

- **Board of Directors**
Business and Finance Committee

January 9, 2007 Board Meeting

8-2

Subject

Authorize payment for calendar year 2007 charges for water from the State Water Project under terms of water supply contracts with the Department of Water Resources

Description

Pursuant to Section 5112 of The Metropolitan Water District of Southern California Administrative Code, the Board must approve payments for the State Water Contract. The California Department of Water Resources' invoices to Metropolitan normally are with its annual Statement of Charges (SOC), which for 2007 amounts to \$573 million. As shown in [Attachment 1](#), this is a \$60 million increase over the CY 2006 SOC.

In July 2006, DWR issued the initial CY 2007 SOC for \$565 million. In late December 2006, DWR issued a revised CY 2007 SOC increasing the charges \$8 million to \$573 million. Prior to requesting authorization to pay these State Water Project charges, staff directed preparation of an audit of the 2007 initial charges and performed an analysis of the July and December SOC.

Analysis of Initial July State Water Project CY 2007 Statement of Charges

Metropolitan's independent outside auditor, Richardson & Company, has completed an audit of the initial CY 2007 SOC. [Attachment 2](#) summarizes the results of the audit. The auditor determined that with the future correction of these audit findings, the initial charges comply with the terms and conditions of the SWP contract.

The initial 2007 charges total \$565 million, which are \$52 million, more than charges for CY 2006. A comparison of CY 2006 and initial CY 2007 SOC is provided in [Attachment 3](#). A summary of the differences is as follows:

- \$55 million increase in Power (variable and off aqueduct) charges. About half of the increase is attributable to increased fuel cost projections for project purchases of power and the off-aqueduct power supply coming from the Reid-Gardner facility in Nevada. The next most significant factor is a revised SOC estimating methodology for the power generation facilities strategically located on the aqueduct. Staff is working with DWR to assess the full implications of the change. Metropolitan's expected increased share of overall energy consumption amongst the SWP contractors is also a factor in the increased charges. These increases are partially offset by adjustments to past charges. In the new year, if SWP supply allocations, energy market rates, or variable transmission costs are less than projected, actual energy costs invoiced to Metropolitan will be lower.
- \$10 million decrease in the Minimum Operation, Maintenance, Power & Replacement (OMP&R) charges. Each year's SOC includes an estimate for the year's operating cost and a catch up adjustment for prior years over or under collection. The decrease in OMP&R charges is attributable to adjustment for prior years over collection of charges.
- \$8 million increase in capital. The increase is attributable to adjustment in past charges for the East Branch Enlargement and anticipated reduction in offsetting Monterey Amendment Rate Reduction Credits. Metropolitan is working with a group of stakeholder contractors and DWR to expand the East Branch Aqueduct's capacity to meet future needs. The East Branch conveys water to Metropolitan's Rialto Feeder, Inland Feeder and the state's Santa Ana Valley Pipeline.

Analysis of December Revision to the Statement of Charges

In December, DWR announced revisions to the SOC increasing the initial charges by \$8 million to \$573 million. A comparison of the initial CY 2007 and the December revision is provided in [Attachment 4](#) and a summary as follows:

- \$2 million increase in Power (variable) charges. This adjustment corrects errors identified in the calculation of variable power charges incurred in CY 2005 water deliveries.
- \$6 million increase in Capital charges. DWR provided Rate Reduction Credits in the initial SOC that offset capital charges. DWR no longer expects to have unencumbered funds available in 2007 for Rate Reduction Credits and is therefore eliminating the credits, which now increases Metropolitan's capital charges by \$7 million. This increase is partially offset by a \$1 million reduction in the Water Revenue Bond Surcharge. The reduction in the surcharge complies with prior audit reports and Protest Letter item that identified that DWR was inappropriately charging contractors for the portion of project facilities that is allocated to recreation and fish and wildlife enhancement. These are the first of a series of adjustments staff anticipates that DWR will be making to the charges related to recreation and fish and wildlife enhancement costs.

March 2007 Revision to the Statement of Charges

- DWR, as part of their broader initiative to resolve the financing for the recreation and fish and wildlife enhancement portion of project charges, is undertaking a comprehensive review of cost allocation methods related to recreation in the Bay-Delta. The review will correct errors or inconsistencies in past charges to the contractors for recreation costs. DWR has indicated a subsequent revision to the 2007 SOC will occur sometime around March. Adjustments are anticipated to the Delta capital and maintenance charges, Water Revenue Bond Surcharge, and power charges. The magnitude of the adjustments and whether Metropolitan's overall charges will decrease or increase is currently unknown. Richardson & Company, as part of their audit, will review the revisions.

Protest of Statement of Charges

To protect its legal position, and to pursue corrections of errors identified during the Richardson & Company audit, Metropolitan formally protested the 2006 SOC. DWR and Metropolitan management and staff are currently working to resolve as many of the protested invoice issues as possible through an administrative process instead of litigation. As part of that process, DWR agreed to defer the contractual requirement to submit Protest Letters concerning the 2007 SOC until at least 30 days after Metropolitan receives the final revised statement, which DWR anticipates issuing in March of 2007. If necessary, staff will file a protest at that time.

Efforts to Manage Power Cost

As a response to Metropolitan's and other State Water Project contractors' requests for a long-term energy plan, the Department of Water Resources has initiated strategic planning for power acquisition and related project management functions. As part of Metropolitan's and the other water contractors' efforts to work with DWR to manage power costs, DWR expanded its gas-hedging program to achieve greater cost certainty on power generated in natural gas plants.

FY 2006/07 Budget

Metropolitan's 2006/07 budget for SWP costs was based on DWR's 2006 SOC, Metropolitan's estimates of the cost of power and Metropolitan's expectation that it would not recall the transfer of 100 TAF of Table A from Desert and Coachella. The budget totals \$396 million. Based on invoices received for the first four months of the year and projections for the remaining eight months, it is anticipated that Metropolitan's actual costs will be \$23 million higher, mainly due to higher than projected power costs. Final Metropolitan expenditures in 2006/07 will depend on the amount of water received (if Metropolitan takes less water than projected, power charges will be lower). Another important factor is that Metropolitan receives refunds and credits that typically range between \$40 million and \$60 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).

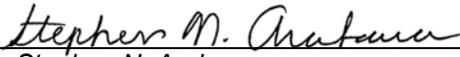
The CEQA determination is: Determine that the proposed action is not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

Staff Recommendation

Adopt the CEQA determination and authorize payments up to a total of \$573 million to the Department of Water Resources.

Fiscal Impact: Maximum payments in CY 2007 of up to a total of \$573 million. Net calendar year payments should be lower because of credits, refunds, and adjustments that are not included in the annual SOC. Payments will also vary with actual energy costs.

Business Analysis: The State Water Project provides approximately 60 percent of Metropolitan's water supply. Under terms of the water supply contracts, Metropolitan's delay in paying the annual charges could result in the suspension of water deliveries and imposition of interest on unpaid amounts. Further, the state may seek to compel the collection of property taxes or assessments in Metropolitan's service area for unpaid charges.


 Stephen N. Arakawa
 Manager, Water Resource Management

12/21/2006

Date


 Jeffrey Kightlinger
 General Manager

12/21/2006

Date

Attachment 1 – Comparison of Metropolitan's CY 2006 and December Revised CY 2007 Statement of Charges

Attachment 2 – Summary Report on the Audit of the 2007 Statement of Charges

Attachment 3 – Comparison of Metropolitan's CY 2006 and Initial CY 2007 Statement of Charges

Attachment 4 – Comparison of Metropolitan's Initial and December Revised Statement of Charges for CY 2007

Comparison of Metropolitan's CY 2006 and December Revised CY 2007 Statement of Charges			
(\$ millions)			
	CY 2006 SOC	Revised CY 2007 SOC	Change*
Total Power	\$ 257	\$ 314	\$ 57
Total Min OMP&R	117	106	(11)
Total Capital	139	153	14
Total SWP Charges	\$ 513	\$ 573	\$ 60

* Increase (Decrease)

Summary Report on the Audit of the California Department of Water Resources (Initial) CY 2007 State Water Project Statement of Charges

Summary

The Metropolitan Water District of Southern California's independent auditor completed an audit of the California Department of Water Resources CY 2007 State Water Project charges and reviewed anticipated credits and adjustments. The initial charges total \$565 million. The auditor determined that with the future correction of audit findings the initial charges materially conform to Metropolitan's State Water Project water supply contracts. A request has been prepared for Metropolitan's Board to authorize payment of the 2007 charges.

At staff's direction, Richardson & Company, Metropolitan's independent auditor, completed an audit of Metropolitan's initial \$565 million Statement of Charges for expected charges through the end of CY 2007 and determined that the charges materially conform to Metropolitan's State Water Project and Devil Canyon-Castaic Contracts. The auditor's complete opinion is on page one of the attached report. Copies of the full detailed audit report will be available from the Executive Secretary. The annual audit is an important phase in the annual Statement of Charges review process.

The auditor identified the following errors:

- Errors totaling \$1 million that resulted in net reductions to the 2007 Statement of Charges (see detail in Table A of the Summary Report).
- Errors totaling \$5.4 million that were identified during this audit that are projected to result in net reductions in future Statement of Charges (see detail in Table B of the Summary Report).

The auditor estimated credits that will be returned to Metropolitan. The estimated credits and adjustments would be reflected in Metropolitan's future annual budgets:

- Credits refunds, or adjustments that will decrease Metropolitan's charges by \$14 million (see detail in Table C of the Summary Report).

As part of their annual audit, Richardson & Company reviews any revisions to the prior Statement of Charges and correction of errors.

**THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA**

**SUMMARY REPORT ON THE
AUDIT OF THE 2007 STATEMENT OF CHARGES**

THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

SUMMARY REPORT ON THE
AUDIT OF THE 2007 STATEMENT OF CHARGES

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INDEPENDENT AUDITOR'S REPORT

The Metropolitan Water District
of Southern California
Los Angeles, California

We have audited the accompanying 2007 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. 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 such as described in our reports and others 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 2007 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, 2006

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

2007 STATEMENT OF CHARGES

<u>WATER SUPPLY CONTRACT</u>	<u>Cost Components</u>		<u>Capital</u>	<u>Total</u>
	<u>Variable</u> ^{1/}	<u>Minimum</u>		
Transportation Charge	\$ 220,944,307	\$ 71,077,628	\$ 53,211,293 ^{2/}	\$ 345,233,228
Off-Aqueduct Power Facilities Charge ^{1/}		90,906,983		90,906,983
Delta Water Charge		26,501,045	20,913,210 ^{2/}	47,414,255
East Branch Enlargement		4,321,833	31,199,400	35,521,233
Water System Revenue Bond Surcharge			34,579,696	34,579,696
Tehachapi Second Afterbay Facilities			207,636	207,636
<u>DEVIL CANYON – CASTAIC CONTRACT</u>				
Operations and maintenance – Article 17(b)		4,239,281		4,239,281
Debt service on bonds – Article 17(a)			7,359,575	<u>7,359,525</u>
			TOTAL ^{3/}	<u>\$ 565,461,837</u>

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

- 1/ Based on a water delivery schedule of 1,711,500 acre-feet.
- 2/ Amounts include Urban Rate Reduction credits of \$4,814,245 in the Transportation Charge and \$2,324,345 in the Delta Water Charge as stated under Article 51 of the Monterey Amendment.
- 3/ Metropolitan pays the capital cost component in semiannual payments and the minimum and variable cost components in monthly payments.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
COMPARISON OF THE 2006 AND 2007 STATEMENTS OF CHARGES

	Transportation Charge				Delta Water Charge		East Branch Enlargement		Water System Revenue Bonds	Total
	Capital	Minimum	Off-Aqueduct Minimum	Variable	Capital	Minimum	Capital	Minimum		
Rebill of the 2006 Statement of Charges dated October 23, 2006	\$ 57,291	\$ 84,102	\$ 71,443	\$ 185,978	\$ 19,439	\$ 28,166	\$ 27,823	\$ 4,317	\$ 34,565	\$ 513,124
Increase (decrease) due to charges in:										
Estimated costs	545	1,366	12,235	30,579	66	(977)		599		44,413
Past cost adjustments	(130)	(10,151)		(10,346)	(60)		3,352	(594)		(17,929)
Change in debt service			8				24		15	47
Power sales				(6,591)						(6,591)
Recovery generation credit				21,324		(688)				20,636
Allocations among contractors			7,221							7,221
Rebates under Monterey Amendment	3,073				1,468					4,541
NET CHANGE	3,488	(8,785)	19,464	34,966	1,474	(1,665)	3,376	5	15	52,338
2007 Statement of Charges dated July 1, 2006	\$ 60,779	\$ 75,317	\$ 90,907	\$ 220,944	\$ 20,913	\$ 26,501	\$ 31,199	\$ 4,322	\$ 34,580	\$ 565,462

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

Comparison of the 2006 and 2007 Statements of Charges

As shown on the previous page, Metropolitan's 2007 charges increased by \$60.9 million compared to the rebill of the 2006 Statement of Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component increased by \$35.0 million between 2006 and 2007. This increase results from a \$30.6 million increase in power costs and a \$21.3 million decrease in the recovery generation credit. These increases are partially offset by decreases due to a \$10.3 million decrease in the past cost adjustment and a \$6.6 million increase in power sales.

The increase in estimated costs is due primarily to an increase in the estimated mill rate for both long term and intermediate power purchases from an average of 53 mills per kilowatt-hour to an average of 65 mills per kilowatt-hour. This increase in the estimated mill rate is offset by an estimated decrease in intermediate power purchases of 1.094 gigawatt-hours as a result of a 571,870 acre-foot decrease in Table A water deliveries. The Department is also anticipating an additional \$3 million of power costs related to an ancillary services agreement with CalISO. An increase also results from the fact that Metropolitan's share of energy costs increased from 62% to 69% due to Metropolitan decreasing their water deliveries by 200,000 acre-feet compared to other contractors decreasing their water deliveries by 371,870 acre-feet. The decrease in the recovery generation credit appears to be the result of the Department correcting a discrepancy discussed in our prior year report where the recovery generation amount included as a power use in the calculation of the Statement of Charges was approximately \$23.3 million less than the amount included as power credits in the calculation. This error occurred only in the estimating process for the Statement of Charges and does not affect the invoicing rate used by the Department for 2006. We noted that the amounts shown as costs and credits are the same in the estimate of the 2007 charges. The power sales credit increased primarily due to the Department including \$13 million in anticipated revenues for CalISO ancillary services revenue, which reduces the need for the more expensive on-peak energy purchases.

The past cost adjustment decreased by \$10.3 million primarily due to the following:

- Metropolitan's calculated component for 2004 decreased \$1.4 million due to the correction of the recording of power costs and sales transactions and payment amounts.
- Metropolitan's 2005 variable charges decreased by \$6.6 million primarily as a result of replacing estimated cost and payment amounts with actual cost and payments amounts. Metropolitan's

2005 payment amount was adjusted to actual, which results in an increase of \$52.0 million in the variable component. The 2005 calculated component decreased \$58.5 million, thereby reducing the variable charges. This decrease in the calculated component is due primarily to a decrease of \$24.4 million as a result of the actual power costs being lower than the amount estimated in the prior year and a reduction in the amount of energy required by the pumping plants by 1.515 gigawatt-hours, the sale of excess energy at an average of 70 mills per kilowatt-hour compared to last year's estimate of 57 mills per kilowatt-hour, and increased revenue from the ISO's for ancillary services of \$25 million. Metropolitan's calculated component was further reduced by \$34.1 million as a result of Metropolitan's actual water deliveries for 2005 being 242,365 acre-feet less than the amount estimated in the prior year.

- The 2006 payments were more than the calculated component as a result of prior cost adjustments, which decreased the past cost adjustment by \$1.4 million.
- The past cost adjustment decreased \$.9 million due to an additional year of interest on this overpayment.

In our prior year report, we reported that we encountered difficulties in our analysis of estimated energy costs that we had 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 Department has corrected this issue by revising the 2006 net pumping power costs projection.

Off-Aqueduct Minimum: The \$19.5 million increase in Metropolitan's off-aqueduct minimum component is due primarily to a \$12.2 million increase in Metropolitan's share of the Reid Gardner Power Plant O&M and coal costs. The 2007 O&M estimate is based on revised estimates of 2006 costs, which were escalated by 30% due to a planned increase in heavy plant maintenance scheduled for 2007. The coal cost increase is due to an expected increase in coal costs from \$40 per ton to \$53 per ton and an increase in coal consumption of 50,000 tons due to an increase in the plant capacity factor from 70% to 75%. In addition to these cost increases, decreases in other contractor water deliveries of 371,870 acre-feet resulted in an increase in costs allocated to Metropolitan of \$7.2 million, even though Metropolitan decreased their requested estimated water delivery by 200,000 acre-feet in 2007. The decrease in the other contractors' water deliveries caused Metropolitan's overall percentage of the costs to increase more than 5%.

Transportation Capital: The increase of \$3.5 million in the transportation capital component is

primarily due to a decrease of \$3.1 million in the rate reduction credit under the Monterey Amendment. In addition, Metropolitan's 2005 payment amount included in the past cost adjustment was reduced by \$6.3 million, at the request of Metropolitan, to reflect the 100,000 acre-feet of water that Metropolitan transferred to Coachella and Desert Water Agencies under terms of the 2003 Exchange Agreements effective January 1, 2006 instead of January 1, 2005. The Department reduced Metropolitan's 2005 payment amount used to calculate the past cost adjustment in the 2007 Statement of Charges and instead reflected this payment as if it had been made by Desert and Coachella. Metropolitan's transportation capital component decreased by \$.4 million as a result of the amortization of this change. The remaining increase in the transportation capital component is due to an increase in estimated costs related to the following items: the pump replacement project at Edmonston Pumping Plant, which is expected to cost \$18 million through fiscal year 2009; work on the Pearblossom Administration building, which is expected to cost \$4.5 million through fiscal year 2008; seismic retrofit work on the East Branch bridges, which is expected to cost \$5 million through fiscal year 2008; Santa Ana Valley pipeline repairs, which are expected to cost \$6.1 million through fiscal year 2007; initial phase of the Perris Dam remediation, which is expected to cost \$79.2 million through fiscal year 2009; Castaic Dam and spillway analysis and repair and Castaic intake tower design and construction, which is expected to cost \$27.3 million through fiscal year 2009; the SWP communications system replacement, which is expected to cost \$14.7 million through fiscal year 2009; and special engineering analysis, which is expected to cost \$4 to \$4.5 million per year.

East Branch Capital: The East Branch Enlargement capital component increased by \$3.4 million due to a decrease in the past cost adjustment credit. The prior year charges included a past cost adjustment credit of \$4.2 million, which was due to revisions to the debt service schedules. The current year past cost adjustment credit is \$.9 million, resulting in a \$3.4 million increase in the East Branch Enlargement capital charges.

Delta Water Charge Capital: The increase of \$1.5 million in the Delta Water Charge capital component is primarily due to a decrease in the Monterey Agreement rebate of \$1.5 million in the 2007 Statement of Charges due to the reduced cash flow of the Department in the Systems Revenue Account compared to 2006.

The Delta Water Charge increased as a result of increases in estimated costs due to the addition of or increase in estimated costs for the following projects: temporary rock barriers cost increases of \$12.3 million, Delta Facilities planning cost increases of \$7.1 million, special engineering activities cost increases of \$4.8 million, the addition of cost estimates for the replacement of the Hyatt Powerplant spare draft tube stop logs and hoists totaling \$1.2 million, communication system replacement costs

of \$1.0 million, pipeline relocation and liner repair costs of \$.6 million and the addition of estimated costs for stabilization work on the Bank Pumping Plant access road of \$.4 million. These increases were partially offset by a decrease in Delta Facilities design costs of \$1.1 million.

The decrease in the Delta Water Charge related to the past cost adjustment is due to the actual costs being lower than what was projected for 2005 in the 2006 Statement of Charges. The reason for the lower costs is partially due to a change in classification of \$21.4 million from the capital to the minimum component for costs that are not funded by bonds. In addition, actual costs for 2005 for Delta Facilities design were lower than what was estimated by \$1.9 million. These decreases were partially offset by actual costs for 2005 exceeding estimated costs for the construction of temporary rock barriers by \$1.4 million.

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

Delta Water Charge Minimum: The decrease of \$1.7 million in the Delta Water Charge minimum component is primarily due to the following:

- Because it was decided that bonds would be issued for costs related to the refurbishment of Hyatt Thermalito Units 2, 4 and 6 and that these costs, along with those for Units 1, 3 and 5, would be recovered through the variable component, a RAS conservation rate was not included in the 2007 Delta Water Charge. The 2006 Delta Water Charge included \$8.6 million of cost estimates for this refurbishment work. The exclusion of the RAS conservation rate results in a decrease of \$4 million in Metropolitan's 2007 Delta Water Charge.
- Recovery generation credits are projected to increase by \$12.3 million for 2006 through 2008 due to the Department revising their estimates for Hyatt-Thermalito O&M and FERC relicensing costs to include the costs associated with the contractors agreement with the City of Oroville to develop a Supplemental Benefit Fund to pay for local projects, which results in a \$.5 million decrease in Metropolitan's Delta Water Charge.
- Decreases in estimates for the aqueduct control system and centralized operations migration project, the water accounting system and automated modeling tools for 2006 through 2008, as described further on page 11, resulted in a decrease in conservation minimum costs totaling \$6.7 million, which resulted in a decrease in Metropolitan's 2007 Delta Water Charge by \$.2 million.
- In our prior year audit, we noted that the Department had incorrectly included \$11.2 million of conservation replacements costs for 2005 to 2007 in the 2006 Delta Water Rate calculation,

which resulted in these costs being billed twice because these costs were already billed through the separate RAS conservation rate. These costs have been properly excluded from the 2007 Delta Water Rate calculation, resulting in a \$.2 million decrease in Metropolitan's Delta Water Charge in the 2007 Statement of Charges.

- Changes in reservoir storage assumptions resulted in an increase of \$ 673,000 in 2006 and 2007 due to revisions in the estimated amount of reservoir drawdown at San Luis Reservoir and an increase of \$1.5 million in 2008 due to a change in the assumption from a drawdown in the prior year to a storage increase at San Luis Reservoir in the current year estimates resulted in an increase in Metropolitan's Delta Water Charge by \$.1 million.
- The Department decreased its estimates for 2006 through 2008 for Oroville control system refurbishment from \$3.4 million to \$3.2 million, and included estimates for the Bidwell Bar Bridge repair for the same period of \$2.5 million. These changes resulted in a \$.1 million increase in Metropolitan's Delta Water Charge.
- The inclusion of estimates in 2006 through 2008 to re-roof Oroville Facilities buildings and to seal and pave roads of \$3.5 million resulted in a \$.1 million increase in Metropolitan's Delta Water Charge.
- As a result of changes in the allocation of State pro-rata costs, the SWP is being allocated more of these costs, as described further on page 61. The portion of these costs allocated to the conservation component increased by \$5.1 million for 2006 through 2008. This change resulted in an increase of \$.2 million in Metropolitan's Delta Water Charge.
- An increase in estimated costs for 2008 for the replacement of butterfly valves at the Gianelli Pumping and Generating Plant from \$2.0 million to \$7.1 million, resulted in an increase in Metropolitan's Delta Water Charge by \$.2 million.
- In our prior year audit, we noted that the Department had incorrectly omitted FERC relicensing cost estimates from the 2006 Delta Water Charge calculation. The Department has included estimates in the 2007 Statement of Charges for 2006 through 2008 of \$9.2 million, resulting in an increase in Metropolitan's Delta Water Charge of \$.3 million.
- O&M cost estimates for 2006 through 2008 were increased as a result of the increase in the average of historical costs for the last three years, upon which these estimates are based, resulting

in an increase of \$15.9 million in the conservation facilities O&M costs and a \$.4 million increase in Metropolitan's Delta Water Charge.

- Cost projections for 2009 through 2035 were increased by 2% for the Oroville, Delta Facilities and North San Joaquin and San Luis divisions, as well as Oroville Power Revenues, resulting in an \$11.8 million increase in the conservation O&M costs and a \$.2 million increase in Metropolitan's Delta Water Charge.
- The Department included CalFed costs of \$22.5 million for 2006 through 2008 for the development of Habitat Conservation Plans and Natural Community Conservation Plans for the Delta and upstream areas, Pelagic Fish Science and establishment of a Species Recovery Capital Fund. At the request of the contractors, the Department has agreed to remove \$12 million of costs related to the Species Recovery Capital Fund until the Department of Fish and Game has identified the specific projects for this money will be used. The inclusion of these costs increased Metropolitan's Delta Water Charge by \$.6 million.
- Increases in 2005 costs by \$30.8 million, due to actual amounts being more than what was projected for 2005 in the 2006 Statement of Charges, resulted in a \$.9 million increase in Metropolitan's Delta Water Charge. The increase is primarily attributed to the change in classification of \$14.3 million of conservation costs from the capital to minimum component because the coding of unbonded capital-related expenditures has been changed in the accounting system to allocate these costs to the minimum component; however, the cost estimates were originally included in the capital component.

Transportation Minimum: The decrease in the transportation minimum component of \$8.8 million is the result of a \$1.4 million increase in cost estimates and a \$10.2 million decrease in the past cost adjustment. The decrease is due primarily to the following increases and decreases:

- The Department's estimate of water gains and losses and reservoir storage changes for 2006 and 2007 was \$5 million lower in the 2007 Statement of Charges due primarily to changes in water storage assumptions in 2006. The Department assumed a large drawdown at Castaic Lake in 2006 in the 2007 Statement of Charges whereas the prior year estimate assumed only a small increase in storage. In addition, water losses for 2005 caused a decrease of \$3.9 million in the 2007 Statement of Charges because the Department did not post the adjustments to record the downstream distribution of costs in the 2006 Statement of Charges. Changes in water loss assumptions for 2007 resulted in a \$.4 million increase in minimum costs. These water

assumption changes resulted in a net \$7.6 million decrease in Metropolitan's transportation minimum component.

- The Department decreased the cost estimates for 2006 and 2007 future operations projects in the 2007 Statement of Charges. Estimates for the aqueduct control system and centralized operations migration project decreased by \$3.6 million due to delays in the project while energy operation support estimates were reduced by approximately \$.8 million. The total estimated remaining cost of the aqueduct control system through fiscal year 2009 is \$12.5 million, which consists of \$5 million for the business process evaluation project, \$3.5 million for the regulatory legal support project, \$1.3 million for the power planning/transmission evaluation project, \$1.1 million for the risk analysis automated modeling tools project, \$.6 million for the transmission rate analysis system, \$.6 for the CPS project and \$.3 million for the automated energy price forecasting and financial hedging project. In addition, the Department did not include cost estimates for the water accounting system and automated modeling tools in the 2007 Statement of Charges because these projects are being deferred to fiscal year 2009 while in the prior year \$7.0 million and \$6.5 million, respectively, were included for these projects. These decreases for future operations were partially offset by an increase in cost estimates for the SAP migration project, which is to upgrade the current SAP system, of \$1.6 million because the work is now extending into 2007. The total cost of the project is estimated to be approximately \$24 million. As a result of these changes, Metropolitan's transportation minimum component decreased by \$5.0 million in the 2007 Statement of Charges.
- Transportation minimum costs incurred for 2005 were approximately \$5.1 million less than the amounts estimated in the 2006 Statement of Charges, which resulted in a decrease in Metropolitan's minimum charges of approximately \$3.1 million.
- The Department revised the 2006 and 2007 estimates for planned extraordinary O&M activities in the 2007 Statement of Charges. Projected costs to overhaul Units 3, 5 and 6 and to recoat the discharge lines interiors at the Teerink Pumping Plant were reduced by \$3.4 million and \$.7 million, respectively, for 2006 and 2007 because the work is now expected to be done over several years rather than completed in fiscal year 2007 as originally expected. The Department expects to expend \$6.8 million on the work at Teerink Pumping Plant through fiscal year 2009. This decrease was partially offset by the addition of \$1.1 million for pump casing refurbishment work on Units 2 and 3 and for the replacement and refurbishment of field poles for Units 1 through 6 at the Pearblossom Pumping Plant and \$2 million for sealing and paving roads in the Southern Field Division. The Department expects to expend \$3.9 million on the work at

Pearblossom Pumping Plant through fiscal year 2009. These additional estimates and revisions to prior year estimates reduced Metropolitan's transportation minimum component by \$1.3 million in the 2007 Statement of Charges.

- The impact of an additional year of interest on the prior over and underpayments results in a \$.6 million decrease in Metropolitan's transportation minimum component.
- The Department posted credits totaling \$.6 million related to special water wheeling in the 2007 Statement of Charges, which resulted in a \$.2 million decrease in Metropolitan's transportation minimum component.
- Metropolitan's transportation minimum component decreased by \$.1 million as a result of revisions the Department made to the costs of the Municipal Water Quality Investigation program for 2004 through 2007.
- The Department updated the transmission costs for 2004 and 2005 from estimates to actual amounts, which resulted in a \$1.1 million increase in the 2004 costs and a \$.7 million decrease in the 2005 costs in the 2007 Statement of Charges. In addition, the estimated transmission costs for 2006 and 2007 increased by a total of \$.1 million for both years. As a result of these increases, Metropolitan's transportation minimum component increased by \$.5 million in the 2007 Statement of Charges.
- Changes in minimum cost estimates for 2006 and 2007 resulted in a \$1.4 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 2006 and 2007 increased by \$1.1 million in the 2007 Statement of Charges.
- For the past three years, the State Water Project (SWP) portion of the Department's pro-rata charges has been relatively small (approximately \$2 million) because most of the costs were allocated to California Energy Resources Scheduling (CERS). Pro-rata charges represent General Fund recoveries of statewide general administrative costs. In the preparation of the 2007 Statement of Charges, the Department revised their allocation methodology for pro-rata costs. Under the revised allocation methodology, pro-rata costs allocated to the SWP increased from \$2 million for fiscal year 2005-2006 to almost \$9 million for fiscal year 2006-2007, a net increase of \$7 million. Each pro-rata cost is allocated first across all the Department's funds (including

special, bond, and general funds) according to a variety of categories such as budget, planned labor hours and state operations. The costs allocated to the bond and general funds are then reallocated to the special funds of the Department, which consist primarily of CERS and the SWP. The SWP is responsible for approximately 61% of the total pro-rata budget. As a result of this new methodology, Metropolitan's transportation minimum component increased by \$3.6 million in the 2007 Statement of Charges.

- The revised 2006 Statement of Charges included a \$4.1 million underpayment due to revisions to 2005 and prior year costs, which causes an increase of this amount when compared to the 2007 Statement of Charges.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

COMPARISON OF THE PREVIOUSLY ESTIMATED 2007 STATEMENT OF CHARGES
TO THE STATEMENT DATED JULY 2006

	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 2007 Statement of Charges	\$ 65,290	\$ 89,320	\$ 73,218	\$ 182,374	\$ 23,231	\$ 28,166	\$ 32,095	\$ 3,539	\$ 34,515	\$ 531,748
Increase (decrease) due to charges in:										
Estimated costs	4,307	243	11,616	12,905	66	(977)		472		28,632
Past cost adjustments	(4,004)	(14,246)		(9,005)	(60)		(890)	311		(27,894)
Change in debt service			210				(6)		65	269
Power sales				15,943						15,943
Recovery generation credit				18,727		(688)				18,039
Allocations among contractors			5,863							5,863
Rebates under Monterey Amendment	(4,814)				(2,324)					(7,138)
NET CHANGE	(4,511)	(14,003)	17,689	38,570	(2,318)	(1,665)	(896)	783	65	33,714
2007 Statement of Charges dated July 1, 2006	\$ 60,779	\$ 75,317	\$ 90,907	\$ 220,944	\$ 20,913	\$ 26,501	\$ 31,199	\$ 4,322	\$ 34,580	\$ 565,462

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

**Comparison of the Previously Estimated 2007 Statement of Charges
to the Statement Dated July 2006**

As shown on the previous page, Metropolitan's 2007 Charges increased by \$33.7 million compared to last year's estimate of the 2007 Charges. The more significant of these changes are the result of the following items:

Transportation Variable: The variable component increased by \$38.6 million between last year's estimate of the 2007 charges and the 2007 Statement of Charges. The increase results from \$12.9 million in higher energy and other variable costs, a \$15.9 million decrease in power sales, and a \$18.7 million decrease in recovery generation credits which are offset by a \$9 million decrease in the past cost adjustment. 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 energy purchases will increase from 30 mills per kilowatt-hour, which was used in last year's estimates, to 38 mills per kilowatt-hour, but that less non-firm purchases will be needed due to a decrease in projected entitlement water deliveries of 540,576 acre-feet. The Department is estimating a \$2 million decrease in net ISO charges, an increase in Hyatt-Thermalito Powerplant costs of \$4.3 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 48 to 71 mills per kilowatt-hour. The Department also included \$.5 million for transportation replacement expenditures for 2007 in the 2007 Statement of Charges, and \$.8 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 57 to 36 mills per kilowatt-hour. The recovery generation credits decreased primarily due to decreased water flow through the powerplants as a result of the reduced water deliveries. The 2006 past cost adjustment overpayment of \$9.0 million is primarily the result of the \$10.3 million overpayment discussed on pages 5 and 6, which is offset by the prior year overpayment of \$1.3 million due to decreased 2006 energy costs.

Off-Aqueduct Minimum: The \$17.7 million increase in Metropolitan's off-aqueduct minimum component is due primarily to an \$11.6 million increase in Metropolitan's share of the Reid Gardner Power Plant O&M and coal costs. The 2007 O&M estimates are based on revised estimates of 2006 costs, which were escalated by 30% to account for planned heavy plant maintenance in 2007. The increase in estimated coal costs is based on an estimated increase in coal consumption of 50,000 tons and an increase in coal costs from \$40 per ton to \$53 per ton. In addition to these cost increases, decreases in other contractor water deliveries of 340,576 acre-feet resulted in an increase in costs

allocated to Metropolitan of \$5.9 million, even though Metropolitan decreased their requested estimated water delivery by 200,000 acre-feet in 2007. The decrease in the other contractors' water deliveries caused Metropolitan's overall percentage of the costs to increase more than 5%.

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

Transportation Minimum: The decrease of \$14 million in the transportation minimum component is due to a \$14.2 million decrease in the past cost adjustment and a \$.2 million increase in estimated costs. The increase in 2007 estimated costs of \$.2 million is primarily due to the following:

- As discussed on page 12, the Department revised their methodology for allocating State pro-rata costs, resulting in a \$4.4 million increase in the transportation minimum costs. As a result, Metropolitan's transportation minimum component increased by \$2.5 million in the 2007 Statement of Charges.
- The Department revised the estimates for 2007 for planned extraordinary O&M activities. Projected costs of \$1.8 million for pump casing refurbishment work on Units 2 and 3 and for the replacement and refurbishment of field poles for Units 1 through 6 at the Pearblossom Pumping Plant were added. Also added were costs of \$1 million to seal and pave roads in the Southern Divisions, \$.5 million for the overhaul of Units 2, 5 and 6 at the Buena Vista Pumping Plant and \$.4 million for road and embankment repairs at Reach 5 of the aqueduct. The Department expects to expend \$1.5 million on the Buena Vista Pumping Plant work and \$1.6 million on the Reach 5 work through fiscal year 2009. In addition, 2007 estimates were increased by \$.5 million for discharge valve repair and the overhaul of Units 11, 12 and 14 at the A. D. Edmonston Pumping Plant. The Department is still projecting costs totaling \$4.7 million to be incurred through fiscal year 2009 for the work at Edmonston. These revisions result in a \$2.4 million increase in Metropolitan's 2007 Statement of Charges.
- Municipal Water Quality Investigation costs for 2007 totaling \$1.2 million, which were not included in the prior year estimate of 2007 charges, were added to the 2007 Statement of Charges.
- Monterey Amendment litigation charges of \$1 million were added to the 2007 Statement of Charges that were not included in the prior estimates. Metropolitan's share of these charges was \$.5 million.

- The estimated costs for transmission service for 2007 were \$.2 million more than the prior year estimate, resulting in a \$50,000 increase in Metropolitan's transportation minimum component.
- The Department's estimate of water losses for 2007 was \$.7 million lower than previously estimated, which results in a decrease in Metropolitan's transportation minimum component by \$.4 million.
- As a result of the Department updating its O&M cost estimates using the previous three years of historical cost information, escalated by 3%, estimated transportation minimum costs for 2007 decreased by \$2 million, causing a \$.9 million decrease in Metropolitan's 2007 Statement of Charges.
- The Department decreased its cost estimates for future operations projects for 2007 in the 2007 Statement of Charges. The decrease is primarily due to the Department excluding approximately \$6.5 million of costs for automated modeling tools and \$6.3 million for the water accounting system from the 2007 Statement of Charges that were included in the prior year 2007 estimates because these projects are being deferred to fiscal year 2009. These decreases were partially offset by \$3.6 million of SAP migration costs estimates added for 2007. As a result of these changes, Metropolitan's transportation minimum component decreased by \$5 million in the 2007 Statement of Charges.

We noted that the \$14.2 million change in past cost adjustment is due mainly to adjustments for 2004 to 2006 consisting of the following:

- The Department's estimate of water gains and losses and reservoir storage changes for 2006 were \$5 million lower in the 2007 Statement of Charges due primarily to changes in water storage assumptions. The Department assumed a large drawdown at Castaic Lake in the 2007 Statement of Charges whereas the prior year estimate assumed only a small increase in storage. In addition, storage changes for 2005 were \$5.3 million lower in the 2007 Statement of Charges because the Department did not post the adjustments to record the downstream distribution of costs. These changes resulted in a net \$9 million decrease in Metropolitan's transportation minimum component.
- The Department decreased the cost estimates for 2006 future operations projects in the 2007 Statement of Charges. The estimates for the aqueduct control system centralized operations

migration project was reduced by \$2.3 million and SAP migration estimates were reduced by \$2 million due to the work being delayed to subsequent fiscal years. In addition, the Department did not include cost estimates for the water accounting system while in the prior year \$.8 million was included for this project. As a result of these changes, Metropolitan's transportation minimum component decreased by \$2.5 million in the 2007 Statement of Charges.

- Transportation minimum costs incurred for 2005 were approximately \$3.7 million less than the amounts estimated in the 2006 Statement of Charges, which resulted in a decrease in Metropolitan's transportation minimum charge of approximately \$2 million.
- The Department revised the estimates for 2006 planned extraordinary O&M activities, causing a \$1.2 million decrease in minimum costs. Projected costs to overhaul Units 3, 5 and 6 and to recoat the discharge line interiors at the Teerink Pumping Plant were reduced by \$3.4 million and estimates for the overhaul of Units 1, 2, 5 and 6 at the Chrisman Pumping Plant were reduced by \$.3 million in the 2007 Statement of Charges because this work is now anticipated to carry over into fiscal years 2008 and 2009, whereas last year's estimates assumed the work would be completed in fiscal year 2007. The Teerink work is expected to cost \$6.8 million and the Chrisman work is expected to cost \$4.5 million through fiscal year 2009. These decreases were offset by the addition of \$1.1 million for 2006 for pump casing refurbishment work on Units 2 and 3 and for the replacement and refurbishment of field poles for Units 1 through 6 at the Pearblossom Pumping Plant. Estimates also increased \$.3 million for the overhaul of Units 3, 5 and 6 at the Buena Vista Pumping Plant and \$1 million for sealing and paving roads in the Southern Division. These revisions to prior year estimates reduced Metropolitan's transportation minimum component by \$1.1 million in the 2007 Statement of Charges.
- The impact of an additional year of interest on the prior over and underpayments results in a \$.6 million decrease in Metropolitan's transportation minimum components.
- The Department posted credits totaling \$.6 million related to special water wheeling in the 2007 Statement of Charges, which resulted in a \$.2 million decrease in Metropolitan's transportation minimum component.
- Due to revisions and adjustments to the Municipal Water Quality Investigation Charges for 2004 to 2006, Metropolitan's transportation minimum component decreased by \$.2 million.

- The Department updated the transmission costs for 2004 and 2005 from estimated to actual amounts, which resulted in a \$1.1 million increase in the 2004 and a \$.7 million decrease in the 2005 costs in Metropolitan's 2007 Statement of Charges. In addition, the estimated transmission costs for 2006 increased by \$.2 million. As a result, of these revisions, Metropolitan's transportation minimum component increased by \$.5 million in the 2007 Statement of Charges.
- As discussed on page 12, the revision of the State pro-rata cost allocation increased 2006 transportation minimum costs by \$2 million, which results in an increase of \$1.1 million in Metropolitan's 2007 Statement of Charges.

Transportation Capital: The decrease of \$4.5 million in the transportation capital component is primarily due to the inclusion of rate reduction credits under the Monterey Amendment of \$4.8 million in the 2007 Statement of Charges. In addition, the Department included the past cost adjustment credit of \$4.0 million, which was offset by an increase in estimated costs for 2006 of \$4.3 million due to projected increases in capital costs at the Mojave and Santa Ana Divisions. The increase at the Santa Ana Division appears to be primarily for the planned seismic retrofit of the East Branch bridges and costs related to Pearblossom administration building improvements. The increase at the Mojave Division is for the Perris Dam Mitigation Project including dam remediation and tower retrofit costs. Included in the past cost adjustment is a decrease of \$.4 million that represents the amortization of the change in the 2005 payment amount related to the Coachella and Desert 2003 Exchange Agreement as described on page 7.

Delta Water Charge Capital: The decrease of \$2.3 million in the Delta Water charge capital component is due to the prior year estimate not including the Monterey Amendment rebate of \$2.3 million. See pages 7 and 8 for the explanation of additional changes.

Delta Water Charge Minimum: Refer to explanation on pages 8 through 10.

Future Potential Refunds and Adjustments

Metropolitan's estimated 2007 charges of \$565 million do not include certain credits, refunds and adjustments that are expected in 2007 as part of the Department's normal accounting and billing process. Refunds are expected to reduce Metropolitan's 2007 billings by approximately \$51.6 million for the following items:

	<u>Estimated Refund Date</u>		
<u>Cover – Off-Aqueduct</u>			
Return of January – June 2005	November 2006	\$ 3,257,000	
Return of July – December 2005	April 2007	<u>3,070,000</u>	\$ 6,327,000
<u>Cover – Water System Revenue Bond (WSRB)</u>			
Return of July 2005	November 2006	7,034,000	
Return of January 2006	April 2007	<u>7,117,000</u>	14,151,000
<u>Cover – East Branch Enlargement (EBE)</u>			
Return of September 2005	November 2006	2,411,000	
Return of March 2006	April 2007	<u>3,203,000</u>	5,614,000
<u>Cover – Tehachapi 2nd Afterbay</u>			
Return of March & September 2005	November 2006	<u>29,000</u>	29,000
<u>Federal Securities Earnings</u>			
Earned January – June 2006	November 2006	500,000	
Earned July – December 2006	March 2007	<u>500,000</u>	1,000,000
<u>SMIF Interest – Off-aqueduct</u>			
Earned January – June 2006	November 2006	339,000	
Earned July – December 2006	March 2007	<u>339,000</u>	678,000
<u>SMIF Interest – WSRB</u>			
Earned January – June 2006	November 2006	576,000	
Earned July –December 2006	March 2007	<u>576,000</u>	1,152,000
<u>SMIF Interest – EBE</u>			
Earned January – June 2006	November 2006	90,000	
Earned July – December 2006	March 2007	<u>90,000</u>	180,000
<u>SMIF Interest – Reserve Account</u>			
Earned January – June 2006	November 2006	1,810,000	
Earned July – December 2006	March 2007	<u>1,810,000</u>	3,620,000
<u>Devil Canyon Second Afterbay</u>			
Return of 2006 EBE debt service credits	May 2007	<u>3,826,000</u>	3,826,000
<u>Prior Year Adjustments – Off-Aqueduct</u>			
OAP prior year adjustments 2005	November 2006	<u>15,000,000</u>	<u>15,000,000</u>
TOTAL ESTIMATED REFUND			<u>\$ 51,577,000</u>

The 2007 variable and off-aqueduct charges may be reduced further if 2007 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 2007 STATEMENT OF CHARGES

During our audit, we encountered a number of issues related to the calculation of various components of the 2007 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.

Variable Component Billings. Since the implementation of SAP, the Department has had difficulty calculating the water table redistribution entries that reallocate costs between the minimum, variable and Delta Water Charge components for water gains and losses and changes in reservoir storage within the SAP system. To properly reflect these water table redistribution entries, the Department has had to perform the calculation outside of the system and post entries manually in SAP for the preparation of the 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. This calculation that was developed in the SAP system has not been used in either the 2006 or 2007 Statement of Charges. For the 2006 and 2007 Statements of Charges, the Department continued to prepare the necessary downstream allocation of costs outside of the system and manually posted the entries to SAP. 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 2007 Statement of Charges, the Department calculated the 2007 WSRB Surcharge using the relative proportion of the Surcharge to total debt service from the 2002 Statement of Charges and applied that proportion to 2007 debt service costs that include WSR bonds through Series AD issued in July 2005. We will monitor the Department's progress in re-evaluating the calculation of the Surcharge in the SAP/CARA system. We will audit the revised calculation after it is completed by the Department.

The Department has included in the Surcharge \$1.6 million in recreation capital costs that have not been reimbursed by the State; however, in evaluating Metropolitan's claim against the Department for

unresolved billing issues, the Department's legal counsel determined that Water Code Section 11912 (part of the Davis Dolwig Act) prohibits the Department from including the costs of the development of recreation, or for fish and wildlife, in charges to the water contractors. These costs are the responsibility of the State of California general fund or other available funds. Legal counsel will not allow the Department to issue revenue bonds until a plan is developed to repay the bonds used to finance recreation costs to comply with revenue bond covenants, and adjust the contractors' bills. The Department has reached its limit on commercial paper capacity and is anticipated to deplete its available cash in November 2006, so capital expenditures may need to be suspended until this issue is resolved.

The Department has determined that it has bonded for \$40.2 million of recreation costs from 1986 to 2006 with Water System Revenue Bonds. Principal payment on this debt through December 2006 total \$7.4 million, along with \$27.4 million of interest payments. The remaining principal balance owned is \$32.8 million. Payments have been made by the Department with excess cash, including \$10 million of payments collected from the contractors through the WSRB Surcharge since 1998. While the Department plans to remove the recreation amount included in the 2007 Surcharge as part of the December 2006 rebilling, the adjustment for 1998 through 2006 will be made by revising the rate management credits, which will cause the rate management credit amount to become negative, whereby the contractors would owe money back to the Department. However, the Department is considering revising the recreation allocation percentage in the Delta so that additional costs are allocated to the contractors, which will result in an increase in Metropolitan's Delta Water Charge. The Department is anticipating that this revision would be made in a revised 2007 Statement of Charges to be prepared in the first quarter of 2007. Metropolitan and the other contractors have expressed to the Department that any supplemental bill that would be required should be due over a period of time rather than all at one time. The Department plans to develop a new bond resolution that will exclude capital costs that have been allocated to recreation. These recreation capital costs will instead be funded from the Capital Facilities Account and reimbursements from the General Fund. A Committee and Workgroup that includes representative from the water contractors has been developed to work with the Department to resolve this issue. We will continue to monitor the progress of this issue and the impact of decisions made on the Statement of Charges.

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. The costs 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, such that a portion of these costs would be billed through the variable component instead of the conservation replacement rate. The Division of Fiscal Services proposed classifying the costs as capital and issuing bonds to finance the costs. However, the Department determined that they could not issue bonds for Units 1, 3, and 5 because the work on these Units was completed in 2004 and bonds can only be issued for costs incurred 18 months prior to the bond offering. As a result, the Department indicated that the costs of Units 1, 3 and 5 would continue to be billed through the conservation replacement rate, while the costs for Units 2, 4 and 6 would be included in the variable component.

Metropolitan expressed to the Department that they believe that the billing for all six units should be treated consistently. Since these pumps and turbines are allocable entirely to the power purpose, Metropolitan believes that costs for all units should be billed through the variable component. As a result of the Hyatt refurbishment costs being included in the conservation replacement rate in the 2006 and prior Statements of Charges, Metropolitan's Delta Water Charge increased by \$12,158,000. If these costs were included in the variable component, costs back to 2000 totaling approximately \$38 million would be included in the computation of the variable charges, of which Metropolitan's share would be approximately \$30,000,000. These additional costs would not increase charges in one year because for the Units 2, 4 and 6 that will be bonded for, the Department will include the debt service amount rather than the actual costs. The Department has indicated that they will include the Hyatt refurbishment costs in the December 2006 rebilling of the 2007 Statement 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 replacement costs of facilities other than Oroville of \$772,000 through 2005 that have not been included in the conservation replacement rate, resulting in an understatement of the Delta Water Charges. 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.

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 consolidated with other reserves even though the 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 contractors' 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 only \$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 indicated that the cover refunds for January through July 2005, expected to be issued October 2006, will reflect the revised allocation.

The Department has not yet addressed the issue of the off-aqueduct reserves funding the debt service reserves for other bond issues, which was initially identified in 2001. 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. We have provided documents to new Department personnel that will be responsible for evaluating this issue.

During 2006, the Department reported to the contractors during an Audit-Finance Committee meeting that the bond debt service reserve account is over funded by \$40 million. We were unable to obtain a response from the Department about whether the excess debt service reserve of \$26,821,239 is included as part of the \$40 million excess reported by the Department in 2006. The Department initially indicated that this \$40 million would be returned by the end of 2006, but it has been delayed by the recreation capital cost reimbursement issue that impacts the Department's cash flow, as discussed on page 23.

Rate Management Credits. For the purpose of computing the rate management credits, the Monterey Amendment states that the allocation of the rate management credits, which utilizes the transportation capital component repayment obligation from 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, 2006 and 2007 should have been computed using the Bulletin 132-04 Table B-15 in order to comply with the five-year provision. The Department has agreed to revise the allocation percentages for the next rate management credit calculation. If the 2005, 2006 and 2007 credits were calculated using the Table B-15 from Bulletin 132-04, Metropolitan's 2005, 2006 and 2007 credits would be reduced by \$860,000, \$555,000 and \$408,000, respectively.

TABLE A
Summary of Settled Audit Findings Resulting in Changes to
the 2007 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 2006 which affected the 2007 Statement of Charges. A more detailed description of these items starts on page 32.

Items	Effect on Metropolitan's 2007 Costs Increase (Decrease)
Corrections to be included in the rebill of the 2007 Statement of Charges	
<u>Previously Reported Findings</u>	
1. Amount representing recreation portion of debt service costs of \$1,648,000 were properly removed from the WSRB Surcharge (refer to pages 32 and 33).	\$ (972,000)
<u>New Findings</u>	
2. Water deliveries of 153,700 acre-feet were excluded from the computation of the variable unit rates (refer to page 33).	975,000
Corrections included in the original 2007 Statement of Charges	
<u>Previously Reported Findings</u>	
3. Coastal Branch Reach 33A debt service charges previously excluded were properly included in the 2006 variable charges instead of the Coastal Extension debt service charges (refer to page 33).	(1,049,000)
4. Wheeling credits for 2002 and 2003 previously excluded were properly included in the computation of the variable fish replacement charge (refer to page 33).	(321,000)
5. The replacement over-/under-adjustment was revised to use correct payment amounts and correct interest factors (refer to pages 33 and 34).	(312,000)
6. Costs totaling \$430,000 previously excluded from the accounting system were properly included in the Delta Water Charge component (refer to page 34).	13,000
7. Debt service amounts for the Tehachapi Second Afterbay previously excluded were properly included in the calculation of the 2005 variable component (refer to page 34).	118,000

Items	Effect on Metropolitan's 2007 Costs Increase (Decrease)
8. FERC costs totaling \$17.5 million that were incorrectly omitted were included in the Delta Water Rate calculation and conservation replacement costs totaling \$11.2 million that were previously included were correctly excluded from the Delta Water Rate calculation (refer to page 34).	\$ 183,000
9. The recovery generation amount were increased by \$433,000 to reflect the correct amounts (refer to page 34).	<u>347,000</u>
NET BENEFIT	<u>\$ (1,018,000)</u>

TABLE B
Summary of Audit Findings Projected to Result in Changes to
the 2008 Statement of Charges

Throughout our examination, we worked with Department and Metropolitan representatives to resolve findings which arose during our audit of the 2007 Statement of Charges. We will work with the Department to ensure the correction of these findings in the 2008 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 2008 Costs Increase (Decrease)
<u>New Findings</u>	
1. The 2007 recovery generation amounts for Alamo and Mojave Siphon included in the variable component calculation are understated by \$1,949,000 (refer to page 35).	\$ (1,559,000)
2. Coastal Extension debt service charges were erroneously included in the 2007 variable charges instead of the Coastal Branch Reach 33A charges (refer to page 35).	(1,167,000)
3. The Los Angeles Department of Water and Power (LADWP) peaking credit was excluded from the computation of the 2005 variable component (refer to page 35).	(470,000)
4. Hyatt-Thermalito operating costs for 2006, included as a credit in the Delta Water Charge, are understated by \$5,125,000 (refer to page 35).	(162,000)
5. The adjustment to the 2007 rate management credit to correct errors in previous credits was understated by \$79,000 (refer to page 36).	(79,000)
6. Debt service amounts for the Tehachapi Second Afterbay were overstated by \$13,000 in the calculation of the 2007 variable component (refer to page 36).	(10,000)
7. Transportation replacement estimates totaling \$500,000 for the Banks Pumping Plant were improperly excluded from the computation of the transportation replacement charges (refer to page 36).	400,000
<u>Previously Reported Findings</u>	
8. Costs incurred at the Oroville facilities associated with FERC relicensing for 1999 to 2005, are overstated in the transportation variable charges by \$1,852,000 and understated in the Delta Water Charge by \$1,948,000, respectively (refer to page 36).	(2,708,000)

Items	Effect on Metropolitan's 2008 Costs Increase (Decrease)
9. Hyatt-Thermalito operating costs for 1998, 1999, 2004 and 2005, 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 \$2,739,000 (refer to pages 36 and 37).	(1,211,000)
10. Peaking credits totaling \$1,884,000 for 1998 and 1999 were excluded from the computation of the variable component (refer to page 37).	(1,080,000)
11. Adjustments related to 2006 and 2007 Thermalito Diversion Dam Powerplant capital cost repayment amounts totaling \$1,320,000 were erroneously included twice in the variable component (refer to pages 37 and 38).	(1,056,000)
12. Final energy costs for 1998 were not recorded or were recorded incorrectly in the bills (refer to page 38).	(906,000)
13. Credits totaling \$993,000 for wheeling water transactions were not recorded in the cost accounting system (refer to page 38).	(437,000)
14. Recovery generation credits for San Luis, Devil Canyon and Warne Powerplants for 1998 are misstated by \$396,000 (refer to page 38).	(22,000)
15. 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 39).	(10,000)
16. Gianelli Pumping Plant replacement costs totaling \$50,000 are improperly included in the calculation of the Delta Water Charge (refer to page 39).	(2,000)
17. Power costs and revenues, transmission, station service, and peaking costs totaling \$31,747,000 for 1999 through 2005 were not recorded or were recorded incorrectly in the accounting system (refer to page 39).	61,000
18. Incorrect wheeling contractor payment and water amounts were used in the variable fish replacement charge calculation (refer to page 39).	627,000
19. Certain cost centers are not properly mapped to the CARA system, excluding costs totaling \$22,777,000 from the Statement of Charges (refer to pages 39 and 40).	1,313,000
20. The 2006 variable fish replacement charge was improperly excluded from the computation of the variable component (refer to page 40).	1,424,000
21. Outdated debt service amounts were used to determine the Devil Canyon Second Afterbay charges for 2002 through 2006 in the variable component (refer to page 40).	<u>1,593,000</u>
NET BENEFIT	<u>\$ (5,461,000)</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 2008 Costs Increase (Decrease)
<u>New Findings</u>	
1. The year-end allocation of 2005 off-aqueduct costs has not been issued, overstating charges to contractors by an estimated \$15.3 million (refer to page 40).	\$ (11,145,000)
2. The Bottlerock debt service cover for 2007 was overstated by \$27,000 (refer to pages 40 and 41).	(20,000)
3. Fuel and O&M costs were understated by \$56,000 in the computation of the 2004 off-aqueduct charges (refer to page 41).	45,000
<u>Previously Reported Findings</u>	
4. 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 41).	(1,561,000)
5. 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 41).	(655,000)
6. Certain Coastal Branch capital cost repayment amounts were excluded from the computation of the 2000 WSRB Surcharge (refer to page 41).	<u>(632,000)</u>
NET BENEFIT	<u>\$ (13,968,000)</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 2007 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 2007 Statement of Charges are summarized in Table A on pages 27 and 28, those projected to be reflected in the 2008 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 2007 Statement of Charges:

- Due to increased scrutiny of the Department's financial condition by bond underwriters in 2001, the Department determined that \$30,807,000 of the Water System Revenue Bond (WSRB) proceeds allocable to recreation would be recovered by an annual charge included in the WSRB Surcharge to

generate a revenue stream for these costs that the State of California has not reimbursed the Department. Consequently, the 2002 through 2007 Surcharges have included \$1,648,000 per year to recover these recreation costs. The Department's legal counsel determined that the Davis Dolwig Act prohibits billing contractors for recreation costs. The Department has agreed to remove the \$1,648,000, of which Metropolitan's share is \$972,000, from the 2007 Statement of Charges as part of the December 2006 rebilling, but will work with the contractors on the approach for returning the amounts included in the 2006 and prior Statements of Charges, since it will result in reductions to rate management credits. We will continue to monitor this situation. (TABLE A, Item 1)

- We compared Metropolitan's 2005 schedule of water deliveries to the Department's records and noted 153,700 acre-feet of water was excluded from Metropolitan's calculated component used to determine the over-/under-payment in the 2007 Statement of Charges. We also noted that these water deliveries, as well as an additional 23,298 of other contractor water deliveries, were excluded from the variable unit rates used to calculate the 2005 variable calculated component. The result of these errors is to understate Metropolitan's variable component by \$975,000 in the 2007 Statement of Charges. We discussed this error with the Department and they indicated that this item will be corrected in the December re-bill of the 2007 Statement of Charges. (TABLE A, Item 2)
- Our prior year comparison of the Coastal Branch power costs included in the variable component to the Department's computation of the Coastal Branch Aqueduct system power charges disclosed 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. The Department made the appropriate correction in the 2007 Statement of Charges. As a result, Metropolitan's variable component decreased by approximately \$1,049,000 in the 2007 Statement of Charges. (TABLE A, Item 3).
- Our prior year audit of the Department's variable fish replacement computation disclosed that the wheeling credits included in the calculation were outdated or were improperly excluded from the computation. These wheeling credits were corrected in the computation of the 2007 variable fish replacement charge, which reduced Metropolitan's variable component in the 2007 Statement of Charges by \$321,000. (TABLE A, Item 4)
- 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. We informed the Department of this error and they used the correct interest rates and the correct 2005 payment amount when calculating the over-/under-adjustment for the 2007 Statement of Charges, which resulted in a decrease to Metropolitan's variable component of \$312,000. (TABLE A, Item 5).

- We noted that costs totaling \$430,000 for 2004 were excluded from the calculation of the Delta Water Charge component in the 2006 Statement of Charges as a result of costs not being allocated properly within the SAP system. These costs were included in the 2007 Statement of Charges and, as a result, Metropolitan's Delta Water Charge minimum component increased by \$13,000. (TABLE A, Item 6)
- In the last year's audit, 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. We notified the Department of this omission and a correction was made in the 2007 Statement of Charges. As a result, Metropolitan's variable component in the 2007 Statement of Charges increased by \$118,000. (TABLE A, Item 7).
- We noted during our prior year audit that FERC estimates for 2005 and 2006, totaling \$17.5 million, 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 also included in the replacement rate, resulting in these estimates being billed twice. The Department has corrected this error in the 2007 Statement of Charges, resulting in an increase in Metropolitan's Delta Water Charge by \$183,000. (TABLE A, Item 8)
- Our prior year audit disclosed that the Department incorrectly calculated the 2005 and 2006 recovery generation credits for the Alamo and Mojave Siphon Powerplants, overstating the value of recovery generation by \$433,000. The amounts were corrected when the Department prepared the revised 2005 power allocations and revised the 2006 recovery generation credit. As a result, Metropolitan's transportation variable component increased by \$347,000 in the 2007 Statement of Charges. (TABLE A, Item 9)

Findings Projected to Result in Changes to the 2008 Statement of Charges:

- Our audit disclosed that the Department calculated the 2007 recovery generation credits for Alamo and Mojave Siphon using incorrect mill rates, understating the value of recovery generation for Alamo by \$785,000 and understating the value of recovery generation for Mojave by \$1,164,000. As a result, Metropolitan's transportation variable component is overstated by \$1,559,000 in the 2007 Statement of Charge. These errors are expected to be corrected when a Preliminary Power Allocation Memo for 2007 is issued. (TABLE B, Item 1).
- 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 2007. The Department erroneously included the Coastal Branch Extension amount of \$3,241,000 instead of the Coastal Branch Reach 33A charge of \$1,781,000. As a result, Metropolitan's variable component is overstated by approximately \$1,167,000 in the 2007 Statement of Charges. The Department plans to make the appropriate correction in the 2008 Statement of Charges. (TABLE B, Item 2)
- LADWP paid \$587,100 to the Department in 2005 for interruption and curtailment of capacity as well as for peaking capacity foregone by the Department at the Castaic Powerplant. However, this payment did not reduce variable costs allocated to the Castaic Powerplant, as it was not properly recorded in the accounting system. The Department's exclusion of this credit results in an overstatement of \$470,000 to Metropolitan's 2005 variable component in the 2007 Statement of Charges. The Department has indicated that the credit will be included when a FALPOC is issued for 2005. (TABLE B, Item 3)
- We were unable to obtain information that we have received in the past showing future estimates for Hyatt-Thermalito O&M costs. However, we did receive a document indicating how the amount included in the variable component was determined. We noted that the charge included in the variable component and the credit included in the Delta Water Charge differed by approximately \$5,125,000. The understatement of the credit included in the Delta Water Charge results in the overstatement of Metropolitan's Delta Water Charge by \$162,000 in the 2007 Statement of Charges. We informed the Department of this difference but received no response. We expect that this error will be corrected in the computation of the 2008 Statement of Charges, when these 2006 charges and credits will be adjusted to actual amounts. (TABLE B, Item 4).

- For the purpose 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 Table A. In previous audits, we reported that the Department had recalculated the credits for 1997 through 2004 because they had incorrectly used a Table B-15 that had been adjusted for the changes related to the permanent transfer of entitlement water. This recalculation resulted in an additional credit of \$803,000 for Metropolitan, of which \$606,000 was included in the 2005 rate reduction credit and \$119,000 plus interest was included in the 2007 rate reduction credit. The remaining \$79,000 was improperly excluded from the 2005 rate reduction credit due to an error in the Department's reallocation computation. We will continue to monitor the return of this additional credit. (Table B, Item 5).
- We noted that the Tehachapi Second Afterbay charge for debt service allocated to the power benefit was overstated by \$13,000 in the calculation of the 2007 variable component. As a result, Metropolitan's variable component in the 2007 Statement of Charges is overstated by \$10,000. We have notified the Department of this difference so that the correct amount can be included in the 2008 Statement of Charges. (TABLE B, Item 6).
- The Department's calculation of the transportation replacement charges for 2007 excluded \$500,000 of estimated replacements costs for 2006 and 2007 for the Banks Pumping Plant. The exclusion of this amount results in a \$400,000 understatement of Metropolitan's transportation variable component in the 2007 Statement of Charges. (TABLE B, Item 7).
- FERC relicensing costs related to Oroville facilities for 1999 through 2005, included in the computation of the variable and Delta Water Charge components, are misstated by \$1,948,000 due to the use of outdated costs and the exclusion of the 1999 amount. As a result, Metropolitan's variable charge is overstated and the Delta Water Charge component is understated by approximately \$2,780,000 and \$72,000, respectively, in the 2007 Statement of Charges. These costs will be updated when the final power allocations are completed for these years. (TABLE B, Item 8).
- We noted a number of inconsistencies in the Hyatt-Thermalito O&M cost data that is included in the contractor billings. The 1998, 1999, 2004 and 2005 Hyatt-Thermalito O&M costs included in the variable component and the credits included in the computation of the Delta Water Charge are understated by \$1,832,000 and \$2,739,000, 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 \$1,239,000 and \$87,000, respectively, and to understate Metropolitan's Delta Water Charge by \$115,000 in the 2007 Statement of Charges. The Department has indicated that the 1999, 2004 and 2005 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 9).

- In 2005, the Department issued a power allocation memo for 1998. This power allocation memo included a peaking charge for 1998 of \$351,000, but the Department had not reduced the system power costs by this amount. If this peaking charge were included in the calculation of the variable charge, Metropolitan's transportation variable and transportation minimum components would be reduced by \$150,000 and \$28,000, respectively. In addition, we noted errors in the calculation of the 1998 peaking service costs that understates these costs by \$206,000. In 2005, the Department also issued a power allocation memo for 1999 in draft form. This power allocation memo includes a peaking charge for 1999 of \$1,533,000. The Department has not reduced the system power costs by this amount. If this peaking charge were included in the calculation of the variable charge, Metropolitan's transportation variable and minimum components would be reduced by \$817,000 and \$85,000, respectively. In addition, we noted errors in the calculation of the 1999 peaking service costs that appears to be understating these costs by \$202,000. We have informed the Department of the errors we noted in the 1998 and 1999 peaking computations and they are revising the calculations. In addition, we believe that the Department should reflect the corrected peaking amounts in the contractor's charges. (TABLE B, Item 10).
- In previous audits, 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 \$24,417,000 are included as part of the O&M estimated costs. However, the Department was not provided the documentation for us to verify that these costs were included in SAP. 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 cost estimates, then these amounts would appear

to be included in the variable charges twice for 2006 and 2007 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 2006 and 2007 by \$1,320,000, which overstates Metropolitan's variable component by \$1,056,000 in the 2007 Statement of Charges. We have requested that the Department provide a detail of the future cost estimates, separately identifying the Powerplant and Diversion Dam amounts. (TABLE B, Item 11).

- 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 \$501,000, transmission costs are understated by \$293,000, station service costs are overstated by \$95,000, 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 component by \$1,048,000 and an understatement of the minimum component by \$142,000 in the 2007 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 12).
- 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, was 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 2007 Statement of Charges is approximately \$437,000. We will continue to monitor the situation to ensure that these deliveries are properly credited to the contractors. (TABLE B, Item 13).
- The value of recovery generation for the San Luis and Warne 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 understate the transportation minimum components by \$28,000 and \$6,000, respectively, in the 2007 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 14).

- The Department used an outdated mill rate when valuing the recovery generation at the Alamo Powerplant, resulting in the value of recovery generation for the Alamo Powerplant for 2002 being 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. The effect to Metropolitan of these errors is an overstatement of the transportation variable component of \$10,000 in the 2007 Statement of Charges. These errors are expected to be corrected when final power allocations are completed. (TABLE B, Item 15).
- 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 2007 Delta Water Charge, which results in the overstatement of Metropolitan's 2007 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 2008 Statement of Charges. (TABLE B, Item 16)
- Power costs totaling \$14,848,000 and sales totaling \$2,676,000 for 1999 through 2005, were not recorded or were recorded incorrectly in the accounting system. In addition, transmission costs of \$14,042,000 and station service costs totaling \$181,000 for 1999, 2000, 2001, 2003, 2004 and 2005 were not recorded properly in the accounting system. These errors result in an understatement of Metropolitan's variable component by \$3,529,000 and an overstatement to the minimum component of \$3,468,000 in the 2007 Statement of Charges. We have provided a list of mispostings to the Department so that the corrections can be made. (TABLE B, Item 17)
- Our audit of the Department's variable fish replacement computation disclosed that actual contractor payment and water delivery amounts were not used in calculating the fish replacement charges. Metropolitan's variable component included in the 2007 Statement of Charges is understated by \$627,000 as a result of these errors. We will continue to work with the Department to resolve these differences. (TABLE B, Item 18).
- We noted that costs totaling \$22,777,000 for 2001 to 2006 were excluded from the calculation of the Delta Water Charge and transportation capital and minimum components, as a result of certain cost centers not being mapped to the CARA system. As a result, Metropolitan's Delta Water Charge, transportation capital and transportation minimum components are understated by \$511,000, \$239,000 and \$563,000, respectively, in the 2007 Statement of Charges. We have provided a list of cost centers to the Department that appear to be improperly excluded from the Statement of Charges

but have not received a response indicating whether they concur with our analysis. (TABLE B, Item 19).

- As noted in our prior year report, the Department did not perform a calculation of the fish replacement charge for the 2006 Statement of Charges. We determined in this year's audit that while the Department has performed the calculation, they did not include the 2006 fish replacement charge of \$1,781,000 in the transportation variable component, resulting in an understatement of \$1,424,000 in Metropolitan's 2007 Statement of Charges. The Department is aware of this omission. We expect that the 2006 fish replacement charges will be included in the 2008 Statement of Charges. (TABLE B, Item 20)
- We compared the Devil Canyon Second Afterbay Charges for debt service included in the variable component to the debt service schedule and noted a \$2,244,000 understatement for 2002 through 2006, due to the use of an outdated debt service schedule. As a result, Metropolitan's variable and minimum components in the 2007 Statement of Charges are understated by \$1,566,000 and \$27,000, respectively. We informed the Department of these discrepancies and they plan to make the appropriate corrections when final power allocations are prepared for these years. (Table B, Item 21)

Findings Resulting in Credits, Refunds and Adjustments:

- The Department has not issued a preliminary year-end allocation of 2005 off-aqueduct costs. A summary of 2005 charges was prepared by the Department in May of 2006 indicating an increase in costs of \$4.3 million and an increase in off-aqueduct sales of \$19.6 million. As a result, had the Department issued a study reflecting these updated amounts, Metropolitan would have received a refund of approximately \$11.1 million. However, it appears that this study does not reflect the latest O & M cost information nor the latest debt service amounts. Thus, Metropolitan's refund amount will likely change when the refund is eventually issued. We inquired of the Department as to when a revised allocation of 2005 costs would be prepared and were unable to obtain a specific date. We anticipate that the study will be issued in time for review during our audit of the 2008 Statement of Charges. (TABLE C, Item 1).
- Our audit of the 2007 off-aqueduct power facilities charge disclosed that the debt service cover for the Bottlerock facility was overstated by \$27,000. The impact to Metropolitan was to overstate the off-aqueduct charges included in the 2007 Statement of Charges by \$20,000. We have informed the

Department of this discrepancy and will verify the amount has been corrected during our audit of the 2008 Statement of Charges. (TABLE C, Item 2).

- The preliminary year-end allocation of 2004 costs prepared in September 2005 did not include the most current O&M and fuel costs for Reid Gardner. As a result, Metropolitan's off-aqueduct charges for 2004 are understated by approximately \$45,000. We will inform the Department of this discrepancy. (TABLE C, Item 3)
- 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 4).
- 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 5).
- 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 6).

Comparison of Metropolitan's CY 2006 and Initial CY 2007 Statement of Charges			
(\$ millions)			
	CY 2006 SOC	CY 2007 SOC	Change*
Total Power	\$ 257	\$ 312	55
Total Min OMP&R	117	106	(11)
Total Capital	139	147	8
Total SWP Charges	\$ 513	\$ 565	52

* Increase (Decrease)

Comparison of Metropolitan's Initial and December Revised Statement of Charges for CY 2007			
(\$ millions)			
	July Initial SOC	December Revised SOC	Change*
Total Power	\$ 312	\$ 314	\$ 2
Total Min OMP&R	106	106	0
Total Capital	147	153	6
Total SWP Charges	\$ 565	\$ 573	\$ 8

* Increase