

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

December 13, 2005 Board Meeting

8-2

Subject

Authorize payments for (1) calendar year 2006 charges for water from the State Water Project under terms of water supply contracts with the Department of Water Resources; and (2) the 2003 Exchange Agreement with Desert Water Agency and Coachella Valley Water District

Description

Pursuant to Section 5112 of the Metropolitan Water District Administrative Code, the Board must approve payments for the State Water Contract. This letter requests authorization to pay the 2006 Statement of Charges for Metropolitan's State Water Project entitlement and to pay the Desert Water Agency and Coachella Water District for State Water Project supplies pursuant to the 2003 transfer and exchange agreement with those agencies. For calendar year 2006, the combined total of Metropolitan's Table A and the exchange agreement is \$581 million. The breakdown of the charges is included in [Attachment 1](#).

Analysis of State Water Project CY 2006 Statement of Charges

Metropolitan's independent auditor, Richardson and Company, has completed an audit of the CY 2006 Statement of Charges and determined that these charges comply with the terms and conditions of the SWP contract. [Attachment 2](#) summarizes the results of the audit.

A comparison of CY 2005 and 2006 Statement of Charges is detailed in [Attachment 3](#). A comparison with last year's charges is as follows:

- \$2 million decrease in Power (variable and off aqueduct) charges. Power charges are \$2 million less than the 2005 Statement of Charges. Metropolitan's share of off-aqueduct charges is \$4 million less than last year as DWR shifts charges to other contractors whose share of energy for water deliveries have increased. The \$4 million is offset by \$2 million due to reduced power sales expected for the SWP generation system.
- \$10 million increase in Minimum Operations, Maintenance, Power, and Replacement (OMP&R) charges. Metropolitan's CY 2006 minimum charges are \$26 million more than shown in 2005 as a result of slightly higher operating costs and a large reduction in the adjustment for overpayment of prior years' charges. The transfer of Table A water to Desert and Coachella reduces CY 2006 charges by \$16 million.
- \$6 million decrease in Capital charges. CY 2006 Capital charges are less than the 2005 Statement of Charges. This is due to the Table A transfer that lowered charges by \$9 million, and an additional \$2 million for the Rate Management Rebate that further lowered charges. Metropolitan's share of the Monterey Amendment Rate Management Rebate is unaffected by the Table A transfer to Desert and Coachella. These reductions are offset by \$5 million more in charges due to scheduled increases in debt service and for additional facilities, mainly in the Delta.

Improved State Water Project Cost Management Practices

One of Metropolitan's State Water Project initiatives is to improve DWR's business process. As a response to Metropolitan's and other State Water Contractors' requests for more stable power costs, the Department of Water Resources has started gas price hedging activities for that portion of their power portfolio that is based on the price of natural gas. DWR has also developed power risk management policies and procedures to guide staff and

are working with the Contractors to oversee the hedging activities. Approximately 20 percent of the SWP energy portfolio is based on the price of gas.

Analysis of CY 2005 and 2006 Recalled Table A Water from Desert and Coachella

As a result of the QSA negotiations, Metropolitan transferred 100,000 AF of Metropolitan's State Water Project Table A water to Desert and Coachella. Under the terms of the agreement, Metropolitan retains annual options to recall the water and pay all associated costs. The payment for water recalled in CY 2005 is up to \$35 million, as set out in **Attachment 4**. In April 2005, Metropolitan exercised the option to recall the water for CY 2005. CY 2005 was a transition year for implementing this agreement by the Department of Water Resources. Recalling the water in CY 2005 left Metropolitan's charges unchanged as DWR included the costs in Metropolitan's 2005 Statement of Charges.

In order to ensure consistency in the SWP cost allocation system, DWR credited Metropolitan with costs associated with the CY 2005 recalled water and increased the charges to Desert and Coachella by an equal amount. In CY 2006, Desert and Coachella will invoice Metropolitan \$35 million, \$26 million for the CY 2005 fixed cost of recalled water along with the actual power costs of approximately \$9 million for the delivered water.

Approval is also sought to pay Desert and Coachella up to \$40 million for CY 2006 recalled Table A water. In the event Metropolitan elects to exercise its option in CY 2006 to recall up to 100,000 acre-feet of SWP water, Desert and Coachella will invoice Metropolitan for fixed costs of \$31 million and variable power costs of up to \$9 million.

In the future, each year's request to authorize payment of the Statement of Charges will also include authorization to pay Desert and Coachella. While authorization is requested to pay for these supplies, Metropolitan would not elect to recall the water and would not incur payment if water conditions are favorable. In that case, Desert and Coachella would pay DWR for all costs associated with 100,000 acre-feet of Table A water.

FY 2005/06 Budget

The 2005/06 budget for State Water Project costs was based on the 2005 Statement of Charges, estimates of the cost of power and the assumption that Metropolitan would recall the transfer from Desert and Coachella. The budget totals \$380 million. Through the first five months of the year, it is anticipated that actual costs will be \$49 million higher due to power. Actual expenditures in 2005/06 will be dependent on water received (if Metropolitan takes less water than projected, power charges will be lower) and a determination regarding recalling Desert and Coachella water in 2006. Typically, Metropolitan receives refunds and credits that range between \$30 million and \$40 million annually that reduce each year's charges. Estimates of these refunds and credits are incorporated into the budget, and actual credits may be higher or lower than estimated.

Policy

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

California Environmental Quality Act (CEQA)

CEQA determination for Staff Recommendation:

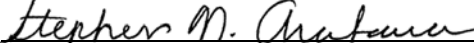
The proposed action is not defined as a project under CEQA because it involves continuing administrative activities, such as general policy and procedure making (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government 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 authorize payments up to a total of \$581 million, with up to a total of \$506 million to the Department of Water Resources and up to \$75 million to Desert Water Agency and Coachella Valley Water District for 2005 and 2006 recall water.

Fiscal Impact: Maximum payments in CY 2006 of up to a total of \$581 million. Net calendar year payments should be lower because of credits, refunds, and adjustments that are not included in the annual Statement of Charges. Fiscal year costs will vary with actual energy costs.



Stephen N. Arakawa
Manager, Water Resource Management

12/1/2005

Date



Debra C. Man
Interim CEO/General Manager

12/1/2005

Date

Attachment 1 – Requested Authorization for CY 2006 State Water Project Deliveries

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

Attachment 3 – Comparison of Metropolitan’s Statement of Charges for CY 2005 and CY 2006

Attachment 4 – Additional Charges for CY 2005 Desert and Coachella's 100,000 AF of Table A Water

**Requested Authorization
for CY 2006 State Water Project Deliveries
(\$ millions)**

Statement of Charges	506
2005 DWCV Recall	35
2006 DWCV Option	40
Total Charges	581

**THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA**

**SUMMARY REPORT ON THE
AUDIT OF THE 2006 STATEMENT OF CHARGES**

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

SUMMARY REPORT ON THE
AUDIT OF THE 2006 STATEMENT OF CHARGES

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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 2006 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 2006 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, 2005

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

2006 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	\$187,915,785	\$ 71,281,057	\$ 48,969,841 2/	\$ 308,166,683
Off-Aqueduct Power Facilities Charge 1/		71,442,683		71,442,683
Delta Water Charge		28,166,493	19,438,586 2/	
East Branch Enlargement		4,317,052	27,822,578	32,139,630
Water System Revenue Bond Surcharge			34,565,228	34,565,228
Tehachapi Second Afterbay Facilities			206,995	206,995
<u>DEVIL CANYON - CASTAIC CONTRACT</u>				
Operations and maintenance - Article 17(b)		4,656,931		4,656,931
Debt service on bonds - Article 17(a)			7,466,502	<u>7,466,502</u>
			TOTAL 3/	<u>\$ 506,249,731</u>

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

- 1/ Based on a water delivery schedule of 1,911,500 acre-feet.
- 2/ Amounts include Urban Rate Reduction credits of \$7,888,060 in the Transportation Charge and \$3,792,860 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 METR OPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
COMPARISON OF THE 2005 AND 2006 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		
2005 Statement of Charges	\$ 66,608	\$ 67,218	\$ 75,033	\$ 185,932	\$ 20,127	\$ 28,518	\$ 24,266	\$ 2,605	\$ 33,839	\$ 504,146
Increase (decrease) due to changes in:										
Estimated costs	(27)	4,390	3,996	(14,934)	971	2,671		393		(2,540)
Past cost adjustments	(2,008)	19,588		5,345	17	20	(4,392)	1,319		19,889
Change in debt service			16				7,949		2,449	10,414
Power sales				16,121						16,121
Recovery generation credit				(4,548)		(1,625)				(6,173)
Allocations among contractors			(7,602)							(7,602)
Rebates under Monterey Amendment	(1,322)				(512)					(1,834)
Entitlement transfer	(6,608)	(15,258)			(1,164)	(1,418)			(1,723)	(26,171)
NET CHANGE	<u>(9,965)</u>	<u>8,720</u>	<u>(3,590)</u>	<u>1,984</u>	<u>(688)</u>	<u>(352)</u>	<u>3,557</u>	<u>1,712</u>	<u>726</u>	<u>2,104</u>
2006 Statement of Charges dated July 1, 2005	<u>\$ 56,643</u>	<u>\$ 75,938</u>	<u>\$ 71,443</u>	<u>\$ 187,916</u>	<u>\$ 19,439</u>	<u>\$ 28,166</u>	<u>\$ 27,823</u>	<u>\$ 4,317</u>	<u>\$ 34,565</u>	<u>\$ 506,250</u>

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

East Branch Capital: The East Branch Enlargement capital component increased by \$3.6 million as a result of increased debt service costs of \$8 million, which is offset by \$4.4 million in past cost adjustments. The increase in debt service costs of \$8 million is due to a scheduled principal payment on Series Y of \$7.4 million in 2006, whereas there was no principal payment required in 2005. In addition, the Department issued Series AC Water System Revenue Bonds after the 2005 Statement of Charges was issued, for which a \$1.4 million interest payment is scheduled to be made in 2006. The \$4.4 million decrease as a result of past adjustments are due to revisions to the debt service schedules. These schedules reflected decreased debt service costs for 2002 and 2003 by \$1.1 million as a result of the bond refunding during 2005 and the reallocation of 2004 and 2005 debt service amounts to Devil Canyon Second Afterbay, which is recovered under the variable component, causing debt service costs allocated to Metropolitan's East Branch Enlargement Capital component to decrease by \$3 million.

Our audit of the East Branch Enlargement capital component disclosed that the amount of debt service costs for 2005 used in the Statement of Charges was \$6,003,000 higher than the debt service schedule because the 25% debt cover was not properly removed in the determination of the Statement of Charges. As a result, Metropolitan's East Branch Enlargement capital component is overstated by \$4,822,000. The Department will make the appropriate corrections in the 2007 Statement of Charges.

East Branch Enlargement Minimum: The East Branch Enlargement minimum component increased by \$1.7 million primarily due to a \$1.3 million increase in the past cost adjustment and \$.4 million due to increased O&M costs from 2005 to 2006. The 2006 Statement of Charges included a \$.9 million under payment due to changes in cost estimates for 2003 through 2005, whereas the 2005 Statement of Charges had included an overpayment of \$.4 million.

Water System Revenue Bond Surcharge: The \$.7 million increase in the Water System Revenue Bond Surcharge consists of an increase of \$2.4 million due to increased debt service costs, which is offset by a decrease of \$1.7 million due to Metropolitan's transfer of 100,000 acre-feet of entitlement to Desert and Coachella Water Agencies. The increased debt service costs are the result of higher scheduled debt service payments in 2006 for Series S, U and Y, compared to the scheduled payments for 2005.

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

Transportation Capital: The decrease of \$10.0 million in the transportation capital component is primarily due to a \$6.6 million decrease in the 2006 calculated component resulting from the transfer of 100,000 acre-feet of entitlement water. In addition, there was an increase in the past cost adjustment

We also noted a discrepancy of \$23.3 million in the amounts used in the projection for the cost of recovery generation included as a power source compared to the recovery generation credits included as a power use. Typically these amounts are the same. The amount shown as costs were less than amounts shown as credits, which could understate Metropolitan's variable component by \$14.4 million, assuming the amounts shown as credits are correct and no other estimates are affected by this discrepancy, such as power purchases.

The past cost adjustment increased by \$5.3 million primarily due to the following:

- Metropolitan's calculated components for 2000 through 2002 increased \$1.7 million due to the correction of the recording of power costs and sales transactions and payment amounts.
- Metropolitan's 2004 variable charges increased by \$.8 million primarily as a result of replacing estimated cost and payment amounts with actual cost and payments amounts. Metropolitan's 2004 payment amount was adjusted to actual, which results in an increase of \$60.8 million in the variable charges. The calculated component decreased \$60 million, thereby reducing the variable charges. This decrease in the calculated component is due primarily to a decrease of \$36.2 million due to the actual power costs being lower than the amount estimated in the prior year and a lower amount of energy required by the pumping plants than previously estimated. Metropolitan's calculated component was further reduced by \$23.8 million as a result of Metropolitan's actual water deliveries for 2004 being 681,418 acre-feet less than the amount estimated in the prior year.
- The 2005 payments were less than the calculated component as a result of prior cost adjustments, which increased the past cost adjustment by \$2.7 million.

Transportation Minimum: The increase of \$8.7 million in the transportation minimum component is due to a \$4.4 million increase in cost estimates and a \$19.6 million increase in past cost adjustments, which were partially offset by a \$15.3 million decrease due to Metropolitan's entitlement transfer. The total increase of \$8.7 million is due primarily to the following increases and decreases:

- The 2005 Statement of Charges included a \$24.2 million underpayment due to revisions to 2004 and prior year costs, which causes an increase of this amount when compared to the 2006 Statement of Charges.
- Changes in cost estimates for 2005 and 2006 resulted in a \$4.4 million increase in Metropolitan's transportation minimum component. As a result of the Department updating its O&M cost

estimates using the previous three years of historical cost information, escalated by 3%, Metropolitan's share of the transportation minimum costs for 2005 and 2006 increased by \$3 million. In addition, the Department reduced its estimate of extraordinary O&M activities for 2005, which reduced Metropolitan's 2006 Statement of Charges by \$.5 million. The Department also increased its extraordinary O&M cost estimates for 2006, which increased Metropolitan's 2006 Statement of Charges by \$1.8 million. These changes are due to eliminating the planned extraordinary O&M activities at Pearblossom and Edmonston Pumping Plants totaling \$2.9 million for 2005 and adding costs totaling \$2.5 million in 2005 and \$5 million in 2006 to recoat discharge lines at Teerink Pumping Plant and costs totaling \$2.7 million for 2005 and \$3 million for 2006 to overhaul Units at Chrisman and Edmonston Pumping Plants.

- The Department increased its estimate of power planning costs by \$14 million in the 2006 Statement of Charges. Included in this increase is \$12 million for the SAP migration project, which is to upgrade the current SAP system. The total cost of this project, including DWR staff costs, is estimated at \$22 million. The 2006 estimates also include increases for the aqueduct control system centralized operations migration project, expected to cost \$14.7 million through fiscal year 2008, and the business process evaluation project, expected to cost \$7 million through fiscal year 2008. As a result, of these items Metropolitan's transportation minimum component increased by \$3.9 million in the 2006 Statement of Charges.
- The actual transportation minimum costs incurred for 2004 were approximately \$6 million less than the amounts estimated in the 2005 Statement of Charges, which resulted in an decrease in Metropolitan's charge of approximately \$2.7 million.
- For the 2004 and 2005 Statement of Charges, the Department had incorrectly posted retention payments totaling \$2.8 million, which resulted in the contractors being billed twice for these costs. The Department removed these retention payments from the 2006 Statement of Charges, which resulted in a \$1.7 million decrease to Metropolitan's transportation minimum component.
- The impact of an additional year of interest on the prior over and underpayments results in a \$1.1 million decrease in Metropolitan's transportation minimum component.
- The Department included \$1 million in settlement costs as a result of litigation related to the Monterey Amendment for 2006 in the 2006 Statement of Charges, whereas the 2005 settlement amount was \$2.8 million. Metropolitan's share of the 2006 settlement costs was \$.5 million, which was \$.8 million lower than the amount included in the 2005 Statement of Charges.

- Metropolitan's transportation minimum component decreased by \$.4 million as a result of corrections and adjustments the Department made for the Municipal Water Quality Investigation program.
- During the past year, the Department received payments totaling \$.8 million related to the wheeling of non-entitlement water and the lease of State Water Project land. The Department posted entries in the accounting system to record credits for these amounts during 2005, which resulted in a \$.3 million decrease in Metropolitan's transportation minimum component.
- Metropolitan's transportation minimum component increased by \$.5 million as a result of water loss redistribution entries made for 2000 to 2003 as a result of the Department updating its power cost allocations for these years. The Department's estimate of water losses for 2004, 2005 and 2006 were \$.8 million lower in the 2006 Statement of Charges due to changes in power and water cost estimates related to the downstream distribution of costs and updating 2004 from estimates to actual power and water costs. These changes resulted in a net \$.3 million decrease in Metropolitan's transportation minimum component.
- Although estimated transmission costs for 2005 and 2006 increased by a total of \$1.8 million for both years, this increase appears to be due to the addition of transmission charges for the East Branch Extension, which are not allocated to Metropolitan. Metropolitan's share of transmission costs decreased by \$.2 million in the 2006 Statement of Charges primarily due to transmission costs being assigned to slightly different reaches this year, resulting in the reallocation of costs from Metropolitan to the other contractors.

As a result of Metropolitan's transfer of 100,000 acre-feet of water to Desert and Coachella Valley Water Agencies, the Department revised the proportionate use of facilities factors beginning in the 2006 Statement of Charges. However, the Department made the transfer effective as of January 1, 2005. As a result, the past cost adjustment decreased by \$7.6 million as a result of the factor changes for 2005 and the 2006 calculated component decreased by \$7.6 million in the 2006 Statement of Charges. Metropolitan staff have had discussions the Department regarding the expectation that the transfer would be effective as of January 1, 2006 instead of 2005. The Department has indicated that they do not plan to revise the Statement of Charges and that Metropolitan would need to pay Desert and Coachella for the additional costs billed to Desert and Coachella for 2005 related to the water transfer. Metropolitan has requested from the Department the information needed to determine the amounts owed to Desert and Coachella.

East Branch Capital: The East Branch Enlargement capital component increased by \$3.6 million as a result of increased debt service costs of \$8 million, which is offset by \$4.4 million in past cost adjustments. The increase in debt service costs of \$8 million is due to a scheduled principal payment on Series Y of \$7.4 million in 2006, whereas there was no principal payment required in 2005. In addition, the Department issued Series AC Water System Revenue Bonds after the 2005 Statement of Charges was issued, for which a \$1.4 million interest payment is scheduled to be made in 2006. The \$4.4 million decrease as a result of past adjustments are due to revisions to the debt service schedules. These schedules reflected decreased debt service costs for 2002 and 2003 by \$1.1 million as a result of the bond refunding during 2005 and the reallocation of 2004 and 2005 debt service amounts to Devil Canyon Second Afterbay, which is recovered under the variable component, causing debt service costs allocated to Metropolitan's East Branch Enlargement Capital component to decrease by \$3 million.

Our audit of the East Branch Enlargement capital component disclosed that the amount of debt service costs for 2005 used in the Statement of Charges was \$6,003,000 higher than the debt service schedule because the 25% debt cover was not properly removed in the determination of the Statement of Charges. As a result, Metropolitan's East Branch Enlargement capital component is overstated by \$4,822,000. The Department will make the appropriate corrections in the 2007 Statement of Charges.

East Branch Enlargement Minimum: The East Branch Enlargement minimum component increased by \$1.7 million primarily due to a \$1.3 million increase in the past cost adjustment and \$.4 million due to increased O&M costs from 2005 to 2006. The 2006 Statement of Charges included a \$.9 million under payment due to changes in cost estimates for 2003 through 2005, whereas the 2005 Statement of Charges had included an overpayment of \$.4 million.

Water System Revenue Bond Surcharge: The \$.7 million increase in the Water System Revenue Bond Surcharge consists of an increase of \$2.4 million due to increased debt service costs, which is offset by a decrease of \$1.7 million due to Metropolitan's transfer of 100,000 acre-feet of entitlement to Desert and Coachella Water Agencies. The increased debt service costs are the result of higher scheduled debt service payments in 2006 for Series S, U and Y, compared to the scheduled payments for 2005.

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

Transportation Capital: The decrease of \$10.0 million in the transportation capital component is primarily due to a \$6.6 million decrease in the 2006 calculated component resulting from the transfer of 100,000 acre-feet of entitlement water. In addition, there was an increase in the past cost adjustment

credit of \$2.0 million and an increase in the rate reduction credits under the Monterey Amendment of \$1.3 million. Approximately \$4 million of the increase in the past cost adjustment is due to the amortization of the change in the 2005 calculated component of \$7.2 million due to the transfer of 100,000 acre-feet of entitlement water. The past cost adjustment also increased by \$1.6 million resulting from an adjustment the Department made to certain historical capital costs totaling \$10.6 million for Metropolitan that had been recorded incorrectly at the time of conversion to SAP.

Off-Aqueduct Minimum: The \$3.6 million decrease in Metropolitan's off-aqueduct minimum component is due primarily to a \$7.6 million decrease in Metropolitan's share of costs due to the decrease in Metropolitan's share of water deliveries in relation to the total water deliveries. Metropolitan increased their deliveries by 100,000 acre-feet, but all other contractors increased their deliveries by 286,287 acre-feet, causing a shift in costs to other contractors. This decrease was partially offset by an increase of \$4.0 million in Metropolitan's share of the Reid Gardner O&M and coal costs, which are based on actual 2005 costs, escalated at 2.5%, and assumes an increase in coal costs from \$34 per ton to \$40 per ton and that the plant will operate at a 70% capacity factor. The increased O&M costs are the result of a major maintenance program at the Reid Gardner Plant.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

COMPARISON OF THE PREVIOUSLY ESTIMATED 2006 STATEMENT OF CHARGES
TO THE STATEMENT DATED JULY 2005

	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		
Prior year Department estimates of the 2006 Statement of Charges	\$ 73,720	\$ 88,953	\$ 76,646	\$ 139,418	\$ 23,408	\$ 28,518	\$ 32,042	\$ 3,084	\$ 35,937	\$501,726
Increase (decrease) due to changes in:										
Estimated costs	1,701	6,872	2,216	20,206	971	2,675		327		34,968
Past cost adjustments	(4,282)	(4,629)		2,696	17	20	(4,241)	906		(9,513)
Change in debt service							22		458	480
Power sales				26,826						26,826
Recovery generation credit				(1,230)		(1,625)				(2,855)
Allocations among contractors			(7,419)							(7,419)
Rebates Under Monterey Amendment	(7,888)				(3,793)					(11,681)
Entitlement Transfer	(6,608)	(15,258)			(1,164)	(1,422)			(1,830)	(26,282)
NET CHANGE	(17,077)	(13,015)	(5,203)	48,498	(3,969)	(352)	(4,219)	1,233	(1,372)	4,524
2006 Statement of Charges dated July, 2005	<u>\$ 56,643</u>	<u>\$ 75,938</u>	<u>\$ 71,443</u>	<u>\$ 187,916</u>	<u>\$ 19,439</u>	<u>\$ 28,166</u>	<u>\$ 27,823</u>	<u>\$ 4,317</u>	<u>\$ 34,565</u>	<u>\$ 506,250</u>

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

**Comparison of the Previously Estimated 2006 Statement of Charges
to the Statement Dated July 2005**

As shown on the previous page, Metropolitan's 2006 Charges increased by \$4.5 million compared to last year's estimate of the 2006 Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component increased by \$48.5 million between last year's estimate of the 2006 charges and the 2006 Statement of Charges. The increase results from \$20.2 million in higher energy and other variable costs, a \$26.8 million decrease in power sales, and a \$2.7 million increase in the past cost adjustment, which are offset by a \$1.2 million increase in recovery generation credits. The increase in estimated costs is due mainly to a higher mill rate resulting from an increase in wholesale energy prices. The Department has assumed that the mill rate for non-firm energy purchases will increase from 41 mills per kilowatt-hour, which was used in last year's estimates, to 51 mills per kilowatt-hour, and that more non-firm purchases will be needed due to decreased energy capacity from the Hyatt-Thermalito Power Plant and the recovery generation plants. The Department is estimating a \$4 million increase in grid management charges, an increase in Hyatt-Thermalito Power Plant costs of \$5.4 million as a result of an expected increase in O&M and FERC relicensing costs, and an increase in rates for Duke energy purchases from 37 to 57 mills per kilowatt-hour. These increases are offset by a decrease in Metropolitan's energy usage from 78% of the total project energy usage to 62%, as described on page 5. In addition, the Department included \$3.0 million for transportation replacement expenditures in 2005, including \$1.3 million for prior years' undercharges. The decrease in power sales is primarily due less energy being available for sale as a result of reduced generation at Hyatt-Thermalito and due to a decrease in non-firm energy sale prices from 58 to 45 mills per kilowatt-hour. The recovery generation credits increased primarily due to increased water flow through the powerplants. The 2006 past cost adjustment overpayment of \$2.7 million is primarily the result of the \$5.3 million underpayment discussed on page 6, which is offset by the prior year overpayment of \$2.6 million due to decreased 2005 energy costs.

East Branch Enlargement Minimum: The East Branch Enlargement minimum component increased by \$1.2 million primarily due to the increase in O&M costs for 2003 through 2006.

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

Transportation Capital: The decrease of \$17.1 million in the transportation capital component is partially due to the inclusion of rate reduction credits under the Monterey Amendment of \$7.9 million in the 2006 Statement of Charges. In addition, Metropolitan's transfer of 100,000 acre-feet of

entitlement water reduced the 2006 calculated component by approximately \$6.6 million. The past cost adjustment of \$4.3 million is the result of the prior years' past cost adjustment credit of \$2.3 million, which was increased by \$.4 million as a result of the amortization of the change in the 2005 calculated component of \$7.2 million due to the transfer of 100,000 acre-feet of entitlement water and due to an increase of \$1.6 million resulting from an adjustment the Department made to remove certain historical capital costs totaling \$10.6 million for Metropolitan that had been recorded incorrectly at the time of conversion to SAP. These decreases were offset by an increase in estimated costs for 2006 of \$1.7 million.

Transportation Minimum: The decrease of \$13.0 million in the transportation minimum component is due to a \$4.6 million decrease in the past cost adjustment and a \$15.3 million decrease due to Metropolitan's entitlement transfer, which are offset by a \$6.9 million increase in estimated costs. The increase in 2006 estimated costs of \$6.9 million is primarily due to the following:

- The Department increased its estimate for project power planning costs for 2006 from \$6 million in the prior estimates to \$15 million in the 2006 Statement of Charges, due to the Department including \$6 million of estimated costs for the SAP migration project, as well as increasing cost estimates for the business process evaluation project and the aqueduct control system centralized operations migration project, which results in a \$3.2 million increase in Metropolitan's transportation minimum component.
- The Department's estimate of extraordinary O&M projects increased by \$2.0 million compared to the estimates used in the prior Statement of Charges. These revised estimates resulted in a \$3.0 million increase in Metropolitan's minimum component because extraordinary O&M costs were increased at Teerink and Chrisman Pumping Plants for recoating discharge lines and overhauling units and cost estimates were eliminated at Pearblossom Pumping Plant, where Metropolitan pays a lower proportionate share of the costs. Costs were also added for 2006 to overhaul units at Edmonston Pumping Plant.
- Municipal Water Quality Investigation costs for 2006 totaling \$1.1 million for Metropolitan were not included in the prior year estimate of 2006 charges but were added to the 2006 Statement of Charges.
- The Department's estimate of water losses for 2006 was \$1.2 million lower than previously estimated, which results in a decrease in Metropolitan's transportation minimum component by \$.8 million.

- The estimated costs for transmission service for 2006 were \$.9 million more than the prior year estimate, resulting in a \$.1 million decrease in Metropolitan's transportation minimum component.
- The Monterey Amendment litigation charges of \$1 million were added to the 2006 Statement of Charges that were not included in the prior estimates of 2006 charges, of which Metropolitan's share was \$.5 million.

We noted that the \$4.6 million change in the past cost adjustment is due mainly to adjustments for 1999 to 2005 consisting of the following:

- The actual minimum costs incurred for 2004 were approximately \$6 million less than the amount estimated in the 2005 Statement of Charges, resulting in a decrease in Metropolitan's charge of approximately \$2.7 million.
- The Department removed retention payments that were erroneously included in the 2004 and 2005 Statements of Charges. As a result of this correction, Metropolitan's minimum component decreased by \$1.7 million.
- The impact of an additional year of interest on the prior year over and under payments resulted in a \$1.1 million decrease in Metropolitan's transportation minimum component.
- The Department posted credits totaling \$.8 million related to special water wheeling and lease payments in the 2006 Statement of Charges, which resulted in a \$.3 million decrease in Metropolitan's transportation minimum component.
- Due to revisions and adjustments to the Municipal Water Quality Investigation Charges for 2000 to 2005, Metropolitan's transportation minimum component decrease by \$.2 million.
- Estimates of transmission costs for 2005 decreased by \$.9 million, reducing Metropolitan's charge by \$.1 million.
- The estimate for 2005 power planning costs increased by \$3.5 million primarily because of including cost estimated for the SAP migration project, which resulted in a \$1.5 million increase in Metropolitan's transportation minimum component.

- The Department made revisions to downstream distribution entries for 2000 to 2003 in the 2006 Statement of Charges as a result of the Department updating its power cost allocations for these years. These changes resulted in Metropolitan's transportation minimum component increasing by \$.5 million.
- Changes in cost estimates for 2005 resulted in a \$.5 million increase in Metropolitan's transportation minimum component. As a result of the Department updating its O&M cost estimates using the previous three years of historical cost information, escalated by 3%, Metropolitan's share of the transportation minimum costs for 2005 increased by \$1 million. In addition, the Department reduced its estimate of extraordinary O&M activities for 2005, which reduced Metropolitan's 2006 Statement of Charges by \$.5 million.

As discussed on page 8, Metropolitan's transfer of 100,000 acre-feet of entitlement resulted in a \$15.3 million decrease in the 2006 Statement of Charges compared to the prior estimate of the 2006 Statement of Charges.

Off-Aqueduct Minimum: The \$5.2 million decrease in Metropolitan's off-aqueduct minimum component is due to a \$7.4 million decrease in Metropolitan's share of costs due to the decrease in Metropolitan's share of water deliveries in relation to the total water deliveries. Metropolitan increased their deliveries by 100,000 acre-feet, but all other contractors increased their deliveries by 286,287 acre-feet, causing a shift in costs to other contractors. This decrease was partially offset by an increase of \$2.2 million in Metropolitan's share of the Reid Gardner O&M and coal costs, which are based on revised estimates of 2005 costs and assumes an increase in coal costs from \$35 per ton to \$40 per ton. The increased O&M costs are the result of a major maintenance program at the Reid Gardner Plant. Had Metropolitan requested their full entitlement for 2006, including the 100,000 acre-feet of entitlement transferred to Desert and Coachella Water Agencies, Metropolitan's Off-Aqueduct charge would have been higher by \$3.9 million.

East Branch Capital: The East Branch Enlargement capital component decreased by \$4.2 million due primarily to a reduction of debt service costs for 2002 and 2003 of \$1.1 million as a result of the bond refunding and a reduction of debt service costs for 2004 and 2005 of \$3 million as a result of the Department reallocating additional debt service amounts to Devil Canyon Second Afterbay, which are recovered under the variable component, resulting in a decrease in the amount of debt service costs allocated to the East Branch Enlargement component.

Delta Water Charge Capital: The decrease of \$4 million in the Delta Water charge capital component is due to the prior year estimate not including the Monterey Amendment rebate of \$3.8 million and a reduction in Metropolitan's charges by \$1.2 million as a result of the transfer of 100,000 acre-feet of entitlement. These decreases are offset by a \$1 million increase due to increased cost estimates related to Delta facilities planning, the temporary barriers program and the Franks Tract, Through-Delta facility and Delta Cross Channel projects.

Water System Revenue Bond Surcharge: The \$1.4 million decrease in the Water System Revenue Bond Surcharge is due to a decrease in Metropolitan's share of the Surcharge as a result of the transfer of 100,000 acre-foot of entitlement to Desert and Coachella Water Agencies, which decreased Metropolitan's Surcharge by \$1.8 million. This decrease is partially offset by an increase of \$458,000 due to increased debt service costs associated with the proceeds from the issuance of Series AC Water System Revenue Bonds utilized for new construction.

Future Potential Refunds and Adjustments

Metropolitan's estimated 2006 charges of \$506 million do not include certain credits, refunds and adjustments that are expected in 2006 as part of the Department's normal accounting and billing process. Refunds are expected to reduce Metropolitan's 2006 billings by approximately \$31.9 million for the following items:

	<u>Estimated Refund Date</u>		
<u>Cover - Off-Aqueduct</u>			
Return of January - June 2004	October 2005	\$ 2,921,000	\$ 5,563,000
Return of July - December 2004	April 2006	<u>3,030,000</u>	
<u>Cover - Water System Revenue Bond (WSRB)</u>			
Return of July 2004	October 2005	7,378,000	
Return of January 2005	April 2006	<u>7,034,000</u>	14,412,000
<u>Cover - East Branch Enlargement (EBE)</u>			
Return of September 2004	October 2005	3,118,000	
Return of March 2005	April 2006	<u>2,411,000</u>	5,529,000
<u>WSRB Securities Earnings</u>			
Earned January - June 2005	September 2005	500,000	
Earned July - December 2005	March 2006	<u>500,000</u>	1,000,000
<u>SMIF Interest - Off-Aqueduct</u>			
Earned January - June 2005	September 2005	200,000	
Earned July - December 2005	March 2006	<u>200,000</u>	400,000
<u>SMIF Interest - WSRB</u>			
Earned January - June 2005	September 2005	325,000	
Earned July - December 2005	March 2006	<u>325,000</u>	650,000
<u>SMIF Interest -EBE</u>			
Earned January - June 2005	September 2005	110,000	
Earned July - December 2005	March 2006	<u>110,000</u>	220,000
<u>SMIF Interest - Reserve Account</u>			
Earned January - June 2005	September 2005	930,000	
Earned July - December 2005	March 2006	<u>930,000</u>	1,860,000
<u>Devil Canyon Second Afterbay</u>			
Return of 2005 EBE debt service credits	May 2006	<u>2,239,000</u>	<u>2,239,000</u>
	TOTAL ESTIMATED REFUND		<u>\$ 31,873,000</u>

The 2006 variable and off-aqueduct charges may be reduced further if 2006 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 31.

UNRESOLVED ISSUES RELATED TO THE 2006 STATEMENT OF CHARGES

During our audit, we encountered a number of issues related to the calculation of various components of the 2006 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 2006 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. 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 subsequent Statements of Charges, the Department continues to develop 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. We encountered difficulties in our analysis of estimated energy costs that we have not encountered in the past. We were unable to reconcile the amounts in the 2006 Net Pumping Power Costs projection to the power costs included in Table B-3 of Bulletin 132-05 and in the Statement of Charges. It appears that the net power charges included in the contractor's billings are approximately \$24.5 million less than those included in the energy projection. We informed the Department of this discrepancy and they intend to make the correction when calculating the actual 2006 invoice rates in December. We estimate that Metropolitan's power charges decreased approximately \$15.3 million as a result of this discrepancy. We also noted a discrepancy of \$23.3 million in the amounts used in the projection for the cost of recovery generation included as a power source compared to the recovery generation credits included as a power use. Typically these amounts are the same. The amount shown as costs were less than amounts shown as credits, which could understate Metropolitan's variable component

by \$14.4 million, assuming the amounts shown as credits are correct and no other estimates are affected by this discrepancy, such as power purchases.

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 2000 through 2002 were used in the 2005 Statement of Charges, although cost and water data had 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 was 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. For the 2006 Statement of Charges, the Department prepared the downstream allocation of costs for 2000 through 2004 outside of the system and manually posted the entries to SAP. These computations used the most current cost and water data available, correcting the errors noted in the 2005 Statement of Charges. 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 produces a Surcharge that is 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 produces a Surcharge that is inconsistent and unreasonable compared to previous computations. As a result, in the 2006 Statement of Charges, the Department calculated the 2006 WSRB Surcharge using the relative proportion of the Surcharge to total debt service from the 2002 Statement of Charges and applied that proportion to 2006 debt service costs that include WSR bonds through Series AC issued in January 2005. In addition to these debt service costs, in order to comply with the bond covenants, the Department continues to include \$1.6 million in recreation capital costs that have not been reimbursed by the State. Also, adjustments resulting from the reallocation of the Surcharge among contractors for water transfers have been incorporated into the computation and \$3.6 million for on-aqueduct bond cover costs have been included. 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 through 2006 Statements of Charges that included conservation replacement costs for 2002 through 2006 totaling \$24.3 million, which was billed as part of the Delta Water Charge. Recent estimates prepared by the O&M Program Control office indicate an additional \$850,000 in costs were budgeted for 2007, for a total of \$25.2 million. 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 Division 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 costs at that time of \$27,850,000, only \$5,079,000 were considered replacement costs and the remaining \$22,771,000 were considered O&M or betterments, which are typically billed as an energy costs through the transportation variable component. Based on the total actual and estimated costs of \$25.2 million and assuming the same proportion of replacements to total costs, as determined by the Division of Engineering, the effect on the 2004 through 2006 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, is an overstatement in Metropolitan's Delta Water Charge of \$10,318,000. Because Hyatt-Thermalito O&M and capital costs are collected through the variable component, Metropolitan's variable charge would increase by \$16,509,000 if these costs were reallocated. Because there is disagreement among the contractors regarding how Hyatt-Thermalito costs should be recovered, and some contractors have filed a claim against the Department related to Hyatt-Thermalito cost allocation issues, this issue will not be resolved in time to reflect changes in the 2007 Statement of Charges. We will continue to monitor this situation to ensure the proper allocation is used in future Statements of Charges.

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 believes that a billing mechanism for other conservation replacement charges was not discussed by the Work Group that met in 2003. The Department incurred actual costs of \$772,000 for 1999 through 2003 and estimates \$120,000 of replacement costs for 2005 associated with the Gianelli Pumping Plant, which were not included in the replacement Delta Water Rate. Metropolitan's 2006 Delta Water Charge is understated by \$444,000 as a result of the exclusion of these costs. In addition, the costs for the Banks Pumping Plant are being allocated entirely to the transportation component instead of being partially allocated to the conservation component. The effect of this error was not quantified, but it would result in an overstatement

to Metropolitan's variable component and an understatement to Metropolitan's Delta Water Charge by a similar amount. The Department believes that the contractors work group addressed the inclusion of only Hyatt-Thermalito Power Plant replacement costs in the conservation replacement rate. The Department plans to work with the contractors on a method to bill these additional conservation replacement costs. We will monitor this situation to ensure the amounts are billed in the future.

Cost Allocation Changes. In our review of changes between 2003 and 2004 for the minimum component costs, we noted several cost centers that, as of July 1, 2004, had changed from being billed as a capital cost to being billed as a minimum cost, including Delta Facilities Planning, Planning Model Development, and Delta Facilities Planning Minimum cost centers. We noted that the Delta Facilities Planning Capital cost center was changed from the minimum to the capital component. We reviewed how these programs were billed prior to the implementation of the SAP system and noted that Delta Facilities Planning was billed through the capital component, while Planning Model Development had some work orders assigned to the capital component and some assigned to the minimum component. The Delta Facilities Planning Capital and Delta Facilities Minimum cost centers were created in 2002 to record the planning costs involving the construction of the temporary barriers and the planning costs associated with proposed construction projects in the Delta, respectively. According to our discussions and correspondence with the Department, the "assessment cycle and master data" redesign project was required to correct funding issues caused by incorrectly funded master data and cross-funded assessment cycles. Costs were being assigned to bond-funded costs centers, yet these costs were not necessarily costs that the Department could bond for, and hence were not being reimbursed. As a result of these incorrect fund assignments, the Department's cash flow was impaired, resulting in a reduction in rate management credits available to the contractors. The changes in SAP were effective as of July 1, 2004, which moved costs for July to December 2004 primarily from the capital component to the minimum component in the 2006 Statement of Charges. The Department has not yet determined how or when changes will be made to the costs in SAP for July 1, 1999 to June 30, 2004. Costs totaling \$11,821,000 for the period July 1, 1999 to December 31, 2003, will need to be moved from the capital to the minimum component, resulting in a significant increase in Metropolitan's minimum component in the future. We will continue to monitor this reallocation of costs.

Debt Service Reserve and Surplus Money Investment Fund (SMIF) Interest. The Department is required by bond covenants to maintain bond debt service reserves. The reserve amount is recomputed with each new series issued. Until 1995, the Department maintained separate accounts for each bond series, which included the reserve, as well as receipts from contractors, SMIF interest and payments of debt service. In 1995, the Department consolidated the accounting for the bonds, combining the reserves into one account. Off-aqueduct reserves were collected from the contractors directly, based on water deliveries, while other reserves were funded by bond proceeds. Since 1995, the SMIF interest earned on the debt service reserve

balance has been returned to the contractors semi-annually in proportion to the contractor's payments of the Off-Aqueduct, East Branch Enlargement, and WSRB charges.

The Department has analyzed the current debt service reserve balance of \$180,954,755 (through Series AA) and has determined that \$56,595,746 of this balance was collected from the contractors in 1983, 1984 and 1985 based on water deliveries in those years to fund reserves required for off-aqueduct bonds. The remaining balance of \$124,359,009 was provided through bond proceeds to fund the reserves required by subsequent bond issues. Recently, the Department has determined that due to the repayment of a portion the off-aqueduct bonds, the current outstanding off-aqueduct bonds require a reserve of \$29,774,507. The remaining amount collected from the contractors of \$26,821,239 is being maintained in the reserve account to meet the reserve requirements for various Water System Revenue Bonds.

The Department has, since 1995, computed the refunds of SMIF interest on the debt service reserve based on the contractor's payment of the Off-Aqueduct, East Branch Enlargement and WSRB components without consideration as to how the reserve was initially funded. It appears that the SMIF interest earned on the off-aqueduct portion of the reserve, funded by the contractors in 1983, 1984 and 1985, should be returned based on the amount paid by those contractors at that time, rather than in proportion to their current Off-Aqueduct charges. The Department has recomputed the refunds since 1995 based on the original payments by the contractors and has determined that a reallocation among the contractors is necessary. This reallocation is expected to result in additional refunds to Metropolitan of approximately \$1,221,000.

The Department has not yet addressed the issue of the off-aqueduct reserves funding the debt service reserves for other bond issues. The portion of the debt service reserve held in excess of the amount required for the off-aqueduct bonds of \$26,821,239 would need to be funded from some other source should it be determined that this amount should be returned to the contractors.

Rate Management Credits. For the purpose of computing the rate management credits, the Monterey Amendment states that the allocation of these credits, which utilizes the transportation capital component repayment obligation from Bulletin 132-99, Table B-15, be recalculated once every five years, unless requested by a contractor to be recalculated more frequently. Bulletin 132-99 has been used to allocate rate management credits since 2000. It appears that the rate management credits for 2005 and 2006 should have been computed using the Bulletin 132-04 Table B-15 in order to comply with the five-year provision. The Department believes that the contractors agreed to waive this requirement; however, we were unable to obtain any documentation of this decision. If the 2005 and 2006 credits were calculated using the Table B-15 from Bulletin 132-04, Metropolitan's 2005 and 2006 credits would be reduced by \$979,000 and \$680,000, respectively.

DIFFICULTIES ENCOUNTERED DURING THE AUDIT

During our audit of the 2006 Statement of Charges, we encountered a number of difficulties that caused delays in the audit, including not receiving a timely response to our inquiries and not receiving the information from the Department to complete certain parts of our audit. Personnel that are key to the preparation of the Statement of Charges were reassigned to the development of the Department's Power Cost Distribution System, and personnel resources were utilized to respond to requests for information related to a pending lawsuit. As a result of the limited personnel assigned to the preparation of the Statement of Charges, the Department was unable to prepare a May estimate of the Statement of Charges, as required by the Water Supply Contract. In addition, as discussed in the Unresolved Issues section of this report, there are a number of areas where the current system cannot calculate certain components of the Statement of Charges correctly that have been outstanding since the implementation of SAP in 2000. The Department needs to evaluate its resources to ensure that it has sufficient, competent personnel to replace personnel that have retired and to ensure adequate staff to address legal and system development issued in addition to calculating an accurate Statement of Charges. Examples of issues we have encountered during our audit include the following:

- As part of our audit, we verify the variable component cost estimates that are included in the Statement of Charges. We requested the supporting documentation for the variable cost estimates in July, but did not receive this information until mid-September. When we received the information, it was incomplete and did not agree with the cost data that was included in the Statement of Charges. See pages 19 and 20 for a further discussion of the discrepancies we noted.
- We never received the Delta Fish Agreement calculation, although the Department has included a number in the variable component and the Delta Water Charge. We believe the Department did not update the calculation for the 2006 Statement of Charges, although we never received verification that this was the case. We were unable to determine what amount, if any, of fish loss charges were included in the 2006 Statement of Charges because the documentation of future cost estimates provided by the Department did not include sufficient detail to make this determination.
- In order to obtain the correct cost information, it is important that we obtain from the Department the dates that they produced each component of the Statement of Charges, to ensure that the data we extract from the system will be consistent with the data used in the preparation of the Statement of Charges. We corresponded with SWPAO personnel regarding these dates, but did not receive a response. Instead, we obtained dates from the fiscal services personnel, as to what they believe are the correct dates. We attempted to confirm these dates but never received a response.

- The B-Tables in Bulletin 132, which provide the underlying data used in the preparation of the Statement of Charges, are instrumental in obtaining data for use during the audit. Typically the Department finalizes and publishes these B-Tables in August. However, final versions of these B-Tables were not officially distributed until October this year. While we are able to print the B-Tables from the system directly for our audit, we cannot be assured that these were the final versions of the B-Tables.
- SWPAO provided us with their revised power cost allocation calculations for 2000 through 2004 in April, which we utilized to perform our interim fieldwork related to the 2006 Statement of Charges, since these costs are maintained on a calendar year basis. However, revisions were made to these power allocations as late as June 15, 2005 and were included in the 2006 Statement of Charges that was issued on July 1, 2005. As a result, we were required to update our audit of these power allocations. These late changes also required fiscal services personnel to revise their downstream distribution calculations that must be calculated manually outside of the system because the billing system implemented in 2000 has not been updated to perform these calculations. The Department needs to ensure that due dates for information are established and enforced.
- We were unable to obtain from the Department a summary of the off-aqueduct costs by facility and cost type for 2006 to support the allocation of off-aqueduct charges used in the 2006 Statement of Charges. A summary of 2006 charges was prepared by the Power Contracts Management personnel in April 2005, but changes appear to have been made from this date to when the Statement of Charges was prepared. As a result of not having this latest cost summary, we were unable to determine whether the current debt service schedules were used in the preparation of the Statement of Charges. In addition, a preliminary year-end allocation of 2004 off-aqueduct costs was not completed in time to be reflected in Attachment 3 of Metropolitan's 2006 Statement of Charges. The calculation was eventually prepared in September 2005 and refunds were issued.
- During our testing of the allocation of East Branch minimum costs in Bulletin 132-05, Table B-27 to Metropolitan, we noted a discrepancy of \$655,000 for 2004 compared to the amounts included as the calculated component in the Statement of Charges. We are unsure as to which amounts are correct and have not received a response from the Department as to why this discrepancy is occurring. The amount included in the Statement of Charges is less than the amounts calculated using Table B-27. We will attempt to work with the Department to resolve this item before the 2007 Statement of Charges is issued.

While the items noted above related primarily to SWPAO, we encountered a situation relative to the timeliness of cost allocations performed by fiscal services personnel. Since the Statement of Charges utilizes costs on a calendar year basis, the Department has from January until the Statement of Charges is generated in June to make adjustments. However, typically SWPAO establishes a deadline for these types of adjustments of approximately April. This past year, fiscal services personnel performed a significant number of cost assessments and adjustments in June that required us to revise testing we performed in May. While these changes are necessary to ensure the most accurate Statement of Charges, we would encourage fiscal services to perform these adjustments by at least May so that they could be included in the May estimates of the Statement of Charges.

We are concerned that these similar problems will arise next year in the preparation of the 2007 Statement of Charges, since key personnel in SWPAO have been assigned to the SAP migration project until approximately May 2006. This SAP migration project will result in a system that is separate from the current SAP system. As a result, SWPAO will be required to deal with the impact that this new SAP system will have on the interface with CARA, the billing system, in addition to the issue of personnel resources to accurately produce the Statement of Charges.

TABLE A
Summary of Settled Audit Findings Resulting in Changes to
the 2006 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 2005 which affected the 2006 Statement of Charges. A more detailed description of these items starts on page 32.

Items	Effect on Metropolitan's 2006 Costs <u>Increase (Decrease)</u>
1. The downstream distribution entries to reallocate costs were properly updated for current cost and water information (refer to pages 32 and 33).	\$ (4,183,000)
2. Retention costs were properly removed from the contractor's transportation minimum charges (refer to page 33).	(1,699,000)
3. The LADWP's estimated peaking payment of \$587,000 for 2004 and 2005 were included in the computation of the unit rates (refer to page 33).	(1,084,000)
4. Debt service amounts used to determine the Devil Canyon Second Afterbay charges for 2000, 2001, 2002 and 2005 were corrected (refer to page 33).	(808,000)
5. Updated mill rates were used in calculating the 2004 recovery generation credits for the Mojave Siphon and Alamo Powerplants (refer to page 33).	(731,000)
6. The Department used updated Hyatt-Thermalito cost estimates in the variable and the Delta Water Charge components for 2004 through 2035 (refer to page 33 and 34).	(175,000)
7. Rate management credits for 2003 and 2004 were recalculated using a Table B-15 that properly excluded costs associated with transfers of entitlement (refer to page 34).	(66,000)
8. Previously unrecorded wheeling water transaction credits totaling \$65,000 have been recorded in the cost accounting system (refer to page 34).	(17,000)
9. Power costs and revenues totaling \$1,167,000 have been corrected in the cost accounting system (refer to page 34).	25,000
10. Costs totaling \$107,000 related to a publication on delivery capabilities of the State Water Project were recorded in the accounting system (refer to page 34).	39,000

<u>Items</u>	<u>Effect on Metropolitan's 2006 Costs Increase (Decrease)</u>
11. Water deliveries totaling 19,208 acre-feet for the 1978 and 1982 exchange agreements were properly removed from the 2000 variable component (refer to pages 34 and 35).	\$ 66,000
12. The allocation of costs totaling \$3,182,000 was corrected in the accounting system properly and included in the transportation minimum and Delta Water Charge components (refer to page 35).	584,000
13. Hyatt-Thermalito operating costs for 2000 through 2003 were updated from estimated to actual amounts, increasing the charge included in the variable component by \$5,773,000 and increasing the credits for Hyatt-Thermalito operating costs included in the Delta Water Charge by \$5,773,000 (refer to page 35).	<u>3,856,000</u>
NET BENEFIT	<u>\$ (4,193,000)</u>

TABLE B
Summary of Audit Findings Projected to Result in Changes to
the 2007 Statement of Charges

Throughout our examination, we worked with Department and Metropolitan representatives to resolve findings which arose during our audit of the 2006 Statement of Charges. We will work with the Department to ensure the correction of these findings in the 2007 Statement of Charges. The items are discussed in detail starting on page 35 of this report. The items are summarized as follows:

Items	Effect on Metropolitan's 2007 Costs Increase (Decrease)
1. The 2005 East Branch Enlargement charges were overstated by \$6,003,000 because the 25% debt cover amount was not properly removed (refer to page 35).	\$ (4,822,000)
2. Power costs and revenues, transmission, station service, and peaking costs totaling \$8,344,000 for 1999 through 2004 were not recorded or were recorded incorrectly in the accounting system (refer to page 35).	(4,233,000)
3. Adjustments related to 2005 and 2006 Thermalito Diversion Dam Powerplant capital cost repayment amounts totaling \$1,334,000 were erroneously included twice in the variable component (refer to page 36).	(1,067,000)
4. Costs incurred at the Oroville facilities associated with FERC relicensing for 1999 to 2004, are overstated in the transportation variable charges and understated in the Delta Water Charge by \$2,855,000, respectively (refer to page 36).	(2,449,000)
5. Hyatt-Thermalito operating costs for 1998, 1999 and 2004, included in the computation of the variable charges are overstated and credits for Hyatt-Thermalito operating costs included in the Delta Water Charge are understated by \$2,001,000 (refer to page 36).	(1,372,000)
6. Outdated debt service amounts were used to determine the Devil Canyon Second Afterbay charges for 2004 in the variable component (refer to page 37).	(1,237,000)
7. Coastal Extension debt service charges were erroneously included in the 2006 variable charges instead of the Coastal Branch Reach 33A charges (refer to page 37).	(1,049,000)
8. Final energy costs for 1998 were not recorded or were recorded incorrectly in the bills (refer to page 37).	(631,000)

Items	Effect on Metropolitan's 2007 Costs Increase (Decrease)
9. Credits totaling \$993,000 for wheeling water transactions were not recorded in the cost accounting system (refer to page 37).	\$ (437,000)
10. The replacement over-/under-adjustment was calculated using an incorrect payment amount and incorrect interest factors (refer to pages 37 and 38).	(312,000)
11. Recovery generation credits for San Luis, Devil Canyon and Warne Powerplants for 1998 are misstated by \$396,000 (refer to page 38).	(16,000)
12. Power costs are understated and recovery generation credits are overstated by \$267,000 due to an incorrect 2002 Alamo mill rate and the use of an outdated 1999 San Luis amount (refer to page 38).	(7,000)
13. Gianelli Pumping Plant replacement costs are improperly included in the calculation of the Delta Water Charge (refer to page 38).	(2,000)
14. Costs totaling \$430,000 were not allocated in the accounting system and were improperly excluded from the Delta Water Charge component (refer to page 38).	13,000
15. Debt service amounts for the Tehachapi Second Afterbay were erroneously excluded from the calculation of the 2005 variable component (refer to page 39).	118,000
16. FERC costs totaling \$17.5 million were excluded from the Delta Water Rate calculation and conservation replacement costs totaling \$11.2 million were incorrectly included in the Delta Water Rate calculation (refer to page 39).	183,000
17. The recovery generation amounts for 2005 are overstated by \$2,610,000 and the recovery generation amounts for 2006 are understated by \$3,043,000 (refer to page 39).	347,000
18. Certain cost centers are not properly mapped to the CARA system, excluding costs totaling \$10,005,000 from the Statement of Charges (refer to page 39).	750,000
19. Incorrect wheeling credit and contractor payment amounts were used in the variable fish replacement charge calculation (refer to page 39).	<u>989,000</u>
NET BENEFIT	<u>\$ (15,234,000)</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 40.

Items	Effect on Metropolitan's Costs Increase (Decrease)
1. Cost estimates continue to be used in the calculation of the 2003 off-aqueduct charges, resulting in an overstatement of Metropolitan's charges (refer to page 40).	\$ (1,561,000)
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 40).	(655,000)
3. Certain Coastal Branch capital cost repayment amounts were excluded from the computation of the 2000 WSRB Surcharge (refer to page 40).	(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 40).	(526,000)
5. Arbitrage payments were incorrectly calculated in the determination of the interest refunds on WSRB investments (refer to page 40).	<u>(31,000)</u>
NET BENEFIT	<u>\$ (3,405,000)</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 2006 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 2006 Statement of Charges are summarized in Table A on pages 27 and 28, those projected to be reflected in the 2007 Statement of Charges are summarized in Table B on pages 29 to 30 and those that will affect credits, refunds and adjustments are summarized in Table C on page 31.

Findings Resulting in Changes to the 2006 Statement of Charges:

- Because the Department was 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 for the 2006 Statement of Charges, the water table redistribution entries for 2003 were calculated using water data for 2002. The Department updated

the cost and water information in the 2006 Statement of Charges, resulting in a decrease in Metropolitan's minimum component of \$5,868,000 and an increase in the variable and Delta Water Charge components of \$1,586,000 and \$99,000, respectively. (TABLE A, Item 1)

- The Department reversed the settlement of contract retention payments at the time of the conversion to the SAP system, which resulted in a double billing of costs totaling \$2.8 million. The correction was made to remove these costs, which was properly reflected in the 2006 Statement of Charges, resulting in a \$1,699,000 decrease in Metropolitan's transportation minimum component. (Table A, Item 2)
- During our audit of the 2005 Statement of Charges, we determined that the Department excluded the Los Angeles Department of Water and Power's 2004 and 2005 peaking capacity payments of \$587,000 each year from the variable unit rate calculation. The peaking payment for 2004 was included in the 2004 preliminary allocation of power costs, and the 2005 peaking payment was included in the revised estimates of the 2005 power charges. The impact to Metropolitan of the inclusion of these amounts is to reduce the 2004 and 2005 calculated components by \$554,000 and \$530,000, respectively, in the 2006 Statement of Charges. (TABLE A, Item 3)
- We compared the Devil Canyon Second Afterbay Charge for debt service included in the variable component to the debt service schedule and determined that discrepancies noted in the 2005 Statement of Charges for 2000, 2001, 2002 and 2005, resulting from the use of an outdated debt service schedule, have been corrected. As a result of this correction, Metropolitan's transportation capital and variable components have been reduced by \$794,000 and \$14,000 in the 2006 Statement of Charges. (TABLE A, Item 4)
- The Department used outdated mill rates when valuing the 2004 recovery generation at Mojave Siphon and Alamo Powerplants in the 2005 Statement of Charges. The amounts were corrected when the Department prepared the preliminary allocation of power costs for 2004. As a result of using the correct mill rates, the value of recovery generation for the Mojave Siphon Powerplant was increased by \$1,066,000 and the recovery generation for the Alamo Powerplant was increased by \$289,000. The effect to Metropolitan of this correction is a decrease in the transportation variable component of \$740,000 and an increase in the transportation minimum component of \$9,000 in the 2006 Statement of Charges. (TABLE A, Item 5)
- In the 2005 Statement of Charges, the Department included outdated Hyatt-Thermalito cost estimates for 2004 to 2035 in the computation of the variable and Delta Water Charge components. The Department updated the estimates for the 2006 Statement of Charges. As a result, Metropolitan's

variable charge increased by \$306,000 and the Delta Water Charge component decreased by approximately \$481,000 in the 2006 Statement of Charges. (TABLE A, Item 6)

- 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. In prior years, the Department calculated the rate management credits for 2003 and 2004 using a Table B-15 that included costs associated with the additional downstream capacity of water transfers. The Department recalculated the rate management credits for these years, resulting in an increase in Metropolitan's rate management credits by \$96,000. The Department applied \$66,000 of the correction to Metropolitan's revised 2005 rate management credit. We will monitor the remaining \$30,000 to ensure that it is applied to future credits. (TABLE A, Item 7).
- 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 2006 Statement of Charges, \$65,000 of these wheeling transactions were billed and credited to the cost accounting system, resulting in a reduction of costs allocated to the water contractors; accordingly, various components of Metropolitan's 2006 Statement of Charges are reduced by \$17,000. (TABLE A, Item 8)
- Power costs totaling \$558,000 and sales totaling \$609,000 for 2000, 2001 and 2002, previously unrecorded or recorded incorrectly, were properly recorded in the accounting system. This correction results in an increase to Metropolitan's variable and minimum components of \$22,000 and \$3,000, respectively, in the 2006 Statement of Charges. (TABLE A, Item 9)
- Costs totaling \$107,000 associated with the preparation of a public report on the delivery capabilities of the State Water Project and for modeling were incorrectly assigned to capital cost objects in the 2005 Statement of Charges. These errors have been corrected, which resulted in a \$3,000 reduction to Metropolitan's 2006 transportation capital component and a \$42,000 increase to Metropolitan's 2006 transportation minimum component. (TABLE A, Item 10)
- In 1978 and 1982, Metropolitan entered into exchange agreements with Kern County Water Agency and the Department that required Metropolitan to store water for delivery to Kern prior to May 31, 1992. Metropolitan delivered all but 24,870 acre-feet of this exchange water. In 2000, Metropolitan

delivered this 24,870 acre-feet 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. However, in correcting this error in the 2005 Statement of Charges, the Department erroneously removed these deliveries twice. In the 2006 Statement of Charges, the Department has corrected the 2000 calculated component, which resulted in an increase of \$66,000 in Metropolitan's variable component. (TABLE A, Item 11)

- In the prior year, we noted that costs totaling \$3,182,000 for 2002 and 2003 were excluded from the calculation of the transportation minimum, transportation capital and Delta Water Charge capital components as a result of costs not being allocated properly within the SAP system. We determined that these costs have been properly settled in SAP and, as a result, Metropolitan's transportation minimum component, transportation capital component and Delta Water Charge capital component increased by \$27,000, \$453,000 and \$104,000, respectively, in the 2006 Statement of Charges. (TABLE A, Item 12)
- In our prior year audit, we noted that the Department had been using estimated amounts for the 2000 to 2003 Hyatt-Thermalito O&M costs included in the computation of the variable and Delta Water Charge components. The Department updated the estimates to actual amounts, increasing the costs and credits by \$5,773,000, which results in an increase in the variable component of \$4,021,000 and a decrease in the Delta Water Charge of \$165,000 in Metropolitan's 2006 Statement of Charges. (TABLE A, Item 13)

Findings Projected to Result in Changes to the 2007 Statement of Charges:

- Our audit of the East Branch Enlargement capital component disclosed that the amount of debt service costs for 2005 used in the 2006 Statement of Charges was overstated by \$6,003,000 because the 25% debt cover amount was not properly removed. As a result, Metropolitan's East Branch Enlargement capital component is overstated by \$4,822,000. The Department will make the appropriate corrections in the 2007 Statement of Charges. (TABLE B, Item 1)
- Power costs totaling \$3,981,000 and sales totaling \$6,288,000 for 1999 and 2004, were not recorded or were recorded incorrectly in the accounting system. In addition, transmission costs of \$10,931,000 and station service costs totaling \$180,000 for 1999, 2000, 2001, 2003 and 2004 were not recorded properly in the accounting system. These errors result in an overstatement of Metropolitan's variable and Delta Water Charge components by \$4,576,000 and \$11,000, respectively, and an understatement to the minimum component of \$354,000 in the 2006 Statement of Charges. (TABLE B, Item 2)

- In last year's audit, we reported that the Thermalito Diversion Dam capital credits totaling approximately \$35 million for 1987 to 2035 had been erroneously excluded from the Delta Water Rate computation. During our 2005 audit, the Department indicated that Thermalito Diversion Dam credits totaling \$9,556,000 for 1987 to 1999 were included during the conversion to SAP and that for 2000 to 2035, credits totaling \$24,436,000 are included as part of the O&M estimated costs. Based on our recalculation of the credits included in the Delta Water Charge for historical years, it appears that the Thermalito Diversion Dam credits are being properly included. We noted that O&M cost estimates, which the Department has indicated to us includes the Thermalito Diversion Dam capital credits are included as a credit in the Delta Water Charge minimum component, so it would appear that the Thermalito Diversion Dam capital credits for future years are being properly included in the Delta Water Charge. However, if the Thermalito Diversion Dam amounts are included in the O&M costs estimates, then these amounts would appear to be included in the variable charges twice for 2005 and 2006 because the variable charge includes amounts for both Oroville O&M costs and Thermalito Diversion Dam capital costs. The result is to overstate the variable costs for 2005 and 2006 by \$1,334,000, which overstates Metropolitan's variable component by \$1,067,000 in the 2006 Statement of Charges. In addition, in the future the Department will provide a detail of the future cost estimates, separately identifying the powerplant and diversion dam amounts. (TABLE B, Item 3)
- FERC relicensing costs related to Oroville facilities for 1999 through 2004, included in the computation of the variable and Delta Water Charge components, are misstated by \$2,855,000 due to the use of outdated costs. As a result, Metropolitan's variable charge is overstated and the Delta Water Charge component is understated by approximately \$2,540,000 and \$91,000, respectively, in the 2006 Statement of Charges. These costs will be updated when the final power allocations are completed for these years. (TABLE B, Item 4)
- We noted a number of inconsistencies in the Hyatt-Thermalito O&M cost data that is included in the contractor billings. The 1998 1999 and 2004 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 and \$1,724,000 and understated by \$1,339,000, respectively, due to the Department not using actual O&M costs. The effect of these errors is to overstate Metropolitan's variable and minimum components by \$1,369,000 and \$87,000, respectively, and to understate Metropolitan's Delta Water Charge by \$84,000 in the 2006 Statement of Charges. The Department has indicated that the 1999 and 2004 amounts will be updated when final power allocations are performed for these years. We will pursue correction of the 1998 error with the Department. (TABLE B, Item 5)

- We compared the 2004 Devil Canyon Second Afterbay Charges for debt service included in the variable component to the debt service schedule and noted a \$1,669,000 understatement, due to the use of an outdated debt service schedule. As a result, Metropolitan's variable, minimum and Delta Water Charge components in the 2006 Statement of Charges are overstated by \$1,215,000, \$19,000 and \$3,000, respectively. We informed the Department and they plan to make the appropriate corrections in the 2007 Statement of Charges. (Table B, Item 6)
- We compared the Coastal Branch power costs included in the variable component to the Department's computation of the Coastal Branch Aqueduct system power charges and noted a discrepancy for 2006. The Department erroneously included the Coastal Branch Extension amount of \$3,094,000 instead of the Coastal Branch Reach 33A charge of \$1,782,000. As a result, Metropolitan's variable component is overstated by approximately \$1,049,000 in the 2006 Statement of Charges. The Department plans to make the appropriate correction in the 2007 Statement of Charges. (TABLE B, Item 7)
- During our reconciliation of the final 1998 energy, transmission and station service costs, we noted that power costs are overstated by \$2,659,000, power sales are understated by \$273,000, 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 \$666,000 and \$3,000, respectively, and an understatement of the minimum component by \$38,000 in the 2006 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 8)
- Our examination of the 2004 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 \$993,000, 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 2006 Statement of Charges is approximately \$437,000. The Department is aware of these unbilled charges and has indicated that they will be recorded when the cash is received. (TABLE B, Item 9)
- Each year the Department computes an estimated replacement accounting system charge and then updates these estimates to actual amounts through an over-/under-adjustment that is included as a separate line item on the variable bill. In the 2006 Statement of Charges, the Department's computation of the adjustment to prior years' charges and payments included an understated payment amount for

2005 of \$192,000 and incorrect interest rates, resulting in an overstatement to Metropolitan's variable component of \$312,000. We have informed the Department of this error and they plan to correct it for the 2007 Statement of Charges. (TABLE B, Item 10).

- The value of recovery generation for the San Luis and Warner Powerplants for 1998 were understated by \$457,000 and \$14,000, respectively, and Devil Canyon recovery generation is overstated 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 \$28,000 and \$5,000, respectively, and understate the Delta Water Charge by \$17,000 in the 2006 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 11)
- The Department used an outdated mill rate when valuing the recovery generation at the Alamo Powerplant. As a result of using an outdated mill rate, the value of recovery generation for the Alamo Powerplant for 2002 is overstated by \$97,000. In addition, we noted that the value of recovery generation for the San Luis Powerplant for 1999 was overstated by \$170,000 in SAP. The effect to Metropolitan of these errors is an overstatement of the transportation variable component of \$14,000 and an understatement of the transportation minimum and Delta Water Charge components of \$1,000 and \$6,000, respectively, in the 2006 Statement of Charges. These errors are expected to be corrected when final power allocations are completed. (TABLE B, Item 12)
- Due to the incorrect coding of a cost center, actual replacement costs totaling \$50,000 for the Gianelli Pumping Plant have been improperly included in the 2006 Delta Water Charge, which results in the overstatement of Metropolitan's 2006 Delta Water Charge by \$2,000. However, since the Department is not including these costs in the replacement charge, this error does not cause a double billing. We will work with the Department to ensure this item is corrected during the preparation of the 2007 Statement of Charges. (TABLE B, Item 13)
- We noted that costs totaling \$430,000 for 2004 were excluded from the calculation of the Delta Water Charge component as a result of costs not being allocated properly within the SAP system. As a result, Metropolitan's Delta Water Charge minimum component is understated by \$13,000 in the 2006 Statement of Charges. We have notified the Department that these cost centers need to be corrected. (TABLE B, Item 14)

- We noted that the Tehachapi Second Afterbay charges for debt service allocated to the power benefit totaling \$148,000 were not included in the calculation of the 2005 variable component. As a result, Metropolitan's variable component in the 2006 Statement of Charges is understated by \$118,000. We have notified the Department of this omission so that corrections can be made in the 2007 Statement of Charges. (TABLE B, Item 15)
- We noted during our audit that FERC cost estimates for 2005 and 2006, totaling \$11.0 million and \$6.5 million, respectively, were improperly excluded from the Delta Water Rate computation. We also noted that \$11.2 million of conservation replacement estimates for 2005 through 2007 were included in the Delta Water Rate computation and were included in the replacement rate, resulting in these estimates being billed twice. The result of these errors is to understate Metropolitan's Delta Water Charge by \$183,000 in the 2006 Statement of Charges. (TABLE B, Item 16)
- The Department did not use the correct calculated mill rates for Alamo and Mojave Powerplants in the recovery generation amounts that were included in the 2005 and 2006 power estimates. As a result, the value of recovery generation for the Alamo Powerplant is overstated by \$525,000 and the recovery generation credits for the Mojave Powerplant are understated by \$92,000. This error results in an understatement of Metropolitan's variable charges of \$347,000 in the 2006 Statement of Charges. These errors are expected to be corrected when Preliminary Power Allocation Memos for 2005 and 2006 are issued. (TABLE B, Item 17)
- We noted that costs totaling \$10,005,000 for 2001 to 2004 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 transportation minimum components are understated by \$372,000 and \$378,000, respectively, in the 2006 Statement of Charges. We have notified the Department of the cost centers that need to be corrected. (TABLE B, Item 18)
- Our prior year 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 2006 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 2007 Statement of Charges. (TABLE B, Item 19)

Findings Resulting in Credits, Refunds and Adjustments:

- The preliminary year-end allocation of 2003 off-aqueduct costs, prepared by the Department in April 2004 and updated in July 2004, has not been updated during 2005 for final costs. The Department appears to still be including contingency amounts totaling approximately \$2,000,000 for potential Reid Gardner fuel and O&M cost increases. As a result, Metropolitan's 2003 off-aqueduct charges are overstated by \$1,561,000. 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 2006. (TABLE C, Item 4)
- Our review and recalculation of Metropolitan's refunds disclosed that the refund for the WSRB earnings on federal securities investments for the period January through June 2004 was understated by approximately \$31,000. We have informed the Department of this error and expect that the Department will adjust the 2005 refund by this amount (TABLE C, Item 5).

Comparison of Metropolitan's Statement of Charges for CY 2005 and CY 2006			
(\$ millions)			
	CY 2005 SOC	CY 2006 SOC	Change*
Total Power	\$ 261	\$ 259	(2)
Total Min OMP&R	98	108	10
Total Capital	145	139	(6)
Total SWP Charges	\$ 504	\$ 506	2
Table A Water AF	2,011,500	1,911,500	(100,000)

* Increase (Decrease)

Additional Charges for CY 2005
Desert and Coachella's 100,000 AF of Table A Water
(\$ millions)

	<u>Fixed Charges</u>
Fixed Power	4
Variable Power	9
Min OMP&R	15
Capital	7
Total Fixed Charges	<u><u>35</u></u>