City of Colorado Springs

Colorado Springs Utilities
It's how we're all connected

Memorial Hospital

COLORADO SPRINGS AIRPORT

Office of the City Auditor

Date: April 7, 2010

To: Honorable Mayor and Members of City Council

Re: 10-07 - 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 Colorado Springs Utilities (CSU) 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 10, 2010 internal monitoring report presented at the March 2010 Utility Board Meeting, and our comments. We conclude the CEO is in material compliance with the policy prohibitions tested. We noted one instance of non-compliance related to EL7 prohibition 2, which is explained at the bottom of page 4. CSU's response concerning this issue is at the top of page 5.

Please contact me if you have any questions on the report. I plan to attend your April 21st Utilities Board meeting when the report will be on the agenda.

Respectfully,

Denny L. Nester
Interim City Auditor

INTERIM CITY AUDITOR, DENNY L. NESTER, MBA CPA CIA CGFM CFE CGAP

TEL 719-385-5691 • FAX 719-385-5699 • FRAUD HOTLINE 719-385-2387
107 N. Nevada Avenue, Suite 200 • P.O. Box 1575, Mail Code 1542 • Colorado Springs, CO 80903

Review of selected Colorado Springs Utilities Executive Limitations

This document contains excerpts from the March 10, 2009 Executive Limitation Monitoring Reports provided by Colorado Springs Utilities and discussed with the Utility Board on March 17, 2010. 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.*

Accordingly, the CEO shall not:

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

> **CEO Compliance Statement:** Colorado 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 and the Manager of Treasury and Finance. A permanent appointment of Manager of Financial Services has not yet been made, so a bond is not in place. Given that a commercial crime policy is in force, we do not consider this significant.

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 Colorado Springs Utilities. During 2009, reports were issued on our reviews of cash and debt management, payroll, and billing. Based on the work performed in the areas described above, 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, 2009, all securities were 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: We verified that Colorado Springs Utilities had adopted *The City of Colorado Springs Procedure Manual for the Acquisition and Disposition of Real Property Interests* as the authoritative policy related to real property transactions.

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, gas, water, wastewater, and common Federal Energy Regulatory Commission (FERC) capital classifications; or
B. Electric, gas, water, wastewater, and administrative & general FERC O&M classifications

CEO Compliance Statement: Appropriations for the fiscal year have not been exceeded. No transfers of unexpended appropriations between or expenditures in excess of budget occurred during the fourth quarter of 2009.

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. During the third quarter of 2009, there was one transfer of $75,429 between services, which was disclosed in the third quarter monitoring report to the Board. 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 2009, there was one (1) new capital project over $500,000 which was not funded in the approved budget.

Comments/Interpretation: Marksheffel Road Casings and Water Main Extensions project: Funds were transferred from the Southern Delivery System project to this project in the amount of $979,000 to construct casings and finisher water mains across Marksheffel Road, as distribution system improvements, but configured to accommodate the future Southern Delivery System (SDS) project prior to the PPRTA widening project to avoid tearing up a newly constructed roadway.

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. We did note the D7 Transformer project was established in July 2009 for $50,000. A subsequent transfer of $500,000 was made from within the same service to the project in November 2009. As this project was not funded in the approved budget for 2009, it should have been included in the fourth quarter monitoring report to the Board. We concluded that CSU was in material compliance with this prohibition.

Colorado Springs Utilities Response: *The D7 Transformer project was originally budgeted for 2010/2011. However, in 2009, it became necessary to begin the work sooner than originally anticipated. Thus, in July 2009 $50,000 was transferred to this project. In November 2009, an additional $500,000 was transferred to the existing D7 Transformer project. Internal interpretation was that this was an active program, therefore the transfer amount of $500,000 was not considered reportable.*

In early 2010, a new database was developed to automate budget transfers as well as enhance the reporting process. The database is now fully operational and will eliminate future misinterpretations of what defines a new capital project or what an appropriate budget transfer is in the future.

Policy prohibition 3: *Transfer revenues between FERC revenue accounts for electric, 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 2009.

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 with the most recent review conducted in August 2009 for the 2009A, 2009B, 2009C and 2009D issues:

- Standard & Poor's: AA
- Moody's: Aa2
- Fitch: AA

The Series 2009C bonds are variable rate bonds and as such, receive short-term bond ratings. Ratings have remained stable with the highest short-term ratings obtainable:

- Standard & Poor's: A-1+
- Moody's: VMIG 1
- Fitch: F1+

Fixed Cost Coverage Ratio: At the end of the fourth quarter of 2009, the fixed-cost coverage ratio was 1.71. The 2009 Council Approved Budget for fixed-cost coverage ratio was 1.67.

Auditor Comments: We verified the 1.71 Fixed Cost Coverage Ratio was supported by the information available at the time that the CEO's Statement was made. The December 31, 2009 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 numbers of days of working capital were as follows:

- October: 100.3 days
- November: 67.9 days
- December: 67.1 days

Auditor Comments: At the end of each month during 2009, 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, gas, water, wastewater, and streetlight services.*

CEO Compliance Statement: Colorado Springs Utilities did not initiate or request any transfers.

The Unrestricted Cash and Investment balance at the end of the fourth quarter of 2009 was $159.2 million, which was $5.3 million (3.4%) higher than the balance at the end of the third quarter. The balances by service for the end of 2009 are as follows: (in thousands)

Electric	$123,840
Street Lighting	3,643
Gas	11,479
Water	18,287
Waste Water	2,183
CFF/Health Care	(206)

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, we noted that during the first through third quarters, the Monitoring Reports indicate some services/funds had negative unrestricted cash and investments balances. 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 2009 were processed and balanced accurately, as scheduled on the normal bi-weekly payroll cycle. Accounts Payable processes payments to vendors that are from authorized and verifiable invoices with future payment due dates, prior to the specified due dates based on a net 30-day basis. Invoices received without a specified due date are processed within three (3) business days after receipt and approval from the initiating department. Payments are then scheduled on a net 30-day basis.

Comments/Interpretation: Under the American Recovery and Reinvestment Act of 2009 ("ARRA"), Colorado Springs Utilities is eligible to claim a COBRA premium assistance payment credit for any qualified recipients. There was one individual who elected the COBRA subsidy and the credit was claimed and filed on the fourth quarter federal payroll 941 tax form.

Auditor Comments: Based on the recurring internal audit work performed in these areas and the external year-end financial audit, the CEO complied with the Executive Limitation in all material respects.

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 2009. 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.

Comments/Interpretation: The completed Colorado State Sales Tax audit for the period of May 01, 2005 through December 31, 2008 noted Colorado Springs Utilities was not collecting all of the required electric and gas services sales taxes. The audit assessed the combined sales tax deficit during the three-year audit period to be approximately $725,000, including interest and penalties.

Colorado Springs Utilities has paid approximately $17,000 of related deficits related to findings with which it agrees. On the remaining findings, Colorado Springs Utilities has filed a dispute with the State as required and is awaiting further notice from the State. Colorado Springs Utilities has completed its review with municipal government and paid $138,326 of relevant deficits that were associated with the State Audit.

Based on the audit information, Colorado Springs Utilities has made necessary corrections for the undisputed items, including:

Corrected approximately thirty five (35) accounts to reflect correct rates.
Corrected approximately one hundred (100) accounts missing tax-exempt forms.
Updated internal processes and procedures.
Updated and provided training to relevant employees.
Housing of tax-exempt forms has been streamlined to a central on-line location.
Account reviews are taking place for tax-exempt accounts outside of the audited account pool.

Auditor Comments: Based on the recurring internal audit work performed in these areas and the external year-end financial audit, the CEO complied with the Executive Limitation for timely filings. CSU made efforts to improve processes related to the State Sales Tax audit findings with which it agrees 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 2009 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 accounts receivable bad debt write-offs as a percent of revenue for each month of the fourth quarter of 2009 was:

- Oct 0.50%
- Nov 0.33%
- Dec 0.30%

Comments/Interpretation: For 2009, write-offs as a percent of revenue were 0.45 percent, which is $945,000 or 0.14 percent less than the previous year. This can be attributed to Colorado Springs Utilities enabling extensive customer assistance such as the Low Income Energy Assistance Program (LEAP) as well as other local community outreach endeavors such as United Way 211, Project COPE and many other conservation and educational programs. During the 2008-2009 heating season, LEAP assisted 11,427 households with over $5.5 million. This number reflects the highest amount of households ever assisted and the highest amount of funds received in one program year for Colorado Springs Utilities customers.

Auditor Comments: Management appeared to have acceptable processes in place to actively work past due accounts. Without CSU's efforts to obtain agency assistance for qualifying customers as noted above, 2009 write-offs might have been significantly higher.