

MEMORANDUM

State of Alaska

Department of Law

TO: Michele Brown, Commissioner
Department of Environmental Conservation

DATE: February 3, 1998

FILE NO: 663-97-0368

TEL. NO: 465-3600

SUBJECT: Review of Draft Legislative
Audit of Village Safe
Water Program

FROM: Marjorie L. Vandor
Assistant Attorney General
Governmental Affairs Section - Juneau

You have asked us to review the Village Safe Water (VSW) program statutes and practices in light of several recommendations and exceptions noted by the division of legislative audit (DLA) in its April 1, 1997, draft audit report with respect to how the VSW program grant funds are being handled by Department of Environmental Conservation (DEC or department). You have indicated that the alleged findings on noncompliance noted in DLA's draft audit may affect the department's federal funding of the state's VSW program. Therefore, legal review is being sought on the following issues:

1. Given the statutes under which the VSW program operates, is the funding approach currently utilized by DEC appropriate?
2. What entity (the State of Alaska or the grantee) owns the grant funds and the interest on the funds held in private financial institutions during the construction phase of a system?
3. Is it proper for the interest and unused grant funds to be applied toward the operation of the facility by the grantee without an appropriation by the legislature?

We will address each of these issues below.

I. General Overview of VSW Program and Current Funding Approach

The Village Safe Water program is established in AS 46.07. The VSW program has been in existence since 1970.¹ Under the VSW program, the commissioner of DEC is required to provide for the construction of safe water and hygienic sewage disposal facilities in villages and certain cities.² Under law, DEC “is authorized to provide for construction [of VSW facilities] by contract or through grants to public agencies or private nonprofit organizations, or otherwise.” AS 46.07.040(a). The VSW program provides for grants of up to 100 percent of project costs.

The legislature has granted DEC broad discretion in how the construction of VSW facilities is accomplished. In AS 46.07.040(c), the legislature has defined the “cost of the construction of a facility” so that it *includes*, in addition to costs directly related to the project, the sum total of all costs of planning, financing and carrying out the project.³ Additionally, AS 46.07.040(c) specifically allows DEC to use VSW money for financing and to pay for fees and expenses of trustees, depositories and financial advisors necessary to the construction of the project.

It is our understanding that the long-standing practice utilized by the legislature in its funding, and by DEC in its program administration of the construction of VSW facilities under AS 46.07, is as follows:

(1) The legislature makes grant appropriations and allocations to named villages to be administered through DEC.

(2) The division of facility construction and operation (FCO) in the department receives a single appropriation for the VSW grants, with named recipient villages set out in the legislation at a specific allocation level.

(3) Before construction of a facility commences or grant money can be transferred, the named recipient village must sign the department’s grant agreement.

¹ Village Safe Water Act, sec. 1, ch. 186, SLA 1970.

² For the purposes of the VSW program, “village” means an unincorporated community that has between 25 and 600 people residing within a two-mile radius, a second class city, or a first class city with not more than 600 residents. AS 46.07.080(2).

³ The term “includes” is not a limiting term but is interpreted as a word of enlargement or illustrative application. Under AS 01.10.040(b), when the words “includes” or “including” are used in a law, they shall be construed as though followed by the phrase “but not limited to.”

(4) The department's grant agreement specifically provides that the village is authorizing the department to act on the village's behalf to procure the services of a third party, an accounting firm, that will provide record and bookkeeping services associated with the administration of the construction of the facility.

(5) The accounting firm is a trustee acting on behalf of the villages and is procured by FCO.⁴ In accordance with the authorization given to the state by a village under the grant agreement, the FCO disburses the village's grant funds in a lump sum to the accounting firm, which then deposits the funds in a bank. If other entities participate in the funding to construct a village's facility (i.e., the federal government), the funds received from that entity are directly deposited with the state funds. The accounting firm is responsible for executing necessary federal and state reporting mechanisms for the village.⁵ The accounting firm maintains a check register, writes payroll and pays vendors for deliverables of the project which have been approved by DEC's VSW engineer.

(6) Under the grant agreement, the plans and specifications of a village's VSW facility must be approved by DEC before construction commences. Use of the grant money to pay for the costs associated with planning and start-up of the project (e.g., studies, surveys, architectural, engineering, or other special services, purchase of property, site preparation, acquisition of machinery) is allowable as "costs of the construction of a facility" under AS 46.07.040(c). DEC oversees the construction of the facility until it is completed.

(7) A VSW engineer is assigned by DEC to manage and oversee the construction of the facility in the same capacity as a city engineer for the recipient village. The VSW engineers' duties include consulting with community leaders on the design of the facility as well as assisting in selection of contractors and approving invoices for payment from the grant funds.

(8) Once the construction of the facility is considered complete by DEC, the village takes title to and must operate and maintain the facility.⁶

⁴ Under AS 46.07.040(a), DEC's contract with the accounting firm is governed by AS 36.30 (State Procurement Code).

⁵ Under its trusteeship, an accounting firm may maintain several villages' accounts. According to your opinion request, the funds are maintained in separate interest-bearing checking accounts that have been established for each village.

⁶ Under AS 46.07.050(a), it is the responsibility of the village's governing body to maintain and operate the safe water and hygienic sewage disposal facility, and upon completion of the facility the commissioner must transfer title to vest complete ownership in the facility in the governing body.

(9) Upon completion of the construction of the facility, the interest income and any grant funds that are unexpended or unobligated are transferred to the village for operation and maintenance of the facility.

II. Response to Exceptions Noted in DLA Draft Audit

A. Advances of Grant Funds

In the draft audit, DLA asks for responses from DEC regarding several aspects of the VSW program.

DLA inquires as to the appropriateness of DEC making an advance payment of a village's grant funds in one lump sum at the beginning of a VSW project⁷, rather than disbursing grant funds over the life of a project and as costs are incurred. DLA claims, *inter alia*, that the state treasury is being denied considerable interest that could be earned on the VSW grant funds that are not immediately necessary to pay for project costs because such funds, instead, are being set up in individual, interest-bearing checking accounts for each village which earn much less interest.

DLA cites the Alaska Administrative Manual, AAM 35.175 (4) in support of its view that DEC's current practice of lump sum distribution of the grant money is not only costly to the state, but is not in keeping with state administrative practices. AAM 35.175, in its entirety, reads:

Payments cannot be made in advance of receipt of goods or services except in the following cases:

1. Rental payments may be made after the first day in which service commences if the lease requires advance payments.
2. Subscriptions of periodicals, the purchase of documents and publications, and payments for postage may be made in advance. All such vouchers must be supported by

⁷ We note that the grant money is not transferred to the grantee (village) until after DEC receives satisfactory assurance that the village governing body will accept such responsibility to own and operate the facility upon completion. This assurance is specifically required prior to the commissioner authorizing construction of a village's facility under AS 46.07.050(a).

written requests for the service from agencies or bills from vendors.

3. Warrants may be written for the purchase of securities, investments and real property before the assets are received.
4. Grants may be made in advance to individuals and to political subdivisions when the law so provides.

DLA claims that there is no law that provides for advance payment to the VSW grantees. However, we believe there are viable arguments to be made that support the current practice of advance payment of the grant money. First, in AS 46.07.040(c), "costs of construction" is broadly defined. It includes costs of financing and confers DEC with broad authority and discretion in administering the VSW program for construction of the facilities.⁸ AS 46.07.040(a) authorizes DEC to provide for the construction by contract or through grants to private agencies or private nonprofit organizations, *or otherwise*. (Emphasis added). Second, DEC has documented the practical need for advance payment of grant funds due to the fact that villages generally lack a secure financial base with whom contractors would normally contract to perform services, and due to Alaska's unique construction season and weather conditions. These factors are all noted in DLA's report, but are discounted on the basis of AAM 35.175.

The powers given DEC in AS 46.07.040 are, we believe, broad enough to include administering the VSW program in a manner that disburses grant funds as allocated to construct a particular village's facility and providing for the investment of those funds during the term of the construction, with the interest and excess grant funds being allowed for operation and maintenance. In coming to this conclusion, we note that DEC's authority with respect to "cost of construction" of a VSW facility explicitly includes costs associated with all phases of a project, from the initial planning phases through actual physical construction as well as financing of the project including expenses of trustees. AS 46.07.040(c). DEC has indicated that it is impracticable as well as unfeasible to obtain bids from contractors for a village's VSW facility without the financing mechanisms in place at the commencement of a project. We also base our conclusion upon long-standing and contemporaneous construction of the program statutes and believe that DEC is fully empowered to administer the VSW program in the manner it has been doing for the past two decades.

⁸ The one restriction noted in AS 46.07.040(a) is the requirement that construction by contract is governed by the State Procurement Code (AS 36.30). This provision was added in 1986 (sec. 35, ch. 106 SLA, 1986).

We believe it would not be in keeping with apparent legislative intent to strictly interpret AAM 35.175 against the broad statutory authority given DEC to administer the VSW program as set out in AS 46.07.040.⁹ And, while it is not our opinion that DEC lacks the requisite authority under AS 46.07 to administer the VSW program in the manner which it currently and consistently has done, we note that AAM 35.100 may also be a means to accomplish a secondary level of approval that would satisfy DLA's concerns. AAM 35.100 allows a disbursing agency to prepay contracts, leases, or other charges when the agency is able to clearly document that the prepayment is in the state's best interest. Prepayments in excess of \$100,000 should be brought to the attention of treasury for fiscal review of the lost revenue earning opportunity. Even though the funds at issue here are considered grant funds, their intended use towards "cost of construction" could qualify the money to be disbursed under general rules on prepayments of contracts. Therefore, it may be prudent for DEC to utilize the process under AAM 35.100 if DLA believes it will satisfy the concerns noted in the draft audit.

B. Contemporaneous and Practical Interpretation of AS 46.07

Part of the basis for our belief that DEC has the authority to provide for advance payment of VSW grant funds is due to an aid of statutory construction known as contemporaneous and practical interpretation. As noted above, the VSW program has been in existence for well over twenty years. Until now, the fiscal administration of the program has not been challenged for the reasons expressed in DLA's draft audit. That is not to say that an erroneous practice by an agency must be allowed to continue without due regard for the law simply because of a long-standing practical interpretation. DLA evidently takes the view that AAM 35.175 requires an explicit statute or regulation to authorize advance payment. However, we believe, as discussed above, that the authority under which DEC currently operates the VSW program reasonably infers the authority to allow for advance payment of grant funds. We certainly believe that interpretation is open to debate and that advance payment under the VSW is not clearly a prohibited practice, particularly in light of the broad powers conferred on DEC in AS 46.07.040. And, where, as here, there has been a long-continued administrative interpretation of a statutory program (AS 46.07) which has

⁹ DLA claims that due to the practice of advancing a village's VSW grant funds and depositing the funds in separate interest-bearing checking accounts that the state treasury could have earned up to \$2 million more in FY 1997, had the funds been retained in the state's general fund until directly needed for payment on a project. However, the loss of potential interest earnings does not automatically render the practice of advance payment as being violative of state laws or accounting rules. The VSW program must be looked at in its entirety -- not on a piecemeal basis -- to determine if the method of administration by DEC complies with current law. The VSW program statutes and the state's accounting rules should be read in *pari material*.

two or more possible reasonable interpretations (one through strict interpretation and one through liberal interpretation), the interpretation of the administrative body should be controlling. 2B C. Sands, *Sutherland Statutory Construction* §49.04 (5th ed. 1992 rev.)¹⁰

While contemporaneous and practical construction is merely an aid to interpretation of a statute, whether an agency's interpretation is bolstered by use of this rule of statutory construction depends, first, on whether it is a matter within the expertise of the agency. *Id.* When an administrative decision involves expertise regarding either complex subject matter or fundamental policy formulation, a court defers to the decision if it has a reasonable basis. *Id.*, citing *Keane v. Local Boundary Comm'n*, 893 P.2d 1239 (Alaska 1995). Where the words of a statute leave room for interpretation as to its meaning, courts will ordinarily give some weight to the construction given the statute by the agency responsible for administering it. *Sutherland* § 4.05.

The conclusiveness of a contemporaneous and practical interpretation will depend upon a number of additional elements that give efficacy to the rule. In general, these elements are: (1) that the interpretation originated from a reliable source; (2) that the interpretation was made at or near the time of the enactment of the statute; and (3) that the interpretation has continued for a long period of time and received wide acceptance and following. *Id.*¹¹

All of these elements of the rule appear to be met in this instance. One, the legislature has conferred upon DEC the broad discretion to administer the VSW program and oversee all aspects of planning, construction and financing that best suit a village's needs, taking into account the uniqueness of construction seasons in Alaska and the need to assist villages to obtain contractors willing to perform work for these entities. Two, the interpretation of the program originates from the commissioner and agency officials within the department who have direct responsibility to administer the VSW program. Three, the VSW program has been in effect for more than 20 years and has been administered in the current or similar fashion throughout the years.

¹⁰ We note that the legislature has amended several sections of AS 46.07 since its inception, but that none of the amendments have changed the basic funding provisions or duties of DEC in a manner inconsistent with the current practice. It is presumed that the legislature is familiar with the contemporaneous interpretation of a statute, especially when it is made by an administrative agency with the duty of enforcing that statute. *Sutherland* § 49.09. Where reenactment of a statute includes a contemporaneous and practical interpretation of a statute, the legislature can be said to have impliedly adopted the agency's interpretation on readoption.

¹¹ In *Sutherland*, it is noted that where these factors are present the vagueness usually surrounding the other aids of construction is not present, and therefore the rule serves as one of the most definite and reliable sources of statutory meaning. *Id.* § 49.04.

Similar to precedent established by court decision, if a contemporaneous and practical interpretation has stood unchallenged for a considerable length of time (as with the VSW program), it will be regarded as very important in arriving at the proper construction of a statute. *Sutherland* § 49.07.

C. Ownership of Grant Funds During Construction Phase

DLA questions the ownership of the VSW grant funds due to the level of oversight by DEC and its contractors. We believe that the degree of oversight exercised by DEC is consistent with its duties under AS 46.07, and that the grant funds are the named recipient village's money, not the state's, for the following reasons. The legislature appropriates the money as grant money to the villages and allocates the funds to named recipient villages. A village cannot obtain the money for a VSW project until the project has been identified and approved by DEC. This approval is required under AS 46.07.030. The village is required to sign a grant application with DEC and must agree to let a trustee in the person of a third-party accountant oversee the bookkeeping and accounting services necessary for the project. As explained to us, the trustee (third-party accountant) is necessary due to the fact few villages have personnel with adequate accounting experience for a construction project of the magnitude of a VSW facility. Also, the grant agreement requires a village's governing body to agree to take over ownership, control, management and liability for a completed system and is therefore consistent with AS 46.07.050.

DLA expresses its view that the practice of obtaining a separate federal Employment Identification Number for the village for construction of the VSW facility goes against a finding that the grant funds belong to the village. It is our understanding that a separate EIN protects the integrity of the grant funds related to a village's VSW project. In our view, this practice is well within the discretion accorded DEC under AS 46.07.040(c) and is reasonable in light of the unique circumstances in administering the program.

In sum, it is our opinion that the VSW grant funds belong to the named recipient village at the time the grant agreement is signed.

D. Interest Income

DLA expresses concern as to the ownership of the interest earned on the VSW grant funds that are placed in the interest-bearing checking accounts. On this issue, DLA is correct in its assertion that interest income on state grant money generally should not be paid to a grantee on the unexpended grant appropriations. This office has opined that where there is no statutory authority to pay interest on unexpended grant appropriations that it cannot be done. 1992 Inf. Op. Att'y Gen. (July 1; 883-92-0141).

We have also stated that it is poor public policy to allow grantees to invest state funds rather than immediately applying them to the stated purpose of the grant. *Id.* However, in the present matter, the grant money appropriated by the legislature for a village's VSW facility *does* remain in the state general fund until the village signs the required grant agreement. To our knowledge, the interest earned on the funds while it is in the state treasury does not transfer to the village; only the principal amount goes to the village. The grant agreement signals that the VSW project has commenced and "costs of construction" as defined in law (AS 46.07.040(c)) may be paid from such funds. The funds are no longer the state's in the same sense we opined in the 1992 opinion.¹² While the legislature could require the interest income earned on a village's grant money (while in the checking account) to be returned to the state at such time the VSW facility is completed, it would require express statutory authority for the state to enforce such a demand once the grant money had been paid to the trustee.

As to the use of the interest income for operation and maintenance of a completed facility, DLA complains that the interest is allowed to be used by the village for this purpose without legislative appropriation. We do not believe an appropriation is necessary because the grant money is owned by the villages as well as the interest earned thereon.

Also, AS 46.07.050(b) authorizes the commissioner to make grants to villages for operation and maintenance of facilities upon completion. The practice of the department has been to authorize use of the interest income and unexpended grant funds for this purpose. It is our opinion that so long as the remaining grant money and the interest accrued are used for the purposes for which the grant was originally appropriated (the VSW program), then it is proper for the commissioner to allow the money to be used by the villages for operation and maintenance of a facility once it is completed.

As to the latter comment, we concur with DLA that, under AS 46.07.050(b), the commissioner should make a determination that a village governing body does not have sufficient financial resources to operate and maintain the facility before enabling the village to use the unexpended VSW grant money and interest for operation and maintenance.

¹² In our 1992 opinion, the items being discussed were two grants to the City of Fairbanks for health care facilities. The problem was that each item purported to also appropriate interest earned on the amount appropriated and the grantee would expect to draw interest on the unpaid part of the grant while the appropriation remained unexpended.

III. Conclusion

In conclusion, it is our opinion that DEC has the requisite statutory authority to advance the grant appropriations to named village recipients at the time the grant agreements are signed.¹³ The statutory definition of "cost of construction" in AS 46.07.040(c) is sufficiently broad to include use of grant funds for financing of the construction of the facility, to obtain the services of a trustee, and for DEC to administer the VSW program in a fashion designed to accomplish construction of the facilities in a manner it determines is in the best interest of the state. Also, the long-standing contemporaneous and practical construction of AS 46.07 supports DEC's interpretation of its authority and practices in administering the program. DEC may wish to consider utilizing the exception to the general rule against prepayments under AAM 35.100, which authorizes prepayment when it has been established that it is in the best interests of the state. And, of course, all doubt as to whether advance payment to villages is proper can be achieved through a statutory change to the program statutes, although we do not believe such clarity is legally necessary. Finally, we agree with DLA's suggestion that DEC should consider less than full advance payment (i.e., half of the principal amount) if it is determined that the effectiveness of the VSW program will not be adversely affected. We also agree that the commissioner should make the requisite determination under AS 46.07.050(b) before grant money and interest can be used for operation and maintenance.

Our advice on this issue is prospective only and is not intended to affect current contracts or grants that have been advanced under the program.

We hope this adequately addresses your and the division of legislative audit's concerns. Please call us if you have questions.

BMB:MLV:jn

cc: Pat Davidson
Acting Legislative Auditor
Legislative Audit Division

¹³ We caution that our opinion as to the authority of DEC to make the advance payment of grant money is limited to the VSW program and is based upon the long-standing contemporaneous and practical interpretation of AS 47.06, the broad powers conferred on DEC, and the documented, unique needs of the villages that are appropriated the funds for the facilities.