memorandum

DATE: February 26, 1998

REPLY TO
ATTN OF: IG-30

SUBJECT: Western Area Power Administration's Fiscal Year 1997 Financial Statement Audit (WR-FC-98-03)

TO: Administrator, Western Area Power Administration

The attached report presents the results of the independent certified public accountants' audit of the Western Area Power Administration's (Western) combined power system statements of assets, Federal investment and liabilities, and the related combined statements of revenues, expenses and accumulated net revenues, and cash flows. The auditors have expressed an unqualified opinion on the 1997 statements.

The 1997 financial statement audit was made under the provisions of the Inspector General Act of 1978 as amended, (5 U.S.C. App. 3), the Government Management Reform Act (31 U.S.C. 3515), and Office of Management and Budget implementing guidance. The auditors' work was conducted in accordance with generally accepted government auditing standards. To fulfill our audit responsibilities, we contracted with the independent public accounting firm of KPMG Peat Marwick LLP (KPMG) to conduct the audit for us, subject to our review.

The auditors' report on Western's internal control structure disclosed three new reportable conditions concerning the lack of (1) a reconciliation of stores inventory from subsidiary ledgers to summary financial information, (2) communication of interest during construction and related adjustments to interest on Federal investment, and (3) a system to prevent and detect power billing errors. None of these reportable conditions were considered to be material weaknesses. Western provided concurrence and corrective action plans for the reportable conditions; therefore, these open recommendations should be tracked in the Departmental Audit Report Tracking System.

The auditors' report on Western's compliance with laws and regulations also disclosed two new instances of noncompliance. Western failed to calculate nonreimbursable expenses in accordance with the Grand Canyon Protection Act and had an unexplained difference in gross Federal investment balances used to calculate interest on Federal investment. Western provided concurrence and corrective action plans for the instances of noncompliance; therefore, these open recommendations should be tracked in the Departmental Audit Report Tracking System.

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Based on KPMG's unqualified opinion and our review of their audit work, we believe the financial statements fairly present the financial condition and results of operations of the Western for the period under audit.

Phillip L. Holbrook
Acting Deputy Inspector General
for Audit Services

Attachment

cc: Audit Liaison, Western Area Power Administration
Team Leader, Audit Liaison Team, CR-2
Manager, Western Regional Audit Office, IG-35

The Global Leader

WESTERN AREA POWER ADMINISTRATION

**Combined Power System
Financial Statements**

September 30, 1997 and 1996

(With Independent Auditors' Report Thereon)

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WESTERN AREA POWER ADMINISTRATION

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OVERVIEW

The Western Area Power Administration (Western) was established December 21, 1977, under Section 302 of the Department of Energy Organization Act. Power marketing responsibilities and transmission system assets previously managed by the U.S. Bureau of Reclamation (Reclamation) were transferred to Western.

Western annually markets and transmits over 10,000 megawatts (MW) of hydropower from 55 plants operated primarily by Reclamation, the U.S. Army Corps of Engineers, and the International Boundary and Water Commission. Western also markets the United States' 547 MW entitlement from the coal-fired Navajo Generating Station near Page, Arizona. These generation and transmission facilities are part of 11 rate setting systems made up of 14 multipurpose water resource projects and one transmission project. Each project maintains separate financial systems and accounting records.

Western and the generation agencies, identified above, though separately managed and financed, operate and maintain portions of the multipurpose projects, allocating their operating expenses among the projects. Costs are allocated among project individual purposes, which include power, navigation, irrigation, flood control, and recreation. The combined power system financial statements include only those amounts allocated to power for repayment for each of the four entities.

The goals shared by these entities include maintaining efficient and reliable generation and transmission systems; providing reliable, cost-effective electricity to power customers; maintaining public safety, as well as a safe, accident-free work place for their employees; protecting and enhancing the environment; providing for national energy security, economic development, and energy diversity; and implementing quality improvements through management initiatives.

In fiscal year 1997, more than 42 billion kilowatt-hours of energy was sold to 634 wholesale power customers and power marketers including municipalities, cooperatives, public utility, and irrigation districts, Federal and state agencies and investor-owned utilities. They, in turn, provided retail electric service to millions of consumers in these central and western states: Arizona, California, Colorado, Iowa, Kansas, Minnesota, Montana, Nebraska, Nevada, New Mexico, North Dakota, South Dakota, Texas, Utah, and Wyoming.

The generating agencies operate and maintain storage dams and reservoirs in addition to powerplants identified above. Western operates and maintains the integrated, high-voltage power transmission system to supply power to its customers. This system consists of 16,857 miles (27,123 kilometers) of transmission lines, 258 substations, and other complex electrical facilities in a 1.3-million-square-mile service area.

Western's staff is located in 48 duty stations throughout the service area. These include the Corporate Service Office in Golden, Colorado; and four regional offices in Billings, Montana; Loveland, Colorado; Phoenix, Arizona; and Folsom, California. Customer service and system operations are also supported by a Customer Service Office in Salt Lake City, Utah, and other offices in Bismarck, North Dakota; Fort Peck, Montana; Huron, South Dakota; and Montrose, Colorado; and an Operations Office staff in Watertown, South Dakota.

Appropriations are obtained to finance the expenses of most of the power systems. However, Western's operations and maintenance and purchased power programs for the Colorado River Storage Project, and the Central Arizona, Fort Peck, Dolores, and Seedskaadee Projects are financed from power revenues. Funding is provided from the Colorado River Dam Fund to carry out the power marketing and transmission activities of the Boulder Canyon Project. Work for other Federal and non-Federal organizations under authority of the Economy Act and the Contributed Funds Act is also performed.

Western generated \$881.6 million in gross operating revenue in fiscal year 1997. Annual expenses for Western and the generating agencies included \$209.8 million for operations and maintenance, \$42.0 million for administrative and general, \$94.7 million for depreciation; \$149.0 million in power purchases; and \$32.1 million in purchased transmission services. Net interest expense totaled \$178.3 million. Approximately \$109 million of Federal investment was repaid in fiscal year 1997.

PERFORMANCE MEASURES

FINANCIAL PERFORMANCE MEASURES

NOTE: As described in note 1(c) of the combined power system financial statements, Western acts as the power marketing agent for the Bureau of Reclamation's (Reclamation) power entitlement in the Navajo generating station, as prescribed by law. Revenues collected by Western are subsequently transferred to Reclamation's Central Arizona Project (CAP). Such transfers are included in "income transfers, net" in the combined power system statement of revenues, expenses, and accumulated net revenues. Western's combined power system financial statements exclude all assets, liabilities, and operating expenses of CAP. For the purpose of the following financial performance measures, CAP revenues transferred to Reclamation have also been excluded.

Debt Service Coverage Ratio:

The debt service coverage ratio measures revenues in excess of operating expenses available to make principal and interest payments. A ratio of 1.0 indicates sufficient cash flow to meet these payments, in addition to all other cash expenses. Western's FY 1997 ratio increased from FY 1996 due to relatively flat operating expenses and an increase in net revenues resulting from higher electric power sales.

<u>FY</u>	<u>Rate</u>
1997	1.62
1996	1.37

Cumulative Principal Payments as a Percent of Total Federal Investment (Investment Repaid):

This indicator measures the progress toward reduction of cumulative principal over time. It compares the cumulative principal payments made relative to the total Federal investment (including irrigation assistance) to date. The FY 1997 rate decreased from the FY 1996 rate mainly as a result of a \$2.1 billion increase in Federal investment. The major investment increase occurred in the Colorado River Storage Project with a \$1.9 billion increase in nonpower investment (aid to irrigation) representing costs to complete the Bonneville Unit of the Central Utah Project. During FY 97 Western repaid \$105 million of federally financed power (to a level of 46.41%), \$2 million of non-federally financed power (to a level of 15.98%) and \$2 million of nonpower investment (to a level of 0.98%) for a combined federal investment repaid rate of 27.25%.

<u>FY</u>	<u>Rate</u>
1997	27.25%
1996	34.30%

Percent Variance of Actual From Planned Annual Principal Payments:

This indicator measures the variance of actual from planned principal payments to the U.S. Department of the Treasury. This indicator is zero if the actual payment is equal to the planned payment. Western's power generation and transmission activities provided \$109 million for repayment of unpaid Federal investment during FY 1997. Due to an above average water year resulting in higher electric power sales, Western's actual FY 1997 principal payments exceeded the planned principal repayment by \$64.4 million.

<u>FY</u>	<u>Rate</u>
1997	144.57%
1996	-56.02%

NOTE: The latest industry statistics currently available are provided in the report titled, "Selected Financial and Operating Ratios of Public Power Systems, 1995," dated February 1997, as prepared by the American Public Power Association. Statistics are calculated based on data from over 400 of the largest publicly-owned electric utilities in the United States.

Operation and Maintenance (O&M) Cost/Kilowatt-hour (kWh) Sold:

O&M and administration and general expenses (AGE) costs per kWh sold is a measure of the cost to operate and maintain the generation and transmission systems, based on firm energy sales, and is measured as a cost per kWh sold. The ratio decreased in FY 1997 due to flat O&M and AGE and an increase in kWhs sold. The FY 1995 industry average was \$0.046/kWh.

<u>FY</u>	<u>Rate</u>
1997	\$0.0080
1996	\$0.0083

Operating Ratio - Total Operation and Maintenance (O&M) Expenses/Total Operating Revenues:

This indicator measures the proportion of revenues received from electricity sales, rate adjustments, and other activities required to cover operating costs (which include O&M, AGE, purchased power, and purchased transmission) associated with producing and selling electricity. Western's FY 1997 rate decreased from that in FY 1996 primarily due to relatively flat operating expenses and higher total operating revenues (\$80.9 million). Significantly impacting total operating revenues was an increase in FY 1997 electric power sales (\$68.5 million) resulting from improved water conditions and higher generation. The above average water year increased electric power sales mainly in the Central Valley Project and the Colorado River Storage Project. The FY 1995 industry rate was 0.776.

<u>FY</u>	<u>Rate</u>
1997	\$0.545
1996	\$0.569

Revenue/Kilowatt-hour (kWh) Sold:

This indicator measures the amount of revenue (dollars) received for each kWh of electricity sold to wholesale customers. Western's FY 1997 rate was consistent with FY 1996. Higher revenues and increased kWh sales in FY 1997 offset to keep the ratio steady. The FY 1995 industry rate was \$0.060/kWh.

<u>FY</u>	<u>Rate</u>
1997	\$0.016
1996	\$0.016

Total Power Supply Expense/Kilowatt-hour (kWh) Sold:

This indicator measures all power supply costs, including generation and purchased power, associated with the sale of each kWh of electricity. Western's FY 1997 cost, as compared to FY 1996, remained constant. Power supply costs increased proportionally to increases in kWhs sold. The FY 1995 industry average was \$0.037/kWh.

<u>FY</u>	<u>Rate</u>
1997	\$0.011
1996	\$0.011

OPERATIONAL PERFORMANCE MEASURES

Western is committed to maintaining a safe, accident-free work place. This commitment is demonstrated by Western's establishment of a Safety and Health Committee dedicated to increasing awareness of safe work practices and the inclusion of safety goals in Western's Bonus Goals Program. Western is also committed to a safe, efficient, and reliable transmission system. In as much, Western reports on a number of operational measures for occupational safety and health and transmission system efficiency.

Occupational Safety and Health Performance Measures

NOTE: The following measures, as adopted by the U.S. Department of Energy (DOE) for occupational injuries and illnesses, are recognized throughout the industry (public and private utilities) and by statistical gathering entities to include the National Safety Council, Bureau of Labor Statistics, and National Institute for Occupational Safety and Health. Industry statistics are provided on a calendar-year (CY) basis, accordingly, Western's measures have been calculated for the same time frame.

Lost Workday Case Rate (Lost-Time Injury Frequency Rate):

This indicator measures the number of accidents (cases) per 200,000 hours worked. The industry average is almost three times greater than Western's. A comparison of Western's rate to the industry average is provided below.

<u>Western</u>		<u>Industry</u>	
<u>CY</u>	<u>Rate</u>	<u>CY</u>	<u>Rate</u>
1997	0.5	1997	1.3
1996	0.4	1996	1.3

Total Recordable Case Rate (Recordable Accident Frequency Rate):

This indicator measures the recordable accident frequency rate by multiplying the number of recordable injuries by 200,000 then dividing by the total hours worked. In 1997 Western's rate is less than a third of the industry average. A comparison of Western's rate to the industry average is provided below.

<u>Western</u>		<u>Industry</u>	
<u>CY</u>	<u>Rate</u>	<u>CY</u>	<u>Rate</u>
1997	1.9	1997	5.7
1996	1.2	1996	5.7

Motor Vehicle Accident (Frequency) Rate:

This indicator measures the accident frequency rate by multiplying the number of recordable accidents by 1,000,000, and then dividing by the recorded miles driven. This rate does not distinguish between "preventable" or "non-preventable" accidents. The industry average is over twice as high as Western's rate. A comparison of Western's rate to the DOE average is provided below.

<u>Western</u>		<u>DOE</u>	
<u>CY</u>	<u>Rate</u>	<u>CY</u>	<u>Rate</u>
1997	1.1	1997	2.5
1996	1.2	1996	2.6

TRANSMISSION SYSTEM PERFORMANCE MEASURE

Operations Performance Measure: Area Control Error (ACE):

ACE measures the instantaneous difference between actual and scheduled electrical power interchange including the effects of deviation from 60 hertz frequency. Each control area should be in compliance with A1 and A2 Criteria at least 90 percent of the time. Control criteria compliance is a measure used to determine if utility employees, control equipment, and generation are responsive to the minute-by-minute load changes throughout the year. Good control performance is required to maintain system reliability and to reduce losses, as well as a matter of equity among interconnected systems. Western's rate is well above both the minimum requirement and the industry average.

<u>Western</u>		<u>Industry</u>	
<u>FY</u>	<u>Rate</u>	<u>FY</u>	<u>Rate</u>
1997	97.2	1997	92.0
1996	98.2	1996	91.9

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Independent Auditors' Report

The Administrator
Western Area Power Administration
United States Department of Energy:

We have audited the accompanying combined power system statements of assets, Federal investment, and liabilities of the Western Area Power Administration (Western) as of September 30, 1997 and 1996, and the related combined power system statements of revenues, expenses, and accumulated net revenues, and cash flows for the years then ended. These combined power system financial statements are the responsibility of Western's management. Our responsibility is to express an opinion on these combined power system financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined power system financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined power system financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial combined power system statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined power system statements referred to above present fairly, in all material respects, the financial position of Western as of September 30, 1997 and 1996, and the results of its operations and changes in accumulated net revenues, and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued reports dated December 12, 1997, on our consideration of Western's internal control over financial reporting and on its compliance with laws and regulations.

Our audits were conducted for the purpose of forming an opinion on the combined power system financial statements taken as a whole. The accompanying combining information is presented for purposes of additional analysis of the combined power system financial statements rather than to present the financial position, results of operations, and cash flows of individual projects. The combining information has been subjected to the auditing procedures applied in the audits of the combined power system financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined power system financial statements taken as a whole.

The information presented in management's *Overview and Performance Measurements* is not a required part of the combined power system financial statements, but is supplementary information required by OMB Bulletin 94-01 and 97-01, *Form and Content of Agency Financial Statements*. We have considered whether this information is materially inconsistent with the combined power system financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the combined power system financial statements and, accordingly, we do not express an opinion on it. The performance information included in management's *Overview and Performance Measurements* is addressed in our auditors' report on internal control over financial reporting in accordance with OMB Bulletin 93-06.

This report is intended for the information of the management of Western and the United States Department of Energy. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

Salt Lake City, Utah
December 12, 1997

WESTERN AREA POWER ADMINISTRATION

Combined Power System Statements of Assets, Federal Investment, and Liabilities

September 30, 1997 and 1996

(In thousands)

	1997	1996
<u>Assets</u>		
Utility plant:		
Completed plant	\$ 5,176,139	5,052,625
Accumulated depreciation	(1,656,408)	(1,669,491)
	<u>3,519,731</u>	<u>3,383,134</u>
Construction work-in-progress	174,885	301,231
Net utility plant	<u>3,694,616</u>	<u>3,684,365</u>
Cash	285,007	312,578
Accounts receivable	157,304	116,294
Other assets	129,593	105,371
Total assets	<u>\$ 4,266,520</u>	<u>4,218,608</u>
<u>Federal Investment and Liabilities</u>		
Federal investment:		
Congressional appropriations	\$ 8,701,121	8,385,061
Interest on Federal investment	3,179,470	2,985,635
Transfer of property and services, net	517,115	582,765
Gross Federal investment	<u>12,397,706</u>	<u>11,953,461</u>
Funds returned to U.S. Treasury	(8,820,931)	(8,327,705)
Net outstanding Federal investment	<u>3,576,775</u>	<u>3,625,756</u>
Accumulated net revenues	389,737	302,526
Total Federal investment	<u>3,966,512</u>	<u>3,928,282</u>
Commitments and contingencies (notes 5, 7, and 8)		
<u>Liabilities</u>		
Accounts payable	63,756	66,490
Other liabilities	236,252	223,836
Total liabilities	<u>300,008</u>	<u>290,326</u>
Total Federal investment and liabilities	<u>\$ 4,266,520</u>	<u>4,218,608</u>

The accompanying notes are an integral part of these combined power system financial statements.

WESTERN AREA POWER ADMINISTRATION

Combined Power System Statements of Revenues, Expenses, and Accumulated Net Revenues

Years ended September 30, 1997 and 1996

(In thousands)

	1997	1996
Operating revenues:		
Sales of electric power	\$ 723,696	655,177
Other operating income	157,882	144,586
Gross operating revenues	881,578	799,763
Income transfers, net	(88,352)	(87,485)
Total operating revenues	793,226	712,278
Operating expenses:		
Operation and maintenance	209,846	204,753
Administration and general	41,999	45,245
Purchased power	149,038	129,136
Purchased transmission services	32,127	29,929
Depreciation	94,689	95,437
Total operating expenses	527,699	504,500
Net operating revenues	265,527	207,778
Interest on Federal investment:		
Interest on Federal investment	196,594	211,350
Allowance for funds used during construction	(18,278)	(17,677)
Net interest expense	178,316	193,673
Net revenues	87,211	14,105
Accumulated net revenues:		
Balance, beginning of year	302,526	288,421
Balance, end of year	\$ 389,737	302,526

The accompanying notes are an integral part of these combined power system financial statements.

WESTERN AREA POWER ADMINISTRATION

Combined Power System Statements of Cash Flows

Years ended September 30, 1997 and 1996

(In thousands)

	1997	1996
Cash flows from operating activities:		
Net revenues	\$ 87,211	14,105
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation	94,689	95,437
Interest on Federal investment	169,827	184,070
Write-on of recoverable asset	-	(13,052)
(Increase) decrease in assets:		
Accounts receivable	(41,010)	26,942
Other assets	(15,537)	4,474
Increase (decrease) in liabilities:		
Accounts payable	(2,734)	26,099
Other liabilities	14,159	(34,358)
Net cash provided by operating activities	306,605	303,717
Cash flows used in investing activities - investment in utility plant	(72,900)	(100,431)
Cash flows from financing activities:		
Congressional appropriations	233,694	248,366
Funds returned to U.S. Treasury	(493,226)	(478,866)
Customer advances	-	400
Principal payments to upraters	(1,744)	(2,263)
Net cash used in financing activities	(261,276)	(232,363)
Decrease in cash	(27,571)	(29,077)
Cash at beginning of year	312,578	341,655
Cash at end of year	\$ 285,007	312,578

Supplemental Schedule of Noncash Investing and Financing Activities

Capitalized interest during construction	\$ 18,278	17,677
Transfer of construction work-in-progress to completed plant	183,004	213,460

The accompanying notes are an integral part of these combined power system financial statements.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

September 30, 1997 and 1996

(1) Basis of Preparation of Combined Power System Financial Statements and Summary of Significant Accounting Policies

(a) General

Western Area Power Administration's (Western) combined power system financial statements include the individual power projects listed in note 2 to these combined power system financial statements. Western is the Federal power marketing administration for these power projects. Except for the Central Arizona Project and the Pacific Northwest-Pacific Southwest Intertie, these power projects are part of multipurpose water resource projects and include certain transmission facilities of Western, an agency of the U.S. Department of Energy (DOE), and certain generating facilities of the U.S. Department of the Interior, Bureau of Reclamation (Reclamation); the U.S. Department of Defense, Army Corps of Engineers (the Corps); and the U.S. Department of State, International Boundary and Water Commission (IBWC). The United States has no ownership in power facilities of the Central Arizona Project (CAP), but Reclamation does have an entitlement to power from the project generating facility and to transmission capacity from transmission facilities. The CAP assets and the associated entitlement are not included in the combined power system financial statements.

Western markets and transmits throughout 15 western states power which is produced by hydropower plants operated by Reclamation, the Corps, and IBWC. Each are separately managed and financed, and maintain separate accounting records. Reclamation, the Corps, and IBWC operate and maintain generating facilities that are part of multipurpose water resource projects and, accordingly, allocate certain operating expenses and net assets among the projects' activities. Costs of the multipurpose projects are allocated to individual purposes (principally power, irrigation, municipal and industrial water, navigation, and flood control) through cost allocation processes (see note 5b). The accompanying combined power system financial statements include only those expenses and net assets which are expected to be recovered through the sale of power and other related income.

Accounts are maintained in accordance with generally accepted accounting principles (GAAP) and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission (FERC). Accounting policies also reflect specific legislation and executive directives issued by Federal government departments. Western's combined power system financial statements are generally presented in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effect of Certain Types of Regulation*. The provisions of SFAS No. 71 require, among other things, that regulated enterprises reflect rate actions of the regulator in their combined power system financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise.

(b) Confirmation and Approval of Rates

The Secretary of Energy (Secretary) has delegated authority to Western's Administrator to develop power and transmission rates for the power projects. The Deputy Secretary of Energy has the authority to confirm, approve, and place such rates in effect on an interim basis.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(b) Confirmation and Approval of Rates (continued)

The Secretary delegated to FERC the authority to confirm, approve, and place such rates in effect on a final basis; to remand; or to disapprove such rates. Refunds with interest, as determined by FERC, are authorized if rates finally approved are lower than rates approved on an interim basis. However, if at any time FERC determines that the administrative cost of a refund would exceed the amount to be refunded, no refunds will be required. No significant refunds are anticipated in connection with rates approved on an interim basis through September 30, 1997.

(c) Operating Revenues

Operating revenues are recorded on the basis of power and services provided. Except for power projects using revolving funds, cash received is deposited directly with the U.S. Department of the Treasury (U.S. Treasury) and is reflected as "Funds Returned to U.S. Treasury" in the accompanying combined power system statements of assets, Federal investment, and liabilities. For power projects using revolving funds, cash received is deposited in the U.S. Treasury and remains available to the project for operation and maintenance expenses. Construction expenditures are primarily financed through Congressional appropriations. For revolving fund projects, cash collected in excess of expenditures is used for repayment of investment to the U.S. Treasury.

Power and transmission rates are established under requirements of the power projects' authorizing legislation and related Federal statutes and are intended to provide sufficient revenue to recover all costs allocated to power and, in some projects, a portion of irrigation-related costs (when such costs are beyond the ability of the irrigation users' ability to repay) (see note 7b). Costs allocated to power include repayment to the U.S. Treasury of its investment in power facilities and interest thereon. Rates are structured to provide for repayment of investment in power facilities, generally over 50 years, while operation and maintenance costs and interest on Federal investment are recovered annually. Replacements to Federal investment are generally to be repaid over their expected service lives.

The projects' enacting legislation does not recognize annual depreciation based on actual service lives as a measure of the required repayment for investment in utility plant. This results in some assets being fully depreciated before costs are recovered whereas annual depreciation costs on other assets continue after such costs have been recovered through revenues. Western matches these costs and revenues by deferring the unmatched portion of the revenues as accumulated net revenues. Because Western is a nonprofit Federal power marketing agency, accumulated net revenues are committed to repayment of the Federal investment.

Income transfers, net, represent the amount of funds collected but subsequently transferred to Reclamation. This revenue relates to the surplus generation marketed from the Navajo Generating Station by Western, on behalf of Reclamation's Central Arizona Project and the Central Arizona Water Conservation District.

(d) Cash

For purposes of reporting cash flows, cash consists principally of the unexpended balance of funds authorized by Congress, customer advances, and revolving fund revenues at the U.S. Treasury.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(e) Utility Plant

Utility plant is stated at original cost, net of contributions in aid of construction by entities outside of the combined power system. Costs include direct labor and materials; payments to contractors; indirect charges for engineering, supervision, and administrative and general expense; and interest during construction (IDC). The costs of additions, major replacements, and betterments are capitalized, with the exception of replacements at the Boulder Canyon Project (the BC Project), which are charged to operation and maintenance expense. Repairs are charged to operation and maintenance expense. The cost of utility plant retired, together with removal costs less salvage, is charged to accumulated depreciation at the time the plant retired is removed from service. Plant assets of the combined power system are currently depreciated using the straight-line method over estimated service lives ranging from 10 to 89 years.

(f) Interest on Federal Investment

Interest is accrued annually on the Federal investment based on Western's interpretation of Federal statute and project legislation. Such interest is reflected as an annual expense in the accompanying statements of revenues, expenses, and accumulated net revenues with a corresponding increase in the gross Federal investment. Western calculates interest on Federal investment based on the annual unpaid balance owed to the U.S. Treasury using rates set by law, administrative orders pursuant to law, or administrative policies. Interest rates range from 2.5 to 12.4 percent depending on the year in which construction on the transmission and generation facilities was initiated or on the authorizing legislation.

As allowed under Federal law, interest is not accrued on Federal investment in irrigation facilities anticipated to be repaid through power sales (see note 7b).

(g) Interest During Construction

The practice of capitalizing IDC is followed for all generating and transmission facilities with the exception of certain portions of Central Valley Power System's generating facilities, which are exempt from IDC. Western calculates IDC based on the average annual outstanding balance of construction work-in-progress. Western's policy is to capitalize IDC through the end of the fiscal year in which assets are placed in service. IDC is recovered over the repayment period of the related plant asset through increased revenues resulting from higher investment. Applicable interest rates ranged from 6.9 to 12.4 percent for the years ended September 30, 1997 and 1996, respectively.

(h) Pension and Other Retirement Benefits

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by employing entity. Under these statements, Western is required to record the costs to the Federal government of providing pension, life and health insurance, and other post-employment benefits (severance payment, counseling and training, workers' compensation benefits, etc.) "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust fund". SFFAS No. 4 and No. 5 are effective for the year ended September 30, 1997. The effects of these standards are discussed in notes 6 and 8c.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(i) Income Taxes

The facilities and income included in these combined power system financial statements are exempt from taxation.

(j) Use of Estimates

Management of the combined power system has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these combined power system financial statements in conformity with GAAP. Actual results could differ from those estimates.

(k) Reclassifications

Certain amounts in the prior year's combined power system financial statements have been reclassified to conform with the fiscal year 1997 presentation.

(l) Fair Value of Financial Instruments

The carrying value for certain short-term financial instruments approximates fair value. Such financial instruments include: cash, accounts receivable, and accounts payable. The carrying value of debt instruments, which include advances from certain customers of the BC Project and from the State of Wyoming (see note 6), approximates fair market value.

(2) Power Projects and Authorizing Legislation

Western's combined power system financial statements include the financial position, results of operations, and cash flows of 15 separate power projects. The following is a list of the Federal power projects and related authorizing legislation. The transmission and generating facilities are operated as individual integrated power projects with the financial results combined in these combined power system financial statements:

Boulder Canyon Power System
Boulder Canyon Project Act of 1928, as amended

Central Arizona Project
Colorado River Basin Project Act of 1968, as amended

Central Valley Power System
Act of August 26, 1937, as amended

Collbran Power System
Act of July 3, 1952

Colorado River Storage Power System
Colorado River Storage Project Act of 1956, as amended

Dolores Power System
Colorado River Basin Project Act of 1968, as amended

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

Falcon-Amistad Power System

Acts of June 18, 1954, and July 7, 1960

Fryingpan-Arkansas Power System

Act of August 16, 1962, as amended

Pacific Northwest-Pacific Southwest Intertie Project

Act of August 31, 1964

Parker-Davis Power System

Act of May 28, 1954

Pick-Sloan Missouri Basin Power System

Flood Control Act of 1944, as amended

Provo River Power System

Finding of Feasibility by the Secretary of the Interior, November 13, 1935

Rio Grande Power System

Act of February 25, 1905

Seedskadee Power System

Act of April 11, 1956

Washoe Power System

Act of August 1, 1956

(3) Other Assets

Other assets as of September 30, 1997 and 1996, consist of the following (in thousands):

	1997	1996
Moveable equipment, net	\$ 50,264	46,470
Stores inventory	20,902	20,627
Abandoned project costs	18,943	11,016
Miscellaneous deferred debits	14,897	11,870
Interchange energy	12,269	10,537
Workers' compensation (see note 6)	7,420	-
Prepayments and advances to others	2,943	2,637
Deposit funds available	1,955	2,214
Total	<u>\$ 129,593</u>	<u>105,371</u>

The abandoned project costs are associated with the Celio-Mead transmission line (see note 8b). In 1997, Western capitalized interest expense associated with these abandoned project costs for the period 1969 through 1996. The amount will be amortized over 23 years.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(4) Utility Plant

Major classes of utility plant and related accumulated depreciation as of September 30, 1997 and 1996, consist of the following (in thousands):

	1997			1996		
	Western	Generating agencies	Total	Western	Generating agencies	Total
Completed plant	\$ 2,359,552 *	2,816,587	5,176,139	2,217,708 *	2,834,917	5,052,625
Accumulated depreciation	(725,357)	(931,051)	(1,656,408)	(701,900)	(967,591)	(1,669,491)
	1,634,195	1,885,536	3,519,731	1,515,808	1,867,326	3,383,134
Construction work-in-progress:	108,702	66,183	174,885	217,419	83,812	301,231
Net utility plant	\$ 1,742,897	1,951,719	3,694,616	1,733,227	1,951,138	3,684,365

* Includes approximately \$28.6 million of intangible assets representing power rights as of September 30, 1997 and 1996.

(5) Federal Investment and Cost Allocation

(a) General

Federal investment consists of Congressional appropriations (net of nonreimbursable expenses), accumulated interest on unpaid Federal investment, and the net transfers of property and costs from other Federal agencies. All power projects (except Central Arizona, Dolores, Seedskaadee, Boulder Canyon, and the operations and maintenance and purchased power programs of the Colorado River Storage Project (CRSP)) are primarily financed through Congressional appropriations for operation and maintenance, construction and rehabilitation, and purchased power expenditures. A portion of construction and rehabilitation, and purchased power expenditures are financed through other mechanisms such as advances from nonfederal entities; reimbursements from other Federal Agencies; alternative methods such as net billing and bill crediting; or any combination thereof.

The Federal investment in the combined power systems' utility plant is to be repaid to the U.S. Treasury within 50 years from the time the facilities are placed in service. Replacements to Federal investments are generally to be repaid over their expected service lives. Operating expenses (excluding depreciation expense) and interest on the unpaid Federal investment should be paid annually. To the extent that funds are not available for payment, such unpaid annual net deficits become payable from the subsequent years' revenue prior to any repayment of Federal investment. Interest is accrued on cumulative annual net deficits until paid. Deficits for operating expenses, net of depreciation expense, begin to accrue interest in the year they occur. Interest expense deficits begin to accrue interest in the year following occurrence. As of September 30, 1997 and 1996, the cumulative unpaid annual operating expenses (excluding depreciation expense) and interest on Federal investment were approximately \$16 and \$81 million, respectively.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(b) Federal Investment in Multipurpose Facilities

The Federal investment in certain multipurpose facilities (primarily dams and appurtenant structures integral to the generation of power), required to be repaid from the sale of power, has been determined from preliminary cost allocation studies based on standards approved by Congress. Allocations between power and nonpower activities may be changed in future years; however, an allocation standard cannot be changed unless the change is also approved by Congress.

Final studies will be performed by Reclamation and the Corps, as appropriate, upon completion of each individual power project and are still pending for all but the Fryingpan-Arkansas Project (FryArk). The FryArk final study was completed by Reclamation in fiscal year 1993. The BC and Parker-Davis Projects are not subject to cost allocation studies since these projects' enacting legislation required the total costs of the dams and appurtenant structures to be repaid through power revenues.

As final cost allocation studies are still pending for many of the individual projects comprising the combined power system, potential exists for significant future adjustment in the Federal investment for the cost of multi-purpose facilities allocated to power, and the related accrued interest on unpaid investment. In 1997, Reclamation studied the implications of a cost reallocation of the Pick-Sloan Missouri Basin Program (P-SMBP) on existing water and power rates. Reclamation's study resulted in costs being reallocated to power. Reallocation of these costs to power range from \$0 to \$416 million depending on the assumptions of the cost methodologies used. Such a reallocation change could substantially affect power rates at the P-SMBP.

(c) Shasta Cold Water Releases

For the years ended September 30, 1997 and 1996, bypass releases at the Shasta Dam resulted in Western increasing its purchased power costs by \$1.9 and \$15.3 million, respectively. As part of the Energy and Water Development Appropriations Act of 1990, Congress included a provision stating that any increase in purchase power costs incurred by Western after January 1, 1986, resulting from bypass releases for temperature control purposes related to preservation of anadromous fisheries in the Sacramento River, shall not be the responsibility of power customers. Accordingly, such costs have been charged against Congressional appropriations in the accompanying combined power system statements of assets, Federal investment, and liabilities. Beginning October 1, 1997, all purchase power costs, incurred by Western for releases at Shasta Dam for temperature control, will be reimbursable.

(d) CRSP Interest Credit

All Western power projects take an annual interest credit for payments made to investment principal. Historically, the CRSP had not incorporated this practice. During 1997, CRSP Customer Service Center personnel along with Western's legal counsel reviewed the provisions of the CRSP Act of April 11, 1956 and determined that an interest credit was appropriate. Beginning in fiscal year 1997, the CRSP began to take an interest credit. Furthermore, CRSP will take an interest credit for the years 1964 through 1996 during the year ended September 30, 1998. Western estimates the interest credit for prior years to be approximately \$20 million.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(6) Other Liabilities

Other liabilities as of September 30, 1997 and 1996, consist of the following (in thousands):

	1997	1996
Customer advances	\$ 168,537	169,173
Miscellaneous deferred credits	19,071	8,301
Cooperative and reimbursable work	15,778	17,801
Workers' compensation	10,475	2,949
Accrued annual leave	9,528	10,024
Accrued payroll benefits	6,242	6,216
Interchange energy	4,663	4,965
Deposit funds	1,958	4,407
Total	<u>\$ 236,252</u>	<u>223,836</u>

Customer advances primarily consist of two components. The first component consists of the principal and interest payable to contractors/customers of the BC Project who provided financing for the cost of upgrading each of the generating units at Hoover Dam. The liability to such customers is being relieved through the issuance of credits on the subsequent sale of power. The obligation is scheduled to be relieved over a period through and including the year 2017, with interest at rates ranging between 5.5 and 8.2 percent. The second component consists of the principal payable to the State of Wyoming which provided partial financing for the cost of improvements at the Buffalo Bill Dam and associated powerplants. The liability to the State of Wyoming is scheduled to be relieved over a period of 35 years beginning in 1996, with an approximate interest rate of 11.1 percent.

Workers' compensation consists of two elements: actuarial liability associated with workers' compensation cases incurred for which additional claims may still be made in the future (future claims) and a liability for expenses associated with actual claims incurred and paid by the Department of Labor (DOL), the program administrator, to whom Western must reimburse. In conjunction with adopting SFFAS No. 4 and No. 5, the DOL determined the actuarial liability associated with future claims using historical benefit payment patterns and discounted to present value (37 years) utilizing economic assumptions for 10 year U.S. Treasury notes and bonds. Accordingly, Western included \$7.4 million as an other liability in the accompanying combined power system statements of assets, Federal investment and liabilities as of September 30, 1997 (comparative information is not available for fiscal year 1996 nor is it available for fiscal year 1997 for the generating agencies).

The recovery of these future claims will be deferred for purposes of the rate-making process until such time the future claims are actually submitted and paid by the DOL. Therefore, the recognition of the expense associated with this actuarially determined liability has been deferred as an other asset in the combined power system statements of assets, Federal investment, and liabilities in accordance with SFAS 71 (see note 3) to reflect the effects of the rate-making process. Western's cumulative unpaid expenses associated with actual claims incurred are \$3.1 and \$2.9 million as of September 30, 1997 and 1996, respectively.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(7) Commitments and Contingencies

(a) General

Western, Reclamation, the Corps, and IBWC are involved in various claims, suits, and complaints which are routine to the nature of their business. These federal government organizations are also fully self insured for claims pertaining to unemployment, long-term disability, and health and life insurance. Liabilities for these claims, as reported in the accompanying combined power system financial statements, are based on reported pending claims, estimates of claims incurred but not yet reported, actuarial reports, and historical analysis. The above entities are contingently liable with respect to claims beyond those actuarially projected. It is management's opinion that such claims will not have a material adverse effect to the combined power system financial statements.

The accompanying September 30, 1997, combined power system statement of assets, Federal investment, and liabilities includes investment in completed plant for the Hoover Dam visitor facilities. Presently, the total cost of the facilities, including IDC, is approximately \$124 million and contingent upon the settlement of the following claim.

The construction contractor for the Hoover Dam visitors center and parking structure submitted a \$32.3 million breach of contract claim to Reclamation on July 28, 1995. The Contracting Officer issued a final decision on the claim on September 21, 1995, stating that the claim, as submitted, was denied. Subsequently, the contractor filed a breach of contract lawsuit against Reclamation with the Court of Federal Claims on October 4, 1995. The matter is currently being litigated.

(b) Irrigation Assistance

Federal statute requires the use of the combined power system's net revenues to repay the U.S. Treasury a certain portion of Reclamation's project capital costs allocated to irrigation purposes determined by the Secretary of the Interior to be beyond the ability of the irrigation customers to repay. Although these costs may be paid through sales of power, such costs do not represent an operating cost of the combined power system. Such payments were \$2 and \$1 million for the years ended September 30, 1997 and 1996, respectively. The most current power repayment studies prepared by Western indicate that approximately \$3.6 billion of non-power Federal investment will be repaid from future power revenues.

(c) Financing of Boulder Canyon Project Improvements

In 1987, Reclamation initiated a project designed to increase (uprate) the generating capacity of the BC Project. Certain customers of the Project agreed to provide funding or the cost of the improvements, primarily through the issuance of long-term bonds. In some cases, proceeds from the issuance of the bonds exceeded the amounts required to fund the cost of the improvements.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(c) Financing of Boulder Canyon Project Improvements (continued)

For purposes of measuring the liability related to the Upgrading Program (the Program), Reclamation reports only the total amount of the advances received from customers in the accompanying combined power system statements of assets, Federal investment, and liabilities. Bond issuance costs are being included in the determination of annual interest expense to be recognized over the term of the debt repayment. The net proceeds from the issuance of the debt, in excess of the amount advanced to Reclamation, have similarly been excluded from the assets of the Project. Presently, interest expense on the liability is measured based on the total outstanding bonded indebtedness. Interest income from excess proceeds will reduce future interest costs subject to arbitrage regulations. Until all improvements are complete, and any remaining excess funds are applied against outstanding debt, the total interest cost of financing the Program will be subject to uncertainty.

(d) Colorado River Storage Project

In October 1992, Congress passed the Grand Canyon Protection Act of 1992 (the Act). The purpose of the Act was to "protect. . . and improve the values for which the Grand Canyon National Park and Glen Canyon National Recreation Area were established."

The Act relieves CRSP power customers of repayment obligations for capital costs equivalent to certain expenses of environmental impact studies, purchased power and other miscellaneous expenses related to the Glen Canyon Dam. However, in connection with this legislation, Congress included a provision that such costs could become the responsibility of the power customers if the overall provisions of the Act cause net offsetting receipts to decrease through fiscal year 1997. Beginning in fiscal year 1998, power customers will receive credit to outstanding capital obligations equal to their spending on the aforementioned environmental expenses.

The Secretary of the Interior in concert with Reclamation management is in the process of studying the provisions of the Act and are reconsidering previous interpretations applied to these costs by Western and Reclamation through 1997. Preliminary assessment has been made with final determination of these costs subject to uncertainty. As such, Western and Reclamation will continue to account for these costs under the current interpretation until the Secretary submits a report with the final determination to the appropriate House and Senate committees. Any future obligations related to the final allocation of these costs will be reflected in the period in which such obligations become evident.

For the years ended September 30, 1997 and 1996, Western and Reclamation incurred an estimated \$7.9 and \$12.8 million, respectively, in environmental costs which were deemed nonreimbursable. Accordingly, such costs have been charged against Congressional appropriations in the accompanying combined power system statements of assets, Federal investment, and liabilities.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(e) Power Contract Commitments

Western has entered into various long-term agreements for power and transmission purchases to meet its contractual obligations. For the years ended September 30, 1997 and 1996, purchased power expenses totaled \$149.0 and \$129.1 million; and purchased transmission service expenses totaled \$32.1 and \$29.9 million, respectively. Western's long-term commitments for power and transmission, subject to the availability of Federal funds and contingent upon annual appropriations from Congress, have various termination dates and are as follows (in thousands):

<u>Year Ending</u> <u>September 30:</u>	<u>Purchased Power</u>	<u>Purchased Transmission</u>	<u>Total</u>
1998	\$ 66,395	7,051	73,446
1999	53,292	7,051	60,343
2000	49,035	7,152	56,187
2001	44,730	7,290	52,020
2002	44,093	7,432	51,525
Thereafter	<u>355,956</u>	<u>36,457</u>	<u>392,413</u>
Total	\$ <u>613,501</u>	<u>72,433</u>	<u>685,934</u>

(f) Effect of FERC Order No. 888

FERC issued its final rule on open access transmission service, Order No. 888, on May 10, 1996, and followed with Order No. 888-A on March 14, 1997. Even though Western is not a public utility under Sections 205 and 206 of the Federal Power Act and is not specifically subject to the requirements of FERC Order Nos. 888 and 888-A, Western is a transmitting utility subject to Section 211 of the Federal Power Act as amended by the Energy Policy Act of 1992. In addition, the Secretary adopted a power marketing open access transmission service policy in October 1995 which stated that DOE supported the spirit and intent of open access transmission service and the Power Marketing Administrations would comply with the principles set forth in the final FERC rule to the extent consistent with applicable law.

Subsequent to Western publishing a Notice of Proposed Tariff in the Federal Register on September 26, 1997, a public comment forum was held on October 7, 1997, as part of a formal comment period lasting 31 days. After considering all comments received, Western will publish a final Tariff in the Federal Register on January 6, 1998, which will become effective February 5, 1998. The Tariff provides for transmission on the unused capacity of transmission facilities under the jurisdiction or control of each of Western's Regional Offices not required for the delivery of long-term firm capacity and energy to customers of the Federal government. Nothing in the Tariff shall alter, amend, or abridge the statutory or contractual obligations of Western to market and deliver Federal power resources and to repay the Federal investment in such projects. Each project has either filed long-term rates for transmission service under the Tariff or will operate under approved rates for sales of short-term transmission service until a new long-term rate adjustment process is completed.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(f) Effect of FERC Order No. 888 (continued)

Western expects no adverse affects from current initiatives to deregulate the electric utility industry. Western is participating in the development of Independent System Operators, Regional Transmission Groups, and other industry organizations to protect the interests of our customers and the Federal government. Western expects to continue selling firm power and energy to existing customers at cost based rates that repay each project. Western has no stranded costs at this time and does not expect to have any in the foreseeable future. The greatest risk, if any, from deregulation of the electric utility industry is the potential for Congress to pass new legislation impacting Western's marketing or rate-setting practices. However, with a Federal agency, this is an inherent risk that is always present.

(8) Other

(a) Washoe Project

The most recent Washoe Project Power Repayment Study indicates the project requires a rate of at least 52 mills per kWh to cover annual operating expenses (excluding depreciation expense) plus interest to repay the Federal investment in project facilities allocated to power. At this time, Western is selling the output of the Stampede powerplant at 14.88 mills per kWh.

Cumulative unpaid annual operating expenses plus interest and the net unpaid Federal investment in Washoe Project facilities total approximately \$3.8 and \$4.1 million and \$8.7 and \$8.9 million as of September 30, 1997 and 1996, respectively. Based on current conditions, it is unlikely the project will be able to generate sufficient revenues to repay the Federal investment.

(b) Celio-Mead Transmission Line

In 1993, Western's management of the Pacific Northwest-Pacific Southwest Intertie Project determined the Celio-Mead 750-kV DC line project should be abandoned. Accordingly, \$13.5 million in costs were charged against operations and maintenance (O&M) expense. In 1996, Western restored the asset through a credit to O&M expense and began amortizing these abandoned project costs. For the year ended September 30, 1996, actual O&M expense on the project amounted to \$3.1 million which includes approximately \$0.5 million in amortization expense.

WESTERN AREA POWER ADMINISTRATION

Notes to Combined Power System Financial Statements

(c) Pension and Other Retirement Benefits

Western, Reclamation, the Corps, and IBWC employees participate in one of the following contributory defined benefit plans: the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). Agency contributions are based on eligible employee compensation and total 7 percent for CSRS and up to 11.5 percent for FERS. These contributions are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Total Western contributions (generating agencies' contributions are not available for fiscal years 1997 and 1996) for the two plans amount to \$7.1 million for the years ended September 30, 1997 and 1996, respectively.

The contribution levels as legislatively mandated do not reflect the full cost requirements to fund the CSRS pension plan (approximately 24.2 percent). Other postretirement benefits administered and partially funded by the OPM are the Federal Employees Health and Benefits Program (FEHB) and the Federal Employee Group Life Insurance Program (FEGLI). FEHB is calculated at \$2,493 per employee, and FEGLI is based on .02 percent of base salary for each employee enrolled in these programs. In addition to the amounts contributed to the CSRS and FERS as stated above, Western recorded operation and maintenance expense and other income for the pension and other retirement benefits in the combined power system statements of revenues, expenses, and accumulated net revenues of \$6.7 million (comparative information is not available for fiscal year 1996 nor is it available for fiscal year 1997 for the generating agencies). This amount reflects the contribution made on behalf of Western by OPM to the trust funds.

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statements of Assets, Federal Investment, and Liabilities

September 30, 1997 and 1996

(In thousands)

	1997			1996		
	Western	Generating agencies ¹	Total	Western	Generating agencies ¹	Total
<u>Assets</u>						
Utility plant:						
Completed plant	\$ 2,359,552	2,816,587	5,176,139	2,217,708	2,834,917	5,052,625
Accumulated depreciation	(725,357)	(931,051)	(1,656,408)	(701,900)	(967,591)	(1,669,491)
	1,634,195	1,885,536	3,519,731	1,515,808	1,867,326	3,383,134
Construction work-in-progress	108,702	66,183	174,885	217,419	83,812	301,231
Net utility plant	1,742,897	1,951,719	3,694,616	1,733,227	1,951,138	3,684,365
Cash	228,598	56,409	285,007	257,028	55,550	312,578
Accounts receivable	156,930	374	157,304	115,893	401	116,294
Other assets	117,692	11,901	129,593	94,557	10,814	105,371
Total assets	<u>\$ 2,246,117</u>	<u>2,020,403</u>	<u>4,266,520</u>	<u>2,200,705</u>	<u>2,017,903</u>	<u>4,218,608</u>
<u>Federal Investments and Liabilities</u>						
Federal investment:						
Congressional appropriations	\$ 4,172,804	4,528,317	8,701,121	3,995,307	4,389,754	8,385,061
Interest on Federal investment	1,366,632	1,812,838	3,179,470	1,224,979	1,760,656	2,985,635
Transfer of property and services, net	2,457,859	(1,940,744)	517,115	2,377,949	(1,795,184)	582,765
Gross Federal investment	7,997,295	4,400,411	12,397,706	7,598,235	4,355,226	11,953,461
Funds returned to U.S. Treasury	(5,853,179)	(2,967,752)	(8,820,931)	(5,378,386)	(2,949,319)	(8,327,705)
Net outstanding Federal investment	2,144,116	1,432,659	3,576,775	2,219,849	1,405,907	3,625,756
Accumulated net revenues (deficit)	(12,641)	402,378	389,737	(119,822)	422,348	302,526
Total Federal investment	<u>2,131,475</u>	<u>1,835,037</u>	<u>3,966,512</u>	<u>2,100,027</u>	<u>1,828,255</u>	<u>3,928,282</u>
<u>Liabilities</u>						
Accounts payable	55,957	7,799	63,756	58,863	10,627	66,490
Other liabilities	58,685	177,567	236,252	44,815	179,021	223,836
Total liabilities	<u>114,642</u>	<u>185,366</u>	<u>300,008</u>	<u>100,678</u>	<u>189,648</u>	<u>290,326</u>
Total Federal investment and liabilities	<u>\$ 2,246,117</u>	<u>2,020,403</u>	<u>4,266,520</u>	<u>2,200,705</u>	<u>2,017,903</u>	<u>4,218,608</u>

¹ Generating agencies are the Bureau of Reclamation, U.S. Army Corps of Engineers, and International Boundary and Water Commission.

See independent auditors' report.

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statements of Revenues, Expenses, and Accumulated Net Revenues (Deficit)

Years ended September 30, 1997 and 1996

(In thousands)

	1997			1996		
	Western	Generating agencies ¹	Total	Western	Generating agencies ¹	Total
Operating revenues:						
Sales of electric power	\$ 723,696	-	723,696	655,177	-	655,177
Other operating income	143,535	14,347	157,882	135,919	8,667	144,586
Gross operating revenues	867,231	14,347	881,578	791,096	8,667	799,763
Income transfers, net	(247,682)	159,330	(88,352)	(229,609)	142,124	(87,485)
Total operating revenues	619,549	173,677	793,226	561,487	150,791	712,278
Operating expenses:						
Operation and maintenance	105,647	104,199	209,846	97,316	107,437	204,753
Administration and general	35,738	6,261	41,999	39,621	5,624	45,245
Purchased power	149,038	-	149,038	129,136	-	129,136
Purchased transmission services	32,127	-	32,127	29,929	-	29,929
Depreciation	55,523	39,166	94,689	53,964	41,473	95,437
Total operating expenses	378,073	149,626	527,699	349,966	154,534	504,500
Net operating revenues (deficit)	241,476	24,051	265,527	211,521	(3,743)	207,778
Interest on Federal investment:						
Interest on Federal investment	143,811	52,783	196,594	149,051	62,299	211,350
Allowance for funds used during construction	(9,516)	(8,762)	(18,278)	(14,325)	(3,352)	(17,677)
Net interest expense	134,295	44,021	178,316	134,726	58,947	193,673
Net revenues (deficit)	107,181	(19,970)	87,211	76,795	(62,690)	14,105
Accumulated net revenues (deficit):						
Balance, beginning of year	(119,822)	422,348	302,526	(196,617)	485,038	288,421
Balance, end of year	\$ (12,641)	402,378	389,737	(119,822)	422,348	302,526

¹ Generating agencies are the Bureau of Reclamation, U.S. Army Corps of Engineers, and International Boundary and Water Commission.

See independent auditors' report.

WESTERN AREA POWER ADMINISTRATION

Combining Power System
Statements of Assets, Federal Investment, and Liabilities, By Project

September 30, 1997

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Assets							
Utility plant:							
Completed plant	\$ 400,934	-	579,274	14,719	1,020,042	35,782	44,447
Accumulated depreciation	(77,485)	-	(223,676)	(4,423)	(311,099)	(1,853)	(12,932)
	323,449	-	355,598	10,296	708,943	33,929	31,515
Construction work-in-progress	-	-	34,727	147	35,322	31	-
Net utility plant	323,449	-	390,325	10,443	744,265	33,960	31,515
Cash	19,321	615	70,644	37	41,958	3,336	541
Accounts receivable	4,617	6,851	72,411	-	22,210	9	-
Other assets	3,338	142	12,439	486	13,529	2	1
Total assets	\$ 350,725	7,608	545,819	10,966	821,962	37,307	32,057
Federal Investment and Liabilities							
Federal investment:							
Congressional appropriations	\$ 626,794	74	2,221,655	28,645	643,738	30,190	60,048
Interest on Federal investment	229,270	66	382,974	11,256	702,397	11,414	39,204
Transfer of property and services, net	690	66	230,483	479	23,660	(3,598)	383
Gross Federal investment	856,754	206	2,835,112	40,380	1,369,795	38,006	99,635
Funds returned to U.S. Treasury	(662,827)	-	(2,449,077)	(32,104)	(817,299)	-	(66,378)
Net outstanding Federal investment	193,927	206	386,035	8,276	552,496	38,006	33,257
Accumulated net revenues (deficit)	7,318	7,178	111,680	2,621	255,066	(1,357)	(1,595)
Total Federal investment	201,245	7,384	497,715	10,897	807,562	36,649	31,662
Liabilities							
Accounts payable	1,606	68	41,107	1	2,446	630	290
Other liabilities	147,874	156	6,997	68	11,954	28	105
Total liabilities	149,480	224	48,104	69	14,400	658	395
Total Federal investment and liabilities	\$ 350,725	7,608	545,819	10,966	821,962	37,307	32,057

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
147,752 (27,665)	208,302 (38,483)	317,968 (130,544)	2,374,389 (820,308)	1,515 (678)	12,788 (3,120)	7,269 (2,370)	8,675 (1,295)	2,283 (477)	5,176,139 (1,656,408)
120,087	169,819	187,424	1,554,081	837	9,668	4,899	7,380	1,806	3,519,731
193	260	8,312	94,836	173	761	123	-	-	174,885
120,280	170,079	195,736	1,648,917	1,010	10,429	5,022	7,380	1,806	3,694,616
316	6,351	16,637	61,200	55	774	2,867	641	59,714	285,007
1,811	1,088	8,059	39,485	28	4	1	139	591	157,304
288	19,870	12,682	52,598	2	268	4	19	13,925	129,593
122,695	197,388	233,114	1,802,200	1,095	11,475	7,894	8,179	76,036	4,266,520
172,022	227,829	728,341	3,811,611	3,899	55,801	2,529	9,769	78,176	8,701,121
107,486	114,163	157,089	1,398,400	731	15,689	5,203	4,128	-	3,179,470
5,851	(4,873)	(1,502)	282,784	(1)	(301)	2,474	59	(19,539)	517,115
285,359	337,119	883,928	5,492,795	4,629	71,189	10,206	13,956	58,637	12,397,706
(140,674)	(91,120)	(715,279)	(3,760,781)	(4,157)	(74,549)	(1,638)	(920)	(4,128)	(8,820,931)
144,685	245,999	168,649	1,732,014	472	(3,360)	8,568	13,036	54,509	3,576,775
(22,429)	(51,406)	54,502	18,545	583	14,607	(704)	(4,894)	22	389,737
122,256	194,593	223,151	1,750,559	1,055	11,247	7,864	8,142	54,531	3,966,512
164	380	1,550	8,064	31	74	1	23	7,321	63,756
275	2,415	8,413	43,577	9	154	29	14	14,184	236,252
439	2,795	9,963	51,641	40	228	30	37	21,505	300,008
122,695	197,388	233,114	1,802,200	1,095	11,475	7,894	8,179	76,036	4,266,520

WESTERN AREA POWER ADMINISTRATION

Combining Power System
Statements of Assets, Federal Investment, and Liabilities, By Project

September 30, 1996

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Assets							
Utility Plant:							
Completed plant	\$ 472,246	-	558,277	14,102	1,010,920	36,072	44,447
Accumulated depreciation	(143,624)	-	(237,697)	(4,232)	(292,750)	(1,273)	(12,188)
	328,622	-	320,580	9,870	718,170	34,799	32,259
Construction work-in-progress	-	-	53,958	147	41,118	16	-
Net utility plant	328,622	-	374,538	10,017	759,288	34,815	32,259
Cash	26,346	360	64,034	74	40,578	2,397	407
Accounts receivable	3,703	7,600	52,837	-	12,330	6	268
Other assets	2,500	57	9,387	514	12,586	5	-
Total assets	\$ 361,171	8,017	500,796	10,605	824,782	37,223	32,934
Federal Investment and Liabilities							
Federal investment:							
Congressional appropriations	\$ 623,190	76	2,073,423	27,354	658,832	30,440	59,082
Interest on Federal investment	216,511	-	371,178	10,970	657,877	9,129	37,016
Transfer of property and services, net	683	36	272,654	448	22,958	(1,494)	475
Gross Federal investment	840,384	112	2,717,255	38,772	1,339,667	38,075	96,573
Funds returned to U.S. Treasury	(644,422)	-	(2,361,734)	(29,945)	(753,285)	-	(62,557)
Net outstanding Federal investment	195,962	112	355,521	8,827	586,382	38,075	34,016
Accumulated net revenues (deficit)	14,332	7,787	107,946	1,674	222,059	(886)	(1,349)
Total Federal investment	210,294	7,899	463,467	10,501	808,441	37,189	32,667
Liabilities							
Accounts payable	1,388	43	31,679	14	3,580	8	142
Other liabilities	149,489	75	5,650	90	12,761	26	125
Total liabilities	150,877	118	37,329	104	16,341	34	267
Total Federal investment and liabilities	\$ 361,171	8,017	500,796	10,605	824,782	37,223	32,934

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
147,609 (26,011)	99,629 (35,772)	298,065 (123,701)	2,338,890 (784,865)	1,515 (653)	12,479 (2,922)	7,269 (2,222)	8,822 (1,158)	2,283 (423)	5,052,625 (1,669,491)
121,598	63,857	174,364	1,554,025	862	9,557	5,047	7,664	1,860	3,383,134
192	100,428	18,668	85,150	173	1,266	115	-	-	301,231
121,790	164,285	193,032	1,639,175	1,035	10,823	5,162	7,664	1,860	3,684,365
676	8,201	14,694	58,481	39	527	773	86	94,905	312,578
1,193	598	4,386	31,997	47	-	-	122	1,207	116,294
65	11,206	14,147	42,280	-	205	-	15	12,404	105,371
123,724	184,290	226,259	1,771,933	1,121	11,555	5,935	7,887	110,376	4,218,608
165,914	224,743	704,240	3,632,289	3,697	54,270	2,120	9,625	115,766	8,385,061
103,153	93,962	144,561	1,315,992	721	15,689	4,658	4,218	-	2,985,635
2,205	(4,994)	(2,080)	307,659	81	(304)	1,571	(33)	(17,100)	582,765
271,272	313,711	846,721	5,255,940	4,499	69,655	8,349	13,810	98,666	11,953,461
(124,574)	(84,397)	(683,435)	(3,501,342)	(3,806)	(72,084)	(1,638)	(920)	(3,566)	(8,327,705)
146,698	229,314	163,286	1,754,598	693	(2,429)	6,711	12,890	95,100	3,625,756
(23,696)	(46,349)	50,805	(37,908)	396	13,652	(834)	(4,828)	(275)	302,526
123,002	182,965	214,091	1,716,690	1,089	11,223	5,877	8,062	94,825	3,928,282
420	486	1,237	13,477	22	100	6	39	13,849	66,490
302	839	10,931	41,766	10	232	52	(214)	1,702	223,836
722	1,325	12,168	55,243	32	332	58	(175)	15,551	290,326
123,724	184,290	226,259	1,771,933	1,121	11,555	5,935	7,887	110,376	4,218,608

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statements of Revenues, Expenses, and Accumulated Net Revenues (Deficit), By Project

Year ended September 30, 1997

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Operating revenues:							
Sales of electric power	\$ 44,438	66,694	177,603	2,159	138,142	2,866	3,552
Other operating income	7,589	22,905	19,965	26	11,524	1	1
Gross operating revenues	52,027	89,599	197,568	2,185	149,666	2,867	3,553
Income transfers, net	892	(88,630)	78	-	(10)	-	-
Total operating revenues	52,919	969	197,646	2,185	149,656	2,867	3,553
Operating expenses:							
Operation and maintenance	25,475	1,111	29,750	750	36,877	460	847
Administration and general	4,012	401	8,645	11	5,879	10	20
Purchased power	-	-	120,084	-	5,629	-	-
Purchased transmission services	-	-	14,922	-	7,685	-	-
Depreciation	9,263	-	10,978	191	18,766	583	744
Total operating expenses	38,750	1,512	184,379	952	74,836	1,053	1,611
Net operating revenues (deficit)	14,169	(543)	13,267	1,233	74,820	1,814	1,942
Interest on Federal investment:							
Interest on Federal investment	21,248	66	11,797	286	44,519	2,285	2,188
Allowance for funds used during construction	(65)	-	(2,264)	-	(2,706)	-	-
Net interest expense	21,183	66	9,533	286	41,813	2,285	2,188
Net revenues (deficit)	(7,014)	(609)	3,734	947	33,007	(471)	(246)
Accumulated net revenues (deficit):							
Balance, beginning of year	14,332	7,787	107,946	1,674	222,059	(886)	(1,349)
Balance, end of year	\$ 7,318	7,178	111,680	2,621	255,066	(1,357)	(1,595)

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
12,571	-	14,838	256,828	333	2,465	1,186	21	-	723,696
666	7,702	23,814	63,177	(3)	6	21	-	488	157,882
13,237	7,702	38,652	320,005	330	2,471	1,207	21	488	881,578
-	(277)	(215)	298	-	-	-	-	(488)	(88,352)
13,237	7,425	38,437	320,303	330	2,471	1,207	21	-	793,226
2,261	4,582	10,240	95,961	174	1,309	387	(41)	(297)	209,846
187	759	5,579	16,463	16	9	5	3	-	41,999
18	-	178	23,211	(82)	-	-	-	-	149,038
3,384	-	-	6,136	-	-	-	-	-	32,127
1,787	2,711	7,017	42,255	25	198	148	23	-	94,689
7,637	8,052	23,014	184,026	133	1,516	540	(15)	(297)	527,699
5,600	(627)	15,423	136,277	197	955	667	36	297	265,527
4,333	11,516	12,529	85,170	10	-	545	102	-	196,594
-	(7,086)	(803)	(5,346)	-	-	(8)	-	-	(18,278)
4,333	4,430	11,726	79,824	10	-	537	102	-	178,316
1,267	(5,057)	3,697	56,453	187	955	130	(66)	297	87,211
(23,696)	(46,349)	50,805	(37,908)	396	13,652	(834)	(4,828)	(275)	302,526
(22,429)	(51,406)	54,502	18,545	583	14,607	(704)	(4,894)	22	389,737

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statements of Revenues, Expenses, and Accumulated Net Revenues (Deficit), By Project

Year ended September 30, 1996

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Operating revenues:							
Sales of electric power	\$ 45,158	60,319	144,738	1,798	117,144	2,920	3,220
Other operating income	10,890	22,699	16,241	25	13,084	-	(284)
Gross operating revenues	56,048	83,018	160,979	1,823	130,228	2,920	2,936
Income transfers, net	-	(87,485)	60	-	75	-	-
Total operating revenues	56,048	(4,467)	161,039	1,823	130,303	2,920	2,936
Operating expenses:							
Operation and maintenance	27,939	863	32,394	839	35,865	414	806
Administration and general	4,551	455	8,486	24	7,677	12	113
Purchased power	3,662	-	112,019	-	676	-	-
Purchase transmission service	-	-	13,454	-	7,521	-	-
Depreciation	10,034	-	12,387	183	18,774	580	744
Total operating expenses	46,186	1,318	178,740	1,046	70,513	1,006	1,663
Net operating revenues (deficit)	9,862	(5,785)	(17,701)	777	59,790	1,914	1,273
Interest on Federal investment:							
Interest on Federal investment	22,180	-	11,120	365	46,110	2,300	2,186
Allowance for funds used during construction	106	-	(4,703)	-	3,298	(2)	-
Net interest expense	22,286	-	6,417	365	49,408	2,298	2,186
Net revenues (deficit)	(12,424)	(5,785)	(24,118)	412	10,382	(384)	(913)
Accumulated net revenues (deficit):							
Balance, beginning of year	26,756	13,572	132,064	1,262	211,677	(502)	(436)
Balance, end of year	\$ 14,332	7,787	107,946	1,674	222,059	(886)	(1,349)

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
13,758	-	11,197	250,559	279	2,728	1,172	187	-	655,177
568	6,741	18,942	55,129	6	2	45	-	498	144,586
14,326	6,741	30,139	305,688	285	2,730	1,217	187	498	799,763
-	-	100	263	-	-	-	-	(498)	(87,485)
14,326	6,741	30,239	305,951	285	2,730	1,217	187	-	712,278
2,720	(10,439)	16,713	98,540	185	1,348	381	115	(3,930)	204,753
272	780	4,981	17,830	29	21	14	-	-	45,245
409	-	277	12,011	82	-	-	-	-	129,136
2,710	-	-	6,244	-	-	-	-	-	29,929
2,633	1,695	5,158	42,796	26	196	147	84	-	95,437
8,744	(7,964)	27,129	177,421	322	1,565	542	199	(3,930)	504,500
5,582	14,705	3,110	128,530	(37)	1,165	675	(12)	3,930	207,778
3,746	16,729	12,734	93,051	19	-	808	360	(358)	211,350
815	(8,084)	(161)	(9,298)	-	-	-	-	352	(17,677)
4,561	8,645	12,573	83,753	19	-	808	360	(6)	193,673
1,021	6,060	(9,463)	44,777	(56)	1,165	(133)	(372)	3,936	14,105
(24,717)	(52,409)	60,268	(82,685)	452	12,487	(701)	(4,456)	(4,211)	288,421
(23,696)	(46,349)	50,805	(37,908)	396	13,652	(834)	(4,828)	(275)	302,526

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statement of Cash Flows, By Project

Year ended September 30, 1997

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Cash flows from operating activities:							
Net revenues (deficit)	\$ (7,014)	(609)	3,734	947	33,007	(471)	(246)
Adjustments to reconcile net revenues (deficit) to net cash provided by operating activities:							
Depreciation	9,263	-	10,978	191	18,766	583	744
Interest on Federal investment	12,694	66	9,533	286	41,813	2,285	2,188
(Increase) decrease in assets:							
Accounts receivable	(914)	749	(19,574)	-	(9,880)	(3)	268
Other assets	(838)	(85)	(3,052)	28	(943)	3	(1)
Increase (decrease) in liabilities:							
Accounts payable	218	25	9,428	(13)	(1,134)	622	148
Other liabilities	128	81	1,347	(22)	(807)	2	(20)
Net cash provided by operating activities	13,537	227	12,394	1,417	80,822	3,021	3,081
Cash flows used in investing activities - investment in utility plant	(4,024)	-	(18,694)	-	(2,068)	(48)	-
Cash flows from financing activities:							
Congressional appropriations	3,611	28	100,253	705	(13,360)	(2,034)	874
Funds returned to U.S. Treasury	(18,405)	-	(87,343)	(2,159)	(64,014)	-	(3,821)
Customer advances	-	-	-	-	-	-	-
Principal payments to upraters	(1,744)	-	-	-	-	-	-
Net cash provided by (used in) financing activities	(16,538)	28	12,910	(1,454)	(77,374)	(2,034)	(2,947)
Increase (decrease) in cash	(7,025)	255	6,610	(37)	1,380	939	134
Cash at beginning of year	26,346	360	64,034	74	40,578	2,397	407
Cash at end of year	\$ 19,321	615	70,644	37	41,958	3,336	541

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
1,267	(5,057)	3,697	56,453	187	955	130	(66)	297	87,211
1,787	2,711	7,017	42,255	25	198	148	23	-	94,689
4,333	4,430	11,726	79,824	10	-	537	102	-	169,827
(618)	(490)	(3,673)	(7,488)	19	(4)	(1)	(17)	616	(41,010)
(223)	21	1,465	(10,318)	(2)	(63)	(4)	(4)	(1,521)	(15,537)
(256)	(106)	313	(5,413)	9	(26)	(5)	(16)	(6,528)	(2,734)
(27)	1,576	(2,518)	1,811	(1)	(78)	(23)	228	12,482	14,159
6,263	3,085	18,027	157,124	247	982	782	250	5,346	306,605
(1)	(1,419)	(8,919)	(37,670)	-	(204)	-	147	-	(72,900)
9,478	3,207	24,679	142,704	120	1,934	1,312	158	(39,975)	233,694
(16,100)	(6,723)	(31,844)	(259,439)	(351)	(2,465)	-	-	(562)	(493,226)
-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	(1,744)
(6,622)	(3,516)	(7,165)	(116,735)	(231)	(531)	1,312	158	(40,537)	(261,276)
(360)	(1,850)	1,943	2,719	16	247	2,094	555	(35,191)	(27,571)
676	8,201	14,694	58,481	39	527	773	86	94,905	312,578
316	6,351	16,637	61,200	55	774	2,867	641	59,714	285,007

WESTERN AREA POWER ADMINISTRATION

Combining Power System Statement of Cash Flows, By Project

Year ended September 30, 1996

(In thousands)

	Boulder Canyon Power System	Central Arizona Project	Central Valley Power System	Collbran Power System	Colorado River Power System	Dolores Power System	Falcon- Amistad Power System (IBWC)
Cash flows from operating activities:							
Net revenues (deficit)	\$ (12,424)	(5,785)	(24,118)	412	10,382	(384)	(913)
Adjustments to reconcile net revenues (deficit) to net cash provided by operating activities:							
Depreciation	10,034	-	12,387	183	18,774	580	744
Interest on Federal investment	12,683	-	6,417	365	49,408	2,298	2,186
Write-on of recoverable asset	-	-	-	-	-	-	-
(Increase) decrease in assets:							
Accounts receivable	3,138	74	16,744	-	3,805	(6)	10
Other assets	(39)	56	759	40	2,989	26	-
Increase (decrease) in liabilities:							
Accounts payable	68	11	10,374	(38)	(1,440)	7	143
Other liabilities	(1,298)	2	(19,635)	48	1,857	26	124
Net cash provided by (used in) operating activities	12,162	(5,642)	2,928	1,010	85,775	2,547	2,294
Cash flows provided by (used in) investing activities - investment in utility plant	(1,754)	2	(34,546)	(188)	2,431	(7,724)	(10)
Cash flows from financing activities:							
Congressional appropriations	1,030	-	116,232	799	(22,770)	5,718	1,393
Funds returned to U.S. Treasury	(18,254)	-	(84,897)	(1,799)	(92,000)	-	(3,287)
Customer advances	400	-	-	-	-	-	-
Principal payments to upraters	(2,263)	-	-	-	-	-	-
Net cash provided by (used in) financing activities	(19,087)	-	31,335	(1,000)	(114,770)	5,718	(1,894)
Increase (decrease) in cash	(8,679)	(5,640)	(283)	(178)	(26,564)	541	390
Cash at beginning of year	35,025	6,000	64,317	252	67,142	1,856	17
Cash at end of year	\$ 26,346	360	64,034	74	40,578	2,397	407

See independent auditors' report.

Fryingpan- Arkansas Power System	Pacific Northwest- Pacific Southwest Intertie Project	Parker- Davis Power System	Pick-Sloan Missouri Basin Power System	Provo River Power System	Rio Grande Power System	Seeds- kadee Power System	Washoe Power System	Other	Combined Total
1,021	6,060	(9,463)	44,777	(56)	1,165	(133)	(372)	3,936	14,105
2,633	1,695	5,158	42,796	26	196	147	84	-	95,437
4,561	8,645	12,573	83,753	19	-	808	360	(6)	184,070
-	(13,052)	-	-	-	-	-	-	-	(13,052)
56	(12)	1,674	1,389	(14)	-	-	18	66	26,942
(29)	3,796	(2,352)	(3,816)	82	(15)	-	5	2,972	4,474
(130)	(439)	108	10,621	(7)	84	5	22	6,710	26,099
54	(605)	(830)	(12,432)	1	25	(2)	(284)	(1,409)	(34,358)
8,166	6,088	6,868	167,088	51	1,455	825	(167)	12,269	303,717
(137)	(10,254)	(9,311)	(38,544)	-	(396)	-	-	-	(100,431)
7,752	4,489	26,144	102,729	208	1,654	(1,715)	301	4,402	248,366
(15,867)	(6,690)	(29,660)	(222,661)	(298)	(2,728)	-	(223)	(502)	(478,866)
-	-	-	-	-	-	-	-	-	400
-	-	-	-	-	-	-	-	-	(2,263)
(8,115)	(2,201)	(3,516)	(119,932)	(90)	(1,074)	(1,715)	78	3,900	(232,363)
(86)	(6,367)	(5,959)	8,612	(39)	(15)	(890)	(89)	16,169	(29,077)
762	14,568	20,653	49,869	78	542	1,663	175	78,736	341,655
676	8,201	14,694	58,481	39	527	773	86	94,905	312,578

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Independent Auditors' Report on Internal Control Over Financial Reporting

The Administrator
Western Area Power Administration
U.S. Department of Energy:

We have audited the combined power system financial statements of Western Area Power Administration (Western) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 12, 1997.

We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended.

Management of Western, a unit of the U.S. Department of Energy (DOE); management of the Bureau of Reclamation (Reclamation), a unit of the U.S. Department of the Interior; management of the Army Corps of Engineers (Corps), a unit of the U.S. Department of Defense; and management of the International Boundary and Water Commission (IBWC), a unit of the U.S. Department of State collectively referred to as "Western" management, are responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that: transactions, including those relating to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the combined power system financial statements and any other laws and regulations that OMB, Western management, or the DOE have identified as being significant and for which compliance can be objectively measured and evaluated; funds, property, and other assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and properly recorded and accounted for to permit the preparation of reliable combined power system financial reports in accordance with generally accepted accounting principles and to maintain accountability over the assets; and, data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because of inherent limitations in internal controls, fraud may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the combined power system financial statements of Western for the year ended September 30, 1997, we considered the combined power system's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion of the combined power system financial statements and not to provide an opinion on internal control over financial reporting. Accordingly, we do not express such an opinion. With respect to internal controls, we obtained an understanding of the design of relevant policies and procedures, determined if they had been placed in operation, assessed control risk, and performed tests of internal controls.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measure control objective, we obtained an understanding of relevant internal control policies and procedures designed to permit the preparation of reliable and complete performance information, and we assessed control risk.

Western has responsibility for certain administrative and financial reporting activities of the combined power system. The generating agencies have certain administrative responsibilities. Accordingly, comments and recommendations contained in this report will be communicated to the other participants in the combined power system.

However, we noted certain matters involving internal controls and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal controls that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertion of management of the combined power system financial statements.

Those matters that we consider to be reportable conditions are summarized as follows:

1. Stores Inventory Balance Reconciliation

Subsidiary ledger information should reconcile with and agree to summary financial information. Western's inventory management system (IMS) is not presently integrated into their financial management system (FMS) (i.e., general ledger). Western periodically performs reconciliations to ensure that the recorded balances between the two systems are the same. Western has not, however, established a formal requirement for periodic reconciliation nor has a reconciliation been performed for any of Western's regions during fiscal year 1997. For example, Western's Rocky Mountain Region's IMS showed a stores inventory balance of \$2 million more than FMS at September 30, 1997. The difference was caused when the Rocky Mountain JJCR project and the Colorado River Storage Project (CRSP) Customer Service Center LLCR project stores inventory balances were combined into the Rocky Mountain Region's (RMR) IMS records without any action taken to remove the stores inventory balance of \$2 million from the CRSP Customer Service Center's IMS records. Western had not detected the error, because they had not performed a recent reconciliation of individual IMS balances to the FMS balances. The error did not affect the accuracy of the combined power system financial statements as the general ledger stores inventory balances were accurate.

Recommendation

Western should establish a requirement of at least quarterly reconciliations of IMS balances to FMS balances.

Management's Response

Concur. Action will be taken in fiscal year 1998 to correct the balance discrepancy found between the two systems. Western will perform quarterly reconciliation between the IMS and FMS. The implementation of the Business Information Decision Support System and MAXIMO (the new maintenance inventory software) in fiscal year 1999 is designed to integrate the inventory and general ledger data so that reconciliation is not necessary.

2. Communicating Interest During Construction Adjustments to Regional Rates Personnel

Western regulations require the charging of interest on federal investment (IOI) for all capitalized project costs. Because interest during construction (IDC) is added to an asset's value, any changes to IDC will change the capitalized value of a project. Such a change will generally require an adjustment for IOI and depreciation expense to prevent a misstatement in the combined power system financial statements. Throughout the year, Western's regional finance personnel review costs in plant-not-classified (account 106) before transferring amounts to plant-classified (account 101).

In 1997, this review process resulted in more than 30 changes to asset values on workorders for the CRSP Customer Service Center, requiring adjustments for IDC. Regional finance personnel did not communicate these adjustments to regional personnel in charge of rate making and determining IOI. Thus, corresponding IOI adjustments, when required, were not calculated by regional rates personnel.

In prior years, regional finance personnel with the aid of Western Corporate Service Office (CSO) cost accountants made both the IDC and related IOI adjustments at the time of review. At the request of the RMR and Upper Great Plains (UGRP) Regions' rates personnel, however, the regional finance and CSO personnel were asked to only make the IDC adjustment and allow the regional rates personnel to make the IOI adjustment. In honoring the regional request, the regional finance and CSO personnel discontinued making the IOI adjustment. Regional finance and CSO personnel have not, however, established a formal procedure to communicate IDC adjustments on workorders to the regional rates personnel. As a result, Western's combined power system financial statements could misstate the IOI and the power rate studies may not fully recover interest due the U.S. Treasury.

Recommendation

Western should establish formal procedures to ensure that communication occurs between regional finance, CSO, and regional rates personnel when IDC adjustments are made to ensure the proper recording of IOI.

Management Response

Concur. Western will establish procedures during fiscal year 1998 to ensure that communication occurs between regional finance, CSO, and regional rates personnel.

3. Separation of Duties for Power Billing

Western enters into contracts to sell power to customers and should bill the customers based on usage and contracted rates. Bills for the sale of power are currently reviewed by the Power Billing Technical Lead, who also helps prepare the bills. Power billing personnel review bills they individually prepare for reasonableness, considering current and historical load factors and the relationship between capacity and total energy usage. However, the RMR does not have any procedural controls in place to ensure that all sold power is actually billed to customers. As a result, the RMR does not have a system to prevent or detect power billing errors.

Recommendation

Western should require the RMR to evaluate the need to implement procedural controls to ensure that all sold power is actually billed to customers.

Management's Response

Concur. The technical lead in the RMR power billing staff will be responsible for the accurate completion of the correct number of monthly bills. This process will include copies of all monthly power bills, along with a cover sheet, being reviewed by the technical lead and being reviewed and initialed by the first-line supervisor. Implementation of the above process will commence with the January 1998 power billing cycle.

Status of Prior Years Findings

Western Area Power Administration U. S. Department of Energy

The purpose of this section is to provide a status report of those comments reported in the prior year, for which management has considered, but are still pending resolution or require further attention.

1. Power Billing Contracts

In the report on internal control over financial reporting for fiscal year 1993, we reported that the Desert Southwest Region (DSR) frequently had to adjust power bills because (i) power was delivered to customers with expired contracts and subsequent contract renewals provided for different rates or (ii) renewal contracts were not received in the billing department in a timely manner. Western agreed to establish procedures that provide adequate lead-time for negotiating contract renewals before existing contracts for selling electrical power expire. Management also agreed to establish procedures to provide timely contractual information to the billing department.

The DSR is working to develop a system for tracking contract expiration dates to provide adequate lead-time for negotiating contracts. The system is currently in the late development stage with targeted completion and testing in late 1998.

Recommendation

Western should continue to monitor the development and implementation of the tracking system to ensure timely completion of the corrective plan.

Management's Response

Concur. Western is continuing to monitor the development and implementation of tracking systems to ensure that billing is being performed in accordance with the terms and conditions of the contract. Western has purchased a Data Imaging system which, when fully implemented, will serve as a valuable tool for the appropriate offices to ensure that proper billing is performed based on the latest contract revision. Western anticipates the system will be on-line in May 1998 and fully operational by December 31, 1998. A complete internal review will be conducted on all power bills to ensure that billing is being performed in accordance with the appropriate power marketing contracts. Completion date is anticipated to be December 31, 1998.

2. Modification of Power Billing Master File Data

In 1995, we reported that a computerized system should not permit user access whereby changes can be made to the system without an edit log showing supervisory approval of changes. Power billing personnel in the Watertown Operations office have access to and can make changes to data on customer contract master files as well as to previously issued power bills. The system does not, however, provide supervisors with a documented edit log of changes for supervisory review. Presently, all users follow an honor system to notify the power billing manager of any changes. In 1995, the UGPR agreed to explore developing an automated edit log and status report for the master files. The edit log would record all modifications to the master file, along with the log-in name performing the modifications, and would be periodically reviewed by the billing department work leader. As of September 30, 1997, the UGPR has not developed an automated edit log. In addition, segregation of duties still does not exist because the team leader responsible for reviewing changes to the master file is also responsible for making many of the changes.

Recommendation

Western should require the UGPR to implement controls that require independent review and documented approval of all changes made to the power billing system.

Management's Response

Concur. With the 1995 finding, manual procedures were implemented that include independent review by supervisory personnel of the master file changes, contract specialist review of bills for contract compliance, and the biennial rotation of billing specialists, all to ensure proper authorization and accuracy of bills. An automated audit log system will be implemented during fiscal year 1998 to provide a greater degree of internal control which should resolve this problem.

* * * * *

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control elements does not reduce to a relatively low level the risk that fraud in amounts that would be material in relation to the combined power system financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal controls would not necessarily disclose all internal control matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the combined power system financial statements of Western for the year ended September 30, 1997.

We also noted other matters involving internal controls and their operation that we have reported to Western's management in a separate letter dated December 12, 1997.

This report is intended for the information of the management of Western, Reclamation, the Corps, and IBWC. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 12, 1997

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Independent Auditors' Report on Compliance with Laws and Regulations

The Administrator
Western Area Power Administration
U. S. Department of Energy:

We have audited the combined power system financial statements of Western Area Power Administration (Western) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 12, 1997.

We conducted our audit in accordance with generally accepted auditing standards (GAAP); the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended.

Compliance with laws and regulations applicable to the individual combined power system financial statements is the responsibility of Western, a unit of the U.S. Department of Energy (DOE); of the Bureau of Reclamation (Reclamation), a unit of the U.S. Department of the Interior; of the Army Corps of Engineers (Corps), a unit of the U.S. Department of Defense; and of the International Boundary and Water Commission (IBWC), a unit of the U.S. Department of State, collectively referred to as "Western" management. As part of obtaining reasonable assurance about whether the combined power system financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the combined power system financial statement amounts, and certain other laws and regulations designated by OMB and DOE, including:

- Boulder Canyon Project Act of 1928, as amended
- Act of August 26, 1937, as amended (Central Valley Power System)
- Act of July 3, 1952 (Collbran Power System)
- Colorado River Storage Project Act of 1956, as amended
- Act of August 16, 1962, as amended (Fryingpan-Arkansas Power System)
- Act of August 31, 1964 (Pacific Northwest-Pacific Southwest Intertie Project)
- Act of May 28, 1954 (Parker-Davis Power System)
- Flood Control Act of 1944, as amended - Authorized the construction of certain public works on rivers and harbors for flood control, and for other purposes (Pick-Sloan Missouri Basin Power System)
- Reclamation Project Act of 1939
- Finding of Feasibility by the Secretary of the Interior, November 13, 1935 (Provo River Power System)
- Act of February 25, 1905 (Rio Grande Power System)
- DOE Order RA 6120.2, Power Marketing Administration Financial Reporting

- 10 CFR 903 - Power and Transmission Rates
- 10 CFR 904 - General Regulations for the Charges for the Sale of Power from the Boulder Canyon Project
- Federal Managers' Financial Integrity Act of 1982 (FMFIA)
- Chief Financial Officers (CFO) Act of 1990
- 18 CFR Part 300
- DOE Delegation Order 02304-108
- Budget and Accounting Procedures Act
- Corps Engineering Regulation 37-2-10
- Anti-deficiency Act
- Grand Canyon Protection Act of 1992
- Federal Financial Management Improvement Act of 1996 (FFMIA)
- Energy and Water Development Act of 1990
- OMB Bulletin No. 93-06, as amended

However, providing an opinion on compliance with those provisions was not an objective of our audit. Accordingly, we do not express such an opinion.

As part of our audit, we obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by the FMFIA and compared Western's most recent FMFIA reports with the evaluation we conducted of the combined power system's internal controls over financial reporting.

The results of our tests disclosed the following instances of noncompliance that are required to be reported under *Government Auditing Standards*. We also noted certain immaterial instances of noncompliance that we have reported to Western's management in a separate letter dated December 12, 1997.

**Western Area Power Administration
U. S. Department of Energy**

1. Grand Canyon Protection Act - Nonreimbursable Expenses

In October 1992, Congress passed the Grand Canyon Protection Act (the Act) of 1992 (H.R. 429-70, Title XVIII-Grand Canyon Protection). The Act's purpose is to "protect, mitigate adverse impacts to, and improve the values for which Grand Canyon National Park and Glen Canyon National Recreation Area were established, including but not limited to natural and cultural resources and visitor use." Section 1804 directs Western to calculate the portion of qualifying nonreimbursable expenses related to the Act annually. Nonreimbursable expenses are costs incurred for purchasing power and other miscellaneous expenses that would not have been incurred had the flow of water from Glen Canyon dam not been restricted.

Western did not calculate qualifying nonreimbursable expenses for fiscal years 1996 and 1997. Actual nonreimbursable expenses in fiscal year 1995 were \$3.9 million. The individual who performed the calculations in 1995 left the agency and Western has not re-assigned the responsibility for making the calculations. In addition to not complying with Section 1804 of the Act, Western has overstated purchased power costs and operation and maintenance expenses in the fiscal year 1996 and 1997 income statement and related power repayment study (PRS).

Recommendation

Western should comply with the requirements of Section 1804 of the Act of 1992 and calculate nonreimbursable expenses annually. Western should also calculate the actual nonreimbursable expenses for fiscal years ended 1996 and 1997 and record the appropriate adjustments in their accounting records.

Management's Response

Concur. Western will complete the calculations for nonreimbursable expenses in fiscal year 1998.

2. Gross Federal Investment Balance

DOE Order RA 6120.2 states that the PRS will include all investment costs allocated to power for existing power systems (gross investment). Western's combined power system financial statement power investment cost consists of allocated Reclamation power plant balances obtained from the Statement of Project Construction Cost and Repayment Schedule (SPCCRS), including interest during construction; added to Western's adjusted plant balances (account 101 and 106), plus Western's retirements (account 180); and the Corps' and the IBWC's plant balances.

The PRS gross investment balance for all Colorado River Storage Project (CRSP) Customer Service Center projects is \$4.7 million less than the final general ledger balance for all CRSP Customer Service projects. CRSP Customer Service employees responsible for preparing the PRS use Reclamation's Schedule 1 for plant additions rather than the SPCCRS. CRSP Customer Service employees could not explain why the amounts were less because Reclamation prepares the SPCCRS from the same Schedule 1.

The PRS balance is used to calculate interest on investment (IOI) and to establish customer power rates to recover the federal investment. Understating the PRS's gross investment balance results in understating interest expense in the combined power system financial statements. In addition, CRSP Customer Service project power rates may not recover all costs associated with the gross federal investment.

Recommendation

Western should require CRSP Customer Service Center projects to reconcile the gross investment difference and adjust the PRS to the balance recorded in the general ledger. In addition, Western should calculate and record the necessary IOI adjustment due to the understatement of the gross Federal investment balance in the PRS.

Management's Response

Concur. The cumulative difference and associated IOI will be reviewed and appropriate adjustments made by September 1998.

Status of Prior Year Findings

The purpose of this section is to provide a status report of those comments reported in the prior year, for which management has considered, but are still pending resolution or require further attention:

Western Area Power Administration U. S. Department of Energy

1. Interest on Other Capitalized Costs

In the prior year, we reported that the Reclamation Project Act of 1939 (1939 Act), Subsection (c) of Section 9, requires recovery of operations and maintenance cost, including interest on an appropriate share of the construction investment. The 1939 Act also provides for recovery of other fixed charges as the Secretary deems proper through power revenues. Concerning recovery of costs from power customers Western's Accounting Handbook, Chapter III, Section (7) states that the federal investment consists of Congressionally appropriated funds invested by Western, including interest charges on those funds, not yet repaid to the government. Invested funds not repaid to the government primarily represents unpaid plant balances. These also include any capitalized costs for which Western defers the recognition of expense to a future period.

We reported that Western excludes capitalized costs not specifically identified as plant from the balance of unpaid federal investment in its power rate setting process. Western also does not accrue interest on such capitalized costs. The capitalized costs not classified as plant consist of (1) unamortized abandoned project costs; (2) average balance of stores inventory costs, and (3) feasibility, engineering, and development costs. During fiscal year 1997, Western began to accrue interest on unamortized abandoned project costs and on the average balance of stores inventory costs. Western, however, has not begun to accrue interest on feasibility, engineering, and development costs. Thus, in our opinion, Western has understated interest owed to the U.S. Treasury and has prevented the recovery of such interest from power customers.

Western does not accrue interest on certain intangible construction work-in-progress (CWIP) costs, consisting of feasibility, engineering, or development costs, until actual construction begins. In some cases, Western did not recognize interest for periods exceeding ten years. To illustrate, Western had about \$7 million for CRSP Customer Service Center projects suspended in CWIP not subject to interest in the prior year estimated at \$750,000 annually. As a result, the U.S. Treasury is financing Western's intangible costs.

Management's interpretation of the 1939 Act, which is influenced by Western's stated objective to minimize costs to its customers, limits the definition of Federal investment subject to interest accrual. This interpretation fails to recognize other deferred costs capitalized on the balance sheet. Exclusion of these costs, understates interest on the federal government's investment.

In the prior year, Western agreed to research the issue and determine requirements for complying with Federal regulations to repay all interest due the U.S. Treasury.

Recommendation

We recommend Western accrue interest on feasibility, engineering, and development costs and include such costs in the power rate setting process until they are either capitalized as utility plant or expensed as maintenance cost.

Management's Response

Concur. Western will research this issue in fiscal year 1998 and determine requirements for complying with Federal regulations.

2. Suspension of Interest During Construction (IDC)

In the 1996 internal control report, we reported that Western's CRSP Customer Service Center had inactive CWIP work orders in a pending status totaling \$7 million as of September 30, 1996, which were not accumulating either IDC or IOI. Western had held some of the \$7 million in an inactive status for two or more years. As a result, Western understated CWIP and Accumulated IDC or IOI and completed plant, depending on when the assets were placed in service. Western also understated the balance of federal investment in the PRS.

Management agreed to evaluate the practice of placing work orders in an inactive status without transferring the costs to completed plant. In addition, management agreed to establish procedures for reviewing all inactive CWIP work orders Western-wide to ensure that either IDC or IOI is properly calculated and recorded in the accounting records and properly reflected in the PRS.

During 1997, Western reviewed inactive workorders that were in a pending status at the CRSP Customer Service Center. For many workorders, Western wrote off the physical costs incurred to operation and maintenance expense and reversed all IDC accumulated to date (i.e., credit CWIP and debit accumulated IDC) as the construction project associated with the workorder was canceled. Thus, Western did not calculate interest expense (i.e., cost of funds), as required, from the point the workorder was placed in a pending status, but also reversed all interest capitalized to date on inactive workorders. Capitalized interest costs were reversed as management believed IDC should never have been accumulated due to a miscoding of physical costs into wrong CWIP tasks.

In addition, during fiscal year 1996 the CRSP Customer Service Center placed in operational service assets associated with workorder FGE-0005-C totaling \$7 million. Western's accounting records reflect workorder FGE-0005-C in an inactive pending status within CWIP at September 30, 1997. As a result, neither IDC or IOI was calculated on the workorder in fiscal year 1997.

Recommendation

Western should evaluate the practice of placing work orders in an inactive pending status without transferring the costs to completed plant. Western should also establish and implement procedures for reviewing all inactive CWIP work orders Western-wide to ensure that either IDC or IOI is properly calculated and recorded in the accounting records and properly reflected in the PRS. Finally, Western should review all workorders written off in 1997 and calculate interest due the U.S. Treasury.

Management's Response

Concur. This finding is directly related to the finding above, Interest on Other Capitalized Costs. Western will review different methodologies for the treatment of inactive CWIP workorders and associated IDC and IOI. Based on the review, the appropriate methodology will be selected and applied to the aforementioned workorders. We anticipate this will be completed by September 30, 1998.

* * * * *

We considered these instances of noncompliance in forming our opinion on whether the combined power system financial statements are presented fairly, in all material respects, in conformity with GAAP, and this report does not affect our report dated December 12, 1997, on those combined power system financial statements.

Western has received a waiver from OMB with respect to the financial statement provisions of OMB Bulletin 94-01, *Form and Content of Agency Financial Statements*, however, Western is required to comply with the overview and performance measures requirements of the OMB Bulletin.

This report is intended for the information of the management of Western, Reclamation, the Corps, and IBWC. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 12, 1997

KPMG Peat Marwick LLP

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The Administrator
Western Area Power Administration
U.S. Department of Energy:

We have audited the combined power system financial statements of Western Area Power Administration (Western) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 12, 1997. In planning and performing our audit of the combined power system financial statements of Western, we considered internal control over financial reporting in order to determine our audit procedures for the purpose of expressing our opinion on the combined power system financial statements and not to provide assurance on internal control over financial reporting. We have not considered internal control over financial reporting since the date of our report.

During our audit, we noted certain matters involving internal control over financial reporting and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control over financial reporting or result in other operating efficiencies.

Western Area Power Administration U. S. Department of Energy (DOE)

1. Net Unpaid Investment

Western's Accounting Handbook states, "annual reports and other reports or publications that are released to the public shall contain reconciled financial statement and repayment data as reflected in the most recent crosswalk." Western's "crosswalk" is a process used to ensure that revenues/expenses recorded in the statement of revenues, expenses, and accumulated net revenues are also recorded in the power repayment study (PRS). The crosswalk does not, however, reconcile net unpaid federal investment as recorded in the combined power system statement of assets, Federal investment, and liabilities with that recorded in the PRS or the status of repayment table. The difference should relate to the time when Western must recognize amounts owed under generally accepted accounting principles (GAAP) on the statement of assets, Federal investment, and liabilities versus owed for recovery purposes on the PRS. The timing differences may be reflected as an investment in construction work-in-progress (CWIP) or in a current asset or liability account such as cash, accounts receivable, inventory, other assets, and accounts payable.

The lack of a reconciliation of net unpaid investment in the crosswalk could result in the reporting of inaccurate data in one or both of the published reports. Publishing the reconciling data could also reduce the possibility of users misinterpreting which amount is correct. For example, the 1996 net unpaid federal investment on the financial statements of the Colorado River Storage Project (CRSP) was \$586.4 million while the status of repayment table showed unpaid Federal investment of \$502.9 million or a difference of \$83.5 million.

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Western Area Power Administration,
U.S. Department of Energy
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Recommendation

Western should establish a procedure that requires reconciling the net unpaid federal investment in the financial statements with the net unpaid federal investment in the PRS to ensure the accuracy of reported data. Western's published reports should display a user friendly reconciliation of combined power system financial statement amounts to repayment data to prevent the misuse or misinterpretation of the reported data.

Management's Response

Concur. Western's compliance and audit liaison workgroup has a procedure in place to reconcile net repaid Federal investment in the combined power system financial statements with the net repaid Federal investment in the PRS. This procedure is performed on a project-by-project and consolidated basis. Net repaid Federal investment is then subtracted from total investment to determine net unpaid Federal investment. However, a specific procedure to determine the detail that comprises unpaid Federal investment has not been developed. We agree that such a procedure should be developed. Also, we will query the crosswalk participants to determine if the presentation can be simplified for better user understanding. These actions will be accomplished in fiscal year 1998.

2. Accounting Handbook Updates

Western Order 2200.1 establishes the Accounting Handbook that contains accounting policies and procedures for performing financial and accounting functions in accordance with Government regulations and GAAP. The provisions in the Accounting Handbook apply to budget, financial management, and rate setting activities at all Western offices. The Order states that the Accounting Handbook should include updates when changes in accounting policies or procedures occur, or as necessary to meet Western's specific needs. Whenever a change in policy or procedure occurs, the administrative assistant was assigned responsibility for issuing changes.

Western has not issued any changes or updates to the Accounting Handbook since March 1990, although Western has implemented numerous accounting policy and procedure changes since that time. The administrative assistant position no longer exists because of organizational changes at Western and management has not reassigned the responsibility for keeping the Accounting Handbook current. As a result, the accounting policies and procedures, and sometimes the lack thereof, are outdated and create the risk of inconsistency with accounting policies and procedures among Western's projects. In addition, outdated Accounting Handbook policies and procedures may lead to inconsistencies with rate setting policies and procedures.

Recommendation

Western should take immediate action to assign responsibility for updating and maintaining the Accounting Handbook current as required by Western Order 2200.1.

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Management's Response

Concur. The responsibility for updating the Accounting Handbook has been assigned to the Corporate Services Office Cost Accounting workgroup. Western will be updating the policies and procedures in the Accounting Handbook during the implementation of the new Oracle Financial System. The update should be complete by March 1999.

3. Multi-Project Cost Allocation Percentages

Resolution 96-2 of the Engineering and Operating Committee (E&OC), comprising a group of customers at the Boulder Canyon Project (BC) and various personnel at Western and the Bureau of Reclamation (Reclamation), requires Western, on an annual basis, to document their (a) analysis for determining the costs and benefits of multi-project costs (MPC) (b) calculations of the costs and benefits of the integrated operations of the Phoenix (Parker-Davis Project (PD)) and Mead (Pacific Northwest Pacific Southwest Intertie Project (IP)) Service Center and the computer system referred to as the Supervisory Control and Data Acquisition (SCADA) System, and (c) method of allocating such benefits and costs.

MPC are costs paid through the appropriations process by one project, but provide benefits to other projects. Consistent with the prior year, Western has determined that the allocation of these MPC will be done by (a) charging the applicable project a percentage based on the direct labor hours charged to each project for the PD and IP Service Centers, and (b) charging the applicable project a percentage based on each project's portion of total distribution of data points relating to the SCADA System at PD. The following Western projects receive allocated portions of MPC: BC, PD, IP, Central Arizona (CA), CRSP, Salinity (SP), and the Colorado River Front Work and Levee System (CRFW&LS).

During fiscal year 1997, Western, has not made the necessary recalculation of the cost and benefit percentages to be allocated to the applicable projects. As such, Western allocated MPC based on the applicable percentages and schedules from fiscal year 1996. Western personnel used prior year allocations as the count for the SCADA data points was not complete until September 1997. Thus, Western personnel were not able to calculate the fiscal year 1997 allocation percentages.

Western's use of fiscal year 1996 MPC allocation percentages causes an overstatement of the allocation expense in BC, IP, CA, CRSP, SP, and CRFW&LS and an overstatement of revenues in PD by approximately \$5,000 to \$15,000 for each project.

Recommendation

Western should complete percentage allocations and supporting schedule revisions for the MPC for fiscal year 1997. Once this process is complete, Western should make the necessary accounting adjustments for each project to properly reflect updates to supporting schedules during fiscal year 1998. In addition, Western should implement procedures to ensure that the proper updates are made to the MPC allocations annually and in a timely manner.

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Management's Response

Concur. Western will complete the MPC percentage allocations and supporting schedule revisions for fiscal year 1997 and make the necessary accounting adjustments for each project during fiscal year 1998. Western will also develop procedures to assure that updates are made to the MPC allocations annually and timely. This task will be completed by March 31, 1998.

4. CWIP Included in Multi-Project Allocations

MPC should include only those costs that are a function of the rate base. Customarily, Western includes in the rate base the following costs: operation and maintenance expense, administrative and general expense, interest on federal investment, and a portion of the federal investment (i.e. completed plant). Historically, the costs that Western includes as CWIP and the interest capitalized associated with CWIP have been excluded as a component of the rate base until substantially complete and moved into completed plant. Once CWIP is complete and moved into completed plant, the interest expense and a portion of the asset are recognized in PRS. The following projects receive allocation portions of MPC from the PD: BC, IP, CA, CRSP, SP, and the CRFW&LS.

In fiscal year 1997, PD followed guidelines and procedures in Resolution 96-2 as approved by the E&OC. This resolution sets forth the criteria to include CWIP balances as part of the MPC to be allocated to the other projects. As the PD followed Resolution 96-2, CWIP balances were included as part of the MPC allocations. This treatment of including CWIP costs into the rate base of the MPC, is contradictory to the customary process for which Western's costs are recognized into the PRS. As such, Western should amend Resolution 96-2 to exclude CWIP balances from the MPC calculation until after the asset is transferred to completed plant.

When Resolution 96-2 was prepared by Western personnel, they were not aware that the CWIP balances should not be part of the MPC allocation base. PD's inclusion of CWIP balances in the MPC allocation base caused the following overstatements of allocated expenses: BC (≈\$21,000), IP (≈\$16,000), CRSP (≈\$12,000), CA (≈\$9,000), SP (≈\$1,000), and CRFW&LS (≈\$1,000) and an overstatement of revenues in PD of approximately ≈\$60,000.

Recommendation

Western should amend Resolution 96-2, as well as make the necessary supporting schedule revisions for the MPC for fiscal year 1997, in order to exclude CWIP from the allocation base. Once this process is complete, Western should make the necessary accounting adjustments for each project to properly reflect updates to supporting schedules during fiscal year 1998. In addition, Western should implement procedures to ensure that future MPC supporting schedules do not include CWIP balances as part of the MPC allocation base.

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Management Response

Concur. Western will amend Resolution 96-2, revise the MPC supporting schedules to exclude CWIP balances from the allocation base for fiscal years 1996 and 1997, and make the necessary accounting adjustments for each project during fiscal year 1998. This task will be completed by September 30, 1998.

5. Useful Lives Used to Calculate Depreciation

GAAP requires asset costs to be expensed over the estimated useful life of the asset. Western uses the estimated useful life set forth in its Replacements Manual. Western calculates depreciation expense on groups of plant assets containing multiple useful lives, using an average of the estimated lives within the group. Western chose the average method for ease of calculation. However, there is no correlation between the value of individual assets in a group and their estimated useful lives. Weighting the average lives with individual asset values would provide a better estimate of depreciation expense. Western is presently installing a new computerized financial system. The design could include computerizing the weighting calculations. The modification could reduce the possibility of overstating or understating depreciation expense in any given year.

Recommendation

Western should consider incorporating a design modification that will calculate depreciation expense for plant assets using a weighted-average method.

Management's Response

Concur. Western's new Oracle based Business Information Decision Support System (BIDSS) will be depreciating property on a unit level eliminating the need to utilize the weighted-average method. This will be complete upon implementation of BIDSS in October 1998.

6. Inconsistencies Between PRS Summary and Detail Information

The PRS facilitates the tracking of unpaid federal investment by respective power project. In addition, the PRS calculates interest expense on the unpaid federal investment. An executive summary is included within the PRS to accumulate PRS detail. For the Rio Grande project, the executive summary did not agree with the PRS detail. Amounts in the executive summary were not linked to the PRS detail, but were rather hard coded. Reliance on repayment data presented to those outside of Western may be called into question if not adequately supported and/or contains errors.

Recommendation

We recommend Western establish a process to ensure that detailed PRS data support summary information. This can be accomplished by electronically linking all support data to summary schedules in PRS spreadsheets.

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Management's Response

Concur. The PRS does link all support data to the executive summary electronically. However, some personnel mistakenly hard coded totals into the executive summary. Western will, via memorandum, reiterate to all personnel utilizing the PRS to utilize the formulas built into the program and not to hard code totals into the executive summary unless there is a visual basic for application macro that generates an executive summary automatically in lieu of electronically linking data.

7. Payroll Actions

Notification of personnel action, Form SF-50, should contain proper signatures indicating approval. Three of ten SF-50s reviewed at the Upper Great Plains Region were not signed to indicate approval by the Personnel Officer. The payroll supervisor could not explain why payroll accepted the SF-50's without an approval signature. Accepting unapproved SF-50's could result in erroneous pay adjustments not being prevented or detected.

Recommendation

Western should emphasize to payroll departments the importance of not accepting SF-50's that do not indicate approval by the appropriate official.

Management's Response

Concur. In the future, all SF-50s will contain signatures indicating approval of the personnel action. This will include mass generated personnel actions, such as annual pay adjustments, which will be approved by the use of signature stamps.

**Bureau of Reclamation
U. S. Department of the Interior**

1. Accounting for Liabilities

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by employing entity. Under these statements, Western is required to record the costs to the Federal government of providing pension, life, health, and other post-employment benefits (severance payments, counseling and training, workers' compensation benefits, etc.) "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds."

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During 1997, the Department of Labor (DOL) took action to implement SFFAS No. 5 related to workers' compensation costs. The Office of Personnel Management (OPM) also took similar action to determine costs funded by their agency on behalf of other entities related to pensions (i.e., Civil Service Retirement System and Federal Employee Retirement System), health insurance, and life insurance. The DOL and OPM allocated these costs to the various departments of the United States including the DOE. The DOE further allocated these costs to the various entities within the DOE including Western. Western properly recorded these costs in the combined power system financial statements for the fiscal year ended 1997. However, the generating agencies, including Reclamation, did not record these amounts in their project's general ledgers, which are used as the basis for compiling financial information for the combined power system as a whole (i.e., transmission and generation of electric power). Reclamation did, however, record the pension, health, and life insurance costs for financial statement purposes at the headquarters level, but did not see the need for allocating these costs to the specific Reclamation projects. Reclamation did not record the workers' compensation liability at any level of Reclamation for fiscal year 1997.

Because Reclamation did not allocate these costs to the project level, the amounts related to power generation are not recorded in the combined power system financial statements as required by SFFAS No. 5 and understate the costs for power generation operations.

Recommendation

We recommend Reclamation determine the amounts for these costs in order that the amounts related to power generation can be reflected in Western's combined power system financial statements.

Management's Response

Concur. Before addressing the recommendation, it may be useful to clarify certain statements made in the discussion section. A statement is made that "Reclamation did not record the workers' compensation liability at any level of Reclamation for fiscal year 1997." This statement implies that Reclamation was remiss in recognizing any such liability. Reclamation did, in fact, record funded and unfunded liabilities based on amounts that will need to be reimbursed to the DOL for claims that the DOL made on Reclamation's behalf.

Reclamation did not, however, recognize a future workers' compensation (FWC) liability based on the DOL's estimated actuarial liability. The Department of the Interior did not receive the information from DOL with sufficient time to allow the allocation of the estimated actuarial liability to the bureaus and to allow the bureaus to make the necessary entries before the end of audit fieldwork for the bureau's financial statements. Accordingly, the Department decided not to provide allocated amounts to the bureaus for inclusion in the fiscal year 1997 financial statements.

To address the recommendation, Reclamation will determine pension costs, other post-employment costs, and workers' compensation amounts related to power generation and provide this information to Western in future years beginning with fiscal year 1998 data.

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**International Boundary and Water Commission (IBWC)
U. S. Department of the State**

1. Accounting for Liabilities

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by employing entity. Under these statements, Western is required to record the costs to the Federal government of providing pension, life, health, and other post-employment benefits (severance payments, counseling and training, workers' compensation benefits, etc.) "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds."

During 1997, the DOL took action to implement SFFAS No. 5 related to workers' compensation costs. The OPM also took similar action to determine costs funded by their agency on behalf of other entities related to pensions (i.e., Civil Service Retirement System and Federal Employee Retirement System), health insurance, and life insurance. The DOL and OPM allocated these costs to the various departments of the United States including the DOE. The DOE further allocated these costs to the various entities within the DOE including Western. Western properly recorded these costs in the combined power system financial statements for the fiscal year ended 1997. However, the generating agencies, including the IBWC, did not record these amounts in their project's general ledgers, which are used as the basis for compiling financial information for the combined power system as a whole (i.e., transmission and generation of electric power).

Because IBWC did not allocate these costs to the project level, the amounts related to power generation are not recorded in the combined power system financial statements as required by SFFAS No. 5 and understate the costs for power generation operations.

Recommendation

We recommend IBWC determine the amounts for these costs and systematically allocate them to individual IBWC projects in order that the amounts related to power generation can be reflected in Western's combined power system financial statements.

Management's Response

Concur. IBWC will take appropriate actions to identify and record these costs at the IBWC project level.

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**Army Corps of Engineers (the Corps)
U. S. Department of the Defense**

1. Accounting for Liabilities

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by employing entity. Under these statements, Western is required to record the costs to the Federal government of providing pension, life, health, and other post-employment benefits (severance payments, counseling and training, workers' compensation benefits, etc.) "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds."

During 1997, the DOL took action to implement SFFAS No. 5 related to workers' compensation costs. The OPM also took similar action to determine costs funded by their agency on behalf of other entities related to pensions (i.e., Civil Service Retirement System and Federal Employee Retirement System), health insurance, and life insurance. The DOL and OPM allocated these costs to the various departments of the United States including the DOE. The DOE further allocated these costs to the various entities within the DOE including Western. Western properly recorded these costs in the combined power system financial statements for the fiscal year ended 1997. However, the generating agencies, including the Corps, did not record these amounts in their project's general ledgers, which are used as the basis for compiling financial information for the combined power system as a whole (i.e., transmission and generation of electric power).

Because the Corps did not allocate these costs to the project level, the amounts related to power generation are not recorded in the combined power system financial statements as required by SFFAS No. 5 and understate the costs for power generation operations.

Recommendation

We recommend the Corps determine the amounts for these costs and systematically allocate them to individual Corps projects in order that the amounts related to power generation can be reflected in Western's combined power system financial statements.

Management's Response

Concur. The Corps agrees that these costs should be determined and allocated to the individual Corps projects so that amounts related to power generation can be reflected in Western's combined power system financial statements. The Headquarters Office of the Corps has contacted OPM and will be contacting the Office of Management and Budget for additional information and guidance. After coordination with the Department of Defense and the U.S. Army, guidance and procedures will be issued to the field for appropriate action.

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Status of Prior Year Comments

The purpose of this section is to provide a status report of those comments reported in the prior year, for which management has considered, but are still pending resolution or require further attention. Of the sixteen Western comments and three Reclamation comments reported in the prior year, ten and two are still outstanding for Western and Reclamation, respectively, and are as follows:

Western Area Power Administration U.S. Department of Energy

1. Undue Delays in Properly Classifying Plant Costs

In 1995, we reported that Western had \$344 million of plant assets recorded as plant-not-classified for periods of time significantly exceeding the three month limit allowed by Western regulations. Western's delay in properly classifying the value of plant assets could result in the overstating of depreciation expense and interest on Federal investment (IOI) in the combined power system financial statements. Western responded that they planned to have the backlog of work orders for amounts recorded as plant-not-classified reduced to the three month limit by September 30, 1996. As of that date, however, Western still had about \$291 million in plant-not-classified for periods exceeding three months. During fiscal year 1997, Western modified the Accounting Handbook policy to allow items in plant-not-classified to remain for a period of six to twelve months depending on the complexity of the work order. As of September 30, 1997, Western still had approximately \$180 million in plant-not-classified exceeding twelve months.

Recommendation

Western should continue giving priority to reducing the age of work orders for amounts recorded as plant-not-classified to less than the six to twelve month maximum.

Management's Response

Concur. Western will continue to give priority to classifying plant in a timely manner.

2. Value of Retired Plant Assets

We reported in fiscal year 1995 that utility industry standards require that any remaining net book value and/or gain or loss from the retirement (disposal) of an asset be included as an element within the accumulated depreciation account with amortization of these amounts occurring over future years through the use of "group depreciation" rather than as an immediate entry to the income statement.

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Western calculates depreciation on the plant account balance excluding the net book value of any disposals or retirement of plant assets (i.e., retirements included within accumulated depreciation). Western was not aware that it should continue reducing the undepreciated balance of retired assets. As a result, the undepreciated balance of retired assets will remain on Western's records until the various projects end. This situation effectively overstates the book value of plant assets for all projects.

In the prior year, Western contacted several public utility companies inquiring about their approach to account for retirements. As a result of these inquiries, Western drafted an issue paper containing several acceptable industry methods. However, Western's financial managers could not agree on a preferred method. Thus in fiscal year 1997, Western performed additional research on each option and also discussed the issue with Reclamation and the other Power Marketing Administrations (PMAs). As of September 30, 1997, Western has yet to conclude on a preferred method.

Recommendation

Western should select an approach to retirements which is consistent with Reclamation, other PMA's, and is consistent with their rate design methodology. Western should then implement the selected method, prepare the appropriate adjustments to the combined power system financial statements, and modify current policies and procedures to reflect the new methodology.

Management's Response

Concur. Western will fully depreciate plant retirements in the year a unit is retired. The implementation and appropriate adjustments are scheduled to be complete by the end of fiscal year 1998.

3. Interest on Investment

Federal Statute requires PMA's to accrue interest during construction (IDC) on Federal projects constructed with appropriations. Federal Statute also requires the accrual of IOI for the unpaid balance after costs are transferred from CWIP to completed plant. In fiscal year 1995, we reported that, in practice, the application of this IOI requirement is inconsistent within Western. During fiscal years 1996 and 1997, Western corrected all inconsistent applications. However, IOI adjustments relating to double counting interest in prior years for the PD and IP projects did not occur. Currently, all Western projects compute a full year of IDC on any transfers to completed plant during the year. IOI expense is calculated on additions to completed plant in the year following transfer.

In comparing Western's methodologies to Southeastern and Southwestern Power Administrations, we noted that these PMA's accrue one-half year of IOI in the year of addition to plant from CWIP (i.e., one-half year convention method) with respect to IOI and only record one-half year's IDC. We also noted that these PMA's have incorporated these procedures within their accounting handbooks and cite DOE Order RA 6120.2 as the underlying authoritative guidance for such procedures. As Western's projects do not use the one-half year convention method, Western may not be complying with the original intent of the Federal Statute.

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Recommendation

In order to achieve consistency among the PMA's, Western should review the basis and methodology for applying IOI and IDC for current year additions to completed plant for both the transmission and generating facilities. Policy and procedures should be modified as appropriate on a go-forward basis, and the Accounting Handbook should be updated accordingly. Western should also evaluate the historical application of the modified policies and procedures to the PD and IP projects and record appropriate accounting adjustments as necessary.

Management's Response

Concur. We agree with the auditor's interpretation of DOE Order RA 6120.2A. However, a fiscal year 1997, issue paper concluded that such a change would not be material in the financial statements or rate studies, and that all interest charges are presently being recorded and reimbursed to Treasury. Corrections to the current procedure would only reclassify the first half-year's interest from capital accounts to annual expenses, and Western believes that the current procedure is a reasonable approach to recording and reimbursement. This approach is necessary because of the uncertainty of plant-in-service transfers and the difficulty in projecting interest for the combined power system financial statements. Western believes that the cost and inaccuracy associated with identifying plant transfers before the end of the fiscal year far outweigh the benefits of interest reclassification. This is especially true because Western's operations are significantly larger than the other PMAs, with over 16,000 miles of transmission lines covering 15 states and over \$5 billion in net utility plant.

Additionally, we agree to evaluate the historical application of the modified policies and procedures to the PD and IP projects and to record appropriate adjustments as necessary. We anticipate this review will be completed by September 30, 1998.

4. Interest on Federal Investment

In 1995, we reported that interest expense on net outstanding Federal investment should be recovered in accordance with the policies established by the Federal agencies associated with production and distribution of power. The details of the finding are as follows:

DOE Order RA 6120.2 requires recovery of interest expense on the net outstanding Federal investment in power projects through power revenues. The criteria for determining the interest rate applicable to each project as it pertains to additions to utility plant is prescribed in each project's enacting legislation, DOE Order RA 6120.2, Department of the Interior Secretarial Order No. 2929, Department of the Army Circular EC 37-2-114, and a September 1, 1983, tri-agency agreement between the PMA's, the Corps, and Reclamation. The calculation of interest expense between the various power projects and agencies should be consistently applied. Consistency of application requires that a position be taken, and a consensus be reached, among management responsible for transmission and generation, as to the proper interest rate to be applied to the outstanding Federal investment. Management should document the position taken, in consideration of and in reference to, the appropriate laws, regulations, guidelines, and agreements indicated above, which have been established for purposes of operating the various power projects.

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Each of the agencies noted above calculate interest on investment in plant facilities related to their participation in the projects. We noted inconsistent application of interest rates to the outstanding Federal investment, in particular as it pertains to calculating interest for replacements and additions to plant on the Pick-Sloan and CRSP power projects. The guidelines for determining interest expense, which are prescribed in the enacting legislation, appear to be very similar in nature. However, management of the two projects clearly interpret the guidelines differently. The generating agency for the CRSP project calculates interest expense on replacements and additions using the rate determined by the Secretary of the Treasury at the time the construction funds were appropriated for the project. The transmission agency calculates interest using a current rate. Both the transmission and generating agencies for the Pick-Sloan project calculate interest expense on replacements and additions using a current rate as determined by the Treasury. The inconsistency in application is a result of unclear guidelines which have contributed to management interpreting these guidelines, on a project-by-project basis without a centralized person or department taking responsibility to assure that the interpretation was consistent for the power system as a whole. The inconsistency in interpretation may have resulted in an under or over recovery of interest expense through power revenues. We are uncertain of the amount of IOI which may have or may have not been collected in excess of the proper amount.

We recommended Western's headquarters management thoroughly research the following documents for each power project: the original enacting legislation, DOE Order RA 6120.2, Department of Interior Secretarial Order No. 2929, Department of the Army Circular EC 37-2-114, and the September 1, 1983, tri-agency agreement between the PMA's, the Corps, and Reclamation.

Upon review of these documents management should establish and document their position as it relates to their interpretation of the above mentioned documents on a project-by-project basis. Once this position is determined it should be conveyed to the generating agencies (i.e., the Corps and Reclamation). Both the transmission and generating agencies should come to an agreement with the interpretation. Once this process is complete interest expense as historically recorded should be evaluated and adjusted in order to comply with applicable laws and regulations.

Management agreed to conduct a review of the interpretation of the original enacting legislation, orders, and circular by the generating agencies, to identify inconsistencies in the calculation of IOL. Furthermore, Western agreed to perform a review of the application of interest rate policies and collaborate with the generating agencies to resolve differences in calculating interest expense by all agencies and develop a common way to calculate interest and an approach to application.

During 1996, legal counsel and representatives from Reclamation and Western met in an attempt to resolve the inconsistent application of interest rates for CRSP. However, upon conclusion of the discussions, the parties agreed that both interpretations of project legislation were correct. Thus, Reclamation would continue to use the original project rate while Western applies the current rate to their project additions and replacements. The parties have yet to prepare and sign a formal agreement. No additional action was taken by either Western or Reclamation in fiscal year 1997.

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Recommendation

Given the potential magnitude of adjustments to interest expense, which may result from these reviews, we strongly recommend each party prepare a written analysis supporting their interpretation. This analysis should include consideration of why the September 1, 1983 agreement does not apply to the CRSP project as well as consideration of the fact that the language or intent of section titled "interest rate" in the original legislation for CRSP and Pick Sloan do not differ significantly. Until Reclamation and Western agree on the method for the use of interest rates, Western should continue to use its method of applying current rates to investments in the PRS and should record interest expense differences in its accounting records.

Management's Response

Concur. Western has written an analysis supporting its interpretation. Until Western is persuaded by Reclamation to adopt their methodology, Western will continue to use the then current interest rate for all additions and replacements regardless of the ownership of the investment. In addition, Western will record the difference between Reclamation's current and historical interest rates in Western's accounting records. This will be accomplished by September 30, 1998.

5. Recording Budgetary Obligations as Expenses

In 1996, we reported that Western's Financial Management System (FMS) automatically records as expense the difference between the beginning and ending balance in Corporate Service Office's (CSO) budgetary obligations at year-end and allocates this amount to regional projects. The regional projects record the allocated change in CSO obligations as an expense in their project general ledgers.

The practice of distributing the change in the budgetary obligation began prior to Western installing the current FMS in 1987 and is system driven. The cumulative effect as of September 30, 1996, was an overstatement in Western's appropriations of \$9.7 million, an understatement of \$14.3 million in beginning accumulated net revenues, and an understatement of \$4.6 million in fiscal year 1996 expenses.

Western agreed to investigate the origins of this practice and evaluate whether recording budgetary obligations as expense should be discontinued. During fiscal year 1997, Western addressed the problem by creating a new general ledger account (i.e., deferred credit) to record the cumulative over clearing. The new general ledger account, however, does not rectify the problem of misstating appropriation, expenses, and beginning net revenues. As of September 30, 1997, the cumulative over clearing of budgetary expenses is \$13.4 million.

Recommendation

Western should investigate the origins of this established practice and evaluate whether the purposes accomplished with recording budgetary obligations as expenses outweigh the purposes of sound financial accounting practices. Assuming this practice does not outweigh the accounting purpose then the practice should be discontinued.

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Management's Response

Concur. During the implementation of the Oracle system, Western will be reexamining the procedures to clear budgetary obligations as expenses and make appropriate correcting entries. This should be completed by March 1999.

6. Payment Discounts and Penalties

In 1996, we reported that Western's FMS records all vendor payment discounts and penalties to CSO work orders used to accumulate overhead costs instead of recording them to the specific project work orders to which the discounts or penalties apply. CSO allocates overhead costs accumulated in these work orders to the various regional projects using the general Western allocation formula. As a result, the project originally charged 100 percent of the invoice cost may only receive a portion of the discount or penalty. This creates a misstatement of costs at the individual project level and either over or undercharges projects and customers.

Western agreed to determine the most cost effective way to apply discounts and penalties to the appropriate work order. In addition, Western agreed to establish procedures based on a result of this review by September 30, 1997. During fiscal year 1997, Western personnel drafted an issue paper to management determining that no action will be taken until Western's Oracle system is implemented.

Recommendation

Although we agree with Western's action plan in the future, procedures should be established in the interim for recording an adjustment to the appropriate work order each time the system processes a vendor discount or penalty.

Management's Response

Concur. Western's new Oracle based BIDSS will apply discounts and penalties to the appropriate workorder. In the interim, Western will monitor the amount of penalties and discounts incurred or taken and perform a costs/benefits analysis to determine if it should apply penalties and discounts to appropriate workorders. This will be accomplished by March 31, 1998.

7. Revenue and Property Transfer Balance

All property and revenue transfer balances between Reclamation and Western should net to zero in financial statement consolidation. However, Reclamation's combined transfer account balances for revenues and property (accounts 3220-P-32B, 3230-P-32H, and 3310-MP-33Z fund 615) exceed the offsetting balances in Western's records (account 212-22, 212-41). These differences most likely represent misclassified or unrecorded transactions not identified because the two agencies do not reconcile inter-agency transfer accounts on a cumulative basis.

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As a result, the net transfer balance in the combined power system financial statements, which should represent net transfers between nonconsolidating entities only, is over or understated by transfers that do not net to zero between Reclamation and Western.

Western agreed to, in a collaborative effort with Reclamation, reconcile the cumulative balance of all revenue and property transfers on both agency's financial accounting records to determine whether the difference can be identified and adjusted accordingly. In fiscal year 1997, the Sierra-Nevada (SNR), Desert Southwest (DSR), CRSP Customer Service Center, and the Rocky Mountain Regions (RMR) reconciled cumulative revenue transfers and made correcting adjustments. In addition, the DSR reconciled cumulative property transfers and made appropriate adjustments.

Recommendation

The Upper Great Plains Regions (UGPR), in a collaborative effort with Reclamation, should reconcile, on a cumulative basis, the balance of all revenue and property transfers on both agencies financial accounting records, to determine whether the difference can be identified and adjusted accordingly. In addition, the SNR, CRSP Customer Service Center, and the RMR, in a collaborative effort with Reclamation, should reconcile, on a cumulative basis, the balance of all property transfers on both agencies financial accounting records and make appropriate adjustments. Once the reconciliation process is complete and differences resolved, the agencies should establish procedures to reconcile transfer accounts annually.

Management's Response

Concur. Western has made progress and is continuing to work with Reclamation to complete reconciliations of the revenue and property transfers at the UGPR and reconciliation of plant transfers at the SNR, the CRSP Customer Service Center, and the RMR. Anticipated completion of these reconciliations is September 30, 1998.

8. Time and Attendance Reports

In 1996, we reported that time and attendance (T&A) corrections reviewed by supervisors at the DSR had not been properly initialed by the supervisor on eight out of the ten T&A's selected for testwork. Western responded that action would be taken to document procedures and provide training to personnel responsible for the review and certification of T&A report accuracy.

However In 1997, the problem continued with three out of the ten T&A corrections tested not being properly initialed. DSR's continued neglect in establishing procedures and providing training increases the possibilities of both errors and irregularities in the reporting of time and the paying of employees.

Recommendation

Western should take the appropriate actions to establish procedures and provide training to personnel responsible for the review and certification of T&A report accuracy.

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Management's Response

Concur. Western has implemented a new Relational Integrated Time and Attendance (RITA) system which will eliminate all hard copy records of time and attendance input documents. Certification of T&A report accuracy by personnel responsible for T&A review will be done electronically. Western has established procedures for using the new T&A system. Training was provided in all Regions, including DSR, during implementation of the RITA system. Additionally, the RITA system will be subject to audit in fiscal year 1998.

9. Interface and Reconciliation Between Power Billings and FMS

In the management letter report for fiscal year 1991, we reported that Western's power billing systems at each regional office do not interface with the FMS, resulting in an inefficient use of personnel. This lack of interface requires that each power bill be entered twice by data entry personnel -- once to produce the power bill report (PO&M) and again to record the sale and receivable in FMS.

This problem has continued in fiscal year 1997 as there is still no interface between the PO&M's and FMS. As a result, Western's data entry personnel enter the same data twice into the applicable systems. Furthermore, during fiscal year 1997, Western's data entry personnel did not prepare the PO&M's on a monthly basis. PO&M's were not prepared monthly as data entry personnel had other demands on their time. In addition, Western's supervisors did not ensure that the PO&M's were properly completed on a timely basis.

As the PO&M reports were not completed monthly, the necessary reconciliation between the PO&M's and FMS was not completed by appropriate Western personnel on a timely basis. Monthly and annual reconciliation's were completed at the end of the fiscal year. As the monthly reconciliation's were not complete until fiscal year end, final revenue amounts were not available for the audit on a timely basis. In addition, as Western did not prepare and reconcile PO&M's to FMS on a monthly basis, the time required to reconcile the systems increased and also delayed the audit process.

Recommendation

Western should take the appropriate actions to prepare and reconcile the PO&M's on a timely basis.

Management Response

Concur. PO&M reconciliations were not being performed on a consistent and timely basis throughout Western. To assure that this occurs, the Chief Financial Officer (CFO) has begun querying Regional Financial Managers at the monthly Financial Leadership Council meeting on the status of the monthly PO&M reconciliations. Documentation of the PO&Ms and the reconciliations with FMS will also be required to be sent to the CFO starting in February 1998.

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**Bureau of Reclamation (Reclamation)
U. S. Department of the Interior**

1. Value of Retired Plant Assets

Utility industry standards require that any remaining net book value and/or gain or loss from the retirement (disposal) of an asset be included as an element within the accumulated depreciation account with amortization of these amounts occurring over future years through the use of group depreciation rather than as an immediate entry to the income statement.

Reclamation calculates depreciation on the plant account balance excluding the net book value of any disposals or retirement of plant assets (i.e., retirements included within accumulated depreciation) and does not use group depreciation. Reclamation was not aware that it should continue reducing the undepreciated balance of retired assets. As a result, the undepreciated balance of retired assets will remain on Reclamation's records until the various projects end. This situation effectively overstates the book value of plant assets for all projects.

In fiscal year 1997, Reclamation consulted with Western regarding their position and drafted their own issue paper on the current methods of accounting for asset retirements. As of September 1997, the issue is still unresolved.

Recommendation

Reclamation should continue to coordinate with Western to reach a resolution of the issue. Once resolved Reclamation should implement the selected method, prepare the appropriate adjustments to the financial statements, and modify current policies and procedures to reflect the new methodology.

Management's Response

Concur. Reclamation is aware of the accounting requirements of SFFAS No. 4, *Accounting for Property, Plant, and Equipment*, and continues to work toward compliance with these requirements. Two major conversions during fiscal year 1997 delayed progress on this effort. Reclamation converted its standard general ledger to the new U.S. Standard General Ledger, concurrent with its conversion to a new programmatic budget structure to better reflect its evolving mission.

In the discussion section, a statement is made that "Reclamation was not aware that it should continue reducing the undepreciated balance of retired assets." The discussion explained that this practice "overstates the book value of plant assets for all projects." On the contrary, we are aware that this is an utility industry accounting standard and are considering this in our assessment of our property, plant, and equipment policies.

As part of this assessment, we are also considering the requirements of SFFAS No. 4. It may be instructive to cite the language of paragraph 38 of this accounting standard:

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38. In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

This conflicting guidance makes resolution of this issue more complex. Nonetheless, we will continue working with Western on this issue.

2. Revenue and Property Transfer Balance

All property and revenue transfer balances between Reclamation and Western should net to zero in financial statement consolidation. However, Reclamation's combined transfer account balances for revenues and property (accounts 3220-P-32B, 3230-P-32H, and 3310-MP-33Z fund 615) exceed the offsetting balances in Western's records (account 212-22, 212-41). These differences most likely represent misclassified or unrecorded transactions not identified because the two agencies do not reconcile inter-agency transfer accounts on a cumulative basis.

As a result, the net transfer balance in the combined power system financial statements, which should represent net transfers between nonconsolidating entities only, is over or understated by transfers that do not net to zero between Reclamation and Western.

Reclamation agreed to, in a collaborative effort with Western, reconcile the cumulative balance of all revenue and property transfers on both agency's financial accounting records to determine whether the difference can be identified and adjusted accordingly. In fiscal year 1997, the Mid-Pacific, Lower Colorado, and Upper Colorado reconciled cumulative revenue transfers and made correcting adjustments. In addition, the Lower Colorado Region reconciled cumulative property transfers and made appropriate adjustments.

Recommendation

The Great Plains Region, in a collaborative effort with Western, should reconcile, on a cumulative basis, the balance of all revenue and property transfers on both agencies financial accounting records, to determine whether the difference can be identified and adjusted accordingly. In addition, the Mid-Pacific and Upper Colorado Regions, in a collaborative effort with Western, should reconcile, on a cumulative basis, the balance of all property transfers on both agencies financial accounting records and made appropriate adjustments. Once the reconciliation process is complete and differences resolved, the agencies should establish procedures to reconcile transfer accounts annually.

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Management's Response

Concur. Reclamation recognizes the importance of working with Western to jointly resolve issues affecting both agencies, including reconciliation of revenue and property transfer balances. As explained above, several regions made significant progress in resolving this issue. Since some of these differences may have occurred when the power marketing function was transferred from Reclamation to Western in 1977, these cumulative reconciliations are often complex, requiring extensive research. Within the available time and resources, Reclamation will continue to work towards fully resolving this issue.

* * * * *

Should you have any questions concerning the matters presented herein, we would be pleased to discuss them with you at your convenience.

This report is intended for the information and use of the management of Western, Reclamation, the Corps, and IBWC. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

December 12, 1997

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