

April 13, 1999

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

From: Timothy H. Quinn
Deputy General Manager

Submitted by: Lambertus H. Becker
Chief Financial Officer

Subject: Status Report Relating to KPMG Peat Marwick, LLP's Management Letter for
the Year Ended June 30, 1998

RECOMMENDATION

For information only.

DETAILED REPORT

At the January 19, 1999, Special Audit Committee meeting, a request was made to provide the Committee with periodic status reports on management's implementation actions to KPMG Peat Marwick, LLP's Management Letter. The first status report was provided on February 8, 1999. This report provides the second status update of management's actions with current updates shown with underscored text.

TED

Attachment 10-29A

Attachment 10-29A

The Metropolitan Water District of Southern California
 Status Report Relating to KPMG's Management Letter for the Year Ended June 30, 1998
 As of April 13, 1999

KPMG's Findings and Recommendations		Management's Response and Status	
Description of Finding	Recommendation	Response	Current Status
Reportable Conditions:			
1. <i>Indirect Cost Allocation Plan</i> Metropolitan has not updated its cost allocation plan since fiscal 1991. This plan is used to identify and allocate costs to various programs, projects or other activities. In order to receive reimbursement for indirect costs, recipients of Federal awards are generally required to prepare a cost allocation plan that provides the basis for allocating indirect costs to Federal programs. Metropolitan's exposure created by the lack of an updated plan is a loss of Federal funding for indirect costs as described in KPMG's findings in Metropolitan's Single Audit reports for fiscal 1994, 1995 and 1996.	Update 1991 cost allocation plan; further recommended to update plan on an annual basis.	Agree with finding and recommendation	Final draft of updated plan received January 13, 1999; final review in progress by staff and external and internal auditors. Corrective action plan has been developed. Plan includes completing review, providing training for employees involved with Federal awards and developing policies and procedures. Implementation of cost allocation plan is now scheduled for July 1, 1999. <u>Grants training has begun for key employees involved with Federal awards. Internal Audit review of plan documents is expected to be performed during April 1999.</u>
2. <i>Assessment of Year 2000 Compliance</i> Given the preliminary stages of Metropolitan's Y2K efforts and the limited time frame available to complete the project, KPMG believes there is a relatively high risk that some systems may not be remediated prior to year 2000.	Undertake a triage approach with the initial focus on remedying, testing, and implementing the mission critical systems. Next, Metropolitan should attempt to remedy the remaining systems in order of risk and criticality.	Agree with finding and recommendation	Completed entire inventory of embedded chips and began remediation work; completed sixth draft of MWD contingency plan; scheduled meeting with member agencies to be held on May 5, 1999. In addition, the Rules Committee voted that the Engineering and Operations Committee will oversee the Y2K efforts. As such, status reports will be provided to that Committee, as well as the Board, on an on-going basis. <u>Completed tenth draft of contingency plan and have scheduled a full scale exercise for May 20, 1999. Over 100 systems will be fully tested and formal testing has begun on business systems. A second business systems test team is being organized to address second tier systems.</u>

The Metropolitan Water District of Southern California
 Status Report Relating to KPMG's Management Letter for the Year Ended June 30, 1998
 As of April 13, 1999

KPMG's Findings and Recommendations		Management's Response and Status	
Description of Finding	Recommendation	Response	Current Status
Current Year Findings and Recommendations:			
1. <i>Federal Grants Management</i> A number of Federal grants had not been reported to accounting for tracking and reporting purposes. Furthermore, management had not determined whether other grant programs included Federal source dollars. Finally, specific procedures have not been developed to identify Federally funded grant programs.	Establish policies and procedures to identify all Federally funded grant programs subject to the requirements of the Single Audit.	Agree with finding and recommendation	This item is related to the indirect cost allocation plan described above. Policies and procedures will be completed by June 30, 1999. <u>On schedule.</u>
2. <i>Research and Development Projects</i> Metropolitan has recorded \$16.4 million as construction -in-progress costs for two research and development projects. Metropolitan has not yet determined the estimated future value of the projects as part of its determination of the appropriate accounting treatment for these costs. While research and development costs are generally expensed as incurred, the cost of intangible assets are generally capitalized and amortized over their estimated useful lives.	Establish policies and procedures to identify research and development projects so that projects likely to result in intangible assets can be tracked and reassessed on a periodic basis; expense those costs not expected to result in intangible assets.	Agree with finding and recommendation	Policies and procedures are being drafted and will be finalized by April 30, 1999. Staff is also in the process of identifying the future value of the intangible assets for capitalization and will write-off to expense those costs not associated with intangible assets as required by generally accepted accounting principles. Expected completion by May 31, 1999. <u>Final drafts of policies and procedures have been completed and are being routed for final approval. Analysis is in process to determine accounting adjustments.</u>
3. <i>Obsolete or Excess Inventory</i> At June 30, 1998, Metropolitan had approximately \$456,000 of obsolete or excess inventory on its books. These items have limited future demand and time limits for disposal (or other handling) have not been established.	Maintain inventory at lowest possible levels by periodically reviewing inventory to identify and develop plans to address obsolete/excess items.	Agree with finding and recommendation	Workshops have been held with all storekeepers to determine the proper level of inventory to have on hand using minimum/maximum inventory techniques. The new min/max levels will help control excess/obsolete inventory levels in the future. In addition, a strategy has been developed to identify and transfer the current excess inventory to those storeroom locations using the items. The value of the excess/obsolete inventory at 12/31/98 was approximately \$400,000. <u>On-going. Inventory value at 3/31/99 was approximately \$397,000.</u>