

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE



Division of Legislative Audit

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SUMMARY OF: A Special Report on the Department of Natural Resources, Division of Agriculture, Agricultural Revolving Loan Fund, Matanuska Maid, Part 2, September 22, 2008.

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted an audit to address various issues and concerns related to the dissolution of the Creamery Corporation which does business as Matanuska Maid (MatMaid). The Creamery Corporation was a private sector, dairy product wholesaler. The State of Alaska through the Department of Natural Resources (DNR), Division of Agriculture, Agricultural Revolving Loan Fund (ARLF) is the sole stockholder in the Creamery Corporation.

REPORT CONCLUSIONS

As the second of a multi-part audit, we were directed to analyze the disposal of the dairy's assets and the accounting for the proceeds generated by disposal. We were also directed to review the process currently in place to manage and account for revenues still being generated by the lease of some MatMaid assets.

The Report Conclusions section sets out our findings related to the other audit objectives, as follows:

1. Sale of MatMaid assets were done in compliance with appropriate standards and practices. Given the classification of the assets involved and the private sector status of the Creamery Corporation d/b/a MatMaid procedures followed in the disposition of assets were appropriate.
2. Buy out value of leased equipment would exceed likely auction value. Some assets with an appraised and assessed value of approximately \$650,000 were leased to a start-up dairy operation in the Matanuska Valley. The start-up dairy operation has the option to purchase all the equipment identified in the lease for approximately \$400,000. If the option to purchase is exercised, the Creamery Corporation would receive over 60% return, which is more than the 46% the auction received of appraised value.

3. \$600,000 of auction proceeds was not accounted for appropriately. In 2007 the legislature appropriated \$600,000 to the DNR to pay for MatMaid operations. The chair of the Creamery Corporation board stated, in a letter requesting the funds, it was the intent of the board that the funds be repaid to the State of Alaska. The language of the appropriation does not require such a repayment and any proceeds generated from the sale of MatMaid assets should be credited to the ARLF.

4. Public confused by the standards used for various decisions made by either the Board of Agriculture and Conservation (BAC) and Creamery Corporation board. The overlapping membership of the BAC and the Creamery Corporation boards generated confusion about what standards and procedures governed a particular decision.

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September 22, 2008

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
AGRICULTURAL REVOLVING LOAN FUND
MATANUSKA MAID
Part 2

September 22, 2008

Audit Control Number
10-30049B-08

We conducted an audit of activities related to the closure and dissolution of Matanuska Maid (MatMaid), a private sector corporation classified as an investment asset of the State of Alaska's Agricultural Revolving Loan Fund (ARLF). The State, through ARLF, is the sole shareholder in MatMaid.

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology.

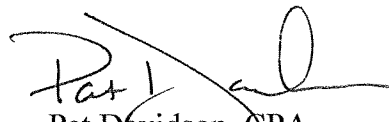

Pat Davidson, CPA
Legislative Auditor

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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 have conducted an audit to address various issues and concerns related to the dissolution of the Creamery Corporation (Corporation) which does business as Matanuska Maid (MatMaid). The Corporation was a private sector, dairy product wholesaler. The State of Alaska through the Department of Natural Resources, Division of Agriculture, Agricultural Revolving Loan Fund (ARLF) is the sole stockholder in the Creamery Corporation.

Objectives

This report is the second of a multi-part audit, with the following objectives:

1. Analyze procedures used to dispose of MatMaid's real and personal property to determine if it was done in accordance with state regulations.
2. Determine if the proceeds from the sale of MatMaid's real and personal property were reported and accounted for appropriately.
3. Assess the adequacy of management's oversight of the lease agreement involving MatMaid's personal property.

Scope and Methodology

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

- Review of regulations related to the ARLF program to determine the process for disposal of assets.
- Attendance at the November 2007 through September 2008 board meetings of the Corporation and the Board of Agriculture and Conservation (BAC). Review of the FY 07 and FY 08 Creamery board and BAC meeting minutes to identify the procedures followed by the boards for disposal of assets.
- Review of disposal documents for MatMaid's real and personal property to assess if they were done in accordance with regulatory requirements.
- Review of ARLF's historical documents related to the establishment of MatMaid as an investment on the State's financial records and subsequent equity adjustments.

- Review of MatMaid’s audited financial statements and financial management reports to identify the net profit or loss since the 1983 bankruptcy.
- Analysis of MatMaid’s financial documentation related to the receipt of the auction proceeds, cash disbursements from the proceeds, and collection of lease revenue. Our analysis included reviews of the 2008 cash receipts and disbursement spreadsheets, including copies of checks. We used this information to analyze the recording of the proceeds and the subsequent disbursements.
- Analysis of MatMaid’s cash balance sheet, accounts payable, and accounts receivable financial records related to 2008 operations to identify the source of funds used to pay creditors and outstanding debt. This information was also used in the analysis of the lease agreement revenue.
- Attendance at MatMaid’s personal property auction to ensure the process was fair and reasonable.
- Comparison of auction proceeds to the personal property appraisal amount to calculate the return on assets of MatMaid.
- Review of the Memorandum of Understanding to identify the delegation of duties for the winding up of MatMaid, funding to pay for the duties, and allocation of asset disposal proceeds.
- Analysis of lease agreement to assess if the terms and condition were based on standard business practices. We also reviewed the November and December 2007 Corporation and BAC board meeting minutes regarding the lease agreement to determine if board actions were reasonable.
- Comparison of the lease agreement buy out value to MatMaid’s return on assets from the auction to determine if the potential sale price for the leased items is as great or greater than if the items would have been auctioned.

ORGANIZATION AND FUNCTION

The goal of the Department of Natural Resources (DNR) is to contribute to Alaska's economic health and quality of life by protecting and maintaining the state's resources, encouraging wise development of these resources, and making them available for public use. DNR manages all state-owned land, water and natural resources, except for fish and game, on behalf of the people of Alaska.

DNR is currently organized into seven divisions that reflect its major programs: Agriculture; Forestry; Geological and Geophysical Surveys; Mining, Land, and Water; Oil and Gas; Parks and Outdoor Recreation; and Support Services.

Division of Agriculture (DoAg or Division)

The Division offers land for agricultural development; works with local producers to promote and support the state's agricultural industry through provision of financing for farmers and processors; promotes plant material research and development; promotes conservation education; provides marketing assistance, inspection, and farm product certification. There are 32 permanent full-time and 12 permanent, part-time budgeted positions.

DoAg's main office is located in Palmer. The Plant Materials Center is an industrial/laboratory complex consisting of several buildings located on a tract in the rural Mat-Su Valley near Pioneer Peak. DoAg also has a northern region satellite office located in Fairbanks.

The functions of DoAg are divided between three organizational components as follows:

Agriculture Development component

- Sales and leases of state land with agricultural covenants. Under this component the Division carries out its responsibilities 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 to promote the sale of their products.
- Inspections. The Division provides inspections and grading of agriculture products. It also provides field inspections for seed certification and disease control.

Agricultural Loan Fund Administration

- Farm loans. The Division currently processes and services Agricultural Revolving Loan Fund (ARLF) loans, which are approved by the Board of Agriculture and Conservation. 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. Some of these are operated by the Division while others are made available to the private sector under various arrangements.

Plant Materials Center (PMC)

- Applied research. PMC provides for the production and development of plant materials. PMC is the state repository for Alaska seed and is responsible for encouraging the development of the seed industry.

Additionally, there are two boards that assist in carrying out the functions of DoAg.

- Alaska Natural Resource Conservation and Development Board. This board primarily acts in an advisory capacity to DNR’s commissioner for soil and water conservation issues and concerns.
- Board of Agriculture and Conservation (BAC). State law (at AS 03.09 and AS 03.10) establishes the BAC and sets out the powers of the board. This citizen board has seven members appointed by the governor who serve staggered, three-year terms. The board is responsible for loan approvals, development of recommendations related to state agriculture policy, and overall oversight of state-owned agriculture facilities. See Exhibit 1 for the list of current board members.

Exhibit 1

<p>Board of Agriculture and Conservation and Creamery Corporation Board (as of August 31, 2008)</p> <p><u>Individuals serving on both Boards</u></p> <p>Kristan C. Cole, Chair BAC Term Expires September 2009 Ben VanderWeele, Vice Chair BAC Term Expires September 2008 Ralph V. Carney BAC Term Expires September 2009 John Schirack BAC Term Expires September 2008</p> <p><u>Individuals listed as only serving on BAC</u></p> <p>Omar Stratman BAC Term Expires September 2009 Ruby Hollembaek BAC Term Expires September 2010 Al Poindexter BAC Term Expires September 2010</p>
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Agricultural Revolving Loan Fund (ARLF)

ARLF was established by the territorial legislature in 1953. The fund’s enabling legislation is codified in state law at AS 03.10, and authorizes the following six types of loans: short-term operating, chattel, farm development, irrigation systems, land clearing, and product processing. By regulation, DNR has established a five percent interest rate for all loan types. A borrower’s total outstanding ARLF balance may not exceed \$1 million. Only Alaska

residents are eligible for loans. As reflected in ARLF's balance sheet in Exhibit 2 the fund has more than \$10.6 million in loans outstanding and cash of approximately \$5 million as of May 31, 2008.

Exhibit 2

Agricultural Revolving Loan Fund Balance Sheet as of May 31, 2008 (unaudited)	
Assets	
Current Assets:	
Cash and Investments	\$ 4,995,000
Interest and Dividends Receivable	118,000
Loans, Notes, and Contracts Receivable	<u>10,646,000</u>
Total Current Assets	15,759,000
Noncurrent Assets:	
Repossessed Property	871,000
Investment in Projects, Partnerships, or Corporations	<u>6,841,000¹</u>
Total Noncurrent Assets	<u>7,712,000</u>
Total Assets	<u>\$ 23,471,000</u>
Liabilities	
Noncurrent Liabilities	\$ 44,000
Total Liabilities	44,000
Fund Equity	<u>23,427,000</u>
Total Liabilities and Fund Equity	<u>\$ 23,471,000</u>

Source: DNR financial records of ARLF balance sheet.

¹ This account is made up of a \$2.8 million valuation assigned to the Alaska Farmer's Cooperative and the balance of the account of just over \$4 million is the assigned book value for Matanuska Maid.

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BACKGROUND INFORMATION

Between 1979 and 1982, Matanuska Maid (MatMaid) borrowed money from the Agriculture Revolving Loan Fund (ARLF), utilizing Anchorage real estate as collateral. Due to the considerable amount of debt owed to ARLF, approximately \$3 million, MatMaid management decided to declare Chapter 11 bankruptcy protection in 1983.

The State, as MatMaid's largest creditor, was permitted in 1984 by the bankruptcy court to take possession of and begin operating MatMaid. During 1985, the State, represented by the Division of Agriculture, commenced foreclosure proceedings against the Anchorage and Palmer properties. In 1988, the bankruptcy court issued its final order to transfer all remaining MatMaid assets to the ARLF in settlement of the debt owed.

At the time of the title foreclosure, the outstanding principal balance of the loans owed by MatMaid to ARLF exceeded \$4.4 million. The difference in MatMaid's indebtedness between the beginning and end of the bankruptcy process is attributable to payments from ARLF to protect the collateral of other loans that relied on continued operation of the dairy. Subsequent cash outlays to MatMaid from ARLF between January 1, 1986 and March 1, 1990 totaled more than \$1.9 million.

Exhibit 3

Initial Balance of ARLF's Investment Account in MatMaid after Bankruptcy	
	Equity Account Balance
MatMaid principal balance of ARLF loans, owed at the time of title foreclosure	\$ 4,470,359
Cash disbursements by ARLF	1,960,721
Palmer Feed Mill operation discontinued and property transferred to ARLF	(1,021,139)
Feed Mill expenses	(132,073)
Net ARLF contributions to MatMaid at the conclusion of bankruptcy takeover	<u>\$ 5,277,868</u>

MatMaid carried as an investment of ARLF on state's financial records

In October 1992 the State, in consultation with the Governmental Accounting Standards Board, determined for financial statement purposes MatMaid should be recorded as an investment, rather than a subsidiary, of ARLF. This determination required the investment to be accounted for using the equity method.² Under the equity method the value of ARLF's investment is directly affected by MatMaid's earnings or losses for the year. Such earnings

² According to generally accepted accounting principals, an investor owning 20% or more of a company's stock is required to account for the investment using the equity method. ARLF owns 100% of the Creamery Corporation's stock.

or losses are to be reported as non-operating revenue/expenses on ARLF's accounting records.

As shown in the Exhibit 4, the state's investment total had fallen from \$5.8 million to an estimated \$3.7 million at the end of 2007. This constituted a drop of \$2.1 million in value due to accumulated operational losses through December 31, 2007.

Exhibit 4

ARLF Investment Account Balance in MatMaid from bankruptcy to December 31, 2007			
	Paid-in Capital	MatMaid Net Income/Loss	Value of ARLF Investment
Paid-in-Capital, beginning	\$5,277,868		\$5,277,868
Accumulated Net Losses as of December 31, 1989 [▲]		(\$2,796,043)	2,481,825
Net Income, December 31, 1990 [▲]		419,674	2,901,499
Net Income, December 31, 1991 [▲]		457,423	3,358,922
Net Income, December 31, 1992 [▲]		328,603	3,687,525
Net Income, December 31, 1993 [*]		190,586	3,878,111
Net Income, December 31, 1994 [*]		354,002	4,232,113
Net Income, December 31, 1995 [*]		62,195	4,294,308
Net Loss, December 31, 1996 [*]		(394,335)	3,899,973
Net Loss, December 31, 1997 [*]		(345,142)	3,554,831
Net Income, December 31, 1998 [*]		250,946 ³	3,805,777
Net Income, December 31, 1999 [*]		200,576	4,006,353
Net Income, December 31, 2000 [*]		421,138	4,427,491
Net Income, December 31, 2001 [▲]		247,317	4,674,808
Net Income, December 31, 2002 [▲]		446,570	5,121,378
Net Income, December 31, 2003 [▲]		264,240	5,385,618
Net Income, December 31, 2004 [*]		60,287	5,445,905
Net Loss, December 31, 2005 [*]		(179,590)	5,266,315
Net Loss, December 31, 2006 [●]		(693,681)	4,572,634
Net Loss, December 31, 2007 [●]		(1,452,127)	3,120,507
Paid-in-capital from the General Fund	600,000	-0-	3,720,507
Ending Balances	<u>\$5,877,868</u>	<u>(\$2,157,361)</u>	<u>\$3,720,507</u>
[*] MatMaid audited financial statements [●] MatMaid financial management reports [▲] Department of Natural Resources equity analysis of MatMaid			

Creamery Corporation votes to discontinue MatMaid operations

In September 2007, the Creamery Corporation (Corporation) board, as the governing body of MatMaid, voted to stop operations and close the dairy. The board also voted to contract for a specialized audit of MatMaid finances and hire a broker to assist in the disposal of the dairy's assets. The Corporation passed a motion to recommend to the Board Agriculture and

³ Original audited financial statement for 1998 reported net income of \$108,946. However, a subsequent correction to the 1998 financial occurred to reflect an understatement of deferred income tax benefit of \$142,000.

Conservation (BAC)⁴ to sell, via sealed bids, all personal assets of MatMaid. The BAC accepted the Corporation's recommendation and voted to sell all the assets of MatMaid, including real and personal property, for \$3.35 million.

Under State regulations,⁵ real and personal property acquired by the State through voluntary relinquishment, repossession, foreclosure, or other actions arising out of agricultural loans must follow specific procedures when disposal of the assets is necessary. MatMaid's real property was deeded to the State as a result of the bankruptcy proceeding that occurred in the mid 1980s, resulting in the State loan program obtaining the real and personal property of MatMaid in lieu of outstanding loans.

The BAC offered the real property and the Corporation offered certain personal property of MatMaid for sale. The BAC believed it was in the best interest of the State to offer the entire MatMaid operation, including real property, for sale as an intact operating dairy in order to attract bidders who would commit to continue processing milk in Alaska. The BAC and the Corporation elected to make a joint offering of MatMaid's properties to also maximize the return to the entities. It was determined that the competitive nature under the state's invitation for sealed bid process would allow the greatest overall return to the ARLF and the Corporation.

As required by state regulation, before publishing the notice to solicit bids, the BAC held a public hearing and set their findings out in a decisional document. The hearing provided the public with an opportunity to submit oral or written comments regarding the proposed sale of all, or substantially all, of the personal property currently owned by MatMaid and the real property owned by the ARLF. The decisional document addressed comments received and set forth the BAC's justification for conducting the sale in the manner proposed.

Following state regulations BAC set the minimum bid for all personal and real property at \$3.35 million based on appraised and assessed values of the property and a desire to attract bidders who would continue to operate the dairy intact. The deadline for submittal of sealed bids was set in early December 2007. No bids were received.

Department of Natural Resources (DNR), BAC and the Corporation enter into an memorandum of understanding (MOU) to establish responsibilities for the winding up of the Corporation's business

On February 26, 2008, pursuant to corporate bylaws and state law,⁶ ARLF being the sole shareholder of the corporation, acting through the BAC, authorized the voluntary dissolution of the Creamery Corporation dba Matanuska Maid. The Corporation, through its board of directors, began to wind up and settle its business affairs, provide written notice of the

⁴ The BAC is the oversight board of ARLF, which is the sole shareholder of MatMaid.

⁵ 11 AAC 39.700 Property subject to disposal.

⁶ AS 10.06.423 and AS 10.06.605(a)(1)

voluntary dissolution, and file a certificate with the State evidencing the election to voluntary dissolve.

Shortly after the voluntary dissolution, the Corporation, BAC, and the DNR entered into a MOU. The purpose of the MOU was to establish the responsibilities of the parties involved. The Corporation Board's authority is limited in that it may only carry out business relating to winding up of its affairs. Thus, all corporate business must cease, except to the extent reasonable and necessary for the beneficial winding up of the business or to preserve the corporation's good will.

Although the shareholder has a vested interest in the dissolution of the corporation, ensuring that its rights are protected, and that all business activities are conducted properly and efficiently; the BAC as a voluntary board cannot monitor or assist in the day-to-day process of winding up the affairs of the corporation. As a result, all the parties to the MOU agreed that it was in the best interest of the State as shareholder to engage the assistance of DNR and Department of Law (DOL) in overseeing the winding up of the corporation's affairs; the liquidation of assets; settlement of claims from creditors and ex-employees; maintaining detailed financial records of all transactions (including payments, receipts, sale of assets); securing and maintaining the real and personal property; collection of outstanding accounts; and final distribution of remaining capital proceeds to ARLF.

As outlined in the MOU, the Corporation shall reimburse DNR and the ARLF for all services provided by DNR and DOL. These services include: assisting the Corporation with winding up business affairs, liquidating assets, and dissolving. The reimbursement amount will be the actual cost of providing the services and will be considered a debt of the Corporation.

As of July 25, 2008, MatMaid issued four checks totaling approximately \$43,550 to reimburse the ARLF for services provided by DNR staff. MatMaid has not reimbursed the state for services provided by DOL.

Another purpose of the MOU covers the distribution of the Corporate Assets. The MOU states that after the Corporation adequately provides for all known debts:

The Corporation will distribute the remaining assets to the ARLF. Although the final distribution may be in money, property or in securities and either in installments or as a whole, the Corporation will make its best, good faith effort to assure that the distribution to the ARLF is to the fullest extent possible, a cash distribution, rather than a distribution of property or securities.

MatMaid governing board decided to sell personal property at public auction

After no bids were received for the intact MatMaid operations, the Corporation board determined the assets should be split apart and disposed of separately. The legal classification of the assets determined what process and procedures were to be followed for disposal. The personal property was considered to be the property of the corporation and, as

a result, not subject to state requirements related to disposal of state assets acquired by ARLF. The real property involved with the corporate operations had been registered as state property, and accordingly was subject to land disposal requirements set out in state regulation.

The Corporation board decided to sell MatMaid's personal property at public auction in segregated lots. The board believed offering such assets at public auction was the best way to obtain greatest return of any residual value in plant, equipment, and rolling stock of the dairy.

Some items were leased or sold in a negotiated manner prior to public auction

In the fall of 2007, the Corporation board and the BAC jointly approved removing 12 pieces of equipment from the intact invitation for sealed bid due to be opened in December. The 12 pieces were determined to be "not essential" to dairy operations – thus, such action would presumably not have an impact on the intact invitation for sealed bid. The Corporation leased the equipment to the Southcentral Dairy Joint Venture (SDJV) prior to the deadline for bids for intact operations.

After receiving no bidders for the intact operation, the Corporation amended the lease agreement with SDJV to add an additional 59 items to the start-up Matanuska Valley dairy. The total value of the leased items is around \$650,000.⁷ Additionally, the Corporation sold SDJV \$10,000 in supplies that had been included in the December intact sealed bid documents.

The lease agreement is between the Corporation and SDJV for a period of one year with monthly payments of \$1,967. SDJV has an option to extend the agreement for one additional year. The lease also provides for an option to purchase all, not part, of the equipment in the amount of \$393,380, provided that no event of default exists as stipulated in the lease agreement.

In addition to the leased equipment, in March 2008, the Corporation sold \$6,500 in equipment to the Department of Corrections for their operations at the Point McKenzie Correctional Farm in Wasilla. Some of the items were purchased at fair market value prices as established by the personal property appraisal that was conducted in September 2007. Most of the items⁸ were not identified on the appraisal but were part of the building fixtures.

ARLF asset manager sought auctioneers using informal solicitation process

In seeking an auctioneer to sell the assets, the ARLF asset manager contacted several auction firms recognized for auctioning dairy equipment and industrial assembly line equipment. He

⁷ Most of the assets were part of the GoIndustry appraisal, totaling approximately \$620,000. The remaining items were a part of an appraised lot or were not included in the appraisal. These items were assessed by the ARLF Asset Manager at \$30,000.

⁸ Items include camera equipment, freezer sliding door, and ceiling lights.

asked the contacted firms to submit proposals for auction services for consideration by the Corporation board.

Unlike State procedure, there was no formal Request for Proposal or Invitation to Bid issued. Use of informal solicitation primarily stemmed from the Assistant Attorney General, DOL, advising the BAC and the Corporation boards that MatMaid's personal property belonged to a private sector company, albeit one owned entirely by the state. Given such status, the formalities of state bidding and proposal review was not required to be followed. Reflecting this advice, the Corporation postponed the deadline for proposals for 10 days at the request of a prospective bidder with an international reputation in the auction field – primarily because this firm had not been among those contacted by the asset manager.

The Corporation received five proposals and followed the recommendation of the ARLF Asset Manager to award the contract to an out-of-state joint venture proposal on March 8, 2008.

Using the personal property appraisal, the auction firm performed a thorough physical inventory of approximately one thousand items of personal property and generated a catalog of items that would be available for auction. The auction was a two day event that took place during late May 2008. As outlined in the contract, the auction firm had two weeks to provide a final accounting of the personal property. The auction disposed of over 90% of the personal property. The remaining items will be sold with the buildings when the real property is disposed.

Auction proceeds equaled almost half the appraised value

MatMaid's personal property was appraised during September 2007 in anticipation for the sale of the intact dairy operation through the invitation for sealed bid. The appraised value of MatMaid's personal property was approximately \$3.6 million. Since the appraisal of the personal property, some items were leased or sold, as previously discussed, that had appraised values of over \$620,000. Removal of the leased or sold asset values from the total appraised value, results in approximately \$3 million of personal property that was available for auction.

The remaining personal property was auctioned during May 2008. Auction proceeds totaled \$1.4 million. The proceeds amounted to almost half of the appraised values of the personal property.

In addition to the proposals received for the personal property auction, the auction firms were also afforded the opportunity to submit a bid to purchase the personal property as a lot. Of the five auction proposals, two submitted offers to purchase the entire lot of the Corporation's personal property. The offers ranged from \$715,000 to \$860,000. As noted above, auction proceeds were approximately \$1.4 million. The state received over \$500,000 more going to auction than if they sold the personal property as an entire lot.

Auction proceeds maintained in corporate account until outstanding debt is resolved

The Corporation's proceeds from the auction totaled approximately \$1.4 million and were deposited into the Corporation's checking account toward the end of June 2008. A check was issued at the beginning of July 2008 to reimburse the general fund for the \$600,000 appropriation the Corporation received in November 2007 that was used for ongoing business obligations and employee severance packages.

At the time of receipt of the auction proceeds, the Corporation had two outstanding lawsuits with claims approximately \$750,000 – along with \$10,000 in payables.

According to the memorandum of understanding entered into by the Corporation, BAC, and DNR during March 2008, the Corporation must adequately provide for the payment of the known debts by setting up a reserve fund to cover contingent debts and liability. Therefore, the remaining auction proceeds will be maintained in the Corporation's account until outstanding debts are resolved.

Real property in Anchorage sold through sealed bid process in August 2008

In June 2008, the BAC passed a motion to dispose of the ARLF real property located in Anchorage by competitive sealed bid with a minimum acceptable bid of \$1.5 million. Public notice for the sale of the real property was generated during mid-July. Under state regulations, a public hearing is required only if disposal of the asset could have a significant effect on the agricultural industry. Since MatMaid operations were discontinued in December 2007 and personal property was disposed of during the May 2008 auction, the disposal of the real property would not have a significant effect on the agricultural industry; therefore, a public hearing is not required.

The deadline to submit a competitive sealed bid for the Anchorage real property was August 21, 2008. Only one bid was received for \$1,527,500. All the required documentation that accompanied the bid was complete. The BAC board is required by regulations to notify the winning bidder that their bid has been accepted within 15 days of the board's acceptance.⁹ However, persons adversely affected by the BAC's decision may, within 30 days or at the next regular meeting whichever is later, ask the board to reconsider its decision.¹⁰

⁹ 11 AAC 39.760

¹⁰ 11 AAC 39.800

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REPORT CONCLUSIONS

The primary focus of this part the audit related to various issues and concerns about the disposal of the dairy's assets and the accounting for the proceeds generated by disposal. A second aspect of our review involved the process currently in place to manage and account for revenues still being generated by the lease of some Matanuska Maid (MatMaid) assets. From our review we have developed the following conclusions:

1. Sale of MatMaid assets were done in compliance with appropriate standards and practices. Given the classification of the assets involved and the private sector status of the Creamery Corporation d/b/a MatMaid procedures followed in the disposition of assets were appropriate.
2. Buy out value of leased equipment would exceed likely auction value. Some assets with an appraised and assessed value of approximately \$650,000 were leased to a start-up dairy operation in the Matanuska Valley. The start-up dairy operation has the option to purchase the equipment identified in the lease for approximately \$400,000. If the option to purchase is exercised, the Creamery Corporation (Corporation) would receive over 60% return, which is more than the 46% the auction received of appraised value.
3. \$600,000 of auction proceeds was not accounted for appropriately. In 2007 the legislature appropriated \$600,000 to the Department of Natural Resources (DNR) to be used to pay for MatMaid operations. In a letter requesting disbursement of the funds the chair of the Corporation stated it was the intent of the Corporation board that the funds would be repaid to the State of Alaska. The language of the appropriation does not require such a repayment and any proceeds generated from the sale of MatMaid assets should be credited to the Agricultural Revolving Loan Fund (ARLF).
4. Public confused by the standards used for various decisions made by either the Board of Agriculture and Conservation (BAC) and Corporation board. The overlapping membership of the BAC and the Corporation boards generated confusion about what standards and procedures governed a particular decision.

Further discussion of our conclusions follows:

Sale of MatMaid assets were done in compliance with appropriate standards and practices

The initial attempt to sell the MatMaid operations was done jointly by the BAC and the Corporation. The joint offering included the MatMaid's real property, which is owned by the state, and the Corporation's personal property. The competitive nature of the state's procurement process through an invitation for sealed bid would allow for the greatest overall

return. Since the sale included the state owned real property, specific state regulations were required to be followed. In accordance with State law, before publishing the notice to solicit bids, the BAC held a public hearing and made written findings in a decisional document. The decisional document addressed comments received and set forth the BAC's justification for conducting the sale as an intact operation. The BAC complied with State law in their determination for the minimum bid amount.

After the invitation for sealed bids for the intact operation did not result in any bids, the personal and real property were separated. The Corporation moved forward selling the personal property while the BAC moved forward with selling the real property.

The subsequent auction of MatMaid's equipment and supplies by the Corporation was not governed by any state regulation or requirement. The selection of an auctioneer was not done in a manner that was as open or publically advertised had the procurement followed state procedures. However, based on the advice of the Department of Law the Corporation was within its authority in proceeding in this manner.

The real property is owned by the State and therefore does have to follow State standards. The ARLF asset manager, under direction of the BAC issued an invitation for sealed bids for the sale of the Anchorage real property. This property was sold during August and the sale complied with the appropriate State regulations.

Buy out value of leased equipment exceeds the likely auction value

The Corporation entered into a one-year lease with Southcentral Dairy Joint Venture (SDJV) for 71 specific pieces of equipment with an estimated value of \$650,000. The revenue generated from the lease payments of \$1,966 will amount to \$22,500. At the end of the lease term, SDJV can exercise its options to either extend the lease agreement for one additional year, or purchase all of the equipment for \$393,380.

The buy out value for the leased equipment is approximately 60% of the estimated value. By comparison, the auction generated \$1.4 million or a 46% return on the sale of equipment estimated at \$3 million. If SDJV exercises its option to purchase the leased equipment, the Corporation could receive a higher return than if the equipment had been auctioned.

\$600,000 of auction proceeds was not recorded appropriately.

In early 2007, at the request of the Creamery Board the BAC submitted a budget request in the amount of \$600,000 "to help MatMaid cover expenses as it plans ways either to meet Alaska's challenging market conditions, or to prepare to end operations later this year." Also stated in the request,

...it is prudent for the BAC to consider various ways to meet its statutory obligations to the ARLF to maximize the value of the dairy's land, facilities

and brand for the state... The \$600,000 would be an investment that would help protect the value of the dairy and preserve managers' options.

Legislation appropriating \$600,000 from the General Fund to DNR was signed by the governor during June 2007. DNR paid the full \$600,000 in early November 2007 to MatMaid. The funds were deposited in MatMaid's main checking account. According to the Corporation these funds were subsequently spent on \$534,100 in personnel services and \$65,900 for the buildings.

The appropriation did not identify the \$600,000 as a loan, or a line of credit with the State's treasury. Specifically, Chapter 30, Section 18 of the 2007 Session Law reads,

The sum of \$600,000 is appropriated from the general fund to the Department of Natural Resources for assistance to the Creamery Corporation, dba Matanuska Maid Dairy.

However, the Creamery Board has stated at several board meetings it was their intention is to pay back the appropriation to the State. Additionally, the Creamery Board's formal request to DNR for the \$600,000 stated,

It is understood that the Creamery Corporation will return these funds, or parts thereof, to the State of Alaska if proceeds from the anticipated sale of corporate assets are sufficient and all our obligations have been satisfied.

Out of the auction proceeds of approximately \$1.4 million, at the direction of Chairman of the Corporation Board, MatMaid drew a check in the amount of \$600,000. The check was given to DNR and was deposited in the general fund as a refund (abatement).¹¹ This was not the appropriate accounting treatment.

The language of the appropriation makes no reference as to the necessity for the funds to be repaid to the General Fund. Accordingly, the funds represent additional capital investment made by the State to MatMaid. This makes the funds unrestricted assets of the corporation, and any distribution of assets in the winding up of MatMaid operations should be credited to the fund that owns the dairy – ARLF.

Processes followed for winding up MatMaid led to confusion

The manner and process used to first extend and then wind up MatMaid operations created confusion in the minds of many interested parties in the general public. Essentially, four individuals served as both the BAC and the Corporation board. These four individuals would take action as the managing directors of a private sector incorporated business and then in a

¹¹ The definition of an abatement according to the Alaska Administrative Manual 40.010, "abatements are reductions or a cancellations of a part or all of an expenditure." This type of transaction would allow the agency to spend the appropriation again.

later meeting, often held afterwards would take action related to MatMaid as representatives of the single owner, the State of Alaska. In addition to overlapping board members, the state provided other direct assistance to MatMaid's operations. This assistance includes:

- a special assistant to the commission of the Department of Commerce Community and Economic Development was responsible for the day-to-day operations of MatMaid during the shut-down of the dairy operations, and
- MatMaid was allowed to contract for administrative, asset management and legal support through a Memorandum of Understanding with the Department of Natural Resources

While most the actions taken by both boards were justifiable and appropriated with established standards, in the view of some members of the public the actions violated what they perceived were requirements placed on state agencies.

Examples of decisions and the various circumstances related to each one is recapped below:

1. The initial invitation for sealed bid was done by BAC following state standards. The first attempted to solicit offers to sell MatMaid as a complete operating entity was done through a joint effort by the BAC and the Corporation. This decision reflected BAC's mission to promote agricultural development in the State of Alaska. The sale of MatMaid's assets was done through the formal state bid solicitation process. During the solicitation process, the Corporation received a request to lease specific equipment identified in the bid solicitation. With the approval of the BAC and the Corporation, the bid solicitation was amended to remove the specific equipment. Under state regulations, this would be a violation had the BAC removed and leased the equipment in the preferential manner carried out by the Corporation. This solicitation, which received no bids/offers, was conducted in accordance with formalized state asset disposition procedures.
2. Lease of equipment and rolling stock done by Creamery Corporation. The Corporation entered into a lease with SDJV for approximately 71 pieces of equipment on a negotiated basis. Some of these items were included in the initial bid package discussed above.

Leasing the equipment was done consistent with BAC's mission to support and promote agriculture; however, it was being carried out under the authority of the Corporation board which does not have such a policy mandate. At the same time the lease was being expanded, the asset manager for ARLF was receiving unsolicited offers to purchase various pieces of MatMaid equipment. These offers were given limited consideration by the Asset Manager as the Corporation was moving forward with a plan to auction off MatMaid's personal property.

While there is nothing to say that the actions of the Corporation were inappropriate it supports a perceived "favored" status of SDJV and the expedited process of the

decisions made by the private sector Corporation board contributed to some negative perceptions about “steering” equipment to favored parties.

3. Selection of auctioneer firm by Corporation done in an informal manner. After deciding to auction off remaining personal property of MatMaid, the four individuals, now sitting as the private sector Corporation board, took two actions that were within the discretion of a private sector commercial enterprise. However, these actions were inconsistent with how state agencies are required to conduct business. The actions involved:

- Informal solicitation of auctioneers. No public notice was given that the Corporation board was soliciting proposals from auctioneers. Alaska-based auctioneers complained they did not learn of MatMaid’s need for their services until they read a newspaper story.
- Extension of the period to accept bids. At the time the board was to select the auctioneering firm on February 26, 2008 the Corporation board made the decision to extend the deadline for bids. This decision was made in large part because a nationally recognized firm asked for an extension because it had not been contacted during the informal solicitation done by the Asset Manager. The board, after discussions in executive session, decided to extend the bid deadline for 10 days, primarily to accommodate this bidder.

Subsequently, during this extended period, at least two Alaska based auctioneer firms became aware of the solicitation. One auctioneer asked for more time to better refine a proposal. The Corporation board, meeting on a Saturday morning by teleconference decided to accept a bid submitted by a joint venture and not extend the time for Alaska based bidders.

The denial for another time extension to accommodate an Alaskan bidder is in contrast to the efforts made by the Corporation in leasing equipment to SDJV in efforts to continue some level of in-state milk processing business.

While the selection of an auctioneering firm is solely the decision of the Corporation, the whole process created confusion in the public’s mind. Factors that contributed to the confusion, include: decisions that were made by individuals who also sat on a statutorily established board; the process was managed by a state employee; an extension of time was granted for a nationally known contractor but an Alaskan based contractor was denied the same request; and the process was done without benefit of a formalized, publicly noticed solicitation process. All these factors contributed to a perception that the Corporation board was acting inappropriately.

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FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The director of administrative services for Department of Natural Resources (DNR) should credit the Agricultural Revolving Loan Fund (ARLF) for the \$600,000 in auction proceeds.

At the direction of the chair of the Creamery Board, \$600,000 of the \$1.4 million in proceeds generated from the auction of Matanuska Maid (MatMaid) equipment and rolling stock have been remitted to the State of Alaska. Ostensibly, this payment was to reimburse the State's General Fund for an appropriation made by the 2007 legislature to assist in the wind-up of MatMaid's dairy operations.

DNR inappropriately credited these funds to the State's General Fund as a refund. There was no provision in the language of the legislation making the appropriation that such a reimbursement would be required. Absent any such condition written in the appropriation, the funds should be considered additional paid-in capital on the part of the State of Alaska. This is supported by the appropriation request that states the funds would be used as an investment. By extension, any distribution of monetized assets should go to the benefit of the direct shareholder – ARLF.

Accordingly, we recommend the DNR's Director of Administrative Services correct this error and properly record the \$600,000 to the ARLF.

Recommendation No. 2

The BAC should take the necessary steps for the long term oversight of MatMaid's assets and revenue-generating lease.

As discussed, MatMaid has leased 71 pieces of equipment to the Southcentral Dairy Joint Venture (SDJV). The lease is generating almost \$2,000 in revenue each month for the Creamery Corporation (Corporation). After the dissolution of the Corporation, the day-to-day oversight and management of this ongoing business transaction has been neglected as the corporation has no employees.

The memorandum of understanding (MOU) signed during March 2008 establishes the responsibilities involving the Corporation board, the Department of Law, and the DNR as they relate to winding up of the corporation's business affairs, liquidating assets and dissolving the Corporation. Although the MOU delegates the responsibility over the corporation's financial records and maintaining the corporation's personnel property, there has been no formal designation for the oversight of the lease agreement.

The state has performed some oversight of the lease agreement; however, this has contributed to a situation where the day-to-day management of the lease has been disjointed and uncoordinated.

This has resulted in various oversights and omissions involving the lease, such as:

1. Charge for a non-sufficient funds (NSF) check was not made for correct amount. One of the lease payments made by SDJV was returned to the State for non-sufficient funds. The state accountant involved did eventually obtain payment plus a charge of \$25 for the NSF check. The lease agreement required that NSF checks be charged \$50. The DNR accountant reported she did not have access to a copy of the lease although she was tasked with some of the lease accounting responsibilities.
2. Late lease payment. For another month, the lease payment was made late by SDJV. Staff at DNR and at the DoAg were unsure which staff was responsible for following up with the lessee to insure payment was submitted.
3. Compliance with conditions of lease related to insurance is not documented. Under the lease, SDJV is required to obtain and keep in place insurance on the assets covered in the lease. Neither the asset manager at the DoAg nor accounting staff at DNR responsible for ARLF believed such inquiry was part of their responsibilities.

As MatMaid is still an investment of the ARLF, the State has an interest in seeing MatMaid's assets are properly managed. The Board of Agriculture and Conservation (BAC), representing the shareholder's interest, has the responsibility to ensure that the Corporate board is taking necessary and prudent steps to safeguard its assets. The Corporation board needs to consider options for the long-term oversight of the lease agreement either through outsourcing its management or amending the MOU to include the ongoing business obligation related to the lease. If the Corporation board fails to take reasonable actions then the BAC must act to safeguard the assets, thus ensuring maximum return to the ARLF once the Corporation has completed its dissolution process.

STATE OF ALASKA

SARAH PALIN, GOVERNOR

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DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

October 16, 2008

RECEIVED

OCT 16 2008

LEGISLATIVE AUDIT

Alaska State Legislature
Legislative Budget and Audit Committee
P.O. Box 113300
Juneau, AK 99811-3300

Re: Department of Natural Resources, Division of Agriculture, Agriculture Revolving Loan Fund Matanuska Maid Preliminary Report, Part 2, September 22, 2008, Audit Control Number 10-30049B-08

Members of the Committee:

Thank you for the opportunity to provide a written response to preliminary report on the closure and dissolution of Matanuska Maid (MatMaid). We have reviewed the report and offer the following response and comments:

Page 10, Paragraph 4

The report states that MatMaid issued four checks totaling approximately \$43,550 to reimburse the ARLF for services provided by DNR staff. The services were performed by State employees funded through the Land Disposal Income Fund and the General Fund. Accordingly, those funds were reimbursed, and not the ARLF.

Recommendation No. 1

The director of administrative services for Department of Natural Resources (DNR) should credit the Agricultural Revolving Loan Fund (ARLF) for the \$600,000 in auction proceeds.

The Department of Natural Resources does not concur with this recommendation.

The appropriation request was to “help the Matanuska Maid Dairy cover expenses as it plans ways either to meet Alaska’s challenging market conditions, or to prepare to end operations later this year [2007].” The language in the bill appropriated the funds to DNR “for assistance to the Creamery Corporation, dba Matanuska Maid Dairy.”

The \$600,000 appropriation was disbursed to the Creamery Corporation in November 2007 to help cover expenses as it prepared to end operations in December 2007. The corporation was not insolvent, and current assets exceeded current liabilities. However, a cash flow projection showed that final payroll, vendor and other obligations would come due before accounts receivable could be collected. After the sale of assets at auction in May of 2008, it was determined that State funds could be reimbursed without impairing the Creamery Corporation’s ability to satisfy its current and expected obligations. The \$600,000 was returned to the original appropriation as an abatement and

remains available to help with necessary and reasonable expenses and obligations of the corporation until final dissolution.

State administrators have a responsibility for adequate control and handling of public funds, which includes assurance that expenditures are essential to state operations (Alaska Administrative Manual 35.140). Since the Creamery Corporation has at no time been insolvent, expenditure of State funds to help the corporation conclude its business has not proved to be essential in protecting the State's interest in its investment.

If the \$600,000 were to be returned to the Creamery Corporation and not expended, it would become additional paid-in capital and ultimately revert to the shareholder (ARLF) upon dissolution. It is DNR's understanding that the legislature's intent was to provide necessary assistance to the Creamery Corporation, not additional funds for the ARLF.

Recommendation No. 2

The BAC should take the necessary steps for the long-term oversight of Matmaid's assets and revenue-generating lease.

The finding states that, "Staff at DNR and at the DoAg were unsure which staff was responsible for following up with the lessee to insure payment was submitted." DNR staff members (which include DoAg) were unsure of responsibilities with regard to the SDJV lease because they have no role in the administration of this agreement between two private entities. Management at DNR would be able to clearly communicate agency and staff responsibilities.

The BAC will provide an overall response to this recommendation.
Please contact Leta Simons at 465-3379 if you have questions or require further information.

Sincerely,



Richard A. LeFebvre
Deputy Commissioner

cc: Leta Simons, Director, DNR Support Services Division
Robert McFarlane, Department of Law

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF AGRICULTURE

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October 20, 2008

RECEIVED
OCT 20 2008
LEGISLATIVE AUDIT

Legislative Auditor
Division of Legislative Audit
Attn: Pauline Henriques, CPA
4341 B Street, Suite 400
Anchorage, AK 99503

RE: BAC Response to Preliminary Audit Report

Dear Ms. Henriques:

Thank you for forwarding the preliminary draft audit report and allowing the Board of Agriculture and Conservation (BAC) a chance to respond. Many of the responses of the BAC are the same as the responses given by the Creamery Corporation so I will not repeat those responses in this letter. The following responses are given in addition to those provided by the Creamery Corporation:

Page 9 paragraph 5 of the report states: Following state regulations BAC set the minimum bid for all personal and real property at \$3.35 million...."

That paragraph should be amended to read "Following state regulations the BAC set the minimum bid for the personal and real property at \$3.35 million...."

Page 21 at Recommendation number 1: The appropriation language may not have required the \$600,000 to be returned to the state. However, this was done as a good faith gesture by the Creamery Corporation in keeping with their commitment to do so.

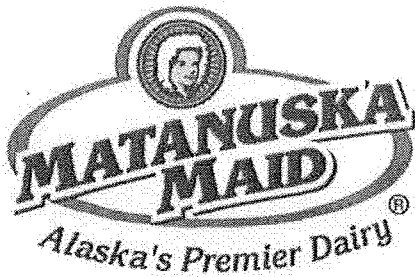
Page 21 at Recommendation number 2: The responsibility for oversight of Mat Maid assets rests with the CC until such time as the CC transfers the ownership interest to the BAC or until the CC requests the Division to take protective custody of the assets pursuant to the MOU. The CC has hired a private firm to assist with the accounting and eventual transfer of all the assets to the ARLF.

Sincerely,



Kristan Cole
BAC Chair

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Matanuska Maid
%Kristan Cole, Chairman
5131 E. Mayflower Lane
Wasilla, AK 99654

October 20, 2008

RECEIVED
OCT 20 2008
LEGISLATIVE AUDIT

Legislative Auditor
Division of Legislative Audit
Attn: Pauline Henriques, CPA
4341 B Street, Suite 400
Anchorage, AK 99503

RE: Creamery Corp. Response to Preliminary Audit Report

Dear Ms. Henriques:

Thank you for forwarding the preliminary draft audit report and allowing the Creamery Corporation a chance to respond with the following comments:

Page 9, paragraph 1 – This first full sentence of this paragraph states: “The BAC accepted the Corporation’s recommendation and voted to sell all the assets of MatMaid including real and personal property for \$3.35 million.”

The sentence should be amended to reflect the fact that the sale was a joint effort by the ARLF and CC to sell both types of assets (real and personal property). For example: “The real property of the ARLF and the Creamery Corporation’s personal property assets were offered in a sealed bid joint sale for \$3.35 million”.

Page 11, paragraph 2 – The reference to “plant” in the second sentence should be deleted because that “plant” is real part of the real property and not personal property. The second sentence should be changed to “The board believed offering such assets at public auction was the best way to obtain the greatest return of any residual value in equipment, inventory and rolling stock of the dairy.”

Page 13 – No mention is made of the potential tax consequences from the sale of MatMaid assets. The tax consequences are unknown at this time.

Report Conclusions:

Page 15, paragraph numbered 4 – That paragraph begins with “Public confused by the standards used for various decisions made by the Board of Agriculture and Conservation (BAC) and the Corporation board.”

There was no misunderstanding about the standards used for various decisions. The BAC and CC boards were very careful to notice out and hold separate meetings and to keep the public informed about specific actions taken by a particular board. The confusion was not about the overlapping membership of the boards since the make up of each board was well known. Any confusion was the result of the public not understating or choosing not to understand that the CC was not required to follow state mandated solicitation and disposal procedures. The Creamery Corporation Board followed all required protocol.

Page 16, paragraph 3 – The second sentence in this paragraph states: “The selection of an auctioneer was not done in a manner that was as open or publically advertised had the procurement followed state procedures.”

This sentence infers wrong doing and gives a negative impression of the actions taken by the CC when no such impression is justified. In fact, the process used by the CC for selection of a qualified auctioneer/purchaser was accomplished utilizing reasonable and acceptable methods commonly practiced in the private sector. Additionally the Department of Law had advised the CC that it had the authority to proceed in this manner.

Page 18, paragraph numbered 1 – About midway down the paragraph numbered 1 the sentence begins “With the approval of the BAC and the Corporation, the bid solicitation was amended to remove the specific equipment. Under state regulations, this would be a violation had the BAC removed and leased the equipment in the preferential manner carried out by the Corporation.”

These two sentences continue to imply wrongdoing by the CC. A better statement would be: “At the request of the Corporation and the approval of the BAC, the bid solicitation was amended to remove the specific equipment. This was not a violation of state regulations as the Corporation was not bound to follow any such regulations.”

Page 18, paragraph numbered 2 – This paragraph says the asset manager gave “limited” consideration to the unsolicited offers to purchase pieces of Mat-Maid property.

The term “limited” is very misleading. That word gives readers a perception that many valid offers were just tossed aside with little or no consideration. In fact, all offers received by the asset manager were considered and forwarded to the members of the CC for their review and consideration. Naturally some offers were rejected because they were “ridiculously low” in comparison with the value of the assets. Unrealistic offers were disposed of quickly but they were given fair consideration. The word “limited” should be removed from the letter to avoid creating an impression that the CC board sloughed off its responsibilities, played favorites or did anything less than give full and fair consideration to each offer.

Paragraph number 2 goes on to state that the decisions made by the private sector Corporation board contributed to some negative perceptions about “steering” equipment to favored parties.

The only negative perceptions of which the CC board was aware were negative statements contained in a local blog posted on the internet. This blog is very political and

it has been very critical of many of the things Mat-Maid has done. The contributors to the blog are all “anonymous” which leads one to wonder about the legitimacy of their “negative perceptions”. If individuals had legitimate concerns about the procedures followed by the CC or the BAC boards they could have written either board a letter and expressed those concerns.

Page 19, paragraph numbered 3 - This paragraph begins by informing readers that the CC took proper action and then ends by implying that the CC board did something wrong. The offending sentence says: “However, these actions were inconsistent with how state agencies are required to conduct business.” A reader will be confused by this statement. The possibility for confusion could be eliminated by removing the sentence or by modifying it in a way that does not imply the CC was obligated to follow state procedures. For example, it could be modified to say: “Although state agencies may be constrained in the actions they are allowed to take, the CC was a private corporation, and it was acceptable for the CC board to take these actions.”

Additionally the item dealing with the 10 day extension needs explanation. The letter says the deadline for submitting bids was extended when a nationally recognized firm asked for an extension because it had not been contacted during the informal solicitation done by the Asset Manager. The purpose of the 10 day extension was to allow all auction companies additional time to physically inspect the assets being sold and to allow additional auction companies the opportunity to participate in the auction process. The extension was not granted to accommodate “primarily” one bidder. Additionally the fact that one auction firm was nationally known or that there was an Alaska bidder had no bearing on denying or accepting any requests submitted to the CC.

The last paragraph again discusses the public confusion issue. There were five auction company “bidders” involved with the auction process and only one of those companies (Grubstake Auction) complained in writing. The way this paragraph is currently written will give readers the impression that there were numerous complaints. One disgruntled auction company bidder does not validate a claim of “public confusion”. It would be accurate to say that a single auction company complained about the process but it would be very inaccurate to elevate the concerns of that one company to the status of “public confusion.” The paragraph should be changed to remove the ambiguous and inaccurate statement that there was “public confusion” and instead, indicate that one auction company complained about the bidding process.

Page 21 - Findings and Recommendations:

Recommendation number 1 says the director of administrative services for Department of Natural Resources should credit the Agricultural Revolving Loan Fund (ARLF) for the \$600,000 in auction proceeds.

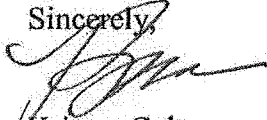
The language in the letter requesting the money was provided and required by DNR in order to receive the appropriation. It was the CC board’s agreement that the money would be used to pay necessary expenses and that whatever wasn’t used would be returned. This summer the CC returned the \$600,000 to DNR per their requirements and our agreement. However, the CC board also understands that if the appropriation funds are needed during the winding down of the corporation, the CC could request those funds for the specific purposes as outlined in the appropriation.

Recommendation number 2 says the BAC should take the necessary steps for the long term oversight of Mat Maid's assets and revenue generating lease.

The responsibility for oversight of Mat Maid assets rests with the CC until such time as the CC transfers the ownership interest to the BAC or until the CC requests the Division to take protective custody of the assets pursuant to the MOU. The CC has hired a private firm to assist with the accounting and eventual transfer of all the assets to the ARLF. DOL and the CC attorney have given guidance to the CC indicating the CC should not transfer any assets to the ARLF until all of the affairs of the corporation are resolved and concluded including any outstanding litigation.

I hope these responses will assist you in preparing the final draft of this report. On behalf of the Creamery Corporation I thank you for your diligent work and appreciate the opportunity to respond to the preliminary audit report. If I can be of any further assistance please do not hesitate to contact me.

Sincerely,



Kristan Cole
Creamery Corporation Chair

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE



Division of Legislative Audit

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October 23, 2008

Members of the Legislative Budget
and Audit Committee:

We have read the responses provided by the Department of Natural Resources, the Board of Agriculture and Conservation, and the Creamery Corporation. In its response, the Department of Natural Resources (DNR) correctly points out that the reimbursements for services provided by DNR staff are repaid to the same fund as the original cost, not the Agricultural Revolving Loan Fund as we indicated.

Other than this correction identified by DNR, nothing in any of the responses causes us to revise or reconsider the report's conclusions or recommendations.

Sincerely,



Pat Davidson, CPA
Legislative Auditor