



Office of Inspector General

OFFICE OF CYBER
ASSESSMENTS AND DATA
ANALYTICS

AUDIT REPORT

THE SOUTHWESTERN FEDERAL POWER SYSTEM'S
FISCAL YEAR 2022 COMBINED FINANCIAL
STATEMENTS AUDIT

DOE-OIG-23-26
JULY 2023



Department of Energy
Washington, DC 20585

July 13, 2023

MEMORANDUM FOR THE ADMINISTRATOR, SOUTHWESTERN POWER
ADMINISTRATION

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

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

SUBJECT: INFORMATION: Audit Report on The Southwestern Federal Power
System's Fiscal Year 2022 Combined Financial Statements Audit

The attached report presents the results of the independent certified public accountants' audit on the Southwestern Federal Power System's (SWFPS) combined balance sheets as of September 30, 2022, and 2021, and the related combined statements of revenues and expenses, changes in capitalization, and cash flows for the years then ended.

To fulfill the Office of Inspector General's audit responsibilities, we contracted with the independent public accounting firm of KPMG LLP (KPMG) to conduct the audit, subject to our review. KPMG is responsible for expressing an opinion on the SWFPS's financial statements and reporting on applicable internal controls and compliance with laws and regulations. The Office of Inspector General monitored audit progress and reviewed the audit report and related documentation. This review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted government auditing standards. The Office of Inspector General did not express an independent opinion on the SWFPS's financial statements.

KPMG concluded that the combined financial statements present fairly, in all material respects, the respective financial position of the SWFPS as of September 30, 2022, and 2021, and the results of its operations and cash flows for the years then ended in accordance with United States generally accepted accounting principles.

As part of this review, auditors also considered the SWFPS's internal controls over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on the determination of financial statement amounts. The audit did not identify any deficiency in internal control over financial reporting that is considered a material weakness. However, the audit identified the following significant deficiencies in internal control over general property, plant, and equipment and hydroelectric power legal claims:

- Controls over General Property, Plant, and Equipment: Controls were not operating effectively to ensure substantially completed construction work in-progress projects are transferred to property, plant, and equipment and depreciated at period end.
- Controls over Hydroelectric Power Legal Claims: Controls were not operating effectively to ensure that all legal claims, including those that occur as a subsequent event, are identified, and appropriately recorded or disclosed in the SWFPS's combined financial statements.

The results of the auditors' review of the SWFPS's compliance with provisions of laws and regulations disclosed no instances of noncompliance or other matters required to be reported under Government Auditing Standards.

We appreciated the cooperation of your staff during the audit.

Attachment

cc: Chief Financial Officer, Southwestern Power Administration, SWPA
Deputy Chief Financial Officer, CF-2

Audit Report: DOE-OIG-23-26

INDEPENDENT AUDITORS' REPORT



SOUTHWESTERN FEDERAL POWER PROGRAM

Combined Financial Statements

September 30, 2022 and 2021

SOUTHWESTERN FEDERAL POWER SYSTEM

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KPMG LLP
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Denver, CO 80202-5598

Independent Auditors' Report

Administrator, Southwestern Power Administration and
Inspector General, United States Department of Energy:

Report on the Audit of the Combined Financial Statements

Opinion

We have audited the combined financial statements of the Southwestern Federal Power System (SWFPS), which comprise the combined balance sheets as of September 30, 2022 and 2021, and the related combined statements of revenues and expenses, changes in capitalization, and cash flows for the years then ended, and the related notes to the combined financial statements. The combined financial statements include the Southwestern Power Administration (Southwestern), a component of the U.S. Department of Energy, and the U.S. Department of Defense, Army Corps of Engineers (the Corps) for which Southwestern markets and transmits power.

In our opinion, the accompanying combined financial statements present fairly, in all material respects, the financial position of the SWFPS as of September 30, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Combined Financial Statements section of our report. We are required to be independent of the SWFPS and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of the combined financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the combined financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the SWFPS's ability to continue as a going concern for one year after the date that the combined financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Combined Financial Statements

Our objectives are to obtain reasonable assurance about whether the combined financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material

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misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the combined financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the combined financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the combined financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the SWFPS's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the combined financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the SWFPS's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Information Other Than the Combined Financial Statements and Auditors' Report Thereon

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplementary information in schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with GAAS. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the combined financial statements as of and for the year ended September 30, 2022, we considered the SWFPS's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the SWFPS's internal control. Accordingly, we do not express an opinion on the effectiveness of the SWFPS's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in



internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified certain deficiencies in internal control, described below, that we consider to be significant deficiencies.

1. Controls Over General Property, Plant, and Equipment (22-SWFPS-01)

The Corps is a hydroelectric power generating function with the SWFPS. With more than \$1.3 billion in net property, plant, and equipment (PP&E), including construction work in progress (CWIP), general PP&E is one of the largest balances on the SWFPS's combined balance sheet. Construction costs are accumulated in CWIP and transferred to PP&E when placed into service.

During our fiscal year 2022 audit, we noted that controls over the Corps hydropower generating function were not operating effectively to ensure substantially completed CWIP are transferred to PP&E and depreciated at period end. Specifically, we examined a sample of 11 CWIP projects and identified 2 projects totaling \$7 million that were substantially complete and in use as of September 30, 2022, but had not been transferred out of CWIP and into PP&E. In response, the Corps performed a review of all outstanding CWIP balances and did not identify any additional misclassified balances. The approximate impact to accumulated depreciation for the impacted projects was less than \$500,000. We resampled the population after management's adjustment and found no additional misstatements.

Recommendation

We recommend that the Chief Financial Officer, Southwestern, work with the Corps to:

1. Enhance existing processes to ensure that all substantially completed projects are transferred from CWIP to PP&E for financial reporting purposes.

Management's Response to Recommendation

Southwestern and the Corps concur with the recommendation and will enhance existing processes to ensure that all substantially completed projects are transferred from CWIP to PP&E for financial reporting purposes.

2. Controls Over Hydroelectric Power Legal Claims (22-SWFPS-02)

During the performance of SWFPS's authorized functions, certain legal claims are presented against the Government. The SWFPS does not have specific legal counsel; rather, in-house legal counsel exists separately at Southwestern and the Corps.

During our fiscal year 2022 audit, we obtained legal letters in response to our inquiries about legal cases impacting the Corps hydroelectric power generation function for each district in our scope. One legal response contained a claim impacting PP&E that existed as of September 30, 2022, and was settled in March 2023 utilizing \$3.5 million of power-specific funding. This settlement represents a subsequent event that indicates the legal liability as of September 30, 2022, is probable and should be accrued and disclosed in the combined financial statements. However, this claim was not identified by Corps management and the information was not furnished to Southwestern for consideration.



Consequently, although subsequently corrected by Southwestern management, the contingency was not initially appropriately recorded or disclosed in SWFPS's combined financial statements.

Recommendations

We recommend that the Chief Financial Officer, Southwestern:

1. Develop policies and procedures for evaluating identified cases for required recognition and disclosure in the SWFPS's combined financial statements including the impact, if any, the U.S. Treasury Judgment Fund has on the recognition.

We also recommend that the Chief Financial Officer, Southwestern, work with the Corps to:

2. Establish policies and procedures to evaluate hydroelectric power liabilities and communicate that information to Southwestern.

Management's Response to Recommendations

Southwestern and the Corps concur with the above recommendations and will develop policies and procedures for evaluating identified cases for required recognition and disclosure in SWFPS's combined financial statements. Further, policies and processes to evaluate hydroelectric power liabilities and communicate that information to Southwestern will be established. Additionally, the Corps responded that the facts of the litigation settlement, final amounts, and payment methods were not determined until February 2023. The assumption was the entire amount of the litigation/settlement would be paid against the Judgment Fund, which is recorded as an unfunded liability/journal entry in the Corps financial management system. The Southwest Division, Little Rock District's Office of Counsel's Legal Response letter contained updated information after the settlement was finalized.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the SWFPS's combined financial statements as of and for the year ended September 30, 2022, are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the combined financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

SWFPS's Responses to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the SWFPS's responses to the findings identified in our audit and described previously. The SWFPS's responses were not subjected to the other auditing procedures applied in the audit of the combined financial statements and, accordingly, we express no opinion on the responses.

Purpose of the Reporting Required by Government Auditing Standards

The purpose of the communication described in the Report on Internal Control Over Financial Reporting and the Report on Compliance and Other Matters sections is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the SWFPS's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Denver, Colorado
June 30, 2023

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Balance Sheets

September 30, 2022 and 2021

Assets	2022	2021
Plant in service	\$ 2,201,545,973	2,008,987,503
Accumulated depreciation	(977,969,863)	(932,857,532)
Construction work in progress	<u>136,758,336</u>	<u>257,844,267</u>
Net utility plant	1,360,334,446	1,333,974,238
Cash	693,644,537	603,713,558
Funds held in escrow	180,133,726	194,713,323
Accounts receivable	24,485,158	28,038,356
Materials and supplies, at average cost	3,957,038	3,401,440
Banking exchange receivables	4,233,882	4,233,431
Deferred workers' compensation (note 4)	11,969,419	8,011,549
Other assets	<u>924,275</u>	<u>596,485</u>
Total assets	\$ <u><u>2,279,682,481</u></u>	<u><u>2,176,682,380</u></u>
Liabilities and Capitalization		
Liabilities:		
Accounts payable and accrued liabilities	\$ 24,742,472	22,447,183
Advances for construction	2,471,234	1,521,985
Accrued workers' compensation	12,746,372	8,734,031
Purchased power and banking exchange deferral (note 4)	63,129,246	70,475,290
Hydropower water storage reallocation deferral (note 4)	<u>58,576,945</u>	<u>59,395,394</u>
Total liabilities	<u>161,666,269</u>	<u>162,573,883</u>
Capitalization:		
Payable to U.S. Treasury	1,355,728,673	1,274,544,522
Accumulated net revenues	<u>762,287,539</u>	<u>739,563,975</u>
Total capitalization	2,118,016,212	2,014,108,497
Commitments and contingencies (notes 6 and 7)		
Total liabilities and capitalization	\$ <u><u>2,279,682,481</u></u>	<u><u>2,176,682,380</u></u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM
 Combined Statements of Changes in Capitalization
 Years ended September 30, 2022 and 2021

	<u>Payable to U.S. Treasury</u>	<u>Accumulated net revenues</u>	<u>Total capitalization</u>
Total capitalization as of September 30, 2020	\$ 1,273,076,890	700,214,526	1,973,291,416
Additions:			
Congressional appropriations	71,261,101	—	71,261,101
Interest on payable to U.S. Treasury and other	12,443,495	—	12,443,495
Transfers of property and services, net	8,910,785	—	8,910,785
Total additions to capitalization	<u>92,615,381</u>	<u>—</u>	<u>92,615,381</u>
Deductions:			
Payments to U.S. Treasury	<u>(91,147,749)</u>	<u>—</u>	<u>(91,147,749)</u>
Total deductions to capitalization	<u>(91,147,749)</u>	<u>—</u>	<u>(91,147,749)</u>
Net revenues for the year ended September 30, 2021	<u>—</u>	<u>39,349,449</u>	<u>39,349,449</u>
Total capitalization as of September 30, 2021	<u>1,274,544,522</u>	<u>739,563,975</u>	<u>2,014,108,497</u>
Additions:			
Congressional appropriations	109,503,347	—	109,503,347
Interest on payable to U.S. Treasury and other	10,795,681	—	10,795,681
Transfers of property and services, net	3,501,880	—	3,501,880
Total additions to capitalization	<u>123,800,908</u>	<u>—</u>	<u>123,800,908</u>
Deductions:			
Payments to U.S. Treasury	<u>(42,616,757)</u>	<u>—</u>	<u>(42,616,757)</u>
Total deductions to capitalization	<u>(42,616,757)</u>	<u>—</u>	<u>(42,616,757)</u>
Net revenues for the year ended September 30, 2022	<u>—</u>	<u>22,723,564</u>	<u>22,723,564</u>
Total capitalization as of September 30, 2022	<u>\$ 1,355,728,673</u>	<u>762,287,539</u>	<u>2,118,016,212</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Revenues and Expenses

Years ended September 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Operating revenues:		
Sales of electric power	\$ 176,992,735	190,852,384
Transmission and other operating revenues	<u>37,430,630</u>	<u>34,075,019</u>
Total operating revenues before deferrals	214,423,365	224,927,403
Net purchased power and banking exchange deferral	<u>8,556,940</u>	<u>3,374,674</u>
Total operating revenues	222,980,305	228,302,077
Non-reimbursable revenues	<u>2,170,048</u>	<u>1,251,117</u>
Total revenues	<u>225,150,353</u>	<u>229,553,194</u>
Operating expenses:		
Operation and maintenance	112,884,069	120,887,211
Purchased power and banking exchange	24,869,181	19,902,646
Depreciation and amortization	54,147,911	39,251,326
Transmission service charges by others	32,913	108,290
Non-reimbursable expenses	<u>3,915,978</u>	<u>3,871,427</u>
Total operating expenses	<u>195,850,052</u>	<u>184,020,900</u>
Net operating revenues	<u>29,300,301</u>	<u>45,532,294</u>
Interest expense:		
Interest on payable to U.S. Treasury and other	13,048,608	14,489,333
Allowance for funds used during construction	<u>(6,471,871)</u>	<u>(8,306,488)</u>
Net interest expense	<u>6,576,737</u>	<u>6,182,845</u>
Net revenues	\$ <u>22,723,564</u>	\$ <u>39,349,449</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Cash Flows

Years ended September 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities:		
Net revenues	\$ 22,723,564	39,349,449
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation and amortization	54,147,911	39,251,326
Benefit expense paid by other Federal agencies	8,369,135	7,678,928
Interest on payable to U.S. Treasury and other	6,576,737	6,182,845
Deferred workers' compensation	(3,957,870)	(728,019)
(Increase) decrease in assets:		
Accounts receivable	3,553,198	(10,994,717)
Materials and supplies	(555,598)	(327,674)
Banking exchange receivables	(451)	(59,991)
Other assets	(327,790)	1,109,112
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	2,295,289	4,222,630
Accrued workers' compensation	4,012,341	802,063
Purchased power and banking exchange deferral	(8,503,254)	(3,423,714)
Advances for construction	949,249	(970,721)
Net cash provided by operating activities	<u>89,282,461</u>	<u>82,091,517</u>
Cash flows used in investing activities:		
Additions to utility plant	<u>(74,036,248)</u>	<u>(70,664,073)</u>
Cash flows from financing activities:		
Congressional appropriations	109,503,347	71,261,101
Payments to U.S. Treasury	(42,616,757)	(91,147,749)
Transfers of property and services, net	(4,867,255)	1,231,857
Hydropower water storage reallocation deferral	<u>(1,914,166)</u>	<u>(1,874,796)</u>
Net cash (used in) provided by financing activities	<u>60,105,169</u>	<u>(20,529,587)</u>
Net increase in cash and funds held in escrow	75,351,382	(9,102,143)
Cash and funds held in escrow, beginning of year	<u>798,426,881</u>	<u>807,529,024</u>
Cash and funds held in escrow, end of year	\$ <u><u>873,778,263</u></u>	\$ <u><u>798,426,881</u></u>
Supplemental cash flow information:		
Interest charged to construction	\$ 6,471,871	8,306,488
Transfer of construction work in progress to plant in service	171,445,118	71,838,086

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2022 and 2021

(1) Summary of Significant Accounting Policies

(a) General Information and Basis of Preparation of Combined Financial Statements

The Southwestern Federal Power System (SWFPS) financial statements combine all of the activities associated with the generation, transmission, and disposition of all Federal power marketed under Section 5 of the Flood Control Act of 1944 (the Flood Control Act) by the Southwestern Power Administration (Southwestern), an agency of the U.S. Department of Energy (DOE). The accompanying combined financial statements include the accounts of Southwestern and the related hydroelectric generating facilities and power operations of the U.S. Army Corps of Engineers (Corps), a component of the U.S. Department of Defense (DOD), for which Southwestern markets and transmits the power. Southwestern and the Corps are separately managed and financed, and each maintains their own accounting records. For purposes of financial and operational reporting, the facilities and related operations of Southwestern and the Corps (power purpose) are combined as SWFPS.

The Corps has constructed and operates hydroelectric generating facilities in the states of Arkansas, Missouri, Oklahoma, and Texas. Operating expenses and net assets of multipurpose Corps projects are allocated to power and non-power purposes (primarily recreation and flood control). Only the portion of such project costs and net assets allocated to power are included in the combined financial statements. Southwestern, as designated by the Secretary of Energy, transmits and markets power generated from these hydroelectric generating facilities.

SWFPS is subject to the accounting regulations of the Federal Energy Regulatory Commission (FERC). Accounts are maintained in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) as established by the Financial Accounting Standards Board (FASB), the uniform system of accounts prescribed for electric utilities by the FERC, the accounting practices and standards established by the DOE and DOD, and the requirements of specific legislation and executive directives issued by government agencies. All material intra-entity balances and transactions are eliminated. SWFPS's combined financial statements follow the accounting and reporting guidance contained in FASB Accounting Standards Codification (ASC) Topic 980, *Regulated Operations*. Allocation of costs and revenues to accounting periods for rate-making and regulatory purposes may differ from bases generally applied by non-regulated companies. Such allocations to meet regulatory accounting requirements are considered to be U.S. GAAP for regulated utilities, provided that there is a demonstrable ability to recover any deferred costs in future rates and such costs or revenues are accounted for as regulatory assets or liabilities.

(b) Confirmation and Approval of New Rates

SWFPS is not a public utility within the jurisdiction of the FERC under the Federal Power Act. Under a Delegation Order issued by the Secretary of Energy, the Administrator of Southwestern has the authority to develop power and transmission rates for SWFPS and place the rates into effect on an interim basis. The FERC has the exclusive authority to confirm, approve, and place into effect on a final basis, to remand, or to disapprove rates developed by the Administrator.

The FERC's review is limited to (1) whether the rates are the lowest possible consistent with sound business principles, (2) whether the revenue levels generated are sufficient to recover the costs of producing and transmitting electric energy, including repayment within the period permitted by law, and (3) the assumptions and projections used in developing the rates component. The FERC shall reject

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2022 and 2021

decisions of the Administrator only if it finds them to be arbitrary, capricious, or in violation of the law. As of September 30, 2022 and 2021, there were no revenues subject to a refund.

The rates in effect as of September 30, 2022 are summarized as follows:

The Integrated System rate schedules were placed into effect October 1, 2013 and were confirmed and approved by the FERC on January 9, 2014. These rate schedules incorporated a 4.7% revenue increase for the period October 1, 2013 through September 30 2017, or until superseded by a new rate schedule. These rate schedules have been subsequently extended by the Deputy Secretary of Energy through September 30, 2019, then extended again through September 30, 2021 by the Assistant Secretary, Office of Electricity and most recently extended by the Administrator, Southwestern to remain in effect through September 30, 2023.

The Sam Rayburn Dam project rate was placed into effect January 1, 2016 and was confirmed and approved by the FERC on June 30, 2016. This rate increase incorporated a 7.9% revenue increase for the period January 1, 2016 through September 30, 2019, or until superseded by a new rate schedule. This rate schedule was extended for a two-year period by the Assistant Secretary, Office of Electricity through September 30, 2021, and extended again for a two-year period by the Administrator, Southwestern to remain in effect through September 30, 2023.

The Robert Douglas Willis (RD Willis) project rate was placed into effect January 1, 2016 and was confirmed and approved by the FERC on June 15, 2016. The rate increase incorporated an 8.6% revenue increase for the period January 1, 2016 through September 30, 2019, or until superseded by a new rate schedule. This rate schedule was extended for a two-year period by the Assistant Secretary, Office of Electricity through September 30, 2021, and extended again for a two-year period by the Administrator, Southwestern to remain in effect through September 30, 2023.

(c) Utility Plant and Depreciation

Utility plant includes items such as dams, spillways, generators, turbines, substations and related components (generating facilities), and transmission lines and related components. Utility plant is stated at original cost, net of contributions by external entities. Property transferred from other government agencies is transferred at net book value. Cost includes direct labor and material, payments to contractors, indirect charges for engineering, supervision and similar overhead items, and an allowance for funds used during construction. The costs of additions and betterments are capitalized. Repairs and minor replacements are charged to operation and maintenance expense. The net cost of utility plant retired, together with removal costs less salvage, is recorded to accumulated depreciation when the property is removed from service.

The policy of Southwestern and the Corps is to move capitalized costs into completed utility plant at the time a project or feature of a project is deemed to be substantially complete. A project is substantially complete when it is providing benefits and services for the intended purpose and is generating project purpose revenue, where applicable.

Depreciation on utility plant is computed on a straight-line basis over the estimated service lives of the various classes of property. Depreciation on utility plant assets is depreciated using the straight-line method over the estimated service lives ranging from 5 to 50 years for transmission assets and 5 to 100 years for generation assets.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2022 and 2021

Most completed utility plant is recovered through the rates regardless of whether an asset is abandoned, loses value, is disposed of significantly before the end of its estimated useful life or is destroyed. Consequently, the cash flow is not impaired regardless of the condition of the asset.

(d) Cash and Funds Held in Escrow

Cash represents the unexpended balance of funds authorized by Congress, customer advances, and spectrum relocation funds, held at the U.S. Department of the Treasury (U.S. Treasury), and allocations of the amount of funds required to satisfy current hydroelectric power obligations.

Funds held in escrow represent the unexpended balance of cash and cash equivalents held in a bank trust escrow account under alternative financing agreements (note 5 (b)) with certain customers and are restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. Under the agreements, funds deposited to the escrow account by customers are credited by Southwestern against accounts receivable for power, energy, and other services sold to the customer. The escrowed funds are transferred to the Corps, as needed, to meet contractual obligations as outlined in the associated agreements. Excess funds held in escrow, if any, are used to fund additional operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region as agreed to between Southwestern, the Corps, and the customers.

(e) Congressional Appropriations

Southwestern and the Corps receive congressional appropriations through the DOE and the DOD, respectively, to finance their operations. A portion of Southwestern's appropriations is offset by the use of receipts collected from the sale of Federal hydroelectric power, resulting in a net zero appropriation. The Corps also receives appropriations to finance construction of its hydroelectric projects. In accordance with the Flood Control Act, Southwestern is responsible for repayment to the Federal government, with interest, of its appropriations, and the portion of congressional appropriations allocated to the Corps for construction and operations of the power projects.

Congressional appropriations received by the Corps are authorized and allocated to individual projects. It is the intent of the Corps' project management to distribute congressional appropriations in amounts approximating estimated current year expenses and to adjust the distribution as necessary within the limits of the transfer authority residing at the district level. Project costs that are not specific to a project purpose are distributed between power and non-power purposes based on project cost allocation.

(f) Operating Revenues

The SWFPS recognizes operating revenues in accordance with ASU No. 2014-09, *Revenue from Contracts with Customers (ASC Topic 606)*, which requires a company to recognize revenue when the company transfers of control of promised goods or services to the customer.

Under the provisions of Topic 606, the SWFPS has elected the following practical expedients:

- Recognize revenue in the amount SWFPS has the right to invoice a customer.
- Apply the standard to a portfolio of contracts with similar characteristics, as the effects of applying the guidance to the portfolio would not differ materially from applying this guidance to the individual contracts.

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Operating revenues are recorded on the basis of service rendered. Rates are established under requirements of the Flood Control Act, related legislation and executive departmental directives, and are to provide sufficient revenues to meet all required repayment of system costs, including operation and maintenance expenses less depreciation, interest, and payment to the U.S. Treasury for the Payable to U.S. Treasury in utility plant. Rates are intended to provide for recovery of the investment in transmission and generating facilities not to exceed 50 years from the date placed in service, while operation and maintenance costs and interest on Payable to U.S. Treasury are intended to be recovered annually.

As set forth in note 1(c), assets are being depreciated for financial reporting purposes using the straight-line method over their estimated service lives. Accordingly, annual depreciation charges are not matched with the recovery of the related capital costs and will, in the case of generating facilities, continue beyond the period within which such costs will have been recovered through rates.

While energy and transmission rates are established to recover the costs of operating the power projects, rates are also required to be at the lowest possible level, consistent with sound business principles. Over the life of the power system, accumulated net revenues represent differences between the timing of the recognition of expenses and related revenues, resulting primarily from the difference between the recognition of depreciation and the related recovery of the U.S. Treasury's investment in utility plant. SWFPS is, in effect, a Federal entity, thus at any given time the accumulated net revenues, to the extent available, are committed to the repayment of the Payable to U.S. Treasury.

The practices followed by Southwestern and the Corps are in conformity with the accounting practices and standards established by DOE and DOD and the requirements of specific legislation and executive directives issued by government agencies. Based upon guidelines established in DOE Order RA 6120.2, revenues distributed to the Corps cover annual operating expenses, including interest, with the remainder applied to the unpaid generation and transmission investment.

In addition to providing electric power and energy, Southwestern provides scheduling, billing, and other ancillary services. Southwestern may provide multiple services to any one customer. Services qualify as separate performance obligations under ASU No. 2014-09 with distinguishable rates, terms, and delivery schedules. Services are provided to meet customer load requirements and revenues are recognized when services are provided.

(g) Regulatory Assets and Liabilities (Note 4)

Regulatory assets and liabilities result from rate actions of Southwestern's Administrator and other regulatory agencies. These assets and liabilities arise from specific costs and revenues that would have been included in the determination of net revenue in one period but are deferred until a different period for purposes of developing rates to charge for services, per the requirements of ASC Topic 980, *Regulated Operations*. SWFPS defers transactions as regulatory assets and liabilities so that costs will be recovered during the periods when the costs are scheduled to be paid, which ensures the matching of revenues and expenses. The assets and liabilities below are regulatory in nature:

Deferred Workers' Compensation

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)

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and a liability for expenses associated with actual claims incurred and paid by the Department of Labor (DOL), the program administrator, whom SWFPS must reimburse. DOL, DOE, and DOD determined Southwestern and the Corps' actuarial liability associated with workers' compensation cases. The actuarial liability for future claims is determined using historical benefit payment patterns and the U.S. Treasury discount rates.

The recovery of these future claims is deferred for purposes of the rate-making process until such time as the future claims are actually submitted and paid by the DOL. Therefore, the recognition of the expenses associated with this actuarially determined liability has been recorded as deferred workers' compensation in the combined balance sheets in accordance with ASC Topic 980 to reflect the effects of the rate-making process. SWFPS does not earn a rate of return on the deferred workers' compensation regulatory asset.

Denison Hydropower Water Storage Reallocation

Section 838 of P.L. 99-662 (Section 838) authorized the Corps to reallocate hydropower storage to water supply storage at Lake Texoma, in increments as needed, up to 150,000 acre-feet for users in the State of Texas and up to 150,000 acre-feet for users in the State of Oklahoma. Section 838 directed that the Corps would provide credits to Southwestern equal to the replacement cost of the hydropower lost as a result of the reallocations, and Southwestern would reimburse the preference customers (Denison allottees) for an amount equal to the customers' replacement cost of the hydropower lost as a result of the reallocations.

In fiscal year 2010, the Corps executed water supply contracts for the 150,000 acre-feet of storage authorized for customers in the State of Texas by Section 838. According to a June 2010 agreement between Southwestern and the Corps, the Corps agreed to deposit all cost of storage payments for storage reallocated under Section 838 into the U.S. Treasury and to provide credits in the same amount to the hydropower income account. The total amount received of \$58,786,011 was deferred by Southwestern for the provision of the reimbursement to the Denison allottees and Southwestern for future hydropower storage revenues foregone. The reallocation deferral accrued interest at 1.88% and 1.63% of the outstanding balance for the years ended September 30, 2022 and 2021, respectively, based on law, administrative order, or administrative policy. Cumulative interest deferred totaled \$20,332,635 and \$19,236,918 and the unpaid principal balance deferred totaled \$38,244,310 and \$40,158,476 for the years ended September 30, 2022 and 2021, respectively.

A September 2010 agreement between Southwestern and the Denison allottees provided the initial hydropower replacement cost as determined by Southwestern and the methodology for providing the reimbursement to the Denison allottees as authorized under Section 838. Beginning with the invoice for the October 2010 service month, reimbursement pursuant to Section 838 began as a credit on the Denison allottees' monthly invoices. Reimbursement to the Denison allottees and distribution of revenue foregone to Southwestern's integrated system will continue as long as there is a reallocation deferred balance of funds, subject to provisions established in the aforementioned agreements between Southwestern and the Corps and between Southwestern and the Denison allottees.

Purchased Power and Banking Exchange Deferral

SWFPS utilizes a separate rate component (purchased power adder) to recover the estimated cost of purchased power based upon the average purchased power costs expected to occur in the future. If

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the actual expenses of purchased power exceed the revenue generated from this adder, the cost is deferred for future recovery through the rates. Likewise, if the expense is less than the adder, the excess revenue is deferred. From time to time, SWFPS may utilize a separate rate component (adder adjustment) to manage additional purchased power expenses or excess revenues, respectively. The net purchased power deferral accrued interest at 1.88% and 1.63% of the outstanding balance for the years ended September 30, 2022 and 2021, respectively, based on law, administrative order, or administrative policy. Interest expense deferred on the outstanding balance totaled \$1,157,210 and \$1,081,107 for the years ended September 30, 2022 and 2021, respectively.

SWFPS has arrangements with certain customers in which excess power available on the power system is banked with the customer until needed by the power system and the customer has power available. The power system records a receivable for the power banked at the cost specified in the marketing arrangement, under the provisions of ASC Topic 845, *Nonmonetary Transactions*. The net revenue or expense associated with banking activity is deferred until the power is returned or delivered.

(h) Accounts Receivable

SWFPS's accounts receivable consist generally of receivables for power and energy sold to its customers who are primarily public bodies and cooperatives. SWFPS provides for uncollectible accounts if collection is in doubt. There is no allowance for uncollectible accounts for the years ended September 30, 2022 and 2021.

Southwestern's billing methods include net billing. Net billing is an agreement between Southwestern and a customer, whereby the customer's power invoice is credited and the funds received from the sale of power are used to fund transmission and generation activities. Net billing is discussed more fully in note 5(b). Under Southwestern billing methods, purchase and sale transactions are reported "gross" in the combined financial statements.

(i) Concentration of Credit Risk

Financial instruments, which potentially subject SWFPS to credit risk, include accounts receivable for customer purchases of power, transmission, or other products and services. These receivables are primarily with a group of diverse customers that are generally stable and established organizations and do not represent a significant credit risk. Although SWFPS is affected by the business environment of the utility industry, management does not believe a significant risk of loss from a concentration of credit exists.

(j) Interest on Payable to U.S. Treasury

Interest on payable to U.S. Treasury is a cost mandated by the Secretary of Energy and by the FERC. SWFPS computes interest in accordance with DOE Order RA 6120.2, which provides that interest be computed on the remaining investment after revenues have been applied to recovery of costs during the year, any prior year unpaid costs, and also to unpaid Federal investment at the applicable interest rate.

(k) Allowance for Funds Used During Construction

The FERC Uniform System of Accounts defines Allowance for Funds Used During Construction as the net costs for the period of borrowed funds used for construction purposes and a reasonable rate on

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other funds when so used. While cash is not realized currently from this allowance, it is realized under the rate-making process over the repayment life of the related property through increased revenues resulting from a higher recoverable investment. The interest rates used were 1.88% and 1.63% for the years ended September 30, 2022 and 2021, respectively, based on law, administrative order, or administrative policy.

(l) Retirement Benefits

SWFPS 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 are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Based on statutory contribution rates, the fiscal years 2022 and 2021 cost factors under CSRS were 46.2% and 42.1%, respectively, of basic pay. The cost factors under FERS for fiscal years 2022 and 2021 were 19.7% and 18.5%, respectively, of basic pay. The contribution levels, however, are legislatively mandated and do not reflect the current full cost requirements to fund the plans. Costs incurred by OPM on behalf of SWFPS are included as transfers of property and services, net, within the Payable to U.S. Treasury on the combined balance sheets.

Other retirement benefits administered by OPM include the Federal Employees Health Benefits Program (FEHB) and the Federal Employees Group Life Insurance Program (FEGLI). FEHB is calculated at \$8,775 and \$8,476 per enrolled employee, for fiscal years 2022 and 2021, respectively, and FEGLI is based on 0.02% of basic pay for each employee enrolled in these programs.

In addition to the amounts contributed to the CSRS and FERS as stated previously, SWFPS recorded an expense and related liability for the pension and other postretirement benefits in the combined financial statements of \$8,369,135 and \$7,678,928 for the years ended September 30, 2022 and 2021, respectively. These amounts reflect the contributions made on behalf of SWFPS by OPM to the benefit program trust funds.

As a Federal agency, all post-retirement activity is managed by OPM, therefore, neither the assets of the plans nor the actuarial data with respect to the accumulated plan benefits relative to Southwestern and the Corps employees are included in this report.

(m) Transfers of Property and Services, Net

Transfers of property and services, net, is a component of total capitalization that represents the cumulative receipt of transfers of assets or costs offset by the cumulative disbursement of revenue transfers. Transfers are recognized upon physical delivery of the asset or performance of the service. Transfers occur between projects, project types, and other Federal entities. Transfers between Southwestern and the Corps eliminate upon combination.

(n) Income Taxes

As agencies of the U.S. Government, Southwestern and the Corps are exempt from all income taxes imposed by any governing body, whether it is a Federal, state, or commonwealth of the United States.

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(o) Use of Estimates

The preparation of the combined financial statements in conformity with U.S. GAAP requires management of SWFPS to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Due to uncertainties inherent in the estimation process, actual results could differ from those estimates.

(p) Non-Reimbursable Activities

Non-reimbursable activities for the years ended September 30, 2022 and 2021 consist of the following:

	2022	2021
Non-reimbursable revenues:		
Non-Federal project revenue	\$ 47,807	129,240
Federal project revenue	92,266	431,544
COVID-19 project revenue	—	533,155
Escrow interest revenue	2,029,975	157,178
Total non-reimbursable revenues	\$ 2,170,048	1,251,117
Non-reimbursable expenses:		
Non-Federal project expense	\$ 47,807	129,240
Federal project expense	92,266	431,544
COVID-19 project expense	—	533,155
White River Minimum Flows Project expense	3,016,926	2,416,011
Spectrum Relocation Fund expense	758,979	361,477
Total non-reimbursable expenses	\$ 3,915,978	3,871,427

Federal and Non-Federal Projects

Southwestern has agreements with Federal and non-Federal entities to provide services on a cost basis. Non-Federal entities are required to provide advance payment for Southwestern's services. The operating revenues and expenses related to these services are excluded from the rate-making process. A portion of cash and advances for construction in the accompanying combined financial statements relate to these activities.

COVID-19 Activity

In May 2020, Southwestern received \$556,041 from DOE in non-reimbursable funding provided under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Public Law 116-136, to prevent, prepare for, and respond to COVID-19 pandemic necessary expenses related to supporting remote access for personnel. The funds remained available until September 30, 2021. This activity is non-reimbursable through the rate-making process.

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Escrow Interest Revenue

Interest revenue represents the interest earned on funds held in escrow. These funds are authorized specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. This activity is non-reimbursable through the rate-making process.

White River Minimum Flows Project

In accordance with Section 132 of P.L. 109-103, Southwestern implemented the offset to the minimum flows project in fiscal year 2010. Section 132 provided that losses to Federal hydropower shall be offset by a reduction in the costs allocated to the Federal hydropower purpose. Southwestern determined the Federal hydropower impacts to include lost on-peak energy and capacity, lost off-peak energy, increased costs due to dissolved oxygen impacts, and increased maintenance costs at Bull Shoals. This activity is non-reimbursable through the rate-making process.

Spectrum Relocation Fund

In December 2004, the U.S. Congress passed and the President signed the Commercial Spectrum Enhancement Act (CSEA, Title II of P.L. 108-494), creating the Spectrum Relocation Fund to streamline the relocation of Federal systems from existing spectrum bands to accommodate commercial use by facilitating reimbursement to affected agencies of relocation costs. In fiscal years 2012, 2009, and 2007, Southwestern received \$17,000,000, \$17,730,000, and \$8,091,360, respectively, in spectrum relocation funds, as approved by the Office of Management and Budget, and as reported to the Congress. Expenses incurred represent labor, construction contracts, travel, and other administrative costs. This activity is non-reimbursable through the rate-making process.

(q) Derivative and Hedging Activities

Southwestern analyzes derivative financial instruments under ASC Topic 815, *Derivatives and Hedging*. This standard requires that all derivative instruments, as defined by ASC Topic 815, be recorded on the combined balance sheets at fair value, unless exempted. Changes in a derivative instrument's fair value must be recognized currently in the combined statement of revenues and expenses, unless the derivative has been designated in a qualifying hedging relationship. The application of hedge accounting allows a derivative instrument's gains and losses to offset related results of the hedged item in the combined statements of revenues and expenses to the extent effective. ASC Topic 815 requires that the hedging relationship be highly effective and that an organization formally designate a hedging relationship at the inception of the contract to apply hedge accounting.

Southwestern enters into contracts for the sale of electricity for use in its business operations. ASC Topic 815 requires Southwestern to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that literally meet the definition of a derivative may be exempted from ASC Topic 815 as normal purchases or normal sales. Normal purchases and sales are contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period of time in the normal course of business. Contracts that meet the requirements of normal purchases or sales are documented and exempted from the accounting and reporting requirements of ASC Topic 815.

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Southwestern's policy is to fulfill all derivative and hedging contracts by providing power to a third party as provided for in each contract. Southwestern's policy does not authorize the use of derivative or hedging instruments for speculative purposes such as hedging electricity pricing fluctuations beyond Southwestern's estimated capability to deliver power. Accordingly, Southwestern evaluates all of its contracts to determine if they are derivatives and, if applicable, to ensure that they qualify and meet the normal purchases and normal sales designation requirements under ASC Topic 815. Normal purchases and normal sales contracts are accounted for as executory contracts as required under U.S. GAAP. As of September 30, 2022 and 2021, Southwestern has no contracts accounted for at fair value as all derivatives qualify as normal purchases and normal sales.

(r) Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. ASU No. 2016-02 is effective for the SWFPS for periods beginning after December 15, 2021 and early adoption is permitted. SWFPS is evaluating the effect that ASU No. 2016-02 will have on the SWFPS's combined financial statements and related disclosures.

(2) Disaggregated Revenue

Disaggregated revenues as of September 30, 2022 and 2021 consists of the following:

	2022	2021
Disaggregated revenues:		
Sale of Federal electric power	\$ 176,302,039	190,104,194
Non-Federal transmission services	16,349,394	16,888,399
Ancillary services	685,639	685,031
Other revenues	21,086,293	17,249,779
Total operating revenue before deferrals	\$ 214,423,365	224,927,403

Revenue from Contracts with Customers

Southwestern provides wholesale Federal electric power (energy and capacity) to preference power customers under long-term firm and non-firm contracts. Southwestern establishes power rates for these contracts in a formal rate setting process. Excess energy is sold at established power rates. Federal electric power revenues are recognized over time as the customer receives and consumes the benefits. Federal electric power revenues are billed monthly based on meter readings and contracted allocations and estimated unbilled electric power revenues are accrued at the end of each reporting period. Revenues can vary from period to period due to hydropower plant availability, hydrological conditions, and customer usage requirements.

Non-Federal transmission service revenues consist primarily of revenue for transmission of non-Federal power on Southwestern's transmission system. Transmission rates are established through a formal rate setting process and revenues are recognized over time as capacity and electric transmission is made available. Transmission services are billed monthly and estimated unbilled transmission services are accrued at the end of each reporting period.

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Ancillary services ensure transmission grid reliability and include items such as scheduling, system control, dispatch, balancing reserves and other services. Ancillary revenue is recognized over time as services are provided. Ancillary services are billed monthly and estimated unbilled ancillary services are accrued at the end of the reporting period.

Other revenues consist of headwater benefits, hydropower benefits foregone revenues and miscellaneous revenues from the Corps attributable to the power function, as well as market participant agreement revenues for the sale of power from Blakely Mountain and DeGray into the Midcontinent Independent System Operator (MISO) market plus miscellaneous revenues for Southwestern. These revenues are recognized upon receipt.

(3) Utility Plant

Utility plant as of September 30, 2022 and 2021 consists of the following:

	<u>2022</u>	<u>2021</u>
Plant in service:		
Generating facilities	\$ 1,681,729,858	1,505,728,576
Transmission facilities	<u>519,816,115</u>	<u>503,258,927</u>
	2,201,545,973	2,008,987,503
Less accumulated depreciation	<u>(977,969,863)</u>	<u>(932,857,532)</u>
Construction work in progress:		
Generating facilities	100,026,139	219,612,211
Transmission facilities	<u>36,732,197</u>	<u>38,232,056</u>
	<u>136,758,336</u>	<u>257,844,267</u>
Net utility plant	<u>\$ 1,360,334,446</u>	<u>1,333,974,238</u>

In accordance with FERC guidelines, SWFPS excludes contributed plant within the combined balance sheets to eliminate the impact on power rates. As of September 30, 2022 and 2021, contributed plant, net, used in SWFPS's operations totaled \$23,003,072.

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(4) Regulatory Assets and Liabilities

Regulatory assets and liabilities as of September 30, 2022 and 2021 consist of the following:

	2022	2021
Regulatory assets:		
Deferred workers' compensation	\$ 11,969,419	8,011,549
Regulatory liabilities:		
Purchased power and banking exchange deferral	\$ 63,129,246	70,475,290
Hydropower water storage reallocation deferral	58,576,945	59,395,394
Total	\$ 121,706,191	129,870,684

Southwestern's purchased power and banking exchange deferral account represents the deferral of net revenues or expenses associated with net purchased power and banking exchange activities as follows:

	Purchased power and banking exchange deferral
September 30, 2020	\$ (72,817,897)
Purchased power adder revenue	(14,544,998)
Purchased power expense	17,998,378
Net banking exchange	(78,706)
Net purchased power and banking exchange deferral	3,374,674
Interest on deferred activities and other	(1,032,067)
September 30, 2021	(70,475,290)
Purchased power adder revenue	(14,378,884)
Purchased power expense	22,952,969
Net banking exchange	(17,145)
Net purchased power and banking exchange deferral	8,556,940
Interest on deferred activities and other	(1,210,896)
September 30, 2022	\$ (63,129,246)

(5) Financing Sources

SWFPS's financing sources include annual appropriations, Federal power receipts, and alternative financing arrangements to fund its operations.

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(a) Payable to U.S. Treasury

Construction and operation of Southwestern's transmission system and the Corps' generating facilities and operations are financed through congressional appropriations. The exceptions are capital assets and maintenance activities funded through the alternative financing arrangements and the funding by non-Federal parties of the construction of the RD Willis project. The U.S. Government's investment in each generating project and each year's investment in the transmission system are to be repaid to the U.S. Treasury over a period not to exceed 50 years from the time the facility is placed in service. There is no requirement for repayment of a specific amount on an annual basis.

Annual revenues are first applied to the current year operating expenses (less depreciation) and interest expense. All annual amounts for such expenses have been paid through fiscal year 2022. Remaining revenues are to be first applied to repayment of operating deficits (which include all expenses except depreciation), if any, and then to repayment of the Payable to U.S. Treasury. To the extent possible, while still complying with the repayment period established for each increment of investment and unless otherwise required by legislation, repayment of the investment is to be accomplished by a repayment of the highest interest-bearing investment first. Interest rates applied to the unamortized investment of the U.S. Government in Southwestern's transmission system and the Corps' hydroelectric generating facilities range from 1.63% to 3.13% for unpaid facilities in service prior to and including fiscal year 2022 (1.88%). The rates have been set by law, by administrative order pursuant to law, or by administrative policies using the U.S. Senate Document No. 97 formula for the fiscal year during which the appropriations were requested.

(b) Alternative Financing

Due to fluctuations in the amount of annual appropriations received to fund operations, maintenance, rehabilitation, and modernization of SWFPS facilities, SWFPS has established an alternative financing program under reimbursable authority regulations. Under agreements with customers to finance projects, which benefit SWFPS, funds received from the sale of power are net billed, allowing a portion of the funds to be utilized to finance agreed-upon projects. Under the agreements with certain customers, alternative financing restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at the hydroelectric generating facilities is held in escrow (note 1(d)).

(6) Commitments and Contingencies

(a) General

Southwestern sells its marketable power to customers under long-term power sales contracts of 15 years, the majority of which require Southwestern to provide 1,200 kilowatt hours per kilowatt of peaking contract demand per year, subject to scheduling constraints outlined in each customer's contract. If sufficient power is unavailable to Southwestern from Corps' hydroelectric facilities to meet these commitments, Southwestern may be required to purchase power from other sources to meet these commitments. The cost to purchase such power is recovered through the purchased power adder discussed more fully in note 1(g).

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(b) Legal

SWFPS has exposure to certain claims and legal actions arising in the ordinary course of business. In February 2023, Southwestern received notification from the Sam Rayburn Municipal Power Agency of its intentions to terminate its power sales contract effective April 2023 relating to the RD Willis powerhouse. This termination potentially impacts a large percentage of RD Willis financial receipts. Southwestern is working in conjunction with the Corps, DOE, and the U.S. Department of Justice to evaluate options for resolution. It is uncertain the impact this matter will have on RD Willis project rates or payments to the U.S Treasury as reimbursement for outstanding project costs.

SWPS has accrued legal liabilities of \$3,474,420 as of September 30, 2022, where additional capital costs were determined to be probable based on a settlement reached as a subsequent event in March 2023.

(7) Leases

Southwestern has a 191-month Occupancy Agreement for office space with the General Services Administration (GSA), which commenced January 19, 2018 and is scheduled to terminate December 31, 2033. The lease agreement between the GSA and the building owner is for a 20-year term, 10-year firm term for the first 10 years and the option to terminate during the second 10-year-term, which commenced on January 1, 2014 and ends on December 31, 2033.

In August 2019, Southwestern purchased a new headquarters building in Tulsa, Oklahoma, with a fiscal year 2023 target move-in date. In accordance with the Occupancy Agreement, Southwestern may relinquish space upon four months' notice to GSA, and will not be obligated to make any additional payments.

As of September 30, 2022, expected future minimum lease payments, given the termination of the Occupancy Agreement by December 31, 2023, are as follows:

Year ending September 30:	
2023	\$ 371,421
2024	<u>92,855</u>
Total future minimum lease payments	<u>\$ 464,276</u>

Rent expense for operating leases during the years ended September 30, 2022 and 2021 was \$522,218 and \$760,635, respectively.

(8) Related Parties

As components of the DOE and the DOD, these departments are considered related parties to Southwestern and the Corps. Southwestern has certain agreements with DOD components to provide electric power, transmission services, and other services. As of September 30, 2022 and 2021, amounts outstanding in accounts receivable relating to DOD components totaled \$277,948 and \$290,323, respectively. For the years ended September 30, 2022 and 2021, total operating revenues earned from DOD components totaled \$3,957,335 and \$4,161,553, respectively.

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(9) Subsequent Events

SWFPS has evaluated subsequent events from the balance sheet date through June 30, 2023, the date the combined financial statements were available to be issued, and such events are disclosed in note 6(b).

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Combining Schedule of Balance Sheet Data

September 30, 2022

Assets	Southwestern	Corps	Total
Plant in service	\$ 519,816,115	1,681,729,858	2,201,545,973
Accumulated depreciation	(276,379,887)	(701,589,976)	(977,969,863)
Construction work in progress	<u>36,732,197</u>	<u>100,026,139</u>	<u>136,758,336</u>
Net utility plant	280,168,425	1,080,166,021	1,360,334,446
Cash	322,771,439	370,873,098	693,644,537
Funds held in escrow	125,064,224	55,069,502	180,133,726
Accounts receivable	24,035,288	449,870	24,485,158
Materials and supplies, at average cost	3,888,126	68,912	3,957,038
Banking exchange receivables	4,233,882	—	4,233,882
Deferred workers' compensation	2,908,637	9,060,782	11,969,419
Other assets	<u>924,275</u>	<u>—</u>	<u>924,275</u>
Total assets	<u>\$ 763,994,296</u>	<u>1,515,688,185</u>	<u>2,279,682,481</u>
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 10,619,576	14,122,896	24,742,472
Advances for construction	2,471,234	—	2,471,234
Accrued workers' compensation	3,451,423	9,294,949	12,746,372
Purchased power and banking exchange deferral	63,129,246	—	63,129,246
Hydropower water storage reallocation deferral	<u>58,576,945</u>	<u>—</u>	<u>58,576,945</u>
Total liabilities	<u>138,248,424</u>	<u>23,417,845</u>	<u>161,666,269</u>
Capitalization:			
Payable to U.S. Treasury	472,005,614	883,723,059	1,355,728,673
Accumulated net revenues	<u>153,740,258</u>	<u>608,547,281</u>	<u>762,287,539</u>
Total capitalization	<u>625,745,872</u>	<u>1,492,270,340</u>	<u>2,118,016,212</u>
Total liabilities and capitalization	<u>\$ 763,994,296</u>	<u>1,515,688,185</u>	<u>2,279,682,481</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Balance Sheet Data

September 30, 2021

Assets	Southwestern	Corps	Total
Plant in service	\$ 503,258,927	1,505,728,576	2,008,987,503
Accumulated depreciation	(267,166,285)	(665,691,247)	(932,857,532)
Construction work in progress	38,232,056	219,612,211	257,844,267
Net utility plant	274,324,698	1,059,649,540	1,333,974,238
Cash	279,623,895	324,089,663	603,713,558
Funds held in escrow	152,234,548	42,478,775	194,713,323
Accounts receivable	27,361,847	676,509	28,038,356
Materials and supplies, at average cost	3,240,425	161,015	3,401,440
Banking exchange receivables	4,233,431	—	4,233,431
Deferred workers' compensation	2,398,167	5,613,382	8,011,549
Other assets	596,485	—	596,485
Total assets	<u>\$ 744,013,496</u>	<u>1,432,668,884</u>	<u>2,176,682,380</u>
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 9,763,611	12,683,572	22,447,183
Advances for construction	1,521,985	—	1,521,985
Accrued workers' compensation	2,893,258	5,840,773	8,734,031
Purchased power and banking exchange deferral	70,475,290	—	70,475,290
Hydropower water storage reallocation deferral	59,395,394	—	59,395,394
Total liabilities	<u>144,049,538</u>	<u>18,524,345</u>	<u>162,573,883</u>
Capitalization:			
Payable to U.S. Treasury	474,975,372	799,569,150	1,274,544,522
Accumulated net revenues	124,988,586	614,575,389	739,563,975
Total capitalization	<u>599,963,958</u>	<u>1,414,144,539</u>	<u>2,014,108,497</u>
Total liabilities and capitalization	<u>\$ 744,013,496</u>	<u>1,432,668,884</u>	<u>2,176,682,380</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Changes in Capitalization Data

Years ended September 30, 2022 and 2021

	Southwestern payable to U.S. Treasury	Southwestern accumulated net revenues (deficit)	Southwestern total capitalization	Corps payable to U.S. Treasury	Corps accumulated net revenues (deficit)	Corps total capitalization	Total capitalization
Total capitalization as of September 30, 2020	\$ 595,678,875	119,354,078	715,032,953	677,398,015	580,860,448	1,258,258,463	1,973,291,416
Additions:							
Congressional appropriations	10,400,000	—	10,400,000	60,861,101	—	60,861,101	71,261,101
Interest on payable to U.S. Treasury and other	928,192	—	928,192	11,515,303	—	11,515,303	12,443,495
Transfers of property and services, net	(188,828,831)	—	(188,828,831)	197,739,616	—	197,739,616	8,910,785
Total additions to capitalization	(177,500,639)	—	(177,500,639)	270,116,020	—	270,116,020	92,615,381
Deductions:							
Payments to U.S. Treasury	56,797,136	—	56,797,136	(147,944,885)	—	(147,944,885)	(91,147,749)
Total deductions to capitalization	56,797,136	—	56,797,136	(147,944,885)	—	(147,944,885)	(91,147,749)
Net revenues for the year ended September 30, 2021	—	5,634,508	5,634,508	—	33,714,941	33,714,941	39,349,449
Total capitalization as of September 30, 2021	474,975,372	124,988,586	599,963,958	799,569,150	614,575,389	1,414,144,539	2,014,108,497
Additions:							
Congressional appropriations	10,400,000	—	10,400,000	99,103,347	—	99,103,347	109,503,347
Interest on payable to U.S. Treasury and other	572,827	—	572,827	10,222,854	—	10,222,854	10,795,681
Transfers of property and services, net	(88,321,531)	—	(88,321,531)	91,823,411	—	91,823,411	3,501,880
Total additions to capitalization	(77,348,704)	—	(77,348,704)	201,149,612	—	201,149,612	123,800,908
Deductions:							
Payments to U.S. Treasury	74,378,946	—	74,378,946	(116,995,703)	—	(116,995,703)	(42,616,757)
Transfers of property and services, net	—	—	—	—	—	—	—
Total deductions to capitalization	74,378,946	—	74,378,946	(116,995,703)	—	(116,995,703)	(42,616,757)
Net revenues for the year ended September 30, 2022	—	28,751,672	28,751,672	—	(6,028,108)	(6,028,108)	22,723,564
Total capitalization as of September 30, 2022	\$ 472,005,614	153,740,258	625,745,872	883,723,059	608,547,281	1,492,270,340	2,118,016,212

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM
Combining Schedule of Revenues and Expenses Data
Year ended September 30, 2022

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 176,992,735	—	176,992,735
Transmission and other operating revenues	<u>34,584,727</u>	<u>2,845,903</u>	<u>37,430,630</u>
Total operating revenues before deferrals	211,577,462	2,845,903	214,423,365
Net purchased power and banking exchange deferral	8,556,940	—	8,556,940
Revenue distributed to Corps	<u>(110,229,178)</u>	<u>110,229,178</u>	<u>—</u>
Total operating revenues	109,905,224	113,075,081	222,980,305
Non-reimbursable revenues	<u>1,379,321</u>	<u>790,727</u>	<u>2,170,048</u>
Total revenues	<u>111,284,545</u>	<u>113,865,808</u>	<u>225,150,353</u>
Operating expenses:			
Operation and maintenance	37,256,541	75,627,528	112,884,069
Purchased power and banking exchange	24,869,181	—	24,869,181
Depreciation and amortization	14,683,521	39,464,390	54,147,911
Transmission service charges by others	32,913	—	32,913
Non-reimbursable expenses	<u>3,915,978</u>	<u>—</u>	<u>3,915,978</u>
Total operating expenses	<u>80,758,134</u>	<u>115,091,918</u>	<u>195,850,052</u>
Net operating revenues	<u>30,526,411</u>	<u>(1,226,110)</u>	<u>29,300,301</u>
Interest expense:			
Interest on payable to U.S. Treasury and other	2,825,754	10,222,854	13,048,608
Allowance for funds used during construction	<u>(1,051,015)</u>	<u>(5,420,856)</u>	<u>(6,471,871)</u>
Net interest expense	1,774,739	4,801,998	6,576,737
Net revenues (losses)	<u>\$ 28,751,672</u>	<u>(6,028,108)</u>	<u>22,723,564</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM
Combining Schedule of Revenues and Expenses Data
Year ended September 30, 2021

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 190,852,384	—	190,852,384
Transmission and other operating revenues	<u>31,421,467</u>	<u>2,653,552</u>	<u>34,075,019</u>
Total operating revenues before deferrals	222,273,851	2,653,552	224,927,403
Net purchased power and banking exchange deferral	3,374,674	—	3,374,674
Revenue distributed to Corps	<u>(141,446,399)</u>	<u>141,446,399</u>	<u>—</u>
Total operating revenues	84,202,126	144,099,951	228,302,077
Non-reimbursable revenues	<u>1,228,819</u>	<u>22,298</u>	<u>1,251,117</u>
Total revenues	<u>85,430,945</u>	<u>144,122,249</u>	<u>229,553,194</u>
Operating expenses:			
Operation and maintenance	38,248,490	82,638,721	120,887,211
Purchased power and banking exchange	19,902,646	—	19,902,646
Depreciation and amortization	15,239,133	24,012,193	39,251,326
Transmission service charges by others	108,290	—	108,290
Non-reimbursable expenses	<u>3,871,427</u>	<u>—</u>	<u>3,871,427</u>
Total operating expenses	<u>77,369,986</u>	<u>106,650,914</u>	<u>184,020,900</u>
Net operating revenues	<u>8,060,959</u>	<u>37,471,335</u>	<u>45,532,294</u>
Interest expense:			
Interest on payable to U.S. Treasury and other	2,974,030	11,515,303	14,489,333
Allowance for funds used during construction	<u>(547,579)</u>	<u>(7,758,909)</u>	<u>(8,306,488)</u>
Net interest expense	2,426,451	3,756,394	6,182,845
Net revenues (losses)	<u>\$ 5,634,508</u>	<u>33,714,941</u>	<u>39,349,449</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2022

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues (losses)	\$ 28,751,672	(6,028,108)	22,723,564
Adjustments to reconcile net revenues to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	110,229,178	(110,229,178)	—
Depreciation and amortization	14,683,521	39,464,390	54,147,911
Benefit expense paid by other Federal agencies	1,416,864	6,952,271	8,369,135
Interest on payable to U.S. Treasury and other	1,774,739	4,801,998	6,576,737
Deferred workers' compensation	(510,470)	(3,447,400)	(3,957,870)
(Increase) decrease in assets:			
Accounts receivable	3,326,559	226,639	3,553,198
Materials and supplies	(647,701)	92,103	(555,598)
Banking exchange receivables	(451)	—	(451)
Other assets	(327,790)	—	(327,790)
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	855,965	1,439,324	2,295,289
Accrued workers' compensation	558,165	3,454,176	4,012,341
Purchased power and banking exchange deferral	(8,503,254)	—	(8,503,254)
Advances for construction	949,249	—	949,249
Net cash provided by (used in) operating activities	<u>152,556,246</u>	<u>(63,273,785)</u>	<u>89,282,461</u>
Cash flows used in investing activities:			
Additions to utility plant	<u>(19,476,233)</u>	<u>(54,560,015)</u>	<u>(74,036,248)</u>
Cash flows from financing activities:			
Congressional appropriations	10,400,000	99,103,347	109,503,347
Payments to U.S. Treasury	74,378,946	(116,995,703)	(42,616,757)
Revenue distributed to Corps	(110,229,178)	110,229,178	—
Transfers of property and services, net	(89,738,395)	84,871,140	(4,867,255)
Hydropower water storage reallocation deferral	(1,914,166)	—	(1,914,166)
Net cash (used in) provided by financing activities	<u>(117,102,793)</u>	<u>177,207,962</u>	<u>60,105,169</u>
Net increase (decrease) in cash and funds held in escrow	15,977,220	59,374,162	75,351,382
Cash and funds held in escrow, beginning of year	<u>431,858,443</u>	<u>366,568,438</u>	<u>798,426,881</u>
Cash and funds held in escrow, end of year	<u>\$ 447,835,663</u>	<u>425,942,600</u>	<u>873,778,263</u>
Supplemental cash flow information:			
Interest charged to construction	\$ 1,051,015	5,420,856	6,471,871
Transfer of construction work in progress to plant in service	12,659,380	158,785,738	171,445,118

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2021

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues (losses)	\$ 5,634,508	33,714,941	39,349,449
Adjustments to reconcile net revenues to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	141,446,399	(141,446,399)	—
Depreciation and amortization	15,239,133	24,012,193	39,251,326
Benefit expense paid by other Federal agencies	1,401,396	6,277,532	7,678,928
Interest on payable to U.S. Treasury and other	2,426,451	3,756,394	6,182,845
Deferred workers' compensation	(596,605)	(131,414)	(728,019)
(Increase) decrease in assets:			
Accounts receivable	(10,808,011)	(186,706)	(10,994,717)
Materials and supplies	(273,284)	(54,390)	(327,674)
Banking exchange receivables	(59,991)	—	(59,991)
Other assets	1,109,112	—	1,109,112
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	813,907	3,408,723	4,222,630
Accrued workers' compensation	539,747	262,316	802,063
Purchased power and banking exchange deferral	(3,423,714)	—	(3,423,714)
Advances for construction	(970,721)	—	(970,721)
Net cash provided by (used in) operating activities	<u>152,478,327</u>	<u>(70,386,810)</u>	<u>82,091,517</u>
Cash flows used in investing activities:			
Additions to utility plant	<u>(14,974,663)</u>	<u>(55,689,410)</u>	<u>(70,664,073)</u>
Cash flows from financing activities:			
Congressional appropriations	10,400,000	60,861,101	71,261,101
Payments to U.S. Treasury	56,797,136	(147,944,885)	(91,147,749)
Revenue distributed to Corps	(141,446,399)	141,446,399	—
Transfers of property and services, net	(190,230,227)	191,462,084	1,231,857
Hydropower water storage reallocation deferral	(1,874,796)	—	(1,874,796)
Net cash (used in) provided by financing activities	<u>(266,354,286)</u>	<u>245,824,699</u>	<u>(20,529,587)</u>
Net increase in cash and funds held in escrow	<u>(128,850,622)</u>	<u>119,748,479</u>	<u>(9,102,143)</u>
Cash and funds held in escrow, beginning of year	<u>560,709,065</u>	<u>246,819,959</u>	<u>807,529,024</u>
Cash and funds held in escrow, end of year	<u>\$ 431,858,443</u>	<u>366,568,438</u>	<u>798,426,881</u>
Supplemental cash flow information:			
Interest charged to construction	\$ 547,579	7,758,909	8,306,488
Transfer of construction work in progress to plant in service	1,401,563	70,436,523	71,838,086

See accompanying independent auditors' report.

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