

- **Board of Directors**
Budget, Finance and Investment Committee

January 14, 2003 Board Meeting

9-2

Subject

Authorize payments for calendar year 2003 charges for State Water Project and Devil Canyon/Castaic contracts

Description

In December, the state Department of Water Resources issued a revised statement of charges totaling \$441 million due for calendar year 2003 under Metropolitan's State Water Project and Devil Canyon/Castaic contracts.

Total charges for 2003 are \$121 million, or 22 percent lower than 2002 charges. [Attachment 1](#) is a comparison of the 2002 and 2003 charges. Noticeable differences are:

- \$153 million decrease in total power charges as stability returned to the energy market
- \$33 million increase in minimum operation, maintenance, power and replacement charges is based on under collection of prior years, actual costs due in part to unanticipated repairs, and increases in planned operations and maintenance expenditures for 2003. Last year's minimum operations, maintenance, power and replacement charges were \$108 million.
- \$1 million decrease in capital charges is due to a reduction in the Delta water charge caused by an adjustment to estimated costs.

Total charges for 2003 are now \$42 million below the value that was presented to this committee in October. Metropolitan, working through the State Water Contractors organization, reviewed DWR's underlying analysis. As a result of that review, DWR issued the reduced billing for CY 2003.

An independent auditor's review was completed verifying that the 2003 statement of charges complies with Metropolitan's SWP contracts. The auditor's report and comparative analysis of these charges are presented in [Attachment 2](#).

The \$441 million in charges presented to Metropolitan does not reflect refunds and credits that typically range between \$60 and \$70 million annually. Furthermore, if Metropolitan takes delivery of less water than the amount DWR used to calculate power costs, then power charges will be lower than projected in this statement of charges. Recognizing these and other adjustments, Metropolitan budgeted \$343.8 million for FY 2002/03 SWP charges. Fiscal year costs will vary with actual energy costs, and are expected to be near the FY 2002/03 budgeted amount.

In order to comply with the terms of its SWP contracts, Metropolitan would pay 2003 charges beginning January 2003. In case of default, the SWP contracts allow DWR to suspend SWP water deliveries as long as the default continues, and require that Metropolitan impose property taxes to recover unpaid charges.

Policy

Metropolitan Water District Administrative Code § 5112: State Water Contract Payments

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA because it involves continuing administrative or maintenance activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options/Fiscal Impacts

Option #1

Adopt the CEQA determination and approve payments up to a total of \$441 million determined to be due and payable under the terms of the State Water Project and Devil Canyon/Castaic contract for CY 2003.

Fiscal Impact: Maximum payments in CY 2003 of \$441 million. Net calendar year payments should be lower than shown in the statement of charges because of credits, refunds, and adjustments that are not included in the annual statement. Fiscal year costs will vary with actual energy costs, and are projected to be near the FY 2002/03 budgeted amount. Sufficient funds will be proposed in the FY 2003/04 budget for July - December payments.

Option #2


Do not authorize payments.

Fiscal Impact: SWP contracts allow DWR to suspend SWP water deliveries and require that Metropolitan impose property taxes to recover unpaid charges.

Staff Recommendation

Option #1

	12/19/2002
Stephen N. Arakawa	Date
Manager, Water Resource Management	

	12/20/2002
Ronald R. Gastelum	Date
Chief Executive Officer	

Attachment 1 – Comparison of Metropolitan’s Statement of Charges for CY 2002 and CY 2003

Attachment 2 – Summary Report on the Audit of the 2003 Statement of Charges

Comparison of Metropolitan's Statement of Charges for CY 2002 and CY 2003 (\$ Millions)			
	CY 2002	CY 2003	Change *
Total Power	\$311	\$158	\$(153)
Total Min OMP&R	108	141	33
Total Capital	143	142	(1)
Total SWP Charges	\$562	\$441	\$(121)

*Increase (Decrease)

**THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA**

**SUMMARY REPORT ON THE
AUDIT OF THE 2003 STATEMENT OF CHARGES**

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

SUMMARY REPORT ON THE
AUDIT OF THE 2003 STATEMENT OF CHARGES

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INDEPENDENT AUDITOR'S REPORT

The Metropolitan Water District
of Southern California
Los Angeles, California

We have audited the accompanying 2003 Statement of Charges submitted to the Metropolitan Water District of Southern California (Metropolitan) by the State of California Department of Water Resources (Department). This Statement of Charges is the responsibility of the Department's management. Our responsibility is to express an opinion on this Statement of Charges based on our audit.

Except as described in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Charges is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Statement of Charges. An audit also includes assessing the accounting practices used and significant estimates made by the Department's management for conformity with our understanding of Metropolitan's Water Supply Contract. The audit also includes evaluating the overall Statement of Charges presentation. We believe that our audit provides a reasonable basis for our opinion.

In conformity with the requirements of Metropolitan's Water Supply Contract with the Department, a significant portion of the Statement of Charges is based on current estimates of future costs which are not susceptible to audit verification. The Statement is also based on interpretations made by the Department's management relating to various provisions of the Water Supply Contract. As described in this and our other reports to Metropolitan, many of these interpretations are the subject of ongoing negotiations. In addition, Metropolitan's contract provides that any overpayment or underpayment, by reason of error in computation or other causes, shall be adjusted in the next succeeding year. Accordingly, the Statement of Charges issued to Metropolitan is a tentative billing which is subject to adjustment when final costs are known and when resolution of unsettled issues as described in our reports are agreed upon.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary if the matters described in the preceding paragraph were susceptible to audit verification, the 2003 Statement of Charges referred to in the first paragraph is fairly presented, in all material respects, in conformity with the provisions of Metropolitan's Water Supply Contract as we understand them.

The Metropolitan Water District
of Southern California

This report is intended solely for the information and use of Metropolitan and the Department and is not intended to be and should not be used by anyone other than these specified parties.

Richardson & Company

October 31, 2002

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

2003 STATEMENT OF CHARGES
(December 2002 Revision)

	<u>Cost Components</u>		<u>Capital</u>	<u>Total</u>
	<u>Variable 1/</u>	<u>Minimum</u>		
<u>WATER SUPPLY CONTRACT</u>				
Transportation Charge	\$ 91,564,383	\$ 104,495,038	\$ 54,821,856 2/	\$ 250,881,277
Off-Aqueduct Power Facilities Charge 1/		66,757,006		66,757,006
Delta Water Charge		26,004,052	15,720,184 2/	41,724,236
East Branch Enlargement		1,352,030	33,467,594	34,819,624
Water System Revenue Bond Surcharge			33,642,945	33,642,945
<u>DEVIL CANYON - CASTAIC CONTRACT</u>				
Operations and maintenance - Article 17(b)		8,896,842		8,896,842
Debt service on bonds - Article 17(a)			4,560,498	<u>4,560,498</u>
			TOTAL 3/	<u>\$ 441,282,428</u>

The accompanying report is an integral part of our presentation of the Statement of Charges.

- 1/ Based on a water delivery schedule of 1,571,526 acre-feet.
- 2/ Amounts include Urban Rate Reduction credits of \$12,703,168 in the Transportation Charge and \$6,145,140 in the Delta Water Charge under Article 51 of the Monterey Amendment.
- 3/ Metropolitan pays the capital cost component in semiannual payments and the minimum and variable cost components in monthly payments.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
 COMPARISON OF THE 2002 AND 2003 STATEMENTS OF CHARGES

	<u>Transportation Charge</u>				<u>Delta Water Charge</u>		<u>East Branch Enlargement</u>		<u>Water System Revenue Bonds</u>	<u>Total</u>
	<u>Capital</u>	<u>Minimum</u>	<u>Off-Aqueduct Minimum</u>	<u>Variable</u>	<u>Capital</u>	<u>Minimum</u>	<u>Capital</u>	<u>Minimum</u>		
2002 Statement of Charges (December 2001 revision)	\$ 60,292	\$ 88,214	\$ 70,984	\$240,560	\$ 16,928	\$ 25,825	\$ 32,992	\$ (5,934)	\$ 32,699	\$ 562,560
Increase (decrease) due to changes in:										
Estimated costs	(778)	9,257	4,970	(155,283)	(1,168)	137		(638)		(143,503)
Past cost adjustments	(132)	15,921		13,010	(40)		476	7,924		37,159
Change in debt service			(8,461)						944	(7,517)
Power sales				3,448						3,448
Recovery generation credit				(10,171)		42				(10,129)
Allocations among contractors			(736)							(736)
NET CHANGE	<u>(910)</u>	<u>25,178</u>	<u>(4,227)</u>	<u>(148,996)</u>	<u>(1,208)</u>	<u>179</u>	<u>476</u>	<u>7,286</u>	<u>944</u>	<u>(121,278)</u>
2003 Statement of Charges (December 2002 revision)	<u>\$ 59,382</u>	<u>\$ 113,392</u>	<u>\$ 66,757</u>	<u>\$ 91,564</u>	<u>\$ 15,720</u>	<u>\$ 26,004</u>	<u>\$ 33,468</u>	<u>\$ 1,352</u>	<u>\$ 33,643</u>	<u>\$ 441,282</u>

Note: The Transportation Capital and Minimum Charges include charges relating to the Devil Canyon-Castaic Contract.

Comparison of the 2002 and 2003 Statements of Charges

As shown on the previous page, Metropolitan's 2003 charges decreased by \$121.3 million compared to the 2002 Statement of Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component decreased by \$149 million between 2002 and 2003. This decrease results from decreases of \$155.3 million in energy and other variable costs and a \$10.2 million increase in recovery generation credits, which are partially offset by increases as a result of a \$13.0 million increase in the past cost adjustment and a \$3.4 million decrease in power sales. The decrease in estimated costs is due primarily to a decrease in water deliveries of 401,000 acre-feet and a lower estimated mill rate for non-firm purchases, which decreased from \$96 to \$21 per megawatt-hour. Also, the 2003 estimates show decreases in non-firm power purchases due to increased energy available from the Southern California Edison capacity exchange and increased generation at the recovery generation plants. A decrease in replacement charges also contributed to a \$.7 million decrease in variable costs as a result of \$1.2 million of adjustments to 2002 and prior replacement costs, offset by the addition of 2003 replacement charges of \$.5 million. The recovery generation credit increased primarily due to the expectation that less maintenance work will be performed on the recovery generation plants and that less water would be redirected around these powerplants. The power sale credit decreased slightly due to the assumption that the Department will sell excess power at lower rates due to the decrease in energy prices, which is offset by an increase in estimated energy available for sale. The past cost adjustment increased by \$13.0 million primarily due to the following:

- Metropolitan's calculated component for 2001 decreased \$329 million due to adjustments from estimated costs and water deliveries to actual amounts, which offset a \$336 million decrease in payments received as a result of revisions to payment received amounts, resulting in an increase of \$10.8 million in the past cost adjustment, after including interest on the past cost adjustment at the project interest rate.
- Metropolitan's calculated component for 2000 increased \$1.9 million due to a \$3.6 million increase in net power costs posted for 2000 due to the correction of the recording of power cost and sale transactions. Metropolitan's payments received for 2000 decreased \$4.8 million due to estimated payments being updated to reflect actual payments. As a result of these items, the past cost adjustment increased by \$5.4.
- Metropolitan's calculated component for 1999 decreased \$2.7 million due to the posting of \$4.0 million in power sales that were previously excluded in determining the variable component charges.

Off-Aqueduct Minimum: The \$4.2 million decrease in the off-aqueduct minimum component is due to an \$8.5 million decrease in Metropolitan's share of debt service costs as a result of prior years' refundings which have reduced debt service costs for 2003 by approximately \$12 million. In

addition, a decrease of \$.7 million is due to a decrease in Metropolitan's requested deliveries of 334,666 acre-feet, while all other contractors decreased their deliveries by 66,000 acre-feet. These decreases were offset by an increase in Metropolitan's charges due to an increase of \$5.0 million in Reid Gardner operating costs and increases in insurance and transmission costs of \$500,000 and \$510,000, respectively. In addition, coal costs increased by a \$1 million due to an estimated increase in the cost per ton from \$32 to \$34.

Delta Water Charge Capital: The decrease of \$1.2 million in the Delta Water Charge capital component is primarily due to the decrease attributable to a reduction in cost estimates of \$1.1 million and is the result of the following:

- Future cost estimates for 2002 through 2005 decreased by \$25.8 million related to the removal of costs associated with the Interim South Delta Facilities in the 2003 Statement of Charges, which resulted in a decrease of \$.7 million.
- Estimated costs for 2001 decreased by \$17 million when adjusted to actual amounts for the 2003 Statement of Charges, resulting in a decrease of \$.5 million.

These decreases are partially offset by increases due to the following.

Transportation Minimum: The increase of \$25.2 million in the transportation minimum component is due to a \$15.9 million increase in past cost adjustments and a \$9.3 million increase in cost estimates. The total increase of \$25.2 million is due primarily to the following increases and decreases:

- Cost estimates for 2002 and 2003 were adjusted for projects that are expected to incur higher costs than previously expected. The Department increased the estimates by approximately \$13.5 million for power scheduling system costs, and \$6.3 million to \$6.7 million per year for transmission costs. The effect of these increases in cost estimates is a \$14.6 million increase in Metropolitan's calculated component for 2002 and 2003.
- In the 2002 Statement of Charges, the Department experienced computer problems when the Statement of Charges were being prepared and was unable to post entries to reflect the water redistribution entries. Although this computer problem has not been resolved, the Department calculated these water redistribution entries outside of the system for the 2003 Statement of

Charges. As a result of the redistribution of energy costs to the minimum component for 2000 and 2001, Metropolitan's transportation minimum component increased by \$10.4 million.

- Additional cost assessments related to the indirect cost variance reallocation, offset by changes to the O&M allocation tables, resulted in an increase of \$9.4 million to Metropolitan's transportation minimum component.
- The 2002 Statement of Charges included a \$7.4 million overpayment due to revisions to 2001 and prior year costs, which causes an increase of this amount when compared to the 2003 Statement of Charges.
- Cost estimates increases in 2002 result in an increase in Metropolitan's transportation minimum component by approximately \$7.0 million.
- In the 2003 Statement of Charges, the Department included historical replacement costs in the minimum component instead of the variable component, resulting in an increase in Metropolitan's 2003 transportation minimum component by \$.7 million. This error is discussed further on page 29.
- The Department did not include the 2000 Municipal Water Quality Investigation charge in the 2002 Statement of Charges. These costs were properly included in the 2003 Statement of Charges, resulting in an increase in Metropolitan's transportation minimum component by \$.7 million.
- The Department recorded credits totaling \$.6 million for the wheeling of special water in 2000. The posting of these credits results in a \$.3 million decrease to Metropolitan's transportation minimum component.
- The impact of an additional year of interest on the prior over and underpayments as well as the change in the project interest rate results in a \$.5 million decrease in Metropolitan's transportation minimum component.
- Cost estimates for 2002 to 2003 were adjusted for maintenance service agreement costs that are expected to be less than in the prior year. The Department decreased estimates by \$1.7 million, decreasing Metropolitan's charges by \$.7 million.

- As a result of lower energy prices, the water loss redistribution entries for 2002 and 2003 made in the 2003 Statement of Charges were lower than those made in the 2002 Statement of Charges, which results in a \$6.6 million decrease in Metropolitan's transportation minimum component.
- The actual minimum costs incurred for 2001 were approximately \$27.9 million less than the amounts estimated in the prior Statement of Charges, resulting in a decrease in Metropolitan's charges of approximately \$15.7 million.

East Branch Enlargement Minimum: The East Branch Enlargement minimum component increased by \$7.3 million due to a \$7.9 million increase in the past cost adjustment, which was partially offset by a \$.6 million decrease in cost estimates from 2002 to 2003. The increase in the past cost adjustment is due mainly to the 2002 past cost adjustment of \$9.7 million that resulted from the revision of the initial date of operation for the East Branch Enlargement facilities in the 2002 Statement of Charges that caused the costs to be reallocated from the East Branch minimum component to the transportation minimum component. This increase is partially offset by the \$1.8 million past cost adjustment for 2003 that resulted from the actual costs for 2001 being \$1.2 million less than the amount previously estimated and the estimated costs for 2002 being reduced by approximately \$.6 million.

Water System Revenue Bond Surcharge: The \$.9 million increase in the Water System Revenue Bond Surcharge is due to increased debt service costs of \$5.4 million resulting from the issuance of Series W Water System Revenue Bonds, which included new construction funds of \$1.7 million and which refunded \$3.7 million of Series J and O.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
 COMPARISON OF THE PREVIOUSLY ESTIMATED 2003 STATEMENT OF CHARGES
 TO THE STATEMENT DATED DECEMBER 2002

	Transportation Charge				Delta Water Charge		East Branch Enlargement		Water System Revenue Bonds	Total
	Capital	Minimum	Off-Aqueduct Minimum	Variable	Capital	Minimum	Capital	Minimum		
Prior year Department estimates of the 2003 Statement of Charge as of December, 2001	\$ 77,944	\$ 91,929	\$ 64,428	\$190,797	\$ 23,050	\$ 25,571	\$ 33,554	\$ 3,306	\$ 32,507	\$ 543,086
Increase (decrease) due to changes in:										
Estimated costs	(3,684)	12,933	2,814	(97,354)	(1,145)	391		(148)		(86,193)
Past cost adjustments	(2,175)	8,530		13,010	(40)		(86)	(1,806)		17,433
Change in debt service			(51)						1,136	1,085
Power sales				(5,472)						(5,472)
Recovery generation credit				(9,417)		42				(9,375)
Allocations among contractors			(434)							(434)
Refund Under Monterey Agreement	(12,703)				(6,145)					(18,848)
NET CHANGE	<u>(18,562)</u>	<u>21,463</u>	<u>2,329</u>	<u>(99,233)</u>	<u>(7,330)</u>	<u>433</u>	<u>(86)</u>	<u>(1,954)</u>	<u>1,136</u>	<u>(101,804)</u>
2003 Statement of Charges (December 2002 revision)	<u>\$ 59,382</u>	<u>\$113,392</u>	<u>\$66,757</u>	<u>\$ 91,564</u>	<u>\$ 15,720</u>	<u>\$ 26,004</u>	<u>\$ 33,468</u>	<u>\$ 1,352</u>	<u>\$ 33,643</u>	<u>\$ 441,282</u>

Note: The Transportation Capital and Minimum Charges include charges relating to the Devil Canyon-Castaic Contract.

**Comparison of the Previously Estimated 2003 Statement of Charges
to the Statement Dated December 2002**

As shown on the previous page, Metropolitan's 2003 Charges decreased by \$101.8 million compared to last year's estimate of the 2003 Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component decreased by \$99.2 million between last year's estimate of the 2003 charges and the 2003 Statement of Charges. The decrease results from \$97.3 million in lower energy and other variable costs, a \$9.4 million increase in recovery generation credits, and a \$5.5 million increase in power sales which are partially offset by an increase of \$13.0 million due to the past cost adjustment. The decrease in estimated costs is due mainly to a lower mill rate resulting from a decrease in wholesale energy prices and a decrease in water deliveries of 452,000 acre-feet. The Department has assumed that the mill rate for non-firm energy purchases will decrease from \$69 per megawatt-hour, which was used in last year's estimates, to \$21 per megawatt-hour, and that less non-firm purchases will be needed due to more energy being available under the Southern California Edison capacity exchange agreement. A decrease in replacement charges also contributed to a \$.7 million decrease in variable costs as a result of \$1.2 million of adjustments to 2002 and prior replacement costs, offset by the addition of 2003 replacement charges of \$.5 million. The recovery generation credit increased primarily due to the expectation that there will be a reduction in maintenance work performed on the recovery generation plants and that less water will be redirected around these powerplants. The increase in power sales is primarily due to the assumption that the Department will have more available power to sell, which is partially offset by a decrease in the anticipated rates of these sales from \$74 to \$34 per megawatt-hour. The 2003 past cost adjustment overpayment of \$13.0 million is primarily the result of adjustments from estimated to actual amounts of water deliveries and power costs for 2001.

Transportation Capital: The decrease of \$18.6 million in the transportation capital component is primarily due to the inclusion of the rate reduction credits of \$12.7 million and the removal of \$62.5 million in construction costs for the Devil Canyon Second Afterbay in the preparation of the 2003 Statement of Charges, which results in a \$2.5 million decrease in estimated costs and a \$1.2 million decrease in past cost adjustments. These costs were incorrectly included in the capital component in the previous estimate of the 2003 Statement of Charges, since these costs are recovered through the variable component. This error was corrected and, as a result, Metropolitan's transportation capital component of the 2003 Statement of Charges decreased by \$3.7 million. In addition, Metropolitan's transportation capital charge decreased by \$2.2 million due to decreased cost estimates for 2002 and 2003 and 2001 actual costs being less than what was estimated last year.

Delta Water Charge Capital: Refer to explanation on page 6.

East Branch Enlargement Minimum: The East Branch Enlargement minimum component decreased by \$2.0 million primarily due to actual costs for 2001 being \$1.2 million less than the amount previously estimated and the estimated costs for 2002 being reduced by \$.6 million. In addition, cost estimates for 2003 decreased by \$.2 million.

These decreases were partially offset by increases due to the following items:

Transportation Minimum: The increase of \$21.5 million in the transportation minimum component is due to a \$12.9 million increase in estimated costs and a \$8.5 million increase in the past cost adjustment. The increase in 2003 estimated costs of \$12.9 million is primarily due to the following:

- Cost estimates for 2003 were adjusted for projects that are expected to incur higher costs than previously expected. The Department increased 2003 minimum estimates by \$15.5 million for power scheduling system costs and \$6.7 million for transmission costs. The cost estimates for additional O&M maintenance agreements decreased by \$1.3 million. The net effect of these changes in cost estimates is a \$10.8 million increase in Metropolitan's transportation minimum component compared to prior year estimates.
- Increased cost estimates for O&M activities result in a \$4.4 million increase in Metropolitan's charges.
- As a result of lower energy costs, the estimated amount of the water loss redistribution entries for 2003 are lower than previously estimated, resulting in a \$2.2 million decrease in Metropolitan's transportation minimum component for 2003.

The \$8.5 million increase in the past cost adjustment is due to the items noted on pages 6 to 8, which describes a \$15.9 million increase related to changes in the past cost adjustment. The remaining difference of \$7.4 million is due to the fact that the 2002 past cost adjustment is not reflected in the 2003 estimate included in the 2002 Statement of Charges.

Off-Aqueduct Minimum: The \$2.3 million increase in the off-aqueduct minimum component is due to a \$2.8 million increase in Metropolitan's share of Reid Gardner costs due to a \$4 million increase in operating costs and increases in insurance and transmission costs of \$500,000 and \$510,000,

respectively, as a result of adjustments to revise these costs to the latest years' actual costs escalated at 5%. These cost increases were offset by a \$1 million decrease in coal costs as a result of a reduction in the contingency amount the Department adds to coal cost estimates. The increase is offset by a \$.4 million decrease as a result of a decrease in Metropolitan's requested deliveries of 356,062 acre-feet, while all other contractors increased their deliveries by a net amount of 95,699 acre-feet. An additional decrease of \$51,000 was the result of a decrease in debt service costs.

Water System Revenue Bond Surcharge: The \$1.1 million increase in the Water System Revenue Bond Surcharge is due to increased debt service costs of \$5.4 million resulting from the issuance of Series W Water System Revenue Bonds, which included new construction funds of \$1.7 million and which refunded \$3.7 million of Series J and O.

Delta Water Charge Minimum: The increase of \$.4 million in the Delta Water Charge minimum component is primarily due to the following:

- Costs for 2000 and prior years increased by \$9.5 million due to various accounting adjustments, including the assessment of previously excluded indirect cost variance reallocations, resulting in an increase of \$356,000.
- Costs for 2001 increased \$7.0 million due to an adjustment from estimated costs to actual amounts, resulting in an increase of \$212,000.
- Cost estimates for 2004 and 2005 increased by \$5.0 million due to an increase in anticipated O&M maintenance agreements and power scheduling system costs. The impact to Metropolitan is an increase of \$107,000.
- Various revisions to future cost estimates for 2002 through 2005 of \$1.7 million result in an increase of \$89,000.
- The recovery generation credits for 1995 through 1997 decreased by \$5.1 million due to the updating of Oroville O&M costs from estimates to actual amounts, resulting in an increase of \$196,000.
- A \$2.3 million water loss adjustment for 2000 resulted in an increase of \$73,000.

- Costs for 2004 and 2005 decreased by \$13.2 million due to prior year Delta Facilities and other conservation costs now being allocated on a statewide basis, which results in a decrease of \$341,000.
- The recovery generation credit for 2001 increased by \$4.8 million due to the inclusion of the FERC relicensing credit, resulting in a decrease of \$146,000. In addition, there was an increase in the credit due to increased Oroville O&M estimated costs of \$212,000 per year for 2002 to 2035 resulting in a decrease of \$101,000.

Future Potential Refunds and Adjustments

Metropolitan's estimated 2003 charges of \$441 million do not include certain credits, refunds and adjustments that are expected in 2003 as part of the Department's normal accounting and billing process. Refunds are expected to reduce Metropolitan's 2003 billings by approximately \$38.7 million for the following items:

	<u>Estimated Refund Date</u>		
Off-Aqueduct Bond Cover:			
Return of July - December 2001 Cover	May 2003	\$ 4,044,000	
Return of January - June 2002 Cover	November 2003	<u>4,044,000</u>	\$ 8,088,000
Water System Revenue Bond Cover:			
Return of January 2002 Cover	May 2003	6,304,000	
Return of July 2002 Cover	November 2003	<u>6,304,000</u>	12,608,000
East Branch Enlargement Cover:			
Return of March 2002	May 2003	3,354,000	
Return of September 2002	November 2003	<u>3,354,000</u>	6,708,000
Earnings on Securities Purchased in Association with the Defeasance of Bonds:			
Earned July - December 2002	August 2003	970,000	
Earned January - June 2003	September 2003	<u>970,000</u>	1,940,000
Off-Aqueduct SMIF Interest:			
Earned July - December 2002	August 2003	459,000	
Earned January - June 2003	September 2003	<u>459,000</u>	918,000
WSRB SMIF Interest:			
Earned July - December 2002	August 2003	431,000	
Earned January - June 2003	September 2003	<u>431,000</u>	862,000
East Branch Enlargement SMIF Interest:			
Earned July - December 2002	August 2003	455,000	
Earned January - June 2003	September 2003	<u>455,000</u>	910,000
Reserve Account SMIF Interest:			
Earned July - December 2002	August 2003	1,253,000	
Earned January - June 2003	September 2003	<u>1,253,000</u>	2,506,000
Devil Canyon Second Afterbay:			
Return of 2001 Principal and Interest Payment	July 2003	4,007,000	
Return of 2001 SMIF interest	July 2003	<u>110,000</u>	<u>4,117,000</u>
TOTAL ESTIMATED 2003 REFUNDS			<u>\$ 38,657,000</u>

The 2003 variable and off-aqueduct charges may be reduced further if 2003 costs are determined to be overstated during the year. Also, amounts described in this section are in addition to the other credits, refunds and adjustments related to audit findings that are summarized on page 23.

UNRESOLVED ISSUES RELATED TO THE 2003 STATEMENT OF CHARGES

During our audit, we encountered a number of issues related to the calculation of various components of the 2003 Statement of Charges that need to be addressed by the Department. Some of these issues result in errors in the Statement of Charges, and others result in discrepancies, but we are unable to determine whether these are errors. The following paragraphs describe the nature of the issues and the potential effect on Metropolitan's Statement of Charges.

Future Cost Estimates. Approximately 80% of the costs billed in Metropolitan's 2003 Statement of Charges represent estimated future costs and are based on assumptions made by the Department regarding future operation of the Project. It is essential these assumptions be identified and properly reflected in the Statement of Charges, as they have a significant impact on Metropolitan's cash flow. Since Metropolitan uses future cost estimates in its long-range financial planning, it is important that estimated costs be based on the best information available at the time the Statement of Charges is issued. Although the Department converted to the SAP system in 1999, the Department continued to use the future cost estimates developed for the 2000 Statement of Charges, adjusted for escalation, due to problems utilizing the budgeting module in SAP. In the 2003 Statement of Charges, the Department began using the budgeted amounts contained within SAP as the basis for the future cost estimates. These estimates for the operation and maintenance of the aqueduct were substantially higher than the estimates included in the 2002 and previous Statements of Charges. The contractors and the auditors have been working with the Department through the SWC Audit-Finance Committee to evaluate these estimates. Upon the Department's further analysis of these estimates, they determined that the cost estimates entered into SAP were unusually high and were substantially higher than the prior year actual amounts. The Department has reduced these estimates to more realistic amounts as part of the December revision to the 2003 Statement of Charges. The reduction in Metropolitan's transportation minimum component of \$40.4 million is primarily the result of reductions in these cost estimates and also from error corrections and other cost revisions that were included in the December revision to the 2003 Statement of Charges. We understand that the State Water Contractors have formed a group to evaluate the Department's procedures for developing budgets and to work with the Department to ensure that a similar situation does not occur for the 2004 Statement of Charges.

Variable Component Billings. Since the implementation of SAP, the Department has had difficulty calculating the water table redistribution entries that reallocate costs between the minimum, variable and Delta Water Charge components for water gains and losses and changes in reservoir storage within the SAP system. As a result, the 2002 Statement of Charges did not reflect entries to record these water table redistribution entries. To properly reflect these water table redistribution entries in the 2003 Statement

of Charges, the Department has had to perform the calculation outside of the system and post entries manually in SAP. We verified these calculations for 2000 and 2001 allocations and noted no exceptions; however, we will continue to monitor the Department's progress in working with the SAP system to perform these allocations.

WSRB Surcharge. In conjunction with the development of the new SAP/CARA system in 2000, the Department developed a new calculation of the WSRB Surcharge using the SAP/CARA system. However, this new system produced a Surcharge that was significantly different from the estimated Surcharge amounts calculated as part of the 2000 Statement of Charges. As a result, since the implementation of SAP, the Department has billed the contractors the estimated WSRB Surcharge amounts that were included in the 2000 Statement of Charges, Attachment 3, which was calculated in 1999. The Department has not been able to determine why the SAP/CARA system produced a Surcharge that was inconsistent and unreasonable compared to previous computations. As a result, in the 2003 Statement of Charges, the Department calculated the 2003 WSRB Surcharge using the 2000 Statement of Charges, Attachment 3, as a basis and adjusting for the 2001 debt service schedules that includes Series W issued in May 2001, the addition of \$1.6 million in recreation capital costs that have not been reimbursed by the State and the reallocation of the Surcharge among contractors for water transfers. We will continue to monitor the Department's progress in re-evaluating the calculation of the Surcharge in the SAP/CARA system and we will audit the revised calculation after it is completed by the Department.

The Department determined in 2000 that of the total Water System Revenue Bond construction proceeds of \$1,131,545,000, issued since 1988, approximately \$30,807,000 have been determined to be allocable to recreation. The Department has computed a repayment schedule to recover these recreation costs showing that \$1,648,000 will need to be added to the Surcharge every year through 2035. Consequently, the 2002 and future Surcharges are increased by approximately \$1,648,000, of which Metropolitan's share is approximately \$972,000. This change in procedures results in charging the contractors for all past recreation capital costs that were financed with Water System Revenue Bonds. While this treatment will result in increasing the systems revenue cash balances available for rebates under the Monterey Amendment, which have been depleted partially due to the lack of reimbursement for recreation costs from the State, this treatment of billing the costs under the Surcharge and returning it as a rebate results in some inequity because the proportional share among contractors of the Surcharge and the rebates is not the same and the contractors may not be assured that the Department will increase the rebates for these amounts. We will work with Metropolitan to determine the propriety of this treatment of recreation costs.

Indirect costs. The Department incurs overhead costs for general administration, staff benefits, prorated operating expenses and line management. These costs are recovered from the benefitting users through the application of an activity rate based on the actual salaries, wages and benefits of each organization involved. The Department determines the activity rates prior to the start of the fiscal year using budgeted information. As a result, variances exist between the amount of salary, benefit, and indirect costs billed to the program cost centers and the amount actually incurred. Typically we would expect that the Department would over-recover its indirect costs using this approach. However, based on our review of reports printed from the SAP system, it appears that the amount of costs billed to the program cost centers was less than actual costs incurred by \$19,939,000 in fiscal years 2000 through 2002. After the 2003 Statement of Charges was prepared, the Department made an entry to allocate \$14,036,000 of this variance to the program cost centers on a statewide basis. As a result of this adjustment, Metropolitan's transportation minimum and Delta Water Charge components in the 2004 Statement of Charges will increase by \$4,918,000 and \$92,000, respectively. The remaining balance of \$5,903,000 will result in an increase to Metropolitan's transportation minimum and Delta Water Charge components by \$2,068,000 and \$39,000, respectively, when the remaining balance is allocated. We will continue to monitor these variances to ensure they are adjusted to actual costs and we will evaluate the impact of any remaining variances on Metropolitan's charges. We will also recommend to the Department that they evaluate their procedures for developing labor rates to ensure that indirect costs are being properly recovered and that large variances such as these do not occur in the future.

TABLE A
Summary of Settled Audit Findings Resulting in Changes to
the 2003 Statement of Charges

Throughout the year, we worked with Metropolitan's representatives and the Department to resolve audit exceptions. The following is a brief summary of the items resolved during 2002 which affected the 2003 Statement of Charges. A more detailed description of these items starts on page 24.

Items	Effect on Metropolitan's 2003 Costs Increase (Decrease)
1. Transportation replacement costs for 2002 through 2005 totaling \$3,625,000 were properly removed from the transportation minimum component and conservation replacement costs for 2002 through 2005 totaling \$23,463,000 were properly removed from the Delta Water Rate computation (refer to pages 24 and 25).	\$ (3,021,000)
2. Oroville power revenues that were understated by \$14,994,000 in the computation of the Delta Water Rate due to a data entry error were corrected (refer to page 25).	(452,000)
3. A credit for 2001 FERC relicensing costs totaling \$5,109,000 was properly included in the Delta Water Rate computation (refer to page 25).	(154,000)
4. Hyatt-Thermalito operating costs totaling \$5,117,000 for 1995 through 1997, previously understated in the Delta Water Charge, were corrected (refer to page 25).	196,000
5. Costs totaling \$950,000 that were improperly excluded from the Statement of Charges were corrected (refer to page 25).	759,000
6. Previously unallocated power sales totaling \$3,977,000 for January through June of 1999 have been allocated to the pumping plants (refer to pages 25 and 26).	(2,312,000)
7. The Department properly recorded water redistribution entries to reallocate costs for 2000 between the minimum, variable and Delta Water Charge components (refer to page 26).	(2,174,000)
8. Corrections were made to the data used in the calculation of the variable fish replacement charges for 2001 and 2002 (refer to page 26).	(753,000)

<u>Items</u>	<u>Effect on Metropolitan's 2003 Costs Increase (Decrease)</u>
9. Previously unrecorded wheeling water transaction credits totaling \$604,000 have been recorded in the cost accounting system (refer to page 26).	\$ (120,000)
10. USBR payments for the capital costs of San Luis totaling \$2,452,000 have been credited to the contractors (refer to page 26).	(62,000)
11. The 2001 minimum contractor payments were corrected in the computation of the Delta Water Rate (refer to page 27).	(40,000)
12. The 1998 capital contractor payments were corrected in the computation of the Delta Water Rate (refer to page 27).	10,000
13. Previously excluded costs for 1999 through 2001 totaling \$522,000 were properly included the billing process (refer to page 27).	17,000
14. The posting of expenditures for Twitchell and Sherman Islands parcels totaling \$1,195,000 were corrected (refer to page 27).	35,000
15. Allocation factors applied to 1999 transmission costs totaling \$586,000 were corrected (refer to page 27).	342,000
16. Municipal Water Quality Investigation costs for 2000, excluded in the prior year, were included in the 2003 Statement of Charges (refer to page 27).	<u>780,000</u>
NET BENEFIT	<u>\$ (6,949,000)</u>

TABLE B**Summary of Audit Findings Projected to Result in Changes to
the 2004 Statement of Charges**

Throughout our examination, we worked with Department and Metropolitan representatives to resolve findings which arose during our audit of the 2003 Statement of Charges. We will work with the Department to ensure the correction of these findings in the 2004 Statement of Charges. The items are discussed in detail starting on page 28 of this report. The items are summarized as follows:

<u>Items</u>	<u>Effect on Metropolitan's 2004 Costs Increase (Decrease)</u>
1. Power costs and revenues, transmission, station service, and peaking costs totaling \$24,634,000 for 1999, 2000 and 2001 were not recorded or were recorded incorrectly in the accounting system (refer to page 28).	\$ (6,907,000)
2. Hyatt-Thermalito operating costs for 1998 through 2001, included in the computation of the variable charges, are overstated by \$6,531,000 and credits for Hyatt-Thermalito operating costs included in the Delta Water Charge are understated by \$6,531,000 (refer to page 28).	(4,460,000)
3. Historical and future costs related to Delta Facilities were improperly allocated statewide as a transportation charge (refer to page 28 and 29).	(1,495,000)
4. Adjustments related to 1963 to 2035 Hyatt-Thermalito and Thermalito Diversion Dam capital credits and recreation and non-contractor revenues totaling \$38 million were erroneously excluded from the 2003 Delta Water Rate computation (refer to page 29).	(921,000)
5. The Department used outdated Hyatt-Thermalito cost estimates in the variable and the Delta Water Charge components for 2002 through 2035 (refer to page 29).	(827,000)
6. Historical conservation costs totaling \$4,221,000 were deducted from the replacement account and billed through the Delta Water Charge component and transportation replacement costs totaling \$1,142,769 were double billed (refer to pages 29).	(882,000)
7. Credits for FERC relicensing costs totaling \$26,204,000 for 2002 through 2005 were improperly excluded from the calculation of the Delta Water Charge (refer to page 29).	(718,000)

Items	Effect on Metropolitan's 2004 Costs Increase (Decrease)
8. Replacement costs totaling \$48,000 related to Banks Pumping Plant are being improperly allocated entirely to the transportation component (refer to page 30).	\$ (31,000)
9. Preliminary energy costs for 1998 were included in the bills (refer to page 30).	(64,000)
10. Recovery generation credits for Devil Canyon and Warne Powerplants for 1998 are overstated by \$89,000 (refer to page 30).	(13,000)
11. Lake Oroville recreation costs totaling \$153,000 for 1999 were improperly included in the contractor billings (refer to page 30).	(5,000)
12. Metropolitan's water deliveries for 2000 are overstated by 325 acre-feet in the calculation of the variable component (refer to pages 30 and 31).	(1,000)
13. Outdated 2000 and 2001 debt service amounts were used for the Devil Canyon Second Afterbay Charges included in the variable component (refer to page 31).	18,000
14. Incorrect water delivery, wheeling credit and contractor payment amounts were used in the variable fish replacement charge calculation (refer to page 31).	<u>93,000</u>
NET BENEFIT	<u>\$ (16,213,000)</u>

TABLE C**Summary of Audit Findings Resulting in Credits, Refunds and Adjustments**

Audit findings affect not only the Statement of Charges but also the amounts of credits, refunds and adjustments the Department issues to Metropolitan. The following is a brief summary of the items found during our audit that affect credits, refunds and adjustments. A more detailed description of these items starts on page 31.

<u>Items</u>	<u>Effect on Metropolitan's Costs Increase (Decrease)</u>
1. Outdated cost estimates were used in the calculation of the 2001 off-aqueduct charges resulting in an overstatement of Metropolitan's charges in the range of \$2.2 to \$4.2 million (refer to page 32).	\$ (2,194,000)
2. Incorrect costs were used to compute the 1992 WSRB Surcharge and an inconsistent project purpose split was used to compute the 1990 to 1993 WSRB Surcharge (refer to pages 32 and 33).	(655,000)
3. Certain Coastal Branch capital cost repayment amounts were excluded from the computation of the 2000 WSRB Surcharge (refer to page 33).	(632,000)
4. Excess recovery generation credits, which total \$526,000, resulting from LADWP water diverted into the SWP in 1985 have not been returned to Metropolitan (refer to page 33).	(526,000)
5. Bottlerock transmission revenues totaling \$577,000 were not included in the computation of the 1991 and 1992 off-aqueduct charges (refer to page 33).	(472,000)
6. Outdated cost estimates were used in the calculation of the 1999 off-aqueduct charges (refer to page 33).	(112,000)
7. Outdated information was used to calculate adjustments to the 1993 Devil Canyon Second Afterbay debt service refunds (refer to pages 33 and 34).	(105,000)
8. Additional 1994 and 1995 off-aqueduct costs and credits have not been billed or refunded (refer to page 34).	<u>(37,000)</u>
NET BENEFIT	<u>\$ (4,733,000)</u>

DISCUSSION OF OUR SERVICES, AUDIT FINDINGS
AND GENERAL COMMENTS

In conformity with the contract between The Metropolitan Water District of Southern California (Metropolitan) and Richardson & Company, we have audited the 2003 Statement of Charges submitted to Metropolitan by the State of California Department of Water Resources (Department).

Scope of the Assignment. The primary service we perform for Metropolitan is the audit of the annual Statement of Charges under Metropolitan's Water Service Contract with the Department. In addition to our audit work, we perform special projects as requested by Metropolitan's staff in areas such as investigating financial and accounting matters, disputes over Department policy, and in negotiating contract amendments and administrative changes in the Department's management of the State Water Project. We also participate with Metropolitan in water contractor meetings that serve as a forum for resolving accounting, billing, and budgeting issues, including meetings of the State Water Contractor (SWC) Audit-Finance Committee and progress meetings with Metropolitan staff to discuss audit findings.

Reporting. The more significant findings and results of our audit, special projects work and participation in meetings are presented in two reports prepared after the completion of our annual audit: a comprehensive report that serves as a working document between the auditors, Department and Metropolitan staff and a summary report that is provided to Metropolitan's Board of Directors and management addressing the results of our audit.

Audit Findings. Our goal is to provide Metropolitan with a thorough audit. The engagement is divided into forty-six separate areas and fieldwork is completed primarily from April through October. Computer auditing techniques are used to test posting, mathematical accuracy and select samples from data files. The following are the more significant findings of our audit. The changes reflected in the 2003 Statement of Charges are summarized in Table A on pages 19 and 20, those projected to be reflected in the 2004 Statement of Charges are summarized in Table B on pages 21 and 22 and those that will affect credits, refunds and adjustments are summarized in Table C on page 23.

Findings Resulting in Changes to the 2003 Statement of Charges:

- Due to time constraints in the preparation of the 2003 Statement of Charges, the Department did not make the appropriate adjustments to allocate future transportation replacement costs in accordance

with the PAYGO methodology and include them in the variable component of the Statement of Charges. As a result, transportation costs for 2002 through 2005 totaling \$3,625,000 were improperly included in the transportation minimum component and future conservation replacement costs for 2002 through 2005 totaling \$23,463,000 were improperly included in the calculation of the Delta Water Charge. As part of the December revision to the 2003 Statement of Charges, the Department made the entries to remove these costs, which reduces Metropolitan's transportation minimum and Delta Water Charge minimum components by \$2,356,000 and \$665,000, respectively. (TABLE A, Item 1)

- Oroville power revenues included in the 2003 Delta Water Rate computation that were understated by \$14,994,000 due to a data entry error have been corrected. This correction results in a \$452,000 reduction in Metropolitan's Delta Water Charge minimum component in the December revision to the 2003 Statement of Charges. (TABLE A, Item 2)
- The 2001 FERC relicensing costs for the Oroville Facilities totaling approximately \$5,109,000, previously billed through both the variable component and Delta Water Charge because the credits included in the Delta Water Charges did not include these FERC relicensing costs, have been corrected. As a result, Metropolitan's Delta Water Charge minimum component is reduced by approximately \$154,000 in the December revision of the 2003 Statement of Charges. (TABLE A, Item 3)
- Our audit disclosed that the 1995 to 1997 Hyatt-Thermalito O&M costs included as credits in the computation of the Delta Water Charge were overstated by \$5,117,000. These credits were updated in the December revision of the 2003 Statement of Charges, which results in an increase in Metropolitan's Delta Water Charge minimum component by \$196,000. (TABLE A, Item 4)
- Our audit disclosed costs totaling \$950,000 were not allocated to cost centers properly, which resulted in the understatement of Metropolitan's transportation minimum component. This error was corrected in the December revision of the 2003 Statement of Charges and, as a result, Metropolitan's transportation minimum component increased by \$759,000. (TABLE A, Item 5)
- In our audit of the 2002 Statement of Charges, we noted that power sales totaling \$3,977,000 were posted in SAP for transactions that occurred between January and June 1999; however, the credits for these sales had not yet been allocated to the pumping plants. The Department corrected this error in

the 2003 Statement of Charges and, as a result, Metropolitan's transportation variable, transportation minimum, and the Delta Water Charge components decreased by \$2,149,000, \$159,000, and \$4,000, respectively. (TABLE A, Item 6)

- In the calculation of the 2002 Statement of Charges, the Department was unable to post the water table redistribution entries which reallocate costs between the minimum, variable and Delta Water Charge components for water gains and losses and changes in reservoir storage. These entries were included in the computation of the 2003 Statement of Charges, resulting in a decrease in Metropolitan's variable component by \$2,929,000 and an increase in Metropolitan's transportation and Delta Water Charge minimum components of \$611,000 and \$144,000, respectively. (TABLE A, Item 7)
- Last year, our review of the Department's fish replacement charges used in the 2002 Statement of Charges revealed that the 2001 fish replacement charge of \$1,116,000 was excluded and the 2002 fish replacement charge was overstated by \$2,058,000. These errors were corrected in the 2003 Statement of Charges, resulting in a \$753,000 decrease in Metropolitan's variable component. (TABLE A, Item 8)
- Charges collected for the wheeling of non-entitlement water on the State Water Project are to be recorded as reductions of variable charges allocated to the State Water Project entitlement contractors. During last year's audit, we reported that credits totaling \$604,000 had been excluded from the variable billings to the entitlement contractors. In the preparation of the 2003 Statement of Charges, these wheeling transactions were credited to the cost accounting system, resulting in a reduction of power costs allocated to the water contractors; accordingly, Metropolitan's transportation variable component in the 2003 Statement of Charges was reduced by approximately \$120,000. (TABLE A, Item 9)
- In our prior year audit, we noted that the Department had not recorded credits in the cost accounting system for payments received from the USBR for San Luis capital costs since the conversion to SAP because the procedures for recording these credits had not been established in the SAP system. Recently the Department developed these procedures and recorded \$2,452,000 of these credits. As a result, Metropolitan's transportation capital and Delta Water Charge capital components decreased by \$53,000 and \$9,000, respectively, in the 2003 Statement of Charges. (TABLE A, Item 10)

- The understatement of 2001 contractor payments of \$1,419,000 in the 2002 Delta Water Charge has been corrected, resulting in a \$40,000 decrease in Metropolitan's Delta Water Charge. (TABLE A, Item 11)
- The 1998 minimum contractor payments included in the 2003 Delta Water Charge calculation, which was overstated in the 2002 Delta Water Charge by \$300,000, were corrected, resulting in an increase in Metropolitan's Delta Water Charge minimum component by \$10,000 in the 2003 Statement of Charges. (TABLE A, Item 12)
- During our verification that all State Water Project costs in SAP were included in the preparation of the 2002 bills, we noted costs totaling \$522,000 for 1999 through 2001 were improperly excluded from the calculation of the Delta Water Charge capital component and the transportation capital component, due to the cost centers not being properly mapped in the SAP system. We informed the Department of this error and the correction was made for the 2003 Statement of Charges, resulting in a \$15,000 increase to Metropolitan's Delta Water Charge capital component and a \$2,000 increase to Metropolitan's transportation capital component. (TABLE A, Item 13)
- Expenditures related to Twitchell and Sherman Islands parcel assessments, totaling \$1,195,000, that were incorrectly coded in the calculation of the 2002 Statement of Charges have been corrected, resulting in a \$35,000 increase in Metropolitan's Delta Water Charge capital component in the 2003 Statement of Charges. (TABLE A, Item 14)
- During our 2000 audit, we noted transmission costs totaling \$663,000, incurred between January and June 1999, were converted into SAP with incorrect allocation factors. A portion of this error was corrected in the 2002 Statement of Charges and the remaining \$586,000 was corrected in the 2003 Statement of Charges, resulting in an increase in Metropolitan's transportation minimum component of \$352,000 and a decrease to the Delta Water Charge minimum component of \$10,000. (TABLE A, Item 15)
- The Municipal Water Quality Investigation costs for 2000 were erroneously excluded from the transportation minimum costs in the SAP billing process for the 2002 Statement of Charges. These costs were properly included in the 2003 Statement of Charges, resulting in an increase in Metropolitan's transportation minimum component by \$780,000. (TABLE A, Item 16)

Findings Projected to Result in Changes to the 2004 Statement of Charges:

- Power costs totaling \$16,038,000 and sales totaling \$25,676,000 for 1999 through 2001, were not recorded or were recorded incorrectly in the accounting system. In addition, transmission costs of \$1,185,000 and station service costs totaling \$116,000 for these years were not recorded properly and peaking costs for 2001 totaling \$458,000 were not recorded in the accounting system. These errors result in an overstatement of the variable and Delta Water Charge components by \$7,134,000 and \$17,000, respectively, and an understatement of the transportation minimum component of \$244,000 in the 2003 Statement of Charges. We have provided the Department with a summary of the entries needed to correct these errors. (TABLE B, Item 1)
- We noted a number of inconsistencies in the Hyatt-Thermalito O&M cost data that is included in the contractor billings. The 1998 Hyatt-Thermalito O&M costs included in the variable component and the credits included in the computation of the Delta Water Charge are overstated by \$1,697,000. The 1999, 2000 and 2001 Hyatt-Thermalito O&M costs included in the computation of the variable component and the credits included in the Delta Water Charge are potentially overstated by \$2,740,000, \$1,186,000 and \$908,000, respectively, due to the use of estimated rather than actual O&M costs. The effect of these errors is to overstate Metropolitan's variable and minimum components by \$4,578,000 and \$91,000, respectively, and to understate Metropolitan's Delta Water Charge by \$209,000 in the 2003 Statement of Charges. The Department has indicated that these amounts will be updated when final power allocations are performed for these years. (TABLE B, Item 2)
- Historical costs and future cost estimates for Bay Delta Environmental Protection Studies, Delta Facilities Planning, Planning Model Development, Compliance Monitoring and Water Transfers, that prior to the implementation of SAP system were allocated to Delta reaches, were allocated statewide in the 2003 Statement of Charges and included in the transportation minimum component. Future costs totaling \$27,714,000 for 2004 and 2005 were erroneously excluded from the Delta Water Rate calculation and historical costs for 1999 to 2001 totaling \$3,661,000 were erroneously excluded from the Delta Water Rate calculation and erroneously included in the transportation minimum component. The result of these errors is an understatement to the Delta Water Charge of \$813,000 and an overstatement to the transportation minimum component of \$2,308,000 in Metropolitan's 2003 Statement of Charges. Due to the difficulty in correcting these errors in the SAP system, the Department was not able to correct this error in the December revision of the 2003 Statement of

Charges; however, we have provided the Department with information related to this error and expect the item to be corrected for the 2004 Statement of Charges. (Table B, Item 3)

- Thermalito Diversion Dam capital credits and recreation and non-contractor revenues totaling \$38 million for 1963 to 2035, intended to reduce Oroville Division minimum costs, were erroneously excluded from the 2003 Delta Water Rate computation. The result of this error is to overstate Metropolitan's Delta Water Charge by \$921,000 in the 2003 Statement of Charges. We have notified the Department of this error so that a correction can be made in the 2004 Statement of Charges. (TABLE B, Item 4)
- The Department included outdated Hyatt-Thermalito cost estimates for 2002 to 2035 in the computation of the variable and Delta Water Charge components. As a result, Metropolitan's variable and Delta Water Charge components are overstated by approximately \$820,000 and \$7,000, respectively, in the 2003 Statement of Charges. We have notified the Department of this error so that a correction can be made in the 2004 Statement of Charges. (TABLE B, Item 5)
- Conservation facility replacement costs are to be paid out of the conservation portion of the Replacement Fund until the entire amount is expended. Although the Department has not completed the reconciliation of the Replacement Fund, it appears that the conservation portion of the Fund still has a balance as of June 30, 2002. However, in the 2003 Statement of Charges, the Department included \$4,221,000 of historical costs in the calculation of the Delta Water Charge. As a result, Metropolitan's 2003 Delta Water Charge is overstated by \$139,000. In addition, historical costs totaling \$1,143,000 were included in the transportation minimum component and billed through the variable replacement component. This error results in an overstatement to Metropolitan's minimum component of \$743,000. We will recommend to the Department that these costs be removed from the calculation of the Delta Water Charge until the Fund balance is depleted and from the minimum component to prevent the double billing of these costs. (TABLE B, Item 6)
- The FERC relicensing costs for the Oroville Facilities totaling \$26,204,000 for 2002 through 2005 are included in the calculation of the Delta Water Charge because the credits included in the Delta Water Charge calculation did not include the relicensing costs. As a result, Metropolitan's 2003 Delta Water Charge is overstated by \$718,000. We have notified the Department of this error and expect that the correction will be made in the 2004 Statement of Charges. (TABLE B, Item 7)

- Upon our review of the allocation of replacement costs, we noted that costs related to Banks Pumping Plant are being allocated entirely to the transportation component, when a portion should be allocated to the conservation component and paid from the conservation portion of the Replacement Fund balance. As a result of this incorrect allocation, \$48,000 of costs are incorrectly included in the transportation variable charge, resulting in an overstatement of Metropolitan's variable component by \$31,000. We will continue to monitor this situation until the proper allocation can be made. (TABLE B, Item 8)
- During our reconciliation of the 1998 energy, transmission and station service costs, we noted that power costs are overstated by \$893,000, transmission costs are understated by \$125,000, station service costs are overstated by \$69,000 and Coastal Branch power costs are understated by \$678,000 due to the use of outdated information. These errors resulted in an overstatement of Metropolitan's variable component by \$89,000 and an understatement of the minimum component by \$25,000 in the 2003 Statement of Charges. Because of the difficulty in revising costs in SAP prior to 1999, these errors are not expected to be corrected unless SWPAO revises the FALPOC and the revisions are significant enough to warrant correction of the contractor's bills. (TABLE B, Item 9)
- The value of recovery generation for the Devil Canyon and Warne Powerplants for 1998 were overstated by \$75,000 and \$14,000, respectively, due to the use of outdated information. The effect to Metropolitan is to overstate the transportation variable and transportation minimum components by \$12,000 and \$1,000, respectively, in the 2003 Statement of Charges. This error is expected to be corrected when a Final Power Memo for 1998 is issued. (TABLE B, Item 10)
- Recreation costs totaling \$153,000 for renovations at the Lime Saddle boat launching area of Lake Oroville were incorrectly charged to the contractors. This error results in an overstatement of Metropolitan's Delta Water Charge capital component by \$5,000 in the 2003 Statement of Charges. The Department is evaluating whether this correction can be made in the system. (TABLE B, Item 11)
- Our procedures include comparing water delivery data on delivery schedules provided by Metropolitan to water data used to calculate contractor billings. We noted that deliveries at Reach 7 for 2000 were overstated by 325 acre-feet due to the use of outdated water, which results in the overstatement of Metropolitan's variable charges by \$1,000 in the 2003 Statement of Charges. We

have communicated this issue to Department staff and expect a correction for the 2004 Statement of Charges. (TABLE B, Item 12)

- We noted that the Devil Canyon Second Afterbay charges for debt service included in the variable component were understated by \$13,000 for both 2000 and 2001 due to the use of an outdated debt service schedule. As a result, Metropolitan's variable component in the 2003 Statement of Charges is understated by \$18,000. We informed the Department and they plan to make the correction in the 2004 Statement of Charge. (TABLE B, Item 13)
- Our audit of the Department's variable fish replacement computation used in the 2003 Statement of Charges disclosed that actual contractor payment amounts were not used in calculating the fish replacement charges, the 1999 wheeling credit was outdated, the 2000 and 2001 wheeling credits were excluded from the computation and the 2002 and 2003 charges were calculated using incorrect water amounts. Metropolitan's variable component included in the 2003 Statement of Charges is understated by \$93,000 as a result of these errors. We expect the Department to correct these errors for the 2004 Statement of Charges. (TABLE B, Item 14)

Findings Resulting in Credits, Refunds and Adjustments:

- The preliminary year-end allocation of 2001 off-aqueduct power facility charges, prepared by the Department in 2002, included preliminary cost information for Reid Gardner, resulting in the overstatement of 2001 off-aqueduct costs within the range of \$3.0 to \$5.5 million, which resulted in an understatement of Metropolitan's 2001 off-aqueduct refund of \$2.2 to \$4.2 million. Adjustments will be made when the Department prepares the year-end allocation of 2001 off-aqueduct costs in the Spring of 2003. (TABLE C, Item 1)
- There was an inconsistency in the application of the recreation Project purpose split between two components of the WSRB Surcharge computation. The error resulted in the overstatement of the WSRB Surcharge in the 1990 through 1993 Statements of Charges totaling \$993,000, of which Metropolitan's share is \$555,000. In addition, as noted in prior year, certain costs were excluded from the computation of the 1992 Surcharge, which results in an overstatement of Metropolitan's 1992 Surcharge of approximately \$100,000. We will work with Metropolitan and the Department to ensure refunds are issued to correct these errors. (TABLE C, Item 2)

- The Department excluded \$19,644,000 of Coastal Branch capital costs that are recovered through the transportation variable component from the computation of the 2000 Surcharge, which resulted in an overstatement of Metropolitan's 2000 Surcharge of \$632,000. We will work with the Department and Metropolitan to ensure that the appropriate corrections can be made in a future Statement of Charges. (TABLE C, Item 3)
- During 1985, the Los Angeles Department of Water and Power (LADWP) diverted water into the State's aqueduct as a result of an outage at LADWP's San Francisquito Powerplant. The transporting of this LADWP water through State Water Project facilities resulted in recovery generation credits at Devil Canyon Powerplant of \$526,000. This credit should be recorded at the Devil Canyon Powerplant reach and returned to Metropolitan, who took delivery of water through the Powerplant. The Department expects to issue a refund in 2003. (TABLE C, Item 4)
- Bottlerock transmission revenue totaling \$577,000, previously included in the variable component, were properly recorded to an off-aqueduct reach in the cost accounting system; however, these revenues were not included in SWPAO's calculation of off-aqueduct charges. The result of this error is to overstate Metropolitan's 1990 off-aqueduct charges by \$338,000 and overstate the 1991 off-aqueduct charges by \$134,000. We have provided the Department with the documentation related to this error; however, they have not indicated how the error will be resolved. (TABLE C, Item 5)
- The revised preliminary year-end allocation of 1999 off-aqueduct power facility charges, prepared by the Department in 2001, did not include actual operation and maintenance costs for South Geysers and included outdated debt service amounts for Bottle Rock and South Geysers. These errors resulted in an overstatement of Metropolitan's 1999 off-aqueduct charges by \$112,000. A correction will be made when the Department prepares the final year-end allocation of 1999 off-aqueduct costs. (TABLE C, Item 6)
- The Department used outdated information when preparing an adjustment to the 1993 Devil Canyon Second Afterbay debt service refund, which resulted in the understatement of Metropolitan's refunds by approximately \$105,000 plus interest. We have discussed this error with Department personnel and they have indicated that the correction will be made in conjunction with other refunds during 2002 or 2003. (TABLE C, Item 7)

- An additional credit of \$56,000 related to 1994 off-aqueduct charges, of which Metropolitan's share is \$41,000, has not yet been processed by the Department. Also, the final estimate of 1995 off-aqueduct costs are understated by \$7,000 due to an incorrect amount of lease income from Bechtel being included in the cost study. Metropolitan's share of this understatement is \$4,000. An adjustment will be made for these items when the Department prepares the revised final year-end allocation of 1994 and 1995 off-aqueduct costs. (TABLE C, Item 8)

GLOSSARY

CARA	Cost Allocation and Repayment Analysis System
CCC	Cost Component Code
CDTSC	California Department of Toxic Substances Control
CFS	Cubic Feet Per Second
DFG	Department of Fish & Game
DRWD	Dudley Ridge Water District
DWR	Department of Water Resources
EBE	East Branch Enlargement
EPA	Environmental Protection Agency
FALPOC	Final Allocation of Power Costs
FERC	Federal Energy Regulatory Commission
IAO	Internal Audit Office
KCWA	Kern County Water Agency
KWB	Kern Water Bank
KWH	Kilowatt - hour
LADWP	Los Angeles Department of Power and Water
LBG	Los Banos Grandes
NPC	Nevada Power Company
O&M	Operations & Maintenance
OMP&R	Operations, Maintenance, Power and Replacements
PALPOC	Preliminary Allocation of Power Costs
PAYGO	Pay-As-You-Go Replacement Accounting System
PIR	Project Interest Rate
POCC	Project Operation Control Center
PUFF	Proportionate Use of Facilities Factor
RFDC	Reach Feature Distribution Code
SAP	The Department's business information and accounting system
SBVMWD	San Bernadino Valley Municipal Water District
SWC	State Water Contractors Association
SWP	State Water Project
SWPAO	State Water Project Analysis Office
TAC	Technical Accounting Committee
UCA	Utility Cost Accounting
USBR	United States Bureau of Reclamation
WSRB	Water System Revenue Bonds