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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

8-2

December 16, 1997

To: Board of Directors (Budget and Finance Committee--Action)
(Water Planning and Resources Committee--Information)

From: *for* General Manager Edward J. Meester

Submitted by: Debra C. Man, Chief Debra C. Man
Planning and Resources

Subject: Authorization to Pay 1998 Invoices Under State Water Service and Devil Canyon-Castaic Contracts

RECOMMENDATION(S)

It is recommended that the General Manager be authorized to approve and make all payments he determines to be due and payable under the terms of the State Water Service and Devil Canyon-Castaic contracts for the 1998 calendar year.

EXECUTIVE SUMMARY

On July 1, 1997, the State Department of Water Resources (DWR) transmitted the Statement of Charges (Invoices) for payments due during the 1998 calendar year under Metropolitan's State Water Service and Devil Canyon-Castaic Contracts (Contracts). DWR is expected to issue revised Invoices at the end of December 1997 to correct certain errors identified since the Invoices were compiled and to reflect resolution of issues under negotiation. The revised Invoices for calendar year 1998 are expected to total \$340.6 million, or approximately \$9.4 million less than the July 1, 1997, Invoices. An estimate of the revised Invoices which are expected in late December 1997 is shown on the attached Table 1. Staff will provide your Board with the actual revised Invoices at your January 1998 Board meeting.

Given staff's expectations that DWR will include needed corrections in the revised Invoices and given that adequate provisions exist for remedies in future adjustments, the General Manager expects to conclude that the Invoices will materially conform with the Contracts and that payments should be authorized.

DETAILED REPORT

An August 27, 1997, letter to your Board summarized the Department of Water Resources (DWR) original July 1, 1997, Statement of Charges (Invoices), totaling \$349,967,177.

Subsequent to issuing these 1998 Invoices, DWR has agreed to issue revised Invoices at the end of December 1997 to correct certain errors identified since the Invoices were compiled and to reflect resolution of issues under negotiation.

The identification of these corrections and negotiated resolutions are part of an on-going program for administering Metropolitan's State Water Project (SWP) contract. As directed by the Board of Directors, this program includes an annual audit of the SWP Statement of Charges conducted by an independent outside audit firm, Richardson & Company. This year's audit identified several errors which staff reasonably expects DWR will correct in its December 1997 rebilling of these Invoices. The magnitude of this year's corrections is consistent with past year's corrections.

The causes of these errors, totaling \$8.5 million, included (1) computer programming errors which overscalated operations and maintenance costs by \$6.8 million, (2) double-billing of \$3.2 million costs for Mojave Siphon Powerplant and Los Banos Grandes Reservoir, and (3) a \$1.5 million undercollection of Metropolitan's payment for East Branch capital costs in 1993. DWR staff has also identified errors since the Invoices were delivered to SWP contractors which staff expects DWR to include in the December 1997 Invoices rebilling. These modifications are financially off-setting and include the proper allocation of costs associated with the American Basin conjunctive use project to Metropolitan and other participating contractors. Detailed explanations of these and other errors, as well as errors anticipated to be corrected in future invoices, are described in the enclosed audit report entitled "Summary Report on the Audit of the 1998 Statement of Charges". In addition, a comprehensive report entitled "Report on the Audit of the 1998 Statement of Charges" will be available for your review in the office of the Executive Secretary.

Table 1 presents staff's estimates of the revised Invoices for 1998. Total charges are expected to be \$9.4 million lower than the July 1, 1997, Invoices reflecting both the \$8.5 million audit corrections and \$0.9 million in corrections primarily caused by revised water delivery estimates to Metropolitan and other contractors. DWR is expected to deliver the revised Invoices to Metropolitan at the end of December 1997, subsequent to the preparation and mailing of this letter to your Board. Staff will present the figures in the revised Invoices issued by DWR at your January 1998 Board meeting.

Some issues remain unresolved at the time this letter is being prepared for your Board. Metropolitan staff, with the assistance of our auditor Richardson & Company, continues to work with DWR staff to assess progress and analyze allocations for these and other unresolved financial issues: (1) the Municipal Water Quality Investigation may be rebilled through Transportation charges rather than through Delta Water charges to properly reflect agreed upon cost allocations, increasing Metropolitan's costs by approximately \$400,000, (2) a portion of the \$600,000 costs associated with DWR's Supplemental Water Purchase Program may be allocated to Metropolitan and other participating contractors reflecting agreed upon cost sharing, and (3) a corrected cost allocation of California Aqueduct historic costs associated with Mojave Water Agency's purchase

of 25,000 acre-feet of water from Kern County Water Agency which incorrectly lowered Metropolitan's charges.

These revised billings will reduce projected SWP expenditures in Metropolitan's fiscal year 1997-98 budget by about \$4 million. A projection of these revised billings has been included in the revenue requirement projections for fiscal year 1998-99. In addition, Metropolitan's budget and revenue requirements for SWP payments are developed with current water sales projections as well as projections of SWP refunds and credits. This results in lower SWP payments used in budget and revenue requirement projections than are shown in DWR's Invoices.

Metropolitan's 1998 charges, as shown in the July Statement of Charges, increased by \$26.5 million compared to the 1997 Statement of Charges. The higher charges are primarily caused by higher water delivery requests by Metropolitan and other contractors which increased Transportation Variable charges by \$17.7 million and Off-Aqueduct charges by \$10.9 million. Factors contributing to the increase between 1997 and 1998 Invoices are shown on Table 2.

Metropolitan and other SWP contractors have disputed certain procedures and assumptions utilized by DWR in calculating past Invoices. DWR is expected to again issue an extension-of-time letter by December 21, 1997, that preserves contractors' opportunities to contest the calculation and the charges included in this billing, should there be a future dispute over DWR's cost allocation methodology. While a number of SWP charges allocated to Metropolitan could be affected by ongoing discussions with DWR, we are not aware of any charges that should be protested at this time.

The General Manager projects the DWR's December 1997 rebilling of Metropolitan's 1998 charges will total approximately \$340.6 million, as shown under "Estimated December 1997 Rebilling" in Table 1, and expects to conclude the corrected Invoices presented to your Board in January 1998 will materially comply with the terms of the Contracts and that payments should be authorized. Adequate remedies exist for adjustment of accounting errors and cost allocations. Sufficient funds are available in the fiscal year (FY) 1997-98 budget. Those charges applicable in FY 1998-99 will be included in that year's budget.

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Attachments

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Table 1

STATE WATER SERVICE AND DEVIL CANYON-CASTAIC CONTRACTS
Summary of Invoices for Payments Due During Calendar Year 1998

(in \$millions)

	July 1, 1997 Statement	Net Change from July	Estimated December 1997 Rebiling
Delta Water Charge (Invoice #98-014-T)			
Capital Component	\$ 21.9	\$ (0.7)	\$ 21.2
Minimum OMP&R Component	\$ 24.3	\$ (0.2)	\$ 24.1
			\$ -
Transportation Charge (Invoice #98-014-T)			\$ -
Water System Revenue Bond Surcharge	\$ 29.4	\$ 0.3	\$ 29.7
Capital Component	\$ 64.2	\$ (2.8)	\$ 61.3
Minimum OMP&R Component	\$ 77.2	\$ (6.1)	\$ 71.0
Variable OMP&R Component	\$ 27.8	\$ (5.4)	\$ 22.4
East & West Branch (exc. carryover) - 970,000 acre-feet			\$ -
			\$ -
Off-Aqueduct Power Facilities Charge (Invoice #98-013-O)	\$ 65.4	\$ (1.2)	\$ 64.2
			\$ -
East Branch Enlargement Charge (Invoice #98-004-E)			\$ -
Capital Cost Component	\$ 28.6	\$ 1.5	\$ 30.1
Minimum OMP&R Component	\$ 1.9	\$ -	\$ 1.9
			\$ -
Devil Canyon-Castaic Contract Charge (Invoice #98-002-DCC)			\$ -
Debt Service	\$ 4.8	\$ -	\$ 4.8
Operation & Maintenance	\$ 4.6	\$ -	\$ 4.6
			\$ -
TOTAL CHARGES.....	\$ 350.0	\$ (14.6)	\$ 335.3

Table 2

**SUMMARY OF SIGNIFICANT FACTORS CONTRIBUTING TO
 INCREASES (DECREASES) IN BILLINGS FROM 1997 TO 1998**

(millions of dollars)

	Increase (Decrease)
Delta Water Charge - Capital and Minimum OMP&R	
Estimated costs	\$ 1.9
Recovery generation credit	\$ (0.1)
Allocations among contractors	\$ 1.0
Refund under Monterey Amendment	\$ (1.4)
Net Change	\$ 1.4
Transportation Charge - Variable OMP&R	
Estimated Costs	\$ 34.9
Past Cost adjustments	\$ 4.1
Power sales	\$ (3.4)
Recovery generation credit	\$ (17.8)
Net Change	\$ 17.7
Transportation Charge - Capital and Minimum OMP&R	
Estimated costs	\$ (2.3)
Past cost adjustments	\$ (0.0)
Refund under Monterey Amendment	\$ (2.9)
Net Change	\$ (5.2)
Off-Aqueduct Power Facilities Charge	
Estimated costs	\$ 4.3
Bond refunding/Project Interest Rate	\$ (3.5)
Allocations among contractors	\$ 10.0
Net Change	\$ 10.9
East Branch Enlargement - Capital and Minimum OMP&R	
Estimated costs	\$ (0.3)
New bond issuances	\$ 3.0
Past cost adjustments	\$ (0.7)
Bond refunding/Project Interest Rate	\$ (3.1)
Net Change	\$ (1.1)
Other Increases and Decreases	
Water System Revenue Bonds	\$ 2.8
Net Change	\$ 2.8
NET CHANGE IN BILLING FROM 1997 TO 1998	\$ 26.5