

MEMORANDUM

State of Alaska
Department of Law

To: The Honorable Deborah B. Sedwick
Commissioner
Department of Community and
Economic Development

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Tel. No.: 465-3600

From: James L. Baldwin
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Governmental Affairs – Juneau

Re: Alaska Science and Technology
Foundation Earnings

You have requested our advice concerning the circumstances under which the Alaska Science and Technology Foundation (ASTF) may expend an operating appropriation set out in ch. 94, SLA 2002. We have reviewed an opinion on this subject prepared by outside counsel for ASTF. In his opinion, counsel concludes that an operating appropriation of ASTF made from earnings of the ASTF endowment fund (the endowment) may be expended on the basis of earnings projected by the Alaska Permanent Fund Corporation (APFC) for the fiscal year, even if those earnings have not as yet been realized.¹

The APFC is the custodian of the ASTF endowment. AS 37.17.020(b). As custodian, APFC provides for the management of investments of the principal of the endowment in income-producing assets. Net income of the endowment is distributed to ASTF to implement its statutory purposes. APFC commingles the ASTF endowment money with the Alaska Permanent Fund for investment and grants to ASTF a proportional share in the assets. The unit shares rise and fall in value along with the market value of the investments. There is no definition of "net income" set out in AS 37.17. It is reasonable to assume that the definition of this term is the same as the definition appearing in AS 37.13.140 that applies to APFC's calculation of Alaska Permanent Fund income available for distribution. There is a specific prohibition against including any

¹ As a preliminary matter, we conclude that sec. 3, ch. 94, SLA 2002, designates the intended source of the appropriation appearing in sec. 1 of that Act (page 7, line 30) to be earnings of the endowment. As a result, we will address only part of the opinion concerning the ability of ASTF to request and receive draws from the endowment against the appropriation. We do not express an opinion whether the appropriation can be construed to allow the expenditure of principal of the endowment.

ASTF endowment earnings in the amount that is ultimately distributed under AS 37.13.145.

Using the APFC definition, income is calculated on the last day of the fiscal year according to generally accepted accounting principles, excluding any unrealized gains or losses. By statute, net income may, if appropriated, be used to fund operations of ASTF. AS 37.17.020(b). The problem for ASTF is caused by short-term losses on investments in which the endowment has been placed. The endowment has shown losses during the last fiscal year through the early part of the present fiscal year, at a time when ASTF needs to make draws on its operating appropriation. APFC uses accounting practices which record the realization of income only after the market value of assets exceeds the value of principal.² Under this method, the value of principal of the Alaska Permanent Fund is established when received and is not allocated to assets of the corporation in which principal is invested. As a result, principal is not adjusted for capital gains or losses. If this accounting method were applied to endowment principal of the ASTF, it would take a substantial increase in the valuation of assets before a gain could be realized for the present fiscal year.

This accounting practice may not be appropriate for the ASTF endowment, which is a statutory fund committed to the custody of APFC. According to statute, principal of the endowment can be adjusted to reflect the market value of assets. Alaska Statute 37.17.030(a) provides: "[t]he net annual realized capital gains of the endowment may be equally divided between the income and the principal of the endowment."³ However, the statutes are silent as to the treatment of capital losses. By implication, it seems reasonable that losses incurred by the ASTF endowment may be apportioned to principal as well. For this reason, we have no basis to disagree with the opinion of outside counsel that the amount attributed to principal could be annually adjusted to reflect gains and losses before determining the amount of income that is designated by law as available for appropriation from the endowment. Under this construction, the value attributed to principal at the close of the preceding fiscal year may be used as the starting principal balance for the purposes of determining the amount of earnings for the present year. We realize this interpretation would allow the endowment to reflect a principal amount that is less than historic contributions. The ASTF enabling act does not

² Principal of the Alaska Permanent Fund is a combination of dedicated mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses, and state appropriations made by the legislature to principal. The Alaska Permanent Fund is accounted for in the state's Comprehensive Annual Financial Report as an unexpendable trust fund while the ASTF endowment is not so classified.

³ A similar provision does not exist in the enabling statutes for APFC.

mandate a strict accounting method for principal. The legislature appears to have appropriated from principal, which is evidence of a construction that principal need not be maintained at historic levels.⁴ The legislature retains the power to appropriate from the ASTF endowment for any public purpose even if the use of the fund is restricted by law. *See Hickel v. Cowper*, 874 P.2d 922, n.23 (Alaska 1994)(amount held by a public corporation is available for an appropriation by the legislature to the extent that it determines to validly exercise the appropriation power).

We also agree with the part of counsel's opinion which concludes that it would be reasonable to permit draws by ASTF based on good faith estimates of earnings income to be realized during the fiscal year. We understand that the estimation of earnings during a fluctuating market period cannot be precise. ASTF must take prudent action to attempt to alleviate the risk of an overpayment of earnings. However, if the estimates are made in good faith and properly relied on, there would be no exposure to either ASTF or APFC if the earnings do not materialize. In that case, ASTF should request the legislature to ratify the expenditure from principal of the endowment when it next convenes. Finally, it would be prudent for ASTF to propose legislation to clarify and make specific the method for calculating earnings and safeguards for preserving the principal of the endowment.

JLB:jn

⁴ *See* sec. 4, ch. 94, SLA 2002 (page 60, line 26)(funding source specification indicating authorization appears in other parts of the bill to expend \$2,315,000 from endowment principal).