

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

MINUTES

AUDIT AND ETHICS COMMITTEE

October 25, 2011

Chair Friedman called the meeting to order at 11:01 a.m. in Committee Room 2-456 at Metropolitan's Headquarters.

Members present: Chair Friedman, Directors Barbre, Blake, Dick, Edwards, Grandsen, Wright, and Wunderlich.

Members absent: Vice Chair Quinonez and Director Ballin.

Other Board Members present: Chairman Foley, Directors Ackerman, Brown, De Jesus, Evans, Grunfeld, Heidel, Little, Murray, Peterson, Record, and Steiner.

Staff present: Bennion, Borrego, Cable, L. Carrillo, DeBacker, D. Elliott (via videoconference), C. Gutierrez, N. Harris, Ivey, Kightlinger, Mares, Pellegrini, D. Phan, Riss, Soper, Scully, Waade, Upadhyay, and E. Yamasaki.

1. OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO ADDRESS THE COMMITTEE ON MATTERS WITHIN THE COMMITTEE'S JURISDICTION

No members of the public responded.

2. APPROVAL OF THE MINUTES OF THE MEETING OF THE AUDIT AND ETHICS COMMITTEE HELD JUNE 28 AND SEPTEMBER 12, 2011

Approved

Motion: Director Edwards

Seconded: Director Grandsen

3. COMMITTEE ITEMS

c. Subject: Ethics Officer's summary of activities for the Ethics Department

Presented by: Ethics Officer Deni Elliott

Ethics Officer Deni Elliott reported that the AB 1234 Metropolitan specific online training for Directors and Officers of Metropolitan is on schedule for completion in January 2012. Further, the Ethics Educator has accepted an invitation to judge the first Southern California Regional Ethics Bowl which will take place at the University of Southern California on December 3, 2011.

d. Subject: Discussion of Ethics Function

Presented by: Ethics Officer Deni Elliott

Ethics Officer Deni Elliott presented a PowerPoint presentation regarding Metropolitan's Ethics Office function. Dr. Elliott stated that Metropolitan's Ethics Office as well as ethics offices in corporations, governmental agencies and nonprofits have four core functions – to develop and enforce ethics policies, provide a resource before questionable action occurs, investigate and report misconduct, and collaborate with the Board of Directors and management to create and maintain an ethical culture.

The reasons for the independent Ethics Office is that the Ethics Office scope is broader than legal and regulatory compliance and is also broader than human resources or audit. The Ethics Office is able to conduct investigations and report back to Department Heads without conflict of interest and also independently report to the Board of Directors.

Dr. Elliott further reported that the Ethics Office is the only Department that has jurisdiction to investigate matters relating to the Board of Directors. According to ten years of research by the Ethics and Compliance Officer Association, these functions are best accomplished by an Ethics Office that is independent from the Legal Department, the Audit Department, and the General Manager's Department. Also, more recently with Pfizer in 2009, some court rulings mandated that the Ethics Office be separated from the Legal Department and the Chief Executive Officer's Department.

In 2004, 35 percent of the Ethics Officers reported directly to the Board of Directors. Now, in 2010, when this survey was done, 55 percent report directly to the Board.

In addition, since 1999, when SB 60 required that Metropolitan establish an Ethics Office, the Metropolitan Board of Directors and the Legal Department determined that the best way to address the state mandate was with an Ethics Officer at the Department Head level who reports directly to the Board of Directors.

Dr. Elliott presented that one of the unique functions of Metropolitan's Ethics Office is that it provides a process for dealing with concerns by and about Directors and no other Metropolitan Department has that jurisdiction. The process that the Board has developed at Metropolitan engages Directors from the beginning so that it is a peer-based review. The Ethics Officer remains independent, provides an independent review, and provides recommendations to the Executive Committee.

As indicated above, there is a confidential process for director concerns. There is also a confidential process for employees.

The Ethics Office supports the mission of Metropolitan. Employees who are concerned about possible misconduct but who are also concerned about retaliation, know that they will be heard by the Ethics Office and not harmed in their attempts to be good agents of Metropolitan.

The Ethics Office's independence and direct reporting to the Board of Directors conveys a tone from the top of the importance of ethics within Metropolitan. It promotes the perception that everyone is accountable and that is what the Ethics Office does.

- e. Subject: Discuss process for selection of the new Ethics Officer
[Public employee appointment – Ethics Officer; any discussion of individual candidates to be heard in closed session pursuant to Gov. Code Section 54957]

Presented by: Chair Friedman

Chair Friedman advised the Committee that Dr. Elliott has identified two search firms that specialize in identifying suitable candidates for the Ethics Officer position. Items under discussion include establishing a schedule to allow Metropolitan to have a new Ethics Office prior to the date of Dr. Elliott's resignation on March 2, 2012; determine whether the Board should hire a specialized search firm; use Metropolitan's internal resources to conduct the search for a new Ethics Officer; and the possible direct appointment of a current staff member as the new Ethics Officer. If there is any discussion about the direct appointment of a current Ethics Officer personnel, the matter will go into closed session.

Dr. Elliott reported that her suggestion is that a committee of Directors be appointed to make procedural recommendations on whether to hire a search firm or not, to work with that firm or internal process to approve job specifications and interview process and timeline. Dr. Elliott further recommends that a full-time Ethics Officer is hired.

Dr. Elliott reported that if the Committee decides to hire an external search firm, the following two firms were recommended by the Ethics and Compliance Officer Association – Korn/Ferry and RSR Partners. The search firms are familiar with Ethics Officers and their scope of work and understand what to look for in terms of leadership skills, experience with working with Boards of Directors, working with

government, and also have a tap into the appropriate candidate pools. There is also a time commitment from an external search firm to meet a tight timeline of bringing someone on board by March 2012.

A discussion was held and the following motions were made.

A motion was made that an outside firm be hired to solicit a replacement for Dr. Elliott.

Motion: Director Edwards

Seconded: Director Wunderlich

APPROVED.

A motion was made that the Ethics Officer position be a full-time position.

Motion: Director Blake

Seconded: Director Edwards

APPROVED.

a. Subject: General Auditor's summary of activities for the Audit Department

Presented by: General Auditor Gerald C. Riss

General Auditor Riss reported that the Audit Department issued six audit reports, three comfort letters, and two special reviews during the four-month period of June through September 2011. He stated that the audit reports were issued with clean opinions and that noted findings have been addressed by management. Mr. Riss then discussed the annual Audit Department Quality Assessment, which evaluated whether department activities conform to Standards established by The Institute of Internal Auditors. He then noted that the overall assessment is that the Audit Department generally conforms to each section of the Standards and Code of Ethics.

b. Subject: Discussion of Independent Auditor's Report from KPMG LLP for fiscal year ending June 30, 2011

Presented by: General Auditor Gerald C. Riss

General Auditor Riss introduced Chris Ray, Partner, KPMG LLP (KPMG), to discuss the results of the fiscal year 2010/11 external audit.

Mr. Ray discussed the applicable auditing standards of financial statement audits. He also highlighted significant elements applicable to and issues encountered during the fiscal year 2010/11 audit. He provided an overview of the audit process, which included

evaluating the control structure and determining the audit procedures. He further noted that part of the process is reviewing management's estimates for reasonableness.

Mr. Ray then conducted a brief discussion of one audit adjustment related to long-term debt that was discussed with management. He explained that the adjustment involved reclassification of \$100 million of long-term debt to current debt and stated that it is disclosed in the financial statements. Mr. Ray noted that there were additional adjustments related to the recording of certain expenses that were "passed on" due to immateriality. Mr. Ray also stated that there were no disagreements with management on financial accounting and reporting matters, and that management fully cooperated with KPMG in providing access to books and records.

Mr. Ray stated that KPMG issued unqualified opinions on the Statement of Cash Receipts and Disbursements and Statement of Cash and Investments for the Colorado River Authority and Six Agency Committee, as well as Metropolitan's fiscal year 2010/11 financial statements. Finally, Mr. Ray stated that KPMG was not aware of any issues that arose requiring Metropolitan to consult with another accounting firm, and that KPMG did not perform any management advisory services as part of its current contract.

Chair Friedman conducted a discussion on materiality and thresholds related to significant findings which are brought to the attention of the Board, the funding status of other post-employment benefits, and classification of operating versus nonoperating revenue. Director Steiner provided questions in writing from the San Diego County Water Authority to Chairman Jack Foley regarding Metropolitan's Basic Statement for Years Ended June 30, 2011 and 2010.

Meeting adjourned at 12:10 p.m.

Laura Friedman
Chair