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SUMMARY OF FINDINGS OF MRW CONSULTING GROUP, LLP RELATING TO AN INDEPENDENT FORENSIC AUDIT OF FINANCIAL MATTERS REFERENCED IN REPORTS PREPARED FOR THE MUNICIPAL ASSEMBLY BY THE MUNICIPAL ATTORNEY FOR THE MUNICIPALITY OF ANCHORAGE

I. INTRODUCTION

In connection with the above referenced matter, MRW Consulting Group, LLP ("MRW") was retained by the Municipality of Anchorage to provide forensic services relative to financial matters referenced in reports prepared for the Municipal Assembly by the Municipal Attorney. This forensic audit, although not a certified audit, was performed for the period of time from approximately January 1, 2008 through December 31, 2008.

II. QUESTIONS ADDRESSED

The questions addressed by the MRW forensic audit were detailed in the scope of work incorporated in the Request for Proposal dated March 5, 2010. The scope of work is as follows:

The Scope of the audit shall be based on Assembly Resolution 2010-57, limited to those issues set out in the two reports by the Municipal attorney, shall not extend beyond those matters, and shall include the following:

In reference to the Municipal Attorney's original report, the audit shall provide independent review and analysis of:

- ☐ The "on behalf" PERS revenue and expense journal entries for the FY 2008 budget and the flow-through of the PERS budget treatment to the departmental budgets;
- ☐ The alignment between revenues and appropriations, and alignment between expenditures, appropriations, fund balance and fund balance reserves and the timeliness of reporting shortfalls/over expenditures to the Assembly.

In reference to the Municipal Attorney's supplemental report, the audit shall:

- ☐ Independently determine if the transactions and the reports identified in the Municipal Attorney's supplement report had a material impact on the unappropriated fund balance;
- ☐ Identify if actions taken with regard to budgeting were in conformance with applicable government accounting standards, provisions of municipal, state and federal law, and prudent fiscal management.

III. FINDINGS AND CONCLUSIONS

The following conclusions are made regarding this forensic audit:

ANALYSIS OF "ON BEHALF" PERS REVENUE AND EXPENSE JOURNAL ENTRIES FOR FY 2008

PERS revenue and expenditures were reversed for the second half of 2008 on the general ledger, but the budget was not adjusted accordingly. Consideration was given by the administration to adjusting the budget to reduce revenues and expenditures in connection with the adjustment to the general ledger, but this was not done. As such, expenditures for all departments combined were under budget at the end of 2008 by $13,393,230. However, if the budget had been reduced by the PERS budget adjustment, all departments combined would have been under budget by $7,413,662. If budgets had been reduced by the amount of the PERS budget adjustment, three departments (Municipal Attorney, Police, and Traffic) would have been over budget by a total of $841,698.

As noted, MRW identified several e-mail communications wherein adjusting the budget to reflect the PERS amounts were discussed, but in no instances was it determined that Former Mayor Begich was informed that this adjustment was not accomplished.

Four departments (Municipal Attorney, Anchorage Parks and Recreation, Economic & Development Agency, and Transit) accomplished budget transfers following the PERS reversal transaction, thereby transferring funding from the account impacted by that reversal to other accounts. Those budget transfers totaled $491,500.

Of the four departments that accomplished budget transfers, only Economic & Development Agency would have been under budget had the PERS adjustment been made to their budget, and the budget transfer for that department could have been accomplished regardless of whether the budget adjustment was made. The remaining departments that accomplished budget transfers would have been over budget had their budgets been reduced by the amount of the PERS adjustment, thus preventing the budget transfers. (Attachment 14 (s), Summary of 1000 Account Series)

MRW determined the Administration failed to practice prudent fiscal management by implementing the PERS reversal entries on the general ledger without insuring the Assembly was aware of the potential impact on department spending and not presenting the Assembly with the opportunity to amend the budget to be consistent with the reversal to the general ledger.

(For additional details refer to pages 10 through 14 of this report.)

ALIGNMENT BETWEEN REVENUES AND APPROPRIATIONS AND EXPENDITURES AND APPROPRIATIONS AND THE TIMELINESS OF REPORTING SHORTFALLS /OVEREXPENDITURES TO THE ASSEMBLY

MRW determined that the CFO failed to "*cause a monthly statement, in condensed format, to be prepared and distributed to the assembly, the mayor and all department heads, showing the aggregate revenues and expenditures of each fund of the municipality for the preceding month as well as the year-to-date accumulative amount."* as required by Section 6.40.010 of the Anchorage Municipal Code. Additionally, the forensic audit found no evidence that the Mayor instructed the CFO to prepare these reports, nor did the Assembly ever specifically ask for these reports.

The Mayor did not make a determination during 2008 *"that revenues will be less than appropriations for a fiscal year*," and as a result he never informed the Assembly that revenues would be less than appropriations. However, during the last quarter of 2008 he issued two press releases touting the sound financial condition of the Municipality.

The MRW audit did not conclusively determine whether the members of the Mayor's executive staff failed to fully inform the Mayor regarding the extent and impact of potential revenue shortfalls during 2008, as there were no notes, minutes, or memoranda prepared relative to Executive Committee Meetings or Executive Briefings. For that reason, no conclusion can be made by MRW regarding whether prudent fiscal management was practiced relative to providing pertinent budget shortfalls and projections to the Mayor.

The MRW review concluded the Administration failed to practice prudent fiscal management by failing to assemble monthly reports of revenues and expenditures and submit those reports to the Assembly as required by the Anchorage Municipal Code. MRW further concluded the Assembly failed to practice prudent fiscal management by failing, as a body, to demand the production of the required reports before making financial decisions that had significant impacts on the Municipality's budget and fund balance.

MRW determined the Assembly is currently being provided with a series of reports on a monthly basis that reflect revenues and expenditures. The Assembly has informed the current CFO that these reports meet their needs regarding the required reporting requirements. It is recommended the CFO continue to provide the Assembly with pertinent information regarding revenues and expenditures on a monthly basis.

(For additional details refer to pages 16 through 22 of this report)

FUND BALANCE AND FUND BALANCE RESERVES

MRW determined the fund balance as of December 31, 2008 was substantially below the requirement of 8.25% of revenue plus reserves. The Assembly was provided a projected fund balance calculation that was later determined to be substantially incorrect. The errors appear to have resulted from incorrect methodology regarding projected revenues and expenditures given the state of the economy during the last quarter of 2008. MRW further determined that the Assembly was provided with this information along with a qualification that included the following statement:

> *"The Municipality's fund balance calculation is extremely complex and has not been estimated mid-year until this time. It is subject to change, and subsequent changes can be material, whether positive or negative."*

For December 31, 2008 the available fund balance for the 8.25% Bond Rating Designation was calculated to be $17,183,000 according to AIM 105-209(A) (sic) and the Operating Emergency Designation for the 1% to 3% of prior year revenue was calculated to be $374,000, for a total of $17,557,000. The analysis included in AIM 105-209(A) (sic) reflects the 2008 bond requirement computed at 8.25% of the prior year revenue was $26,520,000 and the emergency reserve requirement computed at 1% to 3% of prior year revenue was $6,622,000 for a total requirement of $33,142,000. Based on this calculation, the shortfall relative to the 8.25% requirement was $9,337,000, and the shortfall relative to the 3% emergency reserve was $6,248,000 for a combined total shortfall of $15,585,000.

It is recommended that a reporting system be devised to monitor and report fund balance within a reasonable degree of accuracy and to provide that information to the Assembly on a routine basis. MRW recognizes the difficulties involved with the preparation of projected fund balances and suggests routine reporting on a quarterly basis for the first three quarters of each year, followed by monthly reporting during the final quarter of each year may provide sufficient guidance to the Assembly. This recommendation is qualified to include the recommendation that additional interim reporting of projected fund balance be provided at any time extraordinary economic factors are identified that might materially alter prior fund balance projections or anticipated trends. Any schedule of reporting utilized should be consistent with present and/or future codes and ordinances.

The MRW review concluded that the Administration failed to practice prudent fiscal management by failing to heed warnings regarding potential significant mis-calculations relative to the projected fund balance that was submitted to the Assembly. These mis-calculations deprived the Assembly of valuable information needed to make decisions affecting the financial health of the Municipality.

(For additional details refer to pages 22 through 24 of this report.)

INDEPENDENTLY DETERMINE IF THE TRANSACTIONS AND THE REPORTS IDENTIFIED IN THE MUNICIPAL ATTORNEY'S SUPPLEMENTAL REPORT HAD A MATERIAL IMPACT ON THE UNAPPROPRIATED FUND BALANCE

MRW determined the transactions and reports identified in the Municipal Attorney's supplemental did have a significant impact on the unappropriated fund balance in many but not all instances. Furthermore, the Assembly was unaware of potential revenue shortfalls, and therefore lacked adequate information that would have enabled them to exercise prudent fiscal management practices and possibly mitigate the impact on unappropriated fund balances by reducing expenditures or seeking alternate sources of revenue where appropriate.

For those instances involving transactions that did have a significant impact on fund balance, MRW determined the Administration failed to practice prudent fiscal management for the various reasons detailed in that section of this report.

It is recommended that the Assembly continue to receive and monitor reports summarizing revenue, expenditures, and projected fund balance in the future to help avoid situations similar to this in future years.

For additional details refer to pages 24-28 of this report.

DETERMINE IF ACTIONS TAKEN WITH REGARD TO BUDGETING WERE IN CONFORMANCE WITH APPLICABLE GOVERNMENT ACCOUNTING STANDARDS, PROVISIONS OF MUNICIPAL, STATE AND FEDERAL LAW, AND PRUDENT FISCAL MANAGEMENT

The accounting firm of Mikunda, Cottrell & Co., Inc. audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented components units, each major fund, and the aggregate remaining fund information of the Municipality of Anchorage(MOA), Alaska as of and for the year ended December 31, 2008. Their opinion based on the audit and the reports of the other auditors, determined the Municipality of Anchorage to be in conformity with accounting principles generally accepted in the United States of America.

MRW determined the Government Finance Officers Association (GFOA) has established criteria utilized in reviewing a budget for Certification of Excellence. The 2008/2009 Approved General Government Operating Budget includes many, but not all, of the items included in the GFOA criteria. It should be noted that this document does not represent accounting standards, but does provide valuable criteria regarding the drafting of municipal budgets.

Specific examples of pertinent criteria that are not included in the annual budget are as follows:

- The document should include a coherent statement of entity-wide long-term financial policies.
- The document should include a coherent statement of entity-wide non-financial goals and objectives that address long-term concerns and issues.
- The document shall include a budget message that articulates priorities and issues for the budget for the new year. The message should describe significant

changes in priorities and issues from the current year and explain the factors that led to those changes.

It is recommended the Municipality and the Assembly consider adopting those criteria regarding the annual budget process.

MRW further determined the Municipality of Anchorage has enacted numerous laws, ordinances, and guidelines regarding the fiscal management of the city and the reporting of the financial activities to the Assembly. However, MRW determined that in many instances, those guidelines were not followed by the Administration and the Assembly as a body did not practice prudent fiscal management in that it did not specifically require the Administration to provide relevant information, thus leaving the Assembly in some instances without adequate business data and information to assess the financial condition of the city and to enable them to make informed decisions regarding fiscal and budgetary issues.

The MRW audit did not conclusively determine whether the members of the Mayor's executive staff failed to fully inform the Mayor regarding the extent and impact of potential revenue shortfalls during 2008, as there were no notes, minutes, or memoranda prepared relative to Executive Committee Meetings or Executive Briefings. For that reason, no conclusion can be made by MRW regarding whether prudent fiscal management was practiced relative to providing pertinent budget shortfalls and projections to the Mayor.

The MRW review concluded the Administration failed to practice prudent fiscal management relative to budget issues by failing to assemble monthly reports of revenues and expenditures and submit those reports to the Assembly as required by the Anchorage Municipal Code. MRW further concluded the Assembly failed to practice prudent fiscal management by failing, as a body, to demand the production of the required reports before making financial decisions that had significant impacts on the Municipality's budget and fund balance.

MRW determined the Assembly is currently being provided with a series of reports on a monthly basis that reflect revenues and expenditures. The Assembly has informed the current CFO that these reports meet their needs regarding the required reporting requirements. It is recommended the CFO continue to provide the Assembly with pertinent information regarding revenues and expenditures on a monthly basis.

The conclusions based on the MRW forensic audit are limited by the information that was available for analysis.

(For additional details refer to pages 28 through 29 of this report.)

IV. PROFESSIONAL QUALIFICATIONS

My professional qualifications are included on Attachment 49.

V. BACKGROUND AND INFORMATION PROVIDED BY CLIENT

This engagement originated with a public posting of a Request for Proposal ("RFP") by the Municipality of Anchorage. The stated purpose of this solicitation was to select a firm to provide an independent forensic audit of the financial matters referenced in reports prepared for the Municipal Assembly by the Municipal Attorney dated November 18, 2009 and January 21, 2010. (Attachment 41, Report to the Anchorage Assembly Dated November 18, 2009)(Attachment 42, Supplemental Report to the Anchorage Assembly Dated January 21, 2010)

VI. INFORMATION CONSIDERED

MRW conducted interviews and reviewed the following financial and other information to arrive at the conclusions in this report:

1. Memorandum of Interview with Assembly Member Bill Starr
2. Memorandum of Interview with Dan Moore, Treasurer
3. Memorandum of Interview with Dennis A. Wheeler, Municipal Attorney
4. Memorandum of Interview with Assembly Member Elvi Gray-Jackson
5. Memorandum of Interview with Eric Larson, Revenue Analyst and Mike Mullane, Principal Administrative Officer
6. Memorandum of Interview with Lucinda Mahoney, Chief Financial Officer and Pamela Ellis, Assistant Controller
7. Memorandum of Interview with Marilyn Banzhaf, Operating Budget Analyst
8. Memorandum of Interview with Michael K. Abbott, former City Manager
9. Memorandum of Interview with Pamela Ellis, Assistant Controller
10. Memorandum of Interview with Peter Raiskums, Director, Department of Internal Audit
11. Memorandum of Interview with Ross Risvold, Manager, Public Finance & Investments
12. Memorandum of Interview with Sharon Weddleton, Former Chief Financial Officer
13. Memorandum of Interview with Teresa Peterson, Former Controller
14. General Ledger Adjusting Entries Relative to PERS Adjustments for December 2008 (Note: Due to their volume, the following attachments are included on the enclosed DVD)
    a. Chart of Accounts
    b. Master Transaction List
    c. PERS Journal Entry Detail
    d. PERS Journal Entries By Department

e. PERS Journal Entries By Department
f. PERS Summary
g. Journal Entries Out Of Payroll
h. Payroll Account Budget Transfers
i. Budget Transfer Summary
j. 2008 Dept & Acct Budgeted
k. As Budgeted Details
l. Dept & Acct Bud Less PERS
m. Bud Less PERS
n. Bud Less Pers (Sum 1)
o. Bud Less Pers (Sum 2)
p. PERS Budg Adj.
q. Summary of Over Budget Departments And/Or 1401 Budget Transfers.
r. 2008 Budget to Actuals Excluding PERS Budget, Over Budget Departments Only
s. Summary of 1000 Account Series
t. Summary of Over Budget 1000 Account Series
u. Summary of Over Budget 1401 Account Series
v. Actuals By Month
w. Direct
x. IGC
y. Revenue
z. PERS JE's

15. E-Mail Message Dated July 7, 2008 between Sharon Weddleton and Wanda Phillips
16. Assembly Information Memorandum No. 30-2008
17. Assembly Information Memorandum No. 30-2008
18. Assembly Information Memorandum No. 90-2008
19. Assembly Information Memorandum No. 10-2009
20. Analysis of General Government Revenues as 5/31/08
21. Analysis of General Government Revenues as of 6/30/2008
22. Analysis of General Government Revenues as of 7/31/08
23. Analysis of General Government Revenues as of 9/30/08
24. Analysis of General Government Revenues as of 10/31/08
25. E-Mail Transmittals to Invitees to Executive Committee
26. E-Mail Exchange Dated October 22, 2008 Between Wanda Phillips and Sharon Weddleton
27. E-Mail Exchange Dated December 4, 2008 Between Sharon Weddleton, Teresa Peterson, Pamela Ellis, and Wanda Phillips
28. E-Mail Exchange Dated July 24, 2008 Between Sharon Weddleton and Mayor Begich
29. E-Mail Exchange Dated August 4, 2008 between Teresa Peterson, Sharon Weddleton, and Pamela Ellis
30. E-Mail Exchange Dated December 4, 2008 between Teresa Peterson, Sharon Weddleton, and Pamela Ellis, and Marilyn Banzhaf
31. Analysis of Fund Balance-Historical Reserves 2000 to 2009

32. Transmittal Memorandum and Attached Fund Balances Projections As of 11/3/08
33. Memorandum Titled “Financial Markets and the Municipality”
34. E-mail Transmittal Dated December 9, 2008 between Sharon Weddleton and Mark Begich)
35. E-Mail transmittal Dated September 26, 2008
36. E-Mail Transmittal Dated September 29, 2008 between Bill Starr, Sharon Weddleton, Wanda Phillips, and Ross Risvold
37. E-Mail Transmittal Dated November 13, 2008 between Sharon Weddleton and Mark Begich
38. Press Release Dated October 1, 2008
39. Press Release Dated October 13, 2008
40. Memorandum of Interview with Wanda Phillips, Former Director, OMB
41. Report to the Anchorage Assembly Dated November 18, 2009
42. Supplemental Report to the Anchorage Assembly Dated January 21, 2010
43. Memorandum of Interview with Senator Mark Begich
44. 2008/2009 Approved General Government Operating Budget
45. GFOA Budget Forensic audit Criteria
46. Assembly Information Memorandum No. AIM 105-209(A)(sic)
47. Assembly Information Memorandum AIM 28-2002 and attached Memorandum of Agreement
48. Anchorage Resolution AR No. 2004-154
49. Professional Qualifications of Ronald E. Wise, E.A.
50. E-Mail Transmittal Dated August 7, 2008 Between Mark G. Madden and Sharon Weddleton
51. Anchorage Ordinance AO No. 2008-46
52. E-Mail Transmittal Dated October 14, 2008 between Eric Larson and Sharon Weddleton
53. E-Mail Transmittal Dated January 13, 2009 between Eric Larson and Sharon Weddleton
54. E-Mail Transmittals Dated November 17, 2008 between Teresa Peterson, Ginny Fritz, Wanda Phillips, Sharon Weddleton, and Timothy Bisson with subsequent explanations provided to Dennis Wheeler

Many documents reviewed are not exhibited with this report due to their volume. Additionally, Attachments 14a through 14z are included in electronic format on a compact disk provided with this report.

VII. EXTENT AND RESULTS OF ANALYSIS

The results of the analysis conducted by MRW Staff and the evaluation of the information reviewed are detailed below.

ANALYSIS OF "ON BEHALF" PERS REVENUE AND EXPENSE JOURNAL ENTRIES FOR FY 2008

All full-time and regular part-time Anchorage employees not covered by the State of Alaska Teachers' Retirement System or another retirement plan are eligible to participate in Public Employees' Retirement System ("PERS"). For both the defined benefit plan and the defined contribution plan, benefits and contributions are established by State law and may be amended only by the State Legislature.

Employees hired prior to July 1, 2006 and employees hired after July 1, 2006 who have PERS enrollment from prior employment, participate in PERS Tier I-III, a defined benefit public employee retirement system. Employees hired after July 1, 2006 who have no prior PERS participating employment participate in PERS Tier IV, a defined contribution plan with a component of defined benefit post employment healthcare. The defined benefit plan was originally established as an agent multiple-employer plan, but was converted by legislation to a cost-sharing plan, effective July 1, 2008. Under the cost–sharing arrangement, the State of Alaska Division of Retirement and Benefits no longer tracks individual employer assets and liabilities. Rather all plan costs and past service liabilities are shared among all participating employers. Both plans are administered by the State of Alaska (State) to provide pension, post-employment healthcare, death and disability benefits to eligible employees.

Under the newly adopted cost-sharing arrangement, the employer contribution to PERS is statutorily capped at 22% of annual covered salary. Beginning July 1, 2008 the State of Alaska began contributing any amount over 22% such that the total contribution equals the Alaska Management Board adopted rate. This rate will be consistent with the actuarially determined rate.

Until June 30, 2008, the State of Alaska adopted contribution rates for each employer at an amount no less that 14.48% and no more that 22%. The legislature then approved state funding in the form of an "on-behalf" payment for those amounts exceeding the established employer rate up to the actuarially determined rate. This "on-behalf" payment was transferred to the Alaska Division of Retirement Benefits at July 1, but was allocated to the individual employer accounts on a prorated basis with each payroll reporting period. In accordance with GASB Statement Number 24, Anchorage recorded $8,192,950 in its financial statements as PERS relief and related PERS expenditures/expenses. The "on-behalf" payment was included in employer contributions for the purpose of calculating the ending net pension obligation and other postemployment benefit (OPEB) obligation as noted. No Assembly appropriation relative to this payment was required because it was an "on-behalf" payment directed to the State of Alaska retirement by the State.

A heavily debated issue amongst local governments throughout the State of Alaska was whether and how to reflect the State's "on behalf" payments in the local governments' books. The issue was how the PERS payments were recorded and reported for purposes of Comprehensive Annual Financial Report ("CAFR").

Within the Municipality of Anchorage, the issue was also discussed extensively. Those discussions included not only how to enter the PERS reversal, but also the impact it might have on department spending. In an e-mail exchange dated August 4, 2008 between Teresa Peterson, Sharon Weddleton, and Pamela Ellis, Ms. Phillips stated;*"Finance, you need to let people know that the PERS adjustment from Jan to June is going to post soon. People think they have all this budget savings and are trying to spend it."* (Attachment 29, E-Mail Exchange Dated August 4, 2008 between Teresa Peterson, Sharon Weddleton, and Pamela Ellis) In another e-mail exchange dated December 4, 2008, the discussion involves the need to reverse the PERS journal entry for only select departments immediately. In that exchange Wanda Phillips stated *"We need 6 months PERS journal entry reversed for Legal, Transit, Fire, and APD. We need this ASAP."* In a second transmittal in this e-mail chain, Ms. Phillips states *"Sharon and I are in agreement regarding these departments."* In yet another transmittal in this e-mail chain, Ms. Phillips stated *"I am okay with the entire je being reversed but Sharon had concern about that. I believe the departments have been closed to P Cards and the process for requisitions has been slowed or stopped. If this is the case than (sic) the departments (sic) ability to "quickly spend" would be substantially reduced."* In this e-mail exchange, "P Cards" is a reference to procurement cards, and "je" is a reference to a journal entry. (Attachment 30, E-Mail Exchange Dated December 4, 2008 between Teresa Peterson, Sharon Weddleton, and Pamela Ellis, and Marilyn Banzhaf)(Attachment 27, E-Mail Exchange Dated December 4, 2008 Between Wanda Phillips, Teresa Peterson, Pamela Ellis, and Marilyn Banzhaf)

For the second half of 2008, the State's contribution to the PERS was booked by the Municipality in August 2008. In accordance with the provisions of GASB Statement Number 24, Anchorage recorded the State's contribution as a PERS "on-behalf" payment, resulting in both revenue and expense on the books of the Municipality. On December 15, 2008 the PERS entries for the second half of 2008 were reversed relative to both the revenue and expense. In a series of e-mail messages between Sharon Weddleton, Pam Ellis, Wanda Phillips, and Teresa Peterson on December 4, 2008, the timing of the PERS reversal was discussed, with the apparent conclusion being to post the reversal on December 15, 2008 *"to partially minimize year-end spending."* (Attachment 27, E-Mail Exchange Dated December 4, 2008 Between Sharon Weddleton, Teresa Peterson, Pamela Ellis, and Wanda Phillips) These entries are summarized as follows (Attachments 14(a) through 14(f) :

DATE POSTED	ACCOUNT	DEBIT	CREDIT
12/1/2008	Revenue Account - Municipal Assistance (Account No. 9342)	$ 6,182,790	
	Expense Account - Benefits (Account No. 1401)		$ 6,182,790
12/1/2008	Expense Account - Benefits (Account No. 1401)	$ 305,252	
	Revenue Account - Municipal Assistance (Account No. 9342)		$ 305,252
12/1/2008	Revenue Account - Municipal Assistance (Account No. 9342)	$ 494,498	
	Expense Account - Benefits (Account No. 1401)		$ 494,498

The reversal of the PERS transactions as reflected above reduced Account No. 1401-Benefits by a total of $6,372,036. A more detailed summary of these transactions is reflected on the schedule titled Summary of PERS Adjustments By Department. (Attachment No. 14(e)); Summary of PERS Reversing Journal Entries By Department) Due to its volume, the supporting transactional data from which this analysis was derived are exhibited with this report in electronic format.

In a series of e-mail exchanges dated July 7, 2008, Sharon Weddleton stated: *"the Mayor is interested in considering amending the budget down for PERS relief/PERS expense reductions 7/1/08 through 12/31/08,"* and Ms. Weddleton asks that Wanda Phillips prepare a brief "white paper" regarding this issue. In a subsequent e-mail message on July 7, 2008, Ms. Weddleton stated that this paper is not *"the doc that actually goes in front of the Assembly."* (Attachment 15, E-Mail Message Dated July 7, 2008 between Sharon Weddleton and Wanda Phillips) In another e-mail transmission from Sharon Weddleton to Mayor Begich dated July 24, 2008; Ms. Weddleton informed the Mayor *"we cannot present a budget reduction for PERS on the 29th Assembly session,"* as final numbers from the State of Alaska were not available. No responses from the Mayor regarding this issue were located by MRW during the forensic audit. (Attachment 28, E-Mail Exchange Dated July 24, 2008 Between Sharon Weddleton and Mayor Begich) During the forensic audit, Wanda Phillips explained to MRW that Pamela Ellis was unable to obtain necessary data from the State of Alaska enabling her to facilitate the PERS reversing entry until the fall of 2008. Ms. Phillips explained Ms. Ellis preferred to "true up" the accounting before reversing the PERS entry to make the entry more accurate and possibly avoid having to correct that entry later. (Attachment 40, Memorandum of Interview with Wanda Phillips, Former Director, OMB)

Ultimately, the budget was not amended down for the PERS relief/PERS expense reductions as discussed in the previously referenced chain of e-mail transmittals between Sharon Weddleton, Wanda Phillips, and Mayor Begich.

During this forensic audit Former Mayor Mark Begich stated to MRW he believed the budget had been adjusted to reflect the PERS adjustment until he learned otherwise during the MRW forensic audit. (Attachment 43, Memorandum of Interview with Senator Mark Begich) As previously noted, MRW identified several e-mail communications wherein adjusting the budget to reflect the PERS amounts were discussed, but in no instances was it determined that Former Mayor Begich was informed that this adjustment was not accomplished.

Even though the budget was not reduced by the PERS adjustment, the PERS budget adjustments were calculated specifically for the MRW forensic audit. The PERS budget adjustment was calculated by subtracting the original PERS journal entries from the original PERS budget, and adding back PERS correcting journal entries and reversing journal entries. The impact of these journal entries on the budgets of the various departments was determined by subtracting the calculated PERS budget adjustments and December 2008 budget transfers from the November 2008 budget. A summary of the budget adjustments by department is reflected on the attached schedule titled Summary of PERS Budget Adjustments by Department. (Attachment 14 (n), Bud Less Pers (Sum 1) (Attachment 14 (o), Bud Less Pers (Sum 2))

A comparison of "Budget Excluding PERS Adjustment to Actual " for all departments for 2008 reveals all departments combined would have been under-budget for 2008 by $7,413,662 had the budget been reduced by the amount of the PERS adjustment. (Attachment 14 (l), Dept & Acct Bud Less PERS) Further analysis reveals that three departments would have been over budget had their budgets been reduced by the amount of the PERS adjustments. These departments and the amounts they would have been over budget are included on the enclosed schedule titled 2008 Budget to Actuals Excluding PERS Budget, Over Budget Departments Only (Attachment 14(r); Over Budget Departments) and are summarized below:

2008 BUDGET TO ACTUALS EXCLUDING PERS BUDGET ADJUSTMENT			
OVER BUDGET DEPARTMENTS ONLY			
Department	**Budget**	**Actuals**	**Bud 2 Act & ENC Cum Variance**
06-MUNICIPAL ATTORNEY-TOTAL	**7,264,581.53**	**7,401,088.62**	**-136,507.09**
24-POLICE-TOTAL	**83,058,002.73**	**83,729,067.46**	**-671,064.81**
32-TRAFFIC DEPARTMENT-TOTAL	**7,114,409.65**	**7,148,536.24**	**-34,126.59**
TOTAL	**97,436,993.91**	**98,278,692.32**	**-841,698.49**

Since MRW determined the PERS reversal affected only revenue and expense Account 1401, an analysis was performed to determine the effect of the removal of the PERS adjustment from the budgets relative to those particular line items. MRW determined that eight departments had negative variances relative to Account 1401 if the PERS adjustment was removed from their budgets. MRW determined departments' budgets are managed at the account level and not managed to the sub-account level, but the MRW analysis included this level of review in order to determine if the PERS adjustment created an availability of funds for transfer to other accounts. (Attachment 14(s), Summary of 1000 Account Series) (Attachment 14(t), Summary of Over Budget 1000 Account Series) (Attachment 14(u), Summary of 1401 Account Series With Negative Variances)

The remaining departments did not have negative variances relative to Account 1401 even after the reduction in their budgets in amounts equal to the PERS budget adjustments.

In an e-mail message dated October 22, 2008 to Wanda Phillips, Sharon Weddleton stated the following (Attachment 26, E-Mail Exchange Dated October 22, 2008 Between Wanda Phillips and Sharon Weddleton):

> *"Re: the PERS AIM, I agree that one might be able to claim it was covered in the work session, but it's a stretch. I wonder if when we submit the docs for the 2008 budget amendments if we could expand on PERS then. Particularly if we're going to transfer 7/1/08 to 12/31/08 PERS expenditure authority from under spending departments to overspending departments as our source of funding. I agree with your point when we were with Mike (that the revenues have dried up, too) but I think it might help get Assembly support, particularly if they don't think too hard about it. If we don't use transferred PERS expenditure authority I can't imagine what else we could do. As an FYI, we might also try and use the 2008 PERS expenditure authority as a source of funding to pay off the CSA loan. If we could make the CSA loan disappear then our CSA options go way up and 2009 looks far better."*

In order to determine if the PERS reversing journal entries were used as a means to transfer funding from "*under spending departments to overspending departments"* an additional analysis was performed relative to the Account 1401 series. This analysis determined that three departments accomplished budget transfers of funds from Account 1401 into other accounts during December 2008 following the PERS reversing journal entries. These budget transfers are summarized as follows (Attachment 14(i), Budget Transfer Summary):

SUMMARY OF BUDGET TRANSFERS FOR DECEMBER 2008							
		BALANCE TRANSFERS ACCOMPLISHED					
DEPT.	**ORIGINAL PERS BUDGET REVERSAL -ACCOUNT 1401**	**PROF. SER. ACC. # 3101**	**LEGAL SER. ACC. #2000-3111**	**PARKS & REC. ACC. # 1101**	**MULT. ACCS.**	**TOTAL BUDGET TRANSFERS**
06-MUNICPAL ATTORNEY	($253,886)		$157,000			$157,000
30-ANCHORAGE PARKS & REC.	(384,185)			64,000.00		$64,000
33-ECONOMIC & DEVEL. AGENCY	(430,411)	17,500.00				$17,500
35-TRANSIT	(538,071)				$253,000.00	$253,000
TOTALS	($1,598,969)	**$17,500**	**$157,000**	**$64,000**	**$253,000**	**$491,500**

Of the four departments that accomplished budget transfers, only Economic & Development Agency would have been under budget for Account 1401 had the PERS adjustment been made to their budget, and the budget transfer for that department could have been accomplished regardless of whether or not the budget adjustment was made. The remaining departments that accomplished budget transfers would have been over budget had their budgets been reduced by the amount of the PERS adjustment, thus preventing the budget transfers. The PERS adjustment allowed those departments to accomplish budget transfers totaling $474,000 ($491,500-$17,500) using funds that would have not been otherwise available. (Attachment 14 (s), Summary of 1000 Account Series)

In summary, PERS revenue and expenditures were reversed for the second half of 2008 on the general ledger, but the budget was not adjusted accordingly. As such, expenditures for all departments combined were under budget at the end of 2008 by $13,393,230. However, if the budget had been reduced by the PERS budget adjustment, all departments combined would have been under budget by $7,413,662, but three departments would have been over budget as previously noted.

MRW determined the Administration failed to practice prudent fiscal management by implementing the PERS reversal entries on the general ledger without insuring the Assembly was aware of the potential impact on department spending and presenting the Assembly with the opportunity to amend the budget to be consistent with the PERS reversal entries on the general ledger.

ALIGNMENT BETWEEN REVENUES AND APPROPRIATIONS AND EXPENDITURES AND APPROPRIATIONS AND THE TIMLINESS OF REPORTING SHORTFALLS /OVEREXPENDITURES TO THE ASSEMBLY

Article XIII, Section 13.06 of the Anchorage Municipal Charter states the following:

> ***Section 13.06. Reduction and transfer of appropriations***
>
> *(a) If the mayor determines that revenues will be less than appropriations for a fiscal year, the mayor shall so report to the assembly. The assembly may reduce appropriations as it deems necessary. No appropriation may be reduced by more than the amount of the then unencumbered balance.*
> *(b) Except as to the school budget, the mayor may transfer all or part of any unencumbered balance between categories within an appropriation. The school board may transfer part or all of any unencumbered balance between categories within the appropriation for the school budget. Except as to the school budget, the assembly may transfer part or all of any unencumbered balance from one appropriation to another.*

During 2008 and until a revision in March 2010, Section 6.40.010 of the Anchorage Municipal Code stated the following:

> ***6.40.010 Accounts***
>
> *The chief fiscal officer shall install and have supervision over the accounts of all organizational elements of the municipality. Such accounts shall show in detail the financial transactions of all departments. The chief fiscal officer shall cause a monthly statement, in condensed format, to be prepared and distributed to the assembly, the mayor and all department heads, showing the aggregate revenues and expenditures of each fund of the municipality for the preceding month as well as the year-to-date accumulative amount.*

During 2008 the Assembly was presented reports identified as Assembly Information Memoranda (“AIMS”). (Attachments 15 through 18; Assembly Information Memoranda) Four of these reports are summarized as follows:

SUMMARY OF ASSEMBLY INFORMATION MEMORANDA-2008		
AIM NO.	**SUBJECT**	**ASSEMBLY MEETING DATE**
30-2008	1st Quarter 2008 Financial Reports	April 29, 2008
64-2008	2nd Quarter 2008 Financial Reports	July 29, 2008
90-2008	3rd Quarter 2008 Financial Reports	October 28, 2008
10-2009	4th Quarter 2008 Financial Reports	February 3, 2009

Each of the AIM'S reflects it was prepared by Wanda Phillips, OMB Director with the concurrence of Teresa Peterson, Controller; Sharon Weddleton, CFO, and Michael K. Abbott, Municipal Manager. Each was "Respectfully Submitted" by Mark Begich, Mayor. Included in each of these AIMS are reports identified as Budget to Actual by Department; Overtime Budget to Actual by Department; Travel Report; and Charitable Contributions. The reports for the first, second, and third quarters also include Vacancy Reports. Each of the reports included in the AIMS pertain to expenditures as compared with the budget, and none of the reports pertain to revenues.

On May 10, 2010, Mike Mullane, Principal Administrative Officer and Eric Larson, Revenue Analyst were interviewed. (Attachment No. 5; Memorandum of Interview with Mike Mullane and Eric Larson) Mr. Mullane stated he became the Principal Administrative Officer four or five years ago because the Administration wanted to be able to track revenue more accurately. Prior to that, the primary focus of the Administration had been "expense management." In connection with the new focus, a Revenue Analyst position was created to analyze revenue for General Government, monitor revenue variances, and identify those variances that are controllable as opposed to random in nature. Mr. Mullane described his function as creating an "early warning" system for the Administration relative to revenue for Anchorage.

At the end of the first quarter of each year, including 2008, the Treasury Department provided revenue information to the Mayor's executive staff. Eric Larson was responsible for assembling this information. Beginning May 31, 2008, his department prepared a monthly Analysis of General Government Revenues. (Attachments 20 through 23; Analyses of General Government Revenues) These reports were prepared by Eric Larson, reviewed by Mike Mullane, and presented to the Executive Committee by the Treasurer. No minutes were prepared relative to these meetings, but Mr. Mullane provided copies of e-mail transmittals reflecting the names of individuals invited to these meetings. Treasurer Dan Moore said if one of the members of the committee did not attend he (Moore) would make sure he or she received a copy of the "Analysis of General Government Revenues." (Attachment 2, Memorandum of Interview with Dan Moore, Treasurer)

The Analyses of General Government Revenues only address revenue, and do not address expenditures, or fund balances. Wanda Phillips began developing a reporting system around August 2008 that would have included revenue, expenditures, and fund balance all within one report. She anticipated perfecting and unveiling this report around August 2009, but she no longer worked for the Municipality at that time. She noted she was never advised not to prepare these reports nor was she advised to conceal the results of her analyses. She was advised by Sharon Weddleton, however, to be sure the reports were fully developed before they were publicized.

The Analyses of General Government Revenues as prepared by the Treasury Department reflect projected revenue shortfalls as follows:

ANALYSIS OF GENERAL GOVERNMENT REVENUES				
EFFECTIVE DATE	**DATE PRESENTED**	**2008 BUDGET**	**END OF YEAR PROJECTION**	**PROJECTED REVENUE SHORTFALL**
5/31/2008	7/8/2008	$600,730,185	$584,872,042	$15,858,143
6/30/2008	8/11/2008	$600,730,185	$587,151,429	$13,578,756
7/31/2008	9/23/2008	$600,730,185	$587,043,804	$13,686,381
9/30/2008	11/18/2008	$600,938,185	$587,663,346	$13,274,839
10/31/2008	12/17/2008	$601,470,778	$584,867,049	$16,603,729

Former Mayor Mark Begich said he believed he informed the Assembly during one or more work sessions that revenues were "slow," but he was not sure if he had ever seen the reports titled Analyses of General Government Revenues. (Attachment 43, Memorandum of Interview with Senator Mark Begich)

Mr. Mullane and Mr. Larson said they never presented any of the Analyses of General Government Revenues at an Assembly Meeting or Assembly Work Session. However, Mike Mullane and the Treasurer Dan Moore attended some work sessions during 2008, and at some of these meetings they were asked questions regarding revenue. The Executive Committee met in January 2008, but that meeting related to the 2007 budget only. The last meeting in 2008 was on December 17, 2008.

Although the majority of the invitees to the Executive Committee meetings were interviewed, no one acknowledged providing information regarding the contents of the Analyses of General Government Revenues directly to Mayor Begich. Sharon Weddleton, Former Chief Financial Officer; Michael K. Abbott, former City Manager;

Wanda Phillips, Former Director, OMB; and Peter Raiskums, Director, Department of Internal Audit each confirmed they attended the Executive Committee meetings during 2008 and stated Mayor Begich did not attend these meetings.

During the forensic audit MRW determined that Mayor Begich conducted executive briefings each week during which revenues and revenue shortfalls were discussed, but the exact nature of these discussions could not be determined as no minutes or notes were prepared or maintained relative to the executive briefings. (Attachment 40, Memorandum of Interview with Wanda Phillips, Former Director, OMB)

The MRW audit did not conclusively determine whether the members of the Mayor's executive staff failed to fully inform the Mayor regarding the extent and impact of potential revenue shortfalls during 2008, as there were no notes, minutes, or memoranda prepared relative to Executive Committee Meetings or Executive Briefings. (Attachments 8, 10, 12, and 40; Memoranda of Interview)

By comparison, the Comprehensive Annual Financial Report ("CAFR") for 2008 completed June 11, 2009 reflects total general revenues for the year of $561,321,385, a figure that is $23,545,664 lower than the estimates according to the Analysis of General Government Revenues as of December 17, 2008. MRW determined during this audit that the December 17, 2008 Analysis of General Government Revenues was actually a projection based on *"results through October 31 and significant adjustments to these accounts in November and December for a more current analysis."* The 2008 CAFR also reflects a deficiency of revenues over expenditures totaling $37,996,708.

During the forensic audit MRW determined the CFO failed to *"cause a monthly statement, in condensed format, to be prepared and distributed to the assembly, the mayor and all department heads, showing the aggregate revenues and expenditures of each fund of the municipality for the preceding month as well as the year-to-date accumulative amount"* as required by Section 6.40.010 of the Anchorage Municipal Code. Former Mayor Mark Begich explained his administration provided quarterly expenditure information to the Assembly in the form of AIM's, and acknowledged the Assembly was not provided reports regarding revenue and revenue projections. He further explained that this reporting was based on long standing accepted practice. (Attachment 43, Memorandum of Interview with Senator Mark Begich)

The CFO did, on several occasions, however, notify the mayor and other Administration officials of potential revenue shortfalls. In a memorandum to Mayor Mark Begich dated September 26, 2008, Ms. Weddleton advised that 30 day Treasury yields were down to 1%; the Municipality had experienced unrealized losses; and earnings forecasts may be revised downward. (Attachment 33, Memorandum Titled "Financial Markets and the Municipality") In another e-mail transmittal to Mark Begich dated December 9, 2008; Ms. Weddleton stated, *"Our November investment returns were horrible. Additionally, a relatively new issue is that departments (not only Fire) have started blowing their budgets several weeks earlier in the year than normal."* She then added *"We can "cosmetically" make it look like they're adhering to their budgets by reversing the PERS* *for 7/08 to 12/08 but the related state "revenues" disappear, too, so this means that their spending is exceeding their revenues."* (Attachment 34, E-mail Transmittal Dated December 9, 2008 between Sharon Weddleton and Mark Begich)

In an e-mail dated September 26, 2008 entitled "Financial Markets Sept 25, 2008" from Ms. Weddleton to Mayor Begich, cc. to Phillips, Abbott, Ramseur and Reeves, Ms Weddleton wrote *"Mayor-it was my intent to keep this to one page but the issues affect everything at this point. I imagine that there may be a lot of questions on Tuesday night. So I wonder if we should turn this into an AIM to deflect it a bit. If you think that's a good idea let me know and I can pass the AIM out on Tuesday."* Attached to the email is a document from Weddleton, CFO to Mayor Mark Begich wherein she discusses Financial Markets and the Municipality. In this document she addresses issues including a statement that *"if the markets do not improve dramatically the Municipality will have several challenges."* She further states *"We are re-evaluating our remaining 2008 and 2009 earnings forecasts. They may be revised downward due to interest rate and market circumstances that currently exist."* (Attachment 35, E-Mail transmittal Dated September 26, 2008)

MRW found no evidence that any of the referenced above e-mail transmittals were provided to the Assembly.

On September 29, 2008 Assembly Member Starr sent an e-mail message to CFO Weddleton in which he asked *"Is our 'today' cash position adequate to handle day to day needs?"* Weddleton responded the MOA is *"OK cash wise."* Ms. Weddleton then responded to his question regarding borrowing funds in anticipation of tax revenues by explaining *the" TANs transaction has historically been a profitable deal for the MOA (sell debt at 1.92%, earn 3% or 4% tax free)." However, if we were to sell TANS today it would be unprofitable (sell at 7%, earn 2%). So in 2009 we would only sell TANs if; a) the market returned to normalcy or b) we had no choice and truly needed the cash* (Attachment 36, E-Mail Transmittal Dated September 29, 2008 between Bill Starr, Sharon Weddleton, Wanda Phillips, and Ross Risvold)

In an e-mail to Mayor Mark Begich from Sharon Weddleton dated November 13, 2008, Ms. Weddleton stated *"The big elephant in the room is investment income. Right now we have about $10M in unrealized losses which probably won't reverse by 12/31/08. So adhering to our fund balance policy will be a huge problem this year. Most likely, 1st quarter budget revisions will be painful."*(Attachment 37, E-Mail Transmittal Dated November 13, 2008 between Sharon Weddleton and Mark Begich)

During a subsequent interview by MRW during this audit, Ms. Weddleton confirmed that Mayor Begich never responded to any of the e-mail communications from her regarding potential revenue shortfalls during the fall of 2008. A copy of the aforementioned Memorandum of Telephone Conversation and attachments is included as an addendum to this report.

Despite the warnings, the Mayor's office issued a press release dated October 1, 2008 titled "Anchorage Well-Positioned to Weather National Economic Crisis." In this release, CFO Sharon Weddleton is quoted as saying *"Anchorage is more fortunate than most because we have adequate liquidity to endure market turmoil in the coming months. Our focus on liquidity and diversification has reduced the impacts to our portfolio."* (Attachment 38, Press Release Dated October 1, 2008)

On October 23, 2008, the office of the Mayor issued another press release which stated *"Across America, cities are being forced to lay off thousands of employees and deeply cut back services to weather the national economic crisis,"* It continued by stating *."Fortunately, Anchorage's finances are sound and we expect city services will continue to be delivered without interruption, if the crisis is dealt with by the federal government relatively soon."* (Attachment 39, Press Release Dated October 11, 2008)

MRW was unable to determine conclusively when or if the Mayor was informed the expenditures would exceed revenues for 2008, as no monthly reports were prepared by the CFO as required. The Analyses of General Government Revenues reflected substantial anticipated revenue shortfalls, and the AIMS reflected that overall the Municipality was under budget relative to expenditures, but the two reports cannot be compared in order to draw conclusions as the two reports apparently utilize different criteria to reflect budget revenues and expenditures. The 2008 CAFR which was prepared in 2009 does reflect a deficiency of revenues over expenditures totaling $37,996,708.

Former Mayor Begich said he never informed the Assembly he had determined revenues would be less than appropriations for 2008 because he never actually made that determination. He explained although he was aware revenues were "slow," he knew revenues had been positive in prior years. He explained revenues normally fluctuated during any year, and he did not know during 2008 if the trend toward lower revenues would continue. (Attachment 43, Memorandum of Interview with Senator Mark Begich)

During 2008, Elvi Gray-Jackson was the Chairperson of the Budget and Finance Committee. She recalled being provided written reports and verbal commentary by Sharon Weddleton and Wanda Phillips regarding the 2008 budget shortfall during the year. During her tenure as Chairperson, she maintained notes regarding all Committee meetings in a notebook which she gave to Jennifer Johnston when she (Johnston) assumed the role of Chairperson. Ms. Johnston confirmed receiving this notebook from Ms. Gray-Jackson but she said she was unable to locate it for the MRW forensic audit. (Attachment 4, Memorandum of Interview With Assembly Member Elvi Gray-Jackson)

The MRW forensic audit concluded the Administration failed to practice prudent fiscal management by failing to assemble monthly reports of revenues and expenditures and submit those reports to the Assembly as required by the Anchorage Municipal Code. MRW further concluded the Assembly failed to practice prudent fiscal management by failing, as a body, to demand the production of the required reports before making financial decisions that had significant impacts on the Municipality's budget and fund balance.

MRW determined the Assembly is currently being provided with a series of reports on a monthly basis that reflect revenues, expenditures, and fund balance projections. The Assembly has informed the current CFO that these reports meet their needs regarding the required reporting requirements. It is recommended the CFO continue to provide the Assembly with pertinent information regarding revenues and expenditures on a monthly basis.

FUND BALANCE AND FUND BALANCE RESERVES

On March 14, 2002, a Memorandum of Agreement was signed between the Municipality of Anchorage and the Municipality of Anchorage School District which states in part *"General Government agrees to use its best efforts in budgeting and managing expenditures so as to maintain general fund unreserved fund balances in an amount that is equal to or greater than 8.25% of all general fund revenues, less local tax appropriations for the School District."* (Attachment 47, Assembly Information Memorandum AIM 28-2002 and attached Memorandum of Agreement)

Anchorage Resolution AR No. 2004-154 approved July 6, 2004 addressed the need to adopt a formal policy establishing an appropriate level of unreserved fund balance. This resolution states *"It is the policy of the Municipality of Anchorage that the general government shall prepare and manage budgets so as to maintain unreserved general fund balance in an amount equal to 8.25% of prior year revenues."* It further states *"…it is the policy of the Municipality of Anchorage that general government shall prepare and manage budgets so as to maintain unreserved fund balances…in an amount equal to 2.5% of prior year revenues. This shall be referred to as the Operating Emergency Designation."* (Attachment 48, Anchorage Resolution AR No. 2004-154)

During the MRW forensic audit, an analysis of Fund Balance – Historical Reserves 2000 to 2009 was obtained by MRW from Lucinda Mahoney, Chief Fiscal Officer. This analysis is not dated, so MRW could not determine when it was prepared. (Attachment 31, Analysis of Fund Balance – Historical Reserves 2000 to 2009) This analysis reflects the fund balance designation, available funds, and whether the available balance met the bond requirement for each of the years 2000 through 2009. It also reflects the emergency reserve designation computed at 3% of the prior year revenue for each year and the bond rating for each year. Assembly Information Memorandum No. AIM 105-209(A) (sic) dated October 27, 2009 reflects total fund balances equal to the amounts reflected in the analysis obtained from the CFO except that a portion of the balance reflected in AIM 105-209(A) (sic) is designated as Operating Emergency Designation... (Attachment 46, Assembly Information Memorandum No. AIM 105-209(A) (sic))

For December 31, 2008 the available fund balance for the 8.25% Bond Rating Designation was calculated to be $17,183,000 according to AIM 105-209(A) (sic) and the Operating Emergency Designation for the 1% to 3% of prior year revenue was calculated to be $374,000, for a total of $17,557,000. The analysis included in AIM 105-209(A) (sic) reflects the 2008 bond requirement computed at 8.25% of the prior year revenue was $26,520,000 and the emergency reserve requirement computed at 1% to 3% of prior year revenue was $6,622,000 for a total requirement of $33,142,000. Based on this calculation, the shortfall relative to the 8.25% requirement was $9,337,000, and the shortfall relative to the 3% emergency reserve was $6,248,000 for a combined total shortfall of $15,585,000.

On November 16, 2009 Sharon Weddleton, CFO sent a draft fund balance calculation to Wanda Phillips, OMB Director reflecting a *"Projected Current Unreserved Fund Balance 12/31/08"* in the amount of $34,507,748. This calculation was prepared by Teresa Peterson and Pamela Ellis. (Attachment 32, Transmittal Memorandum and Attached Fund Balances Projections As Of 11/13/08)(Attachment 40, Memorandum of Interview With Wanda Phillips) The projected fund balance reflected in this calculation is significantly different from the actual fund balance reflected the Fund Balance – Historical Reserves 2000 to 2009 ($34,507,748 vs. $17,557,000).

Although the November 13, 2008 projections and the actual 2008 fund balance cannot be fully reconciled due to differences in methodology, one significant difference was identified.

At the time the November 13, 2008 projection was being prepared and submitted, the CFO had already engaged in several e-mail communications expressing concerns about revenue shortfalls, and she had been provided with several Analyses of General Government Revenues describing substantial revenue shortfalls for 2008. MRW determined during this audit that Ginny Fritz, Fund Accounting Supervisor communicated with Sharon Weddleton via e-mail transmittal regarding the fund balance projections. On November 17, 2008 she sent a transmittal to Ms. Weddleton, Wanda Phillips and Teresa Peterson with a copy to Timothy Bisson in which she questioned many of the numbers reflected on the fund balance calculation. She later explained she had attached an updated fund balance projection calculation to her e-mail transmittal that was different from the one previously sent to Ms. Weddleton. She noted that the revenues reflected on the November 17, 2008 calculation she transmitted to Ms. Weddleton were $11.8 million less than the projected revenues included on a prior November 14, 2008 transmittal to Ms. Weddleton. (Attachment 54, E-Mail Transmittals Dated November 17, 2008 between Teresa Peterson, Ginny Fritz, Wanda Phillips, Sharon Weddleton, and Timothy Bisson with subsequent explanations provided to Dennis Wheeler)

The projection submitted to the Assembly reflects income and expenditures for the period October 1, 2007 through September 30, 2008, and as such, reflects a revenue surplus when in fact, the true figures for 2008 resulted in a revenue deficiency. Because the state of the economy had deteriorated rapidly since October 1, 2008, actual revenues and expenditures to date during 2008 may have provided more accurate data as a basis for this projection. More current information was obtained from the Office of Management and Budget during the MRW forensic audit, but it was not available at the time the fund balance projection was prepared, as it takes approximately six to eight weeks to complete the posting of the books following the close of the month.(Attachment 14(v), Actuals By Month)(Attachment 14(w), Direct)(Attachment 14(x), IGC)(Attachment 14(y), Revenue)(Attachment 14(z), PERS JE's) (Attachment 40; Memorandum of Interview with Wanda Phillips, Former Director OMB)

The projected fund balance calculation was transmitted to Wanda Phillips, Director, OMB by Sharon Weddleton, CFO with a transmittal which stated "*The Municipality's fund balance calculation is extremely complex and has not been estimated mid-year until this time. It is subject to change, and subsequent changes can be material, whether positive or negative."* (Attachment 32, Transmittal Memorandum and Attached Fund Balances Projections As Of 11/13/08)

During the MRW forensic audit, Former Mayor Mark Begich stated he does not know when he first learned the fund balance was less than the required amount. (Attachment 43, Memorandum of Interview with Senator Mark Begich)

In preparing the Fund Balance forecast on November 13, 2008, the administration utilized information within its possession at that time but it used incorrect methodology in forecasting and determining their fund balance for the period ending December 31, 2008 based on the unstable and declining economic climate. The methodology utilized for this forecast was deficient in its theory, because the forecast presented to the Municipal Assembly on November 16, 2008 did not fully incorporate the effects of the economic downturn. It was noted that the preparer of this forecast did state that this was an estimate of the final fund balance.

The MRW review concluded that the Administration failed to practice prudent fiscal management by failing to heed warnings regarding potential significant mis-calculations regarding the projected fund balance that was submitted to the Assembly and adjusting the fund balance projection in accordance with those warnings and by failing to account for the effect of the rapidly declining economy at that time.

INDEPENDENTLY DETERMINE IF THE TRANSACTIONS AND THE REPORTS INDENTIFIED IN THE MUNICIPAL ATTORNEY'S SUPPLEMENTAL REPORT HAD A MATERIAL IMPACT ON THE UNAPPROPRIATED FUND BALANCE

The Municipal Attorney's Supplemental Report contained references to several transactions that have been addressed by the MRW review. These transactions are briefly discussed below:

Girdwood Library

This transaction pertains to a loan provided by the Municipality in 2006 for the construction of a community development center and library.

The Girdwood Board unilaterally decided to not make the interest payments on this loan and those interest payments were deferred in 2008 and 2009. The former Administration undertook no action that resulted in a resolution of this issue. In 2009 the current Administration took action to begin resolving this issue, and in late 2009 accepted a grant from the local library booster club to pay $36,000 of accrued interest.

The General Government fund balance was negatively impacted by the amount of the deferral of referenced loan payments to the Municipality.

Valley River Center

This transaction pertains to an inter-fund loan from the Area Wide General Fund (101) to the Area Wide CIP Fund (401) to finance the purchase of the Valley River Center in Eagle River. According to RES, former CFO Sharon Weddleton told RES they were not required to make payments of principal or interest on this loan, but she did not obtain approval from the Assembly regarding this agreement. Ms. Weddleton denies this allegation. MRW determined no draws were made against this loan from its inception in 2007 until 2009, and therefore no payments were due during 2008.

In June 2009, draws were first made on this loan and the current Administration required RES to make payments on the outstanding loan amount.

This loan did not impact unappropriated fund balance.

M L & P Land Purchase-Muldoon Road

This transaction relates to the purchase of land in 2006 by the Municipality. The purchase was funded by an inter-fund loan from Municipal Light and Power (M L & P) to RES. RES paid M L & P accrued interest for November and December 2006, but failed to make additional payments due to budget constraints. M L & P continued to recognize and accrue revenue relative to this loan but the Municipality did not record this as an expense. The Municipality did record the loan as a deferred liability on the balance sheet, however.

The MRW audit concluded that the Administration failed to practice prudent fiscal management regarding this issue. Fund balance for general government was overstated due to non-payment and not recording the interest and principal on the books of the Municipality. Interest payments have been made in 2009 and the loan is due in full in 2011. However, the cash impact of the $3.6 million payment of loan will have a significant impact on fund balance at that time.

Solid Waste Services

Anchorage Municipal Code Section 26.10.065 states *"If, in any year, a municipal utility has or is anticipated to have surplus revenues accruing from its operations, a portion of those surplus earnings may be distributed by inclusion in the general government budget for the subsequent year."*

For 2007, SWS incurred a loss exceeding $2,000,000. In an e-mail transmittal from Mark Madden, Director, SWS to Sharon Weddleton on August 7, 2008, Mr. Madden proposed the SWS Disposal Utility not pay a revenue distribution for 2008, citing the 2007 loss. Ms. Weddleton disapproved his request, stating *"…excepting a 6.4+ earthquake (or the sale of SWS), the likelihood of Refuse or SWS avoiding paying their property taxes is basically nil." (Attachment 50,* Mail Transmittal Dated August 7, 2008 Between Mark G. Madden and Sharon Weddleton)

The 2008 Statement of Revenues and Expenses included in the Comprehensive Annual Financial Report reflects SWS amortized $1,495,701 for future landfill closure costs as required, but it only deposited $1,383,415 into its landfill post closure cash reserve. (Attachment 51, Anchorage Ordinance AO No. 2008-46)

Solid Waste Services (SWS) made significant revenue distributions to the Municipality of Anchorage to support general government budgets between 2004 and 2008. For 2008 SWS distributed $825,946 to the Municipality. This distribution had the effect of increasing the fund balance for the Municipality, while decreasing the fund balance for SWS. However, SWS did not set aside funding equal to its amortized expense to ensure funds would be available to pay for its anticipated future liability regarding post-closure of its landfills as required.

The decision to require the revenue distribution to the Municipality was not consistent with prudent fiscal management, as it reduced the ability of SWS to fund its landfill post closure cash reserve as required, thereby creating the possibility that the municipality may have to appropriate funds in the future to cover the shortfall, and the distribution was contrary to Anchorage Municipal Code Section 26.10.065.

OVERSTATED REVENUE IN BUDGETS

Each of the issues relative to overstated revenues described in the supplemental report of the Municipal Attorney ultimately had a negative impact on fund balance.

The supplemental report of the Municipal Attorney determined that a significant portion of ambulance fees from prior years were uncollectable. Those uncollectable fees should be expensed as bad debts upon determination of uncollectabliity. Prudent fiscal management requires that uncollectable debts be considered in determining budgets for subsequent years. Incorrectly including anticipated collections that are, in fact uncollectable, had the effect of overstating revenues and thus overstating projected fund balances.

The MRW audit determined Sharon Weddleton asked Eric Larson for information regarding coastal impact fees on October 14, 2008 and again on January 13, 2009. In an e-mail exchange dated October 14, 2008, Mr. Larson advised her *"The Coastal Impact Assistance Program (CIAP) disbursements to Alaska are assured only for 2008, 2009, and 2010."* In the same e-mail message, he further stated *"The Minerals Management Service currently projects the CIPA payment to Anchorage would be between $1.65M and $2.34M in FY 2009 and 2010."* (Attachment 52, E-Mail Transmittal Dated October 14, 2008 between Eric Larson and Sharon Weddleton)

In the second e-mail exchange on January 13, 2009, Mr. Larson advised her that *"The Minerals Management Service projects that the municipality will receive between $1.65M and $2.3M in FY 2009 from Coastal Impact Assistance Program."* (Attachment 53, E-Mail Transmittal Dated January 13, 2009 between Eric Larson and Sharon Weddleton)

This issue would only have impacted fund balance for 2009 if it was budgeted but not received, and the budget was not adjusted to reflect the reduced revenue. MRW did not determine if this funding was ultimately received.

Building Fund 181 is the building safety fund, deriving its revenue primarily from building permits and inspections. During previous years, building and construction was sufficient to generate adequate revenue for Fund 181 to allow funding to be transferred to the Property Appraiser. As construction declined, construction permits and inspections also declined, causing Fund 181 to be unable to maintain its required fund balance while continuing to fund these transfers. Transfers from Fund 181 to Property Appraisal had a positive impact on the fund balance of the Property Appraiser, but it created a larger deficit for Fund 181. However, had the Begich Administration and the Assembly engaged prudent fiscal management practices during 2008 and fully informed the Assembly of potential revenue shortfalls, the Assembly could have made efforts to reduce spending in other areas or generate alternate sources of revenue in order to meet the financial obligations of the Municipality in a timely manner, thus possibly reducing the deficit in Fund 181 and/or the need to transfer funds to the Property Appraiser.

The Cooperative Services Authority (CSA) was created as a cooperative purchasing agency for Anchorage and other State agencies. Its intended purpose was to facilitate purchases at attractive pricing for member agencies. CSA was governed by a four-member board, one of whom was an Assembly Member. After one year of operation, Anchorage had no partners in this endeavor. Although efforts were undertaken to generate revenue, including the initiation of a 5% surcharge on purchases, CSA continued to operate at a deficit. Eventually, CSA's accounts were transferred to Information Technology Fund 607, and the financial impact was spread among all MOA departments. The increasing deficits incurred by CSA had a negative impact on unappropriated fund balance of MOA as the deficits were incurred. The assumption of the outstanding loan and the spreading of the financial impact to all departments in

2008 had a significant negative impact on the fund balance of each of the departments, and the fund balance of MOA.

MRW determined the transactions and reports identified in the Municipal Attorney's supplemental did have a significant impact on the unappropriated fund balance in many instances. Furthermore, the Assembly was unaware of potential revenue shortfalls, and therefore lacked adequate information that would have enabled them to exercise prudent fiscal management practices and possibly mitigate the impact on unappropriated fund balances by reducing expenditures or seeking alternate sources of revenue where appropriate.

DETERMINE IF ACTIONS TAKEN WITH REGARD TO BUDGETING WERE INCONFORMANCE WITH APPLICABLE GOVERNMENT ACCOUNTING STANDARDS, PROVISIONS OF MUNICIPAL, STATE AND FEDERAL LAW, AND PRUDENT FISCAL MANAGEMENT

The accounting firm of Mikunda, Cottrell & Co., Inc. audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented components units, each major fund, and the aggregate remaining fund information of the Municipality of Anchorage ("MOA"), Alaska for the year ended December 31, 2008, which collectively comprise the Municipality's basic financial statements. The financial statements were the responsibility of the Municipality's management. The auditor's responsibility was to express opinions on the financial statements based on their audit.

Mikunda, Cottell & Co., Inc. conducted their audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards required that Mikunda, Cottell & Co., Inc. plan and perform the audit to obtain reasonable assurance about whether the financial statements were free of material misstatement. The audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Their audit and the reports of the other auditors provided a reasonable basis for their opinion. Their opinion based on their audit and the reports of the other auditors, was that the financial statements referred to present, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Municipality of Anchorage, Alaska, as of December 31, 2008, and the respective changes in financial position and the cash flows where applicable thereof for the year ended December 31, 2008. The report concluded the Municipality of Anchorage to be in conformity with accounting principles generally accepted in the United States of America.

MRW further determined the Municipality of Anchorage has enacted numerous laws, ordinances, and guidelines regarding the fiscal management of the city and the reporting of the financial activities to the Assembly. However, MRW determined that in many instances, the Administration failed to practice prudent fiscal management by failing to follow those guidelines and the Assembly as a body did not practice prudent fiscal management in that it did not specifically require the Administration to provide relevant information, thus leaving the Assembly in some instances without adequate business data and information to assess the financial condition of the city and to enable them to make informed decisions regarding fiscal and budgetary issues.

There are no applicable accounting standards for preparing and determining budgets, forecasting and other such matters, hence there were no specific accounting standards and/or requirements or guidelines that the administration would have been required to utilize in and for preparing budgets for the MOA. However, the Government Finance Officers Association (GFOA) has established criteria utilized in reviewing a budget for Certification of Excellence. It should be noted that this document does not represent accounting standards, but does provide valuable criteria regarding the drafting of municipal budgets. The 2008/2009 Approved General Government Operating Budget includes many, but not all, of the items included in the GFOA criteria. (Attachment 44, 2008/2009 Approved General Government Operating Budget)(Attachment 44, GFOA Budget Forensic audit Criteria)
Specific examples of pertinent criteria that are not included in the annual budget are as follows:

- The document should include a coherent statement of entity-wide long-term financial policies.
- The document should include a coherent statement of entity-wide non-financial goals and objectives that address long-term concerns and issues.
- The document shall include a budget message that articulates priorities and issues for the budget for the new year. The message should describe significant changes in priorities and issues from the current year and explain the factors that led to those changes.

The MRW review concluded the Administration failed to practice prudent fiscal management relative to budget issues by failing to assemble monthly reports of revenues and expenditures and submit those reports to the Assembly as required by the Anchorage Municipal Code. MRW further concluded the Assembly failed to practice prudent fiscal management by failing, as a body, to demand the production of the required reports before making financial decisions that had significant impacts on the Municipality's budget and fund balance.

MRW has had no prior litigation relationship with and has not previously provided forensic advisory services to or on behalf of the Municipality of Anchorage. MRW's fees for professional services provided are based on services rendered at a contractually agreed upon amount. MRW's fees are not contingent on the outcome of this matter.

This report is submitted in accordance with the requirements of Request for Proposal RFP 2010-P005

Ronald E. Wise, E.A, Partner
MRW Consulting Group, LLP