

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

December 14, 2004 Board Meeting

9-3

Subject

Authorize payments for calendar year 2005 charges for State Water Project and Devil Canyon/Castaic contracts

Description

Staff is requesting authorization to pay the calendar year 2005 Statement of Charges for Metropolitan's participation in the State Water Project. Richardson and Company has completed Metropolitan's independent audit of the CY 2005 Statement of Charges and determined that these charges comply with the contracts. The SWP infrastructure currently provides about 70 percent of Metropolitan's imported water supply and represents about 30 percent of its annual budget. The charges are \$504 million, which is \$40 million less than the statement of charges for CY 2004. A comparison of CY 2004 and 2005 charges is detailed in [Attachment 1](#).

Analysis of CY 2005 Statement of Charges

- \$13 million decrease in Power (variable and off-aqueduct) charges. This decrease reflects a combination of factors. The variable is \$38 million lower due to a downward shift in projected power market prices. This reduction, however, will be partially offset by increases in off-aqueduct costs and transmission costs. Off-aqueduct costs are \$5 million higher due to increased debt service offset partially by a decrease in operating costs. CY 2005 Power costs will include transmission costs of \$20 million, which were previously included in the Minimum Operation, Maintenance, Power & Replacement (OMP&R) charge.

Commencing with the 2005 Statement of Charges, DWR is changing the accounting method used to invoice contractors for power transmission costs. Previously transmission costs were based on a contractor's "share" of water conveyance capacity at a pumping plant and were fixed. A new tariff for investor-owned transmission facilities bases charges on actual use. Hence, the transmission cost is being allocated to the variable component. This also results in a reduction to the Minimum OMP&R component, as described below.
- \$17 million decrease in the Minimum OMP&R charges. The decrease is mainly a result of the change in the accounting method for charging transmission costs.
- \$10 million decrease in capital. Since the Monterey Amendment was executed in 1995, DWR annually utilized a portion of cash flow from prior years to reduce the contractors' upcoming capital charges. The decrease in Capital charges is in response to two factors: (1) the increase in the amount of cash flow DWR is making available to reduce capital costs, and (2) a portion of the capital costs were refinanced with lower cost variable interest rate bonds.

The independent auditor's review was completed, verifying that the 2005 statement of charges conforms to our SWP water supply contract. [Attachment 2](#) summarizes the results of the review.

Impact on Budget

The costs contained in the CY 2005 charges will not require an increase in the FY 2004/05 budget. Metropolitan budgeted \$462 million for SWP costs and current estimates indicates \$399 million in costs. The \$504 million in charges does not reflect refunds and credits that typically range between \$60 and \$70 million annually. If Metropolitan takes delivery of less water than projected, Power charges would also be lower.

Ongoing Actions

Staff continues to work with other contractors and DWR to manage costs and expand value for a broad range of project activities. These activities include verifying project cost accuracy and underlying reasonableness; providing reliable and cost effective water supplies; maintaining appropriate levels of infrastructure reliability; managing water quality; managing a cost-effective and reliable energy portfolio; and improving DWR's business practices for administering the project. Staff is also working closely with member agencies to incorporate their suggestions and concerns into our approach.

Policy

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

California Environmental Quality Act (CEQA)

CEQA determination for Staff Recommendation:

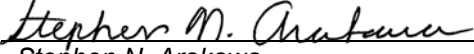
The proposed action is not defined as a project under CEQA because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government 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.

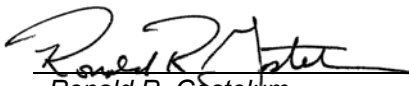
Staff Recommendation

Adopt the CEQA determination and approve payments up to a total of \$504 million.

Fiscal Impact: Maximum payments in CY 2005 of \$504 million. Net calendar year payments should be lower because of credits, refunds, and adjustments that are not included in the annual statement. Fiscal year costs will vary with actual energy costs.


Stephen N. Arakawa
Manager, Water Resource Management

11/15/2004
Date


Ronald R. Gastelum
Chief Executive Officer

11/19/2004
Date

Attachment 1 – Comparison of Metropolitan's Statement of Charges for CY 2004 and CY 2005

Attachment 2 – Summary Report on the Audit of the 2005 Statement of Charges

Comparison of Metropolitan's Statement of Charges for CY 2004 and CY 2005 (\$ millions)			
	CY 2004 SOC	CY 2005 SOC	Change*
Total Power	\$ 274	\$ 261	(13)
Total Min OMP&R	115	98	(17)
Total Capital	155	145	(10)
Total SWP Charges	\$ 544	\$ 504	(40)

* Increase (Decrease)

**THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA**

**SUMMARY REPORT ON THE
AUDIT OF THE 2005 STATEMENT OF CHARGES**

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA
SUMMARY REPORT ON THE
AUDIT OF THE 2005 STATEMENT OF CHARGES

INDEPENDENT AUDITOR'S REPORT 1

2005 STATEMENT OF CHARGES 3

STATEMENT OF CHARGES TRENDS

 Comparison of the 2004 and 2005 Statements of Charges 4

 Comparison of the Previously Estimated 2005 Statement of Charges
 to the Statement Dated July 1, 2004 11

 Future Potential Refunds and Adjustments 16

UNRESOLVED ISSUES RELATED TO THE 2005
STATEMENT OF CHARGES 18

TABLE A--Summary of Settled Audit Findings Resulting in Changes to the
2005 Statement of Charges 21

TABLE B--Summary of Audit Findings Projected to Result in Changes to the
2006 Statement of Charges 22

TABLE C--Summary of Audit Findings Resulting in Credits, Refunds and
Adjustments 25

DISCUSSION OF OUR SERVICES, AUDIT FINDINGS,
AND GENERAL COMMENTS 26

Richardson & Company

550 Howe Avenue, Suite 210
Sacramento, California 95825

Telephone: (916) 564-8727
FAX: (916) 564-8728

INDEPENDENT AUDITOR'S REPORT

The Metropolitan Water District
of Southern California
Los Angeles, California

We have audited the accompanying 2005 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 2005 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, 2004

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

2005 STATEMENT OF CHARGES

	<u>Cost Components</u>		<u>Capital</u>	<u>Total</u>
	<u>Variable 1/</u>	<u>Minimum</u>		
<u>WATER SUPPLY CONTRACT</u>				
Transportation Charge	\$185,932,037	\$ 61,938,521	\$ 61,764,568 2/	\$ 309,635,126
Off-Aqueduct Power Facilities Charge 1/		75,033,466		75,033,466
Delta Water Charge		28,518,455	20,126,746 2/	48,645,201
East Branch Enlargement		2,605,075	24,266,066	26,871,141
Water System Revenue Bond Surcharge			33,839,340	33,839,340
Tehachapi Second Afterbay Facilities			147,935	147,935
<u>DEVIL CANYON - CASTAIC CONTRACT</u>				
Operations and maintenance - Article 17(b)		5,279,951		5,279,951
Debt service on bonds - Article 17(a)			4,695,184	<u>4,695,184</u>
			TOTAL 3/	<u>\$ 504,147,344</u>

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

- 1/ Based on a water delivery schedule of 1,811,500 acre-feet.
- 2/ Amounts include Urban Rate Reduction credits of \$6,566,076 in the Transportation Charge and \$3,280,787 in the Delta Water Charge as stated 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 2004 AND 2005 STATEMENTS OF CHARGES

	Transportation Charge				Delta Water Charge		East Branch Enlargement		Water System Revenue Bonds	Total
	Capital	Minimum	Off-Aqueduct Minimum	Variable	Capital (in thousands)	Minimum	Capital	Minimum		
2004 Statement of Charges (November 2003 revision)	\$ 70,354	\$ 81,358	\$ 69,689	\$ 204,474	\$ 21,066	\$ 30,462	\$ 28,158	\$ 3,041	\$ 35,699	\$ 544,301
Increase (decrease) due to changes in:										
Estimated costs	927	(21,322)	(678)	(13,838)	1,431	(2,024)		(404)		(35,908)
Past cost adjustments	11	7,182		6,652			3,180	(32)		16,993
Change in debt service			6,287				(7,072)		(1,860)	(2,645)
Power sales				(11,449)						(11,449)
Recovery generation credit				93		80				173
Allocations among contractors			(265)							(265)
Rebates under Monterey Amendment	(4,684)				(2,370)					(7,054)
NET CHANGE	<u>(3,746)</u>	<u>(14,140)</u>	<u>5,344</u>	<u>(18,542)</u>	<u>(939)</u>	<u>(1,944)</u>	<u>(3,892)</u>	<u>(436)</u>	<u>(1,860)</u>	<u>(40,155)</u>
2005 Statement of Charges dated July 1, 2004	<u>\$ 66,608</u>	<u>\$ 67,218</u>	<u>\$ 75,033</u>	<u>\$ 185,932</u>	<u>\$ 20,127</u>	<u>\$ 28,518</u>	<u>\$ 24,266</u>	<u>\$ 2,605</u>	<u>\$ 33,839</u>	<u>\$ 504,146</u>

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

Comparison of the 2004 and 2005 Statements of Charges

As shown on the previous page, Metropolitan's 2005 charges decreased by \$40.2 million compared to the 2004 Statement of Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component decreased by \$18.5 million between 2004 and 2005. This decrease results from a decrease of \$13.8 million in energy and other variable costs and an \$11.4 million increase in power sales, which are partially offset by an increase as a result of a \$6.7 million increase in the past cost adjustment. The decrease in estimated costs is due primarily to a lower estimated mill rate for non-firm purchases, which decreased from 66 to 49 mills per kilowatt-hour. Hyatt-Thermalito Power Plant costs are also expected to decrease by \$8.9 million due primarily to a reduction in FERC relicensing cost estimates. The replacement charge included in the variable component decreased by \$3.8 million due to a credit adjustment for prior years' overcharges. These decreases are offset by a \$29 million increase due to the addition of transmission costs in the variable component. Also, the Department anticipates an increase of \$12 million in power purchases from Duke Energy in 2005, due to an anticipated reduction in energy available under the Southern California Edison capacity exchange agreement. The power sales credit increased due to the assumption that the Department will have more excess power to sell in 2005 than in 2004, due to additional energy generation at Hyatt-Thermalito Power Plant, although the mill rate on these sales is expected to decrease from 67 to 47 mills per kilowatt-hour. The past cost adjustment increased by \$6.7 million primarily due to the following:

- Metropolitan's calculated component for 2000 decreased \$.8 million due to the correction of the recording of power cost and sale transactions.
- Metropolitan's calculated component for 2001 decreased \$1.3 million due to the correction of the recording of \$.7 million in power cost and sales transactions. In addition, a decrease of \$.6 million is due to the correction of a cost center allocation error.
- Metropolitan's calculated component for 2002 decreased \$7.9 million due partially to the correction of the recording of power cost and sales transactions totaling \$7.3 million and a decrease of \$.6 million due to the correction of a cost center allocation error.
- Metropolitan's 2003 variable component increased as a result of a \$42.3 million decrease in the payments received amount due to estimated payments being replaced by actual payments. This increase was offset by a \$34.0 million decrease in Metropolitan's calculated component. This

decrease is due to the actual power costs being lower than the amount estimated in the prior year, a lower amount of energy required by the pumping plants than previously estimated and the actual power sales being at higher rates than previously estimated, offset by an increase in grid management costs, all of which decreased Metropolitan's charges by \$30 million. Metropolitan's calculated component was further reduced by \$13.6 million as a result of Metropolitan's actual water deliveries being 126,186 acre-feet less than the amount estimated in the prior year. As a result of estimated water pumped through the plants being replaced by the actual amounts, Metropolitan's calculated component increased \$3.4 million.

- An additional year of interest on the past cost adjustments results in an increase of \$8.5 million.

The Department improperly assigned \$64 million to the value of additional energy produced at the Hyatt-Thermalito Power Plant in the study used to calculate the 2004 pumping plant costs. As a result, Metropolitan's 2004 variable component is overstated by \$53 million. However, since the 2004 variable payments are adjusted to result in the same over/under adjustment as the 2004 Statement of Charges, Metropolitan's 2004 variable payment is also overstated by \$53 million, resulting in no billing error.

Transportation Minimum: The decrease of \$14.1 million in the transportation minimum component is due to a \$21.3 million decrease in cost estimates partially offset by a \$7.2 million increase in past cost adjustments. The total decrease of \$14.1 million is due primarily to the following increases and decreases:

- Due to changes in the rate structure for transmission service, the Department has determined it would be more appropriate to include transmission costs that fluctuate with usage in the variable component instead of the minimum component. As a result of this change, Metropolitan's transportation minimum component decreased by \$24.5 million.
- The Department expects to incur costs for the future operation of the State Water Project, mainly for Phase 2B of SAP and power planning projects. As a result of changes in the years when the Department expects these projects to take place, costs totaling \$14.6 million that were included in the 2004 Statement of Charges have been shifted to future years in the 2005 Statement of Charges. Due to these changes, Metropolitan's transportation minimum component decreased by \$10.3 million.

- The actual minimum costs incurred for 2003 were approximately \$11.5 million less than the amount estimated in the 2004 Statement of Charges, resulting in a decrease in Metropolitan's transportation minimum charge of approximately \$9.9 million.
- The Department included \$2.8 million in settlement costs as a result of litigation related to the Monterey Amendment in the 2005 Statement of Charges. Metropolitan's share of this settlement is \$1.3 million, which is \$2.6 million lower than the amount included in the 2004 Statement of Charges.
- During the past year, the Department received payments totaling \$3.6 million related to the wheeling of non-entitlement water, the lease of State Water Project land and maintenance of the Angeles Tunnel. The Department posted entries within the accounting system to record credits for these amounts during 2004, which results in a \$1.7 million decrease in Metropolitan's transportation minimum component.
- The impact of an additional year of interest on the prior year over and underpayments results in a \$1.4 million decrease in Metropolitan's transportation minimum component.
- The Department revised historical transmission and station service postings to correct errors, which results in Metropolitan's transportation minimum component increasing by \$.4 million.
- Changes in cost estimates for 2004 and 2005 resulted in a \$.7 million decrease in Metropolitan's minimum component.
- Metropolitan's transportation minimum component increased by \$1.2 million as a result of corrections and adjustments the Department made for the Municipal Water Quality Investigation program. In the 2004 Statement of Charges, the Department failed to bill Metropolitan for their 2002 charges. The Department corrected this error in the 2005 Statement of Charges, resulting in a \$1.1 million increase in Metropolitan's transportation minimum component.
- Metropolitan's transportation minimum component increased by \$2.0 million as a result of water loss redistribution entries. The Department's estimate of the water loss redistribution adjustments for 2004 and 2005 were higher in the 2005 Statement of Charges as a result of higher variable unit rates and water losses, which results in a \$2.8 million increase in Metropolitan's transportation minimum component. In the 2004 Statement of Charges, the Department assigned water loss adjustment entries totaling \$.6 million to the variable component instead of the minimum

component. The Department corrected this error for the 2005 Statement of Charges, resulting in a \$.4 million increase in Metropolitan's transportation minimum component. These increases were partially offset by a \$1.2 million decrease as a result of the Department failing to make entries to record the water loss redistribution for 2003 in the 2005 Statement of Charges.

- The Department allocated a \$5.3 million under-recovery of management and overhead costs to program cost centers for the 2005 Statement of Charges. As a result, Metropolitan's transportation minimum component increased by \$2.4 million.
- The 2004 Statement of Charges included a \$31.3 million underpayment due to revisions to 2003 and prior year costs, which causes an increase of this amount when compared to the 2005 Statement of Charges.

Transportation Capital: The decrease of \$3.7 million in the transportation capital component is primarily due to the increase in the Monterey Amendment rebate from \$1.9 in the 2004 Statement of Charges to \$6.6 in the 2005 Statement of Charges due to the Department's evaluation that there was a higher amount of cash available for rebates under the Monterey Amendment.

East Branch Capital: The East Branch Enlargement capital component decreased by \$3.9 million due primarily to Series AB Water System Revenue Bonds being issued to refund portions of Series L and M. The 2004 Statement of Charges included \$7.6 million of debt service costs for Series L and M, which are now refunded and are not included in the 2005 Statement of Charges. The 2005 debt service costs included in the 2005 Statement of Charges include only \$558,000 of interest. Principal payments on Series AB do not begin until 2020. The decreased debt service costs are partially offset by an increase due to the 2004 Statement of Charges including a \$3 million overpayment related to debt refundings in 2002.

Delta Water Charge Minimum: The decrease of \$1.9 million in the Delta Water Charge minimum component is primarily due to the following:

- Estimated equipment replacement costs at Hyatt-Thermalito Power Plant totaling \$5.2 million for 2005 were included in the 2005 Delta Water Charge minimum component, a decrease of \$5.2 million from the prior year, which resulted in an decrease of \$2.4 million in Metropolitan's Delta Water Charge.

- Oroville costs for 2004 to 2006 decreased by \$8,776,000 due to the Department revising the estimates of future costs. These decreases resulted in a \$360,000 decrease in Metropolitan's Delta Water Charge.
- The 2003 costs decreased by \$14.7 million due to actual amounts being less than what was projected for 2003 in the 2004 Statement of Charges, which results in a \$466,000 decrease in Metropolitan's Delta Water Charge.
- Delta Water Charge costs decreased due to changes in the Department's methodology for charging transmission costs. The Delta Water Charge minimum costs decreased by \$3.2 million, which resulted in decrease of \$101,000 in Metropolitan's 2005 Statement of Charges.
- Water wheeling credits for 1999 and 2001 to 2002 totaling \$3,104,000 were recorded during 2004 and resulted in a decrease of \$101,000 in Metropolitan's Delta Water Charge.
- FERC relicensing credits included in the Delta Water Charge for 2003, increased by \$4.6 million when adjusted to actual and the 2004 to 2006 credits were decreased by \$7.5 million when the estimates for these years were revised. These revisions result in a \$68,000 increase in Metropolitan's Delta Water Charge.
- Increases due to the reallocation of costs resulting from the downstream distribution of variable costs totaled \$10.8 million and increased Metropolitan's Delta Water Charge by \$322,000 in the 2005 Statement of Charges.
- The 2007 to 2035 costs included in the Delta Water Charge calculation increased \$26.1 million due to the Department updating the projected amounts for these years using the average of the actual costs for the past three years escalated by 1.7%. These increases result in a \$382,000 increase in Metropolitan's Delta Water Charge.
- North San Joaquin and Delta Facilities costs for 2004 through 2006 increased by \$13,433,000 and \$5,658,000, respectively, due to the Department revising the estimates of future costs. The increase at North San Joaquin relates primarily to pump refurbishment of Units 1 to 3, reroofing and automatic voltage regulators for Units 1 through 7 at Banks Pumping Plant. The increase at Delta Facilities is due to the adjustment of 2006 estimates to represent the average of the escalated actual costs for the past three years, which were higher than the previous year estimate. These increases resulted in an increase of \$543,000 in Metropolitan's Delta Water Charge minimum component.

Water System Revenue Bond Surcharge: The \$1.9 million decrease in the Water System Revenue Bond Surcharge is due to decreased debt service costs of \$5.0 million resulting from the issuance of Series AB Water System Revenue Bonds, which refunded Series L Water System Revenue Bonds and reduced 2005 debt service payments by \$6.2 million. This decrease was partially offset by an increase in the 2005 debt service payment by \$1.2 million due to a portion of the proceeds of Series AB being used for new construction.

Delta Water Charge Capital: The decrease of \$.9 million in the Delta Water Charge capital component is primarily the result of the following:

- The Monterey Amendment rebate of \$3.3 million in the 2005 Statement of Charges is \$2.4 million higher than the rebate included in the 2004 Statement of Charges due to an improvement in the Department's cash flow.
- Costs for 2003 increased by \$13.1 million because actual costs exceeded estimates at the Delta facilities for the construction of temporary rock barriers in the South Delta, resulting in a \$.4 million increase in Metropolitan's Delta Water Charge.
- Estimated costs increased by \$38.9 million for 2004 to 2009 related to costs for Division of Engineering (DOE), DOE facility modifications and consolidation, DOE involvement in technical committees, consultants to provide expertise on technical issues, as-built program for SWP construction projects, researching and processing documents associated with closed or inactive projects, SWP communications system replacement, Delta Facilities design and Delta Field Division water treatment plant modifications, resulting in an increase of \$1 million in Metropolitan's Delta Water Charge.

These decreases are partially offset by an increase due to the following:

Off-Aqueduct Minimum: The \$5.3 million increase in Metropolitan's off-aqueduct minimum component is due primarily to an \$8.4 million increase in debt service costs. This increase was due to principal payments for WSRB Series J bonds increasing from \$800,000 in 2004 to \$7,360,000 in 2005. This debt service increase was offset by an overall decrease of \$1 million in the Reid Gardner O&M cost estimates, which are based on actual 2003 costs, escalated at 2.5%, and assumes the plant will operate at a 75% capacity factor. Metropolitan's requested water deliveries of 1,811,500 acre-feet remained the same but the other contractors increased their total estimated deliveries by 7,776 acre-feet, resulting in a decrease in Metropolitan's share of the costs by \$.3 million.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
COMPARISON OF THE PREVIOUSLY ESTIMATED 2005 STATEMENT OF CHARGES
TO THE STATEMENT DATED JULY 2004

	<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> (in thousands)	<u>Minimum</u>	<u>Capital</u>	<u>Minimum</u>		
Prior year Department estimates of the 2005 Statement of Charge dated November, 2003	\$ 72,264	\$111,616	\$ 77,142	\$279,505	\$ 21,977	\$ 30,462	\$ 31,173	\$ 3,330	\$ 35,611	\$663,080
Increase (decrease) due to changes in:										
Estimated costs	(1,364)	(20,181)	(2,185)	(74,749)	1,431	(2,024)		(312)		(99,384)
Past cost adjustments	2,274	(24,217)		(2,649)			150	(413)	(1,772)	(26,627)
Change in debt service							(7,057)			(7,057)
Power sales				(19,337)						(19,337)
Recovery generation credit				3,162		80				3,242
Allocations among contractors			76							76
Rebates Under Monterey Amendment	<u>(6,566)</u>	<u> </u>	<u> </u>	<u> </u>	<u>(3,281)</u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u>(9,847)</u>
NET CHANGE	<u>(5,656)</u>	<u>(44,398)</u>	<u>(2,109)</u>	<u>(93,573)</u>	<u>(939)</u>	<u>(1,944)</u>	<u>(6,907)</u>	<u>(725)</u>	<u>(1,772)</u>	<u>(158,934)</u>
2005 Statement of Charges dated July, 2004	<u>\$ 66,608</u>	<u>\$ 67,218</u>	<u>\$ 75,033</u>	<u>\$ 185,932</u>	<u>\$ 20,127</u>	<u>\$ 28,518</u>	<u>\$ 24,266</u>	<u>\$ 2,605</u>	<u>\$ 33,839</u>	<u>\$ 504,146</u>

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

**Comparison of the Previously Estimated 2005 Statement of Charges
to the Statement Dated July 2004**

As shown on the previous page, Metropolitan's 2005 Charges decreased by \$158.9 million compared to last year's estimate of the 2005 Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component decreased by \$93.6 million between last year's estimate of the 2005 charges and the 2005 Statement of Charges. The decrease results from \$74.7 million in lower energy and other variable costs, a \$19.3 million increase in power sales, and a \$2.6 million reduction in the past cost adjustment, which are offset by a \$3.0 million decrease in recovery generation credits. The decrease in estimated costs is due mainly to a lower mill rate resulting from a decrease in wholesale energy prices, reduced energy purchases and a \$9.2 million reduction in FERC relicensing costs for the Hyatt-Thermalito Power Plant, offset by an increase of \$29 million of transmission costs that are included in the 2005 variable component. The Department has assumed that the mill rate for non-firm energy purchases will decrease from 66 mills per kilowatt-hour, which was used in last year's estimates, to 49 mills per kilowatt-hour, and that less non-firm purchases will be needed due to increased energy capacity from the Hyatt-Thermalito Power Plant. In addition, the Department included a net credit of \$.3 million for transportation replacement expenditures in 2005 due to prior year overcharges, whereas last year's estimate reflected a charge of \$4.1 million. The recovery generation credits decreased primarily due to reduced water flow through the powerplants due to some of the water bypassing the plant. The increase in power sales is primarily due to increased energy generation from the Hyatt-Thermalito Power Plant offset by a decrease in non-firm energy sale prices from 67 to 47 mills per kilowatt-hour. The 2005 past cost adjustment overpayment of \$2.6 million is primarily the result of the \$6.7 million underpayment discussed on pages 5 and 6, which is offset by the prior year overpayment of \$9.3 million due to decreased 2004 energy costs.

Transportation Minimum: The decrease of \$44.4 million in the transportation minimum component is due to a \$20.2 million decrease in estimated costs and a \$24.2 million decrease in the past cost adjustment. The decrease in 2005 estimated costs of \$20.2 million is primarily due to the following:

- Due to changes in the Department's contracts for transmission service, approximately \$21.2 million of transmission costs are included in the variable component instead of the minimum component. Metropolitan's transportation minimum component decreased by \$17.3 million as a result of this change.

- The estimate of costs for SAP Phase 2B and future power planning expected to be incurred in 2005 are \$3.3 less than the prior estimate, resulting in a \$2.6 million decrease in Metropolitan's transportation minimum component.
- In preparing the estimate of the 2005 transportation minimum costs in the 2004 and 2005 Statement of Charges, the Department used an average of the actual costs incurred for the past three years as the basis for the estimates. The estimates in the 2005 Statement of Charges were \$9.0 million less than in the 2004 Statement of Charges, as a result of the average of the actual costs for 2001 to 2003 being lower than the average for 2000 to 2002. As a result of the reduction in estimated costs, Metropolitan's transportation minimum component decreased by \$6.7 million.
- Due to a reduction in the estimated energy rates for 2005, the amount of the water loss redistribution entries for 2005 were \$.8 million lower than previously estimated. Metropolitan's share of this decrease is \$.5 million.
- The 2005 cost estimates in the 2005 Statement of Charges includes \$6.8 million of extraordinary O&M expenditures at Gianelli Pumping/Generating Plant refurbishment, AD Edmonston Pumping Plant for overhaul and refurbishment and Pearblossom Pumping Plant for sealing and repairing of roads.
- Municipal Water Quality Investigation costs for 2005 totaling \$1.2 million were not included in the prior year estimate of 2005 charges but were added to the 2005 Statement of Charges.
- The Department added Monterey Amendment litigation charges of \$2.8 million for 2005, of which Metropolitan's share is \$1.3 million.

We noted that the \$24.2 million change in the past cost adjustment is due mainly to adjustments for 1999 to 2004 consisting of the following:

- The actual minimum costs incurred for 2003 were approximately \$11.5 million less than the amount estimated in the 2004 Statement of Charges, resulting in a decrease in Metropolitan's charge of approximately \$9.6 million.
- Estimates of transmission costs for 2004 decreased by \$10.4 million, reducing Metropolitan's charge by \$7.2 million.

- The actual costs incurred in 2003 for power planning were \$7.9 million lower than what was estimated in the prior year and the estimate for 2004 power planning and SAP Phase 2B were reduced by \$1 million. These revisions resulted in a \$7.2 million decrease in Metropolitan's charges.
- The Department posted credits totaling \$3.6 million related to special water wheeling, lease payments, and the maintenance of the Angeles Tunnel in the 2005 Statement of Charges that results in a \$1.7 million decrease in Metropolitan's charges.
- The downstream distribution calculation for 2003 was not performed due to time constraints, which results in a \$1.2 million decrease in Metropolitan's minimum component. This decrease was partially offset by a \$.9 million increase in the downstream distribution entries as a result of changes in water gains and losses and storage changes as well as the variable unit rates. In addition, the Department corrected an incorrect cost center assignment used in the downstream distribution process, resulting in a \$.4 million increase in Metropolitan's minimum component.
- The Department made corrections of postings related to minimum energy costs for station service and transmission that results in a \$.5 million increase in Metropolitan's minimum component.
- The Department had incorrectly excluded the Municipal Water Quality Investigation charge for 2002 totaling \$1.1 million from the 2004 Statement of Charges. This amount was properly included in the 2005 Statement of Charges, resulting in an increase.
- The Department allocated an indirect cost variance totaling \$5.3 million to program cost centers, which caused Metropolitan's minimum component to increase by \$2.4 million.
- The impact of an additional year of interest on the prior year over and underpayments results in a \$1.7 million decrease in Metropolitan's transportation minimum component.

East Branch Capital: The East Branch Enlargement capital component decreased by \$6.9 million due primarily to the Series AB Water System Revenue Bonds being issued to refund portions of Series L and M. The previous estimate of the 2005 charges included \$7.6 million of debt service costs for Series L and M, which are now refunded and are not included in the 2005 Statement of Charges. The debt service costs for 2005 include only \$558,000 of interest. Principal payments on Series AB do not begin until 2020.

Transportation Capital: The decrease of \$5.8 million in the transportation capital component is primarily due to the inclusion of rate reduction credits under the Monterey Amendment of \$6.6 million in the 2005 Statement of Charges.

Off-Aqueduct Minimum: The \$2.1 million decrease in Metropolitan's off-aqueduct minimum component is due to a \$3 million decrease in the Reid Gardner O&M and fuel cost estimates as a result of better estimates based on recent actual costs, and a one-dollar decrease in the per-ton cost of coal. In addition, Metropolitan's requested water deliveries of 1,811,500 acre-feet remained the same but the other contractors decreased their total estimated deliveries for 2005, by 3,302 acre-feet. This decrease in the other contractors' water deliveries resulted in an increase in costs allocated to Metropolitan by \$76,000.

Delta Water Charge Minimum: Refer to explanation on pages 8 and 9.

Water System Revenue Bond Surcharge: The \$1.8 million decrease in the Water System Revenue Bond Surcharge is due to decreased debt service costs of \$5.0 million resulting from the issuance of Series AB Water System Revenue Bonds, which refunded Series L Water System Revenue Bonds and reduced 2005 debt service payments by \$6.2 million. This decrease was partially offset by an increase in the 2005 debt service payment by \$1.2 million due to a portion of the proceeds of Series AB being used for new construction.

Delta Water Charge Capital: Refer to explanation on page 10.

Future Potential Refunds and Adjustments

Metropolitan's estimated 2005 charges of \$504 million do not include certain credits, refunds and adjustments that are expected in 2005 as part of the Department's normal accounting and billing process. Refunds are expected to reduce Metropolitan's 2005 billings by approximately \$33.5 million for the following items:

	<u>Estimated Refund Date</u>		
<u>Cover - Off-Aqueduct</u>			
Return of July - December 2003	April 2005	\$ 3,030,000	
Return of January - June 2004	October 2005	<u>2,642,000</u>	\$ 5,672,000
<u>Cover - Water System Revenue Bond (WSRB)</u>			
Return of January 2004	April 2005	7,378,000	
Return of July 2004	October 2005	<u>7,378,000</u>	14,756,000
<u>Cover - East Branch Enlargement (EBE)</u>			
Return of September 2003	April 2004	3,349,000	
Return of March 2004	October 2004	<u>3,118,000</u>	6,467,000
<u>WSRB Securities Earnings</u>			
Earned July - December 2004	March 2005	515,000	
Earned January - June 2005	September 2005	<u>515,000</u>	1,030,000
<u>SMIF Interest - Off-Aqueduct</u>			
Earned July - December 2004	March 2005	312,000	
Earned January - June 2005	September 2005	<u>312,000</u>	624,000
<u>SMIF Interest - WSRB</u>			
Earned July - December 2004	March 2005	201,000	
Earned January - June 2005	September 2005	<u>201,000</u>	402,000
<u>SMIF Interest -East Branch Enlargement</u>			
Earned July - December 2004	March 2005	97,000	
Earned January - June 2005	September 2005	<u>97,000</u>	194,000
<u>SMIF Interest - Reserve Account</u>			
Earned July - December 2004	March 2005	724,000	
Earned January - June 2005	September 2005	<u>724,000</u>	1,448,000
<u>Devil Canyon Second Afterbay</u>			
Return of 2004 EBE debt service credits	May 2005	<u>2,883,000</u>	<u>2,883,000</u>
	TOTAL ESTIMATED REFUND		<u>\$ 33,476,000</u>

The 2005 variable and off-aqueduct charges may be reduced further if 2005 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 25.

UNRESOLVED ISSUES RELATED TO THE 2005 STATEMENT OF CHARGES

During our audit, we encountered a number of issues related to the calculation of various components of the 2005 Statement of Charges that need to be addressed by the Department. Some of these issues result in errors in the Statement of Charges. 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 2005 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, for the 2001 and 2002 Statements of Charges 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. The minimum future cost estimates were determined to be unusually high compared to previous Statements of Charges and were substantially higher than the prior year actual amounts. In response to this situation, the Department reduced the minimum estimates as part of the December revision to the 2003 Statement of Charges, using 2001 actual costs as a basis for determining 2003 estimates. Instead of changing the budgeting process so that projected minimum amounts in SAP could be utilized for the 2004 and 2005 Statements of Charges, the Department developed its future minimum cost estimates outside of the SAP system, using an average of the actual costs for the past three years, adjusted for escalation at 3%, plus any known new projects. We will work with Metropolitan and the other contractors to monitor the Department's progress in developing procedures for preparing budgets.

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. To properly reflect these water table redistribution entries for 2000 to 2002, the Department performed the calculation outside of the system and posted entries manually in SAP for the preparation of the 2003 and 2004 Statements of Charges. During 2004, the Department modified the SAP system to calculate the downstream entries; however, due to time constraints, the process was not completed in time for the preparation of the 2005 Statement of Charges. As a result, the entries calculated for the 2004 Statement of Charges for the 2000 through 2002 were used in the 2005 Statement of Charges, although cost

and water data have changed. In addition, the water table redistribution entries for 2003 were calculated using water data for 2002. The impact of using 2002 data to reallocate 2003 costs is a \$1,586,000 understatement of the variable component, a \$5,868,000 overstatement of the minimum component and a \$99,000 understatement of the Delta Water Charge in the 2005 Statement of Charges. This error is included on Table B on page 22. We will continue to monitor the Department's progress in working with the SAP system to perform these allocations.

Water System Revenue Bond (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. 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 2005 Statement of Charges, the Department calculated the 2005 WSRB Surcharge using the relative proportion of the Surcharge to total debt service from the 2002 Statement of Charges and applied that proportion to 2005 debt service costs that include WSR bonds through Series AB issued in March 2004. In addition to these debt service costs, the Department included \$1.6 million in recreation capital costs that have not been reimbursed by the State and \$3.6 million for on-aqueduct bond cover costs. 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.

Hyatt-Thermalito Refurbishment Costs. The Department prepared a conservation replacement calculation for the 2004 and 2005 Statements of Charges, which included conservation replacement costs for 2002 through 2005 totaling \$15.6 million, that was billed as part of the Delta Water Charge. The costs are primarily estimates and relate to contracts for the refurbishment of the Hyatt-Thermalito Powerplant Turbines, which are identified as a replacement item. Because of the extensiveness of the work and issues raised by Metropolitan and other contractors that the work is more than a routine replacement, the Department of Engineering prepared an analysis of the costs of the refurbishment, that allocates the costs between betterments, O&M and replacements. Metropolitan and the other contractors have not yet concurred with this approach. Under the proposed allocation methodology, of the total estimated cost of \$27,850,000, only \$5,079,000 would be considered replacement costs and the remaining \$22,771,000 is considered O&M or betterments, which are typically billed as an energy cost through the transportation variable component. The effect on the 2004 and 2005 Statements of Charges of including the betterment (capital) and O&M costs in the conservation replacement rate, rather than treating them as capital and O&M costs, was an increase in Metropolitan's Delta Water Charge of \$4,774,000. Because Hyatt-Thermalito O&M and capital costs are collected through the variable component, Metropolitan's variable charge would

increase by \$12,776,000 if these costs were reallocated. The Department has determined that an allocation of these costs will be made for the 2006 Statement of Charges. However, because there is disagreement among the contractors regarding how Hyatt-Thermalito costs should be recovered, and one contractor has filed a claim against the Department, this issue may not be resolved in time to reflect changes in the 2006 Statement of Charges. We will continue to monitor this situation to ensure the proper allocation is used in future Statements of Charges.

TABLE A
Summary of Settled Audit Findings Resulting in Changes to
the 2005 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 2004 which affected the 2005 Statement of Charges. A more detailed description of these items starts on page 26.

Items	Effect on Metropolitan's 2005 Costs Increase (Decrease)
1. Previously unrecorded wheeling water transaction credits totaling \$4,724,000 have been recorded in the cost accounting system (refer to pages 26 and 27).	\$ (950,000)
2. Los Angeles Department of Water and Power (LADWP) peaking charges for 2002 were properly included in the computation of the variable component (refer to page 27).	(547,000)
3. Credits for FERC relicensing costs totaling \$637,000 for 2000 to 2003 that were improperly excluded from the calculation of the Delta Water Charge have been included (refer to page 27).	(16,000)
4. Costs totaling \$956,000 have been allocated in the accounting system and included in the transportation and Delta Water Charge components (refer to page 27).	43,000
5. Fish loss costs totaling \$757,000 were properly included in the Delta Water Charge calculation (refer to page 27).	48,000
6. A cost center, with costs totaling \$612,000, has been properly allocated to the variable instead of the minimum component (refer to page 27).	544,000
7. Municipal Water Quality Investigation costs for 2000 to 2003 were included in the transportation minimum component (refer to page 28).	<u>999,000</u>
NET BENEFIT	<u>\$ 121,000</u>

TABLE B
Summary of Audit Findings Projected to Result in Changes to
the 2006 Statement of Charges

Throughout our examination, we worked with Department and Metropolitan representatives to resolve findings which arose during our audit of the 2005 Statement of Charges. We will work with the Department to ensure the correction of these findings in the 2006 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 2006 Costs Increase (Decrease)</u>
1. Hyatt-Thermalito operating costs for 1998 through 2003, included in the computation of the variable charges, are overstated by \$7,953,000 and credits for Hyatt-Thermalito operating costs included in the Delta Water Charge are understated by \$7,952,000 (refer to page 28).	\$ (5,558,000)
2. The downstream distribution entries to reallocate costs were not updated for current cost and water information (refer to page 28).	(4,183,000)
3. Construction contract retention cost centers were improperly assessed and included in the minimum component (refer to page 28).	(1,699,000)
4. Rate management credits for 2003 through 2005 were allocated using a Table B-15 that erroneously included costs associated with transfers of entitlement (refer to page 29).	(1,178,000)
5. Outdated debt service amounts were used to determine the Devil Canyon Second Afterbay charges for 2000 to 2002 and 2004 to 2005 in the variable component (refer to page 29).	(1,128,000)
6. Power costs and revenues, transmission, station service, and peaking costs totaling \$9,770,000 for 1999 through 2003 were not recorded or were recorded incorrectly in the accounting system (refer to page 29).	(1,624,000)
7. The LADWP's estimated peaking payment of \$554,000 and \$530,000 for 2004 and 2005, respectively, were not included in the computation of the unit rates (refer to page 29).	(1,084,000)
8. Adjustments related to 1963 to 2035 Thermalito Diversion Dam Powerplant capital credits totaling \$34 million were erroneously excluded from the 2005 Delta Water Rate computation (refer to page 29).	(910,000)

Items	Effect on Metropolitan's 2006 Costs Increase (Decrease)
9. Power costs are overstated and recovery generation credits are understated due to incorrect 2004 Mojave Siphon and 2002 Alamo mill rates (refer to page 30).	\$ (732,000)
10. Final energy costs for 1998 were not recorded or were recorded incorrectly in the bills (refer to page 30).	(625,000)
11. Credits totaling \$1,192,000 for wheeling water transactions were not recorded in the cost accounting system (refer to page 30).	(255,000)
12. The Department used outdated Hyatt-Thermalito cost estimates in the variable and the Delta Water Charge components for 2004 through 2035 (refer to page 30).	(175,000)
13. Historical conservation costs totaling \$772,000 were deducted from the replacement account and billed through the Delta Water Charge component (refer to pages 30 and 31).	(26,000)
14. Recovery generation credits for San Luis, Devil Canyon and Warne Powerplants for 1998 are misstated by \$396,000 (refer to page 31).	(13,000)
15. Costs totaling \$107,000 related to a publication on delivery capabilities of the State Water Project are recorded incorrectly in the accounting system (refer to page 31).	39,000
16. Water deliveries totaling 19,208 acre-feet for the 1978 and 1982 exchange agreements were erroneously excluded twice from the 2000 variable component (refer to page 31).	66,000
17. Replacement expenditures at Banks were excluded from the Delta Water Charge (refer to pages 31 and 32).	67,000
18. Debt service amounts for the Tehachapi Second Afterbay were erroneously excluded from the calculation of the 2005 variable component (refer to page 32).	148,000
19. Certain cost centers are not properly mapped to the CARA system, excluding costs totaling \$5,362,000 from the Statement of Charges (refer to page 32).	221,000
20. Costs totaling \$3,182,000 were not allocated in the accounting system and were improperly excluded from the transportation minimum and Delta Water Charge components (refer to page 32).	584,000
21. Costs incurred at the Oroville facilities associated with FERC relicensing for 2000 to 2003, included in the transportation variable charges, are understated by \$792,000 (refer to page 32).	634,000

<u>Items</u>		<u>Effect on Metropolitan's 2006 Costs Increase (Decrease)</u>
22.	Incorrect wheeling credit and contractor payment amounts were used in the variable fish replacement charge calculation (refer to page 32).	<u>\$ 989,000</u>
	NET BENEFIT	<u>\$ (16,442,000)</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 33.

<u>Items</u>	<u>Effect on Metropolitan's Costs Increase (Decrease)</u>
1. Outdated cost estimates were used in the calculation of the 2003 off-aqueduct charges, resulting in an overstatement of Metropolitan's charges (refer to page 34).	\$ (1,287,000)
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 page 34).	(655,000)
3. Certain Coastal Branch capital cost repayment amounts were excluded from the computation of the 2000 WSRB Surcharge (refer to page 34).	(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 pages 34 and 35).	(526,000)
5. Outdated debt service schedules were used in the calculation of the 1999 off-aqueduct charges (refer to page 35).	(4,000)
6. Outdated debt service schedules were used in the calculation of the 2001 off-aqueduct charges, resulting in an overstatement of Metropolitan's charges (refer to page 35).	<u>(2,000)</u>
NET BENEFIT	<u>\$ (3,106,000)</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 2005 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-four 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 2005 Statement of Charges are summarized in Table A on page 21, those projected to be reflected in the 2006 Statement of Charges are summarized in Table B on pages 22 to 24 and those that will affect credits, refunds and adjustments are summarized in Table C on page 25.

Findings Resulting in Changes to the 2005 Statement of Charges:

- 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 a number of deliveries were either unbilled or billed but unrecorded and, therefore, had been excluded from the variable billings to the entitlement

contractors. In the preparation of the 2005 Statement of Charges, \$4,724,000 of these wheeling transaction were billed and credited to the cost accounting system, resulting in a reduction of power costs allocated to the water contractors; accordingly, various components of Metropolitan's 2005 Statement of Charges are reduced by \$950,000. (TABLE A, Item 1)

- Our prior year reconciliation of the 2002 power costs disclosed that the LADWP peaking capacity payment of \$587,000 for 2002 was not recorded in the accounting system. The Department corrected this error and, as a result, Metropolitan's variable component in the 2005 Statement of Charges decreased by \$547,000. (TABLE A, Item 2)
- The FERC relicensing costs related to the Hyatt-Thermalito Powerplant totaling \$637,000 for 2000 through 2003 were improperly included in the calculation of the 2004 Delta Water Charge, instead of the variable component, because the offsetting credits to remove these costs were erroneously excluded from the computation. We noted that the credits related to the FERC costs for these years were properly recorded in the 2005 Delta Water Rate computation, resulting in a decrease to Metropolitan's Delta Water Charge component by \$16,000 in the 2005 Statement of Charges. (TABLE A, Item 3)
- We noted that costs totaling \$956,000 for 2001 and 2002 that in the 2004 Statement of Charges were excluded from the calculation of the transportation capital and Delta Water Charge capital components as a result of costs not being allocated properly within the SAP system, have been properly settled and included in the contractor billings for 2005. As a result, Metropolitan's transportation capital component and Delta Water Charge capital component have increased by \$28,000 and \$15,000, respectively, in the 2005 Statement of Charges. (TABLE A, Item 4)
- Due to the incorrect posting of an adjustment related to a 1987 fish loss charge in the prior year, conservation costs included in the 2004 Delta Water Charge calculation were understated. The Department corrected this error and, as a result, Metropolitan's Delta Water Charge increased by \$48,000 in the 2005 Statement of Charges. (TABLE A, Item 5)
- In our prior year audit, we noted that a cost center used to reallocate variable costs was coded in such a way that these costs, which total \$612,000, were billed through the minimum component instead of through the variable component. This error has been corrected in the 2005 Statement of Charges, resulting in a decrease in Metropolitan's minimum component of \$415,000 and an increase in the variable component of \$959,000. (TABLE A, Item 6)

- The entries to allocate costs for 2000 to 2003 Municipal Water Quality Investigations were excluded from the 2004 Statement of Charges, but were properly included in the 2005 Statement of Charges. The addition of these costs results in an increase of \$999,000 in Metropolitan's transportation minimum component. (TABLE A, Item 7)

Findings Projected to Result in Changes to the 2006 Statement of Charges:

- 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 \$1,616,000. The 1999 through 2003 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 \$2,660,000, \$1,105,000, \$826,000, \$1,105,000 and \$641,000, respectively, due to the Department not using actual O&M costs. Actual cost information had not yet been summarized by the accounting staff and provided to SWPAO due to the information not being easily available in SAP. The effect of these errors is to overstate Metropolitan's variable and minimum components by \$5,751,000 and \$87,000, respectively, and to understate Metropolitan's Delta Water Charge by \$280,000 in the 2005 Statement of Charges. The Department has indicated that the 1999 through 2003 amounts will be updated when final power allocations are performed for these years. (TABLE B, Item 1)
- As discussed in the Unresolved Issues section of this report, the Department has been unable to calculate 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 water table redistribution entries for 2003 were calculated using water data for 2002, resulting in the understatement of the variable component by \$1,586,000, an overstatement of the minimum component of \$5,868,000 and an understatement of the Delta Water Charge of \$99,000 in the 2005 Statement of Charges. The Department expects to make the revisions in the 2006 Statement of Charges. (TABLE B, Item 2)
- In our prior year audit we determined that cost centers for retentions on contracts payable for 1999 totaling \$2,817,000 were erroneously included in the SAP assessment process. These costs were also included in contractor billings when the expenditures were initially incurred in 1999. The Department concurred with this error and made the appropriate adjustment in September 2003; however, the revised amounts were not used in the calculation of the 2005 Statement of Charges. As a result of this error, Metropolitan's transportation minimum component is overstated by \$1,699,000 in the 2005 Statement of Charges. (Table B, Item 3)

- For purposes of computing the rate management credits, the Monterey Amendment states that the transportation capital cost component repayment obligation shall be based on the transportation capital costs in Bulletin 132-99, Table B-15, excluding any costs associated with transfers of entitlement. The Department calculated the rate management credits for 2003 through 2005 using a Table B-15 that included costs associated with the additional downstream capacity of water transfers, resulting in an understatement of Metropolitan's rate management credits by \$1,178,000. The Department plans to correct the rate management credits in the 2006 Statement of Charges. (TABLE B, Item 4)
- We compared the Devil Canyon Second Afterbay Charges for debt service included in the variable component to the debt service schedule and noted a discrepancy of \$13,000 for 2000, \$258,000 for 2002, \$400,000 for 2004 and \$790,000 for 2005 due to the use of an outdated debt service schedule. As a result, Metropolitan's variable component in the 2005 Statement of Charges is overstated by \$1,128,000. We informed the Department and they plan to make the appropriate corrections in the 2006 Statement of Charges. (Table B, Item 5)
- Power costs totaling \$753,000 and sales totaling \$1,545,000 for 1999 through 2003, were not recorded or were recorded incorrectly in the accounting system. In addition, transmission costs of \$488,000 and station service costs totaling \$49,000 for these years were not recorded properly in the accounting system. These errors result in an overstatement of Metropolitan's variable, minimum and Delta Water Charge components by \$1,245,000, \$376,000 and \$3,000, respectively. (TABLE B, Item 6)
- During our audit of the 2005 Statement of Charges, we determined that the Department excluded the LADWP 2004 and 2005 peaking capacity payments from the variable unit rate calculation. The impact to Metropolitan of the exclusion of these amounts is to overstate the 2004 and 2005 calculated components by \$554,000 and \$530,000, respectively, in the 2005 Statement of Charges. The Department has indicated that this error will be corrected when the unit rates are revised in January of 2005. (TABLE B, Item 7)
- Thermalito Diversion Dam Powerplant capital credits totaling \$34 million for 1963 to 2035, intended to reduce Oroville Division minimum costs, were again erroneously excluded from the 2005 Delta Water Rate computation. This error results in a \$910,000 overstatement in Metropolitan's Delta Water Charge in the 2005 Statement of Charges. We have notified the Department of this error so that a correction can be made in the 2006 Statement of Charges. (TABLE B, Item 8)

- The Department used outdated mill rates when valuing the recovery generation at Mojave Siphon and Alamo Powerplants. As a result of using an outdated mill rate, the value of recovery generation for the Mojave Siphon Powerplant for 2004 is overstated by \$777,000 and for the Alamo Powerplant for 2002 it is overstated by \$97,000. The effect to Metropolitan is an overstatement of the transportation variable component of \$739,000 and an understatement of the transportation minimum component of \$7,000 in the 2005 Statement of Charges. These errors are expected to be corrected when final power allocations are completed. (TABLE B, Item 9)
- During our reconciliation of the final 1998 energy, transmission and station service costs, we noted that power costs are overstated by \$1,979,000, power sales are understated by \$275,000, transmission costs are understated by \$293,000, station service costs are overstated by \$103,000, and Coastal Branch power costs are understated by \$680,000 due to the use of outdated information. These errors resulted in an overstatement of Metropolitan's variable and Delta Water Charge components by \$661,000 and \$3,000, respectively, and an understatement of the minimum component by \$39,000 in the 2005 Statement of Charges. Because of the difficulty in revising costs in SAP prior to 1999, the Department has indicated that they do not plan to make corrections for these errors. However, because of their significance, we will propose that the Department make these corrections. (TABLE B, Item 10)
- Our examination of the 2002 and 2003 wheeling transactions revealed a number of unbilled charges related to the wheeling of non-entitlement water because the contracts have not been finalized and provided to accounting staff. As a result, the cost of these transactions, which we estimate to be \$1,192,000, were not credited to the cost accounting system, resulting in an overstatement of power costs allocated to the water contractors. The impact of this overstatement on Metropolitan's 2005 Statement of Charges is approximately \$255,000. The Department is aware of these unbilled charges and has indicated that they will be recorded when the cash is received. (TABLE B, Item 11)
- The Department included outdated Hyatt-Thermalito cost estimates for 2004 to 2035 in the computation of the variable and Delta Water Charge components. As a result, Metropolitan's variable charge is understated by \$306,000 and the Delta Water Charge component is overstated by approximately \$481,000, respectively, in the 2005 Statement of Charges. We have notified the Department of this error so that a correction can be made in the 2006 Statement of Charges. (TABLE B, Item 12)
- In 1978 and 1982, Metropolitan entered into exchange agreements with Kern County Water Agency and the Department that required Metropolitan to store 25,000 and 9,494 acre-feet for delivery to Kern

prior to May 31, 1992. Metropolitan delivered 3,453 acre-feet under the 1978 agreement and 6,171 acre-feet under the 1982 agreement, leaving a balance of 24,870 acre-feet not delivered. In 2000, Metropolitan delivered the 24,870 acre-feet of previously undelivered 1978 and 1982 exchange water to Kern, which released Metropolitan from any monetary obligation. However, the Department erroneously included 19,208 acre-feet of these deliveries in the 2000 calculated component of Metropolitan's variable billing. In our audit of the 2005 Statement of Charges, we determined that the Department removed these deliveries twice, which results in an understatement of Metropolitan's variable component by \$66,000 in the 2005 Statement of Charges. We will provide the Department with our analysis so that they can include these deliveries for the 2006 Statement of Charges. (TABLE B, Item 13)

- Because of the incorrect coding of one cost center, conservation replacement costs totaling \$772,000 have been improperly included in the 2005 Delta Water Charge, which results in the overstatement of Metropolitan's 2005 Delta Water Charge by \$26,000. We will work with the Department to ensure corrections are made during the preparation of the 2006 Statement of Charges. (TABLE B, Item 14)
- The value of recovery generation for the San Luis and Warne Powerplants for 1998 were overstated by \$457,000 and \$14,000, respectively, and Devil Canyon recovery generation is understated by \$75,000, due to the use of outdated information. The effect to Metropolitan is to overstate the transportation variable and transportation minimum components by \$25,000 and \$5,000, respectively, and understate the Delta Water Charge by \$17,000 in the 2005 Statement of Charges. Because of the difficulty in revising costs in SAP prior to 1999, the Department has indicated that they do not plan to make corrections for these errors. However, because of the significance of the various adjustments related to 1998 charges, we will propose that the Department make these corrections. (TABLE B, Item 15)
- Costs totaling \$107,000 associated with the preparation of a public report on the delivery capabilities of the State Water Project were incorrectly assigned to a capital cost object. This error resulted in a \$3,000 overstatement of Metropolitan's 2005 transportation capital component and a \$42,000 understatement of Metropolitan's 2005 transportation minimum component. The Department indicated that this error will be corrected in the 2006 Statement of Charges. (TABLE B, Item 16)
- In the calculation of the conservation replacement Delta Water Rate, the Department included only Oroville replacement cost estimates and not other conservation replacement costs. The Department has estimated \$138,000 of replacement costs associated with Banks Pumping Plant, which were not included in the Delta Water Charge. Metropolitan's 2005 Delta Water Charge is understated by

\$67,000 as a result of the exclusion of these costs. We will monitor this situation to ensure the amounts are billed in the future. (TABLE B, Item 17)

- We noted that the Tehachapi Second Afterbay charges for debt service totaling \$185,000 were not included in the calculation of the 2005 variable component. As a result, Metropolitan's variable component in the 2005 Statement of Charges is understated by \$148,000. We have notified the Department of this omission. (TABLE B, Item 18)
- We noted that costs totaling \$5,362,000 for 2001 to 2003 were excluded from the calculation of the transportation capital and minimum components, as a result of certain cost centers not being mapped to the CARA system. As a result, Metropolitan's transportation capital and minimum components are understated by \$221,000 in the 2005 Statement of Charges. We have notified the Department of the cost centers that need to be corrected. (TABLE B, Item 19)
- We noted that costs totaling \$3,182,000 for 2002 and 2003 were excluded from the calculation of the transportation minimum and Delta Water Charge minimum components as a result of costs not being allocated properly within the SAP system. As a result, Metropolitan's transportation minimum component and Delta Water Charge component are understated by \$480,000 and \$104,000, respectively, in the 2005 Statement of Charges. We have notified the Department of the cost centers that need to be corrected. (TABLE B, Item 20)
- FERC relicensing costs related to Oroville facilities for 2000 through 2003, included in the computation of the variable component, are understated by \$792,000 due to the use of outdated costs. As a result, Metropolitan's variable component is understated by approximately \$634,000. This error will be corrected when the final power allocations are completed for these years. (TABLE B, Item 21)
- Our audit of the Department's variable fish replacement computation disclosed that actual contractor payment amounts were not used in calculating the fish replacement charges and wheeling credits were outdated or excluded from the computation. Metropolitan's 2004 variable component included in the 2005 Statement of Charges is understated by \$989,000 as a result of these errors. We will continue to work with the Department to correct the fish replacement charge calculation for the 2006 Statement of Charges. (TABLE B, Item 22)

Findings Resulting in Credits, Refunds and Adjustments:

- The preliminary year-end allocation of 2003 off-aqueduct costs, prepared by the Department in 2003, did not include actual costs for Reid Gardner fuel or O&M. The omission of these items resulted in an overstatement of Metropolitan's charges by \$1,287,000. The outdated cost information will be corrected when the Department prepares the final year-end allocation of 2003 off-aqueduct costs. (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 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 2005. (TABLE C, Item 4)

- The revised year-end allocation of 1999 off-aqueduct charges, prepared by the Department in 2003, included outdated debt service amounts for Bottle Rock and South Geysers. This error resulted in an overstatement of Metropolitan's share of 1999 off-aqueduct costs by \$4,000. We have communicated these errors to the Department so that revisions can be made. (TABLE C, Item 5)

- The revised year-end allocation of 2001 off-aqueduct costs, prepared by the Department in 2003, used outdated debt service schedules in the revised year-end allocation. As a result, Metropolitan's 2001 off-aqueduct charges costs are overstated by \$2,000. We anticipate that these errors will be corrected when the Department prepares a revised year-end allocation of the 2001 off-aqueduct charges in 2005.
(TABLE C, Item 6)