

ASSURANCE AND ADVISORY
BUSINESS SERVICES

FEBRUARY 19, 2007



ERNST & YOUNG

Quality In Everything We Do

Gainesville Regional Utilities of the City of Gainesville, Florida

Audit Results and Communications

February 19, 2007

Audit and Finance Committee
City of Gainesville, Florida

Dear Members of the Audit and Finance Committee:

We are pleased to present the results of our audit of the September 30, 2006 financial statements of Gainesville Regional Utilities (GRU), a department of the City of Gainesville (the City).

This Report to the Audit and Finance Committee summarizes our audit, the scope of our engagement, and key observations and findings from our audit procedures. The document also contains the audit committee communications required by our professional standards and, where applicable, Government Auditing Standards.

The audit was designed to express an opinion on the September 30, 2006 financial statements. In accordance with professional standards, we obtained a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed. However, we were not engaged to and we did not perform an audit of internal control over financial reporting.

At Ernst & Young, we are continually evaluating the quality of our professionals' work in order to deliver audit services of the highest quality that will meet or exceed your expectations. We encourage you to evaluate our services using our Assessment of Service Quality survey to ensure that we do not overlook a single detail as it relates to the quality of our services.

This report is intended solely for the information and use of the Audit and Finance Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate this opportunity to meet with you to discuss the contents of this report and answer any questions you may have about these or any other audit-related matters.

Very truly yours,



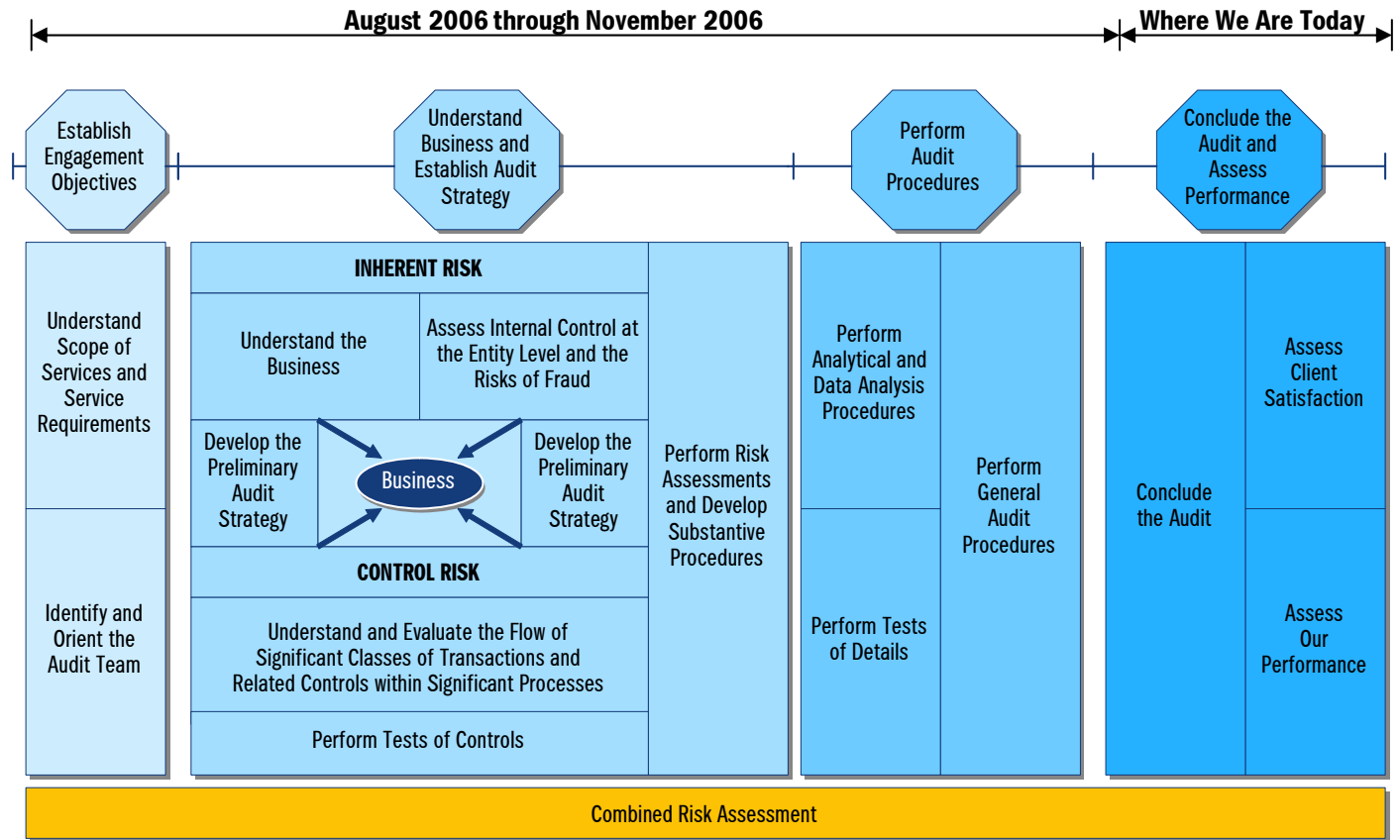
Michael Pattillo

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2006 Financial Statement Audit Results and Communications

THE ERNST & YOUNG AUDIT APPROACH



SUMMARY OF WHAT WE AGREED TO DO

As discussed with management during our planning process, our audit plan represented an approach responsive to the assessment of risk for GRU. Specifically, we designed our audit to:

- Express an opinion on the GRU's financial statements.
- Be made in accordance with auditing standards generally accepted in the United States and generally accepted governmental auditing standards as set forth in the U.S. General Accounting Office's (GAO's) *Government Auditing Standards* (June 2003 Revision), and rules of the Auditor General, State of Florida for the form and conduct of audits of Florida local governments.
- Issue reports on internal control over financial reporting and compliance with certain provisions of laws, regulations, contracts, grants, and other matters.
- Issue a management letter to management and the City Commission.
- Issue this report to the Audit and Finance Committee.

AREAS OF EMPHASIS

The principal areas of audit emphasis were as follows:

- Debt compliance, including continuing disclosure requirements.
- Compliance with applicable laws, regulations, and contractual provisions.
- Evaluation of GRU's accounting for billed and unbilled accounts receivable, emphasizing the integration of GRU's billing system and general ledger.
- Financial statement close process, including significant disclosures.
- Review and testing of IT general controls in support of the financial audit on GRU's information systems through our Technology and Security Risk Solutions personnel.
- Regulatory assets and liabilities, deferred environmental costs and commodity contracts.
- Documentation and review of GRU's accounting policies and practices associated with the investment in The Energy Authority and related electric and gas transaction activity.
- Net asset classifications and compliance with bond covenants with respect to restricted assets.
- Environmental liabilities and related disclosures.
- Computation of required transfers to the City of Gainesville pursuant to applicable Ordinances.
- Consideration of new GASB pronouncements effective for FY 2006.
- Analysis of fuel contracts, hedging programs, and commitment disclosures.

REQUIRED COMMUNICATIONS

Statements of Auditing Standards No. 61 (as amended) and other professional standards require the auditor to communicate certain matters to the Committee that may assist the Committee in overseeing management's financial reporting and disclosure process. Below we summarize these required communications as they apply to GRU.

Area	Comments						
<p>Auditors' Responsibilities Under Generally Accepted Auditing Standards (GAAS)</p> <p>The financial statements are the responsibility of management. Our audit was designed in accordance with auditing standards generally accepted in the United States to provide reasonable, rather than absolute, assurance that the financial statements are free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audit and to determine the nature, timing and extent of testing performed. However, we were not engaged to and we did not perform an audit of internal control over financial reporting.</p>	<p>As a part of our audit, we obtained a sufficient understanding of internal controls to plan our audit and to determine the nature, timing, and extent of testing performed. We have issued an unqualified opinion on GRU's financial statements for the year ended September 30, 2006.</p>						
<p>Our Judgments About the Quality of GRU's Accounting Principles</p> <p>We discuss our judgments about the quality, not just the acceptability, of accounting principles as applied in GRU's financial reporting, including the consistency of the accounting policies and their application and the clarity and completeness of the financial statements and related disclosures.</p>	<p>Accounting principles selected by management are consistent with those prescribed by accounting and industry standards. In addition, management has consistently applied its accounting principles and GRU's financial statements and related disclosures are clearly presented in a complete manner.</p>						
<p>The Adoption of, or a Change in an Accounting Principle</p>	<p>None.</p>						
<p>Significant Accounting Policies</p> <p>Initial selection of and changes in significant accounting policies or their application and new accounting and reporting standards during the year must be reported.</p>	<p>The significant accounting policies of GRU are described in Note 1 to the financial statements. There were no significant accounting policy changes during the 2006 fiscal year.</p>						
<p>Sensitive Accounting Estimates</p> <p>The preparation of the financial statements requires the use of accounting. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations.</p>	<p>Significant estimates and assumptions made by management in preparing the financial statements relate to evaluating the need for potential allowances for uncollectible accounts receivable, recording unbilled revenues, computing and amortizing regulatory assets and liabilities, assessing contingencies, assigning composite depreciation rates (useful lives), determining inventory reserves, and allocating costs among segments.</p>						
<p>Methods of Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas</p>	<p>We are not aware of any significant unusual transactions recorded by GRU during the year or of any significant accounting policies used by GRU related to controversial or emerging areas for which there is a lack of authoritative guidance.</p>						
<p>Significant Audit Adjustments</p>	<table border="0"> <tr> <td>Unamortized Loss</td> <td style="text-align: right;">\$ 336,979</td> </tr> <tr> <td>Expense</td> <td style="text-align: right;">1,326,188</td> </tr> <tr> <td>Deferred Charges</td> <td style="text-align: right;">1,663,167</td> </tr> </table> <p><i>To record loss related to bond issuance and recognize costs associated with debt transactions</i></p>	Unamortized Loss	\$ 336,979	Expense	1,326,188	Deferred Charges	1,663,167
Unamortized Loss	\$ 336,979						
Expense	1,326,188						
Deferred Charges	1,663,167						

REQUIRED COMMUNICATIONS (CONTINUED)

Area	Comments
Unadjusted Audit Differences Considered by Management to be Immaterial	There were no unrecorded audit differences for the year ended September 30, 2006.
Fraud and Illegal Acts	We are not aware of any material fraud or illegal acts. Refer to "Fraud Considerations" section for more information about our procedures related to fraud.
Material Weaknesses in Internal Control	No material weaknesses were identified.
Fees for Consulting Services	For the year ended September 30, 2006, no consulting fees were paid to Ernst & Young LLP.
Disagreements With Management	None.
Serious Difficulties Encountered in Dealing With Management When Performing the Audit	None.
Major Issues Discussed with Management Prior to Retention	None.
Consultation With Other Accountants	None of which we are aware.
Independence Consistent with the report and recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees and as required by Independence Standards Board Standard No. 1, <i>Independence Discussions with Audit Committees</i> , we communicate, at least annually, the following to the Board: <ol style="list-style-type: none"> 1. Disclose, in writing, all relationships between Ernst & Young and our related entities and GRU and its related entities that in our professional judgment may reasonably be thought to bear on independence; 2. Confirm in writing that, in our professional judgment, we are independent of GRU within the meaning of the <i>Government Auditing Standards</i>; and 3. Discuss our independence with the Board. 	<ol style="list-style-type: none"> 1. We are not aware of any relationships between Ernst & Young and GRU that, in our professional judgment, may reasonably be thought to bear on our independence. 2. Relating to our audit of the financial statements of GRU as of September 30, 2006, and for the year then ended, we are independent certified public accountants with respect to GRU within the meaning of the applicable published pronouncements of the Independence Standards Board; Rule 101 of the American Institute of Certified Public Accountants' Code of Professional Conduct, its interpretations and rulings; and <i>Government Auditing Standards</i>. Our policies relating to financial interests (e.g., stock ownership, loans, and other credit) generally are stricter than the requirements imposed by these regulatory and professional bodies. 3. We have not performed any nonaudit services for GRU in the 2006 fiscal year.

You have engaged us to conduct an audit of GRU's financial statements for the year ended September 30, 2006, in accordance with auditing standards generally accepted in the United States, and *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities for testing and reporting on internal control and on compliance with applicable laws and regulations under those standards are described in the table below. Our latest peer review report was previously provided to and included in the 2005 Audit Results and Communications Report to the Audit and Finance Committee dated March 20, 2006.

2006 FINANCIAL STATEMENT AUDIT
RESULTS & COMMUNICATIONS

Service That We Will Provide	Our Responsibility Regarding Internal Control	Our Responsibility Regarding Compliance with Laws and Regulations and Provisions of Contracts or Grant Agreements and Abuse
Financial statement audit—GAAS	We consider internal control to plan the nature, timing, and extent of audit procedures for the purpose of expressing our opinion on the financial statements. We report, orally or in writing, any reportable conditions, including material weaknesses that we identify as a result of our audit procedures. Our report does not provide assurance on internal control over financial reporting.	We design our audit to provide reasonable assurance of detecting fraud that is material to the financial statements and illegal acts that have a direct and material effect on the determination of financial statement amounts. Our report does not express an opinion on compliance with laws, regulations, and provisions of contracts or grant agreements. We have no responsibilities to be alert for, or to report, abuse.
Financial statement audit— <i>Government Auditing Standards</i>	In addition to the GAAS responsibilities, we are required to issue a written report on our consideration of internal control over financial reporting and identify reportable conditions, including material weaknesses, if any. Our reports do not provide assurance on internal control over financial reporting. We report other deficiencies in internal control, except those that are clearly inconsequential, in a management letter.	In addition to the GAAS responsibilities, we design our audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives. We are alert to situations or transactions that could be indicative of abuse. We issue a written report on the results of these procedures; however, our report does not express an opinion on compliance or on other matters. We report significant violations of provisions of contracts or grant agreements and significant abuse in our auditor's report. We report violations of provisions of contracts or grant agreements and abuse that are less than significant but more than inconsequential in a management letter.

Government Auditing Standards paragraph 4.19 defines abuse as follows: “Abuse is distinct from fraud, illegal acts and violations of provisions of contracts or grant agreements. When abuse occurs, no law, regulation, or provision of a grant agreement is violated. Rather, abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances.”

Further, *Government Auditing Standards* footnote 51 provides this example of abuse: “For example, in a financial statement audit, auditors might find abuse when examining sensitive payments such as travel of senior management officials to locations chosen for personal reasons rather than less costly locations which would have been appropriate to satisfy the business objectives of the travel.”

FRAUD CONSIDERATIONS

SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, was issued to heighten the awareness of auditors to the potential for fraud when planning and executing audits. SAS 99 also emphasizes the need for increased professional skepticism throughout the audit engagement. Under SAS 99, we are responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or by fraud. We approach all audits with an understanding that fraud could occur in any company at any time, and could be perpetrated by anyone. The following provides a summary of the principal procedures required under SAS 99 and the results of our procedures.

ENGAGEMENT TEAM DISCUSSION

SAS 99 requires, as part of planning the audit, that there be a discussion among the audit team members, which includes all significant locations. The discussion should allow key members of the team to share thoughts and ideas about how and where they believe the client's financial statements might be susceptible to material misstatement due to fraud. A key element of this discussion, which is led by the partner in charge of the audit, is to emphasize the importance of maintaining the proper mindset throughout the audit regarding the potential for fraud. We conducted our engagement team discussion during the planning phase and updated our discussion after the completion of our interim procedures.

GATHERING INFORMATION NEEDED TO IDENTIFY RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD

SAS 99 requires auditors to perform certain procedures to obtain information that is used to identify risks of material misstatement due to fraud. These procedures include:

- Inquiring of management and others within the organization about the risks of fraud. Inquiries are required to be made of management, the Audit Committee, internal audit, and other operational and financial personnel within the organization, focusing on such areas as the individual's knowledge of actual or suspected fraud and understanding about specific risks of fraud in the organization. Further, inquiries are made regarding the oversight activities of the Audit Committee regarding management's assessment of the risks of fraud, whether programs and controls have been established at the organization to mitigate the risk of fraud, how multiple locations within an organization are monitored for fraud, and how management communicates to employees its views on business practices and ethical behavior;
- Inquiring about matters raised from the Audit Committee procedures for complaints (including 'whistleblowers') regarding accounting, internal accounting controls or auditing matters;
- Considering unusual or unexpected relationships that have been identified in performing analytical procedures in planning the audit;
- Considering whether fraud risk factors exist; and
- Considering other information gathered throughout the audit.

We have made inquiries of management, internal audit, and other operating and financial personnel not directly involved in financial reporting. We have also performed analytical review procedures and conducted engagement team discussions (as described above), with the purpose of considering whether fraud risks exist.

IDENTIFYING, ASSESSING AND RESPONDING TO FRAUD RISKS

As a result of the information gathered from the procedures above, we identify and assess specific fraud risks. The auditor's response to the assessment of the risks of material misstatement of the financial statements due to fraud is influenced by the nature and significance of the risks identified and the organization's programs and controls that address these identified risks. The auditor's response to fraud risks might include a change in the timing or nature of audit procedures, or the auditor might decide that the extent of testing needs to be expanded in certain areas (e.g., expanded testing on revenue cutoff at year end when risks relating to revenue recognition have been identified).

MANDATORY PROCEDURES TO ADDRESS THE RISK OF MANAGEMENT OVERRIDE

Fraudulent financial reporting often involves management override of controls that otherwise appear to be operating effectively. SAS 99 includes the following mandatory procedures to address the risk of management override of controls:

- Examining journal entries and other adjustments for evidence of possible material misstatement due to fraud;
- Reviewing accounting estimates for biases that could result in material misstatement due to fraud, including a retrospective review of significant prior year estimates; and
- Evaluating the business rationale of significant unusual transactions.

EVALUATING AUDIT EVIDENCE

We assess the risk of material misstatement due to fraud throughout the audit. We are mindful of conditions that may be identified during fieldwork that change or support a judgment regarding the assessment of fraud risks, such as discrepancies in the accounting records, conflicting or missing evidential matter, and/or problematic or unusual relationships between the auditor (including internal audit) and management. No such matters were noted during our audit.

KEY TECHNICAL ISSUES—2007 DEVELOPMENTS

Following is a summary of the GASB projects and pronouncements that may affect GRU in the near-term.

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, with modifications to reflect differences between pension benefits and OPEB. Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, addresses financial statement and disclosure requirements for reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

Statement 45 is effective for periods beginning after December 15, 2006 (if annual revenues are greater than \$100 million); after December 15, 2007 (if annual revenues are at least \$10 million but less than \$100 million); and after December 15, 2008 (if annual revenues are less than \$10 million). Earlier application is encouraged. All component units should implement the requirement of this Statement no later than the same year as their primary government.

GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

Statement No. 48 established criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. Such transactions are likely to compromise the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements. This Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components.

The Statement requires enhanced disclosures pertaining to future revenues that have been pledged or sold, provides guidance on sales of receivables and future revenues within the same financial reporting entity, and provides guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations

Statement No. 49 addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of Statement No. 49 excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning.

Once any one of five specified obligating events occurs, a government is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if applicable, capitalized when goods and services are acquired. Obligating events include the following:

- The government is compelled to take pollution remediation action because of an imminent endangerment.
- The government violates a pollution prevention-related permit or license.
- The government is named, or evidence indicates that it will be named, be a regulator as a responsible party or potentially responsible party (PRP) for remediation or as a government responsible for sharing costs.
- The government is named, or evidence indicates that it will be named, in a lawsuit to compel participation in pollution remediation.
- The government commences or legally obligates itself to commence pollution remediation.

The Statement requires that governments that have *sufficient objective and verifiable information* apply the cash flow technique to measurements in prior periods and apply the provisions of the Statement retroactively for all such prior periods. Governments that do not have that information should apply the provisions of this Statement as of the effective date, but pollution remediation liabilities should be measured (using the expected cash flow technique) at the beginning of that period to ensure that beginning net assets can be restated.

KEY ONGOING ISSUES AND TRENDS

RETAIL RESTRUCTURING REMAINS UNEVEN

The energy crisis in California and other Western states, the spectacular implosion of Enron, and the collapse of merchant energy markets have eroded public and political confidence in the restructuring of retail power markets. In January 2000, pre-California energy crisis, all but eight states were actively pursuing restructuring (i.e., enacting enabling legislation or issuing a regulatory order to implement retail access). Following these events, there was a dramatic pullback in retail restructuring activity.

Today, only 19 jurisdictions have either enacted enabling legislation or issued a regulatory order to implement retail access, including Arizona, California, Connecticut, Delaware, District of Columbia, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Texas, and Virginia. However, direct retail access has subsequently been suspended in California.

A total of 32 states are not actively restructuring their retail electric markets. Those states are Alabama, Arkansas, Alaska, Colorado, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nevada, New Mexico, Nebraska, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

PRESIDENT BUSH SIGNED INTO LAW THE ENERGY POLICY ACT OF 2005¹

After four years of failing to pass comprehensive energy legislation, both chambers of Congress finally passed the conference report on the Energy Policy Act of 2005 (EPAcT) before adjourning for August recess. The House of

¹ For a more comprehensive discussion of EPAcT 2005, please refer to J. Franklin, "The Energy Policy Act of 2005: Key Issues Briefing," EY CBK, September 15, 2005, via GRAD Database.

Representatives passed the bill in a 275–156 vote on Thursday, July 28, 2005, and the Senate passed it 74–26 on Friday, July 29, 2005. President Bush signed the bill into law on August 8, 2005.

The 1,700-plus-page legislation is comprehensive in scope, with titles addressing energy efficiency, renewable energy, oil and gas, coal, Native American energy, nuclear energy, vehicles and fuels, hydrogen, research and development, the Department of Energy management, electricity, tax incentives, miscellaneous matters, ethanol and motor fuels, climate change, and incentives for innovative technologies.

Moving the legislation through Congress was a function of timing—with oil more than \$60 per barrel and the nation enduring a heat wave—and, perhaps more critically, compromise. The legislation sidestepped several highly contentious issues, including the opening of the Arctic National Wildlife Refuge to oil and gas drilling activity, liability protection for producers of the fuel additive methyl tertiary-butyl ether (MTBE), a federal renewable portfolio standard, increased fuel-efficiency standards for cars and trucks, and a measure that would have mandated that the President establish ways to reduce US oil consumption by one million barrels per day by 2025.

Nevertheless, the energy bill advances the Bush administration’s key policy goals of supporting the expansion and diversification of the US energy supply, promoting much-needed investment in US energy infrastructure, and advocating energy efficiency improvements and conservation strategies.

POWER GENERATORS TO FACE INCREASING SCRUTINY OF AIR EMISSIONS

NEW EPA RULES

With the Bush administration failing to push through its Clear Skies package, the Environmental Protection Agency (EPA) issued its Clean Air Interstate Rule (CAIR), Clean Air Mercury Rule (CAMR), and Clean Air Visibility Rule (CAVR) under the existing Clean Air Act. The regulations limit interstate movement of power plant emissions in the eastern US, reduce mercury emissions from coal-fired power plants, and limit emissions that reduce visibility by creating or contributing to regional haze.

CAIR, which took effect on May 12, 2005, in 28 eastern states and the District of Columbia, will reduce SO₂ emissions by more than 70% of 2003 levels, and NO_x emissions by more than 60% of 2004 levels, by 2015.² The rule established a two-stage, EPA-administered cap-and-trade system modeled after the highly successful acid rain cap-and-trade program. The EPA believes the rule will provide more than \$100 billion in annual health and visibility benefits by 2015.

² “US EPA Clean Air Interstate Rule Takes Effect,” *Power Market Today*, May 13, 2005, via Factiva, © 2005 Intelligence Press, Inc.

Appendices

APPENDIX A—TABLE OF REQUIRED COMMUNICATIONS WITH AUDIT COMMITTEES

For reference purposes, communication requirements with Audit Committees are summarized below:

	Communicate When Event Occurs	Communicate On a Timely Basis, At Least Annually
Communications Required on All Audits		
Our Responsibility Under GAAS Including Other Information in Documents Containing Audited Financial Statements		SAS 61
Major Issues Discussed with Management in Connection With Initial or Recurring Retention	SAS 61	
Significant Audit Adjustments		SAS 61
Unrecorded Audit Differences Considered by Management to be Immaterial		SAS 61
Our Judgments About the Quality of the Company's Accounting Principles		SAS 61
Disagreements With Management	SAS 61	
Consultations With Other Accountants	SAS 61	
Serious Difficulties Encountered in Dealing With Management When Performing the Audit	SAS 61	
The Adoption of, or a Change in, an Accounting Principle	SAS 61	
Methods of Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas	SAS 61	
Sensitive Accounting Estimates		SAS 61
Fraud and Illegal Acts Involving Senior Management and Fraud and Illegal Acts That Cause a Material Misstatement of the Financial Statements	SASs 99 and 54	
"Reportable Conditions" in Internal Control	SAS 60	

APPENDIX B

Management Letter on Internal Control

The City Commission, City of Gainesville, Florida and
Gainesville Regional Utilities

In planning and performing our audit of the financial statements of Gainesville Regional Utilities (GRU or the Utility) for the year ended September 30, 2006, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. The following suggestions came to our attention that we believe merit your consideration.

Prior Year Recommendations

There were no recommendations in the prior year.

Current Year Recommendations

Financial Statement Close Process

Timely and accurate preparation and review of financial information is essential for control of company resources and accurate interim and year-end financial reporting. Based on our observations and findings during the audit process, it appears that GRU's financial statement close process could be improved. To facilitate effective completion of the month-end and year-end closing procedures and to ensure that the overall timetable is met, formal closing instructions and related accounting practices should be developed. This would consist of: incorporating formal policies and procedures, including roles and responsibilities, timetables, sample formats, and instructions for schedules to be prepared.

We are aware of GRU's plans to re-evaluate their systems, and we agree that such an examination is necessary. We recommend management consider the financial statement closing process, with the overall goal of reducing the cycle time necessary to close and produce financial statements without sacrificing the integrity of reported amounts (i.e., reduce the number of steps required to get to the financial statements, such as incorporate software to output data in specified formats). Additionally, we understand that the development of formal closing procedures and quarterly closes is a longer-term project and is significantly related to any changes with the financial management system.

Management's Response:

Management agrees with this recommendation. We are acutely aware of the shortcomings of our current accounting software, and its effects on our ability to efficiently close our books and produce Financial Statements in a timely manner. We have recently assembled a team to evaluate Financial Management Information Systems (FMIS), with a goal of replacing our current system within two years. Major objectives of this team include timely closing, preparation of interim GAAP statements, improved integration between systems, and improved corporate reporting.

Part of the Requirements Documentation for a new system will involve the evaluation and documentation of all of our procedures, including the close process and creation of financial statements. From this evaluation, we will be able to develop a formal closing procedure manual based on these new processes.

To serve in the interim, we have begun to update our current year end closing procedures to include timetables and assignments. Timetables will need to be coordinated closely with Ernst & Young's audit team to ensure appropriate timing of audit procedures. This will facilitate the year end close and audit for the next two years.

Cash Reconciliations

During our interim and year-end procedures, we identified certain items requiring consideration with respect to the cash and bank reconciliation process. We noted certain opportunities for improvement. The first item relates to evidence of review of the reconciliations. We recommend evidence of review of reconciliations in order to improve documentation of controls. The second item relates to checks outstanding for several years being included within the outstanding check listing. We recommend GRU ensure compliance with Florida requirements. Additionally, we noted items classified as reconciling items were adjusting entries to the general ledger on the bank reconciliations and cash reconciliation. Reconciling items were not resolved timely, as they appeared as reconciling items the following month. We recommend that the total per the general ledger agree to the trial balance after all adjustments are made during month-close and that the adjustments be made timely.

Management's Response:

Management agrees with this recommendation. Beginning this year, the Controller will review the cash reconciliations on a quarterly basis, as financial statements are currently published on a quarterly basis.

As suggested, GRU has researched the Florida requirements for abandoned property, and all monies have been turned over to the state as mandated. We have researched the items appearing as outstanding on cash book records, and found that journal entries to record this activity have not been done in the past several years, although the funds have been properly remitted to the state. This will be corrected in the month of January 2007, and will be handled on a timely basis in the future.

It is part of our current process to reconcile cash on a monthly basis. Reconciling items carried forward were primarily due to staffing issues, which we hope to resolve in the near future. Entries resulting from the reconciliations will be posted promptly.

Information Technology

Program Change

Observation:

During our review of the program change process for CBIS, we noted individuals have access to modify code and promote their own changes.

Risk:

By not segregating duties, a risk exists where programmers can implement changes without approval, which could affect how the application processes data and ultimately affect the financial statements.

Recommendation:

We recommend a segregation of duties be implemented for the program change process. We recommend the individual performing the change be separate from the individual moving the change into production.

Management's Response:

The current billing system, CBIS, is scheduled for decommissioning in April 2007 so that value of changing our current procedure is minimal. All changes currently go through a Quality Assurance process, which, to some degree, mitigates the concern. The new CIS system using the SAP software has a completely different procedure for promoting changes into production, and the desired separation of duties will be accomplished.

User Access

Observation:

During our review of terminated employees, we noted one individual still having access to the Windows system. In addition, we noted that the company does not have a formal notification process to identify terminated employees to the IT Department and Application Administrators, so employees' access can be removed in a timely manner.

Risk:

Users with inappropriate access creates the possibility of gaining unauthorized access to certain financial functions.

Recommendation:

We recommend that the Company (1) develop a formal notification process to identify terminated employees to the IT Department and Application Administrators and that the IT Department and Application Administrators remove terminated users' accounts and note such action on the notification received; and (2) periodically review inactive accounts (i.e., accounts that have not been used over a period of time, perhaps 60 to 90 days), and disable or lock these accounts until the users or users' manager(s) can be contacted to determine if access is still appropriate and necessary.

Management's Response:

Information Technology (IT) Management has involved several stake holding departments to institute the notification for employee changes (new hires, position changes, department changes, and termination) via weekly reports. Account access is modified and decommissioned, if necessary at that time. The current IT process also includes a complete audit of accounts every six months. The weekly reports, coupled with the audits, mitigate this concern somewhat. However, IT will continue to work with other departments that receive employee information to solidify a process to receive and process account and access changes in a timely manner.

User Access*Observation:*

During our review of current access, we noted one individual having inappropriate access and that a formal, periodic process to review users' access to applications was not in place.

Risk:

Users may have inappropriate access or access that might not provide for adequate segregation of duties.

Recommendation:

We recommend that the company develop a formal process to periodically review users' access to the applications and take appropriate action if issues are found.

Management's Response:

IT will continue to work with other departments that have the information about employee position or department changes forwarded to IT for timely processing, thus, keeping account access up-to-date.

In addition, an Application Administration position has been established with the implementation of the SAP software system. The focus of this position will be overall systems administration, which includes software security, authorities, and overall system log file reviews.

A periodic review of appropriate access of all systems is a labor intensive process. Therefore, the initial focus of the periodic reviews of roles and account access will consider systems which hold financial information or interact with these systems (Ellipse, SAP, and Revenue Collector).

This letter is intended solely for the information and use of management, the City Commission of the City of Gainesville, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Ernst + Young LLP

November 17, 2006

APPENDIX C

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

The Honorable Mayor and
Members of the City Commission
City of Gainesville, Florida

We have audited the financial statements of Gainesville Regional Utilities (a department of the City of Gainesville, Florida) as of and for the year ended September 30, 2006, and have issued our report thereon dated November 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Gainesville Regional Utilities' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness, based on auditing standards generally accepted in the United States as established by the American Institute of Certified Public Accountants, is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Gainesville Regional Utilities' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Gainesville Regional Utilities in a separate letter dated November 17, 2006.

This report is intended solely for the information and use of the City Commission, management, and federal and state regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 17, 2006

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0702-0805379