

December 10, 2018

Exxon Valdez Oil Spill Trustee Council
4230 University Drive, Suite 220
Anchorage, AK 99508

RE: EVOSTC Staff Review of Think Tank Report of October 2018

Dear Council Members:

As requested by the EVOS Trustee Council, I have evaluated EVOSTC staff's work to provide support for their review of the self-named EVOS Think Tank of Citizens ("Think Tank") proposal *New Vision for EVOS*. By way of background, I have served as EVOSTC's external accountant since 1994. Over that time, I have become familiar with its operations and activities, including the development and progression of the financial controls in place over the expenditure of funds.

I have interacted with Elise Hsieh, EVOSTC Executive Director, and her staff as they have worked to review and provide documentation related to the Think Tank proposal. EVOSTC's staff's goal was to independently calculate the direct project and overhead costs and rates presented by the Think Tank in its proposal to assist you in evaluating its merits. To accomplish this, they used budget information for fiscal years 2016 through 2018, identifying the various costs that EVOSTC, trustee agencies and other entities incur in carrying out Trustee Council work as either habitat or science related, and then as either direct program or overhead costs.

Staff has developed three documents in response to the Think Tank proposal:

1. An excel workbook that calculates the various cost components of EVOSTC's programs and the related supporting costs. Staff identified costs as science or habitat efforts and for the related administrative overhead and indirect costs that are incurred internally and externally by entities that carry out the EVOSTC programs and projects.
2. A guide for understanding the excel workbook.
3. A response to the Think Tank's proposal that compares the facts and figures in the proposal to the respective amounts calculated by EVOSTC staff.

This documentation and related support were developed by staff based on budget information for EVOSTC fiscal years 2016, 2017 and 2018. My involvement was to understand their approach to developing the cost information contained in the workbook, check the mathematical accuracy and logic of its calculations, and offer suggestions or corrections. I believe they have incorporated all of my suggestions and corrections. I have not performed an audit or review of the information presented in accordance with professional standards issued by the American Institute of Certified Public Accountants so provide no formal assurance on the information presented.

As part of my evaluation, staff also asked me to respond to questions related to EVOSTC's operations and the Think Tank proposal. The questions and my responses follow:

Is the rate of administrative costs incurred by EVOSTC excessive?

As calculated by staff, the combined indirect and administrative cost rate as a percentage of program and project direct costs (including third-party overhead amounts) was 17.5%, 10.8% and 15.5% for the years 2016 through 2018,

respectively. The fairly wide range in rates is due to the larger base of habitat spending in 2017 compared to 2016 and 2018, which has the effect of increasing the base in the percentage calculation.

In general, as administrative cost rates decrease, funds available for direct project expenditure increase. However, an adequately funded administrative function is necessary to ensure that project dollars are being spent for effective programs and projects, and to meet legal and Trustee Council requirements. Staff notes that in recent years the Trustees have initiated and or approved additional funding to further develop a high level of review and management of the projects and to ensure that high-quality results are achieved. This oversight requires funding, and such oversight is critical, of course, to demonstrate that the funds are being spent judiciously and as required.

However, bloated administration does not increase effectiveness. Dollars spent unnecessarily do not add value, and take funding away from important projects. The EVOSTC staff is fairly lean. My experience in comparison to non-profit organizations or similar mission-specific governmental functions indicates that EVOSTC does not overspend on personnel or other costs to accomplish its oversight and administrative function. In 2018, as reflected in the workbook, EVOSTC office-specific administrative cost rates (administrative costs as a percentage of direct program costs) was 14.6% for science programs and 9.9% for the habitat program.

These overhead rates can be compared to non-profit organizations through an evaluation of financial information contained in the federal informational returns filed with the IRS, known as Form 990. Administrative costs as a percentage of program costs for the following non-profit organizations are (per their most recently available Form 990 available at guidestar.org):

<u>Organization</u>	<u>Admin Costs as a Percentage of Program Costs</u>
Seward Assoc for the Adv of Marine Science (Alaska Sealife Center -ASLC)	12.7%
Prince William Sound Science and Technology Institute (PWSCC)	12.8%
Alaska Wildlife Conservation Center	37.6%
Regional Citizens Advisory Council	36.9%

Comparing the rate calculated by EVOSTC staff, the EVOSTC office does not appear to have a high overhead or indirect rate in comparison to these organizations (10.8%, 7.4%, 11.0% for fiscal years 2016, 2017, 2018) - and especially considering the diverse (technical, science, capital projects and habitat enhancement and protection) services performed by the EVOSTC office.

When EVOSTC utilizes the services of PWSCC, ASLC, trustee agencies or other entities to carryout projects or programs, it, of course, is paying these organizations not only for direct programs but also for the administrative costs these entities incur to support their programs. For the trustee agencies, these are the general and administrative (“GA”) reimbursement, and for other entities, it is their negotiated indirect rate, which is established to reimburse nonprofits and non-federal governmental entities for their overhead costs.

The combination of the internal EVOSTC administrative costs plus the external administrative costs reimbursed to third parties yields the 17.5%, 10.8% and 15.5% total overhead rate for 2016-2018 presented by staff in their workbook and review.

How does the current placement of funds with the Alaska Department of Revenue compare to the Think Tank’s proposal to place the funds with the Alaska Community Foundation?

Since November 2000, EVOSTC’s unspent funds have been placed with, and invested by, the Alaska Department of Revenue’s Treasury Division (“Treasury”). Treasury invests all non-Alaska Permanent Fund accounts of the State or Alaska. As of July 31, 2018, Treasury reported \$41.39 billion under management. Two accounts are established for each of EVOSTC’s research and habitat activities with Treasury that are part of Treasury’s total investments under management. EVOSTC assets are allocated among fixed income, and domestic and international equity investment

pools managed by Treasury. Through October 2018, Treasury reports that the research and habitat accounts have returned 6.12% and 7.68% since inception, and 9.74% and 9.69% over the last 10 years, respectively. These returns have provided significant funds for the Trustee Council to carry out its mission. In addition, because of the very large investment pool, Treasuries costs are very low. Fees in each of the last three fiscal years have totaled about .05% of the average balances in both accounts, or about \$100,000 per year.

The Think Tank proposal calls for taking the funds from Treasury and placing them with the Alaska Community Foundation (ACF). ACF is one of a growing number of community foundations around the country that are intended to encourage philanthropy and provide a way to connect endowment donors with entities carrying out humanitarian and other important services. Its most recently issued audited financial statements listed \$92 million in assets. The fee charged for EVOSTC's funds would be .75% per the Think Tank, or about \$1.5 million per year based on existing investment balances.

I admire ACF and its mission and have recommended clients consider it as a choice for establishing an endowment. ACF plays an important role for necessary programs to find needed funding. However, it would seem reasonable to carefully consider whether the ACF's current structure could support the broad oversight that the habitat and research missions of EVOSTC requires within its proposed rate of .75%.

Will the Think Tank's Proposal be Cheaper than the Existing EVOSTC structure?

In its proposal, the Think Tank recommends transferring remaining EVOSTC funds to ACF and that those funds continued to be used to fund existing research commitments through 2022. These research commitments will continue to require the payment of administrative and overhead funds to the respective agencies carrying out these projects as they are now.

The proposal also calls for the establishment of a \$20 million operating endowment for PWSSC and ASLC. Under this scenario, \$150,000 will be paid to ACF for its fee. Both PWSSC and ASLC will also continue to incur their respective administrative charges. So, whether the funds are coming from Treasury or ACF, the dollars incurred for overhead would be the same.

ACF has adopted an investment policy statement that contains a spending plan that allows for a spending rate of between 4% and 5% of the average prior 16 quarters balance of the pool of investments to allow for the effects of inflation at ACF's expected return of 7%. For example, if the endowment currently allows for spending of 4.5% per year then \$900,000 would be available in total to PWSSC and ASLC. Assuming their overhead rates remain relatively consistent with the roughly 12.7% reflected in their recent 990, then total administrative costs of \$127,000 would be used for their administrative functions. Stated a different way, under the proposed Think Tank structure, \$277,000 of \$900,000 of available annual funds would be used for overhead, or 30.1%. This does not include any costs that would likely also be incurred to monitor each entity's programs.

Finally, the proposal calls for establishing an Ocean Research Fund which would carry out "long-term research and monitoring programs." The proposal doesn't specifically address how these monitoring programs would be carried out but presumably there would be some sort of yet to be created oversight and administrative function, similar to the current EVOSTC staff function that would be needed to carry this out. Accordingly, it does not appear, at least with the information presented that the Think Tank's proposal would be cheaper than the existing EVOSTC structure and it would also have to allow for significant start-up costs.

I appreciate the opportunity to be of service to you. Please let me know if you have any further questions. I may be reached at max@mertzcpa.com.

Sincerely,

