



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

# AUDIT REPORT

DOE-OIG-20-01

October 2019

**MANAGEMENT LETTER ON THE  
SOUTHWESTERN FEDERAL POWER  
SYSTEM'S FISCAL YEAR 2018  
FINANCIAL STATEMENT AUDIT**



**Department of Energy**  
Washington, DC 20585

October 10, 2019

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 "Management Letter on the  
Southwestern Federal Power System's Fiscal Year 2018 Financial  
Statement Audit"

KPMG LLP (KPMG), our contract auditors, planned and performed an audit of the combined financial statements of the Southwestern Federal Power System as of and for the year ended September 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The combined financial statements include the Southwestern Power Administration, a component of the U.S. Department of Energy; and the hydroelectric generation and power operations of the U.S. Army Corps of Engineers, a component of the U.S. Department of Defense.

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

During the audit, KPMG noted certain matters involving internal control and other operational matters that are presented in the attached management letter prepared by KPMG. The letter contains three findings that were issued during the course of the Southwestern Federal Power System's Fiscal Year 2018 Financial Statement Audit. Management concurred with the findings and provided planned corrective actions for the recommendations listed in the Management Letter.

Attachment

cc: Deputy Chief Financial Officer  
Chief Financial Officer, Southwestern Power Administration

Report Number: DOE-OIG-20-01

## INDEPENDENT AUDITOR'S REPORT



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

August 27, 2019

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

In planning and performing our audit of the combined financial statements of Southwestern Federal Power System (SWFPS), as of and for the year ended September 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered SWFPS's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the 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 the SWFPS's internal control.

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 (the Corps), a component of the U.S. Department of Defense, for which Southwestern markets and transmits power.

Our consideration of internal control was for the limited purpose described in the above 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. In accordance with *Government Auditing Standards*, we issued our report dated August 27, 2019 on our consideration of SWFPS's internal control over financial reporting in which we communicated certain deficiencies in internal control that we consider to be material weaknesses or significant deficiencies or material weaknesses and significant deficiencies.

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

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

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

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.



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

Very truly yours,

**KPMG LLP**

**Management Letter Index to Exhibits**

**Open Findings – Internal Controls and Other Operational Matters**

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

	<b>Exhibit A</b>
<b>Finding 1:</b> Inaccuracies of Accrued Liabilities Related to Fiscal Year-End (16-SWPA-01)	<b>A.1</b>
<b>Finding 2:</b> Under Recorded Revenues from Headwater Benefits (18-SWPA-01)	<b>A.2</b>
<b>Finding 3:</b> Inaccuracies of Construction in Progress Ending Balance Presentation related to Fiscal Year-End (18-SWPA-02)	<b>A.3</b>
<b>Status of Prior Year Findings</b>	<b>Exhibit B</b>

**Attachment  
Exhibit A.1**

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

KPMG's audit testwork on a sample of 33 subsequent cash disbursements and invoices received and processed after September 30, 2018 identified two invoices at one of the Corps districts (Little Rock) which were under accrued by a total of \$173,442. The effect of the projected misstatement for the full population resulted in accounts payable and program costs being understated by \$2,881,817 (which includes the factual understatement and an offsetting factual overstatement, resulting in a net misstatement of \$166,912). The remaining misstatements are not included in this finding as the amounts were accrued for, but the estimate was different from the actual payment. As such, we do not consider the differences to be the result of control deficiencies.

The under accruals were due to a lack of communication by the project managers to the accounting department of the information necessary to allow for the recording of an appropriate accrual prior to year-end.

*Recommendation:*

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

*Management's Response:*

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

**Attachment  
Exhibit A.2**

**Finding: Under Recorded Revenues from Headwater Benefits (18-SWPA-01)**

KPMG's audit testwork noted Headwater Benefits had increased significantly from 2017 to 2018 in the Tulsa District. After inquiry with the Tulsa District, we were informed there were unrecorded Headwater Benefits for the Tulsa District from 1995–2017 in the amount of \$4,250,057, all of which were all recorded in 2018.

The under recorded Headwater Benefits at the Tulsa District were caused by a lack of understanding and knowledge regarding Headwater Benefits. Additionally, a failure to appropriately review Headwater Benefits resulted in revenue not being properly recorded.

*Recommendation:*

2. We recommend that Southwestern coordinate with the Corps to enhance existing procedures over review of power reports to ensure that all applicable revenue is included for each project.

*Management's Response:*

The Army Corps of Engineers, Southwestern Division, concurs with the finding and the Tulsa District has already taken appropriate actions and posted corrected statements. Existing processes are in place and all Hydropower accountants are aware that Headwater Benefits are to be recorded yearly based on the Annual Headwater Benefit Assessments received from Army Corps of Engineers Headquarters point of contact via the Federal Energy Regulatory Commission.



**Attachment  
Exhibit A.3**

**Finding: Inaccuracies of Construction in Progress Ending Balance Presentation related to Fiscal Year End (18-SWPA-02)**

KPMG's audit testwork noted that 14 of 16 items reviewed for the Tulsa District were improperly in Construction in Progress as of fiscal year end. Through inquiry and inspection of records, it was determined that the 14 items were accruing interest during construction (IDC) on CIP projects that had been transferred to Plant in Service earlier in the year. The 14 items were related to Webbers Falls in the Tulsa District. As a result, the additional IDC led to an overstatement of the CIP balance of \$1,439. We extended our sample by 11 items and found no additional errors. Total interest charged to construction for the year was \$1,798,500 for the Tulsa District. This represents the maximum misstatement possible at the Tulsa District.

KPMG's audit testwork noted that 1 item reviewed for the Vicksburg District was improperly in CIP as of fiscal year end. Through inquiry and inspection of records, it was determined that this item should have been transferred out of CIP in a prior year. The item related to Blakely in the Vicksburg District. As a result, the untimely transfer of the assets from CIP to the appropriate PP&E account led to an understatement of depreciation expense and accumulated depreciation. The asset had a useful life of 100 years and the factual understatement of accumulated depreciation for this asset was \$60,852. We quantified the maximum impact that depreciation expense could be understated in FY 2018 by dividing remaining CIP at the Vicksburg District by the average useful life of assets (40 years) and applying a midyear depreciation convention. This resulted in a maximum misstatement of \$99,473.

The inaccuracy at the Tulsa District related inappropriately accruing IDC was due to the IDC indicator not being manually changed to "N" to stop the IDC calculation.

The inaccuracy of classification of the Vicksburg item was due to a lack of communication between project managers and accounting. A control was in place to monitor and review CIP items to ensure they were appropriately and timely transferred to the appropriate PP&E accounts, but the project manager failed to timely respond to the accounting function inquiries and the accounting function did not perform further follow up.

*Recommendation:*

3. We recommend that Southwestern coordinate with the Corps to:
  - A. Enhance existing procedures and related controls to ensure that items in the Construction in Progress accounts are placed in service in a timely manner;
  - B. Further establish review controls where power accountants review individual projects at year end to ensure Construction in Progress projects are placed in service in a timely manner; and
  - C. Establish review controls to ensure IDC is recorded only for eligible projects.

*Management's Response:*

The Army Corps of Engineers, Southwestern Division, concurs that both items are a control deficiency.

When the Tulsa District transferred construction in progress to PP&E, it missed the process of removing the "N", which stops interest during construction. There is a process in place in the Multi-Purpose Hydroelectric Power Accounting Operational Instructions that explains the process. The Tulsa District has made the required corrections.

The Vicksburg Blakely project's "parent work item" was transferred years ago. The A&B costs were not transferred from construction in progress to PP&E timely after rehab was completed. Coordination is being done with the Program Manager and controls are in place as above.

**Attachment  
Exhibit B**

**Status of Prior Year Findings**

**Prior Year Findings Related to Internal Controls and Other Operational Matters**

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

**Status at September 30, 2018**

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

Open in FY 2018

## **FEEDBACK**

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

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 586-1818. For media-related inquiries, please call (202) 586-7406.