

**State Water Infrastructure Authority
Viable Utility Committee
January 15, 2025 Meeting
Agenda Item C– Updates to Assessment Criteria and Process**

Division of Water Infrastructure Staff Report

Background

Session Law 2020-79, entitled in part “An Act to Improve the Viability of the Water and Wastewater Systems of Certain Units of Local Government...”, authorizes the State Water Infrastructure Authority (Authority) and Local Government Commission (LGC) to develop criteria to assess and review local government units (LGUs), and to utilize the assessment and review process to identify distressed LGUs.

In the Fall of 2020, the Authority and LGC developed the Identification Criteria and Assessment Criteria to evaluate LGUs and identify distressed LGUs. The Authority adopted the Assessment Criteria and the Identification Criteria at its meeting on November 18, 2020.

Identification Criteria

The Authority and LGC adopted the following Identification Criteria to be used to identify distressed LGUs:

1. An LGU whose fiscal affairs are under the control of the LGC pursuant to its authority granted by G.S. 159-181 (“under Commission fiscal control”), or
2. An LGU that has not submitted its annual audits for the last two (2) fiscal years to the LGC as required by G.S. 159-34, or
3. An LGU with a total Assessment Criteria score that:
 - a) Equals or exceeds 9 for LGUs providing both drinking water and wastewater services, or
 - b) Equals or exceeds 8 for LGUs providing only one service, either drinking water or wastewater, or
4. An LGU for which other information is available to or known by the Authority or LGU that reflects and is consistent with, but does not expressly appear in, the Assessment Criteria to account for situations in which the Assessment Criteria score does not wholly or accurately reflect a system’s level of risk due to the limitations of available data.

Assessment Criteria

The Authority and LGC approved 19 parameters to use for calculating the total Assessment Criteria score used for Identification Criterion #3. Changes made in 2024 eliminated two parameters (Drinking Water Population per Mile and Wastewater Population Per Mile) for a total of 17 remaining parameters (see Attachment 1). The parameters capture operational, managerial, and financial issues. Note that the first four parameters are required by statute. Each parameter is assigned a point value that ranges from one to four. Data are compiled for each LGU from a variety of sources, including the UNC Environmental Finance Center, audited financial statements submitted to the LGC, and the Division of Water Resources' compliance information. These data are used to assign points for each parameter for each LGU to compute total scores.

Assessment Rounds and Designations

In 2021, the Division and LGC staff compiled LGU data in accordance with the approved criteria to complete the first assessment to identify distressed LGUs. Additional assessment rounds were conducted in 2022, 2023, and 2024. There are currently 151 LGUs designated as distressed.

Discussion

DWI staff have been reviewing the data from previous assessment rounds and have identified several opportunities to improve the process.

1. Revise the Assessment Parameter for UAL Control Issues

- The Viable Utility (VU) program's Assessment Criteria include a parameter based on accounting control issues as identified in the Unit Assistance List (UAL). The UAL is published by LGC staff several times each year based on audited financial statements and associated data submitted to the LGC and identifies LGUs that may have financial or fiscal management issues contributing to financial risk.
- The current VU assessment UAL Control parameter is based on the 2023 (and prior) UAL, which identifies LGUs that are included on the UAL as having high risk (1), medium risk (2), or low risk (3) of accounting control issues. As the parameter is currently defined, LGUs score three points in the VU assessment for the UAL Control parameter if they are identified as high risk (1) or medium risk (2) of accounting control issues. Units that are on the UAL but identified as low risk (3) do not score points for the UAL Control parameter in the VU assessment.
- In 2024, the LGC changed the process for creating the UAL and no longer uses the low, medium, and high designations for accounting control issues or other categories. Instead, each unit is given a score in different categories based on data from their audit, and the unit is included on the UAL when a given category score exceeds the

threshold set by LGC for that category. The definition for the VU assessment of the UAL Control parameter no longer matches with the UAL.

- Division and LGC staff propose to update the wording for the VU assessment UAL Control parameter to align with the 2024 (and ongoing) process by which units are identified for inclusion on the UAL, as follows [changes noted in red and by strikethrough]:

UAL Control Issues: The UAL is published by LGC staff and identifies units whose audits indicate that they may have financial or fiscal management ~~accounting~~ issues contributing to financial risk. Points are scored for if a unit's UAL "Internal Controls" category score exceeds the established category score threshold set by the LGC staff for that category ~~systems that have been identified by the LGC as medium risk (2) or high risk (1) of accounting control issues.~~

2. Address Missing Data

- The first round of assessment scores was completed in the winter of 2020-2021 using fiscal year 2019 audit data. After analyzing data and developing the assessment process throughout the fall, the first round of notification letters were sent to LGUs designated as distressed in February 2021.
- With the more recent assessments, audit data have been pulled in March from the previous fiscal year. This shift has resulted in significant gaps in available audit data. For example, in 2024, 95 LGUs had not submitted FY 2023 audits to the LGC at the time that data were pulled for the assessment. Similarly, 115 LGUs had not submitted FY 2022 audits at the time the data were pulled for the 2023 assessment.
- Staff have identified two approaches that, if implemented together, will help minimize data gaps and improve the accuracy of the assessment.
 - First, staff recommend shifting the timing such that data will be pulled in July and new "distressed" designations will be issued in the fall. Staff propose shifting the assessment timeline so that audit data available as of July 15 will be used for the assessment. This timeframe aligns with the LGC's internal deadlines and timing for preparing the UAL and will shift the distressed designations under the Viable Utility Program from summer to fall.
 - Second, staff recommend that if the most recent fiscal year's audit data are not available when data are pulled for the assessment, but the previous year's data are available, then the previous year's data will be used for the assessment instead of having no data and therefore no points scored for audit-based parameters. For example, this would mean that for the 2025 assessment round, if an LGU's FY 2024 audit has not been submitted but the FY 2023 audit has been submitted, then the FY 2023 audit data will be used. The use of replacement data will be noted in the assessment scorecards.
 - In combination, these approaches will significantly reduce the number of units that have artificially low scores due to missing data and, thereby, result in no

score for audit-based parameters. Staff do not recommend using data older than what is proposed because they may no longer present an accurate picture of the LGU's circumstances. Further, any LGUs that are missing two or more years of audit data will be reviewed by the LGC for possible designation under Identification Criterion #2.

3. *Adjust Designation Threshold to a Single Value*

- The Identification Criterion #3, which uses the assessment score as the basis for designated LGUs as distressed, currently has two different thresholds: a score of nine (9) or higher for LGUs that provide both water and wastewater service (dual service), or a score of eight (8) or higher for LGUs that provide only water OR wastewater service, but not both (i.e., single service).
- When the criteria were first established, LGUs providing both water and wastewater services could potentially score a total of 27 points, and single service providers could potentially score a total of 25 points because there were separate parameters for Drinking Water Compliance, Wastewater Compliance, population per mile of drinking water pipe, and population per mile of wastewater pipe. Different designation thresholds were set to account for difference in total possible points.
- Changes to the assessment criteria made in 2024 included elimination of the two population per mile criteria. This change reduced the total number of possible points to 25 for dual service providers and 24 for single service providers. This point difference is due to the use of two different parameters for wastewater compliance and drinking water compliance.
- While there is still a single point difference in the total *possible* points between dual and single service providers, past assessment rounds have only had *one or two* LGUs (out of nearly 500) score both of those points. Therefore, starting in 2024, the difference between the actual scores of dual and single service providers is negligible.
- Staff recommend changing the designation threshold to eight (8) points or higher for *all* LGUs (dual AND single service providers) because (a) the 2024 criteria changes lowered the total possible points without lowering the designation threshold, and (b) the 2024 changes largely eliminated the difference in scoring between dual service and single service providers.

Staff Recommendations

Division staff recommend that the VUC present the following Assessment Criteria changes to the full Authority:

1. Revise the VU assessment's UAL Controls parameter so that its definition fits the current process used by the LGC staff.
2. Shift assessment timing from spring/summer to summer/fall.

3. Use audit data from the previous year if the required audit data for assessment is not available.
4. Change the designation threshold from nine points for dual service providers or eight for single service providers to a score of eight for *all* LGUs.