

- **Internal Audit Report for March 2004**

Summary

- **Official Statement for the Water Revenue Refunding Bonds, 2004 Series B Review**
- **Other Income and Expense Report**
- **Construction-In-Progress Process and Controls Report**

Detailed Report

This report highlights significant activities of the Audit Department during March 2004. In addition to identifying the opinions expressed in the Audit Reports or the risk exposure in the Risk Assessment Reports, background information and a discussion of findings noted during the reviews are presented.

Official Statement for the Water Revenue Refunding Bonds, 2004 Series B Review

This review was undertaken to provide the underwriters of the Bonds “comfort” that the Official Statement for the Bonds is complete, consistent with supporting financial records and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed upon review procedures performed, and the results obtained, to the underwriters of the Bonds.

Other Income and Expense Report

Opinion

In our opinion, the accounting and administrative procedures over Other Income and Expense include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period July 1, 2002 through December 31, 2003.

Background

Other Income and Expense is a component of Metropolitan’s Statements of Revenues, Expenses and Changes in Net Assets. Other income items include annexation charges, property rentals, earnings on escrow accounts and vendor rebates. Other expense items include adjustments for the Off-Aqueduct Power Facilities, arbitrage rebate tax and bond marketing. The Other Income and Expense accounts resulted in net income of \$3.05 million for fiscal year 2002-03 and resulted in net expense of \$0.96 million for the six-months ended December 31, 2003.

Comments and Recommendations

There were no material findings to report.

Construction-In-Progress Process and Controls

Opinion

In our opinion, the accounting and administrative procedures over the Construction-in-Progress process include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the eighteen-month period ended December 31, 2003.

Background

The Construction-in-Progress general ledger account is a major component of Property, Plant and Equipment on Metropolitan's balance sheet. This account is used to account for all contract and non-contract construction costs incurred to bring the asset to its intended use. Contract costs include all payments to contractors and consultants, whereas non-contract costs include district direct labor, additives and administrative overhead costs. In addition, non-contract costs also include interest incurred on bond instruments issued by Metropolitan to finance the construction of the projects. As of June 30, 2003, Construction-in-Progress totaled \$1.47 billion. Furthermore, as of December 2003, Construction-in-Progress totaled \$1.49 billion, which consisted of 507 projects, approved fewer than 112 appropriations.

The scope of our review was limited to evaluating the accounting and administrative controls over the Construction-in-Progress account, including monitoring activities, as well as compliance with Generally Accepted Accounting Principles (GAAP) and Metropolitan's Administrative Code. Our scope did not include a review of construction contracts for compliance with the terms and conditions of the individual contract.

Comments and Recommendations

Comments were noted in the areas of periodic reporting, interest capitalization and charges made to completed appropriations. Specifically, we made recommendations for management to prepare an annual board report of inactive appropriations. We also recommended that the Controller verify the interest rates used for capitalizing interest as part of the historical cost of acquiring and making assets ready for use. Finally, we presented a recommendation for management to establish procedures to address the recording of costs incurred for completed appropriations.