



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-18-18

February 2018

**MANAGEMENT LETTER ON THE
SOUTHWESTERN FEDERAL POWER
SYSTEM'S FISCAL YEAR 2016
FINANCIAL STATEMENT AUDIT**



Department of Energy
Washington, DC 20585

February 9, 2018

MEMORANDUM FOR THE ADMINISTRATOR, SOUTHWESTERN AREA POWER
ADMINISTRATION

A handwritten signature in cursive script that reads "Sarah B. Nelson".

FROM: Sarah B. Nelson
Assistant Inspector General
for Audits and Administration
Office of Inspector General

SUBJECT: INFORMATION: Management Letter on the Southwestern Federal
Power System's Fiscal Year 2016 Financial Statement Audit

KPMG LLP, our contract auditors, planned and performed an audit of the combined financial statements of the Southwestern Federal Power System as of and for the year ended September 30, 2016, 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 Southwestern Area Power Administration, a component of the U.S. Department of Energy, and the hydroelectric generation and power operations of the U.S. Army Corps of Engineers; a component of the U.S. Department of Defense.

As part of the audit of the combined financial statements, KPMG LLP considered the Southwestern Federal Power 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 Southwestern Federal Power System's internal control. Accordingly, KPMG LLP did not express an opinion on the effectiveness of the Southwestern Federal Power 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 LLP did not comply, in all material respects, with generally accepted Government auditing standards.

During the audit, KPMG LLP noted certain matters involving internal control and other operational matters that are presented in the attached management letter prepared by KPMG LLP. The letter contains four findings that were issued during the course of the Southwestern Federal Power System's Fiscal Year 2016 Financial Statement Audit. Management concurred with each of the findings and provided planned corrective actions for the recommendations listed in the Management Letter.

Attachment

cc: Chief Financial Officer, CF-1
Chief Financial Officer, Southwestern Power Administration
Deputy Chief Financial Officer, CF-2
Director, Office of Finance and Accounting, CF-10
Deputy Director, Office of Finance and Accounting, CF-10
Assistant Director, Office of Financial Policy and Internal Control, CF-12
Division Director, Office of Financial Policy and Internal Controls, CF-12
Audit Resolution Specialist, Office of Financial Policy and Internal Controls, CF-12
Audit Liaison, Southwestern Area Power Administration

Report Number: DOE-IG-18-18



KPMG LLP
Suite 310
100 West Fifth Street
Tulsa, OK 74103

Attachment

January 8, 2018

The Administrator of Southwestern Power Administration and the
Principal Deputy Inspector General, U.S. Department of Energy:

In planning and performing our audit of the combined financial statements of Southwestern Federal Power System (SWFPS), as of and for the year ended September 30, 2016, 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 SWFPS's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWFPS's internal control. Accordingly, we do not express an opinion on the effectiveness of SWFPS's internal control.

The combined financial statements include the hydroelectric generating and power operations of the U.S. Army Corps of Engineers (Corps), a component of the U.S. Department of Defense and the transmission and disposition of the related power by the Southwestern Power Administration (Southwestern), a component of the U.S. Department of Energy.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. During our audit, we noted certain matters involving deficiencies in internal control and other operational matters that are presented in Exhibit A for your consideration. We have also presented the status of prior year findings in Exhibit B. These findings and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operational efficiencies.

SWFPS' written responses to our comments and recommendations 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 SWFPS' 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 SWFPS' management, the Administrator, and the Principal Deputy 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

Management Letter Index to Exhibits

Open Findings – Internal Controls and Other Operational Matters

(with parenthetical references to findings and recommendations issued during the engagement)

Exhibit A

Finding 1: Inaccuracies of Accrued Liabilities Related to Fiscal Year-End
(16-SWPA-01)

A.1

Finding 2: Inaccuracies of Asset Useful Lives Related to Fiscal Year-End
(16-SWPA-02)

A.2

Finding 3: Inaccuracies of Construction in Progress Ending Balance Presentation Related
to Fiscal Year-End (16-SWPA-03)

A.3

Status of Prior Year Findings

Exhibit B

Finding 1: Inaccuracies of Accrued Liabilities Related to Fiscal Year-End (16-SWPA-01)

KPMG's audit testwork of a sample of 23 subsequent cash disbursements and invoices received and processed after September 30, 2016 identified 7 invoices at 3 Corps districts (Ft. Worth, Little Rock, and Tulsa) which were under-accrued by a total of \$1,786,341.

Three of the five under-accruals at the Little Rock district occurred due to intergovernmental orders that were accrued at a district outside of the SWFPS umbrella. The remaining under-accruals at the Little Rock and Fort Worth districts occurred due to a lack of communication by the project managers with the accounting department of the information necessary to allow for the recording of an appropriate accrual prior to year-end. For the Tulsa district, the under-accrual occurred because the project manager determined that an accrual needed to be made after inspection of the work had occurred, rather than when the work was performed.

Recommendation:

1. We recommend that the Southwestern Power Administration coordinate with the Army Corps of engineers to enhance existing procedures and related controls to ensure all material procurement of goods and services received prior to period-end are timely and accurately accrued.

Management Response:

The U.S. Army Corps of Engineers, Southwestern Division, concurs with the finding. The U.S. Army Corps of Engineers has a mitigating control which we use to ensure the accuracy of Account Payable/Undelivered Orders that we book as an on top adjustment to our Civil Works Financial Statements. This mitigating control catches findings that you found in your testing. Although I agree this adjustment is not recorded against the SWPA numbers as the adjustment does not go down to that level our financial statements are materially correct.

Finding 2: Inaccuracies of Asset Useful Lives Related to Fiscal Year-End (16-SWPA-02)

KPMG's audit testwork consisting of a substantive analytic over depreciation expense revealed an unusual change in Vicksburg's current year depreciation expense. Through inquiry and inspection of records, it was determined that the asset useful lives for additions and betterments in years prior to fiscal year (FY) 2016 at two projects in the Vicksburg district (Blakely and Narrows) were not fully updated in the Corps of Engineers Financial Management System, leading to an overstatement of accumulated depreciation. The Corps adjusted accumulated depreciation was overstated by understating depreciation expense in the current year by \$1,384,423.

The weaknesses identified occurred because four assets related to power or joint purposes at the Vicksburg district were not depreciated over the extended useful lives resulting from additions and betterments due to a lack of knowledge by the individual responsible for updating useful lives and an absence of monitoring and review controls to ensure useful lives for assets are appropriate.

Recommendation:

1. We recommend that the Southwestern Power Administration coordinate with the Army Corps of engineers to enhance existing procedures and related controls to ensure useful lives of assets are appropriate and are being reviewed prior to calculation of depreciation expense.

Management Response:

The U.S. Army Corps of Engineers, Southwestern Division Office, concurs with the findings and has already taken appropriate actions to correct the useful lives of both assets.

Finding 3: Inaccuracies of Construction in Progress Ending Balance Presentation Related to Fiscal Year-End (16-SWPA-03)

KPMG's audit testwork of construction in progress (CIP) ending balance items revealed that 3 of 21 items reviewed were improperly in CIP as of fiscal year end at the Tulsa district. Through inquiry and inspection of records, it was determined that two of the items should have been transferred out of CIP during fiscal year 2010 and one should have been transferred out of CIP during FY 2016. The three items were at two projects in the Tulsa district (Webbers Falls and Keystone). As a result, the untimely transfer of the assets from CIP to the appropriate property, plant and equipment (PP&E) account led to an understatement of depreciation expense and accumulated depreciation. KPMG quantified the maximum impact that depreciation expense could be understated by in FY 2016 by dividing total CIP at the Tulsa district by the average useful life of assets (40 years) and applying a mid-year depreciation convention. This resulted in a maximum misstatement of \$1,668,856.

The weaknesses identified occurred because two assets at the Tulsa district had a completion date in FY 2010 and another asset had a completion date in FY 2016 (prior to September 30, 2016). All three items were not placed in service timely due to a lack of communication between project managers and accounting, and an absence of monitoring and review controls to ensure CIP items are appropriately and timely transferred to the appropriate PP&E accounts.

Recommendation:

1. We recommend that the Southwestern Power Administration coordinate with the Army Corps of Engineers to:
 - a. Enhance existing procedures and related controls to ensure that items in the Construction in Progress accounts are placed in service in a timely manner; and
 - b. Further establish review controls where power accountants review individual projects at year-end to ensure Construction in Progress projects are placed in service in a timely manner.

Management Response:

The U.S. Army Corps of Engineers, Southwestern Division, concur with the finding and have taken appropriate actions to correct the identified errors. The District holds quarterly CIP meetings to review all CIP items on the CIP Matrix.

Finding 4: Inaccuracies in the Preparation of Prior Year Power Reports (15-SWPA-03)

During KPMG's testwork related to the preparation of the combined financial statements, KPMG noted a prior year adjusting journal entry was made by the Army Corps of Engineers Tulsa district to record the cumulative effect of gains/losses not previously reported in the district's income statement(s) (income statements together with balance sheets are part of the district's power reports) that were submitted to Southwestern for the purpose of the preparation of the SWFPS combined financial statements. The adjusting journal entry made by the Tulsa and Little Rock districts netted to \$521,643 and was recorded as an adjustment (decrease) to the capitalization section of the balance sheet.

Recommendation:

1. We recommend that Southwestern coordinate with the Corps to enhance existing procedures and related controls related to the compilation and review of power reports which are submitted to Southwestern to ensure the reports are accurate and complete.

Management Response:

The Corps, Southwestern Division Office, concur with the finding. The Corps of Engineers Financial Management System general ledger is the official accounting document. Automated reports properly include gains and losses related to hydroelectric generating and power operations.

Status of Prior Year Findings

Prior Year Findings Related to Internal Controls and Other Operational Matters

(with parenthetical references to findings issued in the prior year)

Status at September 30, 2016

Finding 1: Inaccuracies of Accrued Liabilities Related to Fiscal Year-End – Southwestern (15-SWPA-01)	Closed in FY 2016
Finding 2: Inaccuracies of Accrued Liabilities Related to Fiscal Year-End – Corps (15-SWPA-02)	Closed in FY 2016
Finding 3: Inaccuracies in the Preparation of Prior Year Power Reports (15-SWPA-03)	Open in FY 2016