



Washington State Auditor's Office

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Accountability Audit Report

City of Moses Lake

Grant County

For the period January 1, 2012 through December 31, 2013

Published June 11, 2015

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Washington State Auditor's Office

June 11, 2015

Mayor and City Council
City of Moses Lake
Moses Lake, 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,

A handwritten signature in cursive script, reading "Jan M. Jutte".

JAN M. JUTTE, CPA, CGFM
ACTING STATE AUDITOR
OLYMPIA, WA

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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.

We recommended the City restrict the length of interfund loans to three years. Further, we recommended the City Council formally approve repayment schedules at the inception of the loan and formally review status of loans on annual basis during an open public meeting.

These recommendations were included in our report as a finding.

We also noted certain matters that we communicated to City management in a letter dated May 22, 2015, related to the City's allocation of expenditures to proprietary funds. We appreciate the City's commitment to resolving those matters.

About the audit

This report contains the results of our independent accountability audit of the City of Moses Lake 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:

- Cost allocation
- Interfund loans
- Procurement – public works
- Payroll - leave accrual and usage
- Third party cash receipting
- Contracts

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

City of Moses Lake
Grant County
January 1, 2012 through December 31, 2013

2013-001 The City has not consistently complied with requirements for interfund loans.

Background

The *Budgeting, Accounting, and Reporting Standards* (BARS) Manual allows local governments to establish interfund loans between funds, but stipulates minimum acceptable procedures for making and accounting for the loans. Specifically, the legislative body must formally approve all loans, including a planned schedule of repayment and setting a reasonable rate of interest, and must review the loan status annually at an open public meeting. Further, the borrowing fund must anticipate sufficient revenues to make specified principal and interest payments as required.

Interfund loans are to be considered “temporary” in nature, which the BARS manual generally defines as three years.

Description of Condition

As of December 31, 2013, the City of Moses Lake had more than \$6.7 million in outstanding interfund loan balances as follows:

Due TO	Due FROM	2011	2012	2013
Sanitation	General Fund	\$896,645	\$765,649	\$459,188
Sanitation	Ambulance Fund	361,782	272,682	182,691
Sanitation	Equipment Rental	336,412	-	-
Water/Sewer	Building Maintenance	5,500,000	5,500,000	5,500,000
Water/Sewer	Sanitation Fund	-	-	100,000
Water/Sewer	Stormwater Fund	80,396	60,596	40,598
Water/Sewer	Ambulance Fund	160,792	421,192	481,196
Total Amount of Interfund Loans*		\$7,336,027	\$7,020,119	\$6,763,673

*In March 2015, the City approved an additional loan from Water/Sewer to the General Fund in the amount of \$1 million.

Our audit revealed the following:

- The City Council approved all interfund loans; however, they did not approve a due date or repayment schedule. Rather, each resolution contained a generic statement that the loan will be repaid when service fee revenues are received to substantially fund the borrowing fund. City management maintained repayment schedules, but they were not approved or reviewed by the Council as required.
- Most repayment schedules maintained by City management established loan terms between five to 10 years. For instance, the Water Sewer Fund made two loans totaling \$5.5 million to the Building Maintenance Fund in 2010 and 2011. Each loan had a 10-year repayment schedule, with no principal payments required until 2015.
- The Sanitation Fund has provided multiple interfund loans to other City funds. However, in 2013 the Sanitation Fund borrowed \$100,000 from the Water Sewer Fund to continue its own operations.
- The number of interfund loans from the Sanitation and Water Sewer Funds to the Ambulance Fund have increased over time as follows:

Loan Date	Loan Amount
December 2010	\$200,000
April 2012	\$300,000
November 2013	\$100,000
December 2013	\$300,000

At the end of 2013, the Ambulance Fund had outstanding loan balances of \$663,887. This brings into question whether the City anticipated sufficient revenues to make specified principal and interest payments without taking additional loans to do so.

- The City Council did not perform a formal review of the loan status on an annual basis as required.

Cause of Condition

City management has relied on interfund loans to offset the operating shortfalls of City funds rather than seeking loans from external sources, because they feel it is more cost effective to the citizens. Rather than paying loan originating costs and sending interest payments outside of the City, they prefer to pay interest to other City funds.

City management was aware of the interfund loan requirements set by the BARS manual. However, they interpreted the requirement of “temporary” loans to allow for any loan that was not permanent in nature, whereas the BARS manual defines a temporary loan generally as three years.

Effect of Condition

Resources loaned to other funds are not available for use by the lending fund. The City has stated that loaned resources consist only of amounts set aside for future projects and emergencies; however, the Sanitation Fund took out an interfund loan to cover its operations after it had loaned its own resources to the Ambulance Fund. Further, because resources set aside for emergencies are tied up in interfund loans, the City may not have timely access to the resources if an emergency were to occur.

To avoid one fund benefiting from another, the City must charge an interest rate based on the external rate available. However, in establishing loans with lengthy repayment periods, the City cannot ensure the interest rate established at loan inception will continue to be similar to external rates throughout the entire period of the loan.

Lastly, the borrowing fund must be able to anticipate sufficient revenues (remain solvent) to be able to make specified principal and interest payments as required. However, when loan repayment periods are lengthy, the City may not be able to accurately anticipate the lending fund’s financial viability throughout the entire period of the loan.

Recommendation

We recommend the City restrict the length of interfund loans to three years. Further, we recommend the City Council formally approve repayment schedules at the inception of the loan and formally review status of loans on an annual basis during an open public meeting, as required by the BARS Manual.

City’s Response

The City agrees with the statements of the SAO that the City has the legal authority to establish interfund loans between funds and that the BARS Manual establishes the minimum acceptable procedures for making and accounting for interfund loans. The SAO recommends two changes to the City’s accounting practices that the SAO believes are required to ensure full compliance by the City with the SAO’s interpretation of the BARS Manual minimum acceptable procedures, to which the City provides the following response.

The BARS Manual minimum acceptable statutory procedures require the following:

- 1. City Council must approve all interfund loans by ordinance or resolution;*
- 2. The authorizing ordinance or resolution must identify the lending and borrowing funds;*
- 3. The authorizing ordinance or resolution must provide a planned schedule of repayment of the loan principal to include due dates of the payments;*
- 4. The authorizing ordinance or resolution must set a reasonable rate of interest to be paid to the lending fund;*
- 5. The borrowing fund must anticipate sufficient revenues to be able over the period of the loan to make the specified principal and interest payments as required by the authorizing ordinance or resolution;*
- 6. The loan status should be reviewed annually by the City Council at any open public meeting;*
- 7. The term of the loan may continue over a period of more than one year, but must be “temporary” in the sense that no permanent diversion of the lending fund results from the failure to repay by the borrowing fund. A loan that continues longer than three years will be scrutinized for a permanent diversion of moneys.*
- 8. Appropriate accounting records should be maintained to reflect the balances of loans in every fund affected by such transactions.*

The Second SAO Recommendation addresses requirements 3 and 6 above. The City Council annually reviews the interfund loan status during budget preparation, review and adoption, but it does not do so as a specific agenda item limited to interfund loans. The City Council will include a formal annual review of all interfund loans as a specific agenda item during an open public meeting. Additionally, although the City Council formally approved all interfund loans, it delegated the formulation of the payment schedule to City management and did not formally approve the due date and/or repayment schedule; the City Council will formally approve the repayment schedules of all interfund loans at the loan’s inception rather than ratifying City management’s repayment schedules.

The First SAO Recommendation addresses requirement 7 above and is based upon the SAO’s own interpretation that the BARS Manual establishes a three year limit on interfund loans. The City disagrees with the SAO’s interpretation; there

is no legal authority that prohibits an interfund loan longer than three years. Case law clearly permits interfund loans so long as the loan is not an appropriation or diversion of funds or is a loan made to an insolvent fund. There is no statute that limits an interfund loan to three years. The only legal authority cited by the SAO to support its recommendation is the language in the BARS Manual which states that loans “longer than three years will be scrutinized for a permanent diversion of moneys.” The plain language of this statutory provision does not create a prohibition on interfund loans longer than three years. Accordingly, a loan in excess of three years is only unlawful to the extent it is determined to constitute a “permanent diversion of moneys”. The SAO’s interpretation is unsupported and is contrary to the plain reading of the BARS Manual. Indeed, many state legislatures have clearly expressed an intent to limit the duration of interfund loans by incorporating specific durational limits in their statutes (e.g., see Nevada Administrative Code §345-290 (1 year); Utah Code §17B-1-626 (10 years)). State law (Chapter 43.09 RCW) requires the SAO to examine the financial affairs of local governments and to issue accounting and reporting requirements for local governments which the SAO has done through its adoption of the BARS Manual. The Washington legislature delegated that authority to the SAO and the BARS Manual clearly and plainly states that interfund loans in excess of 3 years are permitted but will be subjected to a higher level of scrutiny to ensure that there is no permanent diversion of funds.

This higher scrutiny should be fact specific and consistent with the relevant case law and statutory authority. The standard is whether a loan is temporary and not a permanent diversion of funds. If the scrutiny does not establish an appropriation or diversion, then the loan is temporary and is legal and appropriate. The City has made interfund loans from a variety of proprietary funds to other proprietary and enterprise funds. All loans have been approved by the City Council, contain a repayment plan and schedule, and carry an interest rate equal to the rate of return the funds would have received had they remained on deposit and invested. Repayment plans and schedules have been adhered to and interest has been paid. No City fund has lost any revenue as a result of any interfund loan. The City Council has always considered the interfund loans as temporary and has implemented a policy of early repayment in the event the lending fund required the loaned funds prior to scheduled repayment. No interfund loan has been made to an insolvent fund and all borrowing funds have an assured and definite source of revenue, with the user charges, utility rates, collection and General Fund budgeting under the direct control of the City itself. No interfund loan has ever curtailed or delayed any projects or activities of the lending fund. The City Council has always intended that interfund loans shall be

repaid and all interfund loans have been repaid pursuant to the established repayment schedules; such is not a diversion of funds but is a temporary loan.

The City respectfully disagrees with the SAO's interpretation that the BARS Manual statutory language creates an outright prohibition on all interfund loans longer than three years. Interfund loans longer than three years are legal and appropriate even under the BARS Manual language if, upon scrutiny, they do not create a permanent diversion of moneys. The City Council considers its lawful use of interfund loans to be an effective business practice that has enabled the City flexibility in its budgeting process without resorting to external financing at a much higher cost to the City.

Auditor's Remarks

While interfund loans with repayment periods longer than three years are not strictly prohibited by the BARS manual, they reduce the City's ability to comply with the other interfund loan requirements.

We look forward to reviewing the status of our recommendations in the next audit.

Applicable Laws and Regulations

RCW 43.09.200 Local government accounting--Uniform system of accounting, states in part:

The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

BARS Interfund Transactions

The minimum acceptable procedures for making and accounting for interfund loans are as follows:

1. The legislative body of a local government must, by ordinance or resolution, approve all interfund loans, indicating the lending and borrowing funds, and provide in the authorization a planned schedule of repayment of the loan principal as well as setting a reasonable rate of interest (based on the external rate available to the local government) to be paid to the lending fund. The planned schedule of repayment should specify the due date(s) of payment(s) needed to repay the principal and interest on the loan.

2. Interest should be charged in all cases, unless:
 - a. The borrowing fund has no other source of revenue other than the lending fund; or
 - b. The borrowing fund is normally funded by the lending fund.
3. The borrowing fund must anticipate sufficient revenues to be able over the period of the loan to make the specified principal and interest payments as required in the authorizing ordinance or resolution.
4. The loan status should be reviewed annually by the legislative body at any open public meeting.
5. The term of the loan may continue over a period of more than one year, but must be “temporary” in the sense that no permanent diversion of the lending fund results from the failure to repay by the borrowing fund. A loan that continues longer than three years will be scrutinized for a permanent diversion of moneys. (Note: these restrictions and limitations do not apply to those funds which are legally permitted to support one another through appropriations, transfers, advances, etc.)
6. Appropriate accounting records should be maintained to reflect the balances of loans in every fund affected by such transactions.

RCW 43.09.210 Local government accounting – Separate accounts for each fund or activity – Exemption of agency surplus personal property, states in part:

All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.

RELATED REPORTS

Financial

Our opinion on the City's financial statements requirements is provided in a separate report issued in August 2014, which includes the City's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

INFORMATION ABOUT THE CITY

The City of Moses Lake is a non-charter code city serving over 21,250 citizens in Grant County. The City provides a full range of municipal services including police and fire, planning and engineering, street maintenance and construction, storm water, parks and recreation and general administrative services. It also provides sanitation, water and wastewater services, ambulance services and a municipal airport. In addition, the City operates a museum and maintains a library.

An elected, seven-member Council governs the City. Board Members select one Member to serve as Mayor. The Council appoints a City Manager to oversee the District's daily operations as well as its 183 full- and 213 part-time employees. For fiscal years 2012 and 2013, the City operated on annual budgets of approximately \$69 million.

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Information current as of report publish date.

Audit history

You can find current and past audit reports for the City of Moses Lake 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.

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