

February 8, 1999

**To:** Board of Directors (Special Audit Committee--Action)  
(Executive Committee--Action)

**From:** Auditor \_\_\_\_\_

**Subject:** Authorize Supplemental Payment of \$10,000 to KPMG Peat Marwick, LLP, for  
Unexpected Extra Audit Work

### RECOMMENDATION

It is recommended that the Board of Directors authorize a supplemental payment of \$10,000 to KPMG Peat Marwick, LLP, for unexpected extra work performed by the firm in order to complete Metropolitan's required audit services for the fiscal year ended June 30, 1998.

### EXECUTIVE SUMMARY

As a result of unexpected extra work performed by Metropolitan's external auditor, KPMG Peat Marwick, LLP, (Peat Marwick) to complete Metropolitan's required audit services for the fiscal year ended June 30, 1998, authorization from your Board is requested to make a supplemental payment to the firm totaling \$10,000. This payment would be in addition to the \$89,600 already paid to the firm for fiscal 1997-98 audit services which were subject to an annual maximum fee limitation of that amount.

In performing the required external audit services for fiscal 1997-98, Peat Marwick personnel encountered various unexpected difficulties pertaining to the identification, tracking, and reporting of Federal source grant funds, including the preparation of a comprehensive Schedule of Expenditures of Federal Awards. These audit difficulties ultimately resulted in delays in the completion and issuance of Metropolitan's Single Audit Reports for the year ended June 30, 1998. The problems also required Peat Marwick to spend significantly more time than normal to complete the Single Audit work, thus contributing to a large fee overrun for all required audit services for fiscal 1997-98. This extra time, at the firm's discounted contractual billing rates, contributed about \$10,000 to the total of \$18,634 of unbillable fees in excess of the fiscal 1997-98 contract maximum fee limit of \$89,600. Accordingly, it is recommended that the Board of Directors authorize a supplemental payment of \$10,000 to KPMG Peat Marwick, LLP, for the unexpected extra work required by the firm to complete Metropolitan's fiscal 1997-98 audit services.

### DETAILED REPORT

As a result of unexpected extra work performed by Metropolitan's external auditor, KPMG Peat Marwick, LLP, (Peat Marwick) to complete Metropolitan's required audit services for the fiscal year ended June 30, 1998, authorization from your Board is requested to make a supplemental

payment to the firm totaling \$10,000. This payment would be in addition to the \$89,600 already paid to the firm for fiscal 1997-98 audit services which were subject to an annual maximum fee limitation of that amount. A detailed explanation of this matter follows.

Peat Marwick is under contract with Metropolitan to perform specific audit services each year. The contract in effect is the second five-year contract with the firm for such services and the contract will expire in early calendar 2002, once all required audit services for fiscal year 2000-01 have been completed by the firm. The current multi-year agreement specifies an annual maximum fee limit for the services to be rendered by the firm on Metropolitan's behalf for each fiscal year to be audited. These annual fee limits were contractually established in 1996 based on estimates by Peat Marwick representatives of the fees necessary to perform the required audit services for such future years in normal circumstances.

For the first two years of the current contract, as well as the preceding five years, Peat Marwick has performed all required audit services and was paid for such work at the hourly rates applicable for such contract years. For each audit year, the firm's billings for actual time spent conducting the audits have exceeded the maximum fee limits specified in the contracts for such periods. Accordingly, with the exception of a supplemental billing adjustment of \$29,018 for extraordinary extra work for fiscal 1994-95 services, all Peat Marwick charges and billings in excess of the respective annual fee limits have been written off by the firm. The attachment to this letter summarizes the history of billings from Peat Marwick for external audit services during the first five-year contract and first two years of the current agreement.

In performing the required external audit services for fiscal 1997-98, Peat Marwick personnel encountered various unexpected difficulties pertaining to the identification, tracking, and reporting of Federal source grant funds, including the preparation of a comprehensive Schedule of Expenditures of Federal Awards. This schedule is an integral part of Metropolitan's Single Audit Reports which are prepared annually by Peat Marwick in accordance with the requirements of the Federal Single Audit Act and OMB Circular A-133, Audit of States, Local Governments and Non-profit Organizations. These audit difficulties ultimately resulted in delays in the completion and issuance of Metropolitan's Single Audit Reports for the year ended June 30, 1998. The problems also required Peat Marwick to spend significantly more time than normal to complete the Single Audit work, thus contributing to a large fee overrun for all required audit services for fiscal 1997-98. Metropolitan's Single Audit Reports were received last week from Peat Marwick, thus completing the firm's obligation for all required audit services for such year.

Concurrent with the issuance of the Single Audit Reports, Peat Marwick's engagement partner, Mr. Tom Snow, provided me with a final billing recap showing all time spent by the firm in providing fiscal 1997-98 audit services to Metropolitan, together with a February 3, 1999, letter outlining the extra time required to complete the Single Audit work. Mr. Snow's letter noted that the firm had spent 183 hours on the Single Audit work for fiscal 1997-98, which was 114 hours more than the average annual time required for Single Audit work in the prior four years. This extra time, at the firm's discounted contractual billing rates, contributed about \$10,000 to the total of \$18,634 of unbillable fees in excess of the fiscal 1997-98 contract maximum fee limit of \$89,600. Since the need for the excess time was attributable to Metropolitan, Mr. Snow asked me to consider seeking authority to compensate the firm for this unexpected extra work. Due to the fact that the external audit contract is a Board of Directors agreement, authority for payments in excess of contractual annual maximum fee limits requires Board approval.

Upon reviewing the final time and billing information provided by Peat Marwick, as well as the reasons cited in Mr. Snow's February 3, 1999, letter to me pertaining to the extra time needed to complete the Single Audit work, I believe that the firm is entitled to the requested supplemental payment of \$10,000. The reasons for the extra work, as well as the hours billed, appear consistent with the problems encountered by both the Peat Marwick staff and the internal auditors in recent months in dealing with Federal Grants Management issues. In fact, Peat Marwick cited problems pertaining to Federal Grants Management in its Annual Letter to Management, dated October 28, 1998. As shown in the Attachment to this letter, even after excluding the supplemental \$10,000 payment requested by this letter, Peat Marwick will recognize excess fee write-offs of about 10 percent for its services to Metropolitan for fiscal 1997-98. A 10 percent write-off level is consistent with that experienced in recent years by the firm.

It is recommended that the Board of Directors authorize a supplemental payment of \$10,000 to KPMG Peat Marwick, LLP, for the unexpected extra work required by the firm for Metropolitan's fiscal 1997-98 audit services.

MWH:lo

**Attachment 8-4A**

**Attachment 8-4A**

**SUMMARY OF EXTERNAL AUDIT CONTRACT FEE LIMITS  
AND CHARGES FOR FISCAL YEARS 1991-92 THROUGH 1997-98**

FISCAL YEAR

	<u>Prior Five-year Audit Agreement</u>					<u>Current Five-year Audit Agreement</u>	
	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
Maximum Annual Audit Fee Limit (1)	\$61,500	\$61,500	\$67,400	\$74,100	\$81,500	\$81,500	\$89,600
Total Charges For All Required Audit Services	<u>74,140</u>	<u>79,520</u>	<u>77,547</u>	<u>106,979</u> (2)	<u>89,915</u>	<u>89,354</u>	<u>98,234</u> (3)
Services Charges Absorbed by KPMG Peat Marwick (Write-offs)	<u>\$12,640</u>	<u>\$18,020</u>	<u>\$10,147</u>	<u>\$32,876</u>	<u>\$8,415</u>	<u>\$7,854</u>	<u>\$8,634</u>
Write-offs as % of Annual Maximum Fee	21%	29%	15%	44%	10%	10%	10%

- (1) Annual required services include: quarterly audits of cash basis financial statements, the year-end accrual basis financial statements, including issuance of an annual Letter to Management, and preparation of other reports such as the Single Audit Reports in years when required.
- (2) Excludes charges totaling \$29,018 for “extraordinary” work required due to audit problems relating to mid-year implementation of the District’s new integrated financial systems. A supplemental billing for that amount was approved by the Board of Directors in April 1996.
- (3) Includes fees for all audit services performed, except for \$10,000 for unexpected extra work to complete Metropolitan’s required Single Audit Reports due to problems encountered. KPMG Peat Marwick has requested a special “supplemental” payment for such extra work.