



Metropolitan Water District of Southern California

Report to the Audit and Ethics Committee

Audit plan and strategy for the year ending June 30, 2018

July 24, 2018

Introduction

To the Audit and Ethics Committee of The Metropolitan Water District of Southern California,

We are pleased to have the opportunity to meet with you today to discuss our audit of the financial statements of The Metropolitan Water District of Southern California (MWD), as of and for the year ending June 30,2018.

The audit of the financial statements, prepared in accordance with U.S. generally accepted accounting principles (GAAP), will be conducted under the standards of U.S. government accounting generally accepted auditing standards (GAGAAS).

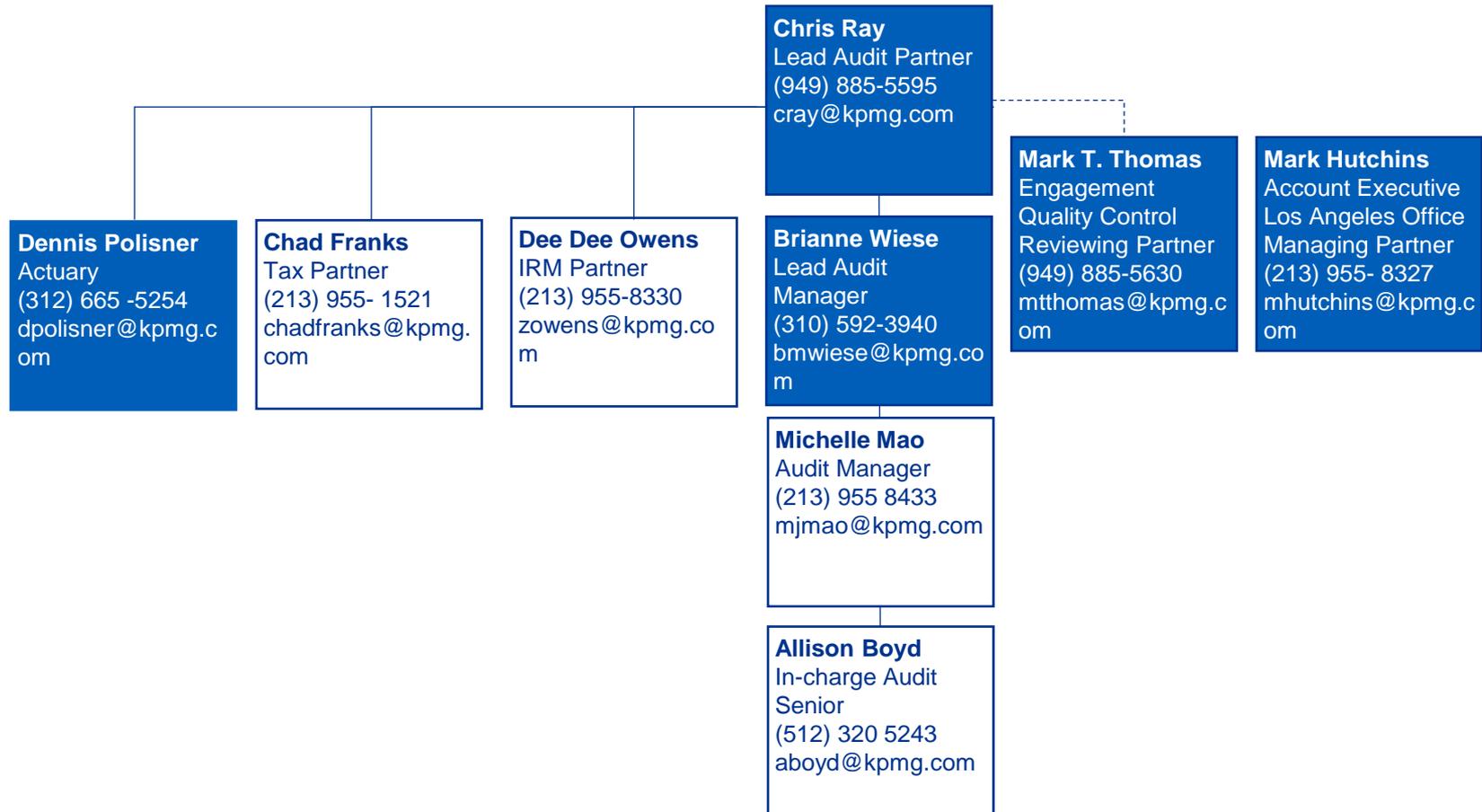
We plan to issue auditor reports on the financial statements of MWD, the CAFR of MWD, the federal awards and on the financial statements of Six Agency Committee and Colorado River Joint Powers Authority. Other planned audit deliverables include material written communications between KPMG and Management, and required communications between KPMG and the Audit and Ethics Committee.

This document, which outlines our risk assessment and planned audit strategy, is being provided to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

We believe the contents of this document should provide a good platform for our discussions when we do meet. We will be pleased to elaborate further on matters covered in this document at the meeting.

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Client service team



Team members with continuity are designated in blue.

Risk assessment

Relevant factors affecting our risk assessment:

Significant risks*	Susceptibility to		Recent significant developments	Complexity	Related parties	Degree of subjectivity	Outside normal course of business
	Error	Fraud					
Management override of controls – Management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk nevertheless is present in all entities.							
State Water Project- Given this significance of the State Water project to operations and the unique nature of the agreements we have identified it as a significant risk.							

 Yes  No

Audit strategy (continued)

Involvement of others

Audit of financial statements	Plan to involve?	Extent of planned involvement
Internal Audit	Y	Internal Audit will provide approximately 800 hours of assistance primary related to internal controls and underlying data
KPMG specialists involved in audit procedures performed	Y	Actuary specialists will be involved with the actuarial estimates of Pensions and OPEB.

 Yes  No

Planned timeline

- **April/May- Planning meetings with management**
 - **Confirming business risks**
 - **Prepare scoping and significant risks**
 - **Determine materiality**
 - **Conduct fraud interviews**
- **June - Interim testwork**
 - **Perform entity level and process level controls**
 - **Completion of certain procedures related to pensions, OPEB and debt**
- **August-September- Final testwork**
 - **Executing substantive procedures**
 - **Updating understanding of controls performed at interim**
- **October- Finalization of audit reports**
 - **Drafting audit opinion based on the results of audit testwork**
 - **Presenting results to management and the Audit and Ethics Committee.**
- **December – MWD Comprehensive Annual Financial Report**

Audit Focus Areas

- **Cash and investments**
- **Capital assets, including participation rights in State Water Project**
- **Derivatives**
- **Long-term debt**
- **Other post-employment benefits (GASB 75 Implementation)**
- **Pensions**
- **Water sales**
- **Power and water costs**
- **Operation and maintenance expenses**

Audit fees

Our estimated fees for the year ending June 30, 2018 of \$417,400 have been approved by the Board.

Our estimated fees for the audit were determined based on estimated level of effort as discussed in detail in our proposal to conduct external audit services (RFP-WM-1167).



Supplemental communications

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Materiality in the context of an Audit

We will apply materiality in the context of the preparation and fair presentation of the financial statements, considering the following factors:

Professional standards require that we exercise professional judgment when we consider materiality and its relationship with audit risk when determining the nature, timing, and extent of our audit procedures, and when evaluating the effect of misstatements.

Information is material if its misstatement or omission could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.

Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Judgments about the size of misstatements that will be considered material provide a basis for

- a) Determining the nature and extent of risk assessment procedures;
- b) Identifying and assessing the risks of material misstatement; and
- c) Determining the nature, timing, and extent of further audit procedures.

Responsibilities

Management responsibilities – Financial statements	<ul style="list-style-type: none"> — Fairly presenting the financial statements, including disclosures in conformity with U.S. GAAP — Adjusting the financial statements to correct material misstatements and affirming in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole
Management responsibilities – GAGAS	<ul style="list-style-type: none"> — Design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
Management responsibilities – Other	<ul style="list-style-type: none"> — To provide the auditor with: <ul style="list-style-type: none"> (1) access to all information of which management is aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters; (2) additional information that the auditor may request from management for the purpose of the audit; and (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence — Identifying and ensuring that MWD complies with laws and regulations applicable to its activities, and for informing the auditor of any known material violations of such laws and regulations — Providing the auditor with a letter confirming certain representations made during the audit, that includes but is not limited to management’s: <ul style="list-style-type: none"> (1) disclosure of all significant deficiencies, including material weaknesses, in the design or operation of internal controls that could adversely affect the Company’s financial reporting (2) acknowledgement of their responsibility for the design and implementation, and maintenance of internal controls to prevent and detect fraud
Audit and Ethics Committee responsibilities	<ul style="list-style-type: none"> — Oversight of the financial reporting process — Oversight of the establishment and maintenance by management of programs and controls designed to prevent, deter, and detect fraud
Management and the Audit and Ethics Committee responsibilities	<ul style="list-style-type: none"> — Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards — Ensuring that MWD’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in the entity’s financial statements.

The audit does not relieve management or the Audit and Ethics Committee of their responsibilities.

Responsibilities (continued)

<p>KPMG – Audit objectives</p>	<ul style="list-style-type: none"> — Forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of the Audit and Ethics Committee are prepared, in all material respects, in accordance with U.S. GAAP
<p>KPMG responsibilities – Audit</p>	<ul style="list-style-type: none"> — Performing the audit in accordance with U.S. GAAS and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements as a whole are free from material misstatement — Performing an audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control over financial reporting
<p>KPMG responsibilities – Other information in documents containing financial statements</p>	<ul style="list-style-type: none"> — The auditors’ report on the financial statements does not extend to other information in documents containing audited financial statements, excluding required supplementary information — The auditor’s responsibility is to make appropriate arrangements with management or the Audit and Ethics Committee to obtain information prior to the report relevant date and to read the other information to identify material inconsistencies with the audited financial statements or misstatement of facts — Any material inconsistencies or misstatement of facts that are not resolved prior to the report release date, and that require revision of the other information, may result in KPMG modifying or withholding the auditors’ report or withdrawing from the engagement

Responsibilities (continued)

<p>KPMG responsibilities – Communications</p>	<ul style="list-style-type: none"> — Communicating significant matters related to the financial statement audit that are in our professional judgment, relevant to the responsibilities of the Audit and Ethics Committee in overseeing the financial process. U.S. GAAS does not require us to design procedures for the purpose of identifying matters to communicate to the Audit and Ethics Committee — Communicating if we suspect or identify noncompliance with laws and regulations exist, unless matters are clearly inconsequential — Communicating to management and the Audit and Ethics Committee in writing all significant deficiencies and material weaknesses in internal control identified during the audit, including those that were remediated during the audit and reporting to management in writing all deficiencies noted during our audit that, in our professional judgment, are of sufficient importance to merit management’s attention. The objective of our audit of the financial statements is not to report on MWD’s internal control — Conducting the audit in accordance with professional standards and complying with the rules and responsibility of the Code of Professional Conduct of the American Institute of Certified Public Accountants and the official standards of relevant CPA Societies, and relevant state boards of accountancy — Communicating to the Audit and Ethics Committee circumstances, if any, that affect the form and content of the auditors’ report — Communicating if we plan to withdraw from the engagement and the reasons for the withdrawal — Communicating to the Audit and Ethics Committee if we conclude no reasonable justification for a change to the audit engagement exists and we are not permitted by management to continue the original audit engagement — Communicating to the Board of Directors in writing any conclusion(s) that the Audit and Ethics Committee’s oversight of external financial reporting and internal control over financial reporting is ineffective — When applicable, we are also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement — Communicating if we have identified or suspect fraud involving; (a) management, (b) employees who have a significant role in internal control, (c) others, when the fraud results in a material misstatement in the financial statements, and (d) other matters related to fraud that are, in the auditors’ professional judgment, relevant to the responsibilities of the Audit and Ethics Committee — Communicating significant findings and issues arising during the audit in connection with the entity’s related parties.
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Questions?

For additional information and Audit Committee resources, including Director Roundtable Series in approximately 25 cities each Spring, a Quarterly webcast, and suggested publications, please visit KPMG's Audit Committee Institute (ACI) at www.kpmg.com/ACI.

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