OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-18-28 March 2018

MANAGEMENT LETTER ON THE WESTERN FEDERAL POWER SYSTEM'S FISCAL YEAR 2017 FINANCIAL STATEMENT AUDIT

Department of Energy
Washington, DC 20585

March 27, 2018

MEMORANDUM FOR THE ADMINISTRATOR, WESTERN AREA POWER ADMINISTRATION

FROM: Sarah B. Nelson
Assistant Inspector General
for Audits and Administration
Office of Inspector General

SUBJECT: INFORMATION: Management Letter on the Western Federal Power System's Fiscal Year 2017 Financial Statement Audit

KPMG LLP, our contract auditors, planned and performed an audit of the combined financial statements of the Western Federal Power System as of and for the year ended September 30, 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. The combined financial statements include the Western Area Power Administration, a component of the U.S. Department of Energy, and the hydroelectric power generating functions of the Bureau of Reclamation, U.S. Department of the Interior; Army Corps of Engineers, U.S. Department of Defense; and the International Boundary and Water Commission, U.S. Department of State.

As part of the audit of the combined financial statements, KPMG LLP considered the Western 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 Western Federal Power System's internal control. Accordingly, KPMG LLP did not express an opinion on the effectiveness of the Western 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 LLP did not comply, in all material respects, with generally accepted Government auditing standards.

During the audit, KPMG LLP noted certain matters involving internal control and other operational matters that are presented in the attached management letter prepared by KPMG LLP. The letter contains six findings that were issued during the course of the Western Federal Power System's Fiscal Year 2017 Financial Statement Audit. Management concurred with each of the findings and provided planned corrective actions for the recommendations included in the Management Letter.

Attachment

cc: Chief Financial Officer, CF-1
Deputy Chief Financial Officer, CF-2
Acting Senior Vice President and Chief Financial Officer, Western Area Power Administration
Vice President of Financial Management, Western Area Power Administration
Director, Office of Finance and Accounting, CF-10
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, Internal Audit and Compliance Office, Western Area Power Administration

Report Number: DOE-IG-18-28

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

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March 9, 2018

The Administrator of Western Area Power Administration and the
U.S. Department of Energy Principal Deputy 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, 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 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 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.

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:

1. Significant Deficiency Over Untimely Access Revocation (17-WAPA-02)

During our testing of general information technology (IT) controls as part of our fiscal year (FY) 2017 financial statement audit of WAPA, which included the Financial Information Management System (FIMS), Yearly Online Gathering Information (YOGI), Corporate Data Repository (CDR), and Business Objects Enterprise (BOE) applications, we observed that 3 of 36 terminated users selected for testing did not have their access removed in a timely manner. Specifically, we noted that:

- One terminated user was not removed from the FIMS application until 12 days after separation;
- One terminated user was not removed from the FIMS application until 24 days after separation; and
- One terminated user was not removed from the FIMS application until 52 days after separation. Prior to separation, this user's job function and duties did not require access to the application. The user last accessed the application on February 11, 2016 and the user's password had expired. Nonetheless, the user's account was not removed.

Two of the three accounts identified had been provisioned to individuals with management-level responsibilities within the organization. While the IT function attempts to remove the access of users within 5 days of termination, neither of these accounts were identified for access revocation by upper management on a timely basis. In certain instances, Personal Identity Verification (PIV) card credentials may mitigate the risk of inappropriate access. However, for all instances identified, FIMS user accounts were not tied to PIV card credentials. Therefore, revocation of PIV cards would not alleviate the potential for insider threat.

In all instances identified, the terminated user's account was not used to access the application after the separation date.

While WAPA's *User Account Management – Enterprise Applications* policy (A2800, June 2017 update) outlines the requirement for user accounts to be removed upon termination, it does not define an acceptable timeframe between termination and access revocation.

Recommendations:

1. With increased scrutiny over insider threats at both a national and industry-wide level, we recommend that the Acting Chief Information Officer, WAPA:

   A. Strengthen and re-communicate exit clearance procedures to all levels within the organization; and

   B. Define the acceptable time frame for both regional office and/or user supervisor notification to IT of terminations and access revocation by IT.

Management Response:

WAPA concurs with the finding, but does not agree that the issue rises to the level of a significant deficiency due to the effectiveness of a compensating control that removes terminated users' network access upon separation from WAPA. To access its network, WAPA requires two-factor authentication (common access card and a unique personal identification number). The common access cards were removed and domain accounts deactivated for the three cited users upon separation from WAPA. The terminated users could not access WAPA's financial systems without the assistance of an internal active user, which WAPA believes has a very low probability of occurring.

To mitigate the issues presented, WAPA will re-evaluate and update (as needed) its current exit clearance procedures to:

- Ensure the IT function is notified timely when employees and contractors separate from WAPA so all systems access is removed;
- Determine whether a time frame should be more clearly defined for IT access revocation, and if so, identify a reasonable time frame; and
- In accordance with Homeland Security Presidential Directive 12 and Office of Management and Budget Memoranda M-14-03, *Enhancing the Security of Federal Information and Information Systems*, WAPA will finalize the implementation of Level of Assurance 4 two-factor authentication for the FIMS system utilizing the PIV cards.

WAPA plans to implement these corrective actions by December 31, 2018. To mitigate the issues presented, WAPA will conduct additional training on this critical responsibility at all levels of the organization as well as increasing testing on the applicable controls.

Auditors' Comment to Management's Response

We agree that removal of the common access cards and deactivation of domain accounts may reduce the risk of unauthorized use, disclosure, or modification of data by the terminated user. However, we believe the extended timeframe between termination and FIMS user access revocation merits the attention of those charged with governance to help prevent nefarious actions by a malicious insider.

2. Significant Deficiency Over Timeliness of Property, Plant, and Equipment Additions (17-WAPA-03)

During test work over Property, Plant, and Equipment (PP&E) at the Bureau of Reclamation (Reclamation), we noted instances of untimely recording of PP&E additions and transfers from Construction in Progress (CIP). Specifically, we noted three Reclamation CIP projects selected for testing were complete, or had portions that were substantially complete and in use, but were not transferred out of CIP and into the associated PP&E account. Consequently, CIP was overstated and PP&E was understated by approximately $46.2 million. Furthermore, accumulated depreciation and depreciation expense were understated by approximately $578,000 as of and for the year ended September 30, 2017. These issues occurred because project managers did not properly notify the appropriate finance offices when a project was substantially complete, and regional/finance offices had not obtained sufficient documentation in a timely manner to initiate and complete transfers.

Recommendation:

2. We recommend that the Vice President of Financial Management, WAPA, work with Reclamation to enhance training and communication of policies and procedures to regional or field offices (those responsible for CIP review and project management) so that both project managers and finance offices are aware of bureau policies related to project completion and timely capitalization as constructed assets are placed in service.

Management's Response:

Management concurs with the finding and recommendation. WAPA management will meet with the appropriate Reclamation officials to determine the best approach to address this recommendation. It is expected that as a result of this approach, both project managers and finance offices will be fully aware of bureau policies related to project completion and timely capitalization as constructed assets are placed in service. The target implementation date for corrective action is September 30, 2018.

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3. Significant Deficiency Over Change in Project Type Attribute (17-WAPA-06)

As of September 30, 2017, Reclamation's PP&E balance attributable to power was approximately $2.5 billion and the associated accumulated depreciation was approximately $1.5 billion. PP&E is recorded to various project types, including multi-purpose and power. The portion of multi-purpose PP&E attributable to power is based on set allocation methodologies. In certain cases, the project type attribute is changed based on updated analyses or a change in facts and circumstances.

During our testing over Reclamation's data load file (power trial balance), WAPA and Reclamation identified inconsistencies in the power trial balance related to changes in the project type attribute of PP&E that should have been corrected in prior periods. Specifically, certain PP&E assets were reassigned from multi-purpose to power in FY 2016; however, the associated accumulated depreciation was not reassigned until FY 2017. Consequently, the net book value in the power trial balance in the prior year was overstated by approximately $11.6 million.

While the discrepancies were identified by management during FY 2017 as part of a continually enhanced review process, the inconsistencies were not identified in a timely manner. The issues noted occurred because the changes in project type attribute of PP&E were not sufficiently analyzed to ensure the net book value was properly adjusted in the power trial balance and adjustments were not effectively communicated between WAPA and Reclamation.

Recommendations:

3. We recommend that the Vice President of Financial Management, WAPA, work with Reclamation to continuously improve processes over the power trial balance to identify and correct inconsistencies in the power-related data in the same year the original transaction was recorded. Specifically, we recommend that:

   A. Procedures are enhanced to ensure that as project type attributes are reassigned, all account balances (such as accumulated depreciation) associated with the transfer are changed within the same accounting period; and

   B. Procedures are enhanced to ensure changes in project type attributes, as well as the justification for such changes, are communicated between WAPA and Reclamation to ascertain the impact on the combined power financial statements and related power rates.

Management Response:

Management concurs with the finding and recommendations. WAPA management will meet with the appropriate Reclamation officials to determine the best approach to address the recommendations. It is expected that as a result of this approach, all account balances associated with transfers due to reassignment of project type attributes will be changed within the same accounting period. In addition, changes in project type attributes, as well as the justification for such changes, will be communicated timely between the organizations to determine the impact on the financial statements and power rates. The target implementation date for corrective action is September 30, 2018.

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:

4. Improper Classification of Expenses (17-WAPA-01)

During our interim testing of operating and maintenance expenses at WAPA, we identified one operating and maintenance expense transaction, totaling $743,784, related to a capital project that was incorrectly expensed. While the transaction was subsequently corrected by regional management, there was no documentation that the necessary correction was identified by WAPA prior to our sample selection. WAPA has an established process in place for reviewing expenses to ensure appropriate classification when recorded. However, we found the process was not sufficient or was not performed at a sufficient level of precision to ensure all expenses were appropriately classified.

Recommendation:

4. We recommend that WAPA's Rocky Mountain Regional Financial Manager enhance its existing process to ensure all expense transactions are properly classified and recorded, which includes strengthening training efforts to ensure those responsible for the review of invoices are able to identify the proper classification.

Management Response:

Management concurs with the finding and recommendation. WAPA believes the processes and procedures for capitalization criteria are well documented and understood. However, we do believe that due to the unique circumstances concerning this specific transaction/contract and the location of the intangible power rights in a different region than the invoice processor, some on-the-job training and additional familiarity with the complicated contract would help enable finance and engineering employees more readily identify similar transactions in the future. The target date for implementation is September 30, 2018.

5. Basin Fund Memorandum of Agreement (17-WAPA-04)

One of the purposes of the Colorado River Storage Project Act is the comprehensive development of the water resources of the Upper Colorado River Basin. In 2011, the System entered into a memorandum of agreement with various states to aid in the development and repayment of certain irrigation costs. During our testing over the Reclamation data load file (power trial balance), we identified that both WAPA and Reclamation identified inconsistencies in the power trial balance relating to the memorandum of agreement that related to prior periods. While the discrepancies were identified by management during FY 2017 as part of a continually enhanced review process, the inconsistencies were not identified in a timely manner. Upon entering into the memorandum of agreement, neither WAPA nor Reclamation designed and implemented sufficient procedures to ensure activity relating to new agreements was properly excluded/included in the power trial balance. Consequently, cash and other assets (prepayments) of $13.9 million and $7.7 million, respectively, were inappropriately excluded from prior years' power trial balances. Similarly, the power trial balances could have inappropriately included activity related to the agreement.

Recommendations:

5. We recommend that WAPA's Vice President of Financial Management work with Reclamation to continuously improve reviews, analyses, and processes over the power trial balance to identify and correct inconsistencies in the power-related data in the same year the original transaction was recorded. Specifically, we recommend that:

    A. Procedures are enhanced to ensure current year memorandum of agreement activity is reviewed to ensure identification of all such transactions are complete and accurately reflected in the power trial balance;

    B. Procedures are developed to ensure new agreements are evaluated and processes are implemented to ensure proper accounting; and

    C. WAPA and Reclamation continue to meet at the Headquarters level and at regional workshops to timely identify unique circumstances or conditions in current year activity that need to be considered in the power trial balance.

Management Response:

Management concurs with the finding and recommendations. WAPA management will meet with the appropriate Reclamation officials to determine the best approach to address this recommendation. It is expected that as a result of this approach, financial activity associated with the current memorandum of agreement will be identified and recorded timely and accurately in the combined financial statements. Procedures will be enhanced to ensure new agreements are fully reviewed and evaluated to ensure proper accounting. Further, WAPA and Reclamation will jointly ensure an increased focus of discussion on identifying unique accounting situations that need to be considered in the power trial balance. The target implementation date for corrective action by September 30, 2018.

6. Reclamation Customer Advances (17-WAPA-05)

Advanced customer funding may be provided to Reclamation for various maintenance activities. As maintenance is performed by Reclamation on the power system assets, the advance is reduced and revenue is recorded. However, for combination purposes, regardless of whether the maintenance has been performed, WAPA reduces the advance account for amounts already credited to customer bills for power delivered. WAPA and Reclamation identified inconsistencies in the power trial balance relating to advances that should have been corrected in prior periods. While the discrepancies were identified by management during FY 2017 as part of a continually enhanced review process, the inconsistencies were not identified in time to be correct in the appropriate period. Specifically, revenues of approximately $10.2 million related to the Parker Davis project were inappropriately included in the prior years' trial balances. Adjustments were appropriately recorded in FY 2016 to adjust the revenues, but were inappropriately deferred as customer advances. Consequently, customer advances were overstated by approximately $10.2 million.

The discrepancies occurred because the advance account was not sufficiently reconciled to ensure Reclamation advance balances were appropriately adjusted in the combined financial statements. In addition, the process and frequency of joint meetings between WAPA and Reclamation was not sufficient and was not performed at a level of precision to ensure all items were recorded in the correct accounting period in accordance with power allocation rules.

Recommendations:

6. We recommend that the Vice President of Financial Management, WAPA work with Reclamation to continuously improve account reconciliation processes and analyses over the power trial balance to identify and correct inconsistencies in the power-related data in the same year the original transaction was recorded. Specifically, we recommend that:

   A. Procedures are enhanced to ensure Reclamation advanced customer funding transactions reported in the power trial balance are reconciled to an appropriate level of detail and timely adjustments are made for purposes of the combined financial statements. Such procedures may include the preparation and review of roll forwards of advance activity, by power system; and

   B. WAPA and Reclamation meet more frequently at the Headquarters level and at regional workshops to timely identify unique circumstances or conditions in current year activity that need to be considered in the power trial balance.

Management Response

Management concurs with the finding and recommendations. WAPA's Vice President of Financial Management will work with Reclamation to implement recommendations by September 30, 2018.

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.

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This communication is intended solely for the information and use of management, the Administrator of the Western Area Power Administration, the U.S. Department of Energy Principal Deputy Inspector General, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

FEEDBACK

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

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