



Office of the City Auditor

Date: April 4, 2008
To: Honorable Mayor and Members of City Council
Re: 08-215 - Executive Limitation 4 and 7

We have 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.

The purpose of the review was to determine whether Utilities and the Utilities' Chief Executive Officer complied with the existing Executive Limitations. 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 12, 2008 internal monitoring report presented to you at the March 2008 Utility Board Meeting, and our comments. We conclude the CEO is not in violation of the policy prohibitions tested.

Please contact me at your convenience if you have any questions on the report. I will also be at your April 16th Utilities Board meeting when the report will be on the agenda.

Sincerely,

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

Jeff Litchfield
City Auditor

Review of selected Colorado Springs Utilities Executive Limitations

This document contains excerpts from the March 12, 2008 Executive Limitation Monitoring Reports provided by Colorado Springs Utilities and discussed with the Utility Board on March 19, 2008. 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: Springs Utilities continues to maintain a stable financial position. Operating Income for the end of the fourth quarter 2007 was \$66.8 million. Net assets increased \$38.5 million year-to-date which were \$1.3 million higher than budget. This increase was primarily due to:

- o Operating Income over budget by \$29.6 million
- o Non-Operating Revenue under budget by \$3.6 million
- o Contributions in Aid of Construction under budget by \$16.8 million
- o CAB asset transfer to City of Colorado Springs for \$8.4 million

Year-to-date capital expenditures were \$188.3 million or \$11.2 million under budget. Unrestricted cash and investment balances at quarter-end were \$198.2 million, a decrease of \$11.0 million (5.2%) from the end of third quarter 2007.

Accordingly, the CEO shall not:

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

CEO Compliance Statement: Springs Utilities maintains a commercial crime insurance policy. Public Official Bonds in the amount of \$500,000 are maintained for coverage of the Chief Planning and Finance Officer, the General Manager of Financial Services, and the Manager of Treasury and Finance.

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: Written purchasing regulations that address and comply with the expectations of this policy prohibition are maintained.

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 Utilities. 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 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: As of December 31, 2007, 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: Springs Utilities operates within land acquisition regulations as set forth in the *City of Colorado Springs Procedure Manual for the Acquisition and Disposition of Real Property Interests* as approved by City Council Resolution 155-07.

Auditor Comments: A new manual, "The City of Colorado Springs Procedure Manual for the Acquisition and Disposition of Real Property Interests," had been developed and complied with this Policy requirement.

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

Year-to-date, total Capital expenditures were \$188.3 million, which were under budget by \$11.2 million (5.6%). The following are breakdowns by service of the total budget variance:

- a. Electric service actual capital expenditures, including Streetlights, were \$70.2 million, which was over budget by \$0.3 million (0.4%).
- b. Gas service actual capital expenditures were \$19.3 million, which was under budget by \$4.4 million (18.6%).
- c. Water service actual capital expenditures were \$38.2 million, which was under budget by \$2.1 million (5.3%).
- d. Wastewater service actual capital expenditures were \$45.7 million, which was under budget by \$4.4 million (8.8%).
- e. Common, Products and Services, and O&M Service Providers' actual capital expenditures were \$14.9 million, which was under budget by \$0.5 million, (3.4%).

B. Operation and Maintenance expenses

- Operation and Maintenance expenses year-to-date were \$654.5 million, which was \$58.6 million (8.2%) lower than budget primarily due to lower electric purchased power expenses of \$30.4 million and purchased natural gas expenses of \$45.1 million under budget, the result of a reduction in the market price for natural gas.

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 2007, no major projects were canceled. One ongoing capital project which had not been budgeted in 2007 accrued costs of more than \$500,000. The fourth quarter reportable budget transfer is detailed below.

- Costs associated with achieving final completion of the J.D. Phillips Water Reclamation Facility were not included in the 2007 budget. Budget transfers in the amount of \$2.5 million from the Clear Springs Regional Water Reclamation Facility and \$0.4 million from the Primary Sedimentation Basins were made to the project to pay for work performed in 2007.

Auditor Comments: Based on our review of Utilities budget information, we verified 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 2007.

Auditor Comments: We reviewed budget transfer data 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: The 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 2007 for the 2007A, 2007B, and 2007C issues.

The Series 2007A and Series 2007B 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 A-1+, VMIG 1 and F1+ ratings are the highest short-term ratings obtainable.

The Series 2007C bonds are fixed rate bonds with an underlying rating of AA (Standard & Poor's) and (Fitch), and Aa (Moody's).

For 2007, the fixed-cost coverage ratio was 1.80.

Auditor Comments: We verified the 1.80 Fixed Cost Coverage Ratio was supported by the information available at the time that the CEO's Statement was made. The December 31, 2007 Financial Statements and Report of Independent Certified Public

Accountants for Colorado Springs Utilities are in agreement with the CEO Compliance Statement above regarding Bond Ratings. 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 153.7 days in October, 128.2 days in November and 109.1 days in December.

Auditor Comments: At the end of each month during 2007, 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: Springs Utilities did not initiate or request 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 the quarterly Monitoring Reports indicate four services had negative unrestricted cash and investments balances during the year. At December 31, 2007, Water had a negative unrestricted cash and investments balance of \$4.4 million. 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: Payrolls for the fourth quarter 2007 were processed and balanced accurately, as scheduled on the normal bi-weekly payroll cycle.

Auditor Comments: Based on the recurring internal audit work performed in these areas and the external year-end financial audit, it appeared that the CEO 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 2007. 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: Based on the recurring internal audit work performed in these areas and the external year-end financial audit, it appeared that the CEO complied with the Executive Limitation.

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 2007 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:

- Oct: 0.07%
- Nov: 0.57%
- Dec: (0.01%)

As resources were shifted to address other critical business processes as a result of converting to the new Customer Care and Billing System (CC&B), the number of closed accounts processed for write-off was less in December 2007. Additionally, collections for previously written off accounts were greater than actual write-offs in December. For these reasons, monthly write-offs as a percent of revenue for December 2007 resulted in a negative percentage of -0.01%. The cumulative year to date write-offs as a percent of revenue is 0.28%.

Auditor Comments: The write-off rate for 2007 was consistent with prior years and within acceptable industry standards. Management appeared to have acceptable processes in place to actively work past due accounts.