

May 24, 1999

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

From: Auditor _____

Subject: **Renewal of Contract for Internal Audit Support Services**

RECOMMENDATION

It is recommended that the Auditor be granted authority to renew the existing contract with the accounting firm of KPMG, LLP, to provide various internal audit support services during fiscal 1999-2000 in an amount not to exceed \$200,000.

EXECUTIVE SUMMARY

In June 1998, the Board authorized the Auditor to enter into a contract with KPMG, LLP (formerly KPMG Peat Marwick, LLP), to provide various internal audit support services to the Audit Department during fiscal 1998-99 in an amount not to exceed \$200,000. Since this agreement represented the first such continuing support services arrangement ever utilized by the department, the initial term of the contract was limited to one year in order to assess the firm's performance. Based on the positive experience of utilizing KPMG's services during fiscal 1998-99 to augment those of the department, authority is sought to renew this agreement for an additional year at the same fee limit of \$200,000. Sufficient funding for this agreement, as well as other professional services as may be required by the Auditor, has been included in the Audit Department's proposed operating budget for fiscal 1999-2000. Board approval of this contract renewal is required since the Auditor's contracting authority is currently limited to \$25,000 per contract per year.

DETAILED REPORT

With the Special Audit Committee's concurrence, the Auditor solicited proposals in April 1998 from six major accounting firms for various internal audit support services. An evaluation of the three proposals received resulted in the selection of the firm of KPMG Peat Marwick, LLP (now KPMG, LLP) as the most qualified firm to provide required support services during fiscal 1998-99. Based on the firm's proposal, a contract was developed which allowed the Auditor to utilize services on either (1) a "turnkey" basis wherein the firm conducts a required assignment in its entirety and issues a written report to Metropolitan's Auditor upon its completion, or (2) on a "partnering" basis wherein the firm works in conjunction with the internal audit staff on a particular assignment. The contract was for an initial one-

year term coinciding with fiscal 1998-99, in order to assess the firm's performance and Metropolitan's needs.

During fiscal 1998-99, the Auditor has utilized KPMG's services under the existing support services contract to conduct a variety of audit assignments. Two "turnkey" assignments have been completed, a third is substantially complete, and two others are in progress. One "partnering" assignment pertaining to the department's continuing program to audit various water reclamation and groundwater recovery programs has also been utilized to great benefit during the past several months. A planned assignment to have KPMG personnel conduct an operational review of Metropolitan's use of consultants was canceled and, instead, the Legal Department has engaged KPMG separately to perform litigation support services of a related nature. Overall, KPMG has provided quality and timely professional audit support services to the Audit Department throughout fiscal 1998-99. As a result, authority is sought to renew the agreement for another year in an amount not to exceed \$200,000. Sufficient funding for this agreement has been included in the Audit Department's proposed operating budget for fiscal 1999-00.

In looking ahead to fiscal 1999-00, the Auditor intends to continue to utilize KPMG personnel to augment existing Audit Department resources in conducting audits of large-scale construction projects, CalFed contract reviews, water program monitoring assignments, and other areas of concern or priority as may arise. The KPMG personnel currently providing internal audit support services have developed a valuable understanding of Metropolitan's procedures and systems. This experience is expected to result in highly efficient future auditing efforts. As is currently the case, the scope of all required services will be agreed upon, prior to commencing any assignment, through the use of a Task Order document. All Task Orders will be prepared in conjunction with KPMG designated personnel to ensure that the scope and timing of deliverables for each assignment are mutually agreed upon in advance.

Renewal of the current internal audit support services agreement with KPMG does not preclude the Auditor from engaging other qualified auditing or consulting firms to perform other services as may be required during the next fiscal year. Indeed, the Auditor intends to engage a separate firm in fiscal 1999-00 to perform a Quality Assurance Review of the Audit Department in order to assess the department's compliance with the Standards for the Professional Practice of Internal Auditing. Other assignments requiring outside consultants or auditors are also likely to materialize which will not involve KPMG. In that regard, the Audit Department's proposed professional services budget for fiscal 1999-00 was increased at the Special Audit Committee's suggestion in order to provide sufficient funding for other needed contract services.

Following is a summary of the work performed or in-progress by KPMG personnel under the support services agreement:

Task Order No.	Assignment Name/Subject	Assignment Cost or Budget	Assignment Status
1.	Operational Review of Metropolitan's Purchasing Functions	\$42,000	Completed. Presented to the Special Audit Committee on January 19, 1999.

Task Order No.	Assignment Name/Subject	Assignment Cost or Budget	Assignment Status
2.	Construction Project Audit--\$15 million Expansion of the Water Quality Laboratory	\$15,000	Completed. To be presented to the Special Audit Committee on June 1, 1999.
3.	Operational Review of MWD's Use of Consultants	- - - -	Canceled. KPMG has been engaged by the Legal Department under a separate contract.
4.	Staff support for Water Program Monitoring Reviews	\$40,000	In-progress. KPMG staff are assigned through June 1999.
5.	CalFed Category III Agreement Compliance Audit—Agreement No. 10265 with Western Canal Water District	\$19,000	Substantially complete. KPMG's audit reports will be issued to management in late May or early June.
6.	CalFed Category III Agreement Compliance Audit--Agreement No. 12664 with Princeton-Codora-Glenn Irrigation District	\$18,000	In-progress. Planning is completed and testing has commenced.
7.	Construction Project Audit--\$28 million Repair of Garvey Reservoir	\$TBD	In-progress. Planning has commenced.

KPMG has provided professional personnel for each assignment who are qualified and experienced in relation to the tasks at hand. The firm, and its staff, conduct their work in accordance with all applicable auditing standards. Under the agreement, Metropolitan's Auditor has the right to direct KPMG to change its personnel on any assignment.

The firm's hourly billing rates for services rendered under the current agreement will remain unchanged during fiscal 1999-00 as follows:

<u>Job Classification</u>	<u>Contract Rates</u>
Partners	
Audit	\$165
Consulting	190

<u>Job Classification</u>	<u>Contract Rates</u>
Senior Managers	
Audit	130
Consulting	160
Managers	
Audit	110
Consulting	140
Supervising Senior Accountants	84
Senior Consultants	110
Senior Accountants	70
Consultants	100
Staff Accountants	65
Assistant Accountants	60

These rates exclude any necessary transportation or travel costs that may be necessary to perform the services required. KPMG includes such costs in its services billings as appropriate.

Board approval of this contract is required since the Auditor's contracting authority, pursuant to Administrative Code Section 6452, is limited to \$25,000 per contract per year. Upon the Board's approval, an amendment to the existing contract will be prepared that is consistent with the matters outlined in this letter.

MWH:lo