City of Federal Way
Annual Report on the Implementation of Recommendations
Performance Audit: Impact Fees

Initiative 900 passed by the voters in 2005 authorized the state auditor's office to conduct performance audits of Washington State agencies and local government entities. This particular performance audit performed by Ernst & Young (the "Auditor"), focused on the development impact fees adopted under the Growth Management Act and revenues collected from 2004 through 2006.

Most of the City's mitigation fees during this audit period are assessed based on the State's Environmental Protection Act, with the only exception the School Impact Fees, which the City adopted in 1995 and was first effective in 1996 as a Growth Management Act based impact fee.

As stated in Initiative 900, "An annual report will be submitted by the legislative body by July 1st of each year detailing the status of the legislative implementation of the state auditor's recommendations. Justification must be provided for the recommendations not implemented. Details of other corrective action must be provided as well."

The Auditor's recommendations related specifically to the City of Federal Way as well as general recommendations are provided below along with the City's implementation status.

AUDIT AREA – INTEREST-BEARING ACCOUNTS

Audit Finding: Impact fee receipts are retained in separate general ledger (GL) accounts, not in separate interest-bearing bank accounts. The impact fees are usually invested with the rest of a city's cash in a variety of investments. At the end of the month, interest earned on these investments is allocated back to the GL accounts. We noted that the interest allocation method used by each city is different. Additionally, we noted that the City of Vancouver's treasury management as a leading practice in tracking investments and appropriately allocating interest to impact fees.

Recommendations: Cities should maintain each impact fee type in its own fund or GL account and allocate actual interest earned on cash investments based on the relative average daily balances, similar to the City of Vancouver, as described above. The Cities should consider procuring technology, which allows for a daily allocation of interest and minimal input.

Cities should not allocate interest based on an interest rate that is not equal to actual interest earned. Redmond and Maple Valley allocate interest to impact fees based on the LGIP rate, even though this will not be the same as their actual earning rate when all city cash is not maintained in the LGIP. Once exception to this recommendation would be the school impact fee interest allocation. Since school impact fees are only held for a short period of time, using the LGIP would make sense – however, only for school impact fees.

Status of City's Implementation: The City collects only school impact fees and allocates interest based on the LGIP rate. **The City has implemented the recommendation and will not report further on it.**

AUDIT AREA – SCHOOL IMPACT FEE INTEREST

Audit Finding: RCW 82.020.070 requires that "Impact fee receipts shall be earmarked specifically and retained in special interest-bearing accounts. Separate accounts shall be established for each type of public facility for which impact fees are collected. All interest shall be retained in the account and expended for the purpose or purposes for which the impact fees were imposed."

Ernst & Young noted that while school impact fees are in the custody of the city, they earn interest because they are deposited in the city's pooled cash bank account and are invested along with other city funds. The cities of Maple Valley and Vancouver remit interest earned between the time the fees are received by the city and the time they are remitted to the school district. The cities of Olympia and Federal Way do not remit any interest to the school districts, sot he interest earned during this time does not appear to be expended for the purpose for which the impact fee was imposed, as required by RCW 82.02.070.

Recommendation: Ernst & Young recommends that the Cities review and allocate actual interest earnings to school impact fees collected and remit those interest earnings to the appropriate school district(s), so the interest earned on the school impact fees can be expended for the purpose for which the school impact fees were imposed. This is required under RCW 82.02.070 in order for all interest earnings to be expended for the purpose or purposes for which the impact fees were imposed. Furthermore, the City should retroactively determine that interest has been properly allocated.

Status of City's Implementation: The City has allocated and remitted retroactive and current interest on school impact fees to the school district. However, the City disagrees with the Auditor in applying the statute to the City when the City's role in the fee collection process is temporary custodian or agent as evidenced by the City Code and demonstrated in the City's accounting of the funds. **The City has implemented the recommendation and will not report further on it.**

AUDIT AREA – SCHOOL IMPACT FEE SCHEDULE/CALCULATION

Audit Finding: Among the Cities that collect school impact fees, there are inconsistencies in determining the level of review of the school impact fee calculation prepared by the school districts.

Recommendations: The Cities should revisit their review process of the school impact fee calculation/schedule and capital facilities plan, knowing that they may be involved if litigation results from a school impact fee assessed. The Cities should pay particular attention to the City

of Vancouver's school impact fee review process, as it has the most in-depth and comprehensive review process.

Status of City's Implementation: The Auditor only reviewed the school impact fee schedule/calculation reviewing process for the Cities of Vancouver and Olympia. They documented Vancouver's review process that includes planning staff, planning commission review, public hearing, and the City Council adoption. They did not provide detailed information of Olympia's process, but only indicated it is "lighter". From this limited review, it was determined that *"Cities may not perform a detailed review of a district's CFP or impact fee calculations…"*

The City of Federal Way reviews Federal Way School District's Capital Facilities Plan for the assumptions, sampling data, and fee calculation and works with District staff to make necessary adjustments/corrections before presenting the results and recommendations to the City Council committee review and then to full Council for adoption. Federal Way's City Code provides clear guidelines for annual school impact fee elements and calculations. **The City considers this recommendation closed and will not report further on it.**

AUDIT AREA – PERMIT SYSTEM

Audit Findings: The cities of Vancouver and Olympia have integrated their permitting systems with their accounting systems. This was identified as a leading practice among the Cities due to the tighter internal controls and lack of manual manipulation.

Recommendations: All Cities should maintain a permit system that automatically interfaces with the city accounting system. A leading practice would be the systems of Vancouver and Olympia. In addition to the automatic interface, the following functions or review should be conducted to tighten internal controls:

a. All impact fees should be automatically calculated by the system, with the understanding that there will always be times when a fee needs to be manually overridden.
b. Fees that are manually overridden should be reviewed on a periodic basis to determine that the overrides are valid and accurate.
c. Access to the permitting system should be restricted to only those city employees who demonstrate the need for access.
d. Access to the cash receipts module should be restricted to only those city employees who demonstrate the need for access.

Status of City's Implementation: Ernst & Young reviewed permit systems of 3 cities: Vancouver, Olympia, and Redmond. Their finding states that Vancouver and Olympia, which have their permit systems integrated with their GL systems, are Best Practices. The Auditor further described the interface between Vancouver's Tidemark permit system and the Oracle-based GL accounting system as follows:

- A customer comes to the permit office to pay the impact fees due and obtain a building permit.
- A permit technician (one who works at the city and issues permits) logs into Tidemark to pull up the building permit application for the customer.
- The permit technician enters the building permit data. The impact fee data is automatically calculated in the system based on the type of land use (i.e., multi-family, single-family, retail, etc, the building site address, and the square footage (if necessary). Manual entry (i.e. override) of the impact fee is possible, but not generally utilized, except for single-family transportation impact fees. Ernst & Young noted that there is no review or approval of the overrides.
- Once a building permit data is entered, an impact fee amount is automatically calculated in Tidemark.
- The customer then pays a cashier the amount of impact fees owed.
- The cashier receives the moneys paid against the amount owed in Tidemark, and the building permit is issued.

Federal Way's permit system and GL system have the same interfaces as Vancouver's and we do not consider them fully integrated. It has been a long-term goal for the City to have its many applications fully integrated with the GL system to eliminate the need for reconciliations and download/upload between systems. However, when the total acquisition and staff support time are considered, a fully integrated, enterprise-wide system is not the best solution for our City. **The City considers this recommendation closed and will not report further on it.**