

February 18, 2004

Internal Audit Report 2004-2
Special Assessments
Anchorage Water and Wastewater Utility

Introduction. An improvement district is a public capital improvement project initiated by property owners in a neighborhood. As noted in Anchorage Municipal Code (AMC) 19.10.020, Special Assessments, there are several types of improvement districts, including but not limited to, road improvement districts (RID), water improvement districts (WID), (sanitary sewer) lateral improvement districts (LID), as well as gas improvement districts, park improvement districts, and service improvement districts. This report focuses on WID/LID projects which were managed by Anchorage Water and Wastewater Utility (AWWU). As of September 30, 2003, there were seven created and active WID/LID projects at some stage in the assessment process.

A special assessment is a levy customarily imposed, after the improvement project is completed, against specific property parcels within the improvement district benefitting from the proposed public improvement. As of September 30, 2003, about \$826,500 in project costs for WID/LID projects were pending submission of final assessment rolls to the Municipal Assembly by AWWU. Assessments are payable in equal annual payments, with terms typically ranging from 1 to 20 years, depending on the principal amount of the assessment. The Special Assessment Section, placed at AWWU, collects all special assessments for the Municipality. To pay for the billing and collecting services provided by the Special Assessments Section, a \$42 annual collection charge is added to each special assessment account. As of August 2003, the Municipality had about \$3.6 million in sewer and water special assessment accounts receivable.

An improvement district begins with a request from neighborhood property owners seeking an improvement. Each request for improvement is evaluated for extension potential and placement of

the utility extension(s). Benefitting property owners are then balloted to obtain confirmation of interest in the project.

If greater than 50 percent of the property owners that would bear the cost of the improvement confirm their interest in the project by an affirmative vote on the ballot(s), the project is then presented to the Assembly for review and approval to create the improvement district (by ordinance). If approved, the creation ordinance is recorded with the Anchorage District Recorder's Office. The Assembly approval of the creation ordinance then prompts the design and subsequent construction of the improvement.

When construction has been completed and final project costs are known, final assessments are calculated and presented to the Assembly for confirmation and approval. With Assembly adoption, the resolution levying the assessment is then recorded with the Anchorage District Recorder's Office, though not specifically required by AMC. The assessment then becomes a lien against the property until paid in full. The first payment is then due within 3 to 4 months - but not sooner than 60 days - following Assembly action. Interest is applied to any unpaid balance; penalties and interest are applied to accounts that become delinquent.

Objective and Scope. The objective of this audit was to determine whether the provisions of Municipal Policy and Procedure (P&P) 46-2, Street Reconstruction and Subdivision Agreement Completion Through Road Improvement Districts; AMC Title 19, Special Assessments; and other related requirements were followed in the creation and processing of special assessments. As part of our audit, we judgmentally selected and reviewed four WID/LID projects that had either been opened or closed since January 2002. In addition, we judgmentally selected and reviewed 47 special assessment accounts receivable from January 2003 through October 2003 with credit balances. We also reviewed all special assessments accounts older than 20 years to determine why they had not been paid in full. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary

in the circumstances. The audit was performed during the period of August through November 2003. The audit was requested by the Administration.

Overall Evaluation. Overall, we found that the special assessment process could be improved. Specifically, we found significant delays in recording pending assessment liens and in submitting projects to the Assembly for approval of final assessments. In addition, Municipality of Anchorage Standard Specifications (M.A.S.S.) were not being followed when Certificates of Compliance and Certificates of Completion were issued. Moreover, there was no segregation of duties in the Special Assessments Section, and special assessment accounts with credit balances were not adequately managed. Further, the annual collection charge was not adequate to cover the administrative costs of the Special Assessments Section. Also, the methodology used to calculate the annual fee was not in compliance with AMC 19.20.010 and 19.20.265 and the assumptions were not correct. Finally, we found there was no comprehensive policy and procedure for special assessment improvement districts.

FINDINGS AND RECOMMENDATIONS

1. Pending Assessment Liens Not Recorded Timely.

- a. Finding.** We found that pending assessment liens were not recorded timely with the Anchorage District Recorder's Office. Specifically, our review of four WID/LID projects revealed it took AWWU an average of 273 days to record the pending lien with the Anchorage District Recorder's Office after Assembly approval of the creation Ordinance. For example, one project was approved by the Assembly on June 2, 1998, but was not recorded in the Anchorage District Recorder's Office until July 9, 1999, 402 days later. As a result, potential home buyers may not have been aware of pending assessments on the property they intended to purchase.

Section 6 of the creation Ordinance states, "The Mayor forthwith shall cause this Ordinance to be recorded in the office of the Anchorage District Recorder." In

addition, AMC Title 19.20.180 states, “The administration shall file on record with the district recorder all ordinances creating or establishing assessment districts.”

b. Recommendation. AWWU should record pending assessment liens with the Anchorage District Recorder’s Office as soon as original documents are available.

c. Management Comments. Management stated, “Concur with recommendation.

“In 2003, AWWU and other municipal offices added and enhanced computer tools, work practices, and work flow processes to provide for better municipal coordination to achieve timelier recording of special assessment district creation ordinances. For example, in contrast to timeframes cited above, an ordinance creating a water improvement district and two resolutions levying water and sanitary sewer assessments that the Assembly approved on December 17, 2003 were presented to the Anchorage District Recorder’s Office for recording on January 8, 2004.....less than a month.

“AWWU is also setting performance metrics and initiatives to record these documents within thirty (30) days of the date the signed document is available.”

d. Evaluation of Management Comments. Management comments were responsive to the audit finding and recommendation.

2. Final Approval Delayed.

a. Finding. Completed projects were not brought before the Assembly for approval of the final assessment roll in a timely manner. AMC 19.20.080 states, “ . . . the assembly by resolution shall confirm the assessment roll for the special assessment district.” Our review of four projects revealed it took an average of 728 days to obtain final Assembly approval for two of the WID/LID projects. The other two

projects were complete on July 24, 2000; however, as of September 30, 2003, they had not been submitted to the Assembly for approval of the final assessment roll. AWWU management attributed the conversion to the PeopleSoft Financial System for some of these delays because cost data had not been converted correctly.

b. Recommendation. AWWU should submit, in a timely manner, the final assessment roll upon completion of a project to the Assembly for approval.

c. Management Comments. Management stated, “Concur with recommendation.

“AWWU also desires and seeks repayment of improvement district costs as soon as possible after the project is completed; project accounts and books are closed; and there is an accurate tally of project costs. To bring projects to closure timelier, AWWU has recently brought Project Management Manuals current to assist project managers and engineers in completing the various tasks involved with project design, construction and closeout. AWWU has also set performance metrics and initiatives by which to measure and gauge timeliness.”

d. Evaluation of Management Comments. Management comments were responsive to the audit finding and recommendation.

3. M.A.S.S. Not Followed.

a. Finding. During our review of time frames for four projects, we found that Certificates of Compliance and Certificates of Completion were either improperly issued, or not issued at all, before making final payment to the contractor. For example, for one of the WID/LID projects we reviewed, the Certificate of Completion was issued on July 24, 2000, but the Certificate of Compliance was not received until December 28, 2000. As a result, there was no assurance that AWWU received the services it paid for. M.A.S.S. Articles 5.26 (Final Inspection) and 7.7

(Final Payment) state that a Certificate of Completion should only be issued by the Engineer after having received the Certificate of Compliance from the contractor. It further states that the contractor shall not submit a request for final payment until the Engineer has received the Certificate of Compliance. The Certificate of Compliance certifies that all work has been performed, materials were supplied according to the contract documents, prevailing wage rates were used, payroll taxes have been paid, and that all claims for material, labor, and other services have been satisfied. A Certificate of Completion is issued when a final inspection verifies that the work has been completed, all code compliance inspections have been performed, and other contract requirements have been fulfilled.

- b. **Recommendation.** AWWU should not make final payments to contractors until Certificates of Compliance and Certificates of Completion have been issued as required by M.A.S.S. Sections 5.26 and 7.7.

- c. **Management Comments.** Management stated, “Concur with recommendation.

“AWWU now has checks and balances in place for completion and execution of the Certificate of Compliance and the Certificate of Completion. Both are included in AWWU’s standard project management checklist.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Lack of Segregation of Duties.**

- a. **Finding.** During our review of the Special Assessments Section, we found a lack of segregation of duties with regard to controls over cash and accounts receivable. Our review found one individual performed all of the billing, collecting, recording and depositing for special assessments. Over the years, Special Assessments staff has

been reduced to only one individual, making it difficult to segregate duties. This issue was previously identified in our 1991 audit of Special Assessments (Internal Audit Report 91-15) where we recommended some essential functions be reassigned to prevent one individual from having total control over cash receipts. At that time there were two clerks and a supervisor. As a result of no segregation of duties, there is an increased risk of error and/or potential misappropriation of funds.

- b. Recommendation.** To reduce the risk of error and/or fraud, key duties and responsibilities should be divided or segregated among different people. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event. Managers should exercise appropriate oversight to ensure individuals do not exceed or abuse their assigned authorities.
- c. Management Comments.** Management stated, “Concur with recommendation.

“AWWU moved the job of posting the Special Assessment payments to the Junior Administrative Officer in the Administration Section of the Customer Service Division on 12/01/03. This person also acts as backup to the individual in the Special Assessments office. This move allows the separation of duties with regards to control over cash and accounts receivable.”
- d. Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. Special Assessments Accounts with Credit Balances Not Adequately Managed.

a. Finding. Special assessment accounts receivables with credit balances have not been adequately managed. Our review of 47 special assessment accounts receivable with credit balances ranging from \$0.06 to \$2,372.95 revealed the following¹:

- Sixteen credit balances were the result of overpayments which had not been refunded.
- Four credit balances were payoff amounts that had not yet been credited to the special assessment accounts.
- Four credit balances were the result of double payments that were held to be applied to the next year's payment when it became due.
- The remaining credit balances consisted of a State of Alaska property that was exempt from special assessments and property owners who prepaid their assessments for various reasons, such as selling a home or a requirement of their mortgage holder to be the first lien holder on the title.

According to management, these credits were not applied to the appropriate accounts because a report showing credit balances had not been reconciled in months.

b. Recommendation. The Special Assessments Section should reconcile all accounts with credit balances on a quarterly basis and either refund the amounts or post them to the appropriate account.

¹In addition, we reviewed all special assessment accounts older than 20 years. We identified no exceptions.

- c. **Management Comments.** Management stated, “Concur with recommendation.

“The Special Assessment Credit Report will be run quarterly. All special assessment accounts with credit balances greater than \$5.00 will be analyzed and refunded or payoff amounts will be credited to the special assessment account.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Annual Collection Charge is Not Adequate.**

- a. **Finding.** Our review of the Special Assessment Section’s annual collection charge revealed that the current \$42 collection charge was not adequate to pay for the previous year’s administrative costs and had not been adjusted since January 2001. For example, in 2002 the Special Assessments Section collected \$38,849 in administrative fee revenue; however, our computation of labor costs alone was \$65,411. AMC 19.20.010 section E states: “Costs of administering and operating assessment districts shall be paid entirely from the district’s assessment revenues, fees, grants or donations but not by either general or municipal tax revenues.” AMC 19.20.265 establishes an annual fee to pay for those costs that are to be added annually to each unpaid special assessment account for each active assessment levied after November 17, 1992. Additionally, AMC 19.20.265 states that this “. . . collection charge for special assessments shall be adjusted annually, if needed, based upon the special assessment district’s previous year’s administrative cost divided by that district’s previous year’s number of active accounts subject to the charge.”

- b. **Recommendation.** AWWU should adjust the collection charge on an annual basis as required by AMC 19.20.265 to ensure all costs for administering the special assessment accounts are paid with special assessment revenue as required by AMC 19.20.010.

- c. **Management Comments.** Management stated, “AWWU agrees with the recommendation.

“AWWU agrees with the finding the \$42 Special Assessment Collection Charge is not adequate to pay the previous year’s administrative costs. AWWU has filed a request with the Regulatory Commission of Alaska (RCA) to increase the amount of the special assessment collection charge from \$42 to \$67 annually for active accounts subsequent to November 17, 1992.

“AMC 19.20.265 only allows charging for post November 17, 1992 active accounts. There is currently no provision in the AMC to recover the costs of administering pre November 17, 1992 active accounts.

“AWWU will work with affected municipal departments to resolve the cost recovery issue with respect to the pre 1992 active accounts given the requirements of AMC 19.20.010. AWWU will request the AMC be revised to clarify cost recovery issues related to the special assessment administrative charge.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Methodology Used to Calculate Annual Charge is Incorrect.**

- a. **Finding.** Our review of the methodology used to calculate the Special Assessment Section’s annual administrative charge found it was not in compliance with AMC 19. For example, AMC 19.20.265 states the annual fee should be calculated based on the prior year’s administrative costs. However, our review found Regulatory Affairs’²

² The Regulatory Affairs Section is part of AWWU and calculates the annual administrative charge for the Special Assessments Section.

fee calculation inflated labor costs as they included anticipated cost increases in future years. In addition, for other computations we reviewed, we found the assumptions used in those methodologies were incorrect. For example:

- The number of active accounts used in the calculation of the special assessments administrative costs were not accurate. Regulatory Affairs used all active accounts which included accounts levied prior to November 1992. AMC 19.20.265 states only accounts after November 17, 1992, were subject to the annual charge.
- The assumptions for labor costs used in the calculation of the administrative cost were incorrect. For example, the assumption used by Regulatory Affairs included labor costs for two full-time employees. Our review revealed one of the employees only charges 1/20th of her time to the special assessments unit.
- The assumptions used to calculate the average per hour labor costs were incorrect. For example, Regulatory Affairs' assumption used 3,132 hours to calculate the average per hour labor costs in the special assessments unit, which represented 1.5 full-time employees. Our review revealed the correct calculation should have used 2,195 hours, which represents only 1.05 full-time employees.
- The assumption used to calculate the annual assessment charge was not based on the administrative costs within each individual assessment district. Instead, Regulatory Affairs' assessment charge was based on the combined administrative cost of all assessment districts. AMC 19.20.265 states: "The collection charge for special assessments shall be adjusted annually, if needed, based upon the special assessment district's previous year's administrative cost . . ."

- b. **Recommendation.** AWWU should review its methodology used to calculate the Special Assessment Section's administrative charge to ensure it is calculated correctly and complies with AMC 19.20.265. If the methodology for calculating the administrative charge is conflicting, AWWU should request AMC be revised to clarify the proper calculation/allocation of the special assessment annual administrative charge.
- c. **Management Comments.** Management stated, "AWWU agrees with the recommendation.

"AWWU believes there is a conflict in the AMC with respect to fully recovering costs, as the AMC is silent about a methodology that may be used to recover costs associated with active pre 1992 costs. AWWU will request the AMC be revised to clarify the proper calculation/allocation of the special assessment annual administrative charge.

"AWWU has the following additional comments as to the audit findings:

1. 'Regulatory Affairs' fee calculation inflated labor costs as they included anticipated cost increases in future years.'

AWWU believes adjusting the prior year's administrative costs for known and measurable changes is appropriate and not precluded by AMC 19.20.265. Adjustments for known and measurable changes, such as labor rate increases, are only prudent in order to fully recover costs, as required by AMC 19.20.010.

2. 'The number of active accounts used in the calculation ... were not accurate.'

AWWU disagrees. AWWU will request the AMC be revised to clarify the proper calculation/allocation of the special assessment annual administrative charge.

3. 'The assumptions for labor costs used in the calculation of the administrative cost were incorrect.'

AWWU agrees the hourly labor cost was calculated incorrectly. AWWU should have calculated a weighted average labor rate.

4. 'The assumption used to calculate the annual assessment charge was not based on the administrative costs within each individual assessment district.'

AWWU believes the methodology currently used yields results that are consistent with the intent of AMC 19.20.265, and it does it in a cost effective manner. However, we concede that it is a "workaround", and does not follow the calculation as laid out in the AMC. AWWU will request the AMC be revised to clarify the proper calculation of the special assessment annual administrative charge."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit recommendation.

8. **Lack of Comprehensive Policy and Procedure.**

- a. **Finding.** There was no comprehensive policy and procedure for special assessment improvement districts. While P&P 46-2, Street Reconstruction and Subdivision Agreement Completion Through Road Improvement Districts, provided guidance for construction and reconstruction of local streets using the 10%/90% cost formula, it did not address any of the other improvement districts. P&P 46-2 also did not

establish time frames and did not assign responsibility for the various actions required for establishing and processing special assessment improvement districts.

- b. **Recommendation.** AWWU should coordinate with the Project Management and Engineering Department to create a separate P&P to provide comprehensive guidance for all improvement districts, and establish time frames for completing steps in the improvement district process.

- c. **Management Comments.** Management stated, “Concur with recommendation.

“AWWU will work with PM&E to develop a common policy and procedure to provide a comprehensive guidance for special assessment improvement districts, to include developing time frames for completing milestones in the process, by the end of the 3rd Quarter, 2004.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on December 1, 2003.

Audit Staff:
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