

February 4, 1999

**To:** Board of Directors (Special Audit Committee—Information)  
(Budget and Finance Committee--Information)

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

**Subject:** Single Audit Reports for the Fiscal Year Ended June 30, 1998

### RECOMMENDATION(S)

For information only.

### DETAILED REPORT

The Federal Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, requires state or local government units that expend \$300,000 or more of federal financial assistance in any one year to have an audit conducted for that year. Metropolitan's accrual basis financial statements are audited annually by the firm of KPMG Peat Marwick, LLP, in accordance with generally accepted auditing standards promulgated by the American Institute of Certified Public Accountants (AICPA). In the event that a so-called "Single Audit" is required to be conducted for a particular year, the cost of such an audit is included as part of the required audit services provided by that firm under its agreement with Metropolitan.

Auditors who conduct audits pursuant to the Single Audit Act are required to comply with Government Auditing Standards issued by the Comptroller General of the United States (the so-called "Yellow Book"), as well as requirements of the Single Audit Act and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. These standards require that various reports be issued by the external auditor in addition to the traditional auditor's report on the entity's general purpose financial statements. The AICPA has established authoritative guidance on the form and content of the reports required by the Single Audit Act.

Due to the magnitude of federal source moneys expended during the fiscal year ended June 30, 1998, Metropolitan was required to have a Single Audit performed. The necessary additional auditing procedures were performed by staff from KPMG Peat Marwick and the required audit reports, dated August 21, 1998, were issued by the firm prior to the statutory deadline of March 31, 1999. Copies of these audit reports will be transmitted by my office to the cognizant and other agencies who require such reports, namely:

- The State Controller of California
- U.S. Department of the Interior, Bureau of Reclamation
- U.S. Federal Emergency Management Agency

- U.S. Environmental Protection Agency
- U.S. Department of Commerce
- U.S. Bureau of the Census

A copy of the required Single Audit Act audit reports from KPMG Peat Marwick is attached to this letter for information purposes.

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**Attachment 10-5A**

**THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA**

Single Audit Reports

Year ended June 30, 1998

**THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA**

Single Audit Reports

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**Independent Auditors' Report on Compliance and  
on Internal Control over Financial Reporting  
Based on an Audit of Financial Statements  
in Accordance with Government Auditing Standards**

The Board of Directors  
The Metropolitan Water District of Southern California:

We have audited the financial statements of The Metropolitan Water District of Southern California (Metropolitan) as of and for the year ended June 30, 1998 and have issued our report thereon, dated August 21, 1998. During the year ended June 30, 1998, Metropolitan adopted Governmental Accounting Standards Board Statement No. 27, "Accounting for Pensions of State and Local Government Employers," No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," and No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 – Deferred Compensation Plans." We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

### **Compliance**

As part of obtaining reasonable assurance about whether Metropolitan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under Government Auditing Standards.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered Metropolitan's 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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a 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 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. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Metropolitan in a separate letter dated October 28, 1998.

This report is intended solely for the information of Metropolitan's Board of Directors, the Board's Special Audit Committee and management, as well as its Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

/ss/KPMG LLP

August 21, 1998

**Independent Auditors' Report on Compliance with  
Requirements Applicable to Each Major Program and  
Internal Control over Compliance in Accordance with  
U.S. Office of Management and Budget Circular A-133**

The Board of Directors  
The Metropolitan Water District of Southern California:

### **Compliance**

We have audited the compliance of Metropolitan with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major Federal programs for the year ended June 30, 1998. Metropolitan's major Federal programs are identified in the Summary of Auditors' Results section of the accompanying Schedule of Findings and Recommendations. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major Federal programs is the responsibility of Metropolitan's management. Our responsibility is to express an opinion on Metropolitan's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about Metropolitan's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Metropolitan's compliance with those requirements.

As described in item 98-1 in the accompanying Schedule of Findings and Recommendations, Metropolitan did not comply with the requirement that its cost allocation plan (CAP) and/or indirect cost allocation rate proposal (IDCRP) be prepared and regularly updated in accordance with requirements governing such CAPs/IDCRPs and be maintained on file for later review by its oversight agency. We believe Metropolitan should update its CAP/IDCRP in accordance with those requirements to comply with the requirements applicable to its major programs: U.S. Department of the Interior, Bureau of Reclamation – Urban Water Conservation Project (CFDA No. 15.BBM) and U.S. Department of Commerce – Seawater Desalination Demonstration Project (CFDA No. 11.609). Compliance with requirements related to CAPs/IDCRPs is necessary, in our opinion, for Metropolitan to comply with the requirements applicable to its Federal programs.

In our opinion, except for the noncompliance described in the preceding paragraph, Metropolitan complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 1998.

## **Internal Control over Compliance**

The management of Metropolitan is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to Federal programs. In planning and performing our audit, we considered Metropolitan's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Metropolitan's ability to administer a major Federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Recommendations as item 98-1.

A material weakness is a 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 noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major Federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of Metropolitan in a separate letter dated October 28, 1998.

## **Schedule of Expenditures of Federal Awards**

We have audited the financial statements of The Metropolitan Water District of Southern California (Metropolitan) as of and for the year ended June 30, 1998 and have issued our report thereon, dated August 21, 1998. During the year ended June 30, 1998, Metropolitan adopted Governmental Accounting Standards Board Statement No. 27, "Accounting for Pensions of State and Local Government Employers," No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," and No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 – Deferred Compensation Plans." Our audit was performed for the purpose of forming an opinion on the basic financial statements of Metropolitan taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole, except for the effects, if any, of indirect costs allocated to Federal award programs in excess of allowable amounts.

This report is intended solely for the information of Metropolitan's Board of Directors, the Board's Special Audit Committee and management, as well as its Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

August 21, 1998

/ss/KPMG LLP

**THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA**

Schedule of Expenditures of Federal Awards

Year ended June 30, 1998

	Federal CFDA number (note 5)	Grant number/ pass- through grantor's number	Federal entitlement amount	Accrued (deferred) grant revenue at June 30, 1997
<b>U.S. Department of the Interior, Bureau of Reclamation</b>				
Direct Programs:				
Urban Water Conservation Project ( <i>major program</i> )	15.BBM	4-FC-30-00120	\$ 3,650,000	(104,567)
Salinity Management Study	15.504	1425-6-FC-30-00900	300,000	129,284
Total U.S. Department of the Interior, Bureau of Reclamation			3,950,000	24,717
<b>U.S. Environmental Protection Agency</b>				
Direct Programs:				
Development of a Quantitative Cell Culture-Based Infectivity Assay for Cryptosporidium Parvum in Source and Finished Water	66.506	R825146-01-0	214,502	40,356
Assessment of Blue-Green Algal Toxins in Raw and Finishing Waters	66.506	256	20,920	—
			235,422	40,356
Water Efficiency Analysis for Hospitality	66.801	X822215-01-0	140,000	(3,139)
Molecular Characterization of Cryptosporidium Species to Discriminate Between Isolates	66.801	96-35102-3875	110,233	—
			250,233	(3,139)
Filter Operational Effects on Pathogens	66.500	490	147,500	—
Total direct programs			633,155	37,217
Passed-through the County Sanitation Districts of the County of Los Angeles – Development of Practical Monitoring Techniques to Identify the Probability of the Presence of Pathogens in Receiving Waters	66.505	97-HHE-1	160,600	—
Total U.S. Environmental Protection Agency			793,755	37,217
<b>U.S. Federal Emergency Management Agency</b>				
Passed-through the California Office of Emergency Services – Public Assistance Grants (note 4):				
1993 Storm Damage	83.544	FEMA-1005-DR-CA/ OES 93-01-102	962,758	103,332
1993 Firestorm Damage	83.544	FEMA-1005-DR-CA/	77,295	26,155
1994 Earthquake	83.544	FEMA-1008-DR-CA/ OES 94-01-041	6,227,051	69,325
1998 El Nino Storm Damage	83.544	FEMA-1203-DR	—	—
Total Federal Emergency Management Agency			7,267,104	198,812
<b>U. S. Department of Commerce</b>				
Passed through Parsons IDE Joint Venture – Seawater Desalination Demonstration Project ( <i>major program</i> )	11.609	70NANB64005	—	—
Total Federal assistance			\$ 12,010,859	260,746

See accompanying notes to Schedule of Expenditures of Federal Awards and Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with U.S. Office of Management and Budget Circular A-133.

Grant revenue received	Matching and other grant revenue	Grant expenses (note 4)			Accrued (deferred) grant revenue at June 30, 1998
		Federal	Non-Federal	Total	
—	—	365,911	—	365,911	261,344
154,364	92,767	153,871	—	153,871	36,024
154,364	92,767	519,782	—	519,782	297,368
42,141	14,346	73,333	—	73,333	57,202
—	6,965	6,059	18,683	24,742	17,777
42,141	21,311	79,392	18,683	98,075	74,979
—	—	—	—	—	(3,139)
—	—	35,778	—	35,778	35,778
—	—	35,778	—	35,778	32,639
14,750	—	3,628	—	3,628	(11,122)
56,891	21,311	118,798	18,683	137,481	96,496
—	—	1,577	—	1,577	1,577
56,891	21,311	120,375	18,683	139,058	98,073
—	—	—	—	—	103,332
—	—	—	—	—	26,155
569	266,560	—	266,560	266,560	68,756
—	68,386	205,158	68,386	273,544	205,158
569	334,946	205,158	334,946	540,104	403,401
263,287	789,859	263,287	789,859	1,053,146	—
475,111	1,238,883	1,108,602	1,143,488	2,252,090	798,842

**THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA**

Notes to Schedule of Expenditures of Federal Awards

Year ended June 30, 1998

**(1) General**

The accompanying Schedule of Expenditures of Federal Awards presents the activity of Federal financial assistance programs of The Metropolitan Water District of Southern California (Metropolitan).

**(2) Basis of Accounting**

The accompanying Schedule of Expenditures of Federal Awards is presented using the accrual basis of accounting, whereby grant revenues are recognized when they are earned and expenses are recognized when they are incurred.

**(3) Definition of Major Federal Financial Assistance Program**

The Single Audit Act Amendments of 1996 define major Federal award programs based upon total Federal expenditures of the grantee during the period reported and inherent risk of the programs audited. Based on the assessment of its external auditors, Metropolitan has determined that the U.S. Department of the Interior, Bureau of Reclamation – Urban Water Conservation Project (CFDA No. 15.BBM) and U.S. Department of Commerce – Seawater Desalination Demonstration Project (CFDA No. 11.609) are considered to be major Federal financial assistance programs for the year ended June 30, 1998. (See Summary of Auditors' Results section of the accompanying Schedule of Findings and Recommendations.)

**(4) Grant Expenses**

Included in Grant Expenses on the accompanying Schedule of Expenditures of Federal Awards are indirect costs (i.e., overhead) charged to the various programs. These costs aggregate approximately \$96,000 for the year ended June 30, 1998. Indirect or administrative costs for FEMA projects are limited based upon the amount of the total final approved claim, typically an amount less than 2% of the approved claim amount. Accordingly, some portion of the indirect costs may be disallowed upon final review by FEMA and OES. In addition, Metropolitan has not updated its indirect cost allocation plan (CAP) or indirect cost allocation rate proposal (IDCRP) since 1990/91. (See Finding 98-1 in the accompanying Schedule of Findings and Recommendations.)

**(5) CFDA Number**

The U.S. Bureau of Reclamation (USBR) – Urban Water Conservation Project, a cooperative agreement between Metropolitan and USBR, has not been assigned a CFDA number. Accordingly, USBR has instructed Metropolitan to identify the program using the designation 15.BBM.

**THE METROPOLITAN WATER DISTRICT  
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Schedule of Findings and Recommendations

Year ended June 30, 1998

**(1) Summary of Auditors' Results**

- (a) The type of report issued on the financial statements: **Unqualified Opinion.**
- (b) Reportable conditions in internal control were disclosed by the audit of the financial statements: **None reported**; Material weaknesses: **No.**
- (c) Noncompliance which is material to the financial statements: **No.**
- (d) Reportable conditions in internal control over major programs: **Yes**; Material weaknesses: **No.**
- (e) The type of report issued on compliance for major programs: **Qualified Opinion.**
- (f) Any audit findings which are required to be reported under section .510(a) of OMB Circular A-133: **Yes.**
- (g) Major programs: **U.S. Department of the Interior, Bureau of Reclamation – Urban Water Conservation Project (CFDA No. 15.BBM) and U.S. Department of Commerce – Seawater Desalination Demonstration Project (CFDA No. 11.609).**
- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$300,000.**
- (i) Auditee qualified as a low-risk auditee under section .530 of OMB Circular A-133: **No.**

**(2) Findings Relating to the Financial Statements Reported in Accordance with Government Auditing Standards**

**None.**

**(3) Findings and Recommendations Relating to Federal Awards**

***Finding No. 98-1 – Cost Allocation Plans – Allowable Costs/Cost Principles (OMB Circular A-87)***

**Finding**

Cost allocation plans (CAP) or, alternatively, indirect cost allocation rate proposals (IDCRP), are used by organizations to identify and allocate direct and indirect charges, including overhead costs, to their various programs, projects and other activities, whether capitalized or expensed. CAPs and IDCRPs are usually prepared or updated annually on a prospective basis using a prior year's financial data; alternatively, current year's budget data is also sometimes used. When the actual costs for the year are determined, the difference between the originally proposed costs and the actual costs are either carried forward to a subsequent CAP/IDCRP or adjusted on a retrospective basis. Metropolitan has not updated its CAP/IDCRP since fiscal 1991.

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## Schedule of Findings and Recommendations

Year ended June 30, 1998

In order to receive reimbursement for indirect costs, recipients of Federal awards are generally required to prepare a CAP and/or IDCPR that provide a basis for allocating indirect costs to Federal programs. Each state, state department and major local unit of government, as well as any other organization specifically requested to do so, must submit its CAP/IDCRP to its cognizant agency for approval. Other unlisted organizations must prepare the appropriate plans/proposals and maintain them on file for later review but may use their results in the meantime. Metropolitan has not been required to submit its CAP and IDCPR to its cognizant agency for review in the past, but as it expects to continue to participate in Federal grant programs, it could be required to do so in the future.

The exposure created by the lack of an updated CAP/IDCRP has been described in our findings in Metropolitan's Single Audit reports for fiscal years 1993, 1994, 1995, 1996 and 1997. Management responses to this finding in the past Single Audit reports have indicated that management concurred with the need to complete an updated CAP/IDCRP. Last year's response from management stated that Metropolitan would obtain formal bids, hire a contractor and prepare a cost allocation plan within the next fiscal year. The contractor hired to complete the cost allocation plan in fiscal 1997 experienced delays in completing the project and did not deliver its draft cost allocation plan to management until well after the expected delivery date. As a result, management has not finalized nor implemented the plan as of the date of this letter. The lack of progress in completing and implementing a CAP/IDCRP over such a long period of time, in spite of repeated assurances that the matter would be resolved, indicates that the matter has not been managed properly nor given sufficient attention by Metropolitan's management.

**Recommendation**

We again recommend that Metropolitan complete its cost allocation plan as soon as possible in order to allocate overhead and other costs to all projects and cost centers as applicable. Implementing this recommendation in conjunction with an updated Federal CAP/IDCRP will enhance the accuracy of the costs of providing service or constructing facilities. The CAP/IDCRP should be updated on an annual basis, and differences between the originally proposed costs of the plan and the actual costs should be carried forward to subsequent CAPs and IDCPRs or adjusted with the granting Federal agency on a retrospective basis, as appropriate. Such plans/rates should consider the effect or reimbursement limitations for certain types of programs such as FEMA Disaster Assistance programs.

**THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA**

Status of Prior Year Findings

Year ended June 30, 1998

**Finding No. 97-1 – Cost Allocation Plans – Allowable Costs/Cost Principles (OMB Circular A-87)**

***Finding***

The finding is substantially the same as Current Year Finding 98-1.

***Recommendation***

We again recommend that Metropolitan complete its cost allocation plan as soon as possible in order to allocate overhead and other costs to all projects and cost centers, as applicable. Implementing this recommendation in conjunction with an updated Federal CAP/IDCRP will enhance the accuracy of the costs of providing service or constructing facilities. The CAP/IDCRP should be updated on an annual basis, and differences between the originally proposed costs of the plan and the actual costs should be carried forward to subsequent CAPs and IDCRPs or adjusted with the granting Federal agency on a retrospective basis, as appropriate. Such plans/rates should consider the effect or reimbursement limitations for certain types of programs such as FEMA Disaster Assistance programs.

***Management's Response***

A draft of the Cost Allocation study is currently under review by management. Management expects the CAP to be finalized in November 1997 with full implementation and automation of the plan by June 30, 1998. Updates based on prior year actual amounts will be performed annually.

***Status***

The contractor hired to complete the cost allocation plan in fiscal 1997 experienced delays in completing the project and did not deliver its draft cost allocation plan to management until well after the expected delivery date. As a result, management has not finalized nor implemented the plan as of the date of this letter. The lack of progress in completing and implementing a CAP/IDCRP over such a long period of time, in spite of repeated assurances that the matter would be resolved, indicates that the matter has not been managed properly nor given sufficient attention by Metropolitan's management. (See Finding 98-1 in the accompanying Schedule of Findings and Recommendations.)

**Finding No. 96-1 – Cost Allocation Plans – Allowable Costs/Cost Principles (OMB Circular A-87)**

***Finding***

The finding is substantially the same as Current Year Finding 98-1.

***Recommendation***

We understand that Metropolitan expects to participate in Federal grant programs in the future in which allocation of allowable direct or indirect costs will continue to be a factor. Accordingly, we recommend that Metropolitan update its CAP and IDCRP on an annual basis in accordance with requirements for such

**THE METROPOLITAN WATER DISTRICT  
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Status of Prior Year Findings

Year ended June 30, 1998

plans. These plans should be developed prospectively as described above, and differences between the originally proposed costs of the plan and the actual costs should be carried forward to subsequent CAPs and IDCRCs or adjusted with the granting Federal agency on a retrospective basis, as appropriate. Automatic allocations in accordance with the approved plans to the grant programs and future updates to the plans based upon actual results should be facilitated by Metropolitan's new computer system. Such plans/rates should consider the effect or reimbursement limitations for certain types of programs such as FEMA Disaster Assistance programs.

*Management's Response*

Metropolitan has received formal bids from qualified vendors to complete this project and expects to award a contract to prepare and complete a CAP/IDCRP in fiscal year 1996-97.

*Status*

The contractor hired to complete the cost allocation plan in fiscal 1997 experienced delays in completing the project and did not deliver its draft cost allocation plan to management until well after the expected delivery date. As a result, management has not finalized nor implemented the plan as of the date of this letter. The lack of progress in completing and implementing a CAP/IDCRP over such a long period of time, in spite of repeated assurances that the matter would be resolved, indicates that the matter has not been managed properly nor given sufficient attention by Metropolitan's management. (See Finding 98-1 in the accompanying Schedule of Findings and Recommendations and Finding 97-1 above.)