



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

AUDIT REPORT

Management Letter on the Western Federal
Power System's Fiscal Year 2015 Financial
Statement Audit

OAI-FS-16-09

May 2016



Department of Energy
Washington, DC 20585

May 6, 2016

MEMORANDUM FOR THE ADMINISTRATOR, WESTERN AREA POWER
ADMINISTRATION

FROM:

A handwritten signature in blue ink, appearing to read "Ricky R. Hass".

Ricky R. Hass
Acting Inspector General

SUBJECT:

INFORMATION: Audit Report for the "Management Letter on the
Western Federal Power System's Fiscal Year 2015 Financial Statement
Audit"

KPMG LLP (KPMG), our contract auditors, planned and performed an audit of the combined financial statements of the Western Federal Power System (the System) as of and for the year ended September 30, 2015, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The combined financial statements include the Western Area Power Administration (Western), a component of the U.S. Department of Energy, and the hydroelectric generation functions of the U.S. Department of Interior, Bureau of Reclamation; the U.S. Army Corps of Engineers; and the U.S. Department of State, International Boundary and Water Commission, for which Western markets and transmits power.

As part of the audit of the combined financial statements, KPMG considered the System's internal control over financial reporting (internal control) as a basis for designing auditing procedures for the purpose of expressing an opinion on the combined financial statements but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, KPMG did not express an opinion on the effectiveness of the System's internal control. The Office of Inspector General monitored audit progress and reviewed the audit report and related documentation. This review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted Government auditing standards.

During the audit, KPMG noted certain matters involving internal control and other operational matters that are presented in the attached management letter prepared by KPMG. The letter contains four new findings and one repeat finding that were issued during the course of the System's Fiscal Year 2015 Financial Statement Audit. Management concurred with four of the findings and provided planned corrective actions for the recommendations listed in the Management Letter. However, management did not concur with one of the findings (15-WAPA-01) related to a lack of financial reporting system conversion testing documentation.

Attachment

cc: Chief Financial Officer, CF-1
Deputy Chief Financial Officer, CF-2
Senior Vice President and Chief Financial Officer, Western Area Power Administration
Vice President of Financial Management, Western Area Power Administration
Director, Office of Finance and Accounting, CF-10
Deputy Director, Office of Finance and Accounting, CF-10
Acting Assistant Director, Office of Financial Policy and Internal Controls, CF-12
Division Director, Office of Financial Policy and Internal Controls, CF-12
Acting Team Leader, Office of Financial Policy and Internal Controls, CF-12
Audit Resolution Specialist, Office of Financial Policy and Internal Controls, CF-12
Audit Liaison, Western Area Power Administration

Report Number: OAI-FS-16-09



KPMG LLP
Suite 800
1225 17th Street
Denver, CO 80202-5598

March 28, 2016

The Administrator of Western Area Power Administration and the
U.S. Department of Energy Office of the Inspector General:

In planning and performing our audit of the combined financial statements of the Western Federal Power System (the System) as of and for the year ended September 30, 2015, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the System's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the combined financial statements but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

The combined financial statements include the Western Area Power Administration (Western), a component of the U.S. Department of Energy, and the hydroelectric generation functions of the U.S. Department of Interior, Bureau of Reclamation; the U.S. Army Corps of Engineers; and the U.S. Department of State, International Boundary and Water Commission for which Western markets and transmits power.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

1. Contributed Plant (14-WAPA-03)

During our testing of contributed plant at Western, we identified insufficient processes to ensure assets either constructed and transferred or donated to Western by third parties are recorded in Western's financial records in a timely manner. Specifically, we identified one contributed plant project totaling approximately \$600,000 that was not recorded in a timely manner and a second contributed plant project estimated at \$3 million that was owned, operated, and utilized by Western for multiple years, but not recorded. Contributed plant and related accumulated depreciation is recorded in Western's Federal financial schedules; however, the contributed plant balances are not recorded in the System's combined financial statements, but are simply disclosed in the footnotes thereto.



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Recommendations

We continue to recommend that Western perform the following:

- A. Strengthen internal controls to ensure contributed plant assets are properly identified and recorded in a timely manner; and
- B. Enhance existing process over contract review approvals to ensure individuals within the accounting and finance department are aware of projects involving assets expected to be contributed.

Management Response

Western concurs with the finding. The Financial Reporting Manager will annually validate each Regional Financial Manager's Contributed Project Pending Log against the current project status listing. Regional Financial Managers identify and track future contributed assets by reviewing all modified and new contracts being offered. Under the current contract review process, implemented in 2012, financial managers review all contracts with the intent of identifying and forecasting financial impacts. The Regional Financial Managers will also ensure annual accounting training is given to new project managers, that trusts projects with pending contributed assets are tracked through a project status list, and that status updates from the project managers focus on communicating completion of work and the timely transfers to plant of all assets.

2. Lack of Financial Reporting System Conversion Testing Documentation (15-WAPA-01)

Evidence demonstrating management's testing activities regarding conversion of the Hyperion to the Business Objects Explorer (BOE) financial reporting system was not retained. The financial reporting query and report writing tool conversion from Hyperion to BOE was not held to system development lifecycle policy standards, including Western's Software Configuration Management Process Policy, requiring the use of a centralized repository of change artifacts including evidence of Western's review and approval over the conversion.

Recommendation

We recommend Western ensure that established configuration management procedures are followed and that a centralized repository is utilized to store key audit artifacts, including evidence of project authorization, testing, go-live approval, and post-implementation review, as applicable to all in-progress and future conversions.

Management Response

Western management agrees that no documentation was retained as of the auditor's initial review date which documented management's approval of the new reports. As identified by the auditors, there were no errors in the process. The reports in question, balance sheet and



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income statement, do normally, and did this year, go through a detailed review and approval process at year-end. Additionally, management did email KPMG that reports were ready for their review, which is the normal process we used to indicate electronic files have been reviewed and approved for distribution to KPMG.

BOE was implemented 2 years ago and the project to implement BOE did use the configuration management concepts. The use of BOE by the Accounting and Reporting team was not identified as an information technology project and does not fall under Western's configuration management policy. As a result, the initial approval was done verbally and not retained. Accordingly, Western does not concur with the finding.

The creation changes to reports in BOE will not use configuration management concepts; however, management does recognize the responsibility to document the approval of new reports which are provided to KPMG and used in the audit. Western management will continue to review reports and in the future, retain auditable documentation to validate the review when there are significant changes to the balance sheet, income statement and other documents considered significant by management to the audit process. Significant changes would include implementation of new reporting software or changes in location. The change is in effect as of November 2015.

Auditor Comment

We acknowledge management's response; however, for fiscal year 2015, BOE is within the scope of the financial statement audit. As such, the BOE system is considered a relevant information technology system as financial reporting is generated from this system. We considered guidance from the United States Government Accountability Office by the Comptroller General of the United States, *Standards for Internal Control in the Federal Government (September 2014)*, Section 3.11, which states that "Management documents internal control to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity." As such, we consider the lack of documentation an internal control deficiency.

3. Lack of Corporate Data Repository Enforced Password Lockout Settings (15-WAPA-02)

The Corporate Data Repository authentication mechanism does not enforce system lockout after a defined number of failed login attempts. The weakness identified occurred because an unauthorized modification to password lockout parameters was implemented as part of a routine program change that went undetected during management's pre-implementation review.



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Recommendations

We recommend that Western:

- A. Reinstate the intended lockout parameters and reinforce configuration management practices such that inadvertent changes aren't included in approved system modifications; and
- B. Expand pre-implementation reviews to include multiple layers of review and/or a comprehensive review of all codes to be migrated to help ensure only intended functionality is modified.

Management Response

Western accepts this finding. Western re-implemented the code that enforces the three login attempt lockout process on September 25, 2015. Western reviewed the process that led to the deficiency and conducted informal awareness training for change approvers that will prevent changes such as these from occurring in the future.

4. Environmental Clean-Up Liability (15-WAPA-03)

During our testing of environmental clean-up liabilities, we identified that Western did not perform a sufficient review over potential environmental clean-up liabilities. Although Western has a process in a place for identifying potential environmental liabilities and the final analysis was below Western's materiality threshold, Western's Accounting and Reporting group did not sufficiently analyze three sites identified as having environmental liabilities in accordance with appropriate accounting guidance.

Recommendation

We recommend that Western enhance its existing process to ensure all identified potential environmental clean-up liabilities are analyzed and recorded in accordance with Federal Accounting Standards Advisory Board Technical Release No.2 (for Federal financial reporting) and Accounting Standards Codification (ASC) 450 (for combined financial reporting) for the regions and for Western as a whole.

Management Response

Western agrees with the finding and will enhance its environmental review procedures. For fiscal year 2016, third quarter reporting, Western will modify its existing data call questionnaire to include guidance on determining whether an environmental liability is probable, and guidance on estimation of the liability including the use of prior experience and enhancement of questions to more clearly identify potential liabilities. Additionally, Accounting and Reporting will be more diligent in reviewing responses and will ensure significant estimates are clearly supported and in situations where an estimate is not available, ensure documentation clearly supports why an estimate is not available.



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5. Lease Classification Review (15-WAPA-04)

During our testing over lease disclosures, we identified that Western failed to perform a complete review of the new lease agreement for its headquarters building during the year to ascertain whether it is a capital or operating lease. While Western correctly classified the lease as an operating lease, Western did not perform its assessment of the fair market value criteria in accordance with ASC 840.

Recommendation

We recommend that Western enhance its review process to ensure all new leases are appropriately classified for recordation and disclosure in the Federal financial schedules and combined financial statements.

Management Response

Western agrees with the finding and will enhance its lease review procedures by the third quarter of fiscal year 2016. Western will implement a lease review checklist listing out the different lease evaluation criteria including a fair market value assessment. The checklist will be signed by the preparer and reviewed and signed by the Accounting and Reporting Manager.

The System's responses were not subjected to the auditing procedures applied in the audit of the combined financial statements and, accordingly, we express no opinion on the responses. Our audit procedures are designed primarily to enable us to form an opinion on the combined financial statements and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the System's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This communication is intended solely for the information and use of the System's management, the Administrator, and the Department of Energy Office of Inspector General, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

FEEDBACK

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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 253-2162.