

May 25, 1999

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

From: Auditor _____

General Counsel _____

Subject: Authority to Amend Agreement with Vargas, Lopez and Company, LLP

RECOMMENDATION

It is recommended that authority be granted to amend the Board's existing contract with the accounting firm of Vargas, Lopez and Company, LLP, to increase the maximum fee limit of \$341,000 by up to \$38,500 for additional services.

EXECUTIVE SUMMARY

In December 1998, the Board authorized the General Counsel to enter into a contract (Agreement No. 20966) on behalf of the Board of Directors with Vargas, Lopez and Company, LLP, to conduct an audit of Metropolitan's Eastside Reservoir Project (ESRP). The audit contract contained a maximum fee limit of \$341,000 for all required audit services.

Vargas Lopez recently completed the required audit services and issued its final report to the Board of Directors on May 3, 1999. The Auditor and General Counsel, as joint administrators of the Board's contract with Vargas Lopez, recently received a letter from Vargas Lopez Managing Partner, Richard Lopez, requesting additional fees for services required beyond the scope of those originally contemplated. These "extra" services pertain to participation, at Metropolitan's request, by the Vargas Lopez audit team in the May 26, 1999, hearing of the Senate Select Committee on Southern California Water Districts' Expenditures and Governance. The cost of such participation is estimated at up to \$38,500.

The time and expenses needed for Vargas Lopez to participate in the May 26, 1999, hearing, or in any subsequent activities, is clearly beyond the scope of the firm's current contract with the Board. Since Metropolitan has requested that Vargas Lopez participate in the Senate Select Committee hearing process to explain the ESRP audit, authority is sought to compensate Vargas Lopez by up to \$38,500 for such additional scope services. Upon approval by your Board of this request, an amendment to existing Agreement No. 20966 will be prepared by the General Counsel to accommodate the increased scope of work and fee limit change.

DETAILED REPORT

In December 1998, the Board authorized the General Counsel to enter into a contract (Agreement No. 20966) on behalf of the Board of Directors with Vargas, Lopez and Company, LLP, to conduct an audit of Metropolitan's Eastside Reservoir Project (ESRP). This engagement was the result of the Board's action on October 13, 1998, directing that an external audit be conducted of total ESRP costs to date and a projected budget overrun of approximately \$220 million. Vargas Lopez was selected by the Board's Special Audit Committee through a competitive process. The scope of the firm's audit was also approved by the Special Audit Committee based on input from the Board's Transition Team. In approving the Vargas Lopez audit plan on January 19, 1999, the Special Audit Committee established a contract maximum fee limit of \$341,000 for all required audit services. This amount represented an increase of \$41,000 over the amount initially estimated by the firm in its proposal to perform Metropolitan's ESRP audit.

Vargas Lopez recently completed the required audit services and issued its final report to the Board of Directors on May 3, 1999. Pursuant to the terms of Agreement No. 20966, representatives from Vargas Lopez (and its subconsultant PinnacleOne) made various presentations to the Special Audit and Executive committees, as well as management. Essentially, with issuance of the final audit report and presentations to the Board of Directors, Vargas Lopez completed its services requirements under Agreement No. 20966.

The Auditor and General Counsel, as joint administrators of the Board's contract with Vargas Lopez, recently received a letter from Vargas Lopez Managing Partner, Richard Lopez, requesting additional fees for services required beyond the scope of those originally contemplated. In essence, Vargas Lopez has been invited to appear at the May 26, 1999, hearing of the Senate Select Committee on Southern California Water Districts' Expenditures and Governance by the Committee Chairman. Metropolitan's Board Chairman and General Manager have both requested that Vargas Lopez participate fully in the hearing by presenting an overview of the ESRP audit and responding to questions on the audit from the Select Committee. Accordingly, Mr. Lopez and several members of the team who were involved in the audit have been working since late April to prepare for an eventual Senate hearing presentation. The time and expenses needed for Vargas Lopez to participate in the May 26, 1999, hearing, or any subsequent activities, is clearly beyond the scope of the firm's current contract with the Board. Therefore, authority is sought to amend the firm's existing contract to compensate Vargas Lopez and its subconsultant for such additional services as may be necessary and appropriate using the same billing rates in the existing agreement.

In a letter dated May 14, 1999, Mr. Lopez estimated that the fees for these "extra" scope services will range from \$25,000 to \$35,000, plus nominal travel expenses of up to \$3,500. Mr. Lopez also stated that, based on audit work to date, the maximum fee limit for all required services of \$341,000 has been reached. A subsequent review of the firm's billings through April 30, 1999, has confirmed this statement. Mr. Lopez also indicated that the firm has actually incurred over 200 hours of audit time in excess of that subject to compensation under Agreement No. 20966.

Since Metropolitan has requested that Vargas Lopez participate in the Senate Select Committee hearing process to explain the ESRP audit, authority is sought to compensate Vargas Lopez by up to \$38,500 for such additional scope services. Upon approval by your Board of this request, an amendment to existing Agreement No. 20966 will be prepared by the General Counsel to accommodate the increased scope of work and fee limit change.

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