

- **Audit, Budget and Finance Committee**  
**Annual Letter of Recommendations from Independent Auditors**

February 12, 2001 Committee Meeting

**10c**

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### Summary

Annual Letter of Recommendations from Independent Auditors dated September 15, 2000.

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### Attachments

Letter of Recommendations, dated September 15, 2000, issued by KPMG, LLP.

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### Detailed Report

Attached is a copy of the [Letter of Recommendations](#), dated September 15, 2000, issued by KPMG, LLP, in connection with the firm's audit of the District's financial statements as of June 30, 2000, and for the year then ended. The accompanying letter reflects the independent auditors' evaluation of the District's internal control structure for purposes of performing the fiscal year 1999-00 audit. The letter also outlines certain findings and recommendations, based upon the audit work performed, for management's information and consideration. [A separate letter will be submitted to the Board by management responding to the recommendations contained in KPMG's letter.](#)

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[Attachment 1—Annual Letter of Recommendations from Independent Auditors dated 9/15/00](#)



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September 15, 2000

The Board of Directors and General Manager  
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, 2000 and have issued our report thereon, dated September 15, 2000. In planning and performing our audit of the financial statements of Metropolitan, we considered its internal control structure 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 structure. We have not considered the internal control structure since the date of our report.

During our audit, we noted certain matters involving the internal control structure and other operational matters that are presented for your consideration. Our comments and recommendations on matters contained in this letter have been discussed with the appropriate members of management and are intended to improve the internal control structure or result in other operational efficiencies. It is important to note that this letter is critical in nature and does not address the positive features of Metropolitan's procedures and controls that we noted during our audit.

This letter is organized into two sections, as follows:

- Section One, beginning on page 2, presents conditions noted during the current year. Our comments include:
  - Metropolitan's Reorganization
  - Changes in the Government Reporting Model
  - Write-off of Property, Plant and Equipment
  - Stale Dated Checks
- Section Two, beginning on page 4, discusses the nature of this letter and its limitations.

All of our other prior year management letter comments and recommendations have been substantially implemented or the conditions satisfactorily corrected, unless otherwise noted in this letter.



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The Board of Directors and General Manager  
The Metropolitan Water District of Southern California  
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### **COMMENTS ON MATTERS NOTED DURING THE CURRENT YEAR**

#### **METROPOLITAN'S REORGANIZATION**

##### **Finding**

This past fiscal year, Metropolitan has undergone a significant reorganization (Phases I, II and III) which resulted in a more streamlined management structure and a commitment to reduce costs in the coming years. The Competitive Action Team (CAT) Phase III Report addresses implementing an organizational structure that better supports Metropolitan's functional requirements. The reorganization has resulted in an organizational structure that has been sufficiently streamlined and compressed the levels of management which provides for more efficient operations.

KPMG commends and heartily supports the CAT efforts in redesigning Metropolitan's organizational structure. Such changes are already having a positive affect on Metropolitan's operations. In that regard, we remind Metropolitan's management that the recent changes have modified existing control procedures and have increased the need to document the revised procedures. Operating policies, procedures manuals, handbooks and training guides need to be revised and documented to reflect the changes in operations that resulted from the reorganization. These new controls and operating policies should be documented in a format easily communicated to all affected employees, management and members of Metropolitan's Board of Directors.

##### **Recommendation**

Metropolitan should reestablish the written and well-documented controls, responsibilities, operating policies and procedures (including manuals and handbooks) as a result of the reorganization, in a format easily communicated to all affected employees, management and members of Metropolitan's Board of Directors.

#### **CHANGES IN THE GOVERNMENT REPORTING MODEL**

##### **Finding**

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB 34). GASB 34 requires all state and local governments to implement a new financial reporting model that dramatically changes the presentation of governments' external financial statements.

Since Metropolitan operates and accounts for its operations as a governmental enterprise, the substantial changes required by GASB 34 are not expected to have a material impact on Metropolitan's current accounting or financial reporting practices. However, under GASB 34's phased implementation plan, which is based on a government's total annual revenues, Metropolitan is slated for implementation for periods beginning after June 15, 2001.



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The Metropolitan Water District of Southern California  
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Because comparative information is presented in Metropolitan's financial statements, FY 2000-01 information must be comparable to that of FY 2001-02. Since FY 2001-02 must be presented under the new financial reporting model outlined by GASB 34, FY 2000-01 information should also reflect the changes and requirements of GASB 34.

#### **Recommendation**

We recommend that Metropolitan make every effort to ensure that the requirements of GASB 34 have been fully implemented early (during FY 2000-01) to facilitate the presentation of comparable information at June 30, 2002.

### **WRITE-OFF OF PROPERTY, PLANT AND EQUIPMENT**

#### **Finding**

During our audit of Metropolitan's financial statements, we noted that 623 pieces of operating equipment with a net book value of \$125,400 and identified as "unlocated" during prior equipment cycle counts have not been written off Metropolitan's accounting records. Consequently, Metropolitan is reporting the value of these assets in the Operating Equipment subledger and general ledger even though these assets cannot be located or accounted for during periodic cycle counts.

#### **Recommendation**

We recommend that Metropolitan establish formal policies and procedures related to the prompt write-off of operating equipment items that cannot be located during equipment cycle counts. Once identified, these "unlocated" assets should be written off Metropolitan's books in a timely and appropriate manner to ensure that operating equipment amounts reported in Metropolitan's financial statements are accurate.

### **STALE DATED CHECKS**

#### **Finding**

During our audit of Metropolitan's financial statements, we noted that Metropolitan has not adequately followed up on and resolved stale dated and/or outstanding drafts (checks). We noted numerous drafts totaling over \$28,000 and dating as far back as 1995 that were still listed as outstanding and which have not been processed by the bank.

One key control over bank accounts is the investigation and resolution of outstanding checks and drafts. Timely follow-up over outstanding drafts prevents them from becoming stale dated and helps to ensure the integrity of the bank accounts.

#### **Recommendation**

We recommend that Metropolitan follow up on and resolve outstanding and stale dated drafts in a timely manner. This action by management will help to ensure the integrity of Metropolitan's bank accounts.



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**DISCUSSION OF THE NATURE OF OUR  
LETTER AND ITS LIMITATIONS**

In connection with our audit, we reviewed and tested Metropolitan's internal control structure to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards, the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of an internal control structure should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any internal control structure. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personnel factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of the financial statements. Further, projection of any evaluation of the internal control structure to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with these procedures may deteriorate.

Our study and evaluation of Metropolitan's internal control structure, which was made for the purpose set forth in the first paragraph above, was not designed for the purpose of expressing an opinion on the internal control structure, and it would not necessarily disclose all material weaknesses in the system.

This report is intended solely for the information of Metropolitan's Board of Directors 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.

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We would like to acknowledge and thank staff and management of the General Auditor's Office for their assistance in the identification and development of certain findings and recommendations contained herein during our quarterly and year-end audit procedures.

Thank you for the opportunity to serve Metropolitan. We appreciate the courtesy and cooperation extended to us during our audit. We would be pleased to discuss the contents of this letter with you at your convenience.

Very truly yours,

**KPMG LLP**

● **Audit, Budget and Finance Committee**  
**Management's Response to Annual Letter of Recommendations from**  
**KPMG LLP, dated September 15, 2000**

February 12, 2001 Committee Meeting

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**Summary**

Management agrees with the findings and recommendations included in KPMG LLP's (KPMG) Letter of Recommendations, dated September 15, 2000. Staff is implementing all of the recommendations as described below.

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**Attachments**

None

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**Detailed Report**

KPMG issued its annual Letter of Recommendations dated September 15, 2000, to management relating to its review of the internal control structure of Metropolitan. This review was performed as part of KPMG's planning and performance of its June 30, 2000 year-end audit. In its letter, KPMG addressed four current year findings. There were no outstanding issues from prior years. KPMG's findings and recommendations are summarized below. Management's response and actions are also provided.

**Metropolitan's Reorganization**

Finding:

This past fiscal year, Metropolitan has undergone a significant reorganization, which resulted in a more streamlined management structure, a commitment to reduce costs in the coming years and a more compressed management structure that provides for more efficient operations. KPMG commends and supports the Competitive Action Team (CAT) efforts in redesigning Metropolitan's organizational structure. Such changes are already having a positive effect on Metropolitan's operations. However, operating policies, procedure manuals, handbooks and training guides need to be revised and documented to reflect the changes in controls and operations that resulted from the reorganization.

Recommendation:

KPMG recommends that Metropolitan should reestablish the written and well-documented controls, responsibilities, operating policies and procedures (including manuals and handbooks) as a result of the reorganization, in a format easily communicated to all affected employees, management and members of Metropolitan's Board of Directors.

Management's Response:

Management concurs with the finding and recommendation. Business Services' staff, the Office of the General Manager and the Group Managers have been working together to update Metropolitan's policies and procedures as changes to the organization occur. The major portion of this initial work will be completed by June 30, 2001. Updates will continue to take place in the future as further organizational modifications occur.

### **Changes in the Government Reporting Model**

#### Finding:

In June 1999, The Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (GASB 34). GASB 34 requires all state and local governments to implement a new financial reporting model that dramatically changes the presentation of governments' external financial statements.

Since Metropolitan operates and accounts for its operations as a governmental enterprise fund, many changes required by GASB 34 will not materially impact its current accounting or financial reporting practices. Under GASB's phased implementation plan, Metropolitan is slated for implementation July 1, 2001. Since FY 2001-02 must be presented under the new financial reporting model outlined by GASB 34, FY 2000-01 information should also reflect the changes and requirements of GASB 34.

#### Recommendation:

KPMG recommends that Metropolitan make every effort to ensure that the requirements of GASB 34 have been fully implemented early (during FY 2000-01) to facilitate the presentation of comparable information at June 30, 2002.

#### Management's Response:

Management concurs with the finding and recommendation. It is staff's intent to have GASB 34 implemented for FY 2000-01.

### **Write-off of Property, Plant and Equipment**

#### Finding:

During the audit of Metropolitan's financial statements, 623 pieces of operating equipment with a net book value of \$125,400 and identified as "unlocated" during prior equipment cycle counts have not been written off Metropolitan's accounting records. Consequently, Metropolitan is reporting the value of these assets in the Operating Equipment subledger and the general ledger even though these assets cannot be located or accounted for during periodic cycle counts.

#### Recommendation:

KPMG recommends that Metropolitan establish formal policies and procedures related to the prompt write-off of operating equipment items that cannot be located during equipment cycle counts. Once identified, these "unlocated" assets should be written off Metropolitan's books in a timely and appropriate manner to ensure that operating equipment amounts reported in Metropolitan's financial statements are accurate.

#### Management's Response:

Management concurs with the finding and recommendation. Policies and procedures related to the prompt write-off of operating equipment are currently being updated and are expected to be completed by January 31, 2001. In addition, \$43,246 (281 items) of the \$125,400 (623 items) has already been written off and \$50,501 (176 items) was subsequently located, leaving a balance of \$31,653 (166 items) currently under review.

### **Stale Dated Checks**

#### Finding:

During the audit of Metropolitan's financial statements, KPMG noted that on the Draft bank account, Metropolitan has not adequately followed up on and resolved stale dated and/or outstanding drafts (checks).

KPMG noted numerous drafts totaling over \$28,000 and dating as far back as 1995 that were still listed as outstanding and which have not been processed by the bank.

Recommendation:

KPMG recommends that Metropolitan follow up on and resolve outstanding and stale dated drafts in a timely manner. This action will help to ensure the integrity of Metropolitan's bank accounts.

Management's Response:

Management concurs with the finding and recommendation. Drafts are issued as a supplement to Metropolitan's formal purchasing process and are used at various locations to make purchases of services and supply items with a value of \$2,500 or less. Prior to November 1998, drafts had a limit of \$500. The drafts are separate from Metropolitan's regular Accounts Payable check payment system.

Staff has already cleared approximately 40 percent of the \$28,000 in outstanding checks. It is anticipated that the remaining items will be cleared by June 30, 2001. In addition, this account is being closely monitored to prevent a future build up of outstanding checks.