




## Department of Energy

Washington, DC 20585

February 16, 2001

### MEMORANDUM FOR THE SECRETARY

FROM:

  
Gregory H. Friedman  
Inspector General

SUBJECT:

**INFORMATION:** Report on the Department of Energy's Consolidated Financial Statements

I am pleased to inform you that the Department's financial statements for Fiscal Year 2000 have received an unqualified audit opinion. This is the second year in a row that the Department has received such an opinion. The audit of the Department's statements was conducted pursuant to the Government Management and Reform Act of 1994. The objective of the Act is to improve financial practices in the Federal Government by issuing audited financial statements for each agency. The preparation of the statements is the responsibility of the Department, and the Office of Inspector General (OIG) is responsible for the audit.

This year, the OIG contracted with the accounting firm of KPMG LLP to conduct the audit. A copy of the report is attached. The accounting firm concluded that the financial statements present fairly, in all material respects, the Department's financial position as of September 30, 2000, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations and custodial activities for the year then ended. The OIG agrees with this opinion.

As part of this determination, the auditors considered the Department's internal control over financial reporting and tested the Department's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on the consolidated financial statements.

Three reportable weaknesses in the Department's system of internal controls were identified. These related to: (1) Performance Measurement Reporting; (2) Financial Management at the Western Area Power Administration (Western); and (3) Unclassified Information System Security. Each of these items represents a repeat finding from the prior year's audit report.

- Although the Department made improvements in reporting the results of its performance activities, the quality of certain measures was questionable. Specifically, performance goals, in many cases, were not output or outcome oriented; some were not meaningful or relevant or stated in objective or quantifiable terms. Additionally, costs were not clearly related to outcomes.



- For most of Fiscal Year 2000, Western's financial system did not generate timely, useful reports containing complete and accurate financial information. To compensate for the increased control risk, an intensive effort was required to ensure reliability of Western's financial information and account balances. As of December 2000, Western had made progress. This improvement allowed KPMG to consider this a reportable condition instead of a material internal control weakness as was reported last year by the OIG.
- In the area of Unclassified Information System Security, the Department has certain network vulnerabilities and general access control weaknesses. Full implementation of the Cyber Security Program throughout the Department should help ensure that Federal information standards are met, and that information systems are adequately protected against unauthorized access.

Significant progress was made in one area relating to the environmental liability estimate. The Department utilizes a parametric model to estimate the majority of the \$26 billion clean-up cost for active and surplus facilities. Most of the active facilities cost is associated with the clean-up of facilities in the National Nuclear Security Administration. This year, the Department improved the quality of input data for this estimate in response to a recommendation in our last year's report. Accordingly, this issue is no longer a reportable condition.

To ensure the quality of the audit, the OIG approved the scope of KPMG's assignment and monitored their work. We also reviewed the audit report and related working papers to ensure compliance with applicable auditing standards.

I would like to thank all elements of the Department for their courtesy and cooperation during the conduct of the audit.

Attachment

cc: Under Secretary for Nuclear Security/Administrator for Nuclear Security  
Chief Financial Officer



2001 M Street N.W.  
Washington, D.C. 20036

## INDEPENDENT AUDITORS' REPORT

The Inspector General, U.S. Department of Energy:

We have audited the Fiscal Year 2000 consolidated financial statements of the U.S. Department of Energy (Department). The objective of our audit was to express an opinion on the fair presentation of the Department's consolidated financial statements. In connection with our audit, we also considered the Department's internal control over financial reporting and tested the Department's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its consolidated financial statements.

### Summary

As stated in our opinion, we concluded that the Department's Fiscal Year 2000 consolidated financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

The cost estimates supporting the Department's environmental remediation liability of \$234 billion, as of September 30, 2000, are based upon assumptions regarding future actions and decisions spanning several decades, many of which are beyond the Department's control. These matters are discussed in Note 13 to the consolidated financial statements.

Our consideration of internal control over financial reporting resulted in reportable conditions in the following three areas:

Performance measurement reporting;  
Network vulnerabilities and access control weaknesses relating to unclassified computer information systems, and  
Financial management at Western Area Power Administration.

Our tests of compliance with certain provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under *Government Auditing Standards*, issued by the U.S. General Accounting Office or Office of Management and Budget (OMB) audit guidance.

The following sections discuss our opinion on the Department's consolidated financial statements, our consideration of the Department's internal control over financial reporting, the results of our tests of the Department's compliance with certain provisions of laws and regulations, and management's and our responsibilities.



## Independent Auditors' Report

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### Opinion on Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of the U.S. Department of Energy as of September 30, 2000, and the related consolidated statements of net cost, changes in net position, budgetary resources, financing, and custodial activities for the year then ended.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the U.S. Department of Energy as of September 30, 2000, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activities for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the consolidated financial statements, the cost estimates supporting the Department's environmental remediation liability of \$234 billion, as of September 30, 2000, are based upon assumptions regarding future actions and decisions spanning several decades, many of which are beyond the Department's control.

The accompanying consolidated financial statements of the Department as of and for the year ended September 30, 1999 were audited by other auditors whose report thereon, dated January 31, 2000, expressed an unqualified opinion on those statements.

The information in the Overview and Required Supplementary Information sections of the Department's *Fiscal Year 2000 Performance and Accountability Report* is not a required part of the consolidated financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board or OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. We did not audit the information in the Overview and Required Supplementary Information sections and, accordingly, we express no opinion on it. We have applied certain limited procedures that consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. We determined that the Department did not complete the intragovernmental balance reconciliations with its non-Department of Energy trading partners, as specified by the January 2000 technical amendment to OMB Bulletin No. 97-01, because certain trading partners did not respond timely to the Department's requests for confirmation.

Our audit was conducted for the purpose of forming an opinion on the Fiscal Year 2000 consolidated financial statements taken as a whole. The consolidating information on pages 96 to 105 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activities of the Department's components individually. The consolidating information for Fiscal Year 2000 has been subjected to the auditing procedures applied in the audit of the Department's consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

## Independent Auditors' Report

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### Internal Control over Financial Reporting

We noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants (AICPA). However, none of the reportable conditions, identified below, are believed to be material weaknesses.

Our consideration of internal control over financial reporting for Fiscal Year 2000 would not necessarily disclose all matters that might be reportable conditions. Under standards issued by the AICPA, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

The objective of our audit was not to provide assurance on the Department's internal control over financial reporting. In addition, our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information or reported performance measures. Consequently, we do not provide an opinion on internal control over financial reporting, Required Supplementary Stewardship Information, or performance measures.

The following reportable conditions are described in more detail in Exhibit I:

- Performance Measurement Reporting – The OMB requires that performance measures, to be useful, be output and outcome oriented, meaningful and relevant, objective and quantifiable, and consistent with the measures developed in the strategic planning process. The Department has made some progress in improving its performance measurement reporting, but more remains to be done. The Department plans to continue improving its performance measures in response to feedback from OMB, the U.S. General Accounting Office, and the Congress.
- Unclassified Information System Security – We noted network vulnerabilities and access control weaknesses in the Department's unclassified computer information systems. Without adequate access and computer security controls, the integrity of essential financial management system data may be threatened.
- Western Area Power Administration (Western) – Throughout Fiscal Years 1999 and 2000, Western has been addressing operational deficiencies in its new financial management system, including problems with system functionality and performance, data accuracy,

## Independent Auditors' Report

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security, and reporting. Western's accounting personnel lack experience and training in the functionality of the new system and have not adequately developed formal reconciliation procedures that are effective in ensuring accurate and timely financial reporting.

Exhibit II presents the status of prior year audit findings.

We also noted other matters involving internal control over financial reporting and its operation that we have reported to Departmental management in a separate letter dated February 1, 2001.

### Compliance with Laws and Regulations

Our tests of compliance with certain provisions of laws and regulations, performed as part of obtaining reasonable assurance about whether the Fiscal Year 2000 consolidated financial statements are free of material misstatement, exclusive of those requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02. In addition, our tests of compliance with FFMIA Section 803(a) requirements disclosed no instances in which the Department's financial management systems did not substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, or the U.S. Government Standard General Ledger at the transaction level. However, providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

### Responsibilities

**Management's Responsibility.** The Government Management Reform Act (GMRA) of 1994 requires Federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' consolidated financial position and results of operations. To meet the GMRA reporting requirements, the Department prepares annual consolidated financial statements.

Management is responsible for:

- Preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and
- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

## Independent Auditors' Report

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**Auditors' Responsibility.** Our responsibility is to express an opinion on the Fiscal Year 2000 consolidated financial statements of the Department based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures relating to the consolidated financial statements;
- Assessing the accounting principles used and significant estimates made by management, and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our Fiscal Year 2000 audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act of 1982.

In addition, as required by OMB Bulletin No. 01-02, we considered the Department's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the Department's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Overview section of the Department's *Fiscal Year 2000 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions.

As part of obtaining reasonable assurance about whether the Department's Fiscal Year 2000 consolidated financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the FFMLA. We

## Independent Auditors' Report

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limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the Department.

In accordance with the provisions of OMB Bulletin No. 01-02 and FFMIA, we performed tests of compliance with FFMLA section 803(a) requirements that indicate whether the Department's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

**Distribution.** This report is intended solely for the information and use of the Department's management, the Department's Office of the Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 1, 2001



**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions**

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**Performance Measurement Reporting**

**Background:** Statement of Federal Financial Accounting Standards (SFFAS) No. 15, *Management's Discussion and Analysis*, requires Federal agencies to include, in documents presenting their financial statements, discussion and analysis of the financial statements and related information. This discussion should provide a clear and concise description of the reporting entity, its mission, activities, accomplishments, and overall financial condition and results. It should also include information on whether and how the mission of the reporting entity is being accomplished.

The Department presents performance measurement data and other information required by SFFAS No. 15, for each of its principal programs in the Overview section of its *Fiscal Year 2000 Performance and Accountability Report*. This performance measurement data is based primarily on information from the Department's *Strategic Plan* and the revised final *Annual Performance Plan* (also published as the Secretary's *Performance Agreement* with the President), which are prepared under the requirements of the Government Performance and Results Act of 1993.

Prior auditors of the Department's consolidated financial statements have observed that the usefulness of many programmatic performance measures presented in the Overview was limited. Management has generally concurred with the auditors' recommendations and agreed to improve the utility of performance information and its presentation. The Department has made some progress in resolving performance reporting issues, but more remains to be done.

**Finding 1: Performance Measurement Reporting**

The OMB requires that performance measures, to be useful, be output and outcome oriented, meaningful and relevant, objective and quantifiable, and consistent with the measures developed in the strategic planning process. Performance measures should also be described in terms understandable to the casual reader.

The Department has made some progress in providing a balanced collection of performance measures to help readers obtain a complete understanding of how the reported programs performed. However, the Department has not yet revised its performance measures to fully meet OMB's requirements. This is partly because the recommendations in the prior year audit report, as well as commentary on the Department's performance reporting by the U.S. General Accounting Office, were not issued until after the Secretary's Fiscal Year 2000 *Performance Agreement* with the President, which established the current measures, was finalized. Management has indicated that its planned Fiscal Year 2001 changes to the performance measurement reporting process will be responsive to the audit recommendations and will be more responsive to feedback the Department has obtained from OMB, the U.S. General Accounting Office, and the Congress.

**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions, Continued**

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The Department's performance reporting for Fiscal Year 2000 contains the following deficiencies, many of which were noted in the Fiscal Year 1999 audit:

- Cost-effectiveness data relating to performance is not presented, except for the total net costs of each business line for the fiscal year.
- The quality of certain measures is questionable. Goals in many cases are not output or outcome oriented; some are not meaningful or relevant, or stated in objective or quantifiable terms. In addition, much of the performance measurement reporting is not easily understood by the casual reader.
- Information regarding the Federal Energy Regulatory Commission is not included.
- Goals and the related results are not consistently presented together, in the Overview.

These deficiencies limit the readers' ability to assess the Department's performance.

**Recommendation:**

We recommend that the Department continue to improve the development, presentation, and reporting of performance measures consistent with the Government Performance and Results Act, applicable OMB guidance, and Federal accounting standards. Making these improvements will require cooperation from all areas within the Department.

**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions, Continued**

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**Unclassified Information System Security**

We noted network vulnerabilities and access control weaknesses in unclassified information systems.

Network Vulnerabilities

**Background:** The Department maintains a series of interconnected unclassified networks and information technology systems. Security over unclassified information systems is an important issue facing government organizations. This issue has taken on greater significance as Federal agencies have migrated from mainframe environments with a closed architecture and limited access to web-based client/server systems. In addition, the U.S. General Accounting Office has designated information system security as a high-risk area.

**Finding 2:** Network Vulnerabilities

Federal and Departmental directives require the establishment and maintenance of security over unclassified information systems, including financial management systems. Past audits identified significant weaknesses in selected systems and devices attached to the computer networks at the Department sites we reviewed. The Department has implemented corrective actions to improve network security at those sites we reviewed in prior years. However, we identified significant weaknesses at two sites we visited in Fiscal Year 2000. At these sites, we identified network vulnerabilities similar to those found at sites visited in previous years, including poor password management, unnecessary access to certain powerful computer services, weak configuration management, outdated software with known security problems, and firewall configuration problems. In addition, we identified inadequate network monitoring at one site that could allow unauthorized intrusion that would not be detected.

The identified weaknesses and vulnerabilities increase the risk that malicious destruction or alteration of data or the processing of unauthorized operations could occur at those two sites. Although these weaknesses and vulnerabilities could impact all unclassified systems, we identified compensating controls over financial system access, data comparison, and backup and recovery procedures that mitigate their potential effect on the integrity of the Department's financial systems.

**Recommendation:**

Due to security concerns, recommendations to address the issues discussed above will be included in a separate report to the Chief Information Officer. Those recommendations include system enhancements and upgrades needed to reduce network vulnerabilities.

**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions, Continued**

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Access Control Weaknesses

**Background:** The Department has mandated compliance with several Federal information security directives and public laws in DOE Notice 205.1, *Unclassified Computer Security Program*, dated July 26, 1999. The program, also referred to as the "Cyber Security Program," also establishes policies for the protection of unclassified information and information systems. Within this security framework, the Department operates the financial management system that forms the basis for preparing its consolidated financial statements.

**Finding 3:** Access Control Weaknesses

Information system controls for accounting applications and the resulting consolidated financial statements are specified in the Department's Cyber Security Program. The Program covers security requirements and information security controls needed to provide adequate access protection. However, at a number of locations, the Program has not been fully implemented. We noted weaknesses in security planning, including outdated risk assessments and security directives. In a few cases, documentation that the program had been implemented, such as a locally-developed implementation plan, does not exist. Actual security practices are also lacking in some instances. At one site, we noted vulnerabilities in the means to re-establish computer functions in the event a disaster occurs. Another site has not implemented important physical security safeguards, such as logging visitor access to the computer center. Without adequate access and computer security controls, the integrity of essential financial management system data may be threatened.

**Recommendation:**

Management should follow up on the implementation of its Cyber Security Program throughout the Department to ensure that the Federal information standards are met and that its information and information systems are adequately protected against unauthorized access.

**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions, Continued**

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**Western Area Power Administration**

**Background:** The Western Area Power Administration (Western), a component of the Department, markets and transmits electric power and provides related services. Western implemented a new financial management system on November 2, 1998. Throughout Fiscal Years 1999 and 2000, Western has been addressing operational deficiencies in the system including problems with system functionality and performance, data accuracy, security, and reporting. As reported in the Department's Fiscal Year 1999 audit, components of Western's new financial system did not have common data elements; consistent controls over data entry, transaction processing, and reporting; or transaction entry procedures to preclude unnecessary duplication. Further, the system lacked adequate internal controls and system documentation to meet user needs.

**Finding 4: Financial Management at Western**

OMB Circular No. A-127, *Financial Management Systems*, requires Federal agencies to ensure that financial systems support management's fiduciary role; support the legal, regulatory, and other special management requirements of the agency; support budget decision making; and comply with internal and external reporting requirements.

Throughout 1999 and for most of 2000, Western's system did not generate timely, useful reports that contained complete and accurate financial information. Thus, Western was unable to accurately track and report on budget execution and meet external reporting requirements, including the preparation of financial statements. For example, Western's separate Fiscal Year 1999 financial statement audit could not be completed until November 2000, and its Fiscal Year 2000 financial statements are not yet ready for separate audit.

There were several causes for Western's financial system problems. During the new system implementation, Western did not run the old financial system in parallel with the new system. Also, Western did not adequately plan, test, and document the new system, and its personnel did not receive adequate user training. Finally, Western made significant changes to the new system without having a disciplined change control process.

To compensate for the increased control risk created by these conditions, Western used alternative measures to verify the reliability of its financial information and account balances included in the Department's consolidated financial statements for Fiscal Years 1999 and 2000.

Although Western has made progress in improving its systems, certain conditions remain that expose Western to potential loss of data integrity, reporting inaccuracies, and operational inefficiencies.

**Independent Auditors' Report**  
**Exhibit I – Reportable Conditions, Continued**

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Specifically, control weaknesses continue to exist in the following areas:

- Methods of implementing changes to the production environment;
- Physical security of the data center;
- Administrative security and review of user access and rights;
- Network access security, and
- Lack of formalized plans or procedures for disaster recovery.

In addition, Western continues to experience difficulties in reconciling subsidiary ledgers to its general ledger. Such reconciliations should be routine in nature, and are standard operating procedure in most organizations. However, Western's personnel lack experience and training in the functionality of the new system, including an understanding of how data is captured and processed; what reports the system is capable of generating; and how these reports may be used to assist in reconciling data. Also, due to personnel constraints and competing priorities, Western has not adequately developed formal reconciliation procedures that are effective in ensuring accurate and timely financial reporting.

Subsequent to September 30, 2000, Western hired additional experienced and Federally-trained accounting personnel. This should strengthen Western's accounting department and mitigate some of the financial management concerns discussed above.

**Recommendations:**

We recommend that the Chief Financial Officer continue to monitor Western's implementation of its detailed corrective action plan, developed originally in 1999, and the additional recommendations, below.

We also recommend that Western's management:

- Review the adequacy of its overall financial management policies and procedures, including development of formal reconciliation procedures.
- Verify that reconciliations are prepared timely and properly.
- Ensure that its accounting department is staffed with sufficient and experienced personnel who meet the core competency requirements outlined for financial accountants in the Federal government's Joint Financial Management Improvement Program guidance.

**Independent Auditors' Report**  
**Exhibit II – Status of Prior Year Audit Findings**

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**Findings Reported in Fiscal Year 1999**  
**(parenthetical disclosure of year first reported)**      **Status at September 30, 2000**

**Material Weakness**

1. Western's New Financial Management System (1999)

Prior audit recommendations are partially implemented. Included in Exhibit I as a reportable condition focused on improving overall financial management at Western.

**Reportable Conditions**

2. Input Data for Active and Surplus Facilities Parametric Model (1999)
3. Network Vulnerabilities (1999)
4. Performance Measure Reporting (1997)

Prior audit recommendations are substantially implemented. No longer considered a reportable condition.

Improvements made, but still reported in Exhibit I as a reportable condition.

Improvements made, but still reported in Exhibit I as a reportable condition.