured waste lagoons and other faulty storage facilities have killed tens of thousands of fish.</i></li> <li>▪ <i>Animal waste runoff can also be a threat to the health of people who come into contact with affected waters because some of the microbes (bacteria, protozoa, and viruses) in animal waste can cause disease.</i></li> </ul>	
<p><small>Source: U.S. Environmental Protection Agency, Proposed Regulations to Address Water Pollution from Concentrated Animal Feeding Operations, publication no. 833-F-00-016 (March 2001).</small></p>	

<sup>17</sup> This claim was made in a state-funded, full-page color advertisement that was printed in the Anchorage Daily News on November 15, 2002.

<sup>18</sup> For example, the auditor saw an unlined, unfenced manure pit as large as an Olympic-size swimming pool. Persons interviewed estimated it to be somewhere between 12 to 30 feet deep.

<sup>19</sup> Governor Knowles stated in Administrative Order No. 200 that “*Alaska must step up and focus its efforts to assess the health of our waters and to maintain vigilant stewardship, as well as act to restore polluted waters.*”

<sup>20</sup> We commend the Department of Environmental Conservation’s Division of Air and Water Quality for taking corrective action to address the immediate manure problems at Point MacKenzie.



addressing animal waste management practices. As an essential part of this regulatory responsibility, the State should not enter into sales, loans, leases, or dairy permits unless the agreement's terms provide a feasible plan for waste disposal.

A farm conservation plan is a regulatory requirement for any Title 38 sale of state agricultural land.<sup>21</sup> Such a plan includes the buyer's proposed arrangements for water conservation which, of course, reasonably includes the protection of the area's watershed from waste and contamination. We believe that DNR should also require a farm conservation plan as a condition in leases of state agricultural land and as a condition of farm projects financed with ARLF loans. More specifically, DNR should ensure a rigorous review of the capability of a potential buyer or tenant to deal with the inevitable issue of animal waste. This technical review will benefit from assistance as necessary from specialists at DEC and the cooperative extension service.

Potential resources so far unutilized by DOAg include the following: (1) cooperative extension agents from Lower 48 universities who specialize in livestock waste management; (2) civil engineering faculty from the University of Alaska; (3) extensive online technical information from agencies both Outside and in Canada; and (4) National Guard training exercises to prepare for the realities of damaged waste treatment facilities from warfare or natural disasters.<sup>22</sup>

Finally, we note the recent, well-publicized demands by the governor and Alaska's congressional delegation for disclosure of the adequacy of military cleanups from experiments with chemical and biological weapons that were conducted along the Gerstle River near Delta Junction. Since some state land placed in agricultural projects is found along the Gerstle River, the Department of Natural Resources should be sure to assess the significance, if any, to area farms as the disclosures come forth.

## *2. Oversight over major state-owned facilities*

The state owns five major agricultural facilities. They include:

- The old feed mill in Palmer, currently used by Matanuska Maid to mold containers and service trucks.
- The Mt. McKinley Meat & Sausage plant, currently used to process dairy farm byproducts and other surplus livestock.
- The former Delta granary building, currently used by local farmers.

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<sup>21</sup> See 11 AAC 67.177.

<sup>22</sup> The Alaska National Guard has a long history of adapting its training in ways that assist state and local agencies with community service, ranging from disasters (Big Lake forest fire, 1964 earthquake) to law enforcement (protection of local police during dangerous raids) to education (helicopter retrieval of remote fossils) to community celebrations (air delivery of Fairbanks-bound statue from Seattle) to the environment (disposal of junk cars near Palmer). Construction assistance with Point MacKenzie farm systems could provide realistic training for events when the Guard would be dispatched to address larger public treatment systems damaged by natural disaster or warfare.

- The former Fairbanks meat plant, now being used as a private fish plant.
- The Matanuska Maid dairy processing plant in Anchorage.

We encountered a variety of problems in DOAg’s handling of these largely obsolete assets. The state-owned feed mill building in downtown Palmer is occupied by Matanuska Maid under a very informal unwritten, rent-free “courtesy” lease. The continued operation of the Mt. McKinley Meat & Sausage plant is uncertain since the Department of Corrections declines to operate it further with prison labor.<sup>23</sup> The former granary in Delta Junction is essentially provided rent free (\$1 per year) to a group of individuals. The lease to the Fairbanks fish plant has expired and is now a month-to-month arrangement. Finally, the State has lost meaningful control over the Matanuska Maid dairy, see Recommendation No. 2.

Since the division and the board have failed to provide adequate oversight of its operational assets, the State would be best served by placing these assets with an agency that can provide the expertise and experience. We believe that agency is the Alaska Industrial Development and Export Authority (AIDEA). The legislature should direct AIDEA to develop a plan in getting these assets into the private sector, and report back to the legislature on its status.

Additionally, the current volume of ARLF loans no longer warrants a separate loan servicing function. The ARLF fund would benefit from economies of scale and a professional banking environment by transferring this function to the Department of Commerce and Economic Development’s Division of Investments. See Recommendation No. 1.

### *3. Traditional safeguards over public funds and equipment*

Due to legislative concern as to the proper use of DOAg funds, we selected approximately 300 risk-based expenditures. Overall, we found DOAg’s purchasing and payment controls acceptable. However, due to the diseconomies of scale inherent in a small division, DOAg was not able to implement some standard safeguards to protect state money and equipment.

We found the traditional safeguards listed in Exhibit 6 were not in effect at the time of the audit, though a few have since been remedied.<sup>24</sup> This diseconomy of scale can be remedied by the restructuring in Recommendation No. 1.

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<sup>23</sup> Like the Mat Maid dairy plant, DOAg acquired this asset when the private owner defaulted on a state loan. DOAg recently issued an RFP that solicited private operation of the meat plant. Even with a lease of only \$1 per year, there was no interest by Alaska businesses.

<sup>24</sup> DNR’s financial services reportedly has taken action to address and monitor the federal tax reporting requirement. Department of Administration, Division of Finance will also be adding information into the state’s administrative manual. Additionally, arrangements are being completed to improve the personal safety of cash custodians.

*4. Integrity of the state-owned “Alaska Grown” trademark*

The “Alaska Grown” symbol is a trademark owned by DNR. According to DOAg’s website, those who grow or process farm products are permitted to use the “Alaska Grown” trademark with the understanding that (1) food products are 100% locally grown or (2) processed products have 75% of contents produced in Alaska. Though a valuable asset, we find DOAg neglecting to protect the integrity of this trademark.

Although the trademark is registered with DCED and thus has protection within Alaska, it is not registered with the U.S. trademark office. Particularly in view of the Internet, persons in other states and countries may potentially dilute it by using it in a deceptive fashion. Additionally, the absence of control over the use of the trademark may ultimately relegate it to the nation’s public domain (like the term “aspirin”). A symbol of respect can even be degraded into an object of ridicule.<sup>25</sup>

DNR should work with DCED to proactively preserve this “Alaska Grown” trademark.



**EXHIBIT 6**  
**MISSING SAFEGUARDS**  
**OVER PUBLIC FUNDS AND EQUIPMENT**

- Separation of job functions to maximize the security of cash
- Missing accountability tags on expensive equipment
- Inconsistent, ambiguous tracking of Alaska Grown expenditures
- Neglect of mandatory federal tax reporting of customer payments with large amounts of currency
- Unresolved insurance responsibility when outside parties use DOAg machinery
- Lax custody of currency from informal sales
- Compromised personal safety of cash custodians

<sup>25</sup> A parody of the symbol already appears on a T-shirt with an image of an illicit cash crop.

**EXHIBIT 7**

**RECOMMENDED STATUTORY RESTRUCTURING TO REDIRECT AND REVITALIZE  
INNOVATIVE ALASKAN AGRICULTURAL DEVELOPMENT**

<u>Function</u>	<u>Current Placement</u>	<u>Most Feasible Reassignment</u>
State's top agricultural official  <i>Currently responsible for a "micro-division" of less than 30 permanent full-time employees</i>	DOAg director	DNR deputy commissioner  <i>Niche discovery and promotion, corporate relations, regulations, Alaska Grown program, Lower 48 publicity, industry liaison to Denali Commission</i>
Inspection of farms and farm products to protect consumers (quality) and public health (disease) (including federal contracts)	DOAg	DEC Environmental Health
Sales and leases of state land with agricultural covenants (AS 38)	DOAg	DNR Mining, Land and Water
Farm loans	DOAg (BAC)	DCED Investments  <i>Approval and servicing of ARLF loans, management and custody of ARLF funds</i>
Oversight of farm-related industrial facilities (non-research)	DOAg (BAC)	AIDEA board of directors and staff
Agricultural research	DOAg Plant Materials Center  Cooperative Extension Service (UAF College of Rural Alaska)  UAF School of Agriculture (including experiment stations)  Alaska Science & Tech. Found.  Federal agencies: NRCS, ARS, FSA	Plant Materials Center statutorily reconstituted under DNR as the Alaska Agricultural Research Consortium (AARC)  Cooperative Extension Service statutorily moved into AARC  ⌈ Applied research work statutorily linked to AARC, consultation with BAC for all agricultural research projects ⌋  MOUs negotiated with federal agencies for consortium participation
Farmer participation in state agricultural policies	DOAg (BAC)	BAC statutorily redefined as an advisory board to the Alaska Agricultural Research Consortium and the DNR's deputy commissioner for agriculture  <i>No BAC role in operations (loan approvals, land sales, or facilities oversight)</i>
Export niche discovery	DOAg	DCED International Trade and Market Development
Game farming regulation	DOAg	DF&G Wildlife Conservation
Livestock identification branding	DOAg	DNR State Recorder's Office

*Abbreviations:* DCED = Department of Community and Economic Development; BAC = Board of Agriculture and Conservation; MOU = memorandum of understanding; UAF = University of Alaska Fairbanks; DEC = Department of Environmental Conservation; AIDEA = Alaska Industrial Development and Export Authority; ARLF = Agricultural Revolving Loan Fund; NRCS = Natural Resource Conservation Service; ARS = Agricultural Research Service; FSA = Farm Service Agency

## FINDINGS AND RECOMMENDATIONS

### Recommendation No. 1

The legislature should statutorily restructure services to agriculture for a more aggressive pursuit of distinctive Alaskan opportunities.

Our conclusions above detail a wide spectrum of specific problems, such as the continuing lack of profitable niches, disjointed research efforts, human resources mismanagement, and deficiencies in the use of physical assets. We find that the current structure of a small division is both perpetuating these problems and actually hindering the advancement of Alaskan agriculture development, rather than facilitating it. The inherent limitations of this small division will continue to narrow the vision of Alaska agriculture to extinction, rather than invigorate it.

We recommend that the legislature take aggressive action to redirect Alaska agriculture. We find no existing services expendable. These services simply need to be redistributed where they can benefit from the economies of scale, teamwork, and breadth of vision found in more innovative corners of the state and federal systems, see Exhibit 7.

### Recommendation No. 2

The Department of Natural Resources (DNR) should consult the attorney general concerning state oversight of Mat Maid.

Just before the new Board of Agriculture and Conservation (BAC) assumed oversight of the Division of Agriculture (DOAg) facilities, the DOAg director surrendered meaningful control over the Matanuska Maid dairy and, in effect, gave its top management and board of directors the freedoms of private ownership while unconditionally immunizing them from any liabilities (even those arising out of crimes).

The Mat Maid dairy is organized as a corporation with DNR owning 100% of its stock, although there has been some public confusion.<sup>26</sup> When the legislature by statute created the BAC effective July 1, 2000, the DOAg director perceived that the new board, rather than himself, would exercise the oversight votes as DNR's shareholder "proxy." There was also a fear that the new board would eliminate the corporation's separate board of directors and directly supervise the dairy's business operations.

Thus, in the two weeks before the new BAC board took effect, the DOAg director took dramatic steps to cement and protect the autonomy of Mat Maid's top management and board

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<sup>26</sup> For example, a recent newspaper editorial erroneously implied that Mat Maid is now in private ownership. See "Agriculture in Alaska? More state farm assistance won't make this dog hunt," *Anchorage Daily News*, Dec. 3, 2002, p. B-4.

of directors. This was accomplished through unilateral changes to the articles of incorporation that were sought by Mat Maid and signed by DOAg's director as proxy. Those changes, which were arranged in secrecy, occurred without notice to the public, without a public shareholder meeting, and without review by the Department of Law or the DNR commissioner. Three days later, the changes were promptly reinforced after a two-hour, unrecorded, executive session of Mat Maid's board, a closed meeting that culminated in the board's immediate adoption of amended bylaws.

If the incoming governor's administration wishes to reestablish public accountability and control over Mat Maid, the attorney general can advise as to the options.

# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

### OFFICE OF THE COMMISSIONER

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January 8, 2003

Ms. Pat Davidson, Legislative Auditor  
Division of Legislative Audit  
PO Box 113300  
Juneau, AK 99811-3300

Dear Ms. Davidson:

Re: Preliminary Report – Audit Control # 10-30017-03 a Special Report on the Department of Natural Resources, Division of Agriculture, November 29, 2002

The Department of Natural Resources (DNR) received your Preliminary Report regarding the Division of Agriculture (DOAg) Audit and appreciates the time and effort you and your organization put into this audit. The following provides background information regarding how and why DOAg performed their functions. You will also find DNR's comments in relation to the report's Conclusions, Findings and Recommendations:

#### **Background:**

The purpose of the audit was to review DOAg's human resource management; use of assets; and the effectiveness of the working relationship among DOAg, the new Board of Agriculture and Conservation (BAC), and other entities involved in Alaska agriculture. The timeframe used for this evaluation is roughly 1998 – 2002, a period during which the Legislature renewed interest in the operations and budgets of the DOAg and mandated a shift in focus. From 1998-2000 DNR worked with the Legislature to establish the BAC. From the implementation of the BAC in 2000 through 2002 DNR assisted the newly appointed BAC to become fully functioning as directed by the Legislature. In this same time frame the DOAg's budget changed as follows:

	<b><u>FY1998</u></b>	<b><u>FY2002</u></b>
Federal	\$ 445.4	\$1,676.9
GF/PR	\$ 229.0	\$ 16.0
LDIF	\$ 0.0	\$ 174.7
CIP	\$ 0.0	\$ 156.5
ARLF, I/A, & SDPR	<u>\$1,476.0</u>	<u>\$2,046.9</u>
Total Budget:	\$2,150.4	\$4,071.0

*“Develop, Conserve, and Enhance Natural Resources for Present and Future Alaskans.”*

The reductions in state GF support forced DNR to look for alternative funding sources in an effort to extend the life of the ARLF. DNR successfully expanded the use of federal receipts authority and deleted ARLF funding for the land disposal program (the legislature provides a separate funding source for this activity).

The change of direction and budgets, combined with some errors made by DOAg Management caused some staff unrest, to this we agree.

One of DOAg's goals during this time was to sell its repossessed agricultural properties to get them back into private hands. DOAg experienced success in this endeavor and continues its efforts to sell the "major" agriculture facilities. DNR, including the DOAg, firmly believes that the private sector can do a better job farming those assets than can state government.

Concurrent with the above mentioned shifts in funding and organizational structure, good management of the ARLF loan portfolio resulted in the lowest default rate (less than one percent) in the history of the ARLF.

DNR's response to your specific recommendations follow.

### **Recommendation No. 1**

The legislature should statutorily restructure services to agriculture for more aggressive pursuit of distinctive Alaska opportunities.

DNR assumes the new administration will take this recommendation and its components under advisement. In 2000 the legislature created the BAC as a management and directing tool. This response does not attempt to support or rebut the suggested parsing out of DOAg functions. Rather than respond to each individual placement, DNR pledges to work with the legislature, the BAC, and the industry to successfully accomplish whatever is deemed appropriate.

Recently DNR evaluated transferring the responsibility of ARLF loan examination to the Division of Investments. DNR felt that preliminary activities, namely separation of the functions of loan examination and asset management, needed to occur prior to any transfer. This concept will be discussed further with the new Administration.

### **Recommendation No. 2**

DNR should consult the attorney general concerning state oversight of Mat Maid.

We agree with this recommendation.

### **Report Conclusions:**

The audit report concludes that the division has made very little progress in advancing agriculture; and, in fact, that the lack of innovative leadership is actually hindering the expansion of Alaska agriculture.



**Agency position:**

DNR does not agree with this conclusion and specifically objects to the statement that DOAg is hindering the expansion of Alaska agriculture! To measure progress there needs to be a standard to measure against.

The auditors attribute the lack of progress to:

**#1 - Lack of innovative leadership hinders Alaska Agriculture expansion**

DNR disagrees with this conclusion. It is a combination of market forces and resources dedicated to farming activities by the Legislature that impact the expansion of the Alaska agricultural industry. DNR and the Legislature measure the success of DOAg against its established Mission & Measures. Specifically, the Legislature measures the success of the DOAg as follows:

**“The monetary value of agricultural products grown in the state that are sold domestically or exported”.**

In 1998 this number was \$27,511,000. Three years later, the monetary value of agricultural products increased by 9.6%, to \$30,152,000. DNR considers \$2.6 million a very respectable increase. Using these criteria, DNR feels that DOAg has been successful despite limited resources.

The level of innovation suggested by this audit requires resources, in terms of staff and dollars, not currently available to the division. The day-to-day demands on state employees at DOAg are already substantial.

In addition, current state policy is purposely one of NOT directing agricultural development. Agriculture in Alaska is still routinely criticized for the state-sponsored projects of twenty-five years ago. We have moved beyond that and look to the future. The division is tasked to assist and support farmers as they innovate, not to direct their activities.

DOAg successfully provided support services for farmers entering niche markets or expanding production for traditional markets. The division pursued federal funding, sold repossessed agricultural land, and provided necessary inspection and marketing assistance. Following is a sampling of accomplishments during the past decade:

- ✓ Sold over 55,000 acres of agricultural covenant State of Alaska (State) lands (120 parcels), both ARLF and Title 38, bringing over \$12 million in return to the State. With only one exception, DOAg did not tell purchasers what to grow or how to farm. To encourage farmers to purchase and to discourage speculators, purchase requirements are generally limited to a minimal clearing requirement for Title 38 sale contracts. Recent media coverage of possible new disposal areas has generated dozens of inquiries from Alaskans.
- ✓ Specialty crops and products have been encouraged through loans, marketing efforts and direct staff support. These crops and products include but are not limited to: fresh cut vegetables, baby-peeled carrots, cheese curds, alternative livestock (elk, bison, yak, reindeer, llamas, and alpacas), organic crops, greenhouse production, and farmers' markets. Our modest financial contribution to USDA Farmers Markets, Women Infant and Children Program (WIC), and Senior coupon

- ✓ Programs has significantly helped small farmers seeking niches (jelly and jams, birch syrup products, organic farmers, etc.) to expand and become profitable.
- ✓ Developed and promoted several specialty niches, actively cooperated with and assisted in the development of six Farmers Markets throughout Alaska (Anchorage, Fairbanks, Homer, Kenai, Eagle River, and Wasilla) and DOAg is currently working on the development of a market in Southeast Alaska.
- ✓ The Cooperative Marketing Program (CMP) funded 19 producer driven promotional projects across Alaska, and 15 of the 19 contracts were for niche type markets. The Kenatzie tribe in Kenai has been a participant in the CMP. Some of the non-traditional products include: aquaculture through the Shellfish farmers, natural teas from rural and southeast Alaska, farmed game meats, organically grown grains and produce for human consumption, family owned greenhouses and nursery producers. Aquaculture shows potential and the division is working with growers, cooperatives, and associations to promote and define this market with the limited staff resources that are available at the division.
- ✓ New products for major distributors: Developed and found markets for Alaska Reindeer products. Product demand for this market continues to go unmet for several reasons, all of which are out of DOAg control.
- ✓ Routine inspection of retail businesses: DOAg staff inspects locally produced products at the shipping point and packing warehouses. This corrects problems with product quality before it enters the marketing chain and provides the efficiency of visiting one packing warehouse instead of several stores. Existing statutory authority only requires the inspection and labeling of potatoes for grade requirements. USDA Licensed Inspection staff does retail produce surveillance as time allows reviewing other produce that is labeled to a USDA grade. Current staffing limitations restrict the ability to conduct more inspections at the retail level.
- ✓ International Trade: DOAg staff cooperated with the Division of Community & Economic Development (DCED), Division of International Trade to develop and identify markets for Alaska Grown products. They also worked with DNR's Division of Forestry, DCED's, International Trade, and USDA to promote the international marketing of Alaskan logs. We welcome the continuation and expansion of these relationships to identify and develop international markets.
- ✓ DOAg supported, through marketing and infrastructure maintenance, "meat and potatoes" farming and commodity farmed dairy, red meat, and grain production. The following examples demonstrate DOAg's successes in this area. DOAg rebuilt the Mount McKinley Meat and Sausage Plant (MMMS) after a major fire in 1997. DOAg aggressively and successfully marketed a record potato crop in 2001 through the *Alaska Grown program*. The agricultural land disposal program resulted in additional Southcentral dairies (not a sale requirement) and a subsequent 40% increase in milk production between 1994 and 2002.

- ✓ The Director of DOAg approached USDA Rural Development leadership regarding Denali Commission funding for agriculture on two occasions. The focus of the Denali Commission at that time was to support “bush communities.” Again in 2001, the Northern Region office approached the Denali Commission concerning development projects at Delta Junction. The Denali Commission informed the regional office that projects in the rail belt were not being considered at that time. In recent months, focus shifted to more rural (road accessible) projects. The division continues to maintain contact with Denali Commission members and supports future efforts by the new administration to pursue similar contacts, including the concept of an agricultural industry liaison, and additional federal funding as envisioned by the audit report.
- ✓ The Division has worked with other federal funding agencies with great success. The Director estimates \$9-10 million in federal funding has been requested and received over the past five years. Much of this money has been in support of the Plant Material Center (PMC) projects (Seed Lab, Plant Quarantine Facility, Cold Regions Research, Germplasm Repository, and Native Plant Commercialization). Marketing and value-added grants have approached \$700,000. DOAg is successfully partnering with the Bureau of Indian Affairs (BIA) on a significant road project in the Delta area, and has language in the USDA appropriations bill for FY 2003 for significant grants or loans to Matanuska Maid Dairy.
- ✓ DOAg created the Cooperative Marketing Program (CMP). This matching small grant marketing program is driven by producers’ ideas and allows them to make their own decisions about marketing efforts. The CMP generated over \$70,000 in advertising for niche and mainstream agricultural products in its first year. Federal grants funded the program at \$50,000 for the past two years and the program generated in excess of \$100,000 in advertising efforts. Positive sales reflect industry support for this new project. The primary beneficiaries are the “niche growers.”
- ✓ Import Substitution does not just relate to “meat and potatoes” farming. It includes native plants, re-vegetation grass seed and vegetables. Since half of all vegetables and potatoes consumed by Alaskans are processed or frozen, the Division supports a federal grant award to the Mat-Su Farm Bureau Chapter to quantify the market for value-added vegetables in our institutional markets, e.g., school lunch programs, correctional facilities, pioneer homes, etc. If feasible, this could double the market for Alaska vegetable farmers growing carrots, potatoes, broccoli, peas, etc.; all are crops that do well here. There is potential for a shared use of a proposed Central Kitchen facility with the Matanuska–Susitna School District or partial utilization of the ASI Plant in Anchorage. This approach is exactly what is leading to successful, non-commodity small farms across the country.
- ✓ An analysis of the USDA statistics shows that contrary to what made up the product mix of ten to fifteen years ago; grain and milk production, while still important, has been overtaken by vegetable and greenhouse production. With State assistance, not direction, sustainable consumer-driven production is occurring. Alaska agriculture cash receipts have returned to the record level of cash receipts from the late 1980s without significant State investment.
- ✓ The PMC has been a national leader in the use and development of Native Seed as a regionally competitive crop for local farmers. Very few states have devoted as much resource to these new crops, as has Alaska through the PMC. Native plant seed is a crop adapted to our state and a crop that is not overly affected by commodity market prices and/or competition from other areas

in the nation. It is a crop that is developed, grown, marketed, priced and used in Alaska. No other crop can make this claim.

- ✓ Agriculture in Alaska is not driven by State developed marketing or product decisions. We sell agricultural lands, monitor contracts, assist with marketing, inspect agricultural product including raw logs and elk fences, make loans for agricultural development, service existing loans, assist the BAC, respond to public requests; all with a handful of staff in each section. The Division has done this knowing those services are being paid for from the corpus of the Agriculture Revolving Loan Fund (ARLF). To do more would require additional draws from the fund, or additional federal resources or an unlikely infusion of state general funds. Agriculture in Alaska is growing in a steady and responsible fashion. The statistics verify this.
- ✓ There are not any “affluent corporate farms in Alaska”; we have 500-700 relatively small family farms.

In summary, DOAg has been successful in many niche areas. They acquired new federal funding and inspections were aimed at areas supported by federal funds. The industry or the Legislature did not mandate pursuing the niches in Exhibit 1, nor has it been funded. All of DOAg’s accomplishments were achieved in an environment of change and at a time when the objective was to get repossessed ARLF assets and other Agricultural properties back into the private sector. DNR feels DOAg has been successful in achieving this objective.

DNR takes exception to Exhibit 2 and the statement that “DOAg’s unfocused approach simply emphasizes the volume of “farmland” that has been re-privatized”. Are the auditors suggesting by their inclusion of Exhibit 2 that either the BAC or the Legislature is sending the DOAg into the wrong jungle? The DOAg inherited assets of a failed agriculture policy established during the early 80’s. Current legislative direction is for the DOAg to be self-supporting with ARLF and federal funds. The disposal of repossessed properties is nearly complete. Disposal of state owned agricultural land has been highlighted as a primary action requested by the Alaskan agricultural community and is also a means of promoting agriculture and protecting the ARLF. The DOAg is now able to step out into new ventures, as determined appropriate by the Legislature and the BAC. However, accomplishments achieved in meeting the DOAg Mission and Measures deserve to be acknowledged. DNR and the BAC respectively recommend that Exhibit 2 and all reference to it be removed from the audit report.

Through Exhibit 3 the auditors assign assumptions to the DOAg that are not subscribed to by DOAg and DNR. DOAg’s practices also do not conform to footnote 8, which implies the State is to provide the costly infrastructure. Our hope is to have the private sector operate without government assistance. DNR does not assume that government can run a business better than the private sector. However, when the private sector fails and their operation is financed with State funds, DOAg is responsible for protecting the State’s financial interest.

The audit mentions the entitlement culture from which the farmers need to be weaned. Farmers are not provided subsidies. DOAg sells land and assets at appraised values. The recent land disposals are at appraised values and any additional infrastructure is at the cost of the buyer.

DOAg practices fiscal responsibility by appropriately managing the assets of the State; this requires repossessing properties when the borrower fails to comply with contractual obligations. DOAg

attempts to place that parcel back into the private sector, which in some instances, may require a lower than appraised value sale price. DOAg cannot increase the monetary value of agricultural products grown in the state that are sold domestically or exported if the division's repossessed property inventory remains out of production.

## **#2 - Fragmented, disjointed research facilities**

DNR disagrees with the statement that the effort of our research failed to result in any profitable niches. Public research in itself cannot produce profit. It is the entrepreneur utilizing the results of research that will create profit. DOAg may have potentially profitable results from research but it is the private sector that must take the next step. There are examples of realized profits as a result of our research. New crop releases from the PMC have given some seed growers sustainable profit.

The comment that the PMC is, in our opinion, inaccurate. We believe that within its areas of specialization the PMC is well recognized and respected in Alaska, throughout the nation, and, to a degree, internationally. Unfortunately, the PMC staff are so specialized that they do not have the luxury of broad public visibility. The PMC is the primary scientific and technical information resource for several outside entities, including, but not limited to the: Alaska Department of Transportation and Public Facilities, Alaska Department of Fish and Game, U.S Air Force in Alaska, Corps of Engineers in Alaska, Department of Environmental Conservation, and the U.S. Public Health Service. These and a number of other state and federal agencies interact with the PMC concerning issues of re-vegetation, erosion control, land reclamation, and habitat enhancement/restoration. In addition to a large professional level customer base, the PMC staff fields a substantial number of requests from the public and is the primary resource for the seed growers in Alaska. The PMC is well known by those who need to know.

It is interesting to note that for a little known facility the PMC seems to bring in a great deal of funding from a broad-based federal agency pool. No agency is required to work with the PMC. Agencies seek out the PMC for assistance based on the PMC's reputation and abilities. The wide spread cooperative agreements and arrangements the PMC has with a multitude of agencies and private sector companies benefits not only the PMC; it is the primary means of marketing the seed grown by the Alaska Seed Growers.

The audit calls the PMC a research facility. In reality, most of what the PMC does is to provide support in the form of information and production of seed and potatoes. These are services, not research. The PMC does complete research in relation to production crops, as there is a critical need for this among producers.

While governmental coordination can always improve, the DOAg can only work cooperatively with those who wish to and have resources to do so. In recent years, Cooperative Extension Service (CES) has taken significant budget cuts. Yet they have been able to reestablish a half time extension position for livestock, and that individual has worked with dairy farmers and non-traditional livestock owners. Ever since late blight was found in the 1998 potato crop, CES, the University Experiment station, and the DOAg have funded a modest pest scout program. DOAg continues to work with USDA APHIS, most recently on pest and disease programs funded through homeland security. The PMC is actively working with USDA ARS through the Arctic Germplasm

repository. Though limited by the small nature of the industry, the various federal, University, and state agencies focused on agriculture in Alaska do cooperate extensively.

The conclusion includes a reference to the fact that the legislature needs to directly, formally, and explicitly mandate an Alaskan Agriculture Research Consortium through amendment of statutes for the PMC and the university system to work together. DNR welcomes a discussion regarding this with a focus to practical outcomes and adequacy of funding.

The BAC believes that attention must be given to the fact that the UAF is a land grant institution and the federal formula funding for agricultural research and extension can only go to the Land Grant University in each state. That university by law is obligated to teach agriculture. This could result in less federal monies being available.

### **#3 - A more meaningful role for the new Board of Agriculture and Conservation**

The legislation that created the BAC has been in effect since July 1, 2000. Among the stated goals was continuity of agricultural policy between administrations, increased industry control of critical ARLF infrastructure assets, regulation promulgation authority, and management of the ARLF. The BAC has worked diligently since its formation two years ago to implement the legislation and adopt regulations that will further its mission. Additional involvement in research and development issues is a good idea. Only recently, having finished the arduous process of developing and implementing regulations, and faced with the Mt. McKinley Meat and Sausage (MMMS) disposal effort, has the BAC been afforded the luxury of entertaining long-range policy issues for agriculture in Alaska. DNR believes they are now well positioned to take on that task.

### **#4 - Human Resources (HR) Mismanaged**

While the past Director of DOAg has acknowledge personal weaknesses in human resource management, over the course of his tenure he communicated the basic premise that professional behavior is expected.

The Department did address most of the bullets in Exhibit 4 and offers the following:

#### **Careless screening of job applicants for any criminal background or dangerous driving records (incomplete applications, little verification, lax follow-up of disclosures to assess risk to public and co-workers)**

This is an inaccurate statement. All applicant profiles and supporting documentation are thoroughly reviewed. If a conviction(s) is reported on an applicant profile and supporting documentation, the conviction(s) is evaluated in accordance with Personnel Rule 2 AAC 07.091 and with established Department of Administration, Standard Operating Procedures. The review and findings are in the central personnel files not in the Division's.

**Inadequate safeguards for accurate communication of pay rates and benefits to hirees.**

DNR's Human Resources staff consistently strive to provide accurate information regarding pay and benefits. Our systems are set up with a cross certification process. When errors are discovered, immediate steps are taken to correct the error.

**Employee confusion over Ethics Act boundaries between official and private behavior.**

DNR acknowledges some employees may have been confused. On June 6, 2002 a meeting was held with all the Palmer Agriculture employees (except the PMC staff) to distribute and review statewide policies and procedures. The meeting was conducted by the Human Resources Manager, Assistant Human Resources Manager, and the Special Assistant to the Commissioner. The Special Assistant to the Commissioner, as the designated Ethics Supervisor for the department, delivered a presentation on the statewide Ethics Act, distributed a copy of the Ethics handbook and conducted a question and answer session.

Recent reports from the Ethics investigator find no ethic violations occurred within the scope of review.

**Neglect of escalating reclassification disputes (duties have expanded to do more with less).**

All the collective bargaining units recognize that the Employer retains the right to manage its affairs, to determine the kind and nature of work to be performed and to direct the work force. The positions in the Division of Agriculture are correctly and appropriately classified. If an individual employee believes their position is inappropriately classified they may obtain a review of their position by utilizing their collective bargaining process.

**#5 - Physical Resources Mismanaged****1. Environmental Stewardship**

The Division is committed to high agricultural environmental standards, and has taken proactive steps to ensure it. To compare us to the other natural resource industries is fair; to imply they have not had their own challenges is not realistic. In order to limit potential environmental problems, DOAg, as a condition of sale of agricultural lands, requires contact with the most capable government resource, the USDA Natural Resource Conservation Service (NRCS). State government has no budget to perform such services. DOAg requires a farm conservation plan before a contract is executed. While that does not ensure environmental compliance for a private property owner, it does establish an initial contact with professionals who can assist with the variety of issues involved in farm development, including animal waste management.

The DOAg website lists reference sites for farmers, both national and international. EPA and USDA are currently working on Concentrated Animal Feeding operation regulations. It is one of the biggest issues facing large corporate farms in the U.S. Alaska has no farms in that category. DOAg acknowledges challenges on a specific farm. Division personnel, including the loan officer, asset manager, and BAC representatives continue to monitor and work toward resolution of the problem. DOAg supported the DEC action referenced in the audit and communicated to the farmer the serious nature of the infraction. As a result of communications with other agencies, DOAg is

aware that an Environmental Quality Improvement Program (EQIP) grant had been secured and that construction of an adequate system is occurring.

The DEC is the responsible agency for dairy permits and DOAg is aware they conduct water sampling of farm wells. To our knowledge, there has been no violation of water quality. While DOAg acknowledges isolated problems, the division has dedicated resources to fix them. On Pt. MacKenzie, Tract 15 was the responsibility of BAC as an ARLF asset and was fixed. The situation has been corrected, with the exception of spreading stockpiled manure. This byproduct is valuable and applied correctly is no threat to the water resource and is an efficient and effective fertilizer source. The division and ARLF have sold these properties and do not entertain leases of farm facilities. Private property owners are urged to contact the appropriate regulatory and support agencies.

The reference to the test at Ft. Greeley / Gerstle River speaks to a much larger environmental issue which the division will track, regardless of responsibility. For several years DNR reviewed, and continues to review, the agricultural area along the Gerstle River for contamination. No contamination has been found.

The mischaracterization of an advertisement in the November 15, 2002 edition of the Anchorage Daily News suggests bias. DOAg agreed, based on our CMP program, to support an ad that was conceived largely by the Mat Valley vegetable growers through the local Farm Bureau Chapter. If the auditors question the amount of herbicides, pesticides and GMO products that were referred to, please provide documentation. Suggesting that one failed lagoon, recognized and with its problems being corrected, as evidence of some massive agricultural environmental problem in Alaska shows a lack of agricultural knowledge and expertise.

## 2. Oversight regarding major state owned facilities

Of the five facilities listed, the former **Fairbanks Meat Plant**, now serving as a fish processing plant, is under consideration for disposal. With the more disposable assets returned to private ownership, division staff will begin to investigate and propose strategies for disposal of this asset.

The other four assets are critical infrastructure assets for agriculture in Alaska. They are best suited to oversight by the BAC, with its agricultural expertise.

**The Matanuska Maid dairy** is running in the black. No public funds have been expended on this facility in more than a decade. Auditors may suggest that Alaskans do not support local milk production because of higher consumer prices, but customers continue to vote with their dollars everyday to keep this business in a profitable situation. USDA funding of new physical plant for Mat Maid remains a real possibility.

The **Feed Mill facility in Palmer** is managed as an asset of Mat Maid. Because of the shortage of space in Anchorage at the primary facility, this location performs critical functions, including bottle and jug making and vehicle maintenance. A new physical plant could make this a disposable asset.

The **Mt. McKinley Meat and Sausage** plant has been offered to the private sector twice in the past two years. The BAC has scheduled a public hearing on January 15, 2003 to discuss further attempts to dispose of the facility.



The **Alaska Farmers Coop facility** is a fertilizer blending facility, as well as a grain storage and grain drying facility that was constructed in the late 1970s. This facility provides a service to any interior farmer looking to either purchase bulk fertilizer or access grain facilities. This makes it an important infrastructure asset for interior farmers. This facility receives no State funding.

### 3. Traditional safeguards over public funds and equipment

DNR is pleased to note that after extensive review of over 300 risk-based transactions, the auditors found purchasing and payment controls acceptable. The division has addressed a number of the suggestions in Exhibit 6 and will continue to look at strengthening safeguards over public funds and equipment.

### 4. Integrity of the state owned “Alaska Grown” trademark

DNR agrees this trademark should be registered with the US trademark office. The DOAg has recently contacted users in an effort to develop an updated and proactive policy with regard to its use.

DNR appreciates the opportunity to respond and looks forward to working on implementation of the improvements suggested in this report.

Sincerely,

Marty Rutherford,  
Acting Commissioner

Cc: Dean Brown, Acting Director, Division of Agriculture  
Nico Bus, Acting Director, Support Services Division

January 13, 2003

Members of the Legislative Budget  
and Audit Committee:

We have reviewed the response to our preliminary audit on the Department of Natural Resources (DNR), Division of Agriculture (DOAg). Nothing contained in this response gives us cause to reconsider our findings.

DNR's response underscores our concerns rather than refutes them. DNR persists in its defense of the status quo that benefits its small DOAg constituency.

First, DNR refuses to acknowledge that the State faces a serious fiscal crisis in which limited resources must be refocused on serious business opportunities. Despite a small division dedicated to "agriculture," federal farm statistics continue to show a small role for farming in the state's economy.<sup>1</sup>

Second, the approach of the response demonstrates deference to existing beneficiaries more than decisive planning for the advancement of the state's agriculture. In fact, DNR asserts that agricultural leadership and innovation are simply not its responsibility. We disagree, though, believing that public resources must now be refocused on those programs with the most promise to significantly advance the state's economy. In short, responsible public choices are part of DNR's job.

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<sup>1</sup> The 2001 production statistics cited by DNR demonstrate the small nature of Alaska agriculture, not its success. To begin with, the \$30.1 million in receipts from Alaska production represents the *gross* amount received rather than any indication of the *net* profitability of farms. The four main components of the \$30.1 million are commercial greenhouses (47%), potatoes (11%), hay (10%), and milk (9%).

The "record" potato crop for the entire state is actually harvested from a total of less than 1½ square miles. The harvested area of its hay crop ranks only above Delaware and Rhode Island in comparison to the Lower 48. Alaska has fewer milk cows than any other state. Despite all of DOAg's "Alaska Grown" publicity campaigns, federal statistics also show that the state's entire crops of carrots, lettuce, and cabbage are each harvested from total areas of less than *one-tenth* of a square mile.

DNR's assertion of "500-700 relatively small family farms" is based on surveys conducted by the U.S. Department of Agriculture (USDA). However, per the USDA statistician, the self-reporting threshold for the federal definition of an Alaskan "farm" is only actual or *potential* sales of at least \$1,000. Thus, the USDA statistics do not indicate the number of commercially viable farms. Even under USDA definitions Alaska is ranked last in the nation in terms of the number of farms.

Further, DNR's assertion that Alaska is devoid of any "affluent corporate farmers" is inconsistent with the department's own records and those of the Department of Community and Economic Development.

In summary, we reaffirm the findings and conclusions presented in the report.

Pat Davidson, CPA  
Legislative Auditor