



Office of the City Auditor

Date: March 30, 2007
To: Utility Board
Re: 07-215 and 07-216 Executive Limitation 4 and 7

The City Auditor's Office has completed the external monitoring as directed by City Council acting in its capacity as the Utilities Board under the Utilities Board Policy Governance. The review covered items 1, 4, 6, 7 and 9 of Policy EL-4 Asset Protection, and all of Policy EL-7 Financial Condition and Activities.

Our work included the review of source documentation and control systems, detail tests of calculations and other auditing procedures we considered necessary to verify the accuracy and reliability of the statements made and the information presented. We also relied on the system audit work performed by our office as well as observations and the work of the external auditors.

The attached document contains the relevant policy prohibitions, the CEO compliance statements from the March 14, 2007 internal monitoring report presented to you at the March 21, 2007 Utility Board Meeting and my comments. Overall, we conclude the CEO is not in violation of the policy prohibitions tested.

The Assistant City Auditor, Denny Nester, will be at the Utilities Board meeting. Either he or I will be available at your convenience to answer any questions you may have.

Sincerely,

A handwritten signature in blue ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

Review of selected Colorado Springs Utilities Executive Limitations

This document contains excerpts from the March 14, 2007 Executive Limitation Monitoring Reports provided by Colorado Springs Utilities and discussed with the Utility Board on March 21, 2007. These excerpts are followed by the City Auditor comments.

Policy: EL 4– Asset Protection

Global policy prohibition: *The chief executive officer shall not allow corporate assets, tangible and intangible, to be unprotected, inadequately maintained or unnecessarily risked.*

CEO Compliance Statement: The chief executive officer's stewardship of assets is represented in part by our organizational financial statements. These statements reflect assets, claims to those assets and the effects of transactions and other events that result in changes in asset balances. The statements are monitored to ensure that management complies with their stewardship responsibilities.

Comments and interpretation: We continue to maintain a stable financial position. Net assets at the end of 2006 totaled \$1.193 billion. The change in net assets was lower than budget by \$88.7 million primarily due to a significant reduction in the valuation of natural gas hedges. Capital expenditures for 2006 were \$197.5 million, or \$50.9 million lower than budget. Unrestricted cash and investments book value balances at year end were \$186.8 million, an increase of \$22.6 million from the previous year. Operating income for 2006 was \$9.3 million higher than budgeted.

Accordingly, the CEO shall not:

Policy prohibition 1: *Allow unbonded personnel access to material amounts of funds.*

CEO Compliance Statement: We continue to maintain a commercial crime insurance policy. Public official bonds in the amount of \$500,000 are maintained for coverage of our chief planning and finance officer and the financial services general manager.

Auditor Comments: We examined evidence that the policies are in place as stated. As noted above, a Public Official Bond was in place for the Chief Planning and Finance Officer, the General Manager of Financial Services and the Manager of Treasury and Finance.

Policy prohibition 4: *Operate without written purchasing regulations assuring legal and fiscal compliance that address such items as competitive acquisition practices, conflict of interest, favoritism, and local vendor policies.*

CEO Compliance Statement: We maintain a set of written purchasing regulations that address and comply with the expectations of this policy prohibition.

Auditor Comments: Utilities has written purchasing regulations, which cover all of the areas mentioned in the limitation.

Policy prohibition 6: *Receive, process, or disburse funds under controls which are insufficient to meet the City Auditor's standards.*

CEO Compliance Statement: All funds are received, processed and disbursed under controls reviewed and approved by the city auditor.

Auditor Comments: We periodically audit all of the major financial systems of the Utility. Within the last several years, we have reviewed the receipting and billing, cash disbursements, purchasing, payroll and investments systems. Based on the work performed in all of the areas described above, it appeared that the CEO has complied with the Executive Limitation.

Policy prohibition 7: *Invest Colorado Springs Utilities funds in violation of Bond Ordinance requirements.*

CEO Compliance Statement: All cash and investments are in U.S. Treasury Notes, U.S. Treasury Bills, U.S. Agency securities, repurchase agreements, money market funds and secured bank accounts that comply with bond ordinance investment security requirements.

Auditor Comments: On a monthly basis, the Office of the City Auditor receives a listing of investments held by Utilities. All securities are held in investments that meet the criteria for compliance with the bond ordinances and Utilities' investment policy.

Policy prohibition 9: *Operate without written land acquisition regulations, assuring legal and fiscal compliance, that address fair and consistent appraisal and negotiation practices, and compliance with applicable relocation benefit requirements.*

CEO Compliance Statement: Our activities are consistent with this expectation. All land acquisitions are guided by an administrative regulation that requires the use of the Acquisition of Real Property Handbook, developed by the City of Colorado Springs Real Estate Services Office. We comply with the interim real property acquisition process until such time as the new process is approved and adopted by City Council.

Auditor Comments: During 2006, the City Auditor issued two reports related to real estate. Those reports noted that the Acquisition of Real Property Handbook, developed by the City of Colorado Springs Real Estate Services Office needed to be updated and strengthened. Springs Utilities staff have been involved in the revision of the handbook. A new manual "The City of Colorado Springs Procedure Manual for the Acquisition and Disposition of Real Property Interests" had been drafted and was in the process of being reviewed.

Policy: EL 7– Financial Condition and Activities

Global policy prohibition: *With respect to actual ongoing financial condition and activities, the chief executive officer shall not cause or allow the development of fiscal jeopardy or a material deviation of actual expenditures from board priorities established in ends policies*

Accordingly, the CEO shall not:

Policy prohibition 1: *Exceed the total appropriations for the fiscal year, nor fail to inform the board in monitoring reports of transfers of unexpended appropriations between, or expenditures in excess of budget in:*

- A. *electric, natural gas, water, wastewater, and common Federal Energy Regulatory capital classifications; or*
- B. *electric, natural gas, water, wastewater, and administrative and general FERC O&M classifications; or*
- C. *regulated and non-regulated services.*

CEO Compliance Statement: Appropriations for the fiscal year have not been exceeded.

A. Capital

Capital expenditures were under budget by \$50.9 million. Water service was under budget \$37.6 million due primarily to less spending on Southern Delivery System activities. Other contributing factors include construction of a raw water pipeline from Pikeview Reservoir to the Mesa Water Treatment Plant and reduced scope of work for non potable water distribution pipeline construction.

Wastewater service capital expenditures exceeded the budget by \$2.3 million due primarily to recognition of capitalized interest expense related to the Northern Water Reclamation Facility. Other contributing factors include acceleration of activities associated with wastewater collection system capital programs and creek crossing related projects in order to ensure compliance with the terms of both the original Compliance Order on Consent and Amendment Number 1.

B. Operation and maintenance expenses

Operation and maintenance expenses in total for the year 2006 were under by \$34.7 million due primarily to purchased gas expenses being under \$38.2 million.

However, operation and maintenance expenses in electric service were over by \$6.6 million primarily as a result of fuel and purchase power being over budget by \$5 million.

C. Non-regulated operations

Non-regulated operation and maintenance expenses were over budget by \$13.7 million as a result of higher than budgeted non-tariff gas sales expense, off-system sales expense and coal sales expense. As a result, non-regulated revenue was \$13.9 million over budget.

Reportable budget transfers

Electric service: In the fourth quarter a transfer in the amount of \$100,828 was made from electric major project Nixon 480v switchgear to operating expenses rebates expense, and a transfer in the amount of \$14,000 was made from electric major project enhanced power solutions to common normal additions

Water service: In the fourth quarter one reportable transfer in the amount of \$157,330 was made from water normal additions to common normal additions to fund vehicles. In addition, a transfer of \$240,000 was made from water service operating expenses to the general city for the stormwater fund.

Wastewater service: As previously reported, the Fountain Creek Recovery Project, which exceeds the \$500,000 reporting threshold, was started in the first quarter and was unfunded in the approved 2006 budget.

The Fountain Creek Recovery Project was presented and approved by Utilities Board in March 2006. This project will provide a system to recover sanitary sewage spills or divert, store, and treat the sewage spills in Fountain Creek. This project was not included in the 2006 approved budget and is a two-year project, with work to be completed by the second quarter of 2007.

This project was funded in the fourth quarter by budget transfers of \$3,011,185; from various Wastewater projects.

Auditor Comments: We have reviewed detailed budget information and compared it with the year-end financial data provided by Utilities. We concluded the total appropriations for the fiscal year were not exceeded. The Policy Prohibition was not violated.

Policy prohibition 2: *Fail to inform the board in monitoring reports of any canceled major capital projects in the approved budget or any new major capital projects over \$500,000 not funded in the approved budget, along with the appropriate budget transfers.*

CEO Compliance Statement: During the fourth quarter of 2006, no major projects were cancelled. We did not initiate any new unfunded capital projects of more than \$500,000. All reportable budget transfers were detailed in prohibition 1.

Auditor Comments: Based on our review of utilities budget information, we verified that the Utilities Board was notified in monitoring reports of canceled major capital projects and all new major capital projects over \$500,000. This Policy Prohibition was not violated.

Policy prohibition 3: *Transfer revenues between FERC revenue accounts for electric, natural gas, water or wastewater services without prior board approval.*

CEO Compliance Statement: There were no transfers of revenues between services for FERC revenue accounts during the fourth quarter 2006.

Auditor Comments: We reviewed revenue accounts to verify that no material transfers occurred between FERC revenue accounts. This Policy Prohibition was not violated.

Policy prohibition 4: *Financially act in any way that endangers the best possible bond ratings or results in an overall fixed-cost coverage ratio of less than 1.6.*

CEO Compliance Statement: Our long-term revenue bond ratings have remained stable at AA (Standard & Poor's), Aa2 (Moody's) and AA (Fitch), with the most recent review conducted in August 2006 for the 2006A and 2006B issues.

The Series 2006A bonds are variable rate bonds, which received a short-term rating of A-1+ (Standard & Poor's), VMIG 1 (Moody's) and F1+ (Fitch).

The Series 2006B bonds are variable rate bonds, which received a short-term rating of A-1 (Standard & Poor's), VMIG 1 (Moody's) and F1+ (Fitch). The F1+, VMIG 1 and A-1+ ratings are the highest prime-quality ratings obtainable.

As of the end of the fourth quarter of 2006, the fixed-cost coverage ratio was 1.79.

Auditor Comments: We verified the 1.79 Fixed Cost Coverage Ratio was supported by the information available at the time that the CEO's Statement was made. The Policy Prohibition was not violated.

Policy prohibition 5: *Allow days of working capital to drop below 45 days of operating and maintenance expenses.*

CEO Compliance Statement: The number of days of working capital was 148.7 days in October, 151.8 days in November and 117.9 days in December.

Auditor Comments: At the end of each month during 2006, the Working Capital per days of operating and maintenance expenses was always above 45 days as required by this Policy Prohibition.

Policy prohibition 6: *Transfer unrestricted cash and investments between services without prior board approval. Such balances are accounted separately for electric, natural gas, water, wastewater, streetlight and non-regulated services.*

CEO Compliance Statement: To date, we have not initiated or requested any transfers.

Auditor Comments: Based on our review of the records presented by Utilities, there were no accounting transfers of unrestricted cash and investments between services. The lack of transfers ensures the integrity of the data per service as presented in Segment Reporting. However, you should note that page 10 of the March 14, 2007 Monitoring Report indicates two services (wastewater and streetlights) have negative unrestricted cash balances at year-end. Such negative balances could be viewed as de facto loans from the services that have positive balances.

Policy prohibition 7: *Fail to settle payroll and debts in a timely manner.*

CEO Compliance Statement: Payroll for the fourth quarter of 2006 were processed and balanced accurately, as scheduled on the normal bi-weekly payroll cycle.

Auditor Comments: We reviewed the payroll, payroll tax and debt service payments for the year. All were paid in a timely manner. Nothing came to our attention in any of our detail testing that would indicate payments of any sort were not being made in a timely manner. We periodically audit all of the major financial systems of Utilities. Within the last four years, we have reviewed cash disbursements and payroll systems. Based on the work performed in these areas, it appeared that the CEO has complied with the Executive Limitation.

Policy prohibition 8: *Allow tax payments or other government ordered payments or filings to be overdue or inaccurately filed.*

CEO Compliance Statement: All submissions of state and federal withholding and local, county and state sales taxes have been made within the required time frame for the fourth quarter of 2006. All required annual filings have been made in a timely manner. All required annual rebate calculations and deposits have been made in a timely manner.

Auditor Comments: We reviewed evidence that the payroll and sales tax filings mentioned above were paid in a timely manner.

Policy prohibition 9: *Acquire real property at more than fair market value without justifiable reason.*

CEO Compliance Statement: The chief executive officer complied with this prohibition, acquiring real property at fair market value.

Auditor Comments: We reviewed the land purchase transactions for 2006 and determined the CEO complied with the Policy Prohibition.

Policy prohibition 10: *Fail to resolve receivables after a reasonable grace period.*

CEO Compliance Statement: The ratio of monthly net bad-debt write-offs as a percent of revenue for each month of the fourth quarter were:

- October: 0.26 percent
- November: 0.21 percent
- December: 0.22 percent

The year-to-date write-off as a percent of revenue is 0.34 percent, which is comparable to the same period last year.

Auditor Comments: The write-off rate for 2006 was consistent with prior years and within acceptable industry standards. Management appeared to have acceptable processes in place to actively work past due accounts.