



# Washington State Auditor's Office

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## Accountability Audit Report

# City of Seattle

King County

For the period July 1, 2013 through June 30, 2014

Published June 18, 2015

Report No. 1014517





## Washington State Auditor's Office

June 18, 2015

Mayor and City Council  
City of Seattle  
Seattle, Washington

### Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for City operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

The attached comprises our report on the City's compliance and safeguarding of public resources. Our independent audit report describes the overall results and conclusions for areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

JAN M. JUTTE, CPA, CGFM  
ACTING STATE AUDITOR  
OLYMPIA, WA

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## AUDIT SUMMARY

### Results in brief

In most areas we audited, City operations complied with applicable requirements and provided adequate safeguarding of public resources. The City also complied with state laws and regulations and its own policies and procedures in the areas we examined.

However, we identified areas in which the City could make improvements.

We recommended that the Light Department comply with state law regulating procurement for public works projects and software purchases.

These recommendations were included in our report as a finding.

### About the audit

This report contains the results of our independent accountability audit of the City of Seattle from July 1, 2013 through June 30, 2014.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

Our audit involved performing procedures to obtain evidence about the City's uses of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters.

In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance.

The following areas were examined during this audit period:

- Seawall and First Hill Streetcar projects – contract payments, change orders, time support, mitigation
- Seattle Center parking garage revenue-progress since prior audit
- Cost allocations to the Seattle Conservation Corps
- Property and liability self-insurance
- Performance-based energy savings contracting
- Department of Finance and Administrative Services interfund charges
- Search for payments to fictitious vendors
- Payroll fraud risk – new hires, unemployment and industrial insurance benefits
- Credit card processes-consistency with policy and documentation
- Search for duplicate payments to multi-government funded nonprofits
- Change orders – King Street Station and Bridge projects
- Department of Transportation interfund charges
- Job order contracting
- Open public meeting minutes

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2014-001 The City of Seattle Light Department inappropriately used the energy saving performance contracting method to build a new building and to purchase maintenance software.**

#### *Background*

State law requires that cities bid certain public works and use a competitive process for software purchases. Alternatively, state law authorizes performance-based energy savings contracts (ESPC) for energy equipment and services when the value of the energy savings exceeds the cost of equipment or services. Essentially, this contracting alternative is for projects where the energy savings are sufficient to cover the cost of the project.

The focus of ESPC authority is on energy saving equipment and services, not for the construction of a new building or for the purchase of nonenergy management systems software. When using this procurement authority, the payment to the contractor is generally limited to a percentage of the annual energy savings, or the savings are to be guaranteed by a bond or insurance policy or a similar guarantee.

#### *Description of Condition*

The Light Department inappropriately used ESPC procurement for a public works project and a software purchase.

The public works project included demolition and replacement of a vacant building, and conversion and expansion of a vacant warehouse into office, warehouse and shop space. Energy savings estimates were not based on actual consumption, but the difference between building to basic or higher efficiency energy code standards.

The public works project did not result in energy savings significant to the cost of the project. The project cost approximately \$8.5 million. The contractor prepared a cash flow analysis projecting total savings for 30 years to be \$272,009. ESPC contracting should not have been used as most of the contract was not for energy equipment or services but instead was for public works construction.

The software purchase was for a facility issue management system used for building maintenance control. The \$258,996 facility issue control system is not energy equipment or services or an energy management system. It should not have been purchased using an ESPC contract. The City does not have support demonstrating that the system energy savings cover the cost of the system. The

proposal for the contract estimates that it will result in 1 percent energy savings, but it does not describe the basis for the estimate. There is no proposed method for measuring the resulting energy savings.

### ***Cause of Condition***

City is unfamiliar with the use of this contracting authority

### ***Effect of Condition***

The Light Department bypassed internal controls for public works projects which resulted in inappropriate use of ESPC contracting authority and noncompliance with public works and electronic data processing procurement requirements. Because the projects did not go through a transparent, open, competitive process potential bidders were denied opportunity to bid and the City cannot demonstrate that it is getting the best work at the lowest price. Further, the City cannot demonstrate that energy savings are greater than the cost of these contracts.

### ***Recommendation***

We recommend that the Light Department comply with state law regulating procurement for public works projects and software purchases.

### ***City's Response***

*The City is appreciative of the evaluation of the State Auditor's Office. The City would like to conduct a legal review of laws pertaining to these types of contracts to ensure that compliance is met and standard protocols and processes are in place for future contracts of this nature.*

### ***Auditor's Remarks***

We appreciate the City's commitment to resolve the identified condition and thank City personnel for their cooperation and assistance during the audit.

### ***Applicable Laws and Regulations***

Chapter 39.35A RCW, Performance-Based Contracts For Water Conservation, Solid Waste Reduction, And Energy Equipment.

RCW 39.35A.010, Findings. The legislature finds that:

- (1) Conserving energy and water in publicly owned buildings will have a beneficial effect on our overall supply of energy and water;
- (2) Conserving energy and water in publicly owned buildings can result in cost savings for taxpayers; and

(3) Performance-based energy contracts are a means by which municipalities can achieve energy and water conservation without capital outlay. Therefore, the legislature declares that it is the policy that a municipality may, after a competitive selection process, negotiate a performance-based energy contract with a firm that offers the best proposal.

RCW 39.35A.020 Definitions.

Unless the context clearly indicates otherwise, the definitions in this section shall apply throughout this chapter.

(1) "Energy equipment and services" means energy management systems and any equipment, materials, or supplies that are expected, upon installation, to reduce the energy use or energy cost of an existing building or facility, and the services associated with the equipment, materials, or supplies, including but not limited to design, engineering, financing, installation, project management, guarantees, operations, and maintenance. Reduction in energy use or energy cost may also include reductions in the use or cost of water, wastewater, or solid waste.

(2) "Energy management system" has the definition provided in RCW 39.35.030.

(3) "Municipality" has the definition provided in RCW 39.04.010.

(4) "Performance-based contract" means one or more contracts for water conservation services, solid waste reduction services, or energy equipment and services between a municipality and any other persons or entities, if the payment obligation for each year under the contract, including the year of installation, is either: (a) Set as a percentage of the annual energy cost savings, water cost savings, or solid waste cost savings attributable under the contract; or (b) guaranteed by the other persons or entities to be less than the annual energy cost savings, water cost savings, or solid waste cost savings attributable under the contract. Such guarantee shall be, at the option of the municipality, a bond or insurance policy, or some other guarantee determined sufficient by the municipality to provide a level of assurance similar to the level provided by a bond or insurance policy.

(5) "Water conservation" means reductions in the use of water or wastewater.

RCW 39.35A.030 Performance-based contracts for water conservation services, solid waste reduction services, and energy equipment and services.

(1) Each municipality shall publish in advance its requirements to procure water conservation services, solid waste reduction services, or energy equipment and services under a performance-based contract. The announcement shall state concisely the scope and nature of the equipment and services for which a performance-based contract is required, and shall encourage firms to submit proposals to meet these requirements.

(2) The municipality may negotiate a fair and reasonable performance-based contract with the firm that is identified, based on the criteria that is established by the municipality, to be the firm that submits the best proposal.

(3) If the municipality is unable to negotiate a satisfactory contract with the firm that submits the best proposal, negotiations with that firm shall be formally terminated and the municipality may select another firm in accordance with this section and continue negotiation until a performance-based contract is reached or the selection process is terminated.

RCW 39.35A.040 Application of other procurement requirements.

If a municipality chooses, by resolution or other appropriate mechanism, to negotiate a performance-based contract under this chapter, no otherwise applicable statutory procurement requirement applies.

RCW 39.35.030 Definitions.

For the purposes of this chapter the following words and phrases shall have the following meanings unless the context clearly requires otherwise:

(5) "Energy management system" means a program, energy efficiency equipment, technology, device, or other measure including, but not limited to, a management, educational, or promotional program, smart appliance, meter reading system that provides energy information capability, computer software or

hardware, communications equipment or hardware, thermostat or other control equipment, together with related administrative or operational programs, that allows identification and management of opportunities for improvement in the efficiency of energy use, including but not limited to a measure that allows:

- (a) Energy consumers to obtain information about their energy usage and the cost of energy in connection with their usage;
- (b) Interactive communication between energy consumers and their energy suppliers;
- (c) Energy consumers to respond to energy price signals and to manage their purchase and use of energy; or
- (d) For other kinds of dynamic, demand-side energy management.

## RELATED REPORTS

### Financial

Our opinion on the City's financial statements is provided in a separate report issued in June 2014, which includes the City's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

That report includes a finding for a significant deficiency in internal controls over financial reporting regarding timely account reconciliations by the Seattle City Employees' Retirement System.

### Federal grant programs

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the City's major federal programs, which are listed in the Federal Summary section of the financial statement and single audit report issued in September 2014. That report includes four federal findings regarding internal controls over and compliance with requirements applicable to U.S. Departments of Housing and Urban Development; Health and Human Services; Energy; and Homeland Security grants. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

### Special investigations

We noted certain matters that we communicated to City management in a letter dated January 2015, relating to a loss of public funds. We appreciate the City's commitment to resolving those matters.

### Other reports

We performed an agreed-upon-procedures examination issued April 13, 2015 which covered the accuracy and completeness of pensionable wages and contributions reported to the Washington State Department of Retirement Systems for the year ended June 30, 2013.

We also conducted a separate audit to examine Seattle City Light, a fund within the City of Seattle, compliance with the requirements of the Energy Independence Act codified in the Revised Code of Washington (RCW) 19.285.040.

These other reports are available on our website, <http://portal.sao.wa.gov/ReportSearch>.

## INFORMATION ABOUT THE CITY

The City of Seattle is the largest city in King County and the state, with a population of over 600,000 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 2014 was approximately \$4.4 billion, including \$1 billion for the General Fund.

The City has approximately 11,400 employees and provides a full range of services including water, drainage and wastewater, solid waste, electric power, police, Municipal Court, fire, emergency medical, parks and recreation (including four golf courses), planning and economic development and municipal libraries.

### Contact information related to this report

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*Information current as of report publish date.*

### Audit history

You can find current and past audit reports for the City of Seattle at <http://portal.sao.wa.gov/ReportSearch>.

## 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.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

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.

Our 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. In addition, we conduct performance audits of state agencies and local governments as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

<b>Contact information for the State Auditor's Office</b>	
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