OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-19-12 January 2019

MANAGEMENT LETTER ON THE FEDERAL ENERGY REGULATORY COMMISSION'S FISCAL YEAR 2018 FINANCIAL STATEMENT AUDIT

Department of Energy
Washington, DC 20585

January 8, 2019

MEMORANDUM FOR THE EXECUTIVE DIRECTOR, FEDERAL ENERGY REGULATORY COMMISSION

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

SUBJECT: INFORMATION: "Management Letter on the Federal Energy Regulatory Commission's Fiscal Year 2018 Financial Statement Audit"

The attached letter presents the results of the independent certified public accountant's consideration of the Federal Energy Regulatory Commission's (FERC) internal control over financial reporting during the FERC Fiscal Year 2018 Financial Statement Audit. The letter contains one prior year finding that was reissued during the course of the audit. Management partially concurred with the finding and recommendations in the Management Letter. Management's comments are included with the finding.

To fulfill the Office of Inspector General's audit responsibilities, we contracted with the independent public accounting firm of KPMG LLP to conduct the audit, subject to our review. KPMG LLP is responsible for expressing an opinion on FERC'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 LLP 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 FERC's financial statements.

We appreciate the cooperation of your staff during the audit.

Attachment

cc: Chief Financial Officer, Federal Energy Regulatory Commission
Chief Financial Officer, CF-1
Deputy Director, Office of Finance and Accounting, CF-10
Assistant Director, Office of Financial Policy and Internal Controls, CF-12
Division Director, Office of Financial Policy and Internal Controls, CF-12
Audit Resolution Specialist, Office of Financial Policy and Internal Controls, CF-12
Audit Liaison, Federal Energy Regulatory Commission

INDEPENDENT AUDITOR'S REPORT

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

December 10, 2018

Federal Energy Regulatory Commission, and
Acting Inspector General, United States Department of Energy

Ladies and Gentlemen:

In planning and performing our audits of the financial statements of the Federal Energy Regulatory Commission (the Commission or FERC) as of and for the years ended September 30, 2018 and 2017, 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 Commission'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 Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission'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. In accordance with *Government Auditing Standards*, we issued our report dated November 6, 2018 on our consideration of the Commission's internal control over financial reporting.

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 did not identify any new deficiencies in internal control that had not previously been reported to management during a prior audit. We note that finding 16-FERC-04, related to FERC's accounting for a capital lease which was entered into during fiscal year 2016, has not been remedied during fiscal year 2018. We have accordingly re-issued our Notice of Finding and Recommendation (NFR) as finding 16-FERC-04, included in Exhibit A.

The Commission's response to the finding identified in our audit is described in the NFR included in Exhibit A. The Commission's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

This purpose of this letter is solely to describe the deficiencies in internal control identified during our audit. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

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.

Internal Control Findings and Recommendations

Exhibit A –

Current Year Findings and Recommendations

No New Findings and Recommendations Issued.

Status of Prior Year Findings and Recommendations

Accounting for Capital Leases
(Finding 16-FERC-04)

Status as of 9/30/18: Reissued. See page 3.

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

Accounting for Capital Leases
(Finding 16-FERC-04)

BACKGROUND:

The Federal Energy Regulatory Commission (Commission) entered into a 5-year lease-to-own contract for the network modernization capital project during fiscal year 2016. The lease was for one base year and four option years. If the Commission chooses not to exercise an option, the equipment will be returned. Otherwise, the Commission will own the equipment at the end of the lease.

CRITERIA:

Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission, and Execution of the Budget*, Appendix B, provides instructions on the budgetary treatment of lease-purchases and leases of capital assets consistent with the scorekeeping rule developed by the executive and legislative branches in connection with the *Budget Enforcement Act of 1990*. The scorekeeping rule focuses on leases and lease-purchases specifically authorized by law. However, these requirements apply to all lease-purchase arrangements and capital leases, including those arrangements that agencies may enter into under existing general legal authorities and arrangements that are financed through the Federal Financing Bank.

Specifically, Section 1(a) states that "When an agency is authorized to enter into a lease-purchase or capital lease contract, budget authority will be scored in the year in which the authority is first made available in the amount of the net present value of the Government's total estimated legal obligations over the life of the contract." Further, Section 1(d) states that "When the lease agreement contains an option to renew that can be exercised without additional legislation, it will be presumed that the option will be exercised for purposes of calculating the term of the lease and scoring budget authority."

CONDITION:

During the Commission's discussion and analysis of how to account for the capital lease, management used OMB Circular A-11, Appendix B, to evaluate whether the lease should be scored. Upon not meeting any of the specific scoring criteria, management determined that the guidance did not otherwise apply to the requirements, including fully funding the lease at the beginning of the lease term. As such, only the base year was obligated during fiscal year 2016 instead of the total estimated obligations over the life of the contract, including all option years. The second and third option years were obligated during fiscal year 2017 and 2018, respectively, leaving the final two estimated option years unobligated as of September 30, 2018.

CAUSE:

The issue identified occurred because management did not appropriately apply guidance from OMB Circular A-11, Appendix B, when obligating the capital lease.

EFFECT:

We determined that the current year obligation was understated by the amount of remaining option years of the contract, approximately $2.0 million. In addition, the liability for the unfunded portion (account 299000) was overstated in the financial statements by approximately $1.3 million and the capital lease liability (account 294000) was understated by the same amount.

RECOMMENDATIONS:

We continue to recommend that the Federal Energy Regulatory Commission's Chief Financial Officer work with appropriate personnel to:

1. Document discussions and decisions made around unusual accounting situations and underlying transactions, including the considerations made and guidance used to reach conclusions; and

2. Discuss ambiguous guidance or other matters dealing with budgetary authority with the Office of General Counsel prior to entering into contracts.

MANAGEMENT RESPONSE:

Management believes that it properly followed the guidance in OMB Circular A-11, Appendix B, and properly accounted for the capital lease. Per OMB Circular A-11, Appendix B, and Appropriation Law, management believes the Commission is required to fund upfront the minimum lease payments required under the lease. Management believes this amount would equal the cancellation clause amount, which is what the Commission funded. The Commission's legal counsel agreed with management's interpretation of OMB Circular A-11, Appendix B, and the amount of funding required for the capital lease. The Accounting Officer does engage Commission counsel prior to making decisions on policy that involves appropriation law.

FEEDBACK

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions, and feedback to OIG.Reports@hq.doe.gov and include your name, contact information, and the report number. You may also mail comments to us:

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.