

**SUPPLEMENTAL REPORT TO THE
ANCHORAGE ASSEMBLY**

JANUARY 21, 2010

OFFICE OF THE MUNICIPAL ATTORNEY

During the investigation authorized under AR 2009-241, certain evidence came to our attention that, while not within the scope of the original investigation, nevertheless raised concerns about the legitimacy of certain financial transactions and financial management decisions. In some degree, the information pertains to the ongoing conversation about how much financial information was previously disclosed to the Assembly or should have been disclosed to the Assembly.

Since the issuance of the report, municipal employees have brought additional information regarding financial matters to the attention of the Finance Department. In turn, the Finance Department contacted the Municipal Attorney's Office.¹ Together, the two Departments have followed up on the information.

This Office has an ongoing obligation to assist and advise the Municipality, including reporting to the legislative branch, the Assembly, those matters that may be of particular interest and may require legislative action to rectify. Some of the information described above was transmitted to the Assembly subsequent to the report. Individually, some members requested this Office provide a publicly available supplemental report. This is an appropriate vehicle to communicate to the Assembly the information gathered for its additional consideration. In light of this obligation, the following issues are presented for consideration:

A. PERS treatment in the 2008 budget. The PERS adjustments noted in the original report at page 43-49 may have resulted in the expenditure of unappropriated fund balance, in violation of the Charter and Anchorage Municipal Code. Charter section 13.08 provides:

- (a) No payment shall be made, or obligation incurred except in accordance with appropriations. Obligations otherwise incurred are void. The assembly by ordinance may provide for exceptions in the case of tax refunds and other routine payments.

Anchorage Municipal Code section 6.30.050 provides:

No contract, agreement or other obligation involving the expenditure of money shall be entered into, nor shall any ordinance, resolution or order for expenditure of money be passed by the assembly or be authorized by any officer of the municipality, unless the chief fiscal officer shall first certify to the assembly or to the proper officer, as the case may be, that the

¹ Part of the obligation to investigate and report is found in AMC section 6.60.020, which provides, in part, [the controller] shall investigate and report to the chief fiscal officer and concurrently to the internal auditor any improper conduct of any employee concerning public fiscal affairs that may be brought to [the controller's] notice.

appropriated to the credit of the fund from which it is to be drawn, and not appropriated for any other purpose. Likewise, no officer of the municipality shall authorize commencement of work on any contract, agreement or obligation without first having been notified of funding approval. The sum so certified shall not thereafter be considered unencumbered until the municipality is discharged from the contract, agreement or obligation.

Notwithstanding statements made by the prior CFO and OMB director indicating the tentative conclusion is in error, we have not been given any information demonstrating the truth of their assertions. In fact, the OMB Director declined to meet with us and cancelled an interview scheduled well in advance of release of the original report. The prior CFO's statements focused on the "actuals"; however the real issue is how PERS was treated in the budget. Finance and OMB staffs have stated that the failure to make adjustments in the budget to match the treatment of PERS in the "actuals" gave the appearance that departments were doing better with their expenditures than was actually the case. There remains some question about the proper treatment of the PERS matter in the 2008 budget. The proposed audit may provide the answer.

B. Revenue forecasting and available fund balance. In the initial report, at pages 18-27, fund balance was discussed as it pertains to the issue of disclosure of the revenue position of the Municipality in 2008. On November 24, 2009 the Assembly received an email containing a zip file showing the level of detail maintained on fund balance in 2008. The email and zip file included information the prior CFO had sent to Standard & Poor's approximately two weeks before the Assembly received the fund balance forecast in November, 2008.

Additional information was subsequently discovered that is pertinent to the 2008 fund balance discussion. To recap:

The fund balance forecast given to the Assembly on November 17, 2008 indicated an unreserved fund balance of \$8.8 million for the 5 major funds, after meeting the 8.25% bond reserve policy (column U of the spreadsheet). According to the memo accompanying the spreadsheet, but not in the spreadsheet itself, the 2-3% emergency designation reduced the available fund balance approximately another \$6.4 million, according to the memo accompanying the spreadsheet. According to the spreadsheet, this left a projection of available unreserved fund balance at the end of 2008 of \$2.4 million.

During this time period, Standard & Poor's was questioning the fund balance numbers. At the same time, the prior CFO had assigned staff to work on the fund balance information, including developing a forecast.

The below emails were discovered since the issuance of the original report and the supplemental information sent to the Assembly in November of 2009. They are summarized as follows:

1. On November 16, 2008 at 7:09 pm, CFO Weddleton sent a draft fund balance spreadsheet to OMB Director Phillips, with instructions regarding distribution to the Assembly. The spreadsheet indicated a fund balance of approximately \$8.8 million after meeting the 8.25% reserve policy.
2. On November 16, 2008 at 7:40 pm, CFO Weddleton sent questions to her own staff regarding the spreadsheet indicating she thought the numbers may be "too rosy" and noting concerns raised by Standard & Poor's regarding the appearance of 4 years of flat fund balance in the Public Offering Statement for the GO bonds.
3. On November 17, 2008 at 8:28 am, CFO Weddleton told OMB Director Phillips not to send out the spreadsheet until after 4 pm because she was waiting to hear back from her staff.
4. On November 17, 2008 at 11:02 am, CFO Weddleton's staff sent her the answers to her questions and a revised spreadsheet indicating fund balance was a negative \$3.1 million, not the \$8.8 million indicated earlier, meaning the fund balance was projected to be short \$3.1 million in terms of meeting the 8.25% bond reserve policy by the end of 2008 (and approximately another \$6.4 million short of meeting the emergency reserve policy).
5. On November 17, 2008 at 11:26 am, CFO Weddleton's staff offered to meet with her to discuss the revised spreadsheet.
6. On November 17, 2008 at 4:18 pm, the Assembly was sent the original draft showing the \$8.8 million fund balance, not the revised draft showing the -\$3.1 million fund balance.

Given this additional evidence, there is no indication as to why the prior CFO sent the Assembly the original draft and not the revised draft. Finance staff have been interviewed and they indicated there was no contact between them and the prior CFO in response to their revised spreadsheet. It does not appear the Assembly was sent another fund balance report prior to the end of the year. In comparing the two spreadsheets and the staff responses to the prior CFO's questions, the main reason for the difference between the spreadsheet the Assembly was given and the revised spreadsheet is projected negative revenues of approximately \$11.8 million. The revised draft spreadsheet, with a more negative report, was withheld from the Assembly. In hindsight, the withheld

spreadsheet's projection of negative revenues appears to be much more accurate than what the Assembly was given. Recall that this exchange of information occurred prior to adoption of the 2009 budget and approval of four union contracts. The Assembly, thus, appears to have conducted its budget and contract discussions without this more accurate spreadsheet being made available to it.

C. Interfund loans. It is not uncommon for distinct funds within government to be used to make loans to other funds. Such loans are authorized by law. These loans, approved by the Assembly, include the accrual of interest. There have been a number of instances where interest and principle payments appear to have been unbudgeted, deferred, waived or forgiven, sometimes verbally, but without Assembly approval:

1. Girdwood library. In AR 2006-215 (approved 8-15-2006), the Assembly authorized a \$600,000 inter-fund loan from the general cash pool to the Girdwood Valley Service Area Capital Improvement fund to be repaid in full by August 31, 2010. The GVSA was authorized to collect \$200,000 in additional property taxes each year for the years 2007-2010 to raise funds and repay the loan. The Municipality has accepted a grant from the local library booster club to pay \$36,000 in accrued interest.

2. Valley River Center. In AO 2007-147 (approved 11-6-2007), the Assembly authorized an inter-fund loan from the Areawide General Fund (101) to the Areawide CIP Fund (401) to finance the purchase of the Valley River Center in Eagle River. The AO provided for a loan to bear interest and be repaid in full on or before December 31, 2028. The AO also provided for the monthly lease repayments assessed on Municipal tenants will be used to repay Fund 101. The associated AM 663-2007 provided for monthly rental fees and the sale of unit 3 to be used towards repayment of the loan. Monthly payments were included in the calculations setting estimated total monthly costs at \$51,000 per year. The loan proceeds began to accrue interest as of June 2009, when the loan was first drawn down and the proceeds put to use.

During the very Assembly meeting at which AO 2007-147 was adopted, the prior CFO emailed Real Estate Services advising Mayor Begich wanted a new debt repayment schedule "that softens the blow in the early years", with the objective "to see if we can drop the delta (increased unbudgeted costs) for the 2008/2009 budget." The CFO asked for two "interest only" scenarios. There is nothing in the Assembly minutes indicating the Assembly was advised of the need to address the immediate unbudgeted problem – paying back the loan, or allowing interest only payments.

According to Real Estate Services, there were insufficient funds to make the payments in 2008 and 2009. In fact, Real Estate Services was apparently verbally advised by the CFO in late 2008 and again at first quarter 2009 that RES did not need to budget for or make the payments. If true, this appears to be a violation of the terms of the ordinance. The loan itself may violate AMC section 6.30.050 if it constitutes a contract or other obligation involving the expenditure of funds without a fund certification (certification that either the loan or the payments can be made). There was no fund certification in AO 2007-147 (compare with AO 2006-149(S), discussed below).

3. ML&P land purchase – Muldoon Road. AO 2006-149(S) (October 24, 2006) approved an inter-fund loan from ML&P to Real Estate Services (RES) for the acquisition of the former Alaska Greenhouse property. The terms for repayment were specified in the AM, to include no more than a 5 year term and annual interest. Although accrued interest was paid in November and December of 2006, no subsequent payments on interest or principal were made. The failure to make payments arguably violates the terms of the ordinance and there is some question about the proper accounting treatment on the Municipality's books. In 2007, the Controller advised that the utility and the municipality were giving the loan inconsistent treatment in their respective accountings. Some accommodation was made to rectify the situation, which included taking the position that the accounting treatment in 2006 was wrong, but because of the passage of time, would not be corrected. RES has indicated that the reason for not paying on the loan was not based on an interpretation of the ordinance which allowed RES to wait until the end of the loan term, but on the simple fact that RES did not have the money to pay.

On December 31, 2008, Mayor Begich re-designated management authority for a portion of the parcel from RES to ML&P, with a grant of use to ML&P and the right to disposition retained by RES, subject to a) any proceeds from disposition going to ML&P, b) cancellation of the loan and all accrued interest and c) Assembly approval. The justification was that RES had insufficient funds to make the payments. No appraisal work was done to support the Mayor's re-designation. The controller division notified the parties involved that if it followed through on this re-designation, this would cause financial harm. ML&P could not accept this designation because the re-designated property had insufficient value to cover the loan. If it had accepted, ML&P would have to take a loss on its loan.

Now, however, it is unclear whether ML&P can disavow management authority without Assembly approval. AMC 25.10.050B. The current administration is working with the utility to resolve the issue. One of the remaining issues here is: if the delegation is direction from the Mayor to cancel the debt owed, in exchange for a use permit and a right to any future proceeds from the disposition of the

property, the delegation appears to be in violation of AO 2006-149(S) and AO 2006-84.

According to the Finance Department, deferred interest was over half a million dollars. AR 2009-308.

D. Solid Waste Services. SWS was required to make significant revenue distributions between 2004 and 2008 to MOA to support general government budgets. This impacted the financial health of SWS. The 2008 distribution in particular was specifically against the recommendations of the SWS Director and an independent analyst because the utility lost money in the prior year. However, the analyst's recommendation (presented at a January 18, 2008 work session) was not endorsed by the administration. In a document attributed to the SWS director, but edited by the CFO and Municipal Manager, the administration's response to the recommendation was that "if a rate increase is approved, the Utility will be financially sound and therefore the suspension will be unnecessary. Additionally, the Municipality, as owner of SWS, should earn and receive a reasonable rate of return its investment as represented by this dividend." SWS January 25, 2008 memorandum attached to AO 2007-146(S).

Rate increases were approved by the Assembly on January 22, 2008. In AM 658-2007(A), supporting AO 2007-146(S), the administration stated "Solid Waste Disposal is projected to operate at a loss of \$2,500,000 in 2008 and therefore cannot continue to provide adequate service without a rate increase."

In July, the Assembly approved another round of rate increases with passage of AO 2008-83. These rate increases went into effect in April of 2009. Because SWS operates as two utilities, one pays rates to the other. This particular increase was in part to offset the effect on one utility of the prior rate increases granted to the other utility.

In August of 2008, SWS recommended that it not make a revenue distribution to general government or at least make only a reduced contribution as part of the 2009 budget. SWS indicated it thought its Disposal utility did not have surplus revenue from 2007. It further indicated that the Collections utility was facing greater costs due to increased costs in the automated curbside program, including due to an administration decision to change the full rollout of recycling from 2010 to 2009.

The prior CFO indicated to SWS that its request would not be approved because the 2007 loss of \$2.4 million in Disposal was because the care and closure accrual under GASB 18 was understated for many years. With that item out of the equation, Disposal actually had "about a break even year", according to the CFO. She further states that Disposal actually had surplus revenues in 2007 of over \$4 million. Finally, she noted that her decision was not debatable, that "the

likelihood of Refuse or SWS avoiding paying their property taxes is basically nil. This is the same message I deliver to all of the enterprise funds that pose this question.”

At the November 14, 2008 work session on SWS’s 2009 budget, there was no mention of the voluntary distribution of revenue to general government, notwithstanding SWS’s presentation that it was expecting a \$1 million loss for 2008.

Starting in 2004, SWS distributed over \$750,000 a year to general government, including \$825,946 in 2008 and \$909,010 in 2009. There seems to be some inconsistency in requiring SWS pay non-mandatory distributions to general government on the basis of positive revenues while just previously advocating before the Assembly for rate increases based on projected losses.

According to AM 195-2008 supporting the creation of the care and closure fund, the liability for care and closure is in the range of \$47 million dollars, using 2005 dollars and is projected to grow to \$83 million by the expected year of closure (2043). In the AM, the prior administration identified a \$7 million dollar gap that it expected to make up by the end of 2015. The administration stated “additional deposits should be made to the restricted account until the liability is fully funded.”

Anchorage Municipal Code section 25.10.06 provides, in part, “Surplus revenues from the operation of municipally owned utilities may be reinvested in the utility and, where prudent fiscal management permits, may be distributed as set forth in Section 26.10.065.” Anchorage Municipal Code section 26.10.065 provides “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. The revenue shall be described as ‘utility revenue distribution from (name of utility).’ The assembly shall hold a public hearing annually on the proposed transfer and use of funds. Payment of this distribution shall be made only after the surplus revenues have been collected by the municipality pursuant to lawful authority and the annual audit has been completed. The amount of distribution for any one year may not exceed five percent of the utility's gross revenues.”

There is a question as to whether the distributions were fiscally prudent, if SWS did not have “surplus revenues accruing from its operations.” SWS needs to build funds to cover the costs of closure of the landfill. Prior to 2008, funds collected for this purpose were undesignated and utilized for other purposes. In effect, this passes the costs of closure onto current and future rate payers. After enactment of AO 2008-46, effective January 1, 2008, funds collected for this purpose include “additional cash to fund the restricted account for any shortfalls in accruals from years prior to establishing the restricted account.” AMC section

26.80.060C. Further, “[t]he additional deposits shall be based on unrestricted funds available after evaluating the utility’s expected cash needs.”

“Withdrawal from the restricted account for purposes other than expressly related to landfill closure activities shall require Assembly approval”, meaning that distributions to general government under AMC 26.10.065 made after January 1, 2008 can include invasion of the care and closure fund, if approved by the Assembly.

I reviewed the transcript of the SWS work session on its 2009 budget and the Assembly meeting minutes on the various budgets. I did not come across a single mention of the revenue distributions. If, in fact, the distributions were not discussed with the Assembly or were not fiscally prudent, the above-referenced code provisions may not have been complied with.

E. Overstated revenue in budgets. Revenue forecasting is not an exact science. It is not uncommon for budget revenues to be either overstated or understated, in hindsight. The issue involving the revenue forecasting in the budgets provided to the Assembly is whether the revenues were known to be grossly inflated. These particular revenue items may fall into that category, based on information provided by staff.

1. Ambulance fees. The revenues to be generated from ambulance fees were overstated in at least two prior years by \$1 million each year and should have been reduced to more realistic amounts because, according to Finance, the receivables associated with this revenue are considered uncollectable under GASB revenue recognition rules.

2. Coastal Impact fees. Approximately \$2 million in revenue was budgeted in 1st quarter 2009 for this item, but the likelihood of actually receiving this money was very low and was not budgeted in the original 2009 budget for that reason. It has also been suggested that this should have been treated as a grant for accounting purposes.

3. Construction Cash Pool Interest earnings. This budget item was set too high during 2009 1st quarter budget revisions, against the advice of the Public Finance & Investments Division to reduce this target by \$1.8 million. At the same time, the prior administration followed the same Division’s advice to reduce the 100 Funds anticipated earnings by \$1.734 million. We have been advised that the Division’s advice proved to be accurate. The Public Finance & Investments Division does not know why its recommendation to reduce the projected earnings on the Construction Cash Pool was not followed.

F. Negative fund balance in Fund 181. Since 2004, \$500,000 in funds generated from building permits fees has been transferred each year to Property Appraisal, with Assembly approval of each year’s budget. However, in 2007,

2008 and 2009 these transfers have been made from Fund 181 even though Fund 181 had insufficient funds. The negative fund balance is now approximately \$2.8 million.

G. Cooperative Services Authority. The CSA received a loan of \$1,575,000 upon its creation. In 2006, the outstanding balance of \$1,344,282 was transferred to Fund 603, the Self Insured Health Fund. The CSA was given additional money of the Finance department's budget in 2006 and 2007. At termination in December of 2008, the loan was still outstanding. CSA's accounts were transferred to IT Fund 607. The final financial impact was \$919,942 to fund balance, which was spread across all MOA departments and utilities, allowing the IT Fund 607 to remain whole.

Conclusion

The original report from this office recommended a third-party audit to help in making the determination if unappropriated fund balance was improperly used, in violation of the charter, code, and other applicable laws. Third party verification, through an audit, may help avoid allegations of improper motive in looking at this issue. This is also true about other issues in this supplemental report. In my opinion, it is important for the Assembly to get as accurate information as possible when making budget decisions. The Assembly has an opportunity to confirm this assessment by authorizing and appropriating funds to conduct an independent audit.

My door is open to anyone – Assembly member, employee, or former employee, or others who may have additional information, or who wish to discuss any of the details in either report. If anyone believes there are errors or omissions in the reports, I encourage them to bring those to my attention so the work product is as accurate as possible. The overriding considerations should be to make sure we improve our accounting methods, fix errors where they exist, take steps to prevent similar occurrences, and build confidence in our citizens that we are diligent stewards of the resources they provide us for use on their behalf. In certain circumstances, failing to revisit the past to identify and correct mistakes means that the adage “history repeats itself” may come true.