

REVIEW OF GRU INVESTMENTS

SEPTEMBER 2009




**CITY AUDITOR'S OFFICE
CITY OF GAINESVILLE, FLORIDA**

City of
Gainesville

Inter-Office Communication

September 28, 2009

TO: Audit, Finance and Legislative Committee
Mayor Pegeen Hanrahan, Chair
Mayor-Commissioner Pro Tem Scherwin Henry, Member

FROM: 
Brent Godshalk, City Auditor

SUBJECT: Review of GRU Investments

Recommendation

The Audit, Finance and Legislative Committee recommend the City Commission:

- 1) Accept the City Auditor's report and response from the General Manager for Utilities, and
- 2) Instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit, Finance and Legislative Committee.

Explanation

In accordance with our Annual Audit Plan, we have completed a Review of GRU Investments. Our report, which includes a response from the General Manager for Utilities, is attached for your review.

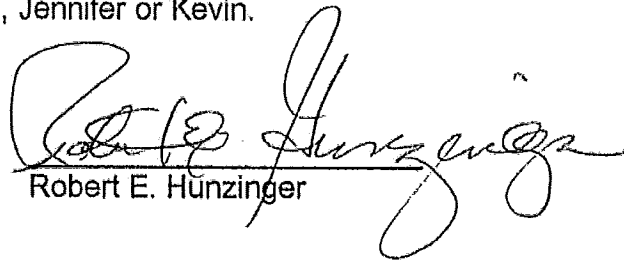
We request that the Committee recommend the City Commission accept our report and the General Manager's response. Also, in accordance with City Commission Resolution 970187, Section 10, Responsibilities for Follow-up on Audits, we request that the Committee recommend the City Commission instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit, Finance and Legislative Committee.



INTER-OFFICE COMMUNICATION
GENERAL MANAGER

DATE: September 18, 2009
TO: Brent Godshalk, City Auditor
FROM: Robert E. Hunzinger, General Manager
SUBJECT: Response to Review of GRU Investments

Attached is our response to the review of GRU Investments (see Management's Response on the last page). We appreciate the efforts of the City Auditor's Office to provide us with opportunities to improve our efficiency and accountability. If you have any questions feel free to call me, Jennifer or Kevin.



Robert E. Hunzinger

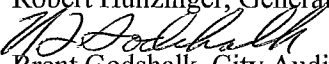
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cc: Jennifer Hunt
Kevin Crawford

City of
Gainesville

Inter-Office Communication

September 10, 2009

TO: Robert Hunzinger, General Manager for Utilities
FROM: 
Brent Godshalk, City Auditor
SUBJECT: Review of GRU Investments

In accordance with our Annual Audit Plan, we have completed a Review of GRU Investments. During our review, we interviewed key personnel, analyzed financial investment information and tested management controls. We also completed an analysis benchmarking recent GRU investment activities to peer Florida public utilities.

The primary objective of this audit was to evaluate the adequacy of management controls over GRU's investment activities and to test GRU's investment transactions for compliance with applicable laws, policies and procedures. We also reviewed the adequacy of security controls over GRU's investment banking transactions.

Based on our review, we believe that the GRU Finance Department has strong internal controls in place and uses sound approaches for investment activities. GRU also has well-developed and documented investment policies and procedures which help to provide management with sufficient latitude to effectively manage funds so as to maximize return within acceptable risk exposure and to ensure compliance with bond covenants and other legal requirements.

The attached draft report provides one recommendation we believe will assist management in continuing to monitor and protect GRU financial investments. Our recommendation has been reviewed with Jennifer Hunt, Chief Financial Officer and Kevin Crawford, Financial Analysis & Compliance Manager. We would like to acknowledge their professional courtesy and cooperation during our review and we look forward to continuing to work together with them to finalize this report and management's response.

In accordance with Commission Resolution 970187, Section 9, please submit your written response to the recommendation presented in the attached report and indicate an actual or expected date of implementation for the recommendation. Our final report, which will include your written response, will then become public record and be submitted to the City Commission's Audit, Finance and Legislative Committee for review and approval. The next meeting is scheduled for September 28, 2009. If your response can be completed prior to that date, we will place this item on that agenda. Otherwise, the report will go on the December 14, 2009 meeting.

As always, please feel free to contact me or my staff to discuss any questions or concerns regarding this draft report.

cc: Jennifer Hunt, Chief Financial Officer
Kevin Crawford, Financial Analysis & Compliance Manager

OBJECTIVES, SCOPE AND METHODOLOGY

In accordance with our Annual Audit Plan, the City Auditor's Office completed a Review of GRU Investments. The primary objective of this audit was to evaluate the adequacy of management controls over GRU's investment activities and to test GRU's investment transactions for compliance with applicable laws, policies and procedures. We also reviewed the adequacy of security controls over GRU's investment banking transactions. Our procedures included interviewing key personnel, analyzing financial investment information and testing management controls. We also completed an analysis benchmarking recent GRU investment activities to peer Florida public utilities. The scope of our review was generally for investment transactions occurring during fiscal year 2008.

As for all of our audits, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Based on the results of our review, we found no significant weaknesses in management controls over the GRU investment process. We believe the Finance Department has strong management controls in place to ensure that investment activities are properly administered. We have prepared one recommendation for improvement regarding enhanced monitoring of brokerage institutions and the investments industry which was discussed with management. This recommendation, as well as management's written response, can be found in the following sections of this report.

BACKGROUND INFORMATION

Gainesville Regional Utilities generally ranks as one of the nation's largest 50 public utilities, according to the Association of Public Power Utilities, with combined utility operating revenues exceeding \$350 million annually. GRU's total investments as of September 30, 2008 exceeded \$250 million, which are generally held in trust by USBank and SunTrust and are administered by GRU's Finance Department through the following operating, construction and debt service funds:

1. Debt Service Fund – Funds accumulated to provide payment of principle and interest on or to redeem outstanding debt. Funds are invested to match cash flow requirements.
2. Subordinated Indebtedness Fund – Funds accumulated to provide payment of principle and interest on or to redeem outstanding debt. Funds are invested to match cash flow requirements.
3. Rate Stabilization Fund – Funds accumulated to stabilize utility rates over future periods through the transfer of funds to and from operations, as necessary and to provide operating reserves for the utility.
4. Utility Plant Improvement Fund – Funds used to pay for certain projects or debt service, the purchase or redemption of bonds, or otherwise provide for the repayment of bonds.
5. Construction Fund – Funds borrowed for the cost of acquisition and construction of the utility systems.

Investment Guidelines

GRU's investment policy conforms to applicable Florida Statutes, City Ordinances and bond covenants. The policy indicates that "the foremost objective in the investment of GRU funds is the preservation of capital." Other key objectives are focused on proper diversification, as well as matching investments with anticipated cash flow requirements.

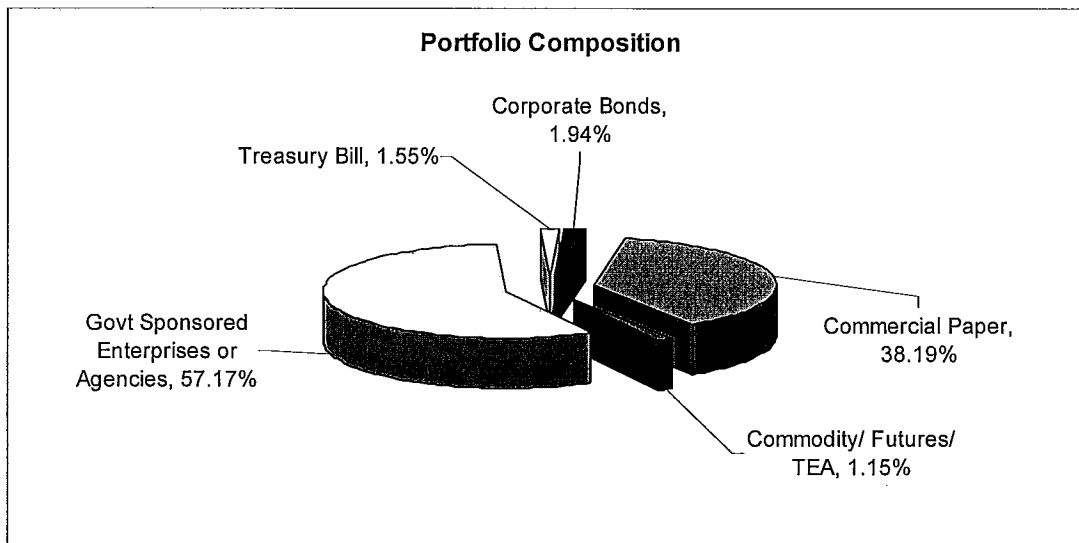
Daily investment transactions are executed by the GRU Finance Department, using authorized brokers, via Bloomberg terminal, telephone or e-mail. Investment monies are administered through one of GRU's trustees (SunTrust or USBank). During our review, we noted that management maintained thorough records documenting investment transactions from initiation to maturity. We also noted that investment staff complied with continuing professional education requirements established by Florida Statutes. Additionally, broker certification forms were on file for current approved brokers.

Investment Reporting

GRU completes quarterly investments reports providing a breakdown of investment activities, such as beginning and ending cash balances, investments outstanding and cash flow requirements by fund. The report also summarizes pertinent market and economic news, cash and investment levels, and overall portfolio performance. GRU completed thorough analyses of investment activities within the quarterly reports. The Investment Committee, consisting of the Utility Chief Financial Officer, Financial Analysis and Compliance Manager, Controller, and Investment Coordinator, reviews the quarterly report to monitor investment activities.

Investments are diversified into various investment instruments. Figure 1 below provides a snapshot and graphical presentation of GRU's investment diversification, as reported in GRU's Quarterly Investment Report for September 30, 2008.

Figure 1

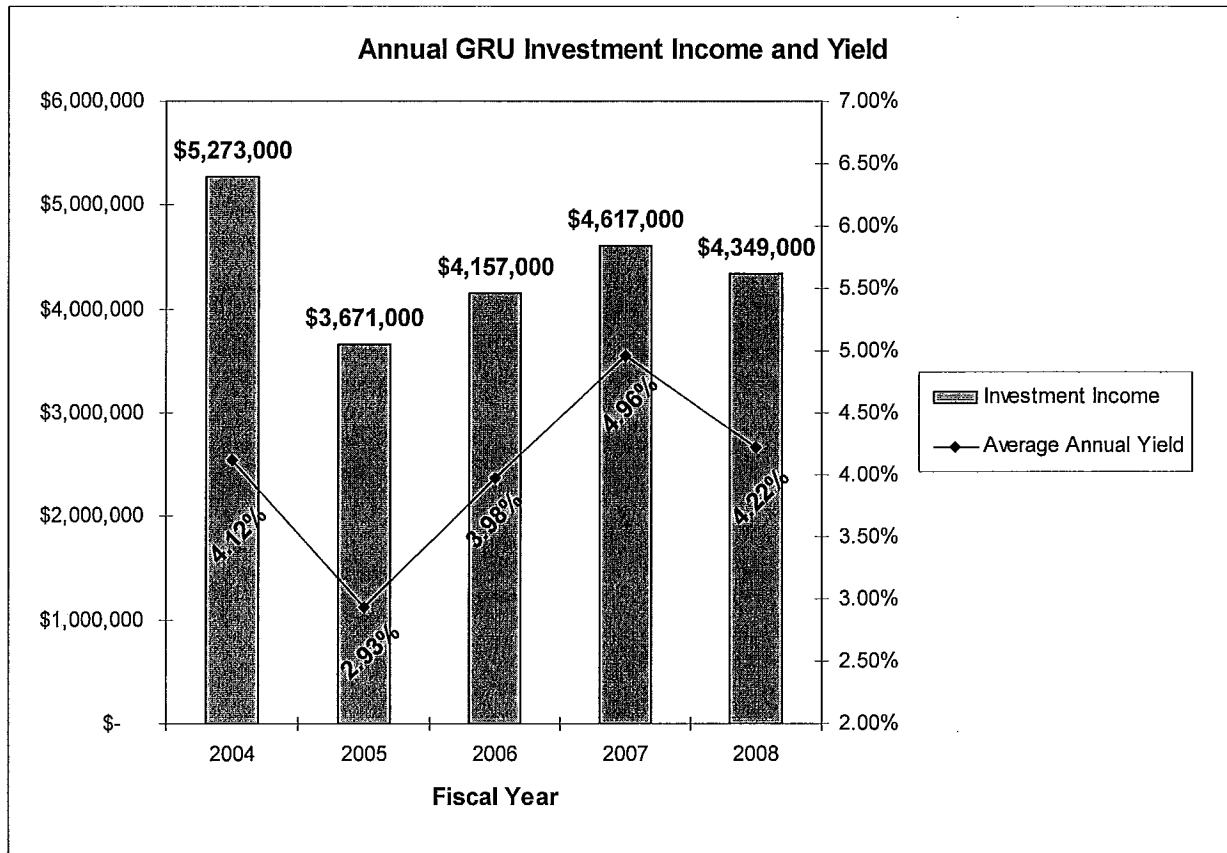


Investment Performance

GRU's investment income fluctuates based on the amount of funds available for investment and the relative returns of investments within GRU's portfolio at any given time. Figure 2 below provides a

graphical comparison of GRU's total investment income over the past five fiscal years, as well as the average annual yield for each year.

Figure 2



Comparison of GRU Policies and Performance to Peer Utilities

During our review, we completed a comparison of GRU's policies and performance to those of neighboring and comparable public utility companies. Benchmarked utilities included Jacksonville Electric Authority, Lakeland Electric, Ocala Electric Utility and Tallahassee Electric Utility. GRU earned an impressive annual yield of 4.22% during fiscal year 2008, which compares favorably to the other benchmarked utilities, second only to Lakeland's reported 4.89%.

Figure 3

	GRU	Jacksonville	Lakeland	Ocala	Tallahassee
Total Investments	\$254 million	\$879 million	\$100 million	\$142 million	\$676 million
FY2008 Annual Yield	4.22%	3.05%	4.89%	4.10%	3.11%

Notable similarities between utilities reviewed were that most invested in commercial paper, all invested in treasury bonds and all limited investments to the top two rating categories of bond rating agencies. Lakeland was the only utility reviewed that did not utilize an investment advisory board.

ISSUE #1

Periodic Reviews of Brokers and Brokerage Institutions

Discussion

The United States and international markets have, over the past several years, experienced a volatile financial environment amid one of the largest recessions in U.S. history. The official time period of the recession is debated, but calendar years 2008 and 2009 have seen high unemployment rates and home foreclosures. The U.S. stock market has also been affected as investors experienced unprecedented drops in investments. Investors also witnessed the closure of numerous banks and financial institutions once thought to be financially sound. Trusted and renowned financial officers have been convicted of fraudulently managing funds, duping investors out of billions of dollars.

The Financial Industry Regulatory Authority (FINRA) is the largest independent regulator for all securities firms doing business in the United States. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services.

FINRA provides a service to investors entitled BrokerCheck, which provides information about FINRA-registered firms and brokers to help investors determine whether to conduct, or continue to conduct, business with these brokerage firms and brokers. The information contained within BrokerCheck is collected through the securities industry's registration and licensing processes. A disclosure section contains information about any customer disputes or regulatory and disciplinary events on a firm or broker's record. In an effort to remain objective, FINRA lists each incident as reported by securities regulators, the individual broker and any involved firms. The presence of the information does not automatically indicate wrongdoing on the part of the firm or broker.

FINRA categorizes broker/brokerage firm disclosure information by the following types:

1. Regulatory Events – Information regarding a broker/brokerage firm's regulatory event detailing a violation of investment-related rules or regulations.
2. Civil Events – Information regarding a broker/brokerage firm's civil action, which includes foreign and domestic court investment-related injunctions, findings, or settlements within the last 10 years.
3. Arbitration Awards – Information regarding FINRA arbitration awards involving securities and commodities disputes between public customers and FINRA-registered firms.

Examples of information provided by FINRA include:

- Regulatory actions
- Investment-related civil suits
- All felony charges and convictions
- Bankruptcies, compromises with creditors, judgments and liens
- Customer disputes that contain allegations of sales practice violations against brokers
- Misdemeanor charges and convictions relating to securities violations

During our review, we searched FINRA's BrokerCheck module to identify information specific to broker and brokerage firm registration information and event disclosures. We reviewed the "Disclosure of Arbitration Awards, Disciplinary, Financial, and Regulatory Events" section which discloses broker and brokerage firm events in a detailed report.

We noted no significant disclosures on the FINRA website related to individual brokers utilized by GRU. However, several of GRU's brokerage firms had numerous SEC disclosures, some disciplinary, of disputes concerning investment practices. Some of these disclosures included significant sanctions accepted by brokerage firms, including multi-million dollar fines and orders to "cease and desist" from certain inappropriate activities. Others were much less significant and some of the firms had relatively few disclosures. Please note that disclosures are common place and almost all investment companies doing business will file disclosures.

Conclusion

FINRA provides detailed information on disclosures related to brokers and brokerage firms. GRU staff relies upon Bloomberg updates to obtain announcements concerning brokerage firms. Bloomberg provides some information on brokerage firms, but does not provide detailed disclosure information and related sanctions assessed by the Securities and Exchange Commission, if any. GRU could potentially suffer a loss if risky or fraudulent practices by brokers and brokerage firms are not identified in a timely manner. In an effort to minimize that risk, GRU's investments are brokered only through nationally or regionally recognized firms.

Recommendation

We recommend management complete periodic reviews of its authorized brokers and brokerage firms utilizing independent monitoring and reporting agencies, such as FINRA BrokerCheck, to determine whether previous reported actions by current or prospective brokers or brokerage firms pose any potential risks.

Management's Response

Management agrees that the periodic review of authorized brokers and brokerage firms is an essential component of prudent investment management. While GRU currently utilizes Bloomberg to monitor its brokers and brokerage firms, we concur that additional monitoring provided by other sources could provide another measure of protection to GRU's investments. As such, the Investment Coordinator will begin monitoring GRU's brokers and brokerage firms through FINRA BrokerCheck on a monthly basis and report to the Investment Committee quarterly.