



Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report

Thurston County

For the period January 1, 2021 through December 31, 2022

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**Office of the Washington State Auditor
Pat McCarthy**

May 20, 2024

Board of Commissioners
Thurston County
Olympia, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The Office of the Washington State Auditor 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 County operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

Attached is our independent audit report on the County's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and value your cooperation during the audit.

Sincerely,

Pat McCarthy, State Auditor
Olympia, WA

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AUDIT RESULTS

Results in brief

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, County operations complied, in all material respects, with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources.

As referenced above, we identified areas where the County could make improvements. These recommendations are included with our report as a finding.

In keeping with general auditing practices, we do not examine every transaction, activity, policy, internal control, or area. As a result, no information is provided on the areas that were not examined.

About the audit

This report contains the results of our independent accountability audit of Thurston County from January 1, 2021 through December 31, 2022.

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.

This audit was conducted under the authority of RCW 43.09.260, which requires the Office of the Washington State Auditor to examine the financial affairs of all local governments. Our audit involved obtaining evidence about the County's use of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters. The procedures performed were based on our assessment of risks in the areas we examined.

Based on our risk assessment for the years ended December 31, 2022 and 2021, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. We examined the following areas during this audit period:

- Assessor's Office – property tax valuations and billings, exemptions and deferrals and new construction appraisals
- District Court – cash receipting, adjustments, and trust account activity
- Procurement – public works and purchases
- Compliance with public work projects – prevailing wages, change orders, and retainage requirements
- Use of restricted funds – real estate excise taxes, veterans relief funds, Blake decision funds, and impact fees

- Interfund loan compliance
- Cash receipting – timeliness and completeness of deposits, voids and adjustments at various County locations
- Payroll – gross wages, leave balances and accruals and benefit deductions
- Accounts payable – general disbursements, fuel cards and electronic funds transfers
- Accounts receivable – utility billing and adjustments
- Tracking and monitoring of theft sensitive assets, such as computers, tools, equipment, and fuel
- Budget compliance
- Self-insurance for unemployment
- Open public meetings – compliance with minutes, meetings and executive session requirements
- Financial condition – reviewing for indications of financial distress

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

Thurston County January 1, 2021 through December 31, 2022

2022-001 The County did not comply with state procurement laws and improperly used Real Estate Excise Tax 1 funds.

Background

During 2022, Thurston County relocated several of its administrative offices and departments to a leased building. Before relocating, the County funded the remodel of the building, as well as the furniture and equipment to furnish it, with Real Estate Excise Tax 1 (REET 1) funds. In 2022, the County's REET revenues and expenditures totaled \$8,942,919 and \$10,623,486, respectively.

Procurement

State law (RCW 36.32.250) requires counties to use a formal competitive bidding process for all public works projects costing more than \$350,000. Under RCW 39.04.010, "public work" includes "all work, construction, alteration, repair or improvement other than ordinary maintenance, executed at the cost of the state or of any municipality."

Restricted Funds – REET 1

State law (RCW 82.46.010) requires REET 1 funds to be used exclusively for capital projects, which are defined as "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; parks; recreational facilities; law enforcement facilities; fire protection facilities; trails; libraries; administrative facilities; judicial facilities . . . and technology infrastructure that is integral to the capital project."

Description of Condition

Procurement

During the audit period, the County entered into a lease agreement with a private property owner (lessor) for a building to house various departments. This project was referred to as the “Atrium Building.” As part of the lease agreement, the County required the lessor to remodel the building to the County’s specifications. The lessor was to make the leasehold improvements to the building and be reimbursed for the cost of improvements in full by the County within 30 days of submitting requests for reimbursement. In 2022, the County paid a total of \$7,520,429 to the lessor for leasehold improvements. The County did not require the lessor to competitively bid this project, as required by state law when a project is executed at the cost of the local government.

The County also purchased furniture and equipment for the Atrium Building. The total cost for all furniture and equipment was \$1,855,201. For most of the furniture and equipment purchased, the County followed required competitive bid procedures. However, the County approved an amendment to this purchase to add \$242,224 of furniture and equipment items that were not included in the original contract. Since these items were not included in the original contract, the County was required by state law to separately procure them to ensure it received the best items at the most reasonable prices and that fair and open competition was available to all interested bidders.

Restricted Funds – REET 1

The County funded the Atrium Building project, and the furniture and equipment using REET 1 funds. Under state law, local governments may only use REET 1 funds for capital projects that are listed in their Capital Improvement Plans (CIPs). Our audit found the furniture and equipment purchased for \$1,855,201 do not meet state law’s definition of a capital project that is an allowable use of REET 1 funds. As such, we determined the purchase of furniture and equipment was not an allowable use of REET 1 funds.

The County accounts for REET 1 revenues and expenses in a separate fund in its general ledger. We noted that the County issued a \$5.6 million interfund loan to the REET 1 fund in 2021. The County repaid this loan in June 2023, but it left the REET 1 fund with a negative cash balance. The County continued to pay its budgeted capital expenditures out of this fund throughout the rest of the year, which resulted in the fund having a negative ending cash balance of about \$327,000 at the end of 2023.

Cause of Condition

County officials said they thought they were following applicable requirements and state laws based on their interpretation of them and their own policies, as well as the legal advice they received regarding the Atrium Building project and use of REET 1 funds for furniture and equipment.

Additionally, while County officials were aware of the negative cash balance in the REET 1 fund, they did not have an effective process in place to ensure the fund was self-sufficient.

Effect of Condition

The County did not perform competitive bidding when it used \$7.5 million of REET 1 revenue to make leasehold improvements on a building it was leasing. Additionally, the County did not perform competitive bidding for \$242,224 of furniture and equipment that it purchased through a contract amendment. State bid laws are designed to protect public resources, promote openness in government, and prevent fraud, collusion and favoritism in the awarding of public contracts. Since the County did not follow these laws, it cannot be sure it obtained the goods and services at the most reasonable prices, or that it gave all interested contractors or vendors an opportunity to bid.

The County used \$1,855,201 of REET 1 funds to purchase furniture and equipment for the Atrium Building, which was not an allowable use of these revenues. When the County uses restricted revenues for unallowable purposes, the public does not receive the full intended benefit of the revenue.

In addition, funds with negative cash balances represent unauthorized interfund loans, which resulted in the REET 1 fund benefiting at the expense of other funds.

Recommendation

We recommend the County establish additional controls and procedures to ensure compliance with state law when procuring public works projects and goods with public funds.

We further recommend the County repay \$1,855,201 to the REET 1 fund for the unallowable furniture and equipment expenses that it charged to this fund.

The County should also establish a process to ensure funds do not have negative cash balances. Specifically, the County should take the necessary steps to bring the REET 1 fund to a positive cash balance.

County's Response

Thurston County appreciates the State Auditor's (SAO) careful review of the procurement processes and expenditures associated with the relocation of administrative offices to a leased space. The County had absolutely every intention of following state law and sought legal guidance and extensive consultation to gather information for decision making. The analysis is complex with nuances in language that are subject to interpretation.

Procurement

After exercising due diligence, the County believes it acted in good faith when it reached the conclusion the administration building (Atrium) tenant improvements did not require competitive bidding. This was because the improvements were completed by a private property owner on their property. The Atrium is not owned by the County, nor will it revert to the County at the end of the lease.

The County's Central Services department reached the determination the Atrium tenant improvements did not require competitive bidding after:

- 1. Careful review of state law, including:*
 - Chapter 39.04 RCW*
 - Chapter 39.12 RCW*
 - Chapter 82.46 RCW*
 - Chapter 84.04 RCW*
- 2. Washington State Office of the Code Reviser Bill Drafting Guide Review of the Municipal Research and Services Center (MRSC) County Bidding Book*
- 3. Review of lease agreements with similar terms entered into by the Department of Enterprise Services*
- 4. Consultation with:*
 - County legal counsel*
 - Municipal Research and Services Center (MRSC)*
 - Department of Enterprise Services Real Estate Services staff*
 - Attorney General's Office staff representing the Department of Enterprise Services.*

The County shared its legal analysis with the SAO as part of this audit process; however, the SAO's analysis reached a different conclusion. It is the County's understanding the issue is the fact the County's lease agreement (which provided for tenant improvements) used a direct reimbursement model to save taxpayer

dollars, where the landlord was reimbursed for the cost of the tenant improvements at the outset. If the County structured the lease using an amortization model, where the rental payments were increased to reimburse the landlord over time, competitive bidding is not required.

As this was an issue about how the Atrium lease was structured, the County does not believe the public was negatively impacted by a lack of competition for the tenant improvements. The County opted for this structure because it resulted in a lower cost to the public. The County appreciates the SAO's analysis and will consider the recommendations for bidding requirements going forward.

The audit identified a change order for glass panels that were not bid. While the total authorized contract amount for the Atrium was never exceeded, and there were some panels in the bid document, the County acknowledges that the contract amendment to add additional glass panels was not included in the original contract. The County appreciates the SAO's careful review and will enhance its procurement processes to ensure compliance.

Restricted Funds

The County's analysis of state law led the County to reach the conclusion that the purchase of furniture and equipment associated with a capital project was an allowable use of Real Estate Excise Tax (REET) funds. The legislature has declared that its intent in limiting the use of proceeds of the real estate excise tax to local capital improvements was "to include in such expenditures the acquisition of real and **personal property** associated with such local capital improvements." The furniture and equipment purchased was necessary for the functioning of the administrative building.

The County believes personal property, such as furniture or equipment for the building, **is associated with the capital project** as defined in RCW 82.46.010(6)(b). In making this determination the county relied upon the explicit intent language of the statute.

RCW 82.46.010 was amended to include an intent section that states the following:
Finding—Intent—Effective date—2021 c 296: See notes following RCW 82.14.310.

The legislature declares that, in section 13, chapter 49, Laws of 1982 1st ex. sess., effective July 1, 1982, its original intent in limiting the use of the proceeds of the tax authorized in RCW 82.46.010(2) to "local capital improvements" was to include in such expenditures the acquisition of real and personal property associated with such local capital improvements. Any such expenditures made by cities, towns, and counties on or after July 1, 1982, are hereby declared to be authorized and valid.

This section states the legislative intent, which is to include acquiring personal property, (furniture and equipment) associated with capital improvements.

The Bill Drafting Guide addresses “Intent Sections” as important. They influence how an act will be interpreted. If you are considering an intent section, follow these guidelines.

(a) Ask whether you really need an intent section. An intent section may be used, for example, to direct the courts to “construe this act liberally so as to effectuate its broad remedial purposes” or, just the opposite, to tell them that “this act should be construed narrowly to protect the civil liberties of those affected by it.” It may guide courts or administrative agencies by explaining the bill's core purposes. But when an intent section is used to clarify an ambiguity that could be solved by editing, or worse, just to explain why the bill is good, you run the risk of creating ambiguities that in turn may be interpreted as granting causes of action that the drafter never intended.

In short, the intent section clarifies what appears to be an ambiguity in a statute: here, the definition section of REET. The Code Reviser considers these intent sections to be important and to aid in interpreting a statute.

The word “associated” is not defined in the statute and does not appear anywhere else in chapter 82.46 RCW, so the word should be given its plain meaning. Merriam Webster defines “associated” as “related, connected, or combined together.”

Here, the administrative building needs furniture and equipment to be functional. The workstations were assembled and specifically designed for the space. Many components of the workstations are affixed to the walls. It is reasonable under the statute that the furniture and equipment is considered personal property and is “associated” (related, connected, or combined) with the administrative building, and the County believed it was a proper use of REET funds based on the statute and its intent section. Although the County and the State Auditor’s Office differ in their interpretation of state law, the County will consider the State Auditor’s recommendation.

The REET 1 fund had a temporary negative cash balance because of a steep decline in expected REET revenue from the slowdown in the housing market. The County developed a plan to bring the fund and cash balance positive. The board held a briefing to discuss a plan regarding a temporary negative balance. The plan was to transfer funds from building reserve funds and unrestricted interest earnings to REET1 after the adoption of the budget amendment on December 15, 2023. At the end of the fiscal year the fund balance was positive. There was one transfer that

was accidentally missed and processed in early January with a December effective date, resulting in a positive fund balance but a negative cash balance on December 31, 2023.

No other fund was impacted or lost interest earnings during the temporary period of the negative cash balance. REET interest earning (or charges) are redirected or swept to the general fund. Only the general fund was impacted by negative interest charges.

The County commits to improve our monitoring processes by involving the County Auditor and the Financial Management Committee in providing information for decision-making.

Auditor's Remarks

We thank the County for its cooperation throughout the audit. Our audits are conducted in accordance with state law, and we reaffirm our finding. We understand the complexity of this project and the steps the County took to manage the project as described in their response. We will review the status of the County's corrective action during our next audit.

Applicable Laws and Regulations

Budgeting, Accounting and Reporting System (BARS Manual), 3.1.9, Bank Reconciliations.

Budgeting, Accounting and Reporting System (BARS Manual), 3.9.1, Interfund Loans.

RCW 36.32.250 – Competitive bids—Contract procedure—Contracts under forty thousand dollars—Small works roster process. (Effective until July 1, 2024.)

RCW 39.04.010 – Public works – Definitions. (Effective until July 1, 2024.)

RCW 82.46.010 – Tax on sale of real property authorized—Proceeds dedicated to local capital projects—Additional tax authorized—Maximum rates.

RELATED REPORTS

Financial

Our opinion on the County's financial statements and compliance with federal grant program requirements is provided in a separate report, which includes the County's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

Federal grant programs

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the County's major federal programs, which are listed in the Schedule of Findings and Questioned Costs section of the separate financial statement and single audit report. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

Special investigations

We issued a report on a misappropriation of public funds at the County. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

INFORMATION ABOUT THE COUNTY

Thurston County covers the southern region of Puget Sound, serving more than 300,000 residents. Its mission is to provide quality, timely and responsive service to its residents in the most cost-effective manner. These services include public safety (sheriff, judicial and emergency services), construction and maintenance of roads and bridges, sanitation facilities, health and social services, culture and recreation facilities and activities, water quality, flood control, planning and zoning services, and general administration services.

An elected, three-member Board of Commissioners is the primary policy-making body, exercising budgetary and financial control for the County. Additional independently elected officials, together with other departments, administer the County's daily operations as well as its 1,200 full-time employees. For fiscal years 2022 and 2021, the County had a general fund operating expenditures budget of \$123.6 million and \$118.3 million, respectively.

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 Thurston County at <http://portal.sao.wa.gov/ReportSearch>.

ABOUT THE STATE AUDITOR'S OFFICE

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

We work with state agencies, local governments and the public to achieve our vision of increasing trust in government by helping governments work better and deliver higher value.

In fulfilling our mission to provide citizens with independent and transparent examinations of how state and local governments use public funds, we hold ourselves to those same standards by continually improving our audit quality and operational efficiency, and by developing highly engaged and committed employees.

As an agency, the State Auditor's Office has the independence necessary to objectively perform audits, attestation engagements and investigations. Our work is designed to comply with professional standards as well as to satisfy the requirements of federal, state and local laws. The Office also has an extensive quality control program and undergoes regular external peer review to ensure our work meets the highest possible standards of accuracy, objectivity and clarity.

Our audits look at financial information and compliance with federal, state and local laws for all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits and cybersecurity audits of state agencies and local governments, as well as state whistleblower, fraud and citizen hotline investigations.

The results of our work are available to everyone through the more than 2,000 reports we publish each year on our website, www.sao.wa.gov. Additionally, we share regular news and other information via an email subscription service and social media channels.

We take our role as partners in accountability seriously. The Office provides training and technical assistance to governments both directly and through partnerships with other governmental support organizations.

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