

February 4, 1999

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

From: General Manager _____

Submitted by: Chief Financial Officer _____

Subject: Management's Response to Single Audit Reports prepared by KPMG Peat
Marwick LLP

RECOMMENDATION(S)

For information only.

EXECUTIVE SUMMARY

Management agrees with KPMG Peat Marwick LLP (KPMG) finding and recommendation included in Metropolitan's 1998 Single Audit Reports covering its Federal grant programs. To improve Metropolitan's ability to administer its Federal programs in accordance with applicable requirements of laws, regulations, contracts and grants, management has prepared a corrective action plan and summary schedule of prior audit findings. These documents are prepared in accordance with §__.315 of U. S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" (OMB Circular A-133).

DETAILED REPORT

On August 21, 1998, KPMG issued Metropolitan's Single Audit Reports for the year ended June 30, 1998. The Single Audit Reports are the result of a consolidated audit of Metropolitan's Federal grant programs and is performed by KPMG as part of the annual audit of Metropolitan's financial statements.

In the Single Audit Reports, KPMG included one current year finding and a carryover finding from prior years which has not been fully addressed. In accordance with the OMB Circular A-133, § __.315, Metropolitan has prepared a corrective action plan and summary schedule of prior audit findings to be included in the Single Audit reporting package. The findings included in the corrective action plan and summary schedule of prior audit findings are identified by the reference numbers assigned by KPMG in the Schedule of Findings and Recommendations and the Status of Prior Year Findings. The corrective action plan includes the audit finding reference number, the corrective actions planned, the names of the contact persons responsible for corrective actions, and the anticipated completion dates. The summary schedule of prior audit findings includes the status of the prior audit findings and the fiscal year in which the initial

findings occurred. Below is management's response to KPMG's 98-1 finding and recommendation, which has been paraphrased in this letter for brevity. Prior Year Findings 97-1 and 96-1 are not reported in this letter since, as indicated in the 1998 Single Audit Reports, such findings are substantially the same as Finding 98-1.

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

Cost allocation plans (CAP), or alternatively, indirect cost allocation rate proposals (IDCRP), are used to identify and allocate costs to various programs, projects or other activities. CAPs and IDCRPs are usually updated annually on a prospective basis using prior year actual costs, or alternatively current year budget amounts. Metropolitan has not updated its CAP/IDCRP since fiscal 1991.

In order to receive reimbursement for indirect costs, recipients of Federal awards are generally required to prepare a CAP and/or IDCRP that provide a basis for allocating indirect costs to Federal programs. If requested, Metropolitan must submit its plan to its cognizant or oversight agency for approval. Metropolitan has not yet been required to submit its CAP or IDCRP to its cognizant or oversight agency for review, 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 was described in KPMG's findings in Metropolitan's Single Audit reports for 1993 - 1997. Last year management stated that it would obtain formal bids, hire a contractor and update its plan within the next fiscal year. While the contractor was hired in fiscal 1997, the costs allocation plan has not been completed. 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 management.

KPMG again recommends 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. They further recommend that the plan be updated on an annual basis.

Management's Response:

Staff concurs with this finding and recommendation. The contractor has substantially completed their update of the CAP/IDCRP. Work on this project began in 1997. Interviews were conducted, data gathered, and numerous iterations of cost allocations were performed. In 1998 the project was subject to unavoidable delays because the contractor was acquired by a third party. This resulted in changes in personnel assigned to the project which disrupted the development of the CAP/IDCRP. A senior vice president has now been assigned as project lead to assure timely completion of the project. A draft CAP was received in September 1998 and a draft IDCRP was received in January 1999. The plan is currently being finalized and is scheduled for delivery in February 1999.

In addition to updating the IDCRP as recommended by KPMG, management plans to provide grant administration training to staff applying for and managing Federally funded grants. Policies and procedures for applying IDCRP rates to grants and Federally funded programs are also being

developed to enhance Metropolitan's ability to receive maximum reimbursement of its indirect costs. These policies and procedures are scheduled to be implemented July 1, 1999.

It should be noted that the lack of not having an updated IDCRP has not had an impact on Metropolitan's ability to be reimbursed for its indirect costs incurred on Federally funded assistance programs. Metropolitan currently has approximately \$12 million in Federal entitlements. Of that amount, programs totaling approximately \$10.9 million have specific limitations regarding indirect cost reimbursements. Reimbursement of indirect costs for U.S. Federal Emergency Management Agency (FEMA) projects is limited based upon the amount of the total final approved claim, typically an amount less than two percent of the approved claim amount. The contract with the U.S. Department of Interior, Bureau of Reclamation - Urban Water Conservation Project only covers direct costs. The other major program Metropolitan is involved in is the U. S. Department of Commerce - Seawater Desalination Demonstration Project. The United States and Israel Science and Technology Foundation, which is providing a portion of the funding for this project, only permits recovery of indirect costs based on 30 percent of allowable direct costs.

A corrective action plan has been developed in accordance with OMB Circular A-133, §__.315 and is attached to this letter.

MCF:jg

Attachment 10-6A

Attachment 10-6A

**Metropolitan Water District of Southern California
Single Audit Reports
Year ended June 30, 1998**

Corrective Action Plan

Audit Finding Reference No.	Corrective Action Planned	Contact Person	Anticipated Completion Date
98-1	1. Draft of the IDCRP received from Consultant	Marti Farley	January 13, 1999
	2. Request Internal Audit to review the draft IDCRP as to form, reasonableness, and conformance with requirements of laws, regulations, contracts, and grants applicable to Federal programs	Marti Farley	February 8, 1999
	3. Second Draft of the IDCRP due from Consultant, including executive summary and implementation strategies	Marti Farley	February 24, 1999
	4. Issue contract for staff training on grant administration, cost principles of OMB A-87, and development of IDCRPs under OMB A-87	Marti Farley	March 31, 1999
	5. Internal Audit review of IDCRP	Michael Hondorp	April 30, 1999
	6. Grant Administration training	Marti Farley	April 30, 1999
	7. External Audit review of IDCRP as to form	KPMG	May 31, 1999
	8. Develop policies and procedures for applying IDCRP rates to grants and federally funded programs	Tom DeBacker	June 30, 1999
	9. Implementation of policies and procedures and application of appropriate IDCRP rates for grants and Federally funded programs	David Furukawa	July 1, 1999

Summary Schedule of Prior Audit Findings

Audit Finding Reference No.	Status
97-1 and 96-1	These findings are substantially the same as Current Year Finding 98-1 and are addressed by the corrective action plan above for Audit Finding 98-1.