U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

MANAGEMENT REPORT
AUDIT OF THE DEPARTMENT OF ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 1996

Report Number: CR-FS-97-02
Capital Regional Audit Office
Date of Issue: May 1, 1997
Germantown, MD 20874

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SUMMARY

The Government Management Reform Act of 1994 requires the Department of Energy (Department) to submit audited financial statements to the Office of Management and Budget (OMB) beginning with the statements as of September 30, 1996. We audited the Department's Consolidated Statement of Financial Position as of September 30, 1996, and the related Consolidated Statement of Operations and Changes in Net Position for the year then ended, to determine whether they presented fairly, in all material respects, the Department's financial position and results of operations. As part of this Departmentwide effort, we examined internal controls, assessed compliance with applicable laws and regulations, and tested selected account balances at Headquarters and at a number of field activities. The results of our audit are included in Audit Report No. IG-FS-97-01, dated February 24, 1997. Additional management level reports addressing local issues are being issued to field elements.

This report addresses managerial-level issues that fall within the purview of the Chief Financial Officer and selected Headquarters program officials. Some performance measure data included in the Overview of the Consolidated Financial Statements was not consistently reported, contained inaccurate information, and was not always adequately supported. System documentation related to the Nuclear Materials Management Safeguards System was not complete and reports were not distributed in a timely manner. Field sites were not specifically accounting for repairs and maintenance expenses. In addition, documentation to support management approval of costs included in an estimated Environmental Safety and Health compliance activities related liability was not provided. Also, certain other issues discovered during the prior year's audit had not been completely resolved.

Management generally concurred with the findings and recommendations and acknowledged that corrective actions were needed. In some instances, the required actions have already been completed. Part II of this report discusses the results and management's comments.

______(Signed)________
Office of Inspector General

PART I

APPROACH AND OVERVIEW

INTRODUCTION

The Government Management Reform Act of 1994 significantly expanded the provisions of the Chief Financial Officers Act of 1990 to require that audited financial statements covering all accounts and associated activities of the Department be submitted to OMB annually. In compliance with this requirement, we audited the Department's Consolidated Statement of Financial Position as of September 30, 1996, and the related Consolidated Statement of Operations and Changes in Net Position for the year then ended. We examined internal controls, assessed compliance with laws and regulations, and tested selected account balances at various Departmental facilities.

The objective of the Departmentwide audit was to determine whether the Consolidated Statement of Financial Position as of September 30, 1996, and the related Consolidated Statement of Operations and Changes in Net Position for the year then ended, presented fairly, in all material respects, the Department's financial position and results of operations. Departmentwide issues developed during our audit are addressed in Audit Report No. IG-FS-97-01. Additional management level reports are being issued to various field activities.

The purpose of this report is to inform the Chief Financial Officer of matters that came to the attention of the Office of Inspector General (OIG) during the audit related to policy issues and other field element issues that fall within the purview of the Chief Financial Officer and selected Headquarters program officials. The findings and recommendations included in this report did not impact the overall opinion on the Department's consolidated financial statements and have not been included in other audit reports. They are, however, matters that need to be addressed and should strengthen the Department's internal control structure or result in operating efficiencies.

SCOPE AND METHODOLOGY

Field work was conducted from April through December 1996 at various Headquarters components of the Office of Chief Financial Officer (CFO). Those components included the Office of Headquarters Accounting Operations and the Departmental Accounting and Analysis Division. Audit work at the Department's field elements was also substantially completed during the same period and included both Departmental and contractor accounting entities. As a part of this effort, we obtained an understanding of the internal control structure, performed tests of control procedures, assessed compliance with applicable laws and regulations, and tested selected account balances as necessary to achieve the Departmentwide audit objectives.

Audit work was performed in accordance with generally accepted Government auditing standards for financial audits. Since we relied on computer-generated data, we evaluated the general control environment of certain systems and evaluated the reliability of the data on a test basis.

Because the audit was limited, it would not necessarily disclose all the internal control weaknesses that exist. Furthermore, because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Issues addressed in this report represent our observations of activities through the end of field work. Projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

The Office of Chief Financial Officer waived an exit conference.

OBSERVATIONS

During our audit we found problems involving issues that fall within the purview of the Chief Financial Officer and selected Headquarters program officials. These issues related to performance measure reporting, the Nuclear Materials Management Safeguards System (NMMSS), accounting for repair and maintenance expenses, and the Environmental, Safety and Health (ES&H) liability for noncompliance. Also, certain other issues discovered during the prior year's audit had not been completely resolved.

Some of the performance measure data included in the Overview was not consistently reported, contained inaccurate information, and was not always adequately supported. For example, claimed staffing reductions were inconsistent with other sources; dollar savings for staffing reductions were calculated inconsistently with claimed reductions; performance measures did not consistently include all Departmental elements; and no support was provided for some performance measures.

System documentation related to the NMMSS was not complete and reports were not distributed in a timely manner. Due to the lack of complete documentation, NMMSS had not received formal approval from the Department, despite being in operation since September 1995. In addition, due to data submission deadlines placed on reporting entities and other factors, significant time lags occurred between the date of data submission and the date final reports were received.

Field sites were not specifically accounting for repair and maintenance expenses. Rocky Flats Field Office, Kaiser-Hill, Chicago Operations Office, Westinghouse Hanford Company, Westinghouse Savannah River Company, and Lockheed Idaho Technologies Company were among the field entities that could not readily account for repair and maintenance expense.

Officials in the Office of Environment, Safety and Health (EH) were not able to provide documentation to support management's approval of costs of activities estimated to be liabilities. In accruing the liability for the costs of activities related to ES&H noncompliance, EH estimated the amount and provided it to the CFO. Officials in EH were unable to provide copies of the original Activity Data Sheets to demonstrate whether management approved the costs of these activities.

In addition, as reported in the prior year's audit, the Department had not completely resolved issues related to application of overhead expenses to purchased assets and use of standard service lives for capitalized assets.

Management generally concurred with the findings and recommendations and acknowledged that corrective actions were needed. In some instances, the required actions have already been completed. Part II of this report provides additional details concerning the audit results and management's comments.

PART II

AUDIT RESULTS

Finding 1: Performance Measure Reporting

Background

In accordance with OMB guidance, each annual financial statement should include a narrative overview of the reporting entity. This overview should provide a clear and concise description of the reporting entity, its mission, activities, accomplishments, and overall financial results and condition. It should also include information on whether and how the mission of the reporting entity is being accomplished. This communication should include the use of explicit measures of program performance (performance measures).

Details of Finding 1

OMB Bulletin No. 94-01 requires the Department to clearly set forth performance measures in the overview and maintain adequate supporting documentation in a form suitable for review and audit. In contrast, some of the performance measure data included in the Department's Overview to the financial statements was not consistently reported, contained inaccurate information, and was not always adequately supported. For example:

- The power marketing administrations and the Federal Energy Regulatory Commission were not consistently included or excluded from measures, while the financial statements and accompanying notes included data for all Departmental elements.

- Dollar savings associated with staffing reductions were calculated using different staffing reductions than those reported in the Overview, resulting in at least a $10 million overstatement of savings.

- Amounts concerning staffing reductions were inconsistent with amounts claimed elsewhere in the Overview and with data obtained from the Department's payroll and personnel system.

- Savings of $6 million initially claimed in draft versions of the Overview from streamlining the National Environmental Policy Act (NEPA) program were unsupported. When Departmental representatives were contacted for support, they acknowledged that these savings could not be supported. In the final version of the Overview, the Department reported that while no accounting data existed specifically for NEPA compliance activities, it estimated that the goal ($6 million in savings) had been met.

- No support was provided for a measure concerning the development of Strategic Diversity Plans. Support was not provided by the responsible program despite repeated requests.

These problems occurred because the Department's internal control structure for ensuring accurate and timely reporting of performance measure data in the Overview was not sufficient. Specifically, formalized data collection procedures were not in place, reported results were not well documented, and validation of supporting data was not accomplished. As a result, the Department risks reporting information in the Overview that does not present an accurate and up-to-date picture of how it is accomplishing its mission.

Recommendation

We recommend that the Office of Chief Financial Officer, in conjunction with the Office of Policy and International Affairs (PO), strengthen its internal control structure for reporting performance measures, including providing program offices specific guidance on maintaining adequate support.

Management Comments

Management generally concurred with the finding and recommendation and plans certain corrective actions. The CFO asserted that the existing internal control structure for reporting performance measures consisted of several coordinated processes conducted within the PO, the CFO, the program offices, and the OIG. The performance reporting process established by PO emphasizes the importance of ensuring that information provided was accurate and complete. In response to guidance and training by the CFO, Heads of Departmental Elements also provided representations indicating an awareness of their responsibility for performance measure data and for completing the necessary validation and support documentation to ensure its accuracy and reliability. Management also asserted that an additional element of the internal control is the OIG's audit of the financial statements, which provides an independent confirmation on the accuracy of performance measure information.

Management recognized that improvements could be made to the process and proposed that PO lead efforts to strengthen and formalize the existing internal control structure, in partnership with the CFO and the OIG, to ensure the accurate reporting of performance results and the maintenance of adequate support documentation. As part of these efforts, the CFO will issue guidance and offer training to program offices to clearly delineate their specific roles and responsibilities in the preparation of the financial statements and related program performance reporting. Management believes that each program office is responsible for its performance data and that the OIG should make program offices responsible for reported deficiencies aware of problems encountered and suggest improvements needed to further improve accountability for future reporting.

Auditor Comments

Although management's proposed actions may be beneficial, they are not completely responsive to our recommendation. Management plans to reemphasize existing requirements, but has not provided specific plans for validating or verifying the accuracy of reported performance data. As part of its effort to strengthen and formalize the existing internal control structure, management should develop consistent standards to be applied by all program elements to ensure that data used to support reported performance measure results are valid and accurate, consistent, and readily verifiable. While programmatic representations should remain an essential part of the internal control structure in this area, they are not, in and of themselves, sufficient to ensure that reported data is properly documented or supported.

We do not agree with the Department's proposal to rely on the OIG to provide independent confirmation of performance measure information rather than including data validation procedures as an integral part of its internal control structure. While the OIG is more than willing to assist management by providing input on the design and implementation of an internal control structure, the ultimate responsibility for good internal controls rests with management. Management's system of internal controls in this area must stand alone and not rely on the results of audit. The OIG's independent audit function generally enhances the internal control structure of the Department but may not be directly substituted for sound internal control policies and procedures.

Finding 2: Nuclear Materials Management Safeguards System

Background

NMMSS is the nationwide system used to track and record all movements of nuclear materials. All Departmental sites with nuclear materials are required to reconcile inventory quantities per site accountability systems to NMMSS on a periodic basis. In addition, certain sites use applicable NMMSS reports to value nuclear materials.

In 1994, Lawrence Livermore National Laboratory (LLNL) was tasked with updating the NMMSS from a mainframe system to a more user friendly and reliable microcomputer-based network system. Upon receiving this task, LLNL subcontracted the work to the Nuclear Assurance Corporation in Norcross, Georgia. After significant system design work, Nuclear Assurance Corporation began sole operation and maintenance of NMMSS on September 1, 1995.

Details of Finding 2

Maintenance of complete system documentation and timeliness of report distribution are among the critical success factors for any computer system. However, system documentation relating to NMMSS was not complete, and report distribution was not timely. Despite being in operation since September 1995, the NMMSS had not received formal approval from LLNL or the Department because of the lack of complete systems documentation. Much of the system knowledge that needed to be documented resided with one of only two programmers. In addition, due to data submission deadlines placed on reporting entities and Nuclear Assurance Corporation's manual review of reports for security, significant time lags occurred between the date of data submission and the date final reports were distributed to users. As a result of these issues, the long-term viability of the system was a concern, and delayed reconciliation procedures increased the potential for incorrect information submissions to Headquarters.

Recommendations

We recommend that the Office of Chief Financial Officer work with the Office of Nonproliferation and National Security to:

Ensure that Nuclear Assurance Corporation completes all system documentation and obtains formal system approval from LLNL and the Department as soon as possible;

Ensure the Nuclear Assurance Corporation has followed through with its intentions to hire additional programmers to enhance system development and operation; and

Work with NMMSS users to modify current user reporting deadlines or Nuclear Assurance Corporation procedures to provide for more timely report distribution.

Management Comments

Management concurred with the finding and recommendations and has taken or plans to take corrective action to improve system documentation and timeliness of report distribution, including hiring two additional programmers and conducting onsite training by NMMSS project staff.

Auditor Comments

Management's proposed and completed actions are responsive to the recommendations.

Finding 3: Repair and Maintenance Expenses

Background

According to the Department's Accounting Handbook, costs for normal maintenance and repair, such as repairing roads, painting buildings, or cleaning structures, are expensed unless the maintenance and repair results in an addition, replacement, or betterment. If the repair costs do result in an addition, replacement, or betterment, the policy requires capitalization of the costs.

For periods beginning after September 30, 1997, Statement of Federal Financial Accounting Standards Number 6, "Accounting for Property, Plant, and Equipment," will require disclosures related to the condition and estimated cost to remedy deferred maintenance of property, plant and equipment. The minimum disclosure required by the Standards must include the method used to measure, and an estimate of deferred maintenance for each major class of property, plant and equipment. If the Department chooses to use the total life-cycle cost method, it must present information on the dollar amount of maintenance actually performed.

Details of Finding 3:

To meet upcoming standards requirements and to aid in proper classification of repair and maintenance expenses, Departmental field sites should specifically account for these types of costs. However, Departmental field sites like Rocky Flats Field Office, Kaiser-Hill, Chicago Operations Office, Westinghouse Hanford Company, Westinghouse Savannah River Company, and Lockheed Idaho Technologies Company did not specifically account for repair and maintenance expenses. For example, Lockheed Idaho Technologies Company could determine the costs for repairs and maintenance completed with indirect funding, but was not readily able to determine direct funded repair and maintenance costs. This condition exists because neither the Department's Accounting Handbook nor the prior Departmental Order required that repair and maintenance costs be recorded in a specific expense account. Without such an account, it is difficult for field sites to evaluate whether required repair and maintenance costs are being properly categorized. In addition, it will be difficult for the Department to comply with the new Statement of Federal Financial Accounting Standards Number 6 if field sites do not classify, record, and report repair and maintenance expenses in specifically identifiable accounts.

Recommendations

We recommend that the Office of Chief Financial Officer:

Develop policy guidance requiring reporting entities to classify, record, and report repair and maintenance expense in specific accounts; and

Establish any other accounts and accounting procedures that will be needed for the Department to comply with deferred maintenance disclosure requirements beginning in Fiscal Year 1998.

Management Comments

Management is in the process of analyzing the applicable Federal Accounting Standards Advisory Board recommended requirements that are effective beginning in Fiscal Year 1998 to determine the appropriate actions that must be taken to establish compliance. While there is no specific requirement to establish "accounts" to achieve compliance with the referenced deferred maintenance disclosure requirements, the CFO will consider this as well as other options during this analytical process.

Auditor Comments

Management's planned analysis is responsive to the finding and recommendations. Identification and implementation of alternative actions that can be taken to meet accounting standards and aid proper classification of costs would be acceptable.

Finding 4: Environmental, Safety and Health Liability

Background

The Department accrued a $1.2 billion estimated liability in Fiscal Year 1996 for those activities necessary to bring its facilities and operations into compliance with existing ES&H laws and regulations. In accruing the liability for the costs of activities related to ES&H noncompliance, EH estimated the amount and provided it to the CFO.

Details of Finding 4:

As a component of its overall internal control structure, the Department is responsible for establishing a system of controls to provide reasonable assurance that estimates supporting accrual of liabilities are complete and readily verifiable. However, officials in EH were not able to provide copies of the original signed Activity Data Sheets used in the ES&H liability estimate to demonstrate whether management approved the costs of the activities. This occurred because the EH database system used to accumulate cost data was not designed to utilize hard copies of Activity Data Sheets, as information was converted to computer form in remote locations. As a result, there was an incomplete audit trail for the ES&H liability estimate and a greater likelihood of the introduction of errors to the estimate.

Recommendation

We recommend that the Office of Chief Financial Officer work with EH to ensure adoption of a system in which staff responsible for calculating the estimated liability receive up-to-date copies of approved Activity Data Sheets in a timely manner.

Management Comments

The CFO concurred with the finding and recommendation and agreed to work with EH to improve the process of receiving data and calculating the estimated ES&H liability.

Auditor Comments

Management's proposed actions are responsive to the recommendation.

Other Matters

In our Fiscal Year 1995 report on the internal control structure, we reported that the Department's internal control system to prevent or detect the inconsistent or misapplication of accounting policies, principles, and procedures was not entirely effective. In relation to this finding, the Department had not completely resolved, during Fiscal Year 1996, issues related to the application of overhead expenses to purchased assets and the use of standard service lives for capitalized assets.

> Certain general and administrative costs were inappropriately included in the cost of capitalized assets. Westinghouse Savannah River Site incorrectly added a surcharge of 20 to 30 percent to the cost capitalized for property, plant and equipment purchases. The surcharge is an allocation of certain overhead costs including purchasing and accounts payable. The CFO stated that its policy in the area of allocation of general and administrative expenses was under formulation and would be transmitted to field offices upon completion.

> Standard service lives specified by accounting guidance were not always used for capitalized assets. Westinghouse Hanford Company was using service lives for certain capital assets that were not consistent with Departmental Standard Service Lives established by the CFO. Westinghouse Hanford Company utilized at least two standard service lives lists. One list was consistent with the Department standard, while another inconsistent list dated back to 1963.

The specific instances cited above are being reported locally in separate management reports to the cognizant Departmental field elements. No additional recommendations to remedy these conditions are being made, as the recommendations from last year's audit are being tracked by the Department.

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