OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

# AUDIT REPORT

DOE-OIG-19-21 March 2019

# MANAGEMENT LETTER ON THE WESTERN FEDERAL POWER SYSTEM'S FISCAL YEAR 2018 FINANCIAL STATEMENT AUDIT

**Department of Energy**
Washington, DC 20585

March 20, 2019

MEMORANDUM FOR THE ADMINISTRATOR, WESTERN AREA POWER ADMINISTRATION

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

SUBJECT: INFORMATION: "Management Letter on the Western Federal Power System's Fiscal Year 2018 Financial Statement Audit"

Pursuant to requirements established by the *Government Management Reform Act of 1994*, the Office of Inspector General engaged the independent public accounting firm of KPMG LLP to perform the audit of the Western Federal Power System's Fiscal Year 2018 Financial Statements. During the audit, KPMG LLP considered the Western Federal Power System's internal controls over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

During the course of the audit, KPMG LLP identified deficiencies in internal controls that are included in the attached management letter. Specifically, the attached letter contains 6 new findings and 10 recommendations that were issued during the audit of the Western Federal Power System's Fiscal Year 2018 Financial Statements. One finding identified during the audit is considered a material weakness, and four findings are considered a significant deficiency. Management fully concurred with all recommendations included in the management letter and had taken or planned to take corrective actions. Management's responses are included with each finding.

I would like to thank all participating Department elements for their courtesy and cooperation during the review.

Attachments

cc: Acting Chief Financial Officer, CF-1
Senior Vice President and Chief Financial Officer, Western Area Power Administration
Vice President of Financial Management, Western Area Power Administration

Report Number: DOE-OIG-19-21

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

February 26, 2019

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

Ladies and Gentlemen:

In planning and performing our audit of the combined financial statements of the Western Federal Power System (the System), as of and for the year ended September 30, 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 the System'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 the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control. The combined financial statements include the Western Area Power Administration (WAPA), a component of the U.S. Department of Energy, and the hydroelectric power generating functions of the U.S. Department of the Interior, Bureau of Reclamation; the U.S. Army Corps of Engineers; and the U.S. Department of State, International Boundary and Water Commission (the generating agencies) for which WAPA markets and transmits power.

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 significant deficiencies.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls 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 System's combined financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiency in the System's internal control to be a material weakness:

**1. Material Weakness Over Generating Agency Journal Entries (18-WAPA-06)**

WAPA utilizes the power portion of the generating agencies project financial statements and power balances for inclusion in the System's combined financial statements. During the combination of the generating agencies' power function into the System, WAPA records a series of top-side journal entries, such as entries to record current and cumulative interest on investment. During 2018, while preparing the top-side entries for combination purpose, WAPA management identified the following errors:

- WAPA recorded an entry in 2017 that inappropriately reduced the U.S. Army Corps of Engineers (Corps) cash balance by approximately $92.7 million as of September 30, 2017. Corps cash is allocated to the power function based on outstanding accounts payable specific to power, obligations incurred but not received that are specific to power, and unobligated balances reserved for future power-related costs. The entry to reduce Corps cash inappropriately removed unobligated cash balances contributed by power customers specifically for power-related costs.
- WAPA recorded an entry in 2017 to allocate a portion of the Corps plant-in-service to non-reimbursable activities. Project Use Energy represents power generation utilized by non-power project purposes, typically recovered through the water rates. While the asset is still managed and controlled by the power function, the portion allocated to Project Use Energy is not required to be repaid to the United States Department of the Treasury through power revenues. The annual adjustment for Project Use Energy reclassifies the payable to the U.S. Department of the Treasury to accumulated net revenues within total capitalization. During the allocation of Project Use Energy, WAPA inappropriately duplicated the allocation of interest during construction, overstating the reclassification by approximately $16.1 million.
- WAPA recorded an entry in 2017 to allocate a portion of accumulated depreciation to the U.S. Department of the Interior, Bureau of Reclamation's (Reclamation) Project Use Energy. During the allocation, WAPA inappropriately allocated accumulated depreciation to land, which is not a depreciable asset, resulting in accumulated depreciation and depreciation expense being overstated by $6.4 million and approximately $756,000, respectively. The gross Project Use Energy asset allocated to non-reimbursable activities was not impacted.

All three entries were identified by WAPA management in 2018 and were either reversed or corrected. However, the cause of the deficiency was not remediated as of September 30, 2018.

**Recommendations:**

1. We recommend that the Vice President of Financial Management, WAPA:

   A. Enhance WAPA's understanding of generating agency project financial data to more thoroughly understand the business purpose and appropriateness of generating agency top-side entries; and

   B. Enhance supporting schedules to ensure the accuracy of generating agency top-side entries.

**Management Response:**

WAPA concurs with the finding. WAPA and the generating agencies will meet during fiscal year (FY) 2019 to ensure we have a solid understanding of the base data the generating agencies provides and, as a result, prepare accurate on-top adjustments. WAPA will use a template for the project use adjustments going forward to ensure accurate, consistent use of the different components of the project use adjustments. The target implementation date is September 30, 2019.

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. We consider the following deficiencies in the System's internal control to be significant deficiencies:

**2. Significant Deficiency Over Untimely Access Revocation (18-WAPA-01)**

During our testing of general information technology (IT) controls of our FY 2018 financial statement audit of WAPA, which included the Financial Information Management System, Corporate Data Repository (CDR), and Business Objects Enterprise applications, we determined that 2 of 25 terminated users selected for testing did not have their access removed in a timely manner. Specifically, we noted that:

- One terminated user located at WAPA headquarters was not removed from the CDR application until 45 days after separation. The clearance ticket to remove access for the separated employee was not opened by the user's supervisor until 22 days after termination. The failure to open the clearance ticket was identified by the system administrator 17 days after separation, or 5 days prior to the creation of the ticket. The user's Active Directory account was disabled over a year prior to the separation. The user had read-only access to the CDR application and the account was not accessed after the user's termination date.
- One terminated user located in WAPA's Sierra Nevada Region was not removed from the CDR application until 26 days after separation. The clearance ticket to remove application access was opened by the user's supervisor 19 days after separation and access was removed by the system administrator 5 business days later. The user's Active Directory account was disabled 1 day prior to the separation. The user had read-only access to the CDR application and the account was not accessed after the user's termination date.

During the FY 2017 audit at WAPA, similar access matters were identified in other financial systems. In response, management determined that a reasonable timeframe for access revocation is termination within 7 days of the IT group being notified through the Human Resource off-boarding process. At the time of our FY 2018 audit, management was in the process of implementing automation within the Human Resource off-boarding system, WAPA At Your Service (WAYS), regional and automated WAYS trainings, and off-boarding policy awareness training by the Chief Administrative Officer to senior management.

**Recommendations:**

2. We recommend that the Chief Administrative Officer and Chief Information Officer, WAPA:

   A. Enhance WAPA's policies to specify the period of time to complete the Human Resource off-boarding process and notify the IT group; specifically, define the policy for total elapsed time between the date of separation or change in job responsibilities and access removal; and

   B. Establish formal exit clearance procedures between business functional leaders and IT officials to ensure revocation of access at separation or a change in job responsibilities is accomplished within the time frame established by WAPA policy.

**Management Response:**

WAPA concurs with the finding. WAPA is currently evaluating and updating its exit clearance procedures to ensure timely revocation of system access upon employee termination. Upon finalizing these procedures, WAPA will evaluate the time frame between the date of employee separation and system access removal by IT to determine the reasonableness of total elapsed time. WAPA management will also assess and determine a reasonable time frame for removal or updating of system access when an employee has a change in job responsibilities.

Once assessed, WAPA will update its policies to include the total time frame for changing system access for employees that separate from WAPA or have a change in job responsibilities. WAPA will provide further training and messaging on the new policy guidance. The target implementation date is June 30, 2019.

**3. Significant Deficiency Over Reclamation's Power Trial Balance (18-WAPA-05)**

The Reclamation power trial balance (data load) is a manual process, beginning with post-close balances obtained from Reclamation's information system (Financial and Business Management System), extracting details behind the 47 power projects applicable to the System, and applying the region-specific allocation rules, including allocation rates for multi-purpose project features.

During our testing over the Reclamation data load, we identified multiple instances where Reclamation did not allocate project's balances to the power function consistently or in accordance with Reclamation's established allocation methodology. For example, we identified that:

- Certain cash balances were duplicated, resulting in an overstatement of approximately $26 million;
- Accumulated depreciation for certain project balances were duplicated, resulting in an overstatement of approximately $234 million; and
- Balances were allocated to the power function at the incorrect allocation rate. Of the 129,524 allocated balances included in the data load, 1,895 contained inaccurate allocation rates resulting in a total net misstatement of approximately $275 million across all accounts.

While WAPA management identified and corrected the matters identified, its review process was manual and resource intensive. Given the nature of WAPA's review and given the extensive number of inconsistencies in the Reclamation data load, misstatements may continue to exist in the Reclamation data load after WAPA's review, impacting the balances reported in the combined financial statements and the accuracy of cost recovery planning.

**Recommendation:**

3. We recommend that the Vice President of Financial Management, WAPA, work with Reclamation to revise and enhance the review process performed by Reclamation over the Reclamation data load to ensure project balances are allocated to the power function consistently and in accordance with Reclamation's established methodology.

**Management Response:**

WAPA concurs with the finding. Reclamation continued to perform reviews and data checks after the data load file was submitted. Reclamation notified WAPA of several errors they identified and WAPA processed on-top adjustments for Reclamation. WAPA and Reclamation will meet during FY 2019 to identify opportunities to improve the data load and other related Reclamation prepared-by-client items. The target implementation date is September 30, 2019.

**4. Significant Deficiency Over Classifications of Property, Plant, and Equipment (18-WAPA-02 and 18-WAPA-04)**

During our test work over property, plant, and equipment at WAPA and the generating agencies, we noted the following conditions:

- Seven power rights assets within WAPA's Transmission Infrastructure Program that were inappropriately classified as land and land rights. Consequently, the categories in property, plant, and equipment were misstated by $36.7 million and accumulated amortization was understated by approximately $3.3 million as of and for the year ended September 30, 2017.
- Multiple instances of untimely recording of property, plant, and equipment transfers from construction in progress at the Corps. Specifically, we noted 15 construction projects were complete, or had portions that were substantially complete, and in use as of September 30, 2018, but were not transferred from construction in progress into the associated property, plant, and equipment account. Consequently, construction in progress was overstated, and property, plant, and equipment was understated, by approximately $36.0 million. Further, accumulated depreciation and depreciation expense were understated by approximately $230,000 as of and for the year ended September 30, 2018.

**Recommendations:**

4. We recommend that the Vice President of Financial Management, WAPA:

   A. Evaluate and enhance existing policies to ensure on-top Construction in Progress to Property, Plant, and Equipment entries made as part of the year-end close process are added into the Fixed Asset module before the close of the next fiscal year;

   B. Improve communication between the Transmission Infrastructure Program accountants and the various project owners, including the implementation of a consistent journal entry coordination and approval process; and

   C. Work with the Corps to develop and implement a process to verify that accounting personnel transfer all substantially completed projects to property, plant, and equipment in the same fiscal year of completion.

**Management Response:**

WAPA concurs with the findings. While management generally concurs with recommendation A, management recognizes it may not happen 100 percent of the time. In addition, this is a procedural issue rather than a policy. If a transfer cannot be booked in production the subsequent year, the region will provide a justification to the Office of the Chief Financial Officer, which documents why it could not be accounted for in production. The justification will be provided as part of the current year's Construction in Progress to Plant journal. A decision document will be created and transmitted to the regional offices to document the new procedure. The target date for implementation was December 31, 2018.

Regarding recommendation B, management concurs with the recommendation. The Accounting and Reporting team will work with the Desert Southwest Region (owner of the specific Transmission Infrastructure Project power system) to ensure the region reviews and signs off on audit journals consistent with established procedures. The target implementation date was December 31, 2018.

Regarding recommendation C, management concurs with the recommendation. The Corps agreed that its process resulted in the FY 2018 inaccuracies and noted, "it is one of their top priorities, as well as a Corps-wide policy, to place completed assets in service by the end of the fiscal year." The breakdown occurred due to the large workload associated with current projects and the allocation of multi-purpose plant. Starting immediately, the Corps will improve the process to ensure the completed plant is recorded correctly on the schedules provided to WAPA. The target implementation date is November 2019.

Although not considered to be significant deficiencies or material weaknesses, we also noted the following items during our audit which we would like to bring to your attention:

**5. Unrecorded Liabilities (18-WAPA-03)**

During our search for unrecorded liabilities at WAPA we noted two disbursements, valued at $1.4 million, made in FY 2019 relating to services provided in FY 2018 were not appropriately accrued as of September 30, 2018. Both errors occurred at the Colorado River Storage Project Management Center and were related to transactions for the Colorado River Storage Project Management Center but were initiated and recorded by the Rocky Mountain Region. The Colorado River Storage Project system is comprised of three power systems: JJCR, LLCR, and GGCR. WAPA Headquarters is primarily responsible for payments related to LLCR and GGCR while the Rocky Mountain Region is primarily responsible for payments relating to JJCR but also purchased power payments for GGCR and LLCR.

**Recommendations:**

5. We recommend that WAPA's Rocky Mountain Regional Financial Manager:

   A. Enhance the checkout process to ensure that purchase power expenses relating to GGCR and LLCR are accrued in the period in which the expense was incurred. This may involve enhanced coordination and communication between the Montrose settlement office and the Loveland office.

   In addition, we recommend that the Colorado River Storage Project Lead Financial Program Analyst:

   B. Enhance monitoring procedures to ensure their regional transactions processed by the Rocky Mountain Region are recorded completely and in the appropriate period.

**Management Response:**

WAPA concurs with the finding. The Rocky Mountain Regional Finance Office, in conjunction with the Colorado River Storage Project Management Center (Salt Lake/Montrose), will hold a coordination meeting prior to the system lock-out of the accounts payable module to ensure and verify purchase power bills have been received/paid or accrued for prior to the financial system going down for fiscal year end. In addition, the Colorado River Storage Project Finance Office, in conjunction with the Rocky Mountain Regional Finance Office, will hold a coordination meeting prior to the system lock-out of the accounts payable module. This will enhance their monitoring procedures to ensure their regional transactions processed by the Rocky Mountain Region are recorded completely and in the appropriate period. The target implementation date is September 30, 2019.

The System's written response to the deficiencies identified in our audit was not subjected to the auditing procedures applied in the audit of the combined financial statements, and accordingly, we express no opinion on it. Exhibit A presents the status of prior year deficiencies.

The purpose of this letter is solely to describe comments and recommendations intended to improve internal control or result in other operating efficiencies. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

**Exhibit A**

**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, 2018** |
|---|---|
| Finding 1: Improper Classification of Expenses (17-WAPA-01) | Closed in FY 2018 |
| Finding 2: Untimely Access Revocation (17-WAPA-02) | Re-Issued in FY 2018 as 18-WAPA-01 |
| Finding 3: Timeliness of Property, Plant, and Equipment Additions (17-WAPA-03) | Closed in FY 2018 |
| Finding 4: Basin Fund Memorandum of Agreement (17-WAPA-04) | Closed in FY 2018 |
| Finding 5: Reclamation Customer Advances (17-WAPA-05) | Closed in FY 2018 |
| Finding 6: Change in Project Type Attribute (17-WAPA-06) | Closed in FY 2018 |

# FEEDBACK

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