Denali Commission

Financial Statements and
Independent Auditors' Report

September 30, 2005 and 2004

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

DENALI COMMISSION

SEPTEMBER 30, 2005 AND 2004

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To the Commission Members
Denali Commission
Anchorage, Alaska

Independent Auditors' Report

We have audited the accompanying balance sheets of the Denali Commission as of September 30, 2005 and 2004, and the related statements of operations and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of the Denali Commission's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Denali Commission as of September 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information on page 11 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we express no opinion on it.

The Commission Members
Denali Commission

In accordance with *Government Auditing Standards*, we have also issued our report dated January 20, 2006 on our consideration of the Denali Commission's internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of the audit.

M.D. Oppenheim & Company, P.C.

January 20, 2006

DENALI COMMISSION
Balance Sheets
September 30

		2005		2004
ASSETS				
Current assets				
Fund balance with Treasury	$	202,132,095	$	183,996,949
Restricted cash		3,700,000		1,209,743
Total cash		205,832,095		185,206,692
Accounts receivable				24,878
Advances to grantees		12,052,016		5,258,647
TOTAL ASSETS		**217,884,111**		**190,490,217**
LIABILITIES AND NET POSITION				
Current liabilities				
Accounts payable		569,261		123,620
Grants payable		16,704,469		54,138,665
Liability for pass-through funding		3,700,000		1,209,743
Accrued payroll		1,350,088		368,484
Accrued leave		48,446		55,423
TOTAL LIABILITIES		**22,372,264**		**55,895,935**
Net position		**195,511,847**		**134,594,282**
TOTAL LIABILITIES AND NET POSITION	**$**	**217,884,111**	**$**	**190,490,217**

See accompanying notes and Independent Auditors' Report

DENALI COMMISSION
Statements of Operations and Changes in Net Position
Years Ended September 30

		2005		2004
REVENUES				
Appropriations received	$	67,000,000	$	56,000,000
Appropriations transferred in		2,789,600		1,988,200
Less: Rescissions		(536,000)		(330,400)
Appropriations (net)		69,253,600		57,657,800
Transfers from other federal agencies		66,441,811		58,142,900
Other revenue		4,412,529		4,273,719
Total revenues		**140,107,940**		**120,074,419**
EXPENSES				
Program costs		74,608,637		80,365,206
Administrative expenses		4,581,738		5,704,015
Total expenses		**79,190,375**		**86,069,221**
NET INCOME		**60,917,565**		**34,005,198**
Net position, beginning of the year		134,594,282		100,589,084
NET POSITION, END OF YEAR	**$**	**195,511,847**	**$**	**134,594,282**

See accompanying notes and Independent Auditors' Report

DENALI COMMISSION
Statements of Cash Flows
Years Ended September 30

	2005	2004
Cash flows from operating activities:		
Net income	$ 60,917,565	$ 34,005,198
Adjustments to reconcile income to net cash provided by operating activities:		
Changes in assets and liabilities:		
Accounts receivable	24,878	
Advances to grantees	(6,793,369)	(5,258,647)
Accounts payable	445,641	(139,581)
Grants payable	(37,434,196)	8,298,343
Liability for pass-through funding	2,490,257	428,197
Accrued payroll	981,604	368,484
Accrued leave	(6,977)	55,423
Net cash provided by operating activities	**20,625,403**	**37,757,417**
Net increase in cash	**20,625,403**	**37,757,417**
Cash at beginning of year	**185,206,692**	**147,449,275**
CASH AT END OF YEAR	**$ 205,832,095**	**$ 185,206,692**

Supplemental disclosures:

No amounts were paid for interest or income taxes in 2005 and 2004.

See accompanying notes and Independent Auditors' Report

Note A – Organization and Mission

The Denali Commission (the "Commission") was established under the Denali Commission Act of 1998 (P.L. 105-277, Division C, Title III), as amended and 42 U.S.C. Chapter 38, Sec. 3121. The Commission, a "designated" federal entity as published by the Office of Management and Budget under the Inspector General Act of 1978, functions as a unique federal-state-local partnership to address crucial needs of rural Alaskan communities, particularly isolated Native villages and other communities lacking access to the national highway system, affordable power, adequate health facilities and other impediments to economic self-sufficiency.

The Commission is comprised of seven members who are appointed by the U.S. Secretary of Commerce. The Federal Co-chair serves a term of four years and may be reappointed. The other six Commissioners are the heads of Alaskan state and non-governmental organizations and have been appointed for the life of the Commission.

The mission of the Commission is to partner with tribal, federal, state, and local governments and collaborate with all Alaskans to improve the effectiveness and efficiency of government services, to develop a well-trained labor force employed in a diversified and sustainable economy, and to build and ensure the operation and maintenance of Alaska's basic infrastructure.

Note B – Summary of Significant Accounting Policies

1. **Major Programs** – The Commission has major programs in the areas of energy, health care, economic development, training, and other infrastructure. Funding for these programs is provided from general federal appropriations as well as funds from various federal agencies.

2. **Reporting Entity –** These financial statements include all of the activities of the Commission including its program and administrative operations. The Commission is also a component unit of the U.S. Government financial reporting entity.

3. **Basis of Accounting -** The accompanying financial statements have been prepared using the accrual method of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred. Appropriations are recognized as revenues when they are received.

Note B – Summary of Significant Accounting Policies (continued)

4. **Financing Sources -** The Commission receives annual no-year federal appropriations to fund program grants and its operations. Funds are available until expended. Intragovernmental one-year and two-year funds transferred from other federal agencies are also used to carry out Commission programs.

5. **Fund Balance with Treasury** – Cash receipts and disbursements for operations are processed by the U.S. Department of Treasury. Funds held by the U.S. Department of Treasury represent funds available for operations.

6. **Restricted Cash** – Restricted cash is pass-through funding from other federal agencies which the Commission pays to non-federal organizations in Alaska on the agency's behalf.

7. **Advances to Grantees** – Payments to grantees are recorded as advances when disbursements are made and are reduced when actual grantee expenditures are recorded by the Commission.

8. **Equipment and Software** – Equipment and software with an acquisition cost of $10,000 and a useful life of at least two years is capitalized. As no assets of the Commission meet this threshold, all equipment and software purchases have been expensed as incurred.

9. **Net Position –** Net position consists of unobligated balances and undelivered orders of the Commission's appropriated funds as well as the cumulative results of operations.

10. **Use of Estimates** – The preparation of the accompanying financial statements requires management to make estimates and assumptions that affect certain amounts and disclosures included in the financial statements. Accordingly, actual results may differ from those estimates.

Note C – Trans-Alaska Pipeline Liability Trust Fund

The Denali Commission Act of 1998 states that one of the purposes of the Commission is to promote rural development, provide power generation and transmission facilities, modern communication systems, water and sewer systems and other infrastructure needs. The Coast Guard and the Environmental Protection Agency enlisted the assistance of the Commission to help in bringing bulk fuel tanks in Alaska up to environmental and safety standards as set by the two agencies.

Note C – Trans-Alaska Pipeline Liability Trust Fund (continued)

To facilitate this work, the Commission was assigned the interest earned on a portion of the principal from Trans-Alaska Pipeline Liability (TAPL) Trust Fund. The use of the interest money is restricted to bulk fuel tank renovation or construction. The Commission received $4,252,043 and $4,273,719 from the TAPL Trust Fund in FY 2005 and 2004, respectively, in support of this effort.

Note D – Pass-through Funding

The Denali Commission Act of 1998 states that one of the purposes of the Commission is to deliver the services of the federal government in the most cost-effective manner practicable by reducing administrative and overhead costs. In the spirit of this legislation, the Commission has offered a service to other federal agencies whereby a federal agency may utilize the Commission to make payments to organizations in Alaska on the agency's behalf. No fee is collected for this service. Amounts received but not disbursed as of September 30, 2005 and 2004 are reported as liabilities on the balance sheets.

Note E – Transfers from Other Federal Agencies

The Commission received intragovernmental revenue from other federal agencies for the years ended September 30 as follows:

	2005	2004
Department of Health & Human Services	$ 39,543,703	$ 34,693,000
Environmental Protection Agency	3,968,000	3,479,400
USDA Rural Utilities Service	15,000,000	15,000,000
Department of Labor	6,944,000	4,970,500
Department of Interior	986,108	
Total	$ 66,441,811	$ 58,142,900

Note F – Retirement and Other Benefit Plans

The Commission participates in the Federal Employees Retirement System (FERS) for federal employees. The FERS plan is administered by the U.S. Office of Personnel Management (OPM). The Commission makes contributions at rates applicable to agencies of the federal government. The contributions do not equal the full service cost of the pension expense, which is the actuarial present value of benefits attributed to

Note F – Retirement and Other Benefit Plans (continued)

services rendered by covered employees during the accounting period. The measurement of service costs requires the use of actuarial cost methods to determine the percentage of the employees' basic compensation sufficient to fund their projected pension benefit. These percentages (cost factors) are provided by OPM.

The excess of total pension expense over the amount contributed by the Commission and Commission employees represents the amount which must be financed directly by OPM. The Commission does not recognize in its financial statements the excess amounts as they are deemed to be immaterial. Contributions to the plan for FY 2005 and FY 2004 were $312,419 and $224,101, respectively.

Several employees also participate in the Federal Employees Health Benefit plan (FEHB) and the Federal Employees Group Life Insurance program (FEGLI), also administered by OPM. The Commission pays the cost of current employees. Post-retirement benefits are paid by OPM. No amounts have been recognized in the financial statements for these imputed costs as they are not deemed material. Contributions to these plans for FY 2005 and FY 2004 were $67,893 and $48,142 for FEHB, respectively and $1,953 and $1,568 for FEGLI, respectively.

The Commission does not report in its financial statements FERS, FEHB or FEGLI assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees. The Commission also contributed $32,653 and $32,459 to the Federal Thrift Savings plan for all eligible employees for the years ended September 30, 2005 and 2004, respectively.

Note G – Lease

The Commission's lease for its office commenced on February 1, 2003 and extends through July 31, 2010. It provides for increases in annual base rent of 2 percent per year. The future minimum lease payments required under this lease are as follows:

Year Ended September 30,		Amount
2006	$	391,000
2007		399,000
2008		407,000
2009		415,000
Thereafter		351,000
Total	$	1,963,000

Additional Information

Federal Budgetary Data

The following summarizes the budgetary data related to the Commission's federal appropriations for the years ended September 30, 2005 and 2004, respectively:

BUDGETARY RESOURCES

	2005	2004
Budget authority – appropriation	$ 71,252,043	$ 60,273,720
Net transfers	2,789,600	1,988,200
Unobligated balance brought forward October 1	9,004,029	1,861,299
Spending authority from offsetting collections	70,002,297	58,875,489
Permanently not available	(536,000)	(330,400)
Total budgetary resources	152,511,969	122,668,308

STATUS OF BUDGETARY RESOURCES

	2005	2004
Obligations incurred	131,905,848	113,664,279
Unobligated balance	20,606,121	9,004,029
Total budgetary resources	$ 152,511,969	$ 122,668,308

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To the Commission Members
Denali Commission
Anchorage, Alaska

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

We have audited the financial statements of the Denali Commission as of and for the years ended September 30, 2005 and 2004, and have issued our report thereon dated January 20, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Denali Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Denali Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the following finding.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. However we believe that the reportable condition described above is a material weakness.

The Commission Members
Denali Commission

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Denali Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* which is described in the accompanying finding.

We also noted certain other matters we reported to management of the Denali Commission in a separate letter dated January 20, 2006.

This report is intended solely for the information and use of the Commission members, the Inspector General, management and others within the organization. However, this report is a matter of public record and its distribution is not limited.

M.D. Oppenheim & Company, P.C.

January 20, 2006

Lack of Adequate Controls Over Grants Accounting and Cash Management

During our audit we found discrepancies in 45 of the 151 grant expenditure balances (30%) confirmed directly to us by the grantees. This represents differences between what the grantees had reported in their on-line quarterly progress reports to the Commission and the grant balances confirmed directly to the auditors for the same periods. Some of the reasons given by the grantees for these discrepancies were cost revisions made subsequent to submitting the progress reports, financial information submitted by grantee program staff without first conferring with their accounting department, or grantees unable to offer an explanation.

At the end of FY 2004, the Commission changed from cash to an accrual basis of grants accounting in compliance with generally accepted accounting principles. Accrual accounting requires that grant expenditures are recorded when reported by the grantees rather than when grant funds are disbursed by the Commission. This basis of accounting places reliance on the integrity of the financial information reported quarterly to the Commission by the grantees. The lack of accurate, reliable cost information increases the risk that grant funds are not being spent in accordance with grant agreements and impairs the Commission's ability to properly manage its grant projects.

Accurate cost information also enables the Commission to monitor the rate that funds are drawn down by the grantees to cover current costs incurred. A grantee should draw down funds only to meet immediate cash flow needs in compliance with federal cash management requirements. Due to the unreliability of grant expenditure information, the Commission could not adequately determine the amount of excess cash being held by the grantees. Based on the audited grant balances, many grantees were drawing down grant funds in advance of the need for those funds. In most cases this appeared to be caused by their lack of knowledge about federal cash management requirements. The lack of adequate cash management controls increases the risk that fraud, waste and abuse may occur and not be detected by the Commission.

OMB Circular A-102, *Grants and Cooperative Agreements with State and Local Governments* states:

> ***Cash Management.*** *Agency methods and procedures for transferring funds shall minimize the time elapsing between the transfer to recipients of grants and cooperative agreements and the recipient's need for the funds.*

The Commission staff generally concurred with our finding and promptly initiated corrective actions to address these issues.

Recommendation

We recommend that the Commission require grant recipients to submit quarterly SF-269 Financial Status Reports to the Finance and Operations Department. Cumulative cost data reported should be reviewed each quarter to ensure the accuracy of the information submitted and that revisions to previously reported amounts are properly documented.

We also recommend that the Commission ensure that all grant recipients are adequately trained in proper cash management requirements and that grant balances are reviewed quarterly to ensure grant recipients do not hold excess cash balances.

Management's Comment

The auditor's recommendations are well taken, and we are strengthening our systems. We now require grantees to submit their spending reports using the traditional OMB Form 269, which should improve their accountability to us for their use of our funding. We will continue our personal training sessions with grantees concerning their cash management, emphasizing the need for careful timing of their expenditures and cash flows consistent with federal rules.

Grant Reporting

Condition: During the prior year audit of the Denali Commission's financial statements, we noted a lack of timely submission of grant progress reports, grants were not being closed out in a timely manner and delinquent reports were not being followed up on in a timely manner.

Recommendation: We recommended that the Denali Commission develop policies and procedures to effectively monitor grantee compliance with grant reporting requirements, which would include requiring progress reports to be submitted quarterly and to promptly follow-up when any instances of non-compliance are noted.

Current Status: This finding has been corrected in the current fiscal year.