



Office of Inspector General

OFFICE OF TECHNOLOGY,
FINANCIAL, AND ANALYTICS

AUDIT REPORT -

SOUTHWESTERN FEDERAL POWER SYSTEM'S
FISCAL YEAR 2020 FINANCIAL STATEMENT AUDIT

DOE-OIG-21-37
SEPTEMBER 2021



Department of Energy
Washington, DC 20585

September 14, 2021

MEMORANDUM FOR THE ADMINISTRATOR, SOUTHWESTERN POWER
ADMINISTRATION

Sarah B. Nelson

FROM: Sarah B. Nelson
Assistant Inspector General
for Technology, Financial, and Analytics
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on the “Southwestern Federal Power
System’s Fiscal Year 2020 Financial Statement Audit”

The attached report presents the results of the independent certified public accountants’ audit of the Southwestern Federal Power System’s combined balance sheets, as of September 30, 2020, and 2019, and the related combined statements of revenues and expenses, changes in capitalization, and cash flows for the years then ended.

To fulfill the Office of Inspector General’s audit responsibilities, we contracted with the independent public accounting firm KPMG LLP (KPMG) to conduct the audit, subject to our review. KPMG is responsible for expressing an opinion on the Southwestern Federal Power System’s financial statements and reporting on applicable internal controls and compliance with laws and regulations. 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. The Office of Inspector General did not express an independent opinion on the Southwestern Federal Power System’s financial statements.

KPMG concluded that the combined financial statements present fairly, in all material respects, the respective financial position of the Southwestern Federal Power System as of September 30, 2020, and 2019, and the results of its operations and its cash flow for the years then ended in conformity with United States generally accepted accounting principles.

As part of this review, the auditors also considered the Southwestern Federal Power System’s internal control over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on the determination of financial statement amounts. The audit did not identify any deficiencies in internal control over financial reporting that is considered a material weakness.

The results of the auditors' review of the Southwestern Federal Power System's compliance with provisions of laws and regulations disclosed no instances of noncompliance or other matters required to be reported under *Government Auditing Standards*.

We appreciated the cooperation of your staff during the audit.

Attachment

cc: Acting Chief Financial Officer, CF-1
Chief Financial Officer, Southwestern Power Administration, SWPA

Audit Report: DOE-OIG-21-37

INDEPENDENT AUDITORS' REPORT



SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Financial Statements

September 30, 2020 and 2019

(With Independent Auditors' Report Thereon)

SOUTHWESTERN FEDERAL POWER SYSTEM

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KPMG LLP
210 Park Avenue, Suite 2650
Oklahoma City, OK 73102-5683

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying combined financial statements of the Southwestern Federal Power System (SWFPS), which comprise the combined balance sheets as of September 30, 2020 and 2019, and the related combined statements of changes in capitalization, revenues and expenses, and cash flows for the years then ended, and the related notes to the combined financial statements. As described in note 1(a), the combined financial statements include the Southwestern Power Administration (Southwestern), a component of the U.S. Department of Energy, and the hydroelectric generating and power operations of the U.S. Army Corps of Engineers, a component of the U.S. Department of Defense, for which Southwestern markets and transmits power.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Southwestern Federal Power System as of September 30, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 1 to the combined financial statements, in 2020 SWFPS adopted new accounting guidance, ASU 2014-09, *Revenue from Contracts with Customers*. Our opinion is not modified with respect to this matter.

Other Matters

Supplementary and Other Information

Our audits were conducted for the purpose of forming an opinion on the SWFPS basic combined financial statements as a whole. The supplementary information in schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic combined financial statements.

The supplementary information in schedules 1 through 4 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic combined financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic combined financial statements or to the basic combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information in schedules 1 through 4 is fairly stated in all material respects in relation to the basic combined financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2021 on our consideration of SWFPS's internal control over financial reporting and our report dated August 31, 2021 on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SWFPS's internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWFPS's internal control over financial reporting and compliance.

KPMG LLP

Oklahoma City, Oklahoma
August 31, 2021



KPMG LLP
210 Park Avenue, Suite 2650
Oklahoma City, OK 73102-5683

Independent Auditors' Report on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the combined financial statements of Southwestern Federal Power System (SWFPS), which comprise the combined balance sheets as of September 30, 2020 and 2019, and the related combined statements of changes in capitalization, revenues and expenses, and cash flows for the years then ended, and the related notes to the combined financial statements, and have issued our report thereon dated August 31, 2021.

Internal Control over Financial Reporting

In planning and performing our audit of the combined financial statements as of and for the year ended September 30, 2020, 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 combined 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.

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. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of SWFPS's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWFPS's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Oklahoma City, Oklahoma
August 31, 2021

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Independent Auditors' Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

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

We have audited, 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 of the Southwestern Federal Power System (SWFPS), which comprise the combined balance sheets as of September 30, 2020 and 2019, and the related combined statements of changes in capitalization, revenues and expenses, and cash flows for the years then ended, and the related notes to the combined financial statements, and have issued our report thereon dated August 31, 2021.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the SWFPS's combined financial statements as of and for the year ended September 30, 2020 are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the SWFPS's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the SWFPS's compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Oklahoma City, Oklahoma
August 31, 2021

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SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Balance Sheets
September 30, 2020 and 2019

Assets	2020	2019
Plant in service	\$ 1,923,197,810	1,885,766,362
Accumulated depreciation	(897,938,508)	(866,436,841)
Construction work in progress	<u>251,214,234</u>	<u>207,719,666</u>
Net utility plant	1,276,473,536	1,227,049,187
Cash	472,931,725	424,101,805
Funds held in escrow	334,597,299	268,219,490
Accounts receivable	17,043,639	19,320,616
Materials and supplies, at average cost	3,073,766	3,321,694
Banking exchange receivables	4,173,440	4,166,832
Deferred workers' compensation (note 4)	7,283,530	9,866,169
Other assets	<u>109,381,401</u>	<u>60,203,264</u>
Total assets	<u>\$ 2,224,958,336</u>	<u>2,016,249,057</u>
Liabilities and Capitalization		
Liabilities:		
Accounts payable and accrued liabilities	\$ 18,224,553	22,894,277
Advances for construction	92,387,043	44,601,903
Accrued workers' compensation	7,931,968	10,486,308
Purchased power and banking exchange deferral (note 4)	72,817,897	75,779,995
Hydropower water storage reallocation deferral (note 4)	<u>60,305,459</u>	<u>60,503,106</u>
Total liabilities	<u>251,666,920</u>	<u>214,265,589</u>
Capitalization:		
Payable to U.S. Treasury	1,273,076,890	1,167,385,188
Accumulated net revenues	<u>700,214,526</u>	<u>634,598,280</u>
Total capitalization	1,973,291,416	1,801,983,468
Commitments and contingencies (notes 6 and 7)		
Total liabilities and capitalization	<u>\$ 2,224,958,336</u>	<u>2,016,249,057</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Changes in Capitalization

Years ended September 30, 2020 and 2019

	<u>Payable to U.S. Treasury</u>	<u>Accumulated net revenues</u>	<u>Total capitalization</u>
Total capitalization as of September 30, 2018	\$ 1,083,165,164	560,816,379	1,643,981,543
Additions:			
Congressional appropriations	76,652,874	—	76,652,874
Interest on payable to U.S. Treasury and other	11,164,069	—	11,164,069
Transfers of property and services, net	<u>7,504,865</u>	<u>—</u>	<u>7,504,865</u>
Total additions to capitalization	<u>95,321,808</u>	<u>—</u>	<u>95,321,808</u>
Deductions:			
Payments to U.S. Treasury	<u>(11,101,784)</u>	<u>—</u>	<u>(11,101,784)</u>
Total deductions to capitalization	<u>(11,101,784)</u>	<u>—</u>	<u>(11,101,784)</u>
Net revenues for the year ended September 30, 2019	<u>—</u>	<u>73,781,901</u>	<u>73,781,901</u>
Total capitalization as of September 30, 2019	<u>1,167,385,188</u>	<u>634,598,280</u>	<u>1,801,983,468</u>
Additions:			
Congressional appropriations	\$ 96,590,184	—	96,590,184
Interest on payable to U.S. Treasury and other	11,886,562	—	11,886,562
Transfers of property and services, net	<u>7,679,079</u>	<u>—</u>	<u>7,679,079</u>
Total additions to capitalization	<u>116,155,825</u>	<u>—</u>	<u>116,155,825</u>
Deductions:			
Payments to U.S. Treasury	<u>(10,464,123)</u>	<u>—</u>	<u>(10,464,123)</u>
Total deductions to capitalization	<u>(10,464,123)</u>	<u>—</u>	<u>(10,464,123)</u>
Net revenues for the year ended September 30, 2020	<u>—</u>	<u>65,616,246</u>	<u>65,616,246</u>
Total capitalization as of September 30, 2020	<u>\$ 1,273,076,890</u>	<u>700,214,526</u>	<u>1,973,291,416</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Revenues and Expenses

Years ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues:		
Sales of electric power	\$ 203,246,478	198,039,439
Transmission and other operating revenues	26,949,095	22,877,335
Total operating revenues before deferrals	230,195,573	220,916,774
Net purchased power and banking exchange deferral	4,771,276	(360,796)
Total operating revenues	234,966,849	220,555,978
Non-reimbursable revenues	3,610,559	5,980,341
Total revenues	<u>238,577,408</u>	<u>226,536,319</u>
Operating expenses:		
Operation and maintenance	93,508,348	84,678,421
Purchased power and banking exchange	21,978,789	16,221,107
Depreciation and amortization	36,118,394	31,499,418
Transmission service charges by others	42,505	44,486
Retirement and other employee benefit expense	10,656,990	9,113,107
Non-reimbursable expenses	3,843,179	3,180,236
Total operating expenses	<u>166,148,205</u>	<u>144,736,775</u>
Net operating revenues	<u>72,429,203</u>	<u>81,799,544</u>
Interest expense:		
Interest on payable to U.S. Treasury and other	15,417,052	14,869,807
Allowance for funds used during construction	(8,604,095)	(6,852,164)
Net interest expense	<u>6,812,957</u>	<u>8,017,643</u>
Net revenues	<u>\$ 65,616,246</u>	<u>73,781,901</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Cash Flows

Years ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Net revenues	\$ 65,616,246	73,781,901
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation and amortization	36,118,394	31,499,418
Benefit expense paid by other Federal agencies	6,070,120	5,349,137
Interest on payable to U.S. Treasury and other	15,417,052	14,869,807
Allowance for funds used during construction	(8,604,095)	(6,852,164)
(Increase) decrease in assets:		
Accounts receivable	2,276,977	(2,587,569)
Materials and supplies	247,928	(185,050)
Banking exchange receivables	(6,608)	(33,135)
Deferred workers' compensation	2,582,639	(1,086,642)
Other assets	(49,178,137)	165,975
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(4,669,724)	4,614,870
Accrued workers' compensation	(2,554,340)	715,016
Purchased power and banking exchange deferral	(4,854,000)	442,138
Advances for construction	47,785,140	(5,560,511)
Net cash provided by operating activities	<u>106,247,592</u>	<u>115,133,191</u>
Cash flows used in investing activities:		
Additions to utility plant	<u>(76,938,648)</u>	<u>(76,581,461)</u>
Cash flows from financing activities:		
Congressional appropriations	96,590,184	76,652,874
Payments to U.S. Treasury	(10,464,123)	(11,101,784)
Transfers of property and services, net	1,608,959	2,155,728
Hydropower water storage reallocation deferral	<u>(1,836,235)</u>	<u>(1,798,466)</u>
Net cash provided by financing activities	<u>85,898,785</u>	<u>65,908,352</u>
Net increase in cash and funds held in escrow	115,207,729	104,460,082
Cash and funds held in escrow, beginning of year	<u>692,321,295</u>	<u>587,861,213</u>
Cash and funds held in escrow, end of year	<u>\$ 807,529,024</u>	<u>692,321,295</u>
Supplemental cash flow information:		
Interest deferred on regulatory liabilities (note 1(g))	\$ 3,530,490	3,705,738

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2020 and 2019

(1) Summary of Significant Accounting Policies

(a) General Information and Basis of Preparation of Combined Financial Statements

The Southwestern Federal Power System (SWFPS) financial statements combine all of the activities associated with the generation, transmission, and disposition of all Federal power marketed under Section 5 of the Flood Control Act of 1944 (the Flood Control Act) by the Southwestern Power Administration (Southwestern), an agency of the U.S. Department of Energy (DOE). The accompanying combined financial statements include the accounts of Southwestern and the related hydroelectric generating facilities and power operations of the U.S. Army Corps of Engineers (Corps), a component of the U.S. Department of Defense (DOD). Southwestern and the Corps are separately managed and financed, and each maintains their own accounting records. For purposes of financial and operational reporting, the facilities and related operations of Southwestern and the Corps (power purpose) are combined as SWFPS.

The Corps has constructed and operates hydroelectric generating facilities in the states of Arkansas, Missouri, Oklahoma, and Texas. Operating expenses and net assets of multipurpose Corps projects are allocated to power and non-power purposes (primarily recreation and flood control). Only the portion of such project costs and net assets allocated to power are included in the combined financial statements. Southwestern, as designated by the Secretary of Energy, transmits and markets power generated from these hydroelectric generating facilities.

SWFPS is subject to the accounting regulations of the Federal Energy Regulatory Commission (FERC). Accounts are maintained in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) as established by the Financial Accounting Standards Board (FASB), the uniform system of accounts prescribed for electric utilities by the FERC, the accounting practices and standards established by the DOE and DOD, and the requirements of specific legislation and executive directives issued by government agencies. All material intra-entity balances and transactions are eliminated. SWFPS's combined financial statements follow the accounting and reporting guidance contained in FASB Accounting Standards Codification (ASC) Topic 980, *Regulated Operations*. Allocation of costs and revenues to accounting periods for rate-making and regulatory purposes may differ from bases generally applied by nonregulated companies. Such allocations to meet regulatory accounting requirements are considered to be U.S. GAAP for regulated utilities, provided that there is a demonstrable ability to recover any deferred costs in future rates and such costs or revenues are accounted for as regulatory assets or liabilities.

(b) Confirmation and Approval of New Rates

SWFPS is not a public utility within the jurisdiction of the FERC under the Federal Power Act. Under a Delegation Order issued by the Secretary of Energy, the Administrator of Southwestern has the authority to develop power and transmission rates for SWFPS. Such rates are approved on an interim basis by the Deputy Secretary of Energy. The FERC has the exclusive authority to confirm, approve, and place into effect on a final basis, to remand, or to disapprove rates developed by the Administrator.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2020 and 2019

The FERC's review is limited to (1) whether the rates are the lowest possible consistent with sound business principles; (2) whether the revenue levels generated are sufficient to recover the costs of producing and transmitting electric energy, including repayment within the period permitted by law; and (3) the assumptions and projections used in developing the rates component. The FERC shall reject decisions of the Administrator only if it finds them to be arbitrary, capricious, or in violation of the law.

The rates in effect as of September 30, 2020 are summarized as follows:

The Integrated System rate schedules were placed into effect October 1, 2013 and were confirmed and approved by the FERC on January 9, 2014, and subsequently extended for a two-year period by the Deputy Secretary of Energy. These rate schedules incorporated a 4.7% revenue increase and remain in effect through September 30, 2019, or until superseded by new rate schedules. The P-13 Rate Schedule had a language change to reflect an update in the Peaking Energy schedule submission time to 2:30 p.m. CT and the Rate Schedule name was change to P-13A to reflect this change. All rate schedules were again extended for a two-year period by the Assistant Secretary, Office of Electricity, to remain in effect through September 30, 2021.

The Sam Rayburn Dam project rate was placed into effect January 1, 2016 and was confirmed and approved by the FERC on June 30, 2016. This rate increase incorporated a 7.9% revenue increase for the period January 1, 2016 through September 30, 2019, or until superseded by a new rate schedule. This rate schedule was extended for a two-year period by the Assistant Secretary, Office of Electricity, to remain in effect through September 30, 2021.

The Robert D. Willis project rate was placed into effect January 1, 2016 and was confirmed and approved by the FERC on June 15, 2016. The rate increase incorporated an 8.6% revenue increase for the period January 1, 2016 through September 30, 2019, or until superseded by a new rate schedule. This rate schedule was extended for a two-year period by the Assistant Secretary, Office of Electricity, to remain in effect through September 30, 2021.

(c) Utility Plant and Depreciation

Utility plant includes items such as dams, spillways, generators, turbines, substations and related components (generating facilities), and transmission lines and related components. Utility plant is stated at original cost, net of contributions by external entities. Property transferred from other government agencies is transferred at net book value. Cost includes direct labor and material, payments to contractors, indirect charges for engineering, supervision and similar overhead items, and an allowance for funds used during construction. The costs of additions and betterments are capitalized. Repairs and minor replacements are charged to operation and maintenance expense. Generally, the net cost of utility plant retired, together with removal costs less salvage, is recorded to accumulated depreciation when the property is removed from service.

The policy of Southwestern and the Corps is to move capitalized costs into completed utility plant at the time a project or feature of a project is deemed to be substantially complete. A project is substantially complete when it is providing benefits and services for the intended purpose and is generating project purpose revenue, where applicable.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2020 and 2019

Depreciation on utility plant is computed on a straight-line basis over the estimated service lives of the various classes of property. Service lives currently range from 5 to 100 years for transmission plant and generating facility components.

Most completed utility plant is recovered through the rates regardless of whether an asset is abandoned, loses value, is disposed of significantly before the end of its estimated useful life, or is destroyed. Consequently, the cash flow is not impaired regardless of the condition of the asset.

(d) Cash and Funds Held in Escrow

Cash represents the unexpended balance of funds authorized by Congress, customer advances, and spectrum relocation funds, held at the U.S. Department of the Treasury (U.S. Treasury). Cash received from the sale of power is generally deposited directly with the U.S. Treasury and is reflected as "Payable to U.S. Treasury" in the accompanying combined financial statements. Cash held for customer advances is restricted for the purposes agreed to between Southwestern and the customer.

Funds held in escrow represent the unexpended balance of cash and cash equivalents held in a bank trust escrow account under alternative financing agreements (note 5(b)) with certain customers and are restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. Under the agreements, funds deposited to the escrow account by customers are credited by Southwestern against accounts receivable for power, energy, and other services sold to the customer. The escrowed funds are transferred to the Corps, as needed, to meet contractual obligations as outlined in the associated agreements. Excess funds held in escrow, if any, are used to fund additional operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region as agreed to between Southwestern, the Corps, and the customers.

(e) Congressional Appropriations

Southwestern and the Corps receive congressional appropriations through the DOE and the DOD, respectively, to finance their operations. A portion of Southwestern's appropriations are offset by the use of receipts collected from the sale of Federal hydroelectric power, resulting in a net zero appropriation. The Corps also receives appropriations to finance construction of its hydroelectric projects. In accordance with the Flood Control Act, Southwestern is responsible for repayment to the Federal government, with interest, of its appropriations, and the portion of congressional appropriations allocated to the Corps for construction and operations of the power projects.

Congressional appropriations received by the Corps are authorized and allocated to individual projects. It is the intent of the Corps' project management to distribute congressional appropriations in amounts approximating estimated current year expenses and to adjust the distribution as necessary within the limits of the transfer authority residing at the district level. Project costs that are not specific to a project purpose are distributed between power and non-power purposes based on project cost allocation.

(f) Operating Revenues

In May 2014, the FASB issued Accounting Standard Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires a company to recognize revenue when the company transfers control of promised goods and services to the customer. Operating revenues are recognized when control of the promised goods or services is transferred to customers at an amount

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that reflects the consideration to be received. ASU No. 2014-09 also revises the disclosure requirements regarding revenue and requires that revenue from contracts with customers be reported separately from other revenues. ASU No. 2014-09 provides that it could be applied retrospectively to each prior period presented or on a modified retrospective basis with accumulative effect adjustment to retained earnings on the date of adoption.

Southwestern implemented ASU No. 2014-09 effective October 1, 2019 using the modified retrospective method of adoption. This adoption of ASU No. 2014-09 did not result in changes to the nature, amount, and timing of the existing revenue recognition processes or information technology infrastructure. Therefore, the adoption of ASU No. 2014-09 had no effect on the amount of revenue recorded in 2020 compared to the amount that would have been recorded under prior U.S. GAAP, no effect on total operating revenues or any other caption within the SWFPS's combined financial statements, and no cumulative effect adjustment was recorded.

Upon the adoption of ASU No. 2014-09, management elected the following practical expedients:

- Recognize revenue in the amount Southwestern has the right to invoice a customer.
- Apply the standard to a portfolio of contracts with similar characteristics, as the effects of applying the guidance to the portfolio would not differ materially from applying this guidance to the individual contracts.

Operating revenues are recorded on the basis of service rendered. Rates are established under requirements of the Flood Control Act, related legislation and executive departmental directives, and are to provide sufficient revenues to meet all required repayment of system costs, including operation and maintenance expenses less depreciation, interest, and payment to the U.S. Treasury for the Payable to U.S. Treasury in utility plant. Rates are intended to provide for recovery of the Payable to U.S. Treasury in transmission and generating facilities not to exceed 50 years from the date placed in service, while operation and maintenance costs and interest on Payable to U.S. Treasury are intended to be recovered annually.

As set forth in note 1(c), Utility Plant and Depreciation, assets are being depreciated for financial reporting purposes using the straight-line method over their estimated service lives, which currently range from 5 to 100 years for transmission and generating facility components. Accordingly, annual depreciation charges are not matched with the recovery of the related capital costs and will, in the case of generating facilities, continue beyond the period within which such costs will have been recovered through rates.

While energy and transmission rates are established to recover the costs of operating the power projects, rates are also required to be at the lowest possible level, consistent with sound business principles. Over the life of the power system, accumulated net revenues represent differences between the timing of the recognition of expenses and related revenues, resulting primarily from the difference between the recognition of depreciation, and the related recovery of the U.S. Treasury's investment in utility plant. SWFPS is, in effect, a Federal entity, thus at any given time the accumulated net revenues, to the extent available, are committed to the repayment of the Payable to U.S. Treasury.

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The practices followed by Southwestern and the Corps are in conformity with the accounting practices and standards established by DOE and DOD and the requirements of specific legislation and executive directives issued by government agencies. Based upon guidelines established in DOE Order RA 6120.2, revenues distributed to the Corps cover annual operating expenses, including interest, with the remainder applied to the unpaid generation investment.

In addition to providing electric power and energy, Southwestern provides scheduling, billing, and other ancillary services. Southwestern may provide multiple services to any one customer. Services qualify as separate performance obligations under ASU No. 2014-09 with distinguishable rates, terms, and delivery schedules. Services are provided to meet customer load requirements and revenues are recognized when services are provided.

(g) Regulatory Assets and Liabilities (Note 4)

Regulatory assets and liabilities result from rate actions of Southwestern's Administrator and other regulatory agencies. These assets and liabilities arise from specific costs and revenues that would have been included in the determination of net revenue in one period but are deferred until a different period for purposes of developing rates to charge for services, per the requirements of ASC Topic 980. SWFPS defers transactions as regulatory assets and liabilities so that costs will be recovered during the periods when the costs are scheduled to be paid, which ensures the matching of revenues and expenses. The assets and liabilities below are regulatory in nature:

Deferred Workers' Compensation

Workers' compensation consists of two elements: actuarial liability associated with workers' compensation cases incurred for which additional claims may still be made in the future (future claims) and a liability for expenses associated with actual claims incurred and paid by the Department of Labor (DOL), the program administrator, whom SWFPS must reimburse. DOL, DOE, and DOD determined Southwestern and the Corps' actuarial liability associated with workers' compensation cases. The actuarial liability for future claims is determined using historical benefit payment patterns and the U.S. Treasury discount rates.

The recovery of these future claims is deferred for purposes of the rate-making process until such time as the future claims are actually submitted and paid by the DOL. Therefore, the recognition of the expenses associated with this actuarially determined liability has been recorded as deferred workers' compensation in the combined balance sheets in accordance with ASC Topic 980 to reflect the effects of the rate-making process. SWFPS does not earn a rate of return on the deferred workers' compensation regulatory asset.

Denison Hydropower Water Storage Reallocation

Section 838 of P.L. 99-662 (Section 838) authorized the Corps to reallocate hydropower storage to water supply storage at Lake Texoma, in increments as needed, up to 150,000 acre-feet for users in the State of Texas and up to 150,000 acre-feet for users in the State of Oklahoma. Section 838 directed that the Corps would provide credits to Southwestern equal to the replacement cost of the hydropower lost as a result of the reallocations, and Southwestern would reimburse the preference customers (Denison allottees) for an amount equal to the customers' replacement cost of the hydropower lost as a result of the reallocations.

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In fiscal year 2010, the Corps executed water supply contracts for the 150,000 acre-feet of storage authorized for customers in the State of Texas by Section 838. According to a June 2010 agreement between Southwestern and the Corps, the Corps agreed to deposit all cost of storage payments for storage reallocated under Section 838 into the U.S. Treasury and to provide credits in the same amount to the hydropower income account. The total amount received of \$58,786,011 was deferred by Southwestern for the provision of the reimbursement to the Denison allottees and Southwestern for future hydropower storage revenues foregone. The reallocation deferral accrued interest at 2.75% and 2.88% of the outstanding balance for the years ended September 30, 2020 and 2019, respectively, based on law, administrative order, or administrative policy. Interest expense deferred on the outstanding balance totaled \$1,638,586 and \$1,715,982 for the years ended September 30, 2020 and 2019, respectively.

A September 2010 agreement between Southwestern and the Denison allottees provided the initial hydropower replacement cost as determined by Southwestern and the methodology for providing the reimbursement to the Denison allottees as authorized under Section 838. Beginning with the invoice for the October 2010 service month, reimbursement pursuant to Section 838 began as a credit on the Denison allottees' monthly invoices.

Purchased Power and Banking Exchange Deferral

SWFPS utilizes a separate rate component (purchased power adder) to recover the estimated cost of purchased power based upon the average purchased power costs expected to occur in the future. If the actual expenses of purchased power exceed the revenue generated from this adder, the cost is deferred for future recovery through the rates. Likewise, if the expense is less than the adder, the excess revenue is deferred. From time to time, SWFPS may utilize a separate rate component (adder adjustment) to manage additional purchased power expenses or excess revenues, respectively. The net purchased power deferral accrued interest at 2.75% and 2.88% of the outstanding balance for the years ended September 30, 2020 and 2019, respectively, based on law, administrative order, or administrative policy. Interest expense deferred on the outstanding balance totaled \$1,891,902 and \$1,989,756 for the years ended September 30, 2020 and 2019, respectively.

SWFPS has arrangements with certain customers in which excess power available on the power system is banked with the customer until needed by the power system and the customer has power available. The power system records a receivable for the power banked at the cost specified in the marketing arrangement, under the provisions of ASC Topic 845, *Nonmonetary Transactions*. The net revenue or expense associated with banking activity is deferred until the power is returned or delivered.

(h) Accounts Receivable

SWFPS's accounts receivable consist generally of receivables for power and energy sold to its customers who are primarily public bodies and cooperatives. SWFPS provides for uncollectible accounts if collection is in doubt. There is no allowance for uncollectible accounts for the years ended September 30, 2020 and 2019.

Southwestern's billing methods include net billing. Net billing is an agreement between Southwestern and a customer, whereby the customer's power invoice is credited and the funds received from the sale of power are used to fund transmission and generation activities. Net billing is discussed more fully in

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note 5(b). Under Southwestern billing methods, purchase and sale transactions are reported "gross" in the combined financial statements.

(i) Concentration of Credit Risk

Financial instruments, which potentially subject SWFPS to credit risk, include accounts receivable for customer purchases of power, transmission, or other products and services. These receivables are primarily with a group of diverse customers that are generally stable and established organizations and do not represent a significant credit risk. Although SWFPS is affected by the business environment of the utility industry, management does not believe a significant risk of loss from a concentration of credit exists.

(j) Interest on Payable to U.S. Treasury

Interest on Payable to U.S. Treasury is a cost mandated by the Secretary of Energy and by the FERC. SWFPS computes interest in accordance with DOE Order RA 6120.2, which provides that interest be computed on the remaining investment after revenues have been applied to recovery of costs during the year, any prior year unpaid costs, and also to unpaid Federal investment at the applicable interest rate.

(k) Allowance for Funds Used During Construction

The FERC Uniform System of Accounts defines Allowance for Funds Used During Construction as the net costs for the period of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. While cash is not realized currently from this allowance, it is realized under the rate-making process over the repayment life of the related property through increased revenues resulting from a higher recoverable investment. The interest rates used were 2.75% and 2.88% for the years ended September 30, 2020 and 2019, respectively, based on law, administrative order, or administrative policy.

(l) Retirement Benefits

SWFPS employees participate in one of the following contributory defined benefit plans: the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). Agency contributions are based on eligible employee compensation and are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Based on statutory contribution rates, the fiscal years 2020 and 2019 cost factors under CSRS were 38.5% and 38.4%, respectively, of basic pay. The cost factors under FERS for fiscal years 2020 and 2019 were 16.7% and 16.9%, respectively, of basic pay. The contribution levels, however, are legislatively mandated and do not reflect the current full cost requirements to fund the plans. Costs incurred by OPM on behalf of SWFPS are included as transfers of property and services, net, within the Payable to U.S. Treasury on the combined balance sheets.

Other retirement benefits administered by OPM include the Federal Employees Health Benefits Program (FEHB) and the Federal Employees Group Life Insurance Program (FEGLI). FEHB is calculated at \$8,038 and \$7,268, per enrolled employee, for fiscal years 2020 and 2019, respectively, and FEGLI is based on 0.02% of basic pay for each employee enrolled in these programs.

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In addition to the amounts contributed to the CSRS and FERS as stated previously, SWFPS recorded an expense and related liability for the pension and other postretirement benefits in the combined financial statements of \$6,070,120 and \$5,349,137 for the years ended September 30, 2020 and 2019, respectively. These amounts reflect the contributions made on behalf of SWFPS by OPM to the benefit program trust funds.

As a Federal agency, all postretirement activity is managed by OPM, therefore, neither the assets of the plans nor the actuarial data with respect to the accumulated plan benefits relative to Southwestern and the Corps employees are included in this report.

(m) Transfers of Property and Services, Net

Transfers of property and services, net, is a component of total capitalization that represents the cumulative receipt of transfers of assets or costs offset by the cumulative disbursement of revenue transfers. Transfers are recognized upon physical delivery of the asset or performance of the service. Transfers occur between projects, project types, and other Federal entities. Transfers between Southwestern and the Corps eliminate upon combination.

(n) Income Taxes

As agencies of the U.S. Government, Southwestern and the Corps are exempt from all income taxes imposed by any governing body, whether it is a Federal, state, or commonwealth of the United States.

(o) Use of Estimates

The preparation of the combined financial statements in conformity with U.S. GAAP requires management of SWFPS to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Due to uncertainties inherent in the estimation process, actual results could differ from those estimates.

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(p) Non-Reimbursable Activities

Non-reimbursable activities for the years ended September 30, 2020 and 2019 consist of the following:

	<u>2020</u>	<u>2019</u>
Non-reimbursable revenues:		
Non-Federal project revenue	\$ 565,949	608,093
Federal project revenue	48,056	7,393
COVID-19 project revenue	22,886	—
Escrow interest revenue	<u>2,973,668</u>	<u>5,364,855</u>
Total non-reimbursable revenues	<u>\$ 3,610,559</u>	<u>5,980,341</u>
Non-reimbursable expenses:		
Non-Federal project expense	\$ 565,949	608,093
Federal project expense	48,056	7,393
COVID-19 project expense	22,886	—
White River Minimum Flows Project expense	2,678,879	2,027,415
Spectrum Relocation Fund expense	524,371	497,335
Other project expense	<u>3,038</u>	<u>40,000</u>
Total non-reimbursable expenses	<u>\$ 3,843,179</u>	<u>3,180,236</u>

Federal and Non-Federal Projects

Southwestern has agreements with Federal and non-Federal entities to provide services on a cost basis. Non-Federal entities are required to provide advance payment for Southwestern's services. The operating revenues and expenses related to these services are excluded from the rate-making process. A portion of cash and advances for construction in the accompanying combined financial statements relate to these activities.

COVID-19 Activity

In May 2020, Southwestern received an appropriation of \$556,041 under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Public Law 116-136, to prevent, prepare for, and respond to COVID-19 pandemic necessary expenses related to supporting remote access for personnel. The funds remain available until September 30, 2021. Total obligations incurred by Southwestern were \$263,182 of which \$22,886 were expensed as of September 30, 2020. The obligations are primarily attributed to information technology (IT) and contractor support labor costs, laptops, cell phones and additional usage charges, additional internet usage, and other IT miscellaneous expenses. This activity is non-reimbursable through the rate-making process.

Escrow Interest Revenue

Interest revenue represents the interest earned on funds held in escrow. These funds are authorized specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. This activity is non-reimbursable through the rate-making process.

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White River Minimum Flows Project

In accordance with Section 132 of P.L. 109-103, Southwestern implemented the offset to the minimum flows project in fiscal year 2010. Section 132 provided that losses to Federal hydropower shall be offset by a reduction in the costs allocated to the Federal hydropower purpose. Southwestern determined the Federal hydropower impacts to include lost on-peak energy and capacity, lost off-peak energy, increased costs due to dissolved oxygen impacts, and increased maintenance costs at Bull Shoals. This activity is non-reimbursable through the rate-making process.

Spectrum Relocation Fund

In December 2004, the U.S. Congress passed and the President signed the Commercial Spectrum Enhancement Act (CSEA, Title II of P.L. 108-494), creating the Spectrum Relocation Fund to streamline the relocation of Federal systems from existing spectrum bands to accommodate commercial use by facilitating reimbursement to affected agencies of relocation costs. In fiscal years 2012, 2009, and 2007, Southwestern received \$17,000,000, \$17,730,000, and \$8,091,360, respectively, in spectrum relocation funds, as approved by the Office of Management and Budget, and as reported to the Congress. In fiscal years 2020 and 2019, Southwestern expensed \$524,371 and \$497,335, respectively. Expenses incurred represent labor, construction contracts, travel, and other administrative costs. This activity is non-reimbursable through the rate-making process.

(q) Derivative and Hedging Activities

Southwestern analyzes derivative financial instruments under ASC Topic 815, *Derivatives and Hedging*. This standard requires that all derivative instruments, as defined by ASC Topic 815, be recorded on the combined balance sheets at fair value, unless exempted. Changes in a derivative instrument's fair value must be recognized currently in the combined statement of revenues and expenses, unless the derivative has been designated in a qualifying hedging relationship. The application of hedge accounting allows a derivative instrument's gains and losses to offset related results of the hedged item in the combined statements of revenues and expenses to the extent effective. ASC Topic 815 requires that the hedging relationship be highly effective and that an organization formally designate a hedging relationship at the inception of the contract to apply hedge accounting.

Southwestern enters into contracts for the sale of electricity for use in its business operations. ASC Topic 815 requires Southwestern to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that literally meet the definition of a derivative may be exempted from ASC Topic 815 as normal purchases or normal sales. Normal purchases and sales are contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period of time in the normal course of business. Contracts that meet the requirements of normal purchases or sales are documented and exempted from the accounting and reporting requirements of ASC Topic 815.

Southwestern's policy is to fulfill all derivative and hedging contracts by providing power to a third party as provided for in each contract. Southwestern's policy does not authorize the use of derivative or hedging instruments for speculative purposes such as hedging electricity pricing fluctuations beyond Southwestern's estimated capability to deliver power. Accordingly, Southwestern evaluates all of its contracts to determine if they are derivatives and, if applicable, to ensure that they qualify and meet the

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normal purchases and normal sales designation requirements under ASC Topic 815. Normal purchases and normal sales contracts are accounted for as executory contracts as required under U.S. GAAP. As of September 30, 2020 and 2019, Southwestern has no contracts accounted for at fair value, as all derivatives qualify as normal purchases and normal sales.

(r) Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. ASU No. 2016-02 is effective for the SWFPS for periods beginning after December 15, 2021 and early adoption is permitted. SWFPS is evaluating the effect that ASU No. 2016-02 will have on the SWFPS's combined financial statements and related disclosures. Effective October 1, 2019, SWFPS adopted the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash and cash equivalents, which will now include restricted cash and restricted cash equivalents in the beginning and ending balances on the statement of cash flows. The adoption of this guidance resulted in a change to the beginning and ending balances of cash and cash equivalents reported on the statement of cash flows, which now include cash and cash equivalents included in funds held in escrow.

(2) Disaggregated Revenue

Disaggregated revenues as of September 30, 2020 and 2019 consists of the following:

	<u>2020</u>	<u>2019</u>
Disaggregated revenues:		
Sale of Federal electric power	\$ 203,246,478	198,039,439
Non-Federal transmission services	15,205,886	17,180,655
Ancillary services	682,760	690,257
Other revenues	<u>11,060,449</u>	<u>5,006,423</u>
Total operating revenue before deferrals	<u>\$ 230,195,573</u>	<u>220,916,774</u>

Revenue from Contracts with Customers

Southwestern provides wholesale Federal electric power (energy and capacity) to preference power customers under long-term firm and non-firm contracts. Southwestern establishes power rates for these contracts in a formal rate-setting process. Excess energy is sold at established power rates. Federal electric power revenues are recognized over time as the customer receives and consumes the benefits. Federal electric power revenues are billed monthly based on meter readings and contracted allocations and estimated unbilled electric power revenues are accrued at the end of each reporting period. Revenues can vary from period to period due to hydropower plant availability, hydrological conditions, and customer usage requirements.

Non-Federal transmission service revenues consist primarily of revenue for transmission of non-Federal power on Southwestern's transmission system. Transmission rates are established through a formal rate-setting process, and revenues are recognized over time as capacity and electric

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transmission is made available. Transmission services are billed monthly and estimated unbilled transmission services are accrued at the end of each reporting period.

Ancillary services ensure transmission grid reliability and include items such as scheduling, system control, dispatch, balancing reserves, and other services. Ancillary revenue is recognized over time as services are provided. Ancillary services are billed monthly, and estimated unbilled ancillary services are accrued at the end of the reporting period.

Other revenues consist of headwater benefits, hydropower benefits foregone revenues, and miscellaneous revenues from the Corps attributable to the power function, as well as market participant agreement revenues for the sale of power from Blakely Mountain and Degray into the MISO market plus miscellaneous revenues for Southwestern. These revenues are recognized upon receipt.

(3) Utility Plant

Utility plant as of September 30, 2020 and 2019 consists of the following:

	<u>2020</u>	<u>2019</u>
Plant in service:		
Generating facilities	\$ 1,426,021,456	1,415,091,938
Transmission facilities	<u>497,176,354</u>	<u>470,674,424</u>
	1,923,197,810	1,885,766,362
Less accumulated depreciation	<u>(897,938,508)</u>	<u>(866,436,841)</u>
Construction work in progress:		
Generating facilities	239,214,933	179,888,339
Transmission facilities	<u>11,999,301</u>	<u>27,831,327</u>
	<u>251,214,234</u>	<u>207,719,666</u>
Net utility plant	<u>\$ 1,276,473,536</u>	<u>1,227,049,187</u>

In accordance with FERC guidelines, SWFPS excludes contributed plant within the combined balance sheets to eliminate the impact on power rates. As of September 30, 2020 and 2019, contributed plant, net, used in SWFPS's operations totaled \$23,003,072.

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(4) Regulatory Assets and Liabilities

Regulatory assets and liabilities as of September 30, 2020 and 2019 consist of the following:

	<u>2020</u>	<u>2019</u>
Regulatory assets:		
Deferred workers' compensation	\$ 7,283,530	9,866,169
Regulatory liabilities:		
Purchased power and banking exchange deferral	\$ 72,817,897	75,779,995
Hydropower water storage reallocation deferral	60,305,459	60,503,106
Total	\$ 133,123,356	136,283,101

Southwestern's purchased power and banking exchange deferral account represents the deferral of net revenues or expenses associated with net purchased power and banking exchange activities as follows:

	<u>Purchased power and banking exchange deferral</u>
September 30, 2018	\$ (73,348,101)
Purchased power adder revenue	(14,452,211)
Purchased power expense	14,171,475
Net banking exchange	(80,060)
Net purchased power and banking exchange deferral	<u>(360,796)</u>
Interest on deferred activities and other	<u>(2,071,098)</u>
September 30, 2019	(75,779,995)
Purchased power adder revenue	(15,182,258)
Purchased power expense	19,974,196
Net banking exchange	(20,661)
Net purchased power and banking exchange deferral	<u>4,771,277</u>
Interest on deferred activities and other	<u>(1,809,179)</u>
September 30, 2020	\$ <u>(72,817,897)</u>

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(5) Financing Sources

SWFPS's financing sources include annual appropriations, Federal power receipts, and alternative financing arrangements to fund its operations.

(a) Payable to U.S. Treasury

Construction and operation of Southwestern's transmission system and the Corps' generating facilities and operations are financed through congressional appropriations. The exceptions are capital assets and maintenance activities funded through the alternative financing arrangements and the funding by non-Federal parties of the construction of the Robert Douglas Willis project. The U.S. Government's investment in each generating project and each year's investment in the transmission system are to be repaid to the U.S. Treasury over a period not to exceed 50 years from the time the facility is placed in service. There is no requirement for repayment of a specific amount on an annual basis.

Annual revenues are first applied to the current year operating expenses (less depreciation) and interest expense. All annual amounts for such expenses have been paid through fiscal year 2020. Remaining revenues are to be first applied to repayment of operating deficits (which include all expenses except depreciation), if any, and then to repayment of the Payable to U.S. Treasury. To the extent possible, while still complying with the repayment period established for each increment of investment and unless otherwise required by legislation, repayment of the investment is to be accomplished by a repayment of the highest interest-bearing investment first. Interest rates applied to the unamortized investment of the U.S. Government in the Corps' hydroelectric generating facilities range from 2.38% to 3.38% for unpaid facilities in service prior to and including fiscal year 2020 (2.75%). The rates have been set by law, by administrative order pursuant to law, or by administrative policies using the U.S. Senate Document No. 97 formula for the fiscal year during which the appropriations were requested.

(b) Alternative Financing

Due to fluctuations in the amount of annual appropriations received to fund operations, maintenance, rehabilitation, and modernization of SWFPS facilities, SWFPS has established an alternative financing program under reimbursable authority regulations. Under agreements with customers to finance projects, which benefit SWFPS, funds received from the sale of power are net billed, allowing a portion of the funds to be utilized to finance agreed-upon projects. Under the agreements with certain customers, alternative financing restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at the hydroelectric generating facilities is held in escrow. All other alternative financing arrangements are collected by Southwestern and deposited as cash held by the U.S. Treasury and are reflected in the accompanying combined balance sheets as other assets with an offsetting liability included in advances for construction until completion of the project, at which time the asset and liability are eliminated.

(6) Commitments and Contingencies

(a) General

Based on the final 2021 Power Repayment Studies (PRSs), the projected increase in capital investment in 2021 is \$115,512,273, which includes \$19,121,061 for transmission facilities and \$96,391,212 for generating facilities. The PRSs are conducted annually to determine the adequacy of the current rates to ensure full cost recovery of the power investments and expenses for the three rate

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systems. The five-year investment increase projected in the 2021 PRSs for fiscal years 2021 through 2025 is estimated to cost \$740,071,302. It is reasonably possible that a change in the future capital investment estimates will occur.

Southwestern sells its marketable power to customers under long-term power sales contracts of 15 years, the majority of which require Southwestern to provide 1,200 kilowatt hours per kilowatt of peaking contract demand per year, subject to scheduling constraints outlined in each customer's contract. If sufficient power is unavailable to Southwestern from Corps' hydroelectric facilities to meet these commitments, Southwestern may be required to purchase power from other sources to meet these commitments. The cost to purchase such power is recovered through the purchased power adder discussed more fully in note 1(g).

(b) Legal

SWFPS has exposure to certain claims and legal actions arising in the ordinary course of business. In management's opinion, any resulting actions will not have a material adverse effect on the financial condition or results of operations of SWFPS as of September 30, 2020 and 2019.

(c) Purchased Power Contract Commitments

Southwestern has entered into various agreements for power purchases that vary in contractual terms but generally do not exceed four years. The current period purchased power costs are included in the combined statements of revenues and expenses. Southwestern's future purchased power commitments associated with current agreements, subject to the availability of Federal funds and contingent upon annual appropriations from Congress, are as follows:

Year ending September 30:	<u>Purchased power</u>
2021	\$ 14,796,750
2022	11,476,500
2023	<u>2,126,250</u>
Total	<u>\$ 28,399,500</u>

In addition, these agreements include variable energy amounts and pricing within a contractually determined rate based on market determinants such as a particular energy market hourly day-ahead locational marginal price or a daily published hub gas price multiplied by the contractual heat rate. One agreement, which term concludes in fiscal year 2022, includes a fixed contractual-year energy amount of 48,000 MWh with the final year allowing for a maximum of 45,600 MWh. The agreement also includes a provision allowing termination by either party upon 90 days' notice, which could decrease or eliminate the above disclosed commitments.

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(7) Leases

SWFPS has a 191-month Occupancy Agreement for office space with the General Services Administration (GSA), which commenced January 19, 2018 and is scheduled to terminate December 31, 2033. The lease agreement between the GSA and the building owner is for a 20-year term, 10-year firm term for the first 10 years and the option to terminate during the second 10-year-term, which commenced on January 1, 2014 and ends on December 31, 2033.

In August 2019, Southwestern purchased a new headquarters building in Tulsa, Oklahoma, with a fiscal year 2021 target move-in date. In accordance with the Occupancy Agreement, Southwestern may relinquish space upon four months' notice to GSA and will not be obligated to make any additional payments.

Expected future minimum lease payments, given a significant reduction in the lease space in FY 2022 and termination of the Occupancy Agreement by the end of FY 2022, as of September 30, 2020, are as follows:

Year ending September 30:	
2021	\$ 748,067
2022	<u>410,138</u>
Total future minimum lease payments	<u>\$ 1,158,205</u>

Rent expense for operating leases during the years ended September 30, 2020 and 2019 was \$764,162 and \$719,654, respectively.

(8) Related Parties

As components of the DOE and the DOD, these departments are considered related parties to Southwestern and the Corps. Southwestern has certain agreements with DOE and DOD components to provide electric power, transmission services, and other services. As of September 30, 2020 and 2019, amounts outstanding in accounts receivable relating to DOE and DOD components totaled \$322,189 and \$362,373, respectively. For the years ended September 30, 2020 and 2019, total operating revenues earned from DOE and DOD sources totaled \$4,486,919 and \$4,336,787, respectively.

(9) Subsequent Events

SWFPS has evaluated subsequent events from the balance sheet date through August 31, 2021, the date the combined financial statements were available to be issued, and such events are disclosed in these accompanying notes to the combined financial statements.

Schedule 1

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Balance Sheet Data

September 30, 2020

Assets	Southwestern	Corps	Total
Plant in service	\$ 497,176,354	1,426,021,456	1,923,197,810
Accumulated depreciation	(252,915,533)	(645,022,975)	(897,938,508)
Construction work in progress	11,999,301	239,214,933	251,214,234
Net utility plant	256,260,122	1,020,213,414	1,276,473,536
Cash	260,368,242	212,563,483	472,931,725
Funds held in escrow	300,340,823	34,256,476	334,597,299
Accounts receivable	16,553,836	489,803	17,043,639
Materials and supplies, at average cost	2,967,141	106,625	3,073,766
Banking exchange receivables	4,173,440	—	4,173,440
Deferred workers' compensation	1,801,562	5,481,968	7,283,530
Other assets	109,381,401	—	109,381,401
Total assets	\$ 951,846,567	1,273,111,769	2,224,958,336
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 8,949,704	9,274,849	18,224,553
Advances for construction	92,387,043	—	92,387,043
Accrued workers' compensation	2,353,511	5,578,457	7,931,968
Purchased power and banking exchange deferral	72,817,897	—	72,817,897
Hydropower water storage reallocation deferral	60,305,459	—	60,305,459
Total liabilities	236,813,614	14,853,306	251,666,920
Capitalization:			
Payable to U.S. Treasury	595,678,875	677,398,015	1,273,076,890
Accumulated net revenues	119,354,078	580,860,448	700,214,526
Total capitalization	715,032,953	1,258,258,463	1,973,291,416
Total liabilities and capitalization	\$ 951,846,567	1,273,111,769	2,224,958,336

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM**Schedule 1**

Combining Schedule of Balance Sheet Data

September 30, 2019

Assets	Southwestern	Corps	Total
Plant in service	\$ 470,674,424	1,415,091,938	1,885,766,362
Accumulated depreciation	(241,882,300)	(624,554,541)	(866,436,841)
Construction work in progress	27,831,327	179,888,339	207,719,666
Net utility plant	256,623,451	970,425,736	1,227,049,187
Cash	208,260,441	215,841,364	424,101,805
Funds held in escrow	223,836,691	44,382,799	268,219,490
Accounts receivable	18,874,897	445,719	19,320,616
Materials and supplies, at average cost	3,160,679	161,015	3,321,694
Banking exchange receivables	4,166,832	—	4,166,832
Deferred workers' compensation	2,387,181	7,478,988	9,866,169
Other assets	60,203,264	—	60,203,264
Total assets	\$ 777,513,436	1,238,735,621	2,016,249,057
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 10,954,136	11,940,141	22,894,277
Advances for construction	44,601,903	—	44,601,903
Accrued workers' compensation	2,834,133	7,652,175	10,486,308
Purchased power and banking exchange deferral	75,779,995	—	75,779,995
Hydropower water storage reallocation deferral	60,503,106	—	60,503,106
Total liabilities	194,673,273	19,592,316	214,265,589
Capitalization:			
Payable to U.S. Treasury	485,517,456	681,867,732	1,167,385,188
Accumulated net revenues	97,322,707	537,275,573	634,598,280
Total capitalization	582,840,163	1,219,143,305	1,801,983,468
Total liabilities and capitalization	\$ 777,513,436	1,238,735,621	2,016,249,057

See accompanying independent auditors' report.

Schedule 2

SOUTHWESTERN FEDERAL POWER SYSTEM
Combining Schedule of Changes in Capitalization Data
Years ended September 30, 2020 and 2019

	Southwestern payable to U.S. Treasury	Southwestern accumulated net revenues (deficit)	Southwestern total capitalization	Corps payable to U.S. Treasury	Corps accumulated net revenues (deficit)	Corps total capitalization	Total capitalization
Total capitalization as of September 30, 2018	\$ 439,866,733	84,615,426	524,482,159	643,298,431	476,200,953	1,119,499,384	1,643,981,543
Additions:							
Congressional appropriations	10,400,000	—	10,400,000	66,252,874	—	66,252,874	76,652,874
Interest on payable to U.S. Treasury and other	(169,883)	—	(169,883)	11,333,952	—	11,333,952	11,164,069
Transfers of property and services, net	(101,770,367)	—	(101,770,367)	109,275,232	—	109,275,232	7,504,865
Total additions to capitalization	(91,540,250)	—	(91,540,250)	186,862,058	—	186,862,058	95,321,808
Deductions:							
Payments to U.S. Treasury	137,190,973	—	137,190,973	(148,292,757)	—	(148,292,757)	(11,101,784)
Total deductions to capitalization	137,190,973	—	137,190,973	(148,292,757)	—	(148,292,757)	(11,101,784)
Net revenues for the year ended September 30, 2019	—	12,707,281	12,707,281	—	61,074,620	61,074,620	73,781,901
Total capitalization as of September 30, 2019	485,517,456	97,322,707	582,840,163	681,867,732	537,275,573	1,219,143,305	1,801,983,468
Additions:							
Congressional appropriations	10,400,000	—	10,400,000	86,190,184	—	86,190,184	96,590,184
Interest on payable to U.S. Treasury and other	(131,981)	—	(131,981)	12,018,543	—	12,018,543	11,886,562
Transfers of property and services, net	(31,954,592)	—	(31,954,592)	39,633,671	—	39,633,671	7,679,079
Total additions to capitalization	(21,686,573)	—	(21,686,573)	137,842,398	—	137,842,398	116,155,825
Deductions:							
Payments to U.S. Treasury	131,847,992	—	131,847,992	(142,312,115)	—	(142,312,115)	(10,464,123)
Total deductions to capitalization	131,847,992	—	131,847,992	(142,312,115)	—	(142,312,115)	(10,464,123)
Net revenues for the year ended September 30, 2020	—	22,031,371	22,031,371	—	43,584,875	43,584,875	65,616,246
Total capitalization as of September 30, 2020	\$ 595,678,875	119,354,078	715,032,953	677,398,015	580,860,448	1,258,258,463	1,973,291,416

See accompanying independent auditors' report.

Schedule 3

SOUTHWESTERN FEDERAL POWER SYSTEM
Combining Schedule of Revenues and Expenses Data
Year ended September 30, 2020

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 203,246,478	—	203,246,478
Transmission and other operating revenues	24,421,302	2,527,793	26,949,095
Total operating revenues before deferrals	227,667,780	2,527,793	230,195,573
Net purchased power and banking exchange deferral	4,771,276	—	4,771,276
Revenue distributed to Corps	(137,719,560)	137,719,560	—
Total operating revenues	94,719,496	140,247,353	234,966,849
Non-reimbursable revenues	3,416,882	193,677	3,610,559
Total revenues	98,136,378	140,441,030	238,577,408
Operating expenses:			
Operation and maintenance	26,267,610	67,240,738	93,508,348
Purchased power and banking exchange	21,978,789	—	21,978,789
Depreciation and amortization	15,499,379	20,619,015	36,118,394
Transmission service charges by others	42,505	—	42,505
Retirement and other employee benefit expense	5,857,647	4,799,343	10,656,990
Non-reimbursable expenses	3,843,179	—	3,843,179
Total operating expenses	73,489,109	92,659,096	166,148,205
Net operating revenues	24,647,269	47,781,934	72,429,203
Interest expense:			
Interest on payable to U.S. Treasury and other	3,398,509	12,018,543	15,417,052
Allowance for funds used during construction	(782,611)	(7,821,484)	(8,604,095)
Net interest expense	2,615,898	4,197,059	6,812,957
Net revenues	\$ 22,031,371	43,584,875	65,616,246

See accompanying independent auditors' report.

Schedule 3

SOUTHWESTERN FEDERAL POWER SYSTEM
Combining Schedule of Revenues and Expenses Data
Year ended September 30, 2019

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 198,039,439	—	198,039,439
Transmission and other operating revenues	20,400,807	2,476,528	22,877,335
Total operating revenues before deferrals	218,440,246	2,476,528	220,916,774
Net purchased power and banking exchange deferral	(360,796)	—	(360,796)
Revenue distributed to Corps	(143,297,300)	143,297,300	—
Total operating revenues	74,782,150	145,773,828	220,555,978
Non-reimbursable revenues	5,588,170	392,171	5,980,341
Total revenues	80,370,320	146,165,999	226,536,319
Operating expenses:			
Operation and maintenance	25,301,563	59,376,858	84,678,421
Purchased power and banking exchange	16,221,107	—	16,221,107
Depreciation and amortization	15,033,117	16,466,301	31,499,418
Transmission service charges by others	44,486	—	44,486
Retirement and other employee benefit expense	5,183,785	3,929,322	9,113,107
Non-reimbursable expenses	3,180,236	—	3,180,236
Total operating expenses	64,964,294	79,772,481	144,736,775
Net operating revenues	15,406,026	66,393,518	81,799,544
Interest expense:			
Interest on payable to U.S. Treasury and other	3,535,855	11,333,952	14,869,807
Allowance for funds used during construction	(837,110)	(6,015,054)	(6,852,164)
Net interest expense	2,698,745	5,318,898	8,017,643
Net revenues	\$ 12,707,281	61,074,620	73,781,901

See accompanying independent auditors' report.

Schedule 4

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2020

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues (losses)	\$ 22,031,371	43,584,875	65,616,246
Adjustments to reconcile net revenues to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	137,719,560	(137,719,560)	—
Depreciation and amortization	15,499,379	20,619,015	36,118,394
Benefit expense paid by other Federal agencies	1,367,266	4,702,854	6,070,120
Interest on payable to U.S. Treasury and other	3,398,509	12,018,543	15,417,052
Allowance for funds used during construction	(782,611)	(7,821,484)	(8,604,095)
(Increase) decrease in assets:			
Accounts receivable	2,321,061	(44,084)	2,276,977
Materials and supplies	193,538	54,390	247,928
Banking exchange receivables	(6,608)	—	(6,608)
Deferred workers' compensation	585,619	1,997,020	2,582,639
Other assets	(49,178,137)	—	(49,178,137)
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	(2,004,432)	(2,665,292)	(4,669,724)
Accrued workers' compensation	(480,622)	(2,073,718)	(2,554,340)
Purchased power and banking exchange deferral	(4,854,000)	—	(4,854,000)
Advances for construction	47,785,140	—	47,785,140
Net cash provided by (used in) operating activities	<u>173,595,033</u>	<u>(67,347,441)</u>	<u>106,247,592</u>
Cash flows used in investing activities:			
Additions to utility plant	<u>(14,353,439)</u>	<u>(62,585,209)</u>	<u>(76,938,648)</u>
Cash flows from financing activities:			
Congressional appropriations	10,400,000	86,190,184	96,590,184
Payments to U.S. Treasury	131,847,992	(142,312,115)	(10,464,123)
Revenue distributed to Corps	(137,719,560)	137,719,560	—
Transfers of property and services, net	(33,321,858)	34,930,817	1,608,959
Hydropower water storage reallocation deferral	(1,836,235)	—	(1,836,235)
Net cash (used in) provided by financing activities	<u>(30,629,661)</u>	<u>116,528,446</u>	<u>85,898,785</u>
Net increase in cash and funds held in escrow	128,611,933	(13,404,204)	115,207,729
Cash and funds held in escrow, beginning of year	<u>432,097,132</u>	<u>260,224,163</u>	<u>692,321,295</u>
Cash and funds held in escrow, end of year	<u>\$ 560,709,065</u>	<u>246,819,959</u>	<u>807,529,024</u>
Supplemental cash flow information:			
Interest deferred on regulatory liabilities	\$ 3,530,490	—	3,530,490

See accompanying independent auditors' report.

Schedule 4

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2019

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues (losses)	\$ 12,707,281	61,074,620	73,781,901
Adjustments to reconcile net revenues to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	143,297,300	(143,297,300)	—
Depreciation and amortization	15,033,117	16,466,301	31,499,418
Benefit expense paid by other Federal agencies	1,593,002	3,756,135	5,349,137
Interest on payable to U.S. Treasury and other	3,535,855	11,333,952	14,869,807
Allowance for funds used during construction	(837,110)	(6,015,054)	(6,852,164)
(Increase) decrease in assets:			
Accounts receivable	(2,549,784)	(37,785)	(2,587,569)
Materials and supplies	(185,050)	—	(185,050)
Banking exchange receivables	(33,135)	—	(33,135)
Deferred workers' compensation	136,118	(1,222,760)	(1,086,642)
Other assets	165,975	—	165,975
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	1,791,191	2,823,679	4,614,870
Accrued workers' compensation	(504,474)	1,219,490	715,016
Purchased power and banking exchange deferral	442,138	—	442,138
Advances for construction	(5,560,511)	—	(5,560,511)
Net cash provided by (used in) operating activities	<u>169,031,913</u>	<u>(53,898,722)</u>	<u>115,133,191</u>
Cash flows used in investing activities:			
Additions to utility plant	<u>(28,767,946)</u>	<u>(47,813,515)</u>	<u>(76,581,461)</u>
Cash flows from financing activities:			
Congressional appropriations	10,400,000	66,252,874	76,652,874
Payments to U.S. Treasury	137,190,973	(148,292,757)	(11,101,784)
Revenue distributed to Corps	(143,297,300)	143,297,300	—
Transfers of property and services, net	(103,363,369)	105,519,097	2,155,728
Hydropower water storage reallocation deferral	(1,798,466)	—	(1,798,466)
Net cash (used in) provided by financing activities	<u>(100,868,162)</u>	<u>166,776,514</u>	<u>65,908,352</u>
Net increase in cash and funds held in escrow	39,395,805	65,064,277	104,460,082
Cash and funds held in escrow, beginning of year	<u>392,701,327</u>	<u>195,159,886</u>	<u>587,861,213</u>
Cash and funds held in escrow, end of year	<u>\$ 432,097,132</u>	<u>260,224,163</u>	<u>692,321,295</u>
Supplemental cash flow information:			
Interest deferred on regulatory liabilities	\$ 3,705,738	—	3,705,738

See accompanying independent auditors' report.

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