



MEMORANDUM

DATE: November 19, 2010

TO: Diane Buckshnis, City Councilmember
Members, Edmonds City Council
City of Edmonds

cc: Mayor Mike Cooper
Lorenzo Hines, Finance Director

FROM: W. Scott Snyder, Office of the City Attorney

RE: Your Inquiry RE Inaccurate Financial Statements - City Liability and Risk

At the November 16, 2010 City Council meeting, Councilmember Buckshnis asked the following question:

Is there a legal risk if we misstate our financial statements, and having inaccurate financial statements that have been intentionally created, are we at legal risk as a city for misstated financials?

For the purpose of this memo, I will assume that a City financial record is inaccurate.¹ This memo addresses the risk from criminal, civil and practical perspectives.

Potential Criminal Liability: RCW 35A.33 establishes the budgeting process for code cities. Budget and reporting duties are set forth in the chapter. As Ms. Buckshnis' discussion indicates, her focus was on RCW 35A.33.140 which requires quarterly reports. That statute states:

At such intervals as may be required by City charter or ordinance, however, being not less than quarterly, the City Council shall submit to the City's legislative body and chief administrative officer a report showing the expenditures and liabilities against each separate budget appropriation incurred during the preceding reporting period and like information for the whole of the current

¹ I am not qualified to evaluate the financial statements.

fiscal year to the first day of the current reporting period together with the unexpended balance of each appropriation. The report shall also show the receipts from all sources.

RCW 35A.33.160 makes it a misdemeanor for

...[A]ny city official, department head or other city employee of knowingly failing, or refusing, without just cause, to perform any duty imposed upon such officer or employee by this chapter, or city ordinance...in connection with the giving of notice, the preparing and filing of estimates of revenues and expenditures or other information required for preparing a budget report in the time and manner required ...”.

If a public official is convicted of “knowingly failing” to fulfill his duties, he may be guilty of a misdemeanor and fined not more than \$500 for each separate violation.

Civil Liability

I consulted with Hugh Spitzer, the City’s Bond Counsel, regarding the potential risks to the City under SEC rules. As you are aware, at the request of an individual Councilmember, I will provide up to one hour of review on an issue. If the Council requires further detailed information in this regard, you should contact Mr. Spitzer.

The primary civil liability which the City could incur relates to bond holder suits for reliance in a future bond offering on the City’s annual financial statements. These statements can be audited or unaudited. Because municipal bonds are public offerings, Security and Exchange Commission rules may apply. A bondholder, in the event of default, has a basis for suit if “knowingly false” or material misstatements of fact are made in the City’s annual financial statement, or the annual financial statement, taken as a whole, omits material information and a bondholder relies on that information. If any public official, as recently occurred in the city of San Diego, provides knowingly false information, he or she can also be in violation of federal law.

Were a City official to be convicted under RCW 35A.33.160 for a “knowing failure, without just cause,” the City would be required to report that fact in future offerings.

Practical Considerations

Pursuant to public initiative, the state of Washington has a performance audit process. A citizen may make a request to the state auditor to conduct a performance audit of any community. In the

Diane Buckshnis, City Councilmember
November 19, 2010
Page 3

event of a complaint, and in response to that complaint, the City could incur significant costs and the use of already precious staff time.

Conclusion

Individual criminal liability could be based upon “knowing” failures to provide information in response to the requirements of Chapter 35A.33. The City can incur civil liability on behalf of the City for providing either “knowingly false” or “materially misleading” financial statements or “omitting material facts” which make the City’s financial statements, taken as a whole, inaccurate. The latter issues can give to either risk of a bondholder’s lawsuit against the City or criminal liability if a public official acted “knowingly.” This is a high standard of proof but serious consequences can follow.

WSS/gjz/nkr