

Washington State Auditor's Office
Accountability Audit Report

City of Seattle
King County

Report Date
June 30, 2008

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WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



**Washington State Auditor
Brian Sonntag**

July 7, 2008

Mayor and City Council
City of Seattle
Seattle, Washington

Report on Accountability

Please find attached our report on the City of Seattle's accountability and compliance with state laws and regulations and its own policies and procedures.

In addition to this work, we also audit the City's financial statements and compliance with federal laws and regulations. The results of that audit will be included in a separately issued audit report.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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**City of Seattle
King County
June 30, 2008**

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Audit Summary

**City of Seattle
King County
June 30, 2008**

ABOUT THE AUDIT

This report contains the results of our independent accountability audit of the City of Seattle.

We performed audit procedures to determine whether the City complied with state laws and regulations and its own policies and procedures. We also examined City management's accountability for public resources. Our work focused on specific areas that have potential for abuse and misuse of public resources.

Areas examined during the audit were selected using financial transactions from January 1, 2006, through June 30, 2007.

RESULTS

The City complied with state laws and regulations and its own policies and procedures in the areas we examined. Internal controls were adequate to safeguard public assets. However, we identified a condition significant enough to report as a finding:

- The City of Seattle did not comply with state law governing the use of Real Estate Excise Tax proceeds.

We also noted certain issues that we communicated to City management. We appreciate the City's commitment to resolving the issues.

RELATED REPORTS

Our opinion on the City's financial statements and compliance with federal program requirements is provided in a separate report, which includes the City's financial statements.

CLOSING REMARKS

We thank City officials and personnel for their assistance and cooperation during the audit.

Description of the City

City of Seattle King County June 30, 2008

ABOUT THE CITY

The City of Seattle is the largest city in King County as well as in the state, with a population of approximately 586,200 citizens. The City has a mayor-council form of government with nine elected Council Members, an elected Mayor and an elected City Attorney. The City's budget for 2007 was \$3.29 billion, including \$841 million for the General Fund. It has approximately 10,000 employees and provides a full range of services including water, drainage and wastewater, solid waste, electric, police, Municipal Court, fire, emergency medical, parks and recreation (including four golf courses), planning and economic development, and municipal libraries.

AUDIT HISTORY

We audit the City annually. The past five audits of the City have found various issues relating to internal controls and legal compliance. The number of accountability findings has ranged from three in 2000, one in 2002, none in 2003, one in 2004 and none in 2005.

City management has responded quickly to the issues noted in prior findings. The Mayor, City Council, department directors and staff have demonstrated a strong commitment to complying with state laws and the City's own ordinances and policies.

The City Auditor continually reviews operations and makes recommendations for improved internal controls. In certain instances, the City Auditor conducts follow-up procedures related to issues noted in our audits.

ELECTED OFFICIALS

These officials served during the audit period:

Mayor

Council Members:

Greg Nickels

Sally Clark (effective February 6, 2006)

Jim Compton (through January 6, 2006)

Richard Conlin

David J. Della

Jan Drago

Jean Godden

Nick Licata

Richard J. McIver

Tom Rasmussen

Peter Steinbrueck

Thomas Carr

City Attorney

APPOINTED OFFICIALS

Director of Finance

Dwight Dively

ADDRESS

City

City Hall
600 4th Avenue
P.O. Box 94726
Seattle, WA 98124-4729

Audit Areas Examined

City of Seattle King County June 30, 2008

In keeping with general auditing practices, we do not examine every portion of the City of Seattle's financial activities during each audit. The areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. Other areas are audited on a rotating basis over the course of several years. The following areas of the City were examined during this audit period:

ACCOUNTABILITY

We evaluated the City's accountability and compliance with laws, regulations, contracts and grant agreements in the following areas:

- Use of Real Estate Excise Tax
- Allocation of Fleets and Facilities charges
- Open Public Meetings Act
- Cash receipting
- Competitive procurement
- Tax limitations
- Use of debt proceeds
- Accounts receivable write offs
- Bond covenants
- Municipal Court activity
- Credit card use
- Use of state grant funding
- Travel
- Accounting for the proceeds of surplus property
- Investments
- Payroll
- Prevailing wages
- Conflict of interest
- Inter-local agreements
- Local improvement districts
- Limitations of indebtedness
- Retirement systems
- Budget
- Insurance and bonding

Schedule of Audit Findings and Responses

City of Seattle King County June 30, 2008

1. The City of Seattle did not comply with state law governing the use of Real Estate Excise Tax proceeds.

Background

State law allows cities to impose two types of real estate excise taxes (REET) on the sale of real property. These are commonly known as REET 1 and REET 2, and the use of their proceeds is restricted. The use of REET 1 is less restricted than REET 2. Both may be used for certain public works projects such as streets, roads and bridges, but only REET 1 money may be used for fire department facilities or trails.

Description of Condition

Between January 1, 2006 and June 30, 2007, the City spent \$35.8 million in REET 2 funds. Of this, \$3,188,702 was spent on unallowable projects.

- The City spent \$2,773,835 on excavation and retaining wall work related to a fire station under construction and a fire department headquarters building planned for the future.
- The City used \$414,867 to create or extend trails.

Cause of Condition

The City stated it was reasonable to allocate this fire department related work to REET 2 because the adjacent street was in need of repair and street repair is an allowable use of REET 2 money. The City could not demonstrate the costs paid with REET 2 funds were for shoring related to street repair.

The City thought it was reasonable to allocate trail costs to REET 2 because the trails function like a sidewalk.

Effect of Condition

When restricted revenues are used for unallowable purposes, citizens do not receive the full intended benefit of the revenue.

Recommendation

We recommend the City ensure all restricted revenues are used for legal purposes. We further recommend the City reimburse the REET 2 funds improperly spent on these projects.

City's Response

Thank you for the opportunity to review your draft audit findings regarding the City's use of Real Estate Excise Tax II (REET II) revenues during the period of January 1, 2006 through June 30, 2007.

As stated in previous communications to your office, the City does not concur with the two audit findings regarding the ineligible use of REET II funds for the Yesler Way retaining wall replacement and for multi-purpose paths/trails.

As demonstrated by backing invoices, the REET II expenditures for Yesler Way were for replacement of the retaining wall that supports the street. The work would have had to be performed in the absence of an adjacent fire station project, and was undertaken concurrent with said project for the sake of construction efficiencies. The audit finding implies that any project to improve a street facility loses eligibility for REET II funding in the event that it abuts and benefits an adjacent property. Since nearly all street improvements ultimately benefit adjacent properties, a logical conclusion of your first audit finding is that REET II funds would become largely unavailable as a funding source for any street improvement project.

The City has also allocated REET II for multi-purpose paths/trails which are part of the pedestrian and bicycle systems. Per the Washington State Department of Transportation's Design Manual (Chapter 1025 Page 6), "Shared-use paths that function as sidewalks must comply with ADA sidewalk requirements." The City designs and builds the multi-use paths/trails to meet or exceed the ADA sidewalk requirements, thereby qualifying them as part of the City's pedestrian sidewalk system.

Despite our disagreement with the two audit findings, the City recognizes that there is some fungibility between REET I and REET II-supported capital projects during the 1/1/06-6/30/07 period. Therefore in response to your audit, the City is prepared to substitute the REET II funding for the Yesler Way retaining wall and multi-purpose path/trail projects with REET I funding that was used for other capital projects that would meet your narrower definition of REET II eligibility. We plan to initiate this transaction this summer.

Auditor's Remarks

We appreciate the City's planned action to reimburse the REET 2 funds and will follow up on this in our next audit.

Applicable Laws and Regulations

RCW 82.46.035, Additional tax--Certain counties and cities--Ballot proposition--Use limited to capital projects--Temporary rescindment for noncompliance, states in part:

(3) Revenues generated from the tax imposed under subsection (2) of this section shall be used by such counties and cities solely for financing capital projects specified in a capital facilities plan element of a comprehensive plan . . .

(5) As used in this section, . . . "capital project" means those public works projects of a local government for planning, acquisition, construction, reconstruction, repair, replacement, rehabilitation, or improvement of streets, roads, highways, sidewalks, street and road lighting systems, traffic signals, bridges, domestic water systems, storm and sanitary sewer systems, and planning, construction, reconstruction, repair, rehabilitation, or improvement of parks.

The Final Bill Report for ESB 6408 states in part:

(2) the definition of “capital project” does not include recreational facilities, law enforcement facilities, fire protection facilities, trails, libraries, administrative and/or judicial facilities, or river and/or waterway flood control projects.

The legislative history also includes a March 18, 1992 letter from the Chair of the House Local Government Committee to the Governor asking that he sign ESB 6408 into law as enacted. From review of that letter, it is clear the Legislature intended REET 2 funds to be more restricted than REET 1. The letter states in part:

EWB 6408 somewhat restricts the uses of receipts from the first local option one quarter percent real estate excise tax and further restricts the uses of receipts from the second local option one quarter percent real estate tax . . .

ESB 6408 is a delicate compromise and should be signed into law.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work in cooperation with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office has 300 employees who are located around the state to deliver our services effectively and efficiently. Approximately 65 percent of our staff are certified public accountants or hold other certifications and advanced degrees.

Our regular audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. We also perform fraud and whistleblower investigations. In addition, we have the authority to conduct performance audits of state agencies and local governments.

The results of our audits are widely distributed through a variety of reports, which are available on our Web site. We continue to refine our reporting efforts to ensure the results of our audits are useful and understandable.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive program to coordinate audit efficiency and to ensure high-quality audits.

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