



Office of the Washington State Auditor  
Pat McCarthy

# Accountability Audit Report

## City of Spokane

For the period January 1, 2020 through December 31, 2020

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

October 24, 2022

Mayor and City Council  
City of Spokane  
Spokane, 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 City 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 City'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

***Americans with Disabilities***

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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, City 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 City 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 the City of Spokane from January 1, 2020 through December 31, 2020.

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 City'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 year ended December 31, 2020, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. We examined the following areas during this audit period:

- Procurement – public works and professional services
- Compliance with public work projects – prevailing wages and contract payments
- Self-insurance for property and liability, health and welfare, unemployment, and workers compensation
- Police Department – disposition of property, drug seizure and forfeiture
- Use of restricted funds – public safety personnel funds and building and land use permit fees
- Use of Transportation Benefit District funds
- Contract compliance – cash receipting and deposit timeliness

- Cost allocation plans – equitable distribution of indirect costs
- Department of Building and Planning – business and development service fee calculations and adjustments
- Compliance with Spokane Municipal Code – General Fund reserve accounts and wastewater collection and treatment system utility taxes
- 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

### City of Spokane January 1, 2020 through December 31, 2020

#### **2020-001 The City did not comply with its adopted municipal code for collecting public wastewater utility taxes.**

##### *Background*

Spokane Municipal Code (SMC) requires the City to levy and collect a 20 percent gross income tax from utility businesses operating a public wastewater collection and treatment system within City limits. The City imposed this utility tax in 1998. The SMC also requires the City to tax its own utility departments. The City of Spokane and Spokane County separately own and operate the two wastewater collection and treatment facilities within City limits.

##### *Description of Condition*

In 2020, the City collected \$21,781,040 in wastewater utility taxes through monthly interfund billings for operating its own public wastewater collection and treatment system. However, our audit found the City has not collected any wastewater utility taxes for Spokane County's wastewater collection and treatment system that began operations in December 2011, as the SMC requires. The County's facility and part of its system are located within City limits and are subject to the 20 percent gross income utility tax.

Our audit also found the City has not amended the SMC or formally approved any tax exemptions that allows it not to enforce the tax uniformly.

##### *Cause of Condition*

In late 2020, the current City administration became aware that the City was not collecting wastewater utility taxes from the County. Current City administration and staff said they did not know why the former administration did not collect the utility tax, and the City does not have written documentation showing approval not to charge the tax to the County. In December 2021, the City Council asked the current Mayor to collect the wastewater utility tax from the County, as the SMC requires. However, the Mayor said they have chosen not to collect the utility tax until they can meet with the County to understand the effects of the tax requirement and decide how to address the situation.

## ***Effect of Condition***

Because the City has not levied and collected the utility tax from the County, it is not uniformly collecting the tax as the SMC requires, and did not receive all utility tax revenues due to it for operating wastewater collection and treatment systems. Based on financial records available for the County's regional water reclamation facility fund for fiscal years 2017 through 2020, we estimated the City did not collect at least \$5.1 million, or likely more, from the County over the four-year period. However, other County funds may also be subject to the tax and should be considered for the tax calculation. The City would need to coordinate closely with the County to fully calculate the utility tax.

## ***Recommendation***

We recommend the City comply with its SMC by enforcing the levy and collection of utility taxes for all wastewater collection and treatment systems within City limits, or amend the SMC. Further, we recommend the City coordinate closely with the County to calculate the amount of the utility tax the SMC would require the City to levy and collect from the County.

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

*Based on the Washington State Auditor's Office audit finding, the ruling from the Washington State Supreme Court in Lakehaven, and the City of Spokane's investigation and review to date, the city will engage in discussions with Spokane County to address and resolve the requirements within the Spokane Municipal Code; including but not limited to including Spokane County in the decision-making process of spending these revenues on regional projects of benefit like better addressing criminal justice, mental health, homelessness and transportation. These discussions will commence within the next 30-days with targeted resolution by January 31, 2023.*

*Should these talks fail to produce resolution, the city will consider next steps to protect the finances of Spokane and its taxpayers to ensure the appropriate revenue under the Spokane Municipal Code are protected.*

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

We appreciate the City's commitment to resolve this finding and thank the City for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular audit.

## *Applicable Laws and Regulations*

City of Spokane Municipal Code, Section 08.10.030 Business Activities Subject to Tax—Amounts, states in part:

- A. There is levied upon and shall be collected from all persons engaging in the following utility business activities a utility gross receipts tax or license fee measured by multiplying the rate specified times the gross income as follows: . . .
  4. Operating a public wastewater collection and treatment system: Twenty percent of gross income.

City of Spokane Municipal Code, Section 08.10.010 Definitions, states in part:

C. Gross Income.

1. “Gross income” or “gross revenues” means the value proceeding or accruing from the sale of tangible personal property or service, and receipts (including all sums earned or charged, whether received or not) by reason of the investment of capital in the business engaged in, including rentals, royalties, fees, interest and other emoluments however designated (excluding receipts or proceeds from the sale or use of real property or any interest therein, and the proceeds from the sale of notes, bonds, mortgages or other evidences of indebtedness, or stocks and the like), and without any deduction on account of the cost of the property sold, the cost of materials used, labor costs, taxes, interest or discount paid, or any expense whatsoever, and without any deduction on account of losses.
2. “Gross income” is further defined to mean the total gross income received or earned as above noted on a cash receipts or on an accrual basis according to the method of accounting regularly employed by the taxpayer during the period for which the taxes are applicable.

City of Spokane Municipal Code, Section 13.01.0316 Municipal Tax on Utilities, states:

This regulation recognizes that the utilities departments are taxed, pursuant to chapter 8.10 SMC, said tax subject to adjustment. The tax is computed not as a surcharge upon the rates but as a cost to the respective utility fund as a percentage of gross income, all as reflected in chapter 8.10 SMC.





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## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

### City of Spokane January 1, 2020 through December 31, 2020

This schedule presents the status of findings reported in prior audit periods.

<b>Audit Period:</b> January 1, 2019 through December 31, 2019	<b>Report Ref. No.:</b> 1028003	<b>Finding Ref. No.:</b> 2019-001
<b>Finding Caption:</b> The City’s Community Housing and Human Services Department bypassed established internal controls regarding procurement of public works contracts, conflicts of interest, sub-recipient agreements, and contractor payments.		
<b>Background:</b> The City contacted the State Auditor’s Office in March 2020, requesting a special review of activities in the Department because of concerns Department staff raised. Specifically, the concerns related to the procurement of public works contracts, evaluation and award of sub-recipient agreements, potential conflicts of interest and inappropriate payments for contracted services. <i>Public works procurement</i> Our audit found the Department did not comply with City policy and procedure for two public works contracts awarded in 2019 and could not ensure it allowed for fair and equitable opportunities for contractors to submit quotes on public works projects and that it received the lowest responsible bidder for the projects. <i>Sub-recipient agreements</i> Our audit found the Department approved three sub-recipient agreements in 2019 for warming center and shelter operations. The Department could not provide evidence it followed its informal practice to solicit requests for proposals or perform a competitive bidding process for these agreements and that it followed a consistent and equitable process to evaluate, select and award agreements.		

*Conflict of interest*

In our review of the three sub-recipient agreements noted above, we found two of the agreements awarded had an appearance of a conflict of interest, which may violate the City’s Municipal Code and state law. There was no documentation to evidence the Department or City resolved the potential conflicts of interest before City employees and elected officials participated in awarding the agreements. Any actual or potential conflicts of interest could violate the City’s Municipal Code and state law.

*Gifting of public funds*

The Department awarded one consulting agency agreement in 2017 to provide free housing legal clinics to citizens and reimbursed the agency for personal, non-business expenses for one of the agency’s employees. The Department did not comply with agreement terms to reimburse the consulting agency for the actual cost of expenditures that are necessary and directly applicable to the work required by the agreement and did not have other documentation showing these costs as allowable business expenses.

**Status of Corrective Action: (check one)**

- |  |   |  |  |
|--|---|--|--|
| <input type="checkbox"/> Fully Corrected | <input checked="" type="checkbox"/> Partially Corrected | <input type="checkbox"/> Not Corrected | <input type="checkbox"/> Finding is considered no longer valid |
|--|---|--|--|

**Corrective Action Taken:**

*The City of Spokane received notice of this finding April of 2021 therefore correction could not be fully implemented until the 2021 fiscal year. With that said, the City made the effort to correct all areas of noncompliance within six months of receipt of the finding.*

*Public Works Procurement*

*Staff in the CHHS Department have received training relating to public works procurement, fraud, waste, abuse, and whistleblower protections within the last six months from the City’s Purchasing staff, and Human Resources staff, as well as through the City’s electronic training platform. Additionally, as new staff are hired, all required training is being administered. A mix of live and electronic trainings are being utilized to ensure all staff are properly trained on all required subjects.*

*Sub-Recipient Agreements*

*The CHHS Department has worked on creating and implementing a policy relating to subrecipient selection. A draft policy was created and is currently being reviewed/finalized in accordance with City policy. The procedures noted within the policy were immediately implemented and the CHHS Department staff has been actively utilizing a consistent and equitable process to evaluate, select, and award agreements to subrecipients. The policy and procedures include guidance on documenting potential conflict of interests.*

*Additionally, the CHHS accounting staff has been ensuring consultants are reimbursed for actual and appropriate expenditures as outlined in individual contracts. The CHHS Department continues to perform subrecipient monitoring to ensure compliance with all federal, state and local rules and regulations.*

*Conflict of Interest*

*CHHS Department staff completed Fraud, Waste, and Abuse, and Whistleblower policy training during the summer of 2021. The expectation is to create an ongoing training schedule for staff once leadership has been hired. Additionally, all new hires are required to read the Code of Ethics as part of their onboarding through Neogov. Finally, CHHS Department documents any conflict of interests as previously mentioned.*

*Gift of Public Funds*

*CHHS Department staff received training on gifting of funds through the Fraud, Waste and Abuse training that was administered and completed during the summer of 2021. CHHS Department program staff work with the CHHS accounting staff on reviewing invoices for appropriateness and allowability.*

*Lastly, the City's internal audit staff provided guidelines and support during the early stages of implementation of correction. There is an expectation to perform a full review of all corrective action taken within the next few months.*

*Overall, the City has put in tremendous effort to properly educate, and train staff on applicable policies and procedures. Improvement has been made across the board with the implementation of the Subrecipient Selection policy and encouraging staff to be open, honest, and ethical employees.*

## 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. 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 City'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>.

## INFORMATION ABOUT THE CITY

The City of Spokane is the second largest city in the state with an estimated population of 223,600 residents. The City was incorporated in 1881 and adopted its first charter in 1910. The City provides police, fire, inspection, street, library, parks and recreation, traffic engineering, water, sewer, solid waste and general administrative services.

In 2001, the City changed to a strong-mayor form of government. An elected, seven-member Council and an independently elected Mayor govern the City. The Council appoints management to oversee the City's daily operations and its 2,100 employees. For fiscal year 2020, the City operated on an annual general fund budget of approximately \$185.9 million.

### Contact information related to this report

Address:	City of Spokane 808 W. Spokane Falls Boulevard Spokane, WA 99201-3304
Contact:	Danielle Arnold, Compliance/Tax Auditor
Telephone:	(509) 625-6389
Website:	<a href="http://www.spokanecity.org">www.spokanecity.org</a>

*Information current as of report publish date.*

### Audit history

You can find current and past audit reports for the City of Spokane 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](http://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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