



**Washington State Auditor's Office**

**Troy Kelley**

**Integrity • Respect • Independence**

## **Accountability Audit Report**

# **City of Des Moines**

**King County**

**For the period January 1, 2013 through December 31, 2013**

**Published December 1, 2014**

**Report No. 1013070**





# Washington State Auditor

## Troy Kelley

December 1, 2014

Council  
City of Des Moines  
Des Moines, 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,

TROY KELLEY  
STATE AUDITOR

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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 over monitoring the City's financial situation.

We recommended the City:

- Adopt and follow a formal comprehensive plan that includes detailed financial benchmarks and guidelines to specifically meet the needed funding requirements.
- Closely monitor and evaluate its financial activities to ensure the plan is being followed and the desired results are achieved.
- Revised the plan as needed to resolve the funding issues.

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 Des Moines from January 1, 2012 through December 31, 2013.

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:

- Financial condition
- Municipal Court – adjustments and system access
- Third party cash receipting
- Procurement – public works projects
- Credit card purchases
- Police Department – property room and citations
- Cash receipting – marina
- Small and attractive assets

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

**1. The City’s financial condition has continued to decline, which puts it at risk for not being able to meet its financial obligations and maintain current service levels.**

*Background*

The City provides the following services: police, community development, parks and recreation, engineering, streets, surface water management, Municipal Court and maintains a marina, as well as other administrative services. Over the past four years, the City’s General Fund ending fund balance has been diminishing due to the downturn in the economy and declining tax revenues.

*Description of Condition*

In the prior audit, we communicated to the Council the need to monitor the City’s financial condition. As of October 2014, the City has not taken steps to address our previous recommendations. The City’s financial condition has continued to decline as the City has not effectively controlled costs in relation to reduced revenues.

The following table depicts how the City’s General Fund net income and ending fund balance has declined for three of the past four years:

| In Thousands        |             |             |             |             |
|---------------------|-------------|-------------|-------------|-------------|
|                     | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> |
| Revenues            | \$23,153    | \$19,816    | \$15,095    | \$16,463    |
| Expenditures        | \$14,194    | \$15,242    | \$15,150    | \$16,212    |
| Net Income (Loss)   | \$ 8,239    | \$ 4,574    | \$ (55)     | \$ 251      |
| Ending Fund Balance | \$1,553     | \$989       | \$960       | \$979       |

The City’s fund balance sufficiency, which reflects the number of days the City can remain in operation based on its General Fund fund balance and General Fund expenditures assuming no further revenues are received, has declined steadily over the past four years; from 38 days in 2010 to 21.9 days in 2013.

Thus, if no further revenues had been generated in 2014, at the given level of 2013 expenditures, the City’s fund balance would have been exhausted in 21.9 days.

During our audit, we noted that the General Fund is using anticipated project revenues to subsidize its general operations, specifically permitting revenues on the Des Moines Creek Business Park (DMCBP). The 2014 budget projections for the General Fund are as follows:

|                             |                  |
|-----------------------------|------------------|
| Recurring revenues          | \$16,017,971     |
| Major Projects revenues     | <u>2,525,051</u> |
| Total budgeted revenues     | \$18,543,022     |
| Recurring expenditure       | \$17,864,551     |
| Major Projects expenditures | <u>194,078</u>   |
| Total budgeted expenditures | \$18,058,629     |

However, the major project revenues are based on various construction projects, of which project activities have not been significant. Based on the City's budget and accounting records for 2014, we noted following discrepancies exist:

| Project                                | 2014 Revenue Budget | Revenues collected through September 2014 | Estimates of additional collections through year-end |
|--|---------------------|---|--|
| Artemis Hotel                          | \$282,235           | \$66,780                                  | \$151,805  |
| Des Moines Creek Business Park (DMCPB) | 1,344,959           | 307,976                                   | \$726,386  |
| Barcelona Mixed Uses                   | <u>897,857</u>      | <u>0</u>                                  | <u>0</u>   |
| Totals                                 | \$2,525,051         | \$374,656                                 | \$878,191  |

As a result, less than 15 percent of the anticipated revenues from the construction projects have actually materialized as of September 2014.

Projecting the impact the shortage of collections of budgeted revenues will have on the General Fund fund balance for year-end December 31, 2014, we anticipate the following:

|                                     | With DMCBP project | Without DMCBP project |
|-------------------------------------|--------------------|-----------------------|
| Beginning General Fund fund balance | \$979,907          | \$979,907             |
| Revenues                            | 16,903,224         | 16,499,858            |
| Expenditures                        | <u>17,581,549</u>  | <u>17,581,549</u>     |
| Ending General Fund fund balance    | \$301,582          | \$(101,784)           |

If the project does not come through, the City's General Fund will be in a deficit as of December 31, 2014.

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

The City has experienced a loss in tax revenues and other financial challenges due to the downturn in the economy. The City took steps to increase its revenue base, however these actions are long-term and do not address the immediate cash needs of the City. The City's steps to cut costs have not been sufficient to keep pace with the decline in revenues. General Fund expenditures have actually increased in three of the four years as shown above.

Further, the City has not adopted and followed a comprehensive plan that includes detailed financial benchmarks and guidelines to specifically meet the needed funding requirements. The City has not closely monitored and evaluated its activities to ensure the plan is being followed and the desired results are achieved.

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

The City is at risk of not being able to meet financial obligations at current service levels. This could result in the City needing to obtain bank loans or find other sources of funding, which may be an additional cost to taxpayers.

### ***Recommendation***

We continue to recommend the City:

- Adopt and follow a formal comprehensive plan that includes detailed financial benchmarks and guidelines to specifically meet the needed funding requirements.
- Closely monitor and evaluate its financial activities to ensure the plan is being followed and the desired results are achieved.
- Revised the plan as needed to resolve the funding issues.

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

*The City of Des Moines respectfully disagrees that the steps the City has taken to address its financial situation, particularly the level of expenditure reductions and deferrals that have been implemented in the past three to four years, justify the finding that has been proposed. When the Legislature eliminated the Sales Tax Equalization Program, the City lost a significant revenue source. In 1999, Sales Tax Equalization revenue totaled \$1,667,000, representing 14.3% of the City's General and Street Fund revenue. If this program had not been eliminated, this revenue, for 2014, is estimated to have been in the range of \$2,800,000.*

*Since 1999, the City has worked diligently to increase revenues and keep expenses in check while ensuring that all the services that our residents expect—and in fact demand—are maintained at an acceptable level. Over the last ten years, the City Council has taken numerous actions to create a more inviting development environment in Des Moines by changing and relaxing dozens of development regulations and authorizing an Economic Development position to work directly with the development community to attract business. The Council has also maximized the use of just about every councilmanic revenue that is allowed under state law—including B&O taxes, Transportation Benefits District vehicle assessments, gambling taxes, utility taxes etc.—to balance its budget. All the while, the Legislature has continued to deal with its budget problems by, in part, diverting revenues that have historically gone to cities. For example liquor revenues Des Moines received in fiscal years 2012, 2013, and 2014 were \$272,065 less than what would have occurred had the Legislature not taken those funds. In 2015, we expect liquor funds to be at least \$65,767 less than what they should be. In addition, the Legislature has swept Public Works Trust Fund revenues into its General Fund, forcing cities to use other revenues to construct vital public works projects or to simply forgo them entirely.*

*Cities in Washington have seen their costs go up because of actions taken at the state and county level. PERS pension costs in 2015 could increase to 12.29% from 9.03%. In the early 2000's, the Legislature decided to keep pension funds artificially low—at 1.0% or less—to help balance its budget. While cities did benefit as a result, this “kick-the-can-down-the-road” approach is partially to blame for this potential increase of over three percentage points in 2015. Each percentage point increase in pension costs equals \$97,000 of additional expense to the City's General and Street Funds.*

*The City (and in fact all King County cities) are seeing additional prosecution and jail costs as a result of the King County Prosecutor deciding not to file felony charges against people accused of certain crimes—particularly theft and robbery charges where the amounts stolen are above felony levels but below \$5,000-\$10,000. This decision is simply a way for the King County Prosecutor to lower his overall costs. However, the victims of these crimes then turn to the cities to file misdemeanor or gross misdemeanor charges in our municipal courts.*

*The City has reduced and deferred numerous expenses throughout the last ten years, always with an eye toward the bottom line, cash flow, and service delivery.*

- In 2010, the City changed its medical insurance provider to lower costs and changed again in 2013 when costs from the new provider were projected to increase 31%. For 2015, we negotiated with our employee groups a greater employee contribution toward premiums for the 2015 and 2016 years.*
- Beginning in 2008, the City Council has steadily reduced positions in all departments. Also, some positions in the Police Department (including four police*

*officer positions) have left unfilled. In 2008, the City's FTE count in the General (including police positions funded by a Levy Lid Lift approved by voters in 2006) and Street Funds was 142.7. The FTE count for 2014 is 112, a reduction of 30.7 positions or 21.5% of all positions.*

- Contributions to equipment replacement funds have been cut or reduced.*
- We contract for landscape maintenance and provide Court, prosecution, and senior services to the City of Normandy Park.*
- In 2009, seven cities in south King County, including Des Moines, built a misdemeanor jail that has resulted in our jail costs being one-third of what they were in 2007, our highest jail expense year.*

*When draconian budget cuts to the Park and Recreation programs were proposed in 2008, residents filled the Council chambers and made it quite clear that these services were vital to the well being of our community and that budget reductions must cut across all City departments, not just one or two. The City Council has worked very hard to make sure that we maintain the highest possible level of services given the realities of our revenue situation. The State Auditor finds that Des Moines has been relying on one-time revenues to balance its budget and the City does not dispute that. It was also pointed out that there are revenues from one-time projects in the 2014 budget that have not fully come in yet. The City acknowledges this as well. However, there are still two months left in the fiscal year and we are seeing an uptick in onetime sales and B&O tax revenue from two of these projects (the DMCBP and the Sheraton Hotel). Also, the DMCBP land clearing and grading started two months later than expected because of a delay in the Port of Seattle finalizing the land lease with the developer, Panattoni. Building permit issuance will occur later in 2014 than we anticipated because of the delay in finalizing the land lease and a change to the City's development agreement with the Port but the permits will be issued this year.*

*The City is fully aware of cash flow and fund balance issues created by these projects being delayed and is ready to take the necessary steps to keep the General Fund ending fund balance and cash flow positive. There are several options open to the City. For example, the City could use excess Real Estate Excise Tax (REET) revenue on a temporary basis to support Park Maintenance in the General Fund. RCW 82.46.010(7) allows cities to use \$100,000 or 35%, which ever is greater but no more than \$1,000,000, of REET revenues for operations and maintenance of capital projects. Another option is an interfund loan from either the Surface Water Capital Fund fund balance or the Equipment Replacement Fund fund balance. At this time, the City intends to use approximately \$300,000 of excess REET revenue to support Park Maintenance operations in the General Fund.*

*The State Auditor noted that the City has not adopted and followed "a comprehensive plan that includes detailed financial benchmarks and guidelines to specifically meet the needed*

*funding requirements.” In addition, the Auditor states that “the City has not closely monitored and evaluated its activities to ensure the plan is being followed and desired results are achieved.” The City agrees that it has not adopted a formal written plan but disagrees that a formal finding is warranted. The City further asserts that having a written plan, while informative and being a guide to future possibilities, does not mean that the City Council and staff are not closely monitoring and evaluating activities. Revenues and expenditures are reviewed each month for all departments by the Finance Department and City Manager. Each department director reviews his or her revenues and expenditures each month. In addition, steps are taken to keep numerous line items below budget, for instance overtime in the Police Department. Positions that become vacant during the year or were authorized in the budget but are not yet needed (e.g. the Plans Examiner/Building Inspector position), have been kept open to reduce costs. Councilmembers are kept aware of the trends in revenues and expenditures and are prepared to take the actions necessary to maintain adequate fund balances.*

*While we see great potential for economic development in our community, until we have more projects break ground, providing us more certainty regarding the long-term prospects for a stronger, more stable on-going revenue stream, it makes no sense to adopt even mid-range plans that could quickly become unreliable and obsolete. It makes more sense to the City to stay acutely aware of both revenue and expense trends on an on-going basis, as we have been for many years, allowing us to direct available resources to address these complex trends and assure fiscally prudent outcomes.*

### ***Auditor’s Remarks***

The State Auditor’s Office is committed to working in partnership with the City to ensure the accountability for the use of public funds. During our audit, we have considered the information provided by the City. However, the City’s financial condition has continued to decline, specifically for three of the past four years, the City’s General Fund net income and ending fund balance has declined, revenues have decreased, and expenditures have increased as shown above. Therefore, the City is at risk of not being able to meet financial obligations at current service levels. The City should continue to actively monitor and evaluate its activities to ensure it meets the needed funding requirements. Further, the City should ensure that funds are used within applicable laws and regulations.

We reaffirm our finding and will review the City’s correction action during our next audit.

## RELATED REPORTS

### **Financial**

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

### **Federal grant programs**

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the City's major federal program, which is listed in the Federal Summary section of the financial statement and single audit report.

### **Special investigations**

We noted certain matters that we communicated to City management in a letter dated November 2014, relating to misappropriation of public assets related to the Parks, Recreation, and Senior Services department. We appreciate the City's commitment to resolving those matters.

## INFORMATION ABOUT THE CITY

The City of Des Moines serves approximately 30,000 citizens in south King County. The City has a council-manager form of government. The seven Council Members are elected to staggered, four-year terms. Every two years, the Council selects one of its members as Mayor.

The City's 2013 general operating expenditures were approximately \$26 million. Approximately 140 employees provide police, community development, parks and recreation, engineering, streets, surface water management, Municipal Court and certain administrative services. The City also operates a marina on Puget Sound. Other entities provide additional services such as fire, emergency medical, water, sewer, solid waste and library.

| <b>Contact information related to this report</b> |  |
|---|--|
| Address:  | City of Des Moines<br>21630 11th Avenue S.<br>Des Moines, WA 98188 |
| Contact:  | Paula Henderson, Finance Director                                  |
| Telephone:  | (206) 870-6512   |
| Website:  | <a href="http://www.desmoineswa.gov">www.desmoineswa.gov</a>       |

*Information current as of report publish date.*

### **Audit history**

You can find current and past audit reports for the City of Des Moines 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> |  |
|---|--|
| <b>Deputy Director for Communications</b>                 | Thomas Shapley<br><a href="mailto:Thomas.Shapley@sao.wa.gov">Thomas.Shapley@sao.wa.gov</a><br>(360) 902-0367 |
| <b>Public Records requests</b>                            | (360) 725-5617   |
| <b>Main telephone</b>                                     | (360) 902-0370   |
| <b>Toll-free Citizen Hotline</b>                          | (866) 902-3900   |
| <b>Website</b>  | <a href="http://www.sao.wa.gov">www.sao.wa.gov</a>   |