



Office of Inspector General

**OFFICE OF CYBER
ASSESSMENTS AND DATA
ANALYTICS**

MANAGEMENT LETTER

**THE WESTERN FEDERAL POWER SYSTEM'S
FISCAL YEAR 2022 FINANCIAL STATEMENT AUDIT**

**DOE-OIG-23-33
SEPTEMBER 2023**



Department of Energy
Washington, DC 20585

September 19, 2023

**MEMORANDUM FOR THE ADMINISTRATOR AND CHIEF EXECUTIVE OFFICER,
WESTERN AREA POWER ADMINISTRATION**

**SUBJECT: Management Letter on The Western Federal Power System's Fiscal Year 2022
Financial Statement Audit**

The Office of Inspector General engaged its contractor, the independent public accounting firm of KPMG LLP, to conduct the fiscal year 2022 financial statement audit of the Western Federal Power System, subject to our review. As part of this audit, auditors 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 that could have a direct and material effect on the combined financial statements.

As indicated in the attached report, the Office of Inspector General issued four findings to the Western Area Power Administration containing six recommendations. Management fully concurred with the findings and recommendations and had taken or planned to take corrective actions. The status of all current year findings evaluated in fiscal year 2022 is detailed in Appendix 2.

We appreciated the cooperation of your staff during the audit.

A handwritten signature in cursive script that reads "Kshemendra Paul".

Kshemendra Paul
Assistant Inspector General
for Cyber Assessments and Data Analytics
Office of Inspector General

Attachment

cc: Chief Financial Officer, Western Area Power Administration, WAPA
Comptroller and Vice President of Finance and Accounting, Western Area Power Administration,
WAPA
Vice President of Governance and Policy, Western Area Power Administration, WAPA



Department of Energy Office of Inspector General

Management Letter on The Western Federal Power System's Fiscal Year 2022 Financial Statement Audit (DOE-OIG-23-33)

WHY THE OIG PERFORMED THIS AUDIT

The Office of Inspector General engaged the independent public accounting firm, KPMG LLP, to perform the fiscal year (FY) 2022 financial statement audit of the Western Federal Power System (WFPS) to review the combined financial statements, evaluate internal accounting controls for adequacy, and determine whether Western Area Power Administration (WAPA) management complied with applicable laws and regulations.

The attached report discusses the results of the internal controls over financial reporting test work conducted as part of the FY 2022 financial statement audit of the WFPS.

What Did the OIG Find?

The Office of Inspector General issued four financial statement audit findings on the WFPS FY 2022 combined financial statements to WAPA, which related to the capitalization of maintenance costs; timeliness of property, plant, and equipment transfers from construction work in process; accuracy of cash allocations; and notes to the combined financial statements. The findings included six recommendations for improvement. In all instances, management concurred with the findings and recommendations, and had taken or planned to take corrective actions.

The identified weaknesses occurred for a variety of reasons. For instance, weaknesses related to the timely transfer of property, plant, and equipment from construction work in process occurred because manual journal entries were frequently utilized to reclassify completed project balances for financial reporting purposes. In addition, financial statement noted weaknesses had occurred because a report used to generate the related party's footnote was not configured properly.

What Is the Impact?

Without improvements to address the weaknesses identified in our report, WAPA could have an increased risk of a pervasive impact on the WFPS combined financial statements.

What Is the Path Forward?

When fully implemented, the recommendations made during FY 2022 should help the WFPS enhance its financial reporting. WAPA should also ensure that corrective actions are completed in a timely manner.

Table of Contents

Introduction.....	1
Internal Controls Findings and Recommendations	
Finding 1: Capitalization of Maintenance Costs (22-WFPS-01).....	2
Finding 2: Timeliness of Property, Plant, and Equipment Transfers from Construction Work in Process (22-WFPS-02)	3
Finding 3: Accuracy of Cash Allocations (22-WFPS-03)	5
Finding 4: Notes to the Combined Financial Statements (22-WFPS-04) ..	6
Appendices	
1. Commonly Used Terms	7
2. Status of Findings.....	8

INTRODUCTION

The Western Federal Power System (WFPS) consists of the Western Area Power Administration (WAPA), a Federal power marketing administration that markets and transmits hydroelectric power throughout 15 western states, and the hydroelectric power-generating functions of the Bureau of Reclamation (Reclamation), the Army Corps of Engineers (Corps), and the International Boundary and Water Commission. The WFPS combined financial statements include WAPA's combined financial position, results of operations, and cash flows, and the hydroelectric power-generating functions of Reclamation, the Corps, and the International Boundary and Water Commission. WAPA prepares, reviews, and publishes the combined financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and Federal Energy Regulatory Commission regulations.

During our fiscal year (FY) 2022 test work on the WFPS internal controls over financial reporting, we noted certain internal control weaknesses that are described in this report.

WESTERN FEDERAL POWER SYSTEM'S FISCAL YEAR 2022 FINDINGS AND RECOMMENDATIONS

Finding 1: Capitalization of Maintenance Costs (22-WFPS-01)

The Corps Omaha District is a component of the Department of Defense and a hydroelectric power generating-function within the WFPS. With more than \$650 million in net property, plant, and equipment (PP&E), including construction work in process (CWIP), general PP&E is one of the largest balances on the Corps Omaha District's hydropower balance sheet.

During our FY 2022 audit, we noted that controls were not operating effectively to ensure project costs not meeting capitalization criteria were expensed. Specifically, we reviewed a sample of five CWIP projects and identified one where approximately \$5 million of the \$8.6 million total asset cost should have been expensed because it related to maintenance.

We determined that the misclassification of expenditures into CWIP occurred primarily because of system limitations with a unique contract containing both maintenance and capital features. Corps management was aware that the contract included both capital and maintenance items. However, because of system limitations, it was management's intention to transfer the capital portion in CWIP to PP&E and expense the remaining maintenance portion at the time of the project's completion. Further, given the contract's unique nature, Corps management did not have a policy established to ensure that costs were recorded in accordance with GAAP.

Recommendation

We recommend that the Vice President of Finance and Accounting, WAPA, work with the Corps to:

1. Develop and implement a process to prevent commingling of expenses, capitalizable costs within the same accounting structure (e.g., work item or work category), and verify that CWIP project balances at period end exclude amounts that do not qualify for capitalization.

Management Response

WAPA and the Corps agreed with the finding. The Corps will process the necessary adjustment once the next construction in progress review is completed in early 2023. The estimated amount of current construction in progress cost that can be transferred to expense, established as a new expense work item, and then reclassified to correct the overstated construction in progress amounts will be confirmed with the project manager. It is currently estimated that the project will be completed prior to the end of FY 2023, thereby correcting all overstated and understated amounts for the hydroelectric financial statements. Based on our construction in progress review completed in August, any future projects containing both construction in progress and expenses will establish a new expense work item and transfer out an estimated expense amount prior to FY end. This new process will be added to our written procedures and implemented before this FY end.

Finding 2: Timeliness of Property, Plant, and Equipment Transfers from Construction Work in Process (22-WFPS-02)

With more than \$2.4 billion in net PP&E, including CWIP, general PP&E is one of the largest balances on WAPA's balance sheet. During our FY 2022 audit, we noted that controls were not operating effectively to ensure substantially completed projects were transferred to PP&E and depreciated at period end. Specifically, we reviewed a sample of 15 CWIP projects and identified 2 Rocky Mountain Region projects totaling \$5.5 million that were substantially completed and in use as of September 30, 2022, but had not been transferred out of CWIP and into PP&E. Because the misstatement was identified in a statistical sample, it was projected to the population, which resulted in a total and factual projected misstatement of approximately \$66.5 million.

In response to the misstatements, WAPA performed a review of all outstanding Rocky Mountain Region CWIP balances, along with targeted project balances in other regions. As a result of the review, WAPA identified multiple completed projects in CWIP and recorded an adjustment of \$62.9 million to reduce CWIP and increase PP&E. The approximate impact to accumulated depreciation for the impacted projects was \$2.5 million. In addition, \$35.8 million of the \$62.9 million adjustment should have been transferred prior to FY 2022. After WAPA completed its review and recorded the adjustment, we resampled the population, and no additional misstatements were identified.

The identified weakness occurred because WAPA's established policies and procedures for reviewing open CWIP balances for transfer to PP&E were not operating at a sufficiently precise level to identify all substantially completed projects or ensure substantially completed projects were transferred to PP&E by the balance sheet date. WAPA frequently utilizes manual journal entries to temporarily reclassify completed project balances from CWIP to PP&E for financial reporting purposes. These manual journal entries are re-recorded in subsequent periods until the balance is formally transferred from CWIP to PP&E within the Facilities Information Management System (FIMS). However, for the errors identified, a manual reclassification entry was not made.

In many cases, temporary adjustments may be required for multiple years. The combination of delays in formally transferring balances within the FIMS and the presence of manual reclassification entries, many of which are repeated for multiple years, result in a complex ending CWIP balance with a project status that is difficult to monitor. For example, we initially identified three sample items that were subsequently reclassified through a manual journal entry.

While the *DOE Financial Management Handbook* provides 6 months to transfer projects from CWIP to PP&E, it does not replace GAAP requirements. Accordingly, this policy would be considered non-GAAP and would require consistent application of the non-GAAP policy and a formalized, routine evaluation of the quantitative and qualitative impacts to the combined financial statements. For FY 2022, these requirements were not met.

Recommendations

We recommend that the Vice President of Finance and Accounting, WAPA:

2. Enhance existing processes to ensure all substantially completed projects are transferred from CWIP to PP&E for financial reporting purposes.
3. Modify existing processes to provide a timely transfer of CWIP to PP&E within the FIMS, thereby reducing the number of projects requiring a manual reclassification entry.

Management Response

Management concurred with the finding and recommendations and will enhance procedures prior to the completion of FY 2023 financial reporting to include the following:

- The Rocky Mountain Region Financial Manager will implement a project monitoring process to ensure completed CWIP projects are transferred timely to PP&E.
- Accounting and Reporting will work with regional finance offices to develop, or agree upon, a Business Object Enterprise CWIP project report to be used for monitoring CWIP projects. The report will include the power system, project number, project manager, current period activity, and cumulative balance.
- Regional Financial Managers will ensure that CWIP is monitored for timely transfers to PP&E. Special attention will be paid to validating estimated or actual in-service dates, assessment of projects with zero or minimal activity during the period, and timely processing in the FIMS.
- Governance and Compliance will sample test yearend CWIP balances for proper accounting while validating the in-service date with the project manager. Governance and Compliance will provide a report to the Regional Financial Managers and Vice President of Finance and Accounting prior to the completion of the yearend financial reporting. This process will be added to WAPA's yearend calendar as well as the Accounting and Reporting's yearend financial reporting checklist.
- The Accounting and Reporting Supervisory Accountant will compile a list of late transfers with justifications and provide it to the Vice President of Finance and Accounting for evaluation and discussion with the Regional Financial Manager. Current CWIP Policy, Section 7.a.(14), requires that the Financial Manager provide justification to Accounting and Reporting for projects that have not been formally transferred in the FIMS within 12 months as of fiscal yearend. In addition, the revised process will be added to the Accounting and Reporting yearend financial reporting checklist.
- CWIP policy Section 6.e.(1) will be modified to clarify the Department of Energy's 6-month policy. Specifically, where the current policy states, "A transfer is considered timely if it is recorded within six months (DOE Policy) of the date the asset is placed in service," the revised version will read that "[a] transfer is considered timely if it is

recorded within six months (DOE Policy) of the date the asset is placed in service during interim periods. At fiscal yearend, all projects with in-service date prior to yearend must be transferred to Plant.”

Finding 3: Accuracy of Cash Allocations (22-WFPS-03)

As a component of the Department of the Interior, Reclamation includes a hydroelectric power generating-function within the WFPS. Cash balances, for purposes of Reclamation’s hydropower balance sheet, is comprised of allocated cash held at the Department of the Treasury (Treasury) and allocated cash necessary to cover outstanding power undelivered obligations and outstanding liabilities. When preparing the hydroelectric power-generating function cash balance, Reclamation begins with a subset of its total cash and proceeds to allocate Treasury balances based on established allocation rules. While the Reclamation cash balance fluctuates annually, it typically represents approximately 25 percent of the \$1.8 billion unrestricted cash balance within the WFPS.

During our testing over Reclamation’s FY 2022 allocation of cash held at Treasury to the hydroelectric power-generating function, we identified that approximately \$39.6 million in cash was overstated. The identified weakness occurred because trial balance signs (i.e., positive and negative) were flipped when allocating Reclamation-wide cash balances to the hydroelectric power generating-function trial balance (the dataload). The sign flip was not detected by Reclamation, largely because only a portion of Reclamation-wide Treasury balances were included in the allocation process. Consequently, Reclamation did not ensure the cash allocation process started with a complete set of Reclamation-wide balances that reconcile to the general ledger.

While the condition was specific to cash, the lack of processes to ensure the power trial balance starts with a complete set of Reclamation-wide balances could have a more pervasive impact on the balances reported to WAPA for WFPS’ combined financial statements. Reclamation’s reporting of cash and congressional appropriations were overstated by approximately \$39.6 million as of September 30, 2022. However, it is WAPA’s process to record an adjustment to Reclamation’s cash such that the current year change in cash equals the warrant received from the Reclamation Fund less cash used in operating activities, as well as the investment in CWIP in preparing WFPS’ combined financial statements. Consequently, there was no impact on the combined financial statements at the WFPS level. Nonetheless, given the underlying cause, the deficiency could have had a more pervasive impact on the combined financial statements.

Recommendations

We recommend that the Vice President of Finance and Accounting, WAPA, work with Reclamation to:

4. Enhance the existing allocation process to include all Reclamation balances before applying the established allocation rules.
5. Modify the existing allocation process to create a standard tie-point analysis that reconciles unallocated balances to the Reclamation-wide trial balance.

Management Response

Management concurred with the finding. Reclamation does not agree with initially including all Reclamation balances as this would increase the population and dataload preparation significantly. Reclamation has made substantial steps over the past few years to fine-tune and reduce the amount of work required to prepare the final dataloads and stated that this could set its process improvements back. However, Reclamation will include a standard tie-point analysis to reconcile unallocated balances to a Reclamation-wide trial balance for the power projects. Reclamation will also verify these allocations during the final data tie-points before submitting them to WAPA.

Finding 4: Notes to the Combined Financial Statements (22-WFPS-04)

As part of its responsibilities, WAPA has various arrangements to provide electric power, transmission services, and other services to the Department of Energy, the Department of the Interior, and the Department of Defense. As of September 30, 2022, total revenue earned by the WFPS under these arrangements was \$189.4 million. In preparing WFPS' FY 2022 combined financial statements, WAPA identified an error in the data used to disclose related party transactions. Consequently, the FY 2021-related party revenue disclosed as \$238.4 million should have been \$160.3 million, representing a \$78.1 million overstatement. The data was corrected for purposes of WFPS' FY 2022 combined financial statements.

The identified weakness occurred because the report used by WAPA to generate the related party's footnote was not configured properly to provide an accurate value for FY 2021-related party revenues. The related party revenue disclosure for the period ended September 30, 2021, was overstated by \$78.1 million. There was no impact to the statement of revenues and expenses.

Recommendation

We recommend that the Vice President of Finance and Accounting, WAPA:

6. Evaluate the reliability of data utilized for purposes of preparing notes to the WFPS' combined financial statements.

Management Response

Management concurred with the finding and recommendation. In response, the Accounting and Reporting Manager will perform a review of the current footnote process and underlying reports to ensure accuracy prior to July 31, 2023. In addition, a detailed review and analysis of all processes and reports for new footnote disclosures will be performed.

Commonly Used Terms

Army Corps of Engineers	Corps
Bureau of Reclamation	Reclamation
Construction Work in Process	CWIP
Department of Energy	DOE
Department of the Treasury	Treasury
Facilities Information Management System	FIMS
Fiscal Year	FY
Property, Plant, and Equipment	PP&E
U.S. Generally Accepted Accounting Principles	GAAP
Western Area Power Administration	WAPA
Western Federal Power System	WFPS

Status of Findings

WESTERN FEDERAL POWER SYSTEM		
Finding Reference	Finding Title	Status
22-WFPS-01	Capitalization of Maintenance Costs	New
22-WFPS-02	Timeliness of Property, Plant, and Equipment Transfers from Construction Work in Process	New
22-WFPS-03	Accuracy of Cash Allocations	New
22-WFPS-04	Notes to the Combined Financial Statements	New

Status Legend:

New – Finding issued in current year

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