



**DISTRICT OF COLUMBIA
WATER AND SEWER AUTHORITY**

Board of Directors

Audit Committee

Thursday, March 26, 2015

9:00 a.m.

Meeting Minutes

COMMITTEE MEMBERS PRESENT

Nicholas Majett, Chairman
Shirley Branch, Committee Member

INTERNAL AUDIT STAFF PRESENT

Dan Whelan, McGladrey LLP
Jennifer Murtha, McGladrey LLP
Charles Barley Jr., McGladrey LLP
Jill Reyes, McGladrey LLP
Kelly Johnson, McGladrey LLP

DC WATER STAFF PRESENT

Mark Kim, Chief Financial Officer
Mustafa Dozier, Acting Chief of Staff
Meena Gowda, General Counsel's Office
Linda Manley, Secretary to the Board

EXTERNAL AUDIT STAFF PRESENT

Paul Geraty, KPMG
Steve Max, KPMG
Richard McLean, KPMG

Call to Order (Item 1)

The audit committee meeting began at 9:40 a.m. The meeting was called to order by Mr. Majett. Mr. Majett then turned the meeting over to Mr. Kim.

FY 2014 Financial Statements (Item 2)

Mr. Kim presented the FY 2014 financial results, indicating a strong financial position and double digit growth over the previous year. The results were in line with expectations and consistent with historical performance; including maintenance of string credit ratings during the year.

Mr. Kim spent a few moments describing the Authority's revenue structure, noting that there is not one revenue source that makes up more than 28% of the mix, and that all but one source showed an increase year-over-year. The one source of declining revenues is from the Federal Government. The Authority believes there are three drivers to the decline: An Executive Order to reduce energy consumption (including water conservation) by 2% per year; a publicly announced effort by the GAO to downsize the

Federal footprint by converting Federal land to other uses, such as the Old Post Office being sold for a future hotel project; and the high percentage of Federal customers that are billed based upon estimated consumption due to restricted access facilities.

Mr. Majett asked whether overall water usage is declining, and Mr. Kim stated that DC Water projects a 1% long-term rate of decline and consumption, which requires a rate increase of 1% just to get to the same place from a revenue standpoint. Year over year, more recently, Mr. Kim further explained that the current decline in consumption is closer to 2-2.5%. The Authority is still comfortable with the 1% long-term assumption.

Mr. Kim then described the operating expenditures were relatively flat year over year, as a result of increased operating expenditures being offset by a decline in payment-in-lieu of taxes (PILOT) due to a renegotiated agreement.

Mr. Majett asked whether there was a correlation between a drop in water usage/consumption and the amount it costs to produce. Mr. Kim stated that there is some correlation, but that the Authority maintains a high percentage of fixed costs (approximately 70%) that remains even if none of the customers use the service.

Mr. Kim then described the capital program spending is at its peak, with strong growth in capital assets. He explained the impact to the balance sheet as assets are completed and put into service, and how the reductions in construction in progress will result in increases to the infrastructure asset categories.

External Auditors Report of Fiscal 2014 Financial Statements (Item 3)

Mr. Kim turned the meeting over to Mr. Geraty, who presented the required communications the external auditor is to prepare for those charged with governance of the Authority. Mr. Geraty stated that KPMG issued a “clean” or unmodified opinion on the FY 2014 Financial Statements, which is the highest level of assurance that can be given. KPMG also issued a report on internal control, required by government auditing standards, noting no Material Weaknesses and three (3) Significant Deficiencies. There is also a report on Compliance, noting no instances of non-compliance with laws, regulations, or contracts that would be material to the financial statements. KPMG also issued a management letter, noting opportunities for continuous improvement.

Mr. Geraty then reviewed the required communications for significant financial estimates contained in the financial statements (no uncommon estimates, reasonably estimated), audit differences and adjustments (none that were material), any disagreements with management (none).

Mr. Majett requested clarification on note 12C for “Significant and Unusual Transactions”.

Mr. Geraty then turned the presentation over to Mr. Max, for discussion of the Information Technology General Controls (ITGC) testing and results. Mr. Max described the ITGC process and how it supports the overall audit. Mr. Max went on to describe the Significant Deficiency related to IT and the management comments noted, also providing a comparison to the prior year, noting significant improvements.

Mr. McLean then introduced the two Significant Deficiencies on the financial side, related to improving time and attendance processes, and the reporting of Conflicts of Interest at the Board-level, along with updating the Ethics policy.

Mr. Majett inquired whether these items are included in the open items discussed at the previous meeting. Mr. Kim clarified that those items are handled by the Internal Auditors, and these items are not included in that listing.

Mr. Kim also supplied an updated status of what management has done to-date to address these three Significant Deficiency items, with the expectation that they will be remediated by fiscal year end. There was discussion amongst the attendees for timesheet approval and the risks involved.

Finally, Mr. McLean discussed the results of the Authority's Single Audit, which is the audit of the Authority's Federal award programs, noting KPMG issued an unmodified "clean" opinion on compliance with the laws and regulations of the program audited (EPA's Safe Drinking Water Act program), and did not identify any questioned costs for internal control findings.

At the conclusion of the External Audit presentation, Mr. Kim reminded the Committee that this was the second year of audit by KPMG, with a significant amount of improvement shown, with reduction from five (5) Significant Deficiencies down to three (3), and from twenty-six (26) individual management comments down to ten (10), and the Authority is committed to a strong compliance culture and working with two of the best firms in the country, as well as a dedicated staff, lead by Controller, John Madrid in driving the Authority forward. The Committee then recognized Mr. Madrid and attending staff members.

Review of Internal Audit Status (Item 4)

Mr. Kim turned the meeting over to Mr. Whelan from McGladrey LLP to review the status of the FY15 audit plan. Mr. Whelan announced that as a result of the delayed Audit Committee meetings (due to weather), the Internal Audit plan was modified at the permission of the Chairman, as a result of the Committee's concerns over Procurement at the last meeting in October, and subsequent research performed by the internal auditors. The audit will focus on the pre-award and selection process, follow-up on previously identified recommendations, and will begin in April.

Mrs. Murtha reviewed the Internal Audit Matrix, describing the color-coding and where the Committee can track the inherited open items from the previous auditors, as well as illustrating the audits in process and what is being issued today.

Mr. Majett asked for clarification on the number of open items, and Miss Johnson stated the number at the close of the October meeting was 82.

Mr. Whelan then reviewed the Procurement Memo, summarizing the audits and other consulting projects performed over the past five years, as well the results, in support of the change to the internal audit plan.

Miss Johnson then reported on the process for updating and reporting the current status of the prior audit findings, which were 82 at October. There are 44 Open items, 19 that were Closed, and 14 that management indicates are closed but have not yet been tested due to pending documentation. There are also 5 items in Action Deferred status, which indicates that resources are not going to be available for a year or longer to properly address the item or the issue is dependent on another open item before it can be addressed.

Miss Johnson explained that the status of the items has also been presented by Business Unit and Theme. She stated that the new estimated completion dates, as presented by management, will be used to track timeliness of completion, and that at the next Audit Committee meeting, the status report will also include past due items based upon those dates. She also stated that some of the dates are fairly far out, such as February 2016, as a result of collaboration between several departments and reliance on IT solutions.

Mrs. Reyes introduced the Intellectual Property report and results, discussing the timing of issuing an internal controls audit and program assessment even though the program is in its infancy. Mrs. Reyes reminded the Committee that due to the Authority's unique standing as one of the only public sector agencies in the IP business, there are few benchmarks or best practices and comparisons that can be made, with the closest benchmark being the university setting. Mrs. Reyes stated the report outlines the current and desired future states of the program, with an explanation of the obstacles to get there. She stated that the primary obstacles relate to funding and personnel resources.

Mrs. Reyes noted five opportunities for improvement, from documented policies and procedures to contract language and valuation of assets. She stated these items would be added to the listing of ongoing follow-up of open items based upon the agreed-upon completion dated.

Mr. Whelan then introduced Mr. Saul Kinter from the Innovations team, who addressed the Committee to explain the actions to-date and planned actions, as well as management's commitment to a robust program, and their pleasure with the process working with the internal auditors.

Mr. Whelan explained that an External Communication Plan has been provided to the Committee, and that a quarterly meeting between Internal Audit, Department of Security, the Chief of Staff/Labor Relations and the OGC will be added, as well.

Miss Johnson gave a brief update of the Fraud Hotline calls, and Mr. Whelan confirmed that due to reaching the end of the Committee meeting time, with another Committee meeting to follow, the Executive Session will be postponed to the April 23 Audit Committee meeting.

Executive Session (Item 5)

Postponed to April 23 meeting.

Adjournment (Item 6)

At 10:55a.m., the meeting was adjourned by Mr. Majett.