



OFFICE OF THE CITY AUDITOR COLORADO SPRINGS, COLORADO

14-10 Annual External Report on Executive Limitation EL-4 Asset Protection and EL-7 Financial Conditions and Activities

May 2014

Purpose

The purpose of this review was to determine whether Colorado Springs Utilities and the Utilities Chief Executive Officer complied with the existing Executive Limitations (EL) 4, Asset Protection Policy Prohibitions 1,4,6,7 & 9, and all of EL-7, the Financial Condition and Activities Policy Prohibitions for the year ended December 31, 2013. In addition to verifying management's report, the Office of the City Auditor would report any known violations if such violations were not reported by management.

Highlights

We conclude the Chief Executive Officer was in compliance with policy Prohibitions EL-4 and EL-7 with the exception of EL-7 Prohibition 3 related to adjusted debt service coverage. Management previously reported non-compliance with this Prohibition to the Utilities Board on March 12, 2014.

The Utilities Board monitored the organization's operations through boundaries established by the Executive Limitations Policies. The Office of the City Auditor annually verifies compliance with Executive Limitations 4 and 7. Key components of the prohibitions were :

- Asset Protection (EL-4) - required that Colorado Springs Utilities have policies and procedures in place that ensure sound business practices to protect assets. These included purchasing and real estate regulations, investment procedures, bonding requirements for personnel with access to funds, and controls over receipt and disbursement of funds.
- Financial Condition and Activities (EL 7) - required compliance with financial measures such as cash on hand and debt service coverage. Additionally, this limitation required management to inform the Utilities Board of expenditures in excess of appropriations and major new or cancelled capital projects.

Our audit included the review of source documentation, detail tests of calculations, and other audit procedures as we deemed necessary. We verified the accuracy and reliability of the statements made along with information presented in the EL-4 and EL-7 reports

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Recommendations

No specific recommendations were made.

Management Response

No responses by Colorado Springs Utilities management were required.

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prepared by Colorado Springs Utilities for the Utilities Board. We also relied on the major transaction systems audit work performed by our office, as well as the work of the external auditors. Our review did not include detailed tests of controls and systems that ensure policy compliance.

In December 2012, the Utilities Board approved removal of EL-7 Prohibitions 3 and 6 effective with the 2013 reports. These prohibitions addressed the transfer of unrestricted cash, investments and revenues between FERC revenue service accounts. As the prohibitions were removed, those areas were not reviewed in this audit.

The following statements from management's revised fourth quarter report dated April 24, 2014, on non-compliance with Prohibition 3 are included below:

Observation 1: Failed to meet expectations in maintaining an Adjusted Debt Service Coverage above 2.0.

The CEO reports that, as of the fourth quarter, the preliminary, unaudited year-end Adjusted Debt Service Coverage is below 2.00, which is in violation of this policy prohibition. Adjusted Debt Service Coverage is the amount of cash flow, after surplus/PILT payments to the municipal government, available to pay both principal and interest on Utilities' debt. Adjusted Debt Service Coverage was 1.83 at year-end.

Management explained there were two primary drivers for this result:

- 1. Water revenue shortfall due to the drought situation.*
- 2. Additional expenses were incurred in connection with both drought/conservation efforts and with flood events.*

Utilities' is making its best effort to offset the severe financial impacts of drought and natural disasters. The expense reductions required to return Adjusted Debt Service Coverage back above 2.0 for the year would require taking unacceptable risks and would not be operationally responsible. Utilities will communicate with the Credit Rating Agencies in order to provide them assurance that our financial management remains strong and we are committed to achieve Adjusted Debt Service Coverage greater than 2.00 times in 2014 and beyond.

I plan to attend the Utilities Board meeting on May 21. I will be available to answer questions.

Sincerely,



Denny L. Nester, MBA, CPA, CIA, CGFM, CFE, CGAP
City Auditor

The audit was conducted in a manner that conforms with the International Standards for the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors.