AUDIT REPORT

Departments of Finance and Public Works

Debt Management

May 2018

Office of the Auditor
Audit Services Division
City and County of Denver

Timothy M. O'Brien, CPA
Denver Auditor

Photo sources: denvergov.org and dmns.org

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Audit report year: **2018**

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May 17, 2018

AUDITOR'S REPORT

We have completed an audit of Debt Management. The objective of the audit was to evaluate whether the Department of Finance is effectively managing certain elements of its debt issuance process and to assess the effectiveness of the City's administration of bonds and certificates of participation (COPs). In addition, our objective included an evaluation of the Departments of Finance and Public Works' management of expenditures of bond and COP proceeds. The audit also assessed agencies' general controls over critical information systems.

As described in the attached report, our audit revealed that the Departments of Finance and Public Works should strengthen and enforce existing policies related to COPs, debt management post-issuance controls, bond proceed expenditures, and the maintenance, oversight, and security of certain critical information systems. We also found that agencies using third-party vendors to provide services related to bond management are not obtaining and reviewing assurance reports over service reliability and data security.

Through stronger policies and procedures, agencies will be positioned to provide better debt process oversight, ensuring compliance with bond covenants and other regulatory requirements, and that bond proceed management is aligned with the voter-approved ballot issues. Our report lists several related recommendations.

This performance audit is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, *General Powers and Duties of Auditor*, and was conducted 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.

We extend appreciation to the Departments of Finance and Public Works and the personnel who assisted and cooperated with us during the audit.

Denver Auditor's Office

Timothy M. O'Brien, CPA
Auditor

Debt Management
May 2018

Objective

The objective of the audit was to evaluate how well the Department of Finance is managing debt issuance and post-issuance processes. We also evaluated how the Departments of Finance and Public Works managed the expenditures of debt proceeds. In addition, the audit assessed agencies' general controls over critical information systems.

Background

The City incurs debt and other obligations to help fund capital improvements, purchase equipment, or finance capital leases.

Our audit focused on management of two bond programs totaling $1.3 billion: The Better Denver Bond Program, authorized by voters in 2007, which allowed the City to issue up to $550 million in general obligation bonds; and Ballot Measure 2C, approved by voters in 2015, which authorized borrowing of up to $778 million.

Finally, we looked at certificates of participation (COPs) executed and delivered in the last three years.

REPORT HIGHLIGHTS

Highlights

Our review of City processes over debt issuance, administration of bonds and certificates of participation (COPs), management of bond proceed expenditures, and general controls over technology systems identified eight issues:

Finding 1: Debt Policy Does Not Require Documentation for Necessary Policy Deviations – The City executed and delivered COPs in 2015 without sufficiently meeting guidelines for new revenue, savings, or efficiencies. The reasons for this departure were not documented.

Finding 2: Post-Issuance Controls Could Be Improved – Various controls, such as review of covenant compliance checklists, review of the arbitrage rebate calculation, and compliance with private use requirements could be stronger.

Finding 3: Lack of a Citywide Expenditure Policy for Debt Funds – There is no formal policy to define allowable expenditures paid with funds from debt issuances.

Finding 4: Inadequate Succession Planning Over the Capital Integration System Application – One individual, who works for a third-party contractor, supports software application code for the City's Capital Integration System, which tracks critical details of capital project management and planning. However, there is no backup for this position.

Finding 5: Risk of Unauthorized Access to Critical Debt Management Systems – The City does not have policies and procedures governing user access to three critical software systems used for managing City debt, project payments, and project and program management.

Finding 6: Software System Changes Could Not Be Verified – The Department of Public Works does not reconcile software changes made to the program management system by the vendor.

Finding 7: Departments of Finance and Public Works Are Not Reviewing SOC Reports – Departments of Finance and Public Works are not obtaining or reviewing Service Organization Control reports, which would offer assurance over the services provided by vendors.

For a copy of this report, visit www.denvergov.org/auditor or contact the Auditor's Office at 720.913.5000.

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BACKGROUND

Capital Improvement

Cities have a responsibility to maintain and provide infrastructure for their residents through making capital improvements. Broadly speaking, capital improvements are investments in City-owned infrastructure and include renovations and new construction of buildings, roads, bridges, and other capital assets. The City and County of Denver (City) incurs debt and other obligations in order to fund capital improvement initiatives throughout the City. Total outstanding debt and other obligations of the City as of December 31, 2016, not including pension obligations, was $6 billion.[1] This figure includes debt and other obligations of governmental activities totaling $1.8 billion and debt of business-type activities of $4.2 billion. The City uses general obligation (GO) bonds, revenue bonds, and certificates of participation to finance capital improvement initiatives.

Most Debt Issued by the City Takes the Form of General Obligation Bonds and Revenue Bonds

The City issues multiple types of long-term debt to finance capital projects such as the purchase of equipment, ongoing maintenance and repair of City assets, and other critical infrastructure improvements. Most debt is issued through general obligation (GO) bonds and through revenue bonds.

General Obligation Bonds Are the Most Commonly Used Type of Governmental Activity Debt

GO bonds are tax-exempt, long-term debt issued by the City to finance capital improvements benefiting the public interest, such as roads, parks, libraries, and other public buildings. Essential public projects without associated revenue streams are the strongest candidates for GO bond financing. GO bonds may only be issued by voter approval, and payments of principal and interest are unconditionally guaranteed by the City. Part of the voter approval process is approving a specific property tax levy to repay the bonds. The largest bulk of the City's debt is in general obligation bonds.

General Obligation Bond Programs – In November 2007, voters approved a GO bond program, known as the Better Denver Bond Program, allowing the City to issue up to $550 million in general obligation bonds for City infrastructure improvements. In November 2017, the voters approved a new GO bond program encompassing seven project categories and authorizing up to $937 million in new general obligation bonds.[2] The new general obligation bond program includes plans to complete more than 460 projects over the next ten years. Additionally, the City selected a consultant to serve as the program manager for the 2017 GO bond program, which is similar to the management plan for the Better Denver Bond Program. The consultant will assist the City with determining when projects will be undertaken, assist with coordination between various City

[1] The December 31, 2017 Comprehensive Annual Financial Report was not complete at the time of the audit. As such, December 31, 2016 figures were utilized for the purposes of this report.

[2] The seven categories are: 1. Transportation and Mobility System; 2. Cultural Facilities; 3. Denver Health and Hospital Authority; 4. Public Safety System; 5. Library System; 6. Parks and Recreation System; and 7. Public Facilities System.

agencies and outside partners, report on the progress of the projects both within the City and to the community, and help coordinate when to issue bonds to finance the projects.

Revenue Bonds Are Used for Both Governmental Activity and Business-Type Activity Debt

Revenue bonds are tax-exempt, long-term debt issued to fund capital projects payable from a specific, dedicated revenue source. These bonds do not include an unconditional guarantee from the City as repayment is tied to a specific revenue source. According to the City's debt policy, revenue bonds are appropriate if "direct beneficiaries of a given improvement can be clearly identified and such beneficiaries can pay for a fair share of the improvement's costs."[3] Revenue bonds funded from governmental activities require voter approval because they typically rely on a specific tax levy, while revenue bonds funded from City-owned enterprises do not require voter approval as they do not rely on a tax levy.

Governmental activity revenue bonds are repaid by portions of certain excise taxes, such as the lodger's tax, food and beverage tax, and short-term car rental tax, among others. Some of these excise taxes are dedicated to the repayment of the bonds that are being issued under Ballot Measure 2C.

Revenue Bond Program – In 2015, Denver voters approved Ballot Measure 2C, which authorized borrowing of up to $778 million to finance improvements at the Convention Center and to help finance (along with several other partners) the redevelopment of the National Western Center Complex. Borrowing under Ballot Measure 2C will also be used for several smaller projects, such as helping with cleanup of the South Platte River. This ballot measure was funded by the extension of a 1.75 percent lodger's and car rental tax.

Certificates of Participation Provide Financing through Lease-Purchase Agreements

Certificates of participation (COPs) are lease-purchase agreements in which a specific City capital asset serves as collateral for the transaction. Leases associated with COPs are a specific type of transaction and are recorded in the City's Comprehensive Annual Financial Report as a capital lease. The outstanding balance of capital leases for governmental activities, which primarily consist of COPs, was $375.1 million as of December 31, 2016.

Lease-Purchase Agreements – Lease-purchase agreements are renewable one-year agreements that do not constitute legal indebtedness of the City and are not subject to legal debt limitations or voter approval. The City acts as lessee and makes periodic rent payments to a lessor for the use of the leased property. The City's obligation to make lease payments is contingent upon City Council appropriating funds to make rent payments each fiscal year. If the City fails to appropriate funds or otherwise fails to make the lease payments, the lease may be terminated. If the lease is terminated, the City loses its right to the pledged capital asset. Lease-purchase agreements are typically entered into for smaller capital equipment acquisitions such as automobiles, golf carts, or crime lab equipment. Once the lease payments are complete, the City retains ownership of the equipment or property.

[3] The City's debt policy, instituted in 1999, was most recently revised in 2014.

COPs Are a Type of Lease-Purchase Agreement – As with other lease-purchase agreements, COPs exist for a renewable one-year term that, legally, does not constitute indebtedness of the City. Similarly, COPs do not require voter approval. Unlike other types of lease-purchase agreements, a COP involves borrowing funds that are used to finance a capital project. In return, the borrower receives annual lease payments. City Council must appropriate funds for the annual lease payments, and under the City's COP guidelines, the payments must be funded by new revenue streams or measurable cost efficiencies or savings. While COPs are not subject to legal debt limits, the City's Debt Policy limits annual lease payments to no more than 5 percent of the general fund or of an enterprise fund's annual revenues.

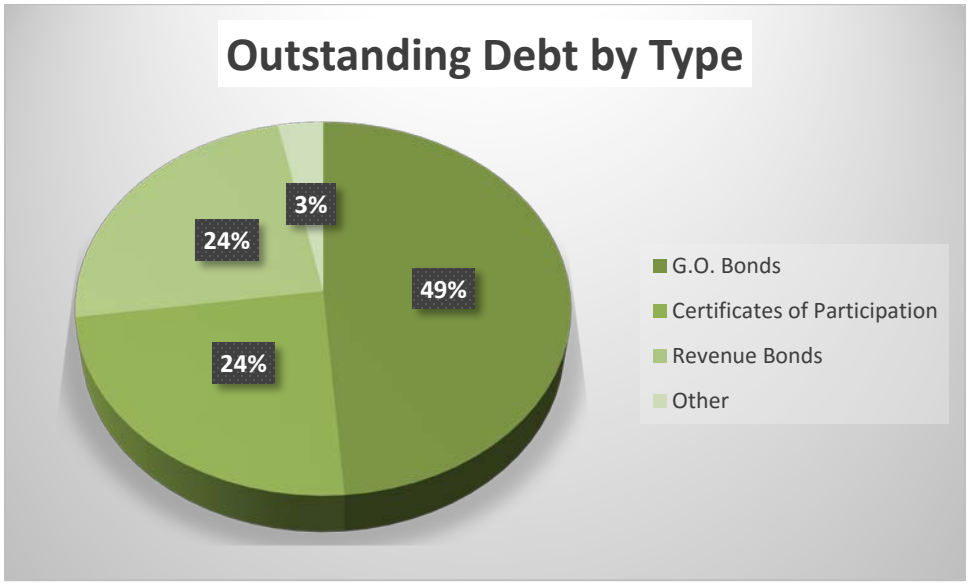
Certificates of participation do not require voter approval

COPs are sold to investors with the expectation the City will continue the lease each year by appropriating funds for the annual lease payments. As collateral to secure the financing, the facility's critical necessity to City operations provides purchasers of COPs increased assurance by reducing the possibility of the City terminating the lease. For example, COPs were used to finance the construction of the Wellington Webb Building, which houses many of the City's administrative offices. As with other types of lease-purchase agreements, once the final payment is made on the COPs, the City regains full ownership of the facility used to secure the COP agreement.

Allocation of Outstanding Debt and Other Obligations

The total outstanding debt and other obligations of the City's governmental activities as of December 31, 2016, excluding pension obligations, was $1.8 billion. As shown in Figure 1, GO bonds represent the largest portion of the City's 2016 governmental activities outstanding debt, with 49 percent of the total, while COPs and revenue bonds are the next largest, with 24 percent of the total each.

Figure 1: Governmental Activities – Debt and Other Obligations by Type



Source: City and County of Denver, Comprehensive Annual Financial Report, December 31, 2016

Overview of Key City Personnel Responsible for the Capital Improvement Program and Issuance of Debt

The annual capital planning process is a collaborative effort and requires the cooperation of multiple agencies within the City. The Capital Improvement Program has many functions, including identifying capital maintenance and expansion priorities for the annual budget and establishing the six-year capital improvement plan.[4][5] The most recent six-year plan, Elevate 2020, describes roles and responsibilities as follows:

City agencies – City agencies develop capital maintenance priorities and develop a list of prioritized discretionary project requests for submittal to the Budget and Management Office.

Budget and Management Office – A division of the Department of Finance, the Budget and Management Office prepares and provides other City agencies with instructions and guidelines for the capital planning program and six-year capital plan. The Budget and Management Office also reviews the prioritized lists of discretionary projects and works with City agencies and the Mayor's Office to recommend which of these capital projects can be undertaken within the available funds. This recommendation is made to the Executive Development Council.

Executive Development Council – The Executive Development Council includes representatives from numerous City agencies who have significant roles in the capital improvement planning process. The Executive Development Council develops the annual capital improvement program budget using recommendations provided by the Budget and Management Office. The Executive Development Council also serves as the decision-making body that recommends discretionary projects to be completed with currently available capital funding once commitments to payments and capital maintenance are realized.

City Council – City Council is responsible for final approval of the annual capital budget and the underlying capital funding recommendations made by the Executive Development Council. City Council also approves the issuance of new bonds under voter-approved bond programs and the issuance of certificates of participation.

In addition to the agencies mentioned in the Elevate 2020 document, we noted two other key agencies involved in the debt management process.

Cash, Risk, and Capital Funding Division (CRCF) – A division of the Department of Finance, CRCF manages and invests the City's funds. CRCF also oversees the issuance and administration process of bonds, certificates of participation, and other debt of the City. CRCF is responsible for the identification, analysis, and management of the City's risk and exposure, including risk analysis, insurance, workplace safety, and worker's compensation.

Department of Public Works – Among the many duties for which Public Works is responsible is the design and construction of various City projects, including streets, alleys, and bridges. In addition, Public Works oversees construction projects bid out to external contractors. This process includes preparation of plans, specifications, and cost estimates, as well as the administration of contracts

[4] City Charter mandates a six-year capital planning process.
[5] All information in this section was derived from the City and County of Denver, Colorado Six-Year Capital Improvement Plan 2015 – 2020, Elevate 2020, and from the City's Department of Finance website.

for construction of City facilities. The agency is also responsible for overseeing agreements with outside consultants involved in managing capital projects .

In addition, beginning in 2018, a new division of the Department of Finance was created to help oversee the debt management process. This division, called the **Capital Planning and Programming Division (CPP)**, is tasked with the oversight of financial planning, budgeting, program oversight, and contract administration of capital projects. CPP was established in response to the City's growing capital projects portfolio. This includes the projects authorized under Ballot Measure 2C, the 2017 bond program, among others. Many of the activities historically associated with the previously mentioned agencies will be under the authority of the CPP going forward.

Denver's Debt Issuance Is Governed by Both City and State Laws

The City is subject to various external requirements and internally developed practices regulating debt issuance. Requirements outside of management's control include the Taxpayer's Bill of Rights (TABOR) amendment to the Colorado Constitution, and City ordinance language requiring voter approval and debt limits, as well as review of the City's debt issuances by national credit rating agencies. Internal oversight of the debt issuance process includes the involvement of various City entities, such as the Budget and Management Office; the Cash, Risk, and Capital Funding Division of the Department of Finance; the Executive Development Council; the City Attorney's Office; and City Council. In addition, there are rules established in the Denver Revised Municipal Code covering bond issuances, as well as City debt, capital lease financing, and certificate of participation policies.

Voter Approval Requirements and Debt Limits – Article X, Section 20—The Taxpayer's Bill of Rights—of the Colorado Constitution requires the City to obtain voter approval prior to issuing any multi-year fiscal debt or obligations, except for debt issued by City enterprises and when refunding outstanding bonds. Additionally, Article XI, Section 6 – Local Government Debt of the state constitution limits the amount of general obligation debt the City may incur. City ordinance establishes Denver's debt limitation for GO bonds at 3 percent of actual valuation of taxable property within the City.[6]

As shown in Table 1, the City's outstanding GO bonds are well below the maximum GO debt allowable.

[6] Denver Revised Municipal Code § 7.5.2

TABLE 1. Legal General Obligation Debt Margin Calculation (in thousands)

TOTAL ESTIMATED ACTUAL PROPERTY VALUATION – December 31, 2016	**$105,772,919**
Maximum general obligation debt, limited to 3% of actual valuation	$3,173,188
Less outstanding bonds chargeable to limit[1],[2]	(761,406)
LEGAL DEBT MARGIN – December 31, 2016	**$2,411,782**

Source: City and County of Denver, Colorado 2017 Disclosure Statement

Internal Rules, Policies, Guidelines, and System – City ordinance establishes rules on bond issuances, including, but not limited to, using a financial adviser and notifying City Council before any bond issuances.[7] The ordinance also sets rules on approving a bond sale and for refunding requirements. The City's debt policy says the City must consult with external legal and financial consultants on debt obligations, including the use of bond counsel and financial advisers. To further structure debt-related activities, the City has adopted additional written guidelines specific to capital leases and COPs. In addition, the City uses a debt management database to track and manage outstanding long-term debt and other obligations, including general obligation and revenue bonds, and COPs.

[1] This figure represents outstanding gross principal of the City's General Obligation Bonds. Debt Margin calculation in the City's CAFR is outstanding principal net of the Debt Service fund balance as of December 31, 2016 allocated to Bond Principal in the amount of approximately $29.4 million. Amounts in the Debt Service Fund may be applied to both principal and interest of General Obligation Bonds.

[2] On March 6, 2017, the General Obligation Better Denver Bonds, Series 2010D and 2011A, were legally defeased, thereby reducing the outstanding bonds chargeable to limit by $45.6 million.

[7] Denver Revised Municipal Code § 20-92 through 20-97.

OBJECTIVE

The objective of the audit was to evaluate whether the Department of Finance is effectively managing certain elements of its debt issuance process and to assess the effectiveness of the City's administration of bonds and certificates of participation. In addition, our objective also included an evaluation of the Departments of Finance and Public Works' management of expenditures of bond and certificate of participation proceeds. The audit also assessed agencies' general controls over critical information systems.

SCOPE

Bonds issued by the City to fund major capital projects are subject to bond covenants and regulatory compliance requirements through maturity many years later. Our audit assessed the City's pre-issuance and post-issuance procedures for outstanding bonds and certificates of participation, and management of bond proceed expenditures. These procedures included an assessment of information technology general controls over key information technology systems identified during the course of our audit. We excluded bonds issued and certificates of participation executed and delivered by City-owned enterprises and other business-type activities from the scope of our audit.

METHODOLOGY

We applied multiple methodologies to gather and analyze information pertinent to the audit scope, which included the following:

- Interviewing personnel from Public Works; Department of Finance; other agencies; and bond program contractors to gain an understanding of their roles and responsibilities in their day-to-day management and of the process and systems used in debt management
- Identified, reviewed, and, where applicable, tested key internal controls over the debt management process
- Reviewing documents related to recent certificates of participation issuances
- Comparing issuance costs on recent City bond issuances to those of similar cities to determine if the City's costs are in line with those of peer communities
- Judgmentally selecting a sample of debt covenants for compliance testing
- Randomly selecting a nonstatistical sample of debt service payments to test for timeliness and accuracy
- Reviewing contracts and amendments for Better Denver Bond program management consultants and performing additional testing to determine compliance with the terms of the contract
- Reviewing documentation related to the purchase, development, and implementation of the Capital Integration System software application for tracking capital projects

- Examining debt-funded expenditures from July 1, 2012, through June 30, 2017, and selecting a random, nonstatistical sample to test for proper project authorization, proper approval, accuracy of amounts charged, and allowability of the item charged
- Performing information technology general controls testing for critical debt management systems

FINDING 1

The City's Debt Policy Does Not Require Documentation of Exceptions to Guidelines for Certificates of Participation

The majority of the City and County of Denver's (City's) debt is issued through bonds. In addition to bonds, the City executes and delivers security instruments called certificates of participation (COPs) to finance construction of capital improvements essential to City operations. These securities are executed without voter approval. According to various agencies involved in the process, COPs are used when a bond initiative and subsequent voter approval would take too long to realize the construction or renovation of essential city facilities or as otherwise appropriate under the City's debt policy. Since COPs are executed and delivered without voter approval and paid from taxpayer dollars, the Department of Finance has determined important guidelines for such issuances. For the COPs executed and delivered in 2015, the Department of Finance deviated from one of its guidelines: that capital improvements using COP funds result in new revenue, cost efficiencies, or cost savings that will be realized and dedicated to the COP payments. Although we determined that it was reasonable to deviate from the guidelines, best practice suggests that those deviations should be documented. This provides important historical context for subsequent decision making and reviews. The current debt policy does not require the Department of Finance to document reasons for departing from the guidelines within the policy.

The City executed and delivered COPs in 2015 for $23.4 million to help purchase and fund capital improvements of two buildings for the Department of Safety (Safety): 911 center and fleet maintenance facility.[8]

The Cash, Risk, and Capital Funding Division Did Not Accurately Estimate New Revenue or Realized Cost Savings for the 911 Building Financed by the 2015 Certificates of Participation

The 911 call center was identified as a need in 2006 and had been on the six-year capital improvement plan since that time. Safety's existing emergency call center did not meet code requirements for such a facility, and agency officials said it was too small to house the number of needed employees. In 2014, the City's Real Estate Division found an existing, nonemergency call center for sale, with enough room to house employees. The appraiser of the property recommended an appropriate price for purchase and noted the property's value would likely increase in the next several years. There were several problems identified with the financial projections for this facility.

No realized cost savings - Public Works' project managers determined that the cost to build a new call center, the same size as the one being considered for purchase, would be $40 million to $45 million. The building considered for purchase was more than double the size needed for call center purposes. Project managers also determined that the cost to purchase and retrofit the appraised building would be about $23 million. This calculation shows the advantage of buying the building versus building one. However, it does not represent cost savings that would be used to make COP payments. The policy states that the COP-funded facility should generate cost

[8] The City did not use the two purchased facilities to secure the COPs, instead the City secured these COPs with a lease on three fire stations and a library.

savings or efficiencies compared to the existing facility, or that the COP-funded project generate new revenues to the City. For example, if an agency moves several divisions from separate locations into one building that has a lower lease payment than the separate locations, there are cost savings. These savings can be used for debt service payments.

Inaccurate rent income projections - Further, there were issues with an analysis performed to help determine the appropriateness of delivering COPs for the purchase of this building. Safety prepared a five-year cash flow projection based on the call center's budget to determine if debt service payments were feasible. This projection included a new revenue source for repayment of the COPs. We identified two inaccuracies in this projection. First, the analysis showed that another government agency would make $469,000 in annual rent payments to the City to use part of the facility. These payments were calculated based on an intergovernmental agreement signed by the Real Estate Division to begin January 1st, 2016. However, according to the project management plan, approved by Public Works project managers, the project was not due for completion until November of 2017. It was, therefore, unreasonable for the Department of Safety or Real Estate Division to anticipate rent payments twenty-three months before the building was ready to be occupied. Still, when Safety and the Cash, Risk, and Capital Funding Division (CRCF) of Finance presented their justification to City Council, the rent payments were represented as available funds for COP repayment beginning January 1, 2016.

It was unreasonable to anticipate rent payments before the call center could be occupied.

Incorrect 911 employee cost estimates - Second, the Safety Department incorrectly estimated salary expenses in its cash flow projection. To help the agency sustain debt payments, some call-center employees' positions were to be temporarily funded by the general fund. We noted that salaries for thirteen, twelve, and ten employees were supposed to be removed from Safety's budget in 2016, 2017, and 2018, respectively. Instead, salaries for thirteen, twenty-five, and thirty-five employees were removed in those years. This, together with unreasonable timing of rent payments, resulted in lower projected expenditures and higher projected revenues of the division during the period from January 2016 to 2019. CRCF does not appear to have a process to verify the accuracy of financial analyses provided by agencies to support COP issuances.

The call center has a current estimated completion date of December 2019. When the COPs were executed and delivered, the estimated completion date presented to City Council was August 2017. The current completion date is approximately twenty-seven months after the date presented to the council. While this delay is occurring, the City is incurring about $68,000 per month in interest costs on the COPs. In addition, monthly rent payments of $39,000 from the intergovernmental agreement will not be collected until the facility is complete.

The Cash, Risk, and Capital Funding Division Did Not Document the Reasons for Departure from Guidelines for the Fleet Maintenance Building

The second facility purchased was a fleet maintenance building for Department of Safety vehicles that would also house the Electronic Engineering Bureau, a division of Technology Services. At the time of the purchase analysis, these divisions were housed in a facility scheduled to be torn down as part of the National Western Complex improvement and renovation project. For the fleet maintenance relocation project, we saw analyses of other options, including moving these divisions into other existing City buildings. The analysis showed that the best option was to buy a new building. The Real Estate Division found a building with existing car bays for fleet vehicles,

implying cost efficiencies in the purchase. However, there were still no cost savings or revenue streams identified to contribute to the COP debt service payments. The debt policy does not state what procedures should be followed when a facility is being torn down and the affected City agencies need to move, potentially requiring debt funding.

Best Practice Suggests Documenting Necessary Deviations from the Policy

The Government Finance Officers Association (GFOA) offers best practices for a debt policy.[9] The City of Denver's debt policy contains many of these best practices, such as limitations on indebtedness and structural features for types of debt issued. GFOA's best practices state that a debt policy should "preserve flexibility" for situations that may arise in the debt issuance process, which would include executing and delivering COPs. The City's debt policy should be more explicit in creating procedures to guide the debt issuance process when there is an opportunity or scenario that justifies departing from the policy. In addition, "Standards for Internal Control in the Federal Government," known as the "Green Book," states that effective internal control systems require documentation.[10] As the City's debt policy is part of the internal control environment, the reasons for deviating from standard COP execution and delivery processes should be documented.

The City's debt policy states that its purpose "…is not to regulate the issuance of any such [debt] Obligation(s)." Also, CRCF stated that COP guidelines in the debt policy are not requirements for executing COPs. The debt policy does not specify exceptions to the standard procedures, nor does it determine what to do when an exception is justified.

An undocumented departure from the City's debt policy when executing and delivering COPs may result in the agencies not properly vetting projects and create a risk the City may not receive anticipated revenue to offset finance charges. Since COPs are executed and delivered without voter approval, the City should be more prudent in how it manages this type of debt and should document exceptions to City policy.

RECOMMENDATION 1.1

The Department of Finance should update the City's debt policy to require documentation for any deviation from the policy.

Agency Response: Agree – August 2018

[9] Patricia Tigue, "A Guide for Preparing a Debt Policy," Government Finance Officers Association, accessed February 20, 2018, http://www.gfoa.org/sites/default/files/AGuideForPreparingADebtPolicy.pdf

[10] U.S. Government Accountability Office. *Standards for Internal Control in the Federal Government.* GAO-14-704G (Washington, DC, 2014), 25, http://www.gao.gov/assets/670/665712.pdf.

RECOMMENDATIONS

We make the following recommendation to the Department of Finance:

1.1 **Debt Policy Should Require Documentation of Exceptions**—The Department of Finance should update the City's debt policy to require documentation for any deviation from the policy.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: While the Department of Finance does collect and review supporting documentation for financings of the City, we agree the Debt Policy should be revised to document deviations from debt policy guidelines.

FINDING 2

Opportunities Exist to Improve Post-Issuance Internal Controls in the Debt Management Process

An internal control is a process to help an agency comply with laws and regulations, run operations efficiently and effectively, and report reliable information about its operations. We found that the City's debt-related internal controls can be improved in three areas. First, some post-issuance internal controls are not documented, creating a risk that employees may not have a clear understanding of their responsibilities and fail to perform assigned controls.[11] Second, there is not a formal process to ensure that the City Attorney's Office and the Cash, Risk, and Capital Funding Division (CRCF) within the Department of Finance are informed of all potential private uses in facilities funded by tax-free bonds and certificates of participation. Finally, CRCF has not developed a formal procedure to scrutinize City operations for disclosable events in a timely manner.

Cash, Risk, and Capital Funding Division and the Controller's Office Do Not Document Some Post-Issuance Controls

We found several examples of post-issuance internal controls being performed but not documented. This included controls surrounding the covenant compliance checklist, the annual arbitrage calculation, and debt information data used for the Comprehensive Annual Financial Report (CAFR).

Covenant compliance checklist - Each long-term debt issuance has certain covenants, which are either financial restrictions or commitments to perform certain post-issuance tasks such as issuance of the City's annual financial disclosures. According to the City's debt policy, CRCF is responsible for annually reviewing existing financial covenants under all existing obligations. The division uses a covenant compliance checklist as the primary method to monitor whether these covenants are met. The checklist is updated annually to include any new debt issuance covenants based on official statements and continuing disclosure undertaking documents.[12] When all covenants are listed, various responsible Department of Finance employees and enterprise agency personnel confirm compliance with covenants by signing and dating the checklist item they are responsible for. Staff from different agencies perform a secondary review of items on the compliance checklist, either during the checklist preparation period or during the year as part of their routine responsibilities. However, there is no procedure specifically identifying which staff members are to perform this secondary review of the checklist nor are signatures required for these reviews.

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[11] Post-issuance refers to all debt-related procedures after debt has been issued, such as recording debt in the City's financial system, tracking debt-related information, making timely debt service payments, and complying with any requirements in debt documents and local, state, or federal laws and regulations.

[12] Official Statement (OS) and Continuing Disclosure Undertaking (CDU) are two of the many documents prepared as part of bond or COP issuances. OS is a document describing essential terms of the debt issuance. CDU describes required disclosures. In a direct or private placement sale situation, bonds are directly sold to a small number of investors as opposed to an open market sale. An OS is not required for private placement situations, but may be prepared if a direct purchaser requests it. CDUs are not required for private placements, and any disclosures are voluntary. Rating agencies have recommended in recent years that issuers disclose these obligations. The City provides general terms for these types of obligations on https://emma.msrb.org/, a website maintained by the federal Municipal Securities Rulemaking Board.

Annual arbitrage calculation - The Controller's Office prepares annual workpapers supporting the CAFR. Among others, those workpapers include an arbitrage rebate liability calculation and long-term debt-related data such as future debt payments. Arbitrage, when used in the context of tax-exempt debt, is money earned ". . . when the gross proceeds of an issue are used to acquire investments that earn a yield that is materially higher than the yield on the bonds of the issue."[13] In other words, this is the difference between the interest earned from investing debt proceeds once they are borrowed vs. the interest paid to debt holders. The Internal Revenue Service allows a certain amount of interest to be earned in excess of interest paid before a portion of the earnings, or the "arbitrage rebate," must be paid to the federal government.

To discourage excess interest earnings, the IRS has rules and exceptions applicable in different situations. Based on these rules, the City has several processes in place, such as monitoring how fast proceeds are expended, investment decisions for proceeds, five-year arbitrage reports for issuances prepared by a third party, and an annual arbitrage rebate liability estimate prepared by the Controller's Office. While the Controller's Office has an adequate process for calculating the annual liability estimate, the manager of financial reporting does not document her review of the arbitrage liability estimate, which may result in undetected errors.

Debt information entry - An accounting specialist at the Controller's Office enters debt information into the City's debt management software program based on debt documents prepared by external financial advisers. There is no review process to verify accuracy of this data following the entry. There are compensating controls, such as matching of debt payments from this program to paying agents' invoices, which would help identify discrepancies. Debt issuances and payments are also recorded in Workday, the City's financial accounting system. These entries go through the regular entry review and approval process, which helps ensure Workday records are accurate. As some CAFR debt workpapers are based on the Controller's debt management software reports, it is important to review them for accuracy. The manager of financial reporting is reviewing these workpapers, but this review process is not documented.

"Standards for Internal Control in the Federal Government," known as the "Green Book," states that documentation is required for the effective design, implementation, and operation of an agency's internal control system.[14] Management should use judgment in determining the extent of documentation, but internal control responsibilities documented in policies and procedures is one of the Green Book's minimum requirements.

CRCF and the Controller's Office were not aware of best practices for documentation of the review process or how they would apply in this situation. CRCF officials say they are in the process of adding and improving procedures. In some instances, such as the review of debt workpapers for the CAFR or for the arbitrage liability calculation, the Controller's Office said there is not written evidence of review because electronic workpapers without signature approval fields are used.

If internal control documentation is not required, the result may be lack of clarity of responsibilities and responsible employees, and hence, failure to perform necessary controls. If the arbitrage rebate liability estimate is incorrect, the result could be erroneous debt-related information in the CAFR. Additionally, the Controller's Office may not have adequate financial planning to make the rebate payments. Although the risk of arbitrage rebates is low at this time due to current

[13] IRS Publication 4079: Tax-Exempt Governmental Bonds, p.11. https://www.irs.gov/pub/irs-pdf/p4079.pdf. Accessed on 9/28/17.
[14] U.S. Government Accountability Office. *Standards for Internal Control in the Federal Government.* GAO-14-704G (Washington, DC, 2014), 25, http://www.gao.gov/assets/670/665712.pdf.

economic conditions, good internal controls would help ensure such risks are minimized in any market environment. If covenant requirements are not met, the City would have to address the noncompliance, which could damage investor confidence and negatively impact the City's credit ratings. To mitigate these risks, we offer the following recommendation:

RECOMMENDATION 2.1

The Department of Finance should improve internal controls over post-issuance procedures by requiring documentation of supervisory review of the covenant compliance checklist, the arbitrage rebate liability calculation, and debt workpapers for the Comprehensive Annual Financial Report.

Agency Response: Agree – March 2019

The Cash, Risk, and Capital Funding Division and the City Attorney's Office Do Not Have Adequate Procedures to Comply with Rules on Private Use of Tax-Exempt, Debt-Funded Facilities

One of the Internal Revenue Service requirements for tax-exempt government bonds and certificates of participation (COPs) is compliance with private business use rules. Examples of private use would be rental of public space to a for-profit restaurant or a nonprofit organization, free use of facilities by nongovernmental organizations, or research agreements where a nongovernmental organization uses the City's space or equipment. At the time of issuance, CRCF cooperates with various agencies, including the City Attorney's Office and outside bond and tax counsel, to evaluate if there will be any private business use in the financed projects. If private use of more than 10 percent is expected, taxable debt may be issued to allow for this flexibility.[15] While the City's pre-issuance private activity-related procedures appear to be robust, its post-issuance procedures on private use could be improved.

After debt is issued, the City must monitor tax-free debt-funded projects for potential private use rules. The City's procedures for post-issuance private use compliance are:

- When debt is issued, CRCF asks "receiving agencies," or those expending bond or COP proceeds, to disclose potential private use issues in the future. However, over the life of a debt issuance, employees responsible for monitoring private use may depart an agency, and without written procedures, there is a risk a potential private use will not be reported to CRCF;[16]

[15] Private use calculations are complex and vary depending on bond issuance. Generally, 10 percent private use means rental space exceeding 10 percent of total facility space and income from a nongovernmental entity exceeding 10 percent of debt payments for this facility. There are various exceptions, and use is cumulative, which means new use must be added to previous use, and earlier calculations may have to be revised to account for new information. Therefore, these calculations are usually outsourced to the outside bond tax counsels.

[16] A receiving agency is an agency receiving tax-free funding for its projects, for example, Parks and Recreation Department would be a receiving agency for new parks and recreation centers.

- The City Attorney's Office is responsible for reviewing all City contracts. However, receiving agencies may inappropriately receive purchase orders or make verbal agreements for the use of their facilities and fail to inform the City Attorney's Office. Such agreements are unlikely to exceed the 10 percent limit. However, the City Attorney's Office must be aware of all agreements to evaluate the impact;
- Any agency can contact the City Attorney's Office or CRCF to seek an opinion on potential private use issues, but there is no process to periodically reach out to agencies to identify potential issues in a timely manner; and
- When the City Attorney's Office is aware of potential issues, it obtains an outside legal opinion on potential issues, which includes calculations to comply with the 10 percent limits.

Internal Revenue Service private use rules require that, to be tax-exempt, governmental bonds must comply with private business rules at issuance and on an ongoing (post-issuance) basis. IRS Code Section 141(b) states that a bond issue exceeds the limits of the private business test if the use exceeds both the 10 percent limit of the private business use test and the 10 percent limit of the private payment test.[17] Denver's debt policy states that the City will not take any action that would cause any of its outstanding tax-exempt obligations to become private activity bonds. The City's post-issuance procedures state that the City's compliance officer (in this case, the capital funding director in the CRCF Division) is responsible for reviewing compliance on an annual basis. The annual compliance review must include confirmations with the Budget and Management Office, controllers of city-owned enterprises, the City Attorney's Office, and the Real Estate Division that there have not been any new or proposed changes in the use of financed facilities that could constitute private use.[18]

CRCF has explained that internal controls over on-going compliance with private use rules are not fully developed because the City is currently developing new processes to meet the most recent post-issuance compliance guidance from the federal government.

Lack of adequate private use compliance procedures may result in private business activity going unnoticed, leading to the City's noncompliance with IRS regulations. If private use rules are violated, the City bonds and COPs may lose their tax-exempt status from the day of issuance. To mitigate this risk, we offer the following recommendation:

RECOMMENDATION 2.2

The Cash, Risk, and Capital Funding Division should work with the Controller's Office to add a question to the annual financial questionnaire to City agencies. The question should be structured to ask agencies about new potential private use of tax-free, debt-funded facilities.

Agency Response: Agree – September 2018

[17] In addition to the 10 percent basic rule, there are additional limits on private business activity, for example, when private business use is disproportionate to governmental use.

[18] City-owned enterprise examples are Denver International Airport and Wastewater Management.

The City's Procedures for Reporting Disclosable Events Are Not Sufficiently Detailed

The Securities and Exchange Commission (SEC) requires that municipal debt issuers disclose fourteen identified events that could cause official statements to be materially misstated or not useful for investor purposes. These disclosures must be filed with the federal Municipal Securities Rulemaking Board through its EMMA.msrb.org website for public availability. We found that the City's disclosable event process is not sufficiently detailed and formalized.

At the time of issuance, required disclosures are described in the continuing disclosure undertaking of the official statements, stating a municipality's agreement to disclose, according to the disclosures defined in the SEC regulation. The Cash, Risk, and Capital Funding Division (CRCF) is responsible for disclosures in the City. Based on interviews and observations, we found that CRCF has a good process for preparing and publishing the annual financial disclosure.

In addition to annual disclosures, certain events are disclosed throughout the year. Some events requiring disclosure could indicate financial hardships, such as unscheduled draws on debt service reserves, or late principal or interest payments. Some other events could indicate that the City was taking opportunities to save money, such as "calling" bonds—redeeming them early—or "defeasing" debt—a technique of refinancing debt. CRCF would be aware of many of these events, should they occur. For example, if a new trustee bank were appointed to make debt service payments, CRCF would be responsible for contracting with the new trustee. Also, if an adverse Internal Revenue Service tax opinion arose for a debt issuance, CRCF would be engaged for the audit process. For some events, other divisions of the Department of Finance should notify CRCF. If a payment were made late, or missed entirely, the Controller's Office would notify CRCF. Also, CRCF has followed its post-issuance procedures and engaged a third-party dissemination agent to help ensure certain events are disclosed. Finally, CRCF has filed voluntary disclosures, which are not required by SEC regulation.

While our examination showed CRCF has made all disclosures promptly and accurately, we noted that the division only had three types of disclosable events in the past five years: bond calls, debt defeasance, and changes to ratings. Though CRCF follows the City's current post-issuance procedures related to disclosable events, the procedures are not specific and only outline general responsibilities for disclosure without identifying procedures for individual CRCF staffers. Further, CRCF does not document its biweekly team meetings, where disclosable events would be discussed, nor does the team otherwise document its consideration of potential disclosable events.

The Government Finance Officers Association offers best practices for continuing disclosure procedures.[19] The City of Denver's post-issuance procedures do not adhere to two of the association's five guidelines. First, the association suggests that continuing disclosure procedures include processes to "ensure accuracy and timeliness of reported information." Timeliness is a key element when designing procedures, as the SEC requires these events be reported within ten days

[19] "Understanding Your Continuing Disclosure Responsibilities," Government Finance Officers Association, accessed February 13, 2018, http://www.gfoa.org/understanding-your-continuing-disclosure-responsibilities-0.

of occurrence. Second, the procedure should identify who in the department is responsible for filing the event disclosures.

The City's post-issuance procedures name the entire CRCF Division with responsibility to file disclosures timely. Further, disclosure filings on the EMMA website show that CRCF team members or the contracted third party may file these reports. Audit work determined that the Department of Finance is not currently reviewing the third parties' controls and processes to ensure accurate and timely reporting.

Without a process to ensure that all responsible parties are aware of their responsibilities and perform them, there is a risk of failed succession planning for post-issuance procedures. While the current managers and administrators at CRCF have consistently filed disclosures accurately and in a timely manner, there is no process to ensure employees understand the requirements for filing disclosures going forward. When management performs internal controls, this performance should be documented. Failure to comply with disclosure requirements could result in a variety of penalties, ranging from a requirement to address the missed disclosure to defaulting on the terms of the debt. A settlement would likely result in further negative effects for future debt issuances, such as lowered ratings and difficulties gaining the trust of voters for approval of debt for capital improvements.

RECOMMENDATION 2.3

The Department of Finance should improve oversight of event disclosure by establishing a formal process to periodically review all potential event disclosures.

Agency Response: Agree – September 2018

RECOMMENDATIONS

To improve post-issuance internal controls in the debt management process, we make the following recommendations to the Department of Finance:

2.1 **Documentation of Internal Controls**—The Department of Finance should improve internal controls over post-issuance procedures by requiring documentation of supervisory review of the covenant compliance checklist, the arbitrage rebate liability calculation, and debt workpapers for the Comprehensive Annual Financial Report.

Auditee Response: Agree, Implementation Date - March 2019

Auditee Narrative: As is noted in the Audit, a secondary review of compliance checklist items is currently performed by appropriate staff; however, the Department of Finance will add a signature block to the checklist to document who is performing this review.

Arbitrage Rebate Liability Calculation and debt workpapers for the CAFR – The majority of all Comprehensive Annual Financial Report workpapers are electronic. The Controller's Office currently tracks the status of all workpapers including the number, description, date needed, responsible party, date the external auditor receives and notes/comments. We will add a column to include reviewer and date reviewed.

2.2 **Stronger Internal Controls Over Private Use**—The Cash, Risk, and Capital Funding Division should work with the Controller's Office to add a question to the annual financial questionnaire to City agencies. The question should be structured to ask agencies about new potential private use of tax-free, debt-funded facilities.

Auditee Response: Agree, Implementation Date - September 2018

Auditee Narrative: The Department of Finance's post issuance procedures (based on GFOA best practices and guidance from outside disclosure counsel on tracking private use of tax-exempt financed assets) currently calls for a review of financed assets on a periodic basis. Additionally, post issuance compliance is audited randomly by the U.S. Internal Revenue Service (IRS) and the Department has been found in compliance with all such audits.
CR&CF is in the process of enhancing its procedures and documenting the internal controls for post issuance practices by developing a comprehensive procedural checklist. CR&CF feels this document, which focus solely on financed assets, is more targeted versus including a question as part of the City's annual questionnaire to all City agencies.

2.3 **Stronger Internal Controls Over Disclosable Events**—The Department of Finance should improve oversight of event disclosure by establishing a formal process to periodically review all potential event disclosures.

Auditee Response: Agree, Implementation Date - September 2018

Auditee Narrative: We agree that the current disclosure process could be better documented. We believe the Department has a robust and comprehensive process in place to track its ongoing post issuance disclosure obligations as evidenced in the comprehensive review of disclosure compliance performed in 2014 as part of The Security and Exchange Commission's Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") and recent random financing audits performed by the IRS. The Department of Finance routinely evaluates its disclosure obligations and is in the process of enhancing its procedures and will include the documentation of periodic reviews of potential event disclosures.

FINDING 3

Denver Lacks a Citywide Policy Governing Bond and Certificate of Participation Expenditures

Federal law restricts the spending of proceeds from tax-exempt bonds and certificates of participation (COPs) to capital improvements, rather than operating expenditures. However, there are some gray areas on what constitutes an operating expenditure. The main weakness we found was that Denver does not have a Citywide policy including ineligible expenditure guidance that would apply across all bond- and COP-funded projects. Instead, to ensure proper control of expenditures of long-term debt funds, the Department of Finance and the Department of Public Works create policies and provide training specific to each program. We could not find such policies for some programs within our scope, and we noted a lack of awareness of these policies.

We looked at the City's Fiscal Accountability Rule (FAR) 4.3 for capital projects. As a majority of projects funded by bonds and COPs are capital projects, we reviewed this rule and found that agencies must obtain approval from the Budget and Management Office before spending debt proceeds on items typically prohibited for capital project funds, such as travel, lodging, and subscriptions. No full list of generally prohibited expenditures was included in this rule. Budget and Management Office officials said that while this rule generally applies to capital improvement projects, each bond-funded program has its own separate expenditure policy. Policies for individual bond programs are created before budget development and take into consideration legal guidance from the City Attorney's Office and from outside counsel. Meanwhile, Budget and Management Office officials stated that for COPs, which typically fund one or two projects, there are only verbal discussions of allowable expenditures at the beginning of the project.

We requested policies, procedures, and training materials from the Departments of Finance and Public Works to understand their expenditure procedures and to review allowable expenditures for bond programs within our scope. Based on interviews, observations, and various documents provided, we noted the following steps in the review and approval of allowable expenditures:[20]

- Conceptual (i.e., high-level estimates) project management plans are prepared for planned projects. The City budget shows total amounts for approved projects (either voter-approved as part of bond approval or the capital improvement plan in the Budget Book).
- The Budget Management Office, Public Works, and the City Attorney's Office create allowable expenditure policies for new bond programs.[21]
- Public Works prepares details of project management plans for projects in the bond program applying the expenditure policy.

[20] There may be a few slight variations of this process. For example, if a project's receiving agency is the Parks and Recreation Department, the invoice must first be approved by Parks and Recreation's project manager, then a Public Works project manager.

[21] In early 2018, the newly created Capital Planning and Programming Division within the Department of Finance has taken over most capital project responsibilities of the Budget and Management Office described throughout the report. The new division has reported that it is currently updating processes and procedures related to capital projects.

- Public Works and agencies that own the project prepare requisition requests based on project budgets.[22]
- The Budget and Management Office approves requisitions based on project purpose, on whether the total project amount is within budget, and on the required timing of the project.
- The project manager, usually from Public Works, reviews all invoices for allowable expenditures. The project manager's supervisor performs secondary reviews.
- The contracts administrator, also usually from Public Works, reviews invoices for mathematical accuracy and proper accounting coding.

We found the following weaknesses in this process:

- Neither Public Works nor the Budget and Management Office could provide policies on allowable expenditures for the 2015 revenue bond and 2017 general obligation bond programs. The City has issued bonds under the 2015 program for the National Western Complex and Colorado Convention Center renovations in 2016 and has expended some bond proceeds. In addition, Public Works was preparing detailed project management plans for the 2017 bond program as of February 2017. These actions have occurred without clear guidance on what expenditures are allowable.
- There were several allowable expenditure policies for the 2007 general obligation bond program spread across multiple agencies, rather than organized as one list of permissible expenditures. While there was no contradiction between the three documents, they covered different types of expenditures. Further, some employees with approval responsibilities did not have copies of the policies and did not know about them. These employees, however, confirmed receiving some training in 2009 or when they started working for the 2007 bond program and appeared to have some basic information.
- Since Budget and Management officials don't always scrutinize expenditures when approving requisitions, project managers appear to be the primary control point in determining allowable expenditures. However, project managers may be relying on the agency that owns the project to determine what costs are permissible, and these agencies have an incentive to use funds from bonds or certificates of participation to cover operating expenses, which aren't permissible expenditures.
- A position at the Department of Finance responsible for giving final review and approval to 2007 bond program expenditures has been vacant for a year. Department of Finance management did not reassign review responsibilities because City employees and the bond program manager did not adequately coordinate responsibilities.

The Government Finance Officers Association's guidance for capital project monitoring and reporting states that a capital project policy should include considerations for arbitrage, bond covenants, and Securities and Exchange Commission regulations. In other words, this policy should include items relevant for bonds and COPs.

[22] A requisition is an internal document prepared by an agency to obtain an advanced authorization from an agency approving requisitions to pay for a product or service. The City has policies and procedures to specify which purchases must be pre-approved via a requisition. In most cases, requisitions have an estimated or specific monetary amount, a vendor or service provider, time period, and an approval from the requesting agency.

The main weakness is that the capital project policy lacks a description of what types of expenditures are appropriate to pay with funds from debt issuances. In addition, management has not provided clear guidance and recent training or distributed responsibilities related to expenditures of proceeds from bonds and certificates of participation. Though the Budget Management Office said a list of disallowed expenditures for bond- and COP-funded projects was not prepared because each program or project is unique, based on the response from the City Attorney's Office and our review of provided legal references, we conclude that a general policy would be both permissible and beneficial.

Without clear responsibilities and written policies, City employees responsible for bond- and COP-funded project expenditures may approve expenses not allowed under federal law. While a majority of expenditures are for capital project design, engineering, and construction, which are clearly allowable, others, such as supplies, photocopying, new cameras, and maintenance projects may be questionable. Even if legally allowed when allocated to bond-funded projects, spending should be evaluated to determine whether the City wants to pay interest on typical operating expenditures for multiple years, reducing funds available for bond-funded capital projects. With two large bond programs from 2015 and 2017 underway, it is especially important to establish proper safeguards over taxpayer funds. Poor controls surrounding expenditures can negatively impact citizens' confidence in the City's management and undermine support for future bond programs.[23]

RECOMMENDATION 3.1

The Capital Planning and Programming Division should create a policy governing expenditures of tax-exempt debt proceeds or incorporate such a specific policy into existing City rules or policies for capital projects.

Agency Response: Agree – July 2018

RECOMMENDATION 3.2

The Capital Planning and Programming Division and the Department of Public Works should provide and document training on the new policy.

Agency Response: Agree – July 2018

[23] Although the processes described in our report refer to the Budget and Management Office, our recommendations are addressed to the newly created Capital Planning and Programming Division within the Department of Finance, which is now responsible for these functions.

RECOMMENDATIONS

To strengthen the controls surrounding bond and certificate of participation fund expenditures, we make the following recommendations to the Capital Planning and Programming Division and the Department of Public Works:

3.1 **Policy Governing Tax-Exempt Debt Proceeds**—The Capital Planning and Programming Division should create a policy governing expenditures of tax-exempt debt proceeds or incorporate such a specific policy into existing City rules or policies for capital projects.

Auditee Response: Agree, Implementation Date - July 2018

Auditee Narrative: In early 2018, The Department of Finance undertook an organizational restructure to form the new Capital Planning and Programming Division to provide more robust citywide capital financial management. As part of the restructure, the new Capital Planning and Programming Division in collaboration with the Cash, Risk and Capital Funding Division and the Controller's Office has commenced the drafting of a Citywide policy providing additional City guidelines for expenditures of tax-exempt debt proceeds in preparation for upcoming debt issuances for major capital programs and projects.

It is important to note that IRS regulations govern tax-exempt debt expenditures and certain expenditures are disallowed by IRS regulations. An expenditure may be allowable legally under IRS regulations, but may conflict with City policy decisions. The Department's new Capital Policy will provide guidelines on allowable expenditures for capital program/project budgets, taking market and economic conditions into consideration (e.g., city project management personnel). The City Attorney's Office and the City's Bond Counsel review capital project expenditures at multiple stages throughout capital project/program implementation to ensure compliance with IRS regulations.

3.2 **Training on New Policy**—The Capital Planning and Programming Division and the Department of Public Works should provide and document training on the new policy.

Auditee Response: Agree, Implementation Date - July 2018

Auditee Narrative: The Department of Finance Capital Planning and Programming Division will collaborate with the Department of Public Works to provide and document training on the capital policy.

FINDING 4

Internal Controls Related to Succession Planning for the Capital Integration System Application Are Inadequate

The City uses a software application called the Capital Integration System (CIS) to aggregate financial data and integrate scheduling baselines to track project and program management progress and to provide critical project details. This software enables the City to monitor and report on the progress of capital projects related to the 2007 bond program and other nonbond-funded capital improvements. For a more thorough summary of software applications audited in this report, please refer to Appendix A. As a third-party contractor, the 2007 bond program manager developed and currently supports this software application for the City. However, the City and the third-party program manager rely solely on one individual employee of the program manager to make necessary changes to the underlying software code. Therefore, currently there is no backup for this critical function provided by the contractor.

This support includes making requested changes to the underlying computer code that controls how the application works, including how data is processed or reported. When we inquired of the third-party contractor if there were any other staff capable of providing this type of support, company officials indicated they did not have any other staff who could support the application. They also noted the City had not requested they have any other support for this function.

The City relies solely on one individual contractor to make necessary changes to the Capital Integration System software code.

With the advent of the new general obligation bond program approved in 2017, there will be a new influx of projects managed by the CIS application software. Changes for the underlying software code will be required to meet the new needs of these new projects. Because there is only one contractor currently making these changes, there is a risk that if that contractor were not available for any reason, required changes to the application would not be possible. This would prevent the needed changes from being made, causing delays to projects, lack of appropriate management data for decisions, and potential cost overruns.

The General Accounting Office issued the Standards for Internal Control in the Federal Government, also known as the federal "Green Book," which establishes best practices for creating and maintaining a government's system of internal controls.[24] One of the elements of good internal controls is that management defines succession plans for key roles, chooses succession candidates, and trains succession candidates to assume key roles. If management relies on a "service organization" (a third-party vendor that might provide an ongoing service such as web and online software hosting or payroll and billing services) to fulfill the assigned responsibilities of key roles in the entity, management assesses whether the service organization

[24] **GAO 4.07** - Management defines succession plans for key roles, chooses succession candidates, and trains succession candidates to assume the key roles. If management relies on a service organization to fulfill the assigned responsibilities of key roles in the entity, management assesses whether the service organization can continue in these key roles, identifies other candidate organizations for the roles, and implements processes to enable knowledge sharing with the succession candidate organization. **GAO 4.08** - Management defines contingency plans for assigning responsibilities if a key role in the entity is vacated without advance notice. The importance of the key role in the internal control system and the impact to the entity of its vacancy dictates the formality and depth of the contingency plan.

can continue in these key roles, identifies other candidate organizations for the roles, and implements processes to enable knowledge sharing with the succession candidate organization.

RECOMMENDATION 4.1

The Department of Public Works should require the new external program manager to train additional staff on how to operate and make changes to the underlying code of the Capital Integration System software. This training should be completed as quickly as possible to ensure that the City's investment in this system is protected.

Agency Response: Agree – August 2018

RECOMMENDATION

We make the following recommendation to the Department of Public Works to improve the change management process for Capital Integration System:

4.1 **Third-Party Program Manager Should Provide Training to City Developers**—The Department of Public Works should require the new external program manager to train additional staff on how to operate and make changes to the underlying code of the Capital Integration System software. This training should be completed as quickly as possible to ensure that the City's investment in this system is protected.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will employ resourcing methodologies to enable the appropriate breadth and depth of technical and administrative documentation and training.

FINDING 5

Weak Oversight Controls Could Result in Unauthorized Access to Critical Debt Management Systems

In addition to the Capital Integration System application for managing debt-funded projects, the City uses a system called DBC Debt Manager to track debt information from issuance through maturity and a system called Textura that verifies documents and approvals for payments made to general contractors.

We found there were no policies or documented procedures for adding, removing, and changing user access into the Capital Integration System, DBC Debt Manager, or Textura. Public Works is responsible for application administration for the Textura and Capital Integration Systems applications. The Department of Finance is responsible for application administration for DBC Debt Manager. We were unable to directly test if users' access was appropriate, approved, and reasonable. At our request, application administrators reviewed users' access and noted no problems. However, we were not able to replicate this review.

Currently, there are no reports in these three applications to show the users and their access rights. The only way to determine user access was by pulling screenshots directly out of the applications. Adding, removing, or changing users' access rights is approved and documented via emails. Application administrators noted they would not be able to provide all these supporting emails if requested.

The National Institute of Standards and Technology (NIST) provides guidance on securing and reviewing user access. NIST Special Publication 800-53 revision 4 specifies that organizations should document adding, changing, or removing user access to individuals. It also specifies that organizations should develop, document, and disseminate an access control policy. User access reviews should be documented and performed at least semi-annually.

Users with inappropriate access to critical software applications could make unauthorized changes to data.

The reason for the lack of policies and procedures for user access is that the application administrators were not aware of user access control requirements. These applications are not supported by the City's Technology Services Department and are using third-party contractors and thus not operating under Technology Services' policies and procedures. Because there are no documented policies and procedures for the user access process for these applications, there is a risk user access is improper. Users with inappropriate access could make unauthorized changes to the data. This could result in changes that directly or indirectly affect the overall capital project systems, resulting in inaccurate payments, missed deadlines, or cost overruns.

RECOMMENDATION 5.1

The Department of Public Works should implement user access policies for Textura and the Capital Integration System based on Technology Services' user access policies as soon as possible. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.

Agency Response: Agree – August 2018

RECOMMENDATION 5.2

The Department of Public Works should fully document the procedures for setting user access based on the policies noted in Recommendation 5.1. as soon as possible.

Agency Response: Agree – August 2018

RECOMMENDATION 5.3

The Department of Finance should implement user access policies for DBC Debt Manager based on Technology Services' user access policies. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.

Agency Response: Agree – August 2018

RECOMMENDATION 5.4

The Department of Finance should fully document the procedures for setting user access based on the policies noted in Recommendation 5.3.

Agency Response: Agree – August 2018

RECOMMENDATIONS

We make the following recommendations to the Departments of Finance and Public Works to improve controls surrounding debt management:

5.1 **Implement User Access Policies for the Capital Integration System and Textura Applications**—Public Works should implement user access policies for Textura and the Capital Integration System based on Technology Services' user access policies as soon as possible. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will work with Technology Services to review, adapt and implement and train staff on user access policies and procedures appropriate for the Capital Integration System and Textura.

5.2 **Document User Access Procedures for the Capital Integration System and Textura Applications**—Public Works should fully document the procedures for setting user access based on the policies noted in Recommendation 5.1. as soon as possible.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will review, adapt, implement and train staff on user access policies and procedures appropriate for the Capital Integration System and Textura.

5.3 **Implement User Access Policies for the DBC Debt Manager application**—The Department of Finance should implement user access policies for DBC Debt Manager based on Technology Services' user access policies. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Finance will work with Technology Services to develop a policy of user access for the DBC Debt Management System.

5.4 **Document User Access Procedures for DBC Debt Manager**—The Department of Finance should fully document the procedures for setting user access based on the policies noted in Recommendation 5.3.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Finance will document the procedure for setting DBC user access.

FINDING 6

The Department of Public Works Could Not Verify Software Changes to the Capital Integration System

There is no documented process in place to verify changes to the Capital Integration System application software code. An application software code is the underlying set of instructions that performs the actual function of the application.

Auditors sought to determine if there had been any changes to the software code for the application. However, we were unable to perform audit tests because the consultants who maintain the application were unable to provide a complete list of changes directly from the application. An alternative way to gain comfort over the software changes was to inquire of Public Works for its listing of change requests made. Unfortunately, Public Works did not maintain a list of change requests prior to June 2017. Therefore, we were unable to test if the process to change the application software code was effective or reasonable.

The National Institute of Standards and Technology (NIST) provides guidance on application changes. NIST Special Publication 800-53 revision 4 specifies that it is necessary to be able to present a reliable change population for completeness and accuracy purposes.

The reason there is no process to ensure a complete and accurate change population was due to Public Works and the third-party program manager being unaware of change management control requirements. Hosted applications are not supported by the City's Technology Services Department and thus not operating under Technology Services' policies and procedures.

If changes to the Capital Integration System application are not documented and reconciled on a periodic basis by Public Works, unauthorized changes could be made to the system without the City's consent or approval. Additionally, this could result in changes that affect the overall reporting of various downstream capital project applications, resulting in inaccurate payments, missed deadlines, or cost overruns.

RECOMMENDATION 6.1

The Department of Public Works should implement change management policies for the Capital Integration System application based on Technology Services' change management policies. These policies should include requirements for how changes are requested, approved, and implemented into the production environment.

Agency Response: Agree – August 2018

RECOMMENDATION 6.2

The Department of Public Works should implement change management procedures for the Capital Integration System application based on the policies noted in Recommendation 6.1.

Agency Response: Agree – August 2018

RECOMMENDATION 6.3

The Department of Public Works should work with the new program manager to develop a procedure to identify and reconcile changes that have been made to the Capital Integration System application and its underlying database. This procedure should occur on a routine basis, at least annually.

Agency Response: Agree – August 2018

RECOMMENDATIONS

We make the following recommendations to the Department of Public Works to improve controls surrounding debt management:

6.1 **Implement Change Management Policies**—The Department of Public Works should implement change management policies for the Capital Integration System application based on Technology Services' change management policies. These policies should include requirements for how changes are requested, approved, and implemented into the production environment.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will review, adapt and implement and train staff on change management policies and procedures appropriate for the Capital Integration System production environment.

6.2 **Implement Change Management Procedures**—The Department of Public Works should implement change management procedures for the Capital Integration System application based on the policies noted in Recommendation 6.1.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will review, adapt and implement and train staff on change management policies and procedures appropriate for the Capital Integration System production environment.

6.3 **Reconcile Capital Integration System Changes**—The Department of Public Works should work with the new program manager to develop a procedure to identify and reconcile changes that have been made to the Capital Integration System application and its underlying database. This procedure should occur on a routine basis, at least annually.

Auditee Response: Agree, Implementation Date – August 2018

Auditee Narrative: The Department of Public Works will develop a process and procedure for documentation of changes to be made to the Capital Integration System production environment and associated annual review process.

FINDING 7

The Departments of Finance and Public Works Do Not Collect and Review Service Organization Control Reports from Service Providers

The Departments of Finance and Public Works contract with third-party service providers for debt and project management services. Although this type of contracting is common, agencies must comply with the City's fiscal rules. Fiscal Accountability Rule 11.2 states "each department/agency shall complete the Financial Disclosure Certification confirming effective internal controls have been established." Thus, the agencies using third parties for debt and project management services need to confirm that these vendors can prove the efficacy of their system of internal accounting and administrative control. Vendors can do this by providing assurance that the system or processes they use include sufficient and effective internal controls that will ultimately provide the City with accurate and reliable debt and project management services.

In order to help service providers offer this type of assurance to their clients, the American Institute of Certified Public Accountants developed the Statement on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization. This statement requires that service providers must provide an independent audit report attesting to the suitability of the design and operating effectiveness of the controls in their processing system. This assurance is formally provided by an independent firm, which produces a Service Organization Controls (SOC) I report after an examination engagement.

The American Institute of Certified Public Accountants also developed the Service Organization Controls (SOC) II report on internal control as a method for a service organization to provide assurance of the security, availability, process, integrity, confidentiality, or privacy of data being processed by the vendor. Table 2 describes the types of reports that can be prepared that describe a service organization's organizational, system, or hosting control environment. [25]

[25] SOC 2- SOC for Service Organizations: Trust Services Criteria, Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality or Privacy, AICPA. HTTP://WWW.AICPA.ORG/INTERESTAREAS/FRC/ASSURANCEADVISORYSERVICES/PAGES/AICPASOC2REPORT.ASPX, accessed March 8, 2018.

TABLE 2. Types of Service Organization Control Reports for Service Organizations

Report Type	Report Description
SOC I, Type I	Independent audited report that provides assurance over the design of the internal control environment over the financial reporting process provided by a contracted service provider, without testing the effectiveness of the control implementation.
SOC I, Type II	Independent audited report that provides assurance over the design and implementation of the effectiveness of the internal control environment over the financial reporting process provided by a contracted service provider.
SOC II, Type I	Independent audited report that provides assurance regarding the design of the controls over security, availability, processing integrity, confidentiality, and privacy of data being processed by a contracted service provider without testing the effectiveness of the control implementation based on specific standards issued by the American Institute of Certified Public Accountants.
SOC II, Type II	Independent audited report that provides assurance regarding the effectiveness of the design and implementation of the controls over security, availability, processing integrity, confidentiality, and privacy of data being processed by a contracted service provider based on specific standards issued by the American Institute of Certified Public Accountants.

Source: SSAE 16 Guidance & SOC 2- SOC for Service Organizations: Trust Services Criteria, American Institute of Certified Public Accountants.

Public Works project managers and external Better Denver Bond program management consultants use three externally hosted applications for project and program management: Textura, Primavera, and the Capital Integration System. The Textura application, which is owned by a third-party organization, generates construction invoices and routes them for approvals. It also verifies and documents the timely payments to subcontractors and the signatures of lien releases. Primavera is used by third-party consultants for scheduling capital projects and giving updates to interested stakeholders. This includes reporting on their progress according to the project schedule and budget. The Capital Integration System application is used in tandem with Primavera, reporting on project details used by project managers or third-party consultants to determine project status (expected vs. actual). The Capital Integration System was developed and is maintained for Public Works by the program manager. The program manager maintains the solution on IT infrastructure hosted by a subcontractor.

The Cash, Risk, and Capital Funding Division (CRCF) is responsible for managing debt funds and complying with post-issuance regulations determined by the Securities and Exchange Commission, as discussed in Finding 2. CRCF retains two service organizations to help with these responsibilities. The first organization is the City's dissemination agent and helps report on municipal debt to the public. This organization also notifies CRCF when a ratings change occurs, which could affect the value of City-issued securities and may need to be published on the EMMA.msrb.org website.

The second organization is the City's paying agent and helps ensure accurate and timely debt service payments. The paying agent would also notify CRCF if there were a late or missed payment, which would need to be reported to the same website for public disclosure.

We found that the agencies have not periodically obtained or reviewed Service Organization Control (SOC) reports or designed other controls to ensure vendors' services are reliable.

City employees appeared unaware of SOC reports and their responsibility to monitor controls at service organizations. In the absence of the assurance provided by these reports, risk exists that may result in undetected errors in payments to vendors, erroneous scheduling and reporting on bond projects, regulatory noncompliance and errors in processing payments to bondholders, which could ultimately harm the city's reputation and cause financial reporting errors.

RECOMMENDATION 7.1

The Cash, Risk, and Capital Funding Division should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties.

Agency Response: Agree – March 2019

RECOMMENDATION 7.2

The Department of Public Works should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties.

Agency Response: Agree – March 2019

RECOMMENDATIONS

We make the following recommendations to the Department of Public Works and the Cash, Risk, and Capital Funding Division of the Department of Finance to gain assurance over services provided by third parties:

7.1 **Define Ownership for Reviewing Controls Around Hosted Services**—The Cash, Risk, and Capital Funding Division should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties.

Auditee Response: Agree, Implementation Date – March 2019

Auditee Narrative: The Department of Finance is working on an overall strategy around collection and review of Service Organization Control (SOC) reports through the Information Governance Committee. This strategy will include any systems mentioned in this report. As a part of this strategy, the Department of Finance in conjunction with Technology Services will collect and review SOC reports annually.

7.2 **Define Ownership for Reviewing Controls Around Hosted Services**—The Department of Public Works should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties

Auditee Response: Agree, Implementation Date – March 2019

Auditee Narrative: The Department of Finance is working on an overall strategy around collection and review of Service Organization Control (SOC) reports through the Information Governance Committee. This strategy will include any systems mentioned in this report. As a part of this strategy, Public Works in conjunction with Technology Services will collect and review SOC reports annually.

APPENDICES

Appendix A – List of Relevant Applications

TABLE 3. Relevant Applications

Application	Hosted or In-house?	Description
Primavera (P6)	Hosted	An enterprise project portfolio management software that leverages a scheduling engine to distribute resources over time. This application works in tandem with CIS.
Capital Integration System (CIS)	Hosted	Aggregates financial data and integrates scheduling baselines from Primavera to track project and program management progress over time.
Textura	Hosted	Web-based application, recently purchased by Oracle, that verifies all necessary documents and approvals are in place for payments made to general contractors at both the City and Denver International Airport.
DBC Debt Manager	In-house	Controls the data and lookup, retrieval, and reporting of municipal bonds. The user interface sends information to and retrieves information from the database. The database definition has been developed by DBC Inc. and is accessed by the user through the application, representing various tables and relationships for the data.

Source: Created by auditors based on interviews, observations, and flowcharts provided by Departments of Finance and Public Works.

AGENCY RESPONSE

DEPARTMENT OF FINANCE

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DENVER
THE MILE HIGH CITY

Michael B. Hancock
Mayor

May 3, 2018

Auditor Timothy O'Brien, CPA
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. O'Brien,

The Office of the Auditor has conducted a performance audit of Debt Management.

The Department of Finance would like to acknowledge and thank the Audit Team for their diligence and professionalism during the audit and their recommendations for improvements. We are pleased that there were no areas of non-compliance (which is consistent with the most recent IRS financing audits) and that the audit recognized the Department "has a good process for preparing and publishing annual financial disclosure." The Department takes pride in its recognized sound debt management practices and financial controls as we prepare to undertake major bond programs/projects to improve Denver. We appreciate the improvements identified by the Audit Team to enhance our debt management practices and feel the recommendations are in line with the Department's recent efforts, such as:

- The creation of the Capital Planning and Programing Division;
- Implementation of the Workday accounting system; and
- Revisions of the City's Debt Policy and Procedures

This memorandum provides a written response for each recommendation noted in the Auditor's Report final draft that was sent to us on April 9, 2018. This response complies with Section 20-276 (c) of the Denver Revised Municipal Code (D.R.M.C.).

AUDIT FINDING 1
The City's Debt Policy Does Not Require Documentation of Exceptions to Guidelines for Certificates of Participation

RECOMMENDATION 1.1 The Department of Finance should update the debt policy to require documentation for any deviation from the policy.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Guadalupe Gutierrez 720-913-9370

While the Department of Finance does collect and review supporting documentation for financings of the City, we agree the Debt Policy should be revised to document deviations from debt policy guidelines.

AUDIT FINDING 2
Opportunities Exist to Improve Post-Issuance Internal Controls in the Debt Management Process

RECOMMENDATION 2.1 The Department of Finance should improve internal controls over post-issuance procedures by requiring documentation of supervisory review of the covenant compliance checklist, the arbitrage rebate liability calculation, and debt workpapers for the Comprehensive Annual Financial Report.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	March 2019 (This will be for the 2018 Audit process)	Guadalupe Gutierrez 720-913-9370 Shanna Tohill 720-913-5008

Covenant Compliance Checklist- As is noted in the Audit, a secondary review of compliance checklist items is currently performed by appropriate staff; however, the Department of Finance will add a signature block to the checklist to document who is performing this review.

Arbitrage Rebate Liability Calculation and debt workpapers for the CAFR- The majority of all Comprehensive Annual Financial Report workpapers are electronic. The Controller's Office currently tracks the status of all workpapers including the number, description, date needed, responsible party, date the external auditor receives and notes/comments. We will add a column to include reviewer and date reviewed.

RECOMMENDATION 2.2 The Cash, Risk, and Capital Funding Division should work with the Controller's Office to add a question to the annual financial questionnaire to City agencies. The question should be structured to ask agencies about new potential private use of tax-free debt-funded facilities.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree, as part of procedural checklist	September 2018	Guadalupe Gutierrez 720-913-9370

The Department of Finance's post issuance procedures (based on GFOA best practices and guidance from outside disclosure counsel on tracking private use of tax-exempt financed assets) currently calls for a review of financed assets on a periodic basis. Additionally, post issuance compliance is audited randomly by the U.S. Internal Revenue Service (IRS) and the Department has been found in compliance on all such audits.

CR&CF is in the process of enhancing its procedures and documenting the internal controls for post issuance practices by developing a comprehensive procedural checklist. CR&CF feels this document, which focus solely on financed assets, is more targeted versus including a question as part of the City's annual financial questionnaire to all City agencies.

RECOMMENDATION 2.3 The Department of Finance should improve oversight of event disclosure by establishing a formal process to periodically review all potential event disclosures.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	September 2018	Guadalupe Gutierrez 720-913-9370

We agree that the current disclosure processes could be better documented. We believe the Department has a robust and comprehensive process in place to track its ongoing post issuance disclosure obligations as evidenced in the comprehensive review of disclosure compliance performed in 2014 as part The Security and Exchange Commission's Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") and recent random financing audits performed by the IRS. The Department of Finance routinely evaluates its disclosure obligations and is in the process of enhancing its procedures and will include the documentation of periodic reviews of potential event disclosures.

AUDIT FINDING 3

Denver Lacks a Citywide Policy Governing Bond and Certificate of Participation Expenditures

RECOMMENDATION 3.1 The Capital Planning and Programming Division should create a policy governing expenditures of tax-exempt debt proceeds or incorporate such a specific policy into existing City rules or policies for capital projects.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	July 2018	Laura Perry 720-913-5537

In early 2018, The Department of Finance undertook an organizational restructure to form the new Capital Planning and Programming Division to provide more robust citywide capital financial management. As part of the restructure, the new Capital Planning and Programming Division in collaboration with the Cash, Risk and Capital Funding Division and the Controller's Office has commenced the drafting of a Citywide policy providing additional City guidelines for expenditures of tax-exempt debt proceeds in preparation for upcoming debt issuances for major capital programs and projects.

It is important to note that IRS regulations govern tax-exempt debt expenditures and certain expenditures are disallowed by IRS regulations. An expenditure may be allowable legally under IRS regulations, but may conflict with City policy decisions. The Department's new Capital Policy will provide guidelines on allowable expenditures for capital program/project budgets, taking market and economic conditions into consideration (e.g., city project management personnel.) The City Attorney's Office and the City's Bond Counsel review capital project expenditures at multiple stages throughout capital project/program implementation to ensure compliance with IRS regulations.

RECOMMENDATION 3.2 The Capital Planning and Programming Division and the Department of Public Works should provide and document training on the new policy.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	July 2018	Laura Perry 720-913-5537

The Department of Finance Capital Planning and Programming Division will collaborate with the Department of Public Works to provide and document training on the capital policy.

AUDIT FINDING 4
Internal Controls Related to Succession Planning for the Capital Integration System Application Are Inadequate

RECOMMENDATION 4.1
The Department of Public Works should require the new external program manager to train additional staff on how to operate and make changes to the underlying code of the Capital Integration System software. This training should be completed as quickly as possible to ensure that the City's investment in this system is protected.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will employ resourcing methodologies to enable the appropriate breadth and depth of technical and administrative documentation and training.

AUDIT FINDING 5
Weak Oversight Controls Could Result in Unauthorized Access to Critical Debt Management Systems

RECOMMENDATION 5.1
The Department of Public Works should implement user access policies for Textura and Capital Integration System based on Technology Services' user access policies as soon as possible. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will work with Technology Services to review, adapt and implement and train staff on user access policies and procedures appropriate for the Capital Integration System and Textura.

Please note there are reports in Textura that show user roles. Public Works has user permission reports that can be run to audit users and user permissions.

RECOMMENDATION 5.2
The Department of Public Works should fully document the procedures for setting user access based on the policies noted in Recommendation 5.1 as soon as possible.

Agree or Disagree with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of specific point of contact for implementation
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will review, adapt, implement and train staff on user access policies and procedures appropriate for the Capital Integration System and Textura.

RECOMMENDATION 5.3 The Department of Finance should implement user access policies for DBC Debt Manager based on Technology Services' user access policies. These policies should include requirements for new users' access, changes in users' access, removing users' access, and periodic review of users' access rights by the appropriate business process owner.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Jessica Chandler 720-913-5223

The Department of Finance will work with Technology Services to develop a policy of user access for the DBC Debt Management System.

RECOMMENDATION 5.4 The Department of Finance should fully document the procedures for setting user access based on the policies noted in Recommendation 5.3.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Jessica Chandler 720-913-5223

The Department of Finance will document the procedure for setting DBC user access.

AUDIT FINDING 6

The Department of Public Works Could Not Verify Software Changes to the Capital Integration System

RECOMMENDATION 6.1 The Department of Public Works should implement change management policies for the Capital Integration System application based on Technology Services' change management policies. These policies should include requirements for how changes are requested, approved, and implemented into the production environment.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will review, adapt and implement and train staff on change management policies and procedures appropriate for the Capital Integration System production environment.

RECOMMENDATION 6.2 The Department of Public Works should implement change management procedures for the Capital Integration System application based on the policies noted in Recommendation 6.1.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will review, adapt and implement and train staff on change management policies and procedures appropriate for the Capital Integration System production environment.

RECOMMENDATION 6.3 The Department of Public Works should work with the new program manager to develop a procedure to identify and reconcile changes that have been made to the Capital Integration System application and its underlying database. This procedure should occur on a routine basis, at least annually.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	August 2018	Michael Sheehan 720-865-2664

The Department of Public Works will develop a process and procedure for documentation of changes to be made to the Capital Integration System production environment and associated annual review process.

AUDIT FINDING 7

The Departments of Finance and Public Works Do Not Collect and Review Service Organization Control Reports from Service Providers

RECOMMENDATION 7.1 The Cash, Risk, and Capital Funding division should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	First stage – August 2018 Second stage - March 2019	Beth Machann 720-913-5515

The Department of Finance is working on an overall strategy around collection and review of Service Organization Control (SOC) reports through the Information Governance Committee. This strategy will include any systems mentioned in this report. As a part of this strategy, the Department of Finance in conjunction with Technology Services will collect and review SOC reports annually.

RECOMMENDATION 7.2 The Department of Public Works should review Service Organization Control reports on an annual basis to gain assurance over services provided by third parties.		
Agree or Disagree with Recommendation	**Target date to complete implementation activities (Generally expected within 60 to 90 days)**	**Name and phone number of specific point of contact for implementation**
Agree	First stage – August 2018 Second stage – March 2019	Beth Machann 720-913-5515

The Department of Finance is working on an overall strategy around collection and review of Service Organization Control (SOC) reports through the Information Governance Committee. This strategy will include any systems mentioned in this report. As a part of this strategy, Public Works in conjunction with Technology Services will collect and review SOC reports annually.

Please contact me at 720-913-9370 with any questions.

Sincerely,

Guadalupe Gutierrez-Vasquez
Managing Director of Capital Funding

cc:
Valerie Walling, Deputy Auditor, CPA, CMC
Heidi O'Neil, CPA, CGMA, Director of Financial Audits
Dawn Wiseman, CRMA, Audit Manager
Jeremy Creamean, CPA, Audit Supervisor
Vilma Balnyte, Lead Internal Auditor