



U.S. DEPARTMENT OF ENERGY

Office of Inspector General

DOE-OIG-26-30

April 8, 2026

Internal Control Weaknesses Identified During the Southwestern Federal Power System's Fiscal Year 2024 Combined Financial Statements Audit



MANAGEMENT LETTER



Department of Energy
Washington, DC 20585

April 8, 2026

MEMORANDUM FOR THE ACTING ADMINISTRATOR AND CHIEF EXECUTIVE
OFFICER, SOUTHWESTERN POWER ADMINISTRATION

SUBJECT: Management Letter: *Internal Control Weaknesses Identified During the
Southwestern Federal Power System's Fiscal Year 2024 Combined Financial
Statements Audit*

The Office of Inspector General engaged the independent public accounting firm of KPMG LLP to conduct the fiscal year 2024 combined financial statements audit of the Southwestern Federal Power System, subject to our review. As part of this audit, KPMG LLP considered Southwestern Federal Power System's internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing its opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of Southwestern Federal Power System's internal control.

During the audit, KPMG LLP identified certain deficiencies in internal control that are included in the attached management letter. The attached letter contains 5 findings and 17 recommendations that were issued to Southwestern Power Administration during *The Southwestern Federal Power System's Fiscal Year 2024 Combined Financial Statements Audit*. Management concurred with the findings and recommendations and had taken or planned to take corrective actions. Management's responses are included with each finding.

We appreciated the cooperation of your staff during the review.

A handwritten signature in blue ink, appearing to read "MDD", with a horizontal line extending to the right.

Matthew D. Dove
Assistant Inspector General
for Audits
Office of Inspector General

cc: Deputy Secretary
Chief of Staff
Senior Vice President and Chief Operating Officer, Southwestern Power Administration
Acting Chief Financial Officer, Southwestern Power Administration

DOE OIG HIGHLIGHTS

Internal Control Weaknesses Identified During the Southwestern Federal Power System's Fiscal Year 2024 Combined Financial Statements Audit

Why the Audit Was Performed

The Office of Inspector General engaged the independent public accounting firm of KPMG LLP (KPMG) to conduct the fiscal year 2024 combined financial statements audit of the Southwestern Federal Power System (SWFPS), subject to our review. As part of this audit, KPMG considered SWFPS' internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing its opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of SWFPS' internal control.

KPMG performed the audit in accordance with generally accepted government auditing standards.

What the Audit Found

During the audit, KPMG identified certain deficiencies in SWFPS' internal control related to entity level controls, post-retirement benefits, workers' compensation, personal protective equipment, and operation and maintenance expenses that are included in the attached management letter.

What the Audit Recommends

The attached letter contains 5 findings and 17 recommendations that were issued to Southwestern Power Administration during *The Southwestern Federal Power System's Fiscal Year 2024 Combined Financial Statements Audit*. Management concurred with the findings and recommendations and had taken or planned to take corrective actions. Management's responses are included with each finding.



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

February 27, 2026

Management
Southwestern Power Administration
Tulsa, Oklahoma

To the management of Southwestern Power Administration (Southwestern):

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, 2024, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered the 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 the SWFPS's internal control. Accordingly, we do not express an opinion on the effectiveness of the SWFPS's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and/or significant deficiencies and therefore, material weaknesses and/or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency and in accordance with *Government Auditing Standards*, we communicated this material weakness and significant deficiency in our report dated February 27, 2026.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projects of any evaluation of effectiveness to future periods are subject to the risk that control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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. During our audit, we identified certain deficiencies in internal control that we considered to aggregate to a material weakness which was communicated in our report dated February 27, 2026 and those deficiencies that comprise the material weakness are included in Exhibit A of this letter.

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. During our audit we identified a deficiency in internal control that we consider to be a significant deficiency which was communicated in our report dated February 27, 2026 and the deficiency that comprised of the significant deficiency is included in Exhibit B of this letter.

KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.



Management
Southwestern Power Administration
February 27, 2026
Page 2 of 2

Although not considered to be significant deficiencies or material weaknesses, we also noted other deficiencies in internal control during our audit which we would like to bring to your attention. These control deficiencies are included in Exhibit C. We have also presented the status of prior year findings in Exhibit D.

Southwestern's written response to the deficiencies identified in our audit are included in Exhibits A through C. Southwestern's written response was not subjected to the auditing procedures applied in the audit of the combined financial statements, and accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the SWFPS management, and is not intended to be, and should not be, used by anyone other than these specific parties.

Very truly yours,

KPMG LLP

Index to Exhibits

OPEN DEFICIENCIES (I.E. FINDINGS) – INTERNAL CONTROLS AND OTHER OPERATIONAL MATTERS
*(with parenthetical references to findings and recommendations issued during the engagement)***OPEN FINDINGS RELATED TO FISCAL YEAR (FY) 2024 NOTICES OF FINDINGS AND RECOMMENDATIONS (NFR) – MATERIAL WEAKNESS****Exhibit A**

Process Area	NFR Number	NFR Description	Page
Capitalization	24-SWFPS-PRB-Expenses-FSA-01	Controls over Post Retirement Benefits Expenses	A-1
Expenses and Accounts Payable	24-SWFPS-WC-FSA-01	Controls over Workers' Compensation	A-3

OPEN FINDINGS RELATED TO FY 2024 NFRs - SIGNIFICANT DEFICIENCY**Exhibit B**

Process Area	NFR Number	NFR Description	Page
CERAMICs	24-SWFPS-ELC-FSA-01	Deficiency in Entity Level Controls - Communication	B-1

OPEN FINDINGS RELATED TO FY 2024 NFRs – CONTROL DEFICIENCIES**Exhibit C**

Process Area	NFR Number	NFR Description	Page
Property, Plant and Equipment	24-SWFPS-PP&E-FSA-01	Ineffective Controls Over Plant in Service	C-3
Expenses and Accounts Payable	24-SWFPS-O&M-FSA-01	Ineffective Controls over Operations and Maintenance Expenses	C-1

STATUS OF PRIOR YEAR FINDINGS**Exhibit D****ACRONYMS****Exhibit E**

Exhibit A

MANAGEMENT LETTER

OPEN FINDINGS RELATED TO FISCAL YEAR (FY) 2024 NFRs – MATERIAL WEAKNESS

24-SWFPS-PRB Expense-FSA-01 – Controls Over Post Retirement Benefit Expenses

Background

The Southwestern Federal Power System (SWFPS) is comprised of the Southwestern Power Administration (Southwestern), a component of the Department of Energy (DOE), and the Army Corps of Engineers (Corps), a component of the Department of Defense (DOD). Southwestern is responsible for marketing and transmitting the hydroelectric power generated by the Corps within Southwestern's marketing areas and is responsible for the preparation and presentation of the SWFPS combined financial statements.

An annual Post Retirement Benefit (PRB) expense is calculated to capture Federal Government costs for pension and other retirement benefits for Corps employees that support the Federal Hydropower program within the SWFPS. In order to account for all Corps employees that support the Federal Hydropower program, an overhead factor is calculated to account for "Indirect" employees (i.e., personnel who support the operations but do not directly contribute to the execution of any individual power projects). This overhead factor is calculated by dividing indirect labor expenses by total indirect expenses for each Corps district.

The overhead factor is then utilized to calculate the indirect costs for the following PRB elements:

- Pension expense that is estimated as the total cost of the pension minus the employee and employer contributions.
- Health benefits (Federal Employee Health Benefits or Federal Employee Health Benefits Plan).
- Life Insurance (Federal Employee Group Life Insurance).

These costs are calculated using the data inputs discussed above by a Corps of Engineers Financial Management System generated report at the individual hydroelectric power project level. The SWFPS has 24 hydroelectric power projects. Southwestern relies on these Corps of Engineers Financial Management System generated reports when recording the PRB expense within the SWFPS combined financial statements.

Condition

During our testing over the SWFPS combined financial statements, we identified the following conditions:

- During our review of fiscal year (FY) 2024 PRB expenses, we identified a 52 percent increase compared to the prior year. After multiple inquiries with SWFPS management, it was determined that this increase resulted from a system error originating in FY 2016. Specifically, the Corps system-generated reports used to calculate PRB expenses inadvertently duplicated indirect labor expense data, which inflated the overhead factor used in calculations. As a result, annual PRB expenses have been increasingly overstated since FY 2016.
- During further analysis of the Corps system-generated reports, we noted that the Corps' reports did not consistently use the correct Office of Personnel Management cost factors to calculate PRB expenses causing immaterial errors. Specifically, we noted the following:
 - In FY 2016 and FY 2024, the employer's expense cost factor for Federal Employees Retirement System KF and Federal Employees Retirement System KR were switched in the calculations for pension expense for all districts.

A-1

- In FY 2017, the Federal Employee Health Benefits cost factor used in the calculations of Federal Employee Health Benefits expense at all districts was not the cost factor published by Office of Personnel Management.
- In FY 2019, the Employer's Contribution cost factors for FERS categories was incorrect and the districts applied the FY 2020 factors instead at all districts.
- In FY 2021 and FY 2022, all districts used the Regular Postal cost factor instead of the Regular Offset Non-Postal cost factor in calculating pension expense for the Civil Service Retirement System C category.

Criteria

The U.S. Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (Green Book), sets the standards for an effective internal control system and provides an overall framework for designing, implementing, and operating effective internal control systems. Relevant criteria include the following principles:

- Green Book, Principle 10, *Design Control Activities*, paragraph 10.03 - 10.04, 10.10
- Green Book, Principle 11, *Use Quality Information*, paragraph 11.05
- Green Book, Principle 13, *Use Quality Information*, paragraph 13.04 -13.05
- Green Book, Principle 16, *Perform Monitoring Activities*, paragraph 16.05
- Green Book, Principle 14, *Communicate Internally*, paragraph 14.03

Cause and Effect

SWFPS management lacks controls to ensure the completeness, accuracy, and validity of system-generated reports used in calculating PRB expenses. The Corps extracts these reports and provides them to Southwestern, who records the amounts in SWFPS's annual financial statements without management review for reasonableness or assessment of the calculation's validity. Additionally, the Corps did not effectively communicate quality information related to PRB expenses, as required by Green Book Principle 14, and Southwestern did not establish adequate procedures to verify the accuracy of PRB expense reporting. As a result, errors in the system-generated reports went undetected. This caused the PRB expense to be overstated since FY 2016. See below for the approximate total overstatements per year:

- FY 2016: \$291,000
- FY 2017: \$374,000
- FY 2018: \$1.4 million
- FY 2019: \$1.0 million
- FY 2020: \$2.3 million
- FY 2021: \$3.5 million
- FY 2022: \$4.3 million
- FY 2023: \$7.7 million
- FY 2024: \$12.4 million

The total cumulative expense error since FY 2016 is \$33.3 million.

Recommendations

We recommend that the Acting Chief Financial Officer, Southwestern:

1. Partner with the Corps to develop and implement a formal review process for the annual PRB expense calculation, including procedures to verify the reasonableness of the estimation methodology;
2. Collaborate with the Corps to establish robust procedures that ensure the completeness, accuracy, and validity of data used in the PRB expense calculation. This should include validating source data and implementing effective controls to prevent errors; and
3. Work jointly with the Corps to reinforce consistent reporting lines and communication protocols across all districts, ensuring uniform application of policies and procedures and enhancing overall data integrity and accountability.

Management's Response

Management concurs with the finding. Specifically, Southwestern and the Corps concur with the above recommendations and will work collaboratively to develop and implement formalized procedures and policies that address post-retirement benefit expenses. Specifically, both agencies will coordinate efforts to: (1) develop and implement a formal review process for the annual PRB expense calculation, including procedures to verify the reasonableness of the estimation methodology, (2) establish robust procedures that ensure the completeness, accuracy, and validity of data used in the PRB expense calculation; and (3) and reinforce consistent reporting lines and communication protocols across all districts, ensuring uniform application of policies and procedures and enhancing overall data integrity and accountability. The target completion date for implementing these actions is September 30, 2026.

24-SWFPS-WC-FSA-01 – Controls Over Workers' Compensation*Background*

Workers' compensation liability has two components: (1) actuarial liability for cases already incurred but with potential future claims; and (2) liability for expenses paid by the program administrator, the Department of Labor (DOL), which SWFPS must reimburse. The actuarial liability is determined by DOL, DOE, and DOD, based on historical benefit payment patterns and DOL's discount rates.

Recovery of future claims is deferred until they are submitted and paid by DOL. Accordingly, for the rate-making process, the related expenses are recorded as deferred workers' compensation on the combined balance sheets, in line with Accounting Standards Codification Topic 980, Regulated Operations, to reflect the effects of the rate-making process. SWFPS does not earn a return on this deferred workers' compensation regulatory asset.

DOL's Office of Workers' Compensation Programs estimates the Actuarial Liability for Future Workers' Compensation Benefits by applying wage (Cost of Living Adjustment) and medical (consumer price index-medical) inflation factors to projected benefits and adjusting historical payments to current-year dollars. The liability assumes annual mid-year payments and uses 5-year average inflation rates: compensation rates from *Federal Employee Compensation Act* Cost of Living Adjustment (updated annually by the Division of Federal Employees', Longshore and Harbor Workers' Compensation) and medical rates from consumer price index-medical, published by the Bureau of Labor Statistics and the Office of Management and Budget.

The Corps receives a workers' compensation report from DOL on an annual basis from which they calculate their liability estimate utilizing the method and assumptions discussed above. Southwestern relies on the Corps' estimate when compiling the SWFPS annual combined financial statements.

Condition

During our testing over the SWFPS combined financial statements, we identified the following conditions within the Corps provided Workers' Compensation calculation:

- During our review of the September FY 2024 Worker's Compensation Liability, there was an unexplained increase of \$14 million (or 204 percent increase) in the balance when compared to the prior year. Upon multiple inquiries, it was determined that this increase was related to an error in the prior year data compiled by the Corps resulting in a \$13.8 million understatement of the FY 2023 Worker's Compensation Liability related to the Kansas City, Little Rock, and Tulsa districts.
- During our testing of the September 2024 Worker's Compensation Liability Calculation, the Corps did not consistently calculate the liability using their estimate's methodology. Specifically, we noted the following:
 - The Fort Worth and Little Rock Districts calculated the total liability using 38 years vs. the model's 37-year calculation.
 - The Little Rock District incorrectly included a refund at the Ozark project and projected the refunded amount out into their 37-year model which incorrectly netted down their total liability.
 - The Kansas City District did not use the DOL medical inflation factor throughout their calculation.
 - The Tulsa District used the 2030 DOL rates for medical inflation factor and Worker's Compensation Benefit rate for the out years vs. the 2029 rate that should have been used.
- During our testing of the September 2023 Worker's Compensation Liability Calculation, the Corps did not consistently calculate the liability using their estimate's methodology. Specifically, we noted the following:
 - The Kansas City District did not use the DOL medical inflation factor throughout their calculation.
 - The Little Rock District calculated the total liability using 38 years vs. the model's 37-year calculation.
 - The Tulsa District used the 2029 DOL rates for medical inflation factor and Worker's Compensation Benefit rate for the out years vs. the 2028 rate that should have been used.

Criteria

The GAO's Green Book, sets the standards for an effective internal control system and provides an overall framework for designing, implementing, and operating effective internal control systems. Relevant criteria include the following principles:

- Green Book, Principle 10, *Design Control Activities*, paragraph 10.03 -10.04, 10.10
- Green Book, Principle 13, *Use Quality Information*, paragraph 13.04 -13.05
- Green Book, Principle 16, *Perform Monitoring Activities*, paragraph 16.05
- Green Book, Principle 14, *Communicate Internally*, paragraph 14.03

Cause and Effect

SWFPS management has not properly designed control activities to assess the completeness and accuracy of the data used in the Workers' Compensation model for SWFPS to ensure that Workers' Compensation balances are accurately reported as of the balance sheet date. The Corps did not effectively communicate quality information related to Workers' Compensation as required by Green Book Principle 14 and

Southwestern did not effectively implement a process at the correct level of precision to ensure Workers' Compensation balance were completely and accurately recorded in the financial statements. This allowed errors in the calculation to go undetected.

As a result, the Workers' Compensation Liability was understated in both September 2023 and September 2024 due to incomplete and inaccurate data and calculation errors. In September 2023, the liability was understated by approximately \$13.8 million as a result of incomplete and inaccurate data, and by an additional \$280,000 due to errors in the calculation of the liability. In September 2024, the liability was further understated by \$140,000, also stemming from calculation errors.

Recommendation

We recommend that the Acting Chief Financial Officer, Southwestern:

4. Collaborate with the Corps to establish procedures that ensure the completeness and accuracy of data used in the Workers' Compensation Liability calculation. This includes validating source data and implementing controls to prevent omissions or errors.
5. Work with the Corps in developing a formal review process for the Workers' Compensation Liability calculation. The process should include verifying the accuracy of the calculation and ensuring that excluded items—such as refunds—are appropriately omitted.
6. Create a standardized review checklist or set of procedures at Southwestern to assess the data and calculations provided by the Corps. This should include steps for identifying discrepancies and resolving issues prior to finalizing the liability.
7. Collaborate with the Corps to reinforce consistent reporting lines and communication protocols across all districts to help ensure uniform application of policies and procedures and improve overall data integrity and accountability.

Management's Response

Management concurs with the finding. Specifically, Southwestern and the Corps concur with the above recommendations and are committed to working collaboratively to develop and implement formalized procedures and policies that address Workers' Compensation Liability. Specifically, both agencies will coordinate efforts to: (1) establish procedures for ensuring the completeness and accuracy of data used in the calculation; (2) develop a formal review process for the calculation; (3) create a standardized review checklist and set of procedures within Southwestern to comprehensively assess the data and calculations provided by the Corps; and (4) reinforce consistent reporting lines and communication protocols across all districts. The target completion date for implementing these actions is September 30, 2026.

Exhibit B

MANAGEMENT LETTER

OPEN FINDINGS RELATED TO FY 2024 NFRs - SIGNIFICANT DEFICIENCY

24-SWFPS-ELC-FSA-01 – Deficiency in Entity Level Controls – Communication

Background

The hydroelectric power dams that the Southwestern Division of the Corps own are operated by six districts: Tulsa, Oklahoma; Little Rock, Arkansas; Kansas City, Missouri; St. Louis, Missouri; Vicksburg, Mississippi; and Fort Worth, Texas. Each hydroelectric project within these districts is a multi-purpose dam, with costs allocated to both power and non-power purposes such as flood control, irrigation, recreation, and wildlife conservation. For financial reporting purposes, each Corps district prepares power reports by individual power generating project that contain a statement of assets and liabilities (balance sheet) and statement of revenues and expenses (income statement). The power reports provided by the Corps are consolidated by Southwestern for financial reporting in the combined financial statements.

Condition

During FY 2024, several of the control deficiencies¹ identified were related to the financial information the Corps exchanged with Southwestern. Through inquiries with management to better understand the root-cause of the issue, we noted that, although Southwestern and the Corps communicate throughout the year, there are no formal policies, procedures, or documented responsibilities that define financial reporting roles, review expectations, and communication channels between the components. Specifically, we noted the following:

1. While Southwestern is responsible for the preparation and presentation of the SWFPS combined financial statements, Southwestern management has not established formal policies or procedures requiring the Corps to provide data that is complete and accurate.
2. Southwestern has not implemented a review framework for Corps' data. Although ad hoc reviews and inquiries occur, no documented review criteria exists. There is no consistent follow-up on anomalous items and no audit trail demonstrating that the Corps' information is systematically and formally reviewed and validated.
3. SWFPS management has not established consistent, documented communication channels, reporting lines, or a responsibility matrix across Southwestern and the related Corps districts and centers. As a result, it is unclear who is accountable for specific data elements or who should be contacted when reporting issues arise.

Criteria

The GAO's Green Book, sets the standards for an effective internal control system and provides an overall framework for designing, implementing, and operating effective internal control systems. Relevant criteria include the following principles:

- Green Book, Principle 14, *Communicate Internally*, paragraph 14.02 -14.03, 14.05
- Green Book, Principle 3, *Establish Structure, Responsibility, and Authority*, paragraph 3.02, 3.04

¹ 24-SWFPS-O&M-01, 24-SWFPS-PP&E-FSA-01, 24-SWFPS-WC-FSA01, and 24-SWFPS-PRB Expense-FSA-01

Cause and Effect

SWFPS management has not formalized governance over inter-component financial reporting between Southwestern and the Corps. Specifically, management did not establish documented policies, procedures, roles, review criteria, or communication protocols that define responsibilities and expectations for the preparation, validation, and transmission of Corps' data used in the combined financial statements. This gap has allowed reliance on informal, ad hoc communications and inconsistent review practices rather than repeatable, controlled processes.

As a result, the failure to establish an organization structure and communicate effectively internally, or across components, increases the risk of misstatement in the combined financial statements of the SWFPS.

Recommendations

We recommend that the Acting Chief Financial Officer, Southwestern:

8. Define documented review criteria and thresholds for follow-up (e.g., materiality, variance percentage, exception types) related to financial data/information the Corps provides to Southwestern for inclusion in the SWFPS combined financial statements. Require standardized review procedures for anomalous items and a sign-off process by designated reviewers.
9. Develop a formal agreement among Corps districts and centers to provide clear guidance on responsibilities, ensure controls over the completeness and accuracy of data, and establish consistent policies and procedures over financial reporting. Policies should define required controls, acceptable file formats, submission deadlines, and documentation standards.
10. Collaborate with the Corps to define clear reporting lines to ensure that management roles are properly identified across the system.

Management's Response

Management concurs with the finding. Specifically, Southwestern and the Corps partially concur with the above recommendations and will work collaboratively to define responsibilities and expectations for the preparation, validation, and transmission of Corps' data used in the combined financial statements. Specifically, both agencies will: (1) define documented review criteria and thresholds for follow-up related to financial data/information provided by the Corps for inclusion in the SWFPS combined financial statements and require standardized review procedures for anomalous items and establish a sign-off process by designated reviewers; (2) define clear reporting lines to ensure that management roles are properly identified across the system; and (3) develop a formal agreement among Corps districts and centers to provide clear guidance on responsibilities, ensure controls over the completeness and accuracy of data, and establish consistent policies and procedures over financial reporting. A Memorandum of Understanding (formal agreement) exists between Southwestern and the Corps, outlining obligations and responsibilities in regards to the SWFPS financial procedures and accounting reporting requirements, including the Corps' financial reporting responsibilities to Southwestern. However, Southwestern recognizes the need to refine this agreement to clarify guidance and expectations for the data the Corps provides for the combined financial statements. The target completion date for implementing these actions is September 30, 2027.

Exhibit C

MANAGEMENT LETTER

OPEN FINDINGS RELATED TO FY 2024 NFRs – CONTROL DEFICIENCIES

24-SWFPS-O&M-FSA-01 – Ineffective Controls over Operations and Maintenance Expenses

Background

With more than \$97 million in operating and maintenance (O&M) expenses for generating power, O&M expenses are one of the largest balances on the SWFPS Statement of Revenues and Expenses. For financial reporting purposes, each Corps district prepares power reports by individual power generating project that contain a statement of assets and liabilities (balance sheet) and statement of revenues and expenses (income statement). Corps districts generate the power reports through a series of automated reports and manual adjustments from the Corps of Engineers Financial Management System II IT system. The power reports provided by the Corps are consolidated by Southwestern for financial reporting in the combined financial statements.

Condition

During our testing over the SWFPS combined financial statements, we identified the following conditions:

- During our testing of O&M expenses reported on SWFPS financial statements, we noted that an expense had been improperly reported using incorrect information provided to Southwestern by the Corps. Specifically, we noted that one of the eight O&M expense transactions we sampled should have been classified as an Addition and Betterment (and thus capitalized as plant in service on the balance sheet) but was instead expensed. This resulted in SWFPS' O&M expenses being overstated by \$1,100.
- Additionally, a transaction was incorrectly recorded as an expense in the wrong accounting period. The transaction was related to an order of supplies and services for the Corps' Little Rock District in August of 2023; however, it was not properly accrued for in FY 2023, nor evidence provided to support goods received in FY 2024. This resulted in an understatement in FY 2023 O&M expenses and an overstatement in FY 2024 O&M expenses totaling \$527,000.

Criteria

The GAO's Green Book, sets the standards for an effective internal control system and provides an overall framework for designing, implementing, and operating effective internal control systems. Relevant criteria include the following principles:

- Green Book, Principle 3, *Establish Structure*, Responsibility, and Authority, paragraph 3.04
- Green Book, Principle 10, *Design Control Activities*, paragraph 10.01, 10.03, 10.
- Green Book, Principle 12, *Implement Control Activities*, 12.01
- Green Book, Principle 14, *Communicate Internally*, paragraph 14.03

Furthermore, Generally Accepted Accounting Principles mandate that businesses record expenses in the correct period through the matching principle. This principle, also referred to as the expense recognition principle, requires that expenses be recorded in the same period as the revenues they helped generate. The matching principle is a guiding concept within the broader accrual accounting framework defined by the Financial Accounting Standards Board Accounting Standards Codification.

In addition, the Corps Regulation No. 37-1-30 (ER 37-1-30), which sets forth the principles and standards governing the design and operation of the financial/cost accounting and reporting systems for the Corps, states that "The standards on accrual accounting contained in GAO Title II are prescribed by 31 U.S.C 3512(e) and allow obligation accounting where required for budgetary purposes. That law states that the head of each executive agency will cause the accounts of that agency to be maintained on an accrual accounting basis. Thus, the accrual basis is the prescribed basis of accounting to be used by federal agencies. Accrual accounting is also the preferred method of accounting of the American Institute of Certified Public Accountants, the Securities and Exchange Commission, the Internal Revenue Service, and FASAB [Federal Accounting Standards Advisory Board]. Corps has adopted this method as the basis for accounting for all appropriations."

Cause and Effect

SWFPS management has not designed control activities to ensure that information provided to it by the Corps is adequate to support complete and accurate reporting of all transactions. Specifically, SWFPS's established reporting lines did not effectively ensure that the Corps, and individuals involved in the financial reporting process, provided the quality information necessary for management to fulfill their overall financial reporting responsibilities. The Corps did not effectively communicate quality information related to O&M expenses as required by Green Book Principle 14 and Southwestern did not effectively implement a process to ensure O&M expenses were completely and accurately recorded in the financial statements.

As a result, O&M expenses and the corresponding accounts payable were understated by \$527,000 as of and for the year ended September 30, 2023, and expenses were overstated by \$527,000 as of and for the year ended September 30, 2024, for the error related to out of period expense. Additionally, O&M expenses were overstated by \$1,100, and plant in service was understated by the same amount for the year ended September 30, 2024. Furthermore, annual O&M expenses are included in SWFPS's system-wide power rate schedule to appropriately recover the costs for the power system so incomplete or inaccurate recording of O&M expenses increases the risk of inaccurate rates.

Recommendation

We recommend that the Acting Chief Financial Officer, Southwestern:

11. Collaborate and communicate with the Corps to ensure there is a formal, consistent method to identify capitalizable expenses;
12. Collaborate and communicate with the Corps to implement clearly defined procedures to ensure that all expenses are recorded in the correct period and are properly accrued at period end; and
13. Collaborate and communicate with the Corps to implement clearly defined policies and procedures to ensure completeness and accuracy of the data recorded on the Corps power reports.

Management's Response

Management concurs with the finding. Specifically, Southwestern and the Corps concur with the above recommendations and are committed to working collaboratively to develop and implement formalized procedures and policies that address each of the identified areas. Specifically, both agencies will coordinate efforts to; (1) establish a consistent method for identifying capitalizable expenses; (2) implement clearly defined procedures to ensure expenses are properly recorded and accrued in the correct accounting period; and (3) ensure the completeness and accuracy of data reflected in the Corps' power reports. The target completion date for implementing these actions is September 30, 2026.

24-SWFPS-PP&E-FSA-01 – Ineffective Controls Over Plant in Service

Background

With more than \$1 billion in net property, plant, and equipment (PP&E), including construction work in progress (CWIP), PP&E is one of the largest balances on SWFPS's balance sheet. Costs are accumulated in CWIP during the construction of property. When the asset has been completed and placed in service, the costs are transferred out of CWIP into completed plant in service and then depreciated. Costs are expected to be transferred to plant in service timely after completion. At the end of a CWIP work order (project) life cycle, the project manager submits a project completion notice with the date of completion and date the assets were placed in service. At fiscal year-end, if a completed project has not been transferred to plant in service or if a project is still open but includes assets that were placed in service, Southwestern posts a journal entry to move the completed costs to plant in service.

Condition

During our testing over the SWFPS combined financial statements, we identified the following conditions:

- During our testing of ending CWIP balances reported on the SWFPS financial statements for the period ended September 30, 2024, we noted balances were improperly classified in CWIP rather than completed plant in service at Southwestern. Specifically, we noted in one of our six sampled transactions a project that involved installing five devices for a server. Four of those five devices totaling \$328,000 were determined to be in-use as of year-end; however, they were not transferred to completed plant in service. This resulted in PP&E balances being misclassified on the balance sheet and accumulated depreciation being understated.
- During our testing of SWFPS completed plant additions for the period ended September 30, 2024, we noted that one of six sampled transactions did not have the correct asset code data element at the Tulsa Corps District. The asset data elements (e.g., asset code) determine the assigned asset useful life. The improper asset code had been entered into the Corps' financial system, and the Corps provided this information to SWFPS.
- During our testing of PP&E additions for the period ended September 30, 2024, we noted that a transfer from CWIP to completed plant in service did not occur in the correct fiscal year. Specifically, we tested five PP&E journal entries at Southwestern that transferred amounts from CWIP to PP&E at year-end. We identified one project totaling \$2.9 million that was in use in a prior fiscal year; however, this project was not transferred to completed plant in service until the current fiscal year. This resulted in PP&E balances being misclassified on prior years' balance sheet and accumulated depreciation being understated.
- During our testing of PP&E additions for the period ended September 30, 2024, we noted that a transfer from CWIP to plant in service was incorrectly recorded before the asset was complete and in use. Specifically, we identified one of five entries where equipment, totaling \$175,000 was not complete and in use as of September 30, 2024. This resulted in PP&E balances being misclassified on the balance sheet and accumulated depreciation being overstated.

Criteria

The GAO's Green Book, sets the standards for an effective internal control system and provides an overall framework for designing, implementing, and operating effective internal control systems. Relevant criteria include the following principles:

- Green Book, Principle 3, Establish Structure, Responsibility, and Authority, paragraph 3.04
- Green Book, Principle 10, Design Control Activities, paragraph 10.01, 10.03-10.04

- Green Book, Principle 12, Implement Control Activities, 12.01, 12.03
- Greek Book, Principle 16, *Perform Monitoring Activities*, paragraph 16.05

In addition, Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 360, Property, Plant, and Equipment, Section 10-35-4, states that "The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the facility." Further, Section 10-50-1 states that "Because of the significant effects on financial position and results of operations of the depreciation method or methods used, all of the following disclosures shall be made in the financial statements or in notes thereto: a) depreciation expense for the period; b) balances of major classes of depreciable assets, by nature or function, at the balance sheet date; c) accumulated depreciation, either by major classes of depreciable assets or in total, at the balance sheet date; and d) a general description of the methods used in computing depreciation with respect to major classes of depreciable assets."

Cause and Effect

SWFPS management has not properly designed control activities to transfer balances from CWIP to plant in service when the asset is in use, ensuring that PP&E amounts are correctly classified as of the balance sheet date and accumulated depreciation is accurately recorded. Specifically, SWFPS's established reporting lines did not effectively ensure that project managers at Southwestern and the Corps provided the quality information necessary for management to fulfill its overall financial reporting responsibilities. Additionally, SWFPS management has not properly designed control activities to identify inaccuracies in asset relevant data elements.

The net effect of these exceptions resulted in a CWIP overstatement of approximately \$3 million, completed plant in service understatement of approximately \$3 million, and accumulated depreciation was understated by approximately \$615,000 as of September 30, 2024.

Upon correcting relevant data elements related to completed plant in service, it was determined that the useful life of the asset remained unchanged and, thus, did not have a financial statement impact. While there is no factual misstatement in the current year, the control failure impacts the reliability of data and could result in future misstatements related to depreciation costs not accurately spread over the expected useful life of the asset.

Recommendation

We recommend that the Acting Chief Financial Officer, Southwestern:

14. Review, update, and document Southwestern internal controls and processes to align with accounting standards and ensure balances are transferred from CWIP to plant in service once an asset is in use;
15. Establish stronger lines of communication with project managers to better identify completed projects and units placed in service, allowing for costs to be properly classified on the balance sheet;
16. Collaborate and communicate with the Corps to help ensure completed Corps assets are transferred to plant in service timely and in the correct fiscal year; and
17. Collaborate and communicate with the Corps to ensure the proper asset data elements are entered into financial systems so that useful lives are properly recorded.

Management's Response

Management concurs with the finding. Specifically, Southwestern and the Corps concur with the above recommendations. Southwestern will review, update, and document Southwestern internal controls and

processes to align with accounting standards. Southwestern and the Corps will work collaboratively to ensure balances are transferred from CWIP timely and establish stronger lines of communication with project managers to identify completed projects and units placed in service. The target completion date for implementing these actions is September 30, 2026.

Exhibit D

MANAGEMENT LETTER

STATUS OF PRIOR YEAR FINDINGS

Prior Year Findings Related to Internal Controls and Other Operational Matters (with parenthetical references to findings)

Status as of September 30, 2024

A. Controls over Plant in Service (23-SWFPS-01)

Closed in FY24

Exhibit E

MANAGEMENT LETTER

ACRONYM

Southwestern	Southwestern Power Administration
SWFPS	Southwestern Federal Power System
NFR	Notice of Findings and Recommendations
FY	Fiscal Year
DOE	Department of Energy
DOD	Department of Defense
PRB	Post Retirement Benefit
GAO	Government Accountability Office
DOL	Department of Labor
Corps	Army Corps of Engineers
O&M	Operations and Maintenance
PP&E	Property, Plant, and Equipment
CWIP	Construction Work in Progress
OPM	Office of Personnel Management

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