DOE F 1325.8

(08-93)

United States Government **Department of Energy**

Memorandum

DATE: December 20, 2010

REPLY TO
ATTN OF: IG-322 (A10FN006)

SUBJECT: Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2010

TO: Chief Financial Officer, CF-1

Attached is the subject letter prepared by KPMG LLP, our contract auditors. The letter contains 23 new findings (see letter, Exhibit A) and 4 repeat findings (see letter, Exhibit B) that were issued during the course of the Fiscal Year 2010 audit of the Department of Energy's (Department) Consolidated Financial Statements. Management generally concurred with and provided planned corrective actions for most of the recommendations listed in the Management Letter and management's comments are included in each finding.

No Departmental position is required for the findings in this report. However, the recommendations are open and should be tracked in the Department's Audit Report Tracking System.

We appreciate the cooperation of your staff during the review.

Daniel M. Weeber

Daniel M. Weeber
Director, Environment, Technology,
and Corporate Audits Division
Office of Inspector General

Attachment

Audit Report No: OAS-FS-11-05

cc w/attachment:
Assistant Secretary for Nuclear Energy, NE-1
Director, Office of Legacy Management, LM-1
Principal Deputy Assistant Secretary for Environmental Management, EM-1
Principal Deputy Assistant Secretary for Fossil Energy, FE-1
Director, Office of Health, Safety and Security, HS-1
Deputy Director for Field Operations, Office of Science, SC-3
Deputy Chief Financial Officer, CF-2
Associate Administrator for Management and Administration, NA-60
Director, National Energy Technology Laboratory
Director, Environmental Management Consolidated Business Center
Director, Office of Field Financial Management
Director, Office of Human Resource Services, HC-30
Manager, Sandia Site Office
Site Manager, Berkeley Site Office
Manager, Chicago Office
Interim Manager, Idaho Operations Office
Manager, Los Alamos Site Office
Manager, Livermore Site Office
Acting Manager, Kansas City Site Office
Manager, Y-12 Site Office
Manager, Nevada Site Office
Manager, Portsmouth Paducah Project Office
Manager, Oak Ridge Office
Manager, Richland Operations Office
Manager, Office of River Protection
Manager, Savannah River Operations Office
Manager, Carlsbad Field Office
Manager, Pacific Northwest Site Office
Manager, Brookhaven Site Office
Manager, Naval Reactors Laboratory Field Office
Director, Office of Business Operations, NA-66
Chief Business Officer, EM-4
Office of Assistant Project Manager, Strategic Petroleum Reserves Project Office, FE-445
Assistant Director, Office of Risk Management, CF-80
Director, Office of Finance and Accounting, CF-10
Director, Energy Finance and Accounting Service Center, CF-11
Director, Office of Financial Control and Reporting, CF-12
Director, Office of Program Analysis and Evaluation, CF-20
Director, Office of Internal Controls, NA-66
Acting Director, Office of Financial Policy, CF-50
Acting Director, Office of Procurement and Assistance Management, MA-60
Audit Resolution Specialist, Office of Risk Management, CF-80

Team Leader, Office of Risk Management, CF-80
Audit Liaison, Office of Environmental Management, EM-4.1
Audit Liaison, Office of Fossil Energy, FE-3
Audit Liaison, Office of Nuclear Energy, NE-42
Audit Liaison, Office of Science, SC-41
Audit Liaison, Office of Health, Safety and Security, HS-1
Audit Liaison, Berkeley Site Office
Audit Liaison, Office of Legacy Management, LM-10
Audit Liaison, Chicago Office
Audit Liaison, Idaho Operations Office
Audit Liaison, Portsmouth Paducah Project Office
Audit Liaison, Oak Ridge Office
Audit Liaison, Richland Operations Office
Audit Liaison, Office of River Protection
Audit Liaison, Savannah River Operations Office
Audit Liaison, National Energy Technology Laboratory
Audit Liaison, Lawrence Livermore National Laboratory
Audit Liaison, Environmental Management Consolidated Business Center
Audit Liaison, Carlsbad Field Office
Audit Liaison, Pacific Northwest Site Office

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

MANAGEMENT LETTER

December 15, 2010

Mr. Gregory Friedman
Inspector General
U.S. Department of Energy
1000 Independence Avenue, S.W. Room 5D-039
Washington, DC 20585

Dear Mr. Friedman:

We have audited the consolidated financial statements of the United States Department of Energy (Department or DOE) as of and for the year ended September 30, 2010, and have issued our report thereon dated November 12, 2010. In planning and performing our audit of the consolidated financial statements, in accordance with auditing standards generally accepted in the United States of America, we considered the Department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

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 significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed below and as more fully described in our *Independent Auditors' Report*, which is included in the financial section of the Department's *Fiscal Year 2010 Agency Financial Report*, we identified certain deficiencies in internal control related to information technology (IT) that we consider to be a significant deficiency.

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. The significant deficiency described below is not believed to be a material weakness. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following to be a significant deficiency in internal control:

- ***Unclassified network and information systems security*** – We noted network vulnerabilities and weaknesses in access and other security controls in the Department's unclassified computer information systems. The identified weaknesses and vulnerabilities increase the risk that malicious destruction or alteration of data or unauthorized processing could occur. The Department should fully implement policies and procedures to improve its network and information systems security.

We will issue a separate management letter addressing IT control deficiencies, including those matters we consider collectively to be a significant deficiency.

Although not considered to be significant deficiencies or material weaknesses, we noted certain matters involving internal controls and other operational matters that are presented in Exhibit A, for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the Department's internal control or result in other operating efficiencies.

Exhibit B presents the status of prior year management letter comments.

Management's reaction to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

We appreciate the courteous and professional assistance that Department personnel extended to us during our audit. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the United States Department of Energy and its Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Management Letter
Index to Exhibit A and Listing of Other Exhibits

Comments Related to Internal Controls and Other Operational Matters (with parenthetical references to findings and recommendations issued during the engagement)

Exhibit A

Exhibit A

COMMENTS

Environmental Liabilities

Background: The Department has several categories of environmental liabilities, including the Office of Environmental Management (EM) program's baseline estimates for its cleanup projects; stabilization, deactivation, and decommissioning of active facilities; and restructured environmental liabilities (REL), covering cleanup projects and facilities that are not addressed in the EM or active facilities liabilities.

The Department owns many government facilities and laboratories for which the Department's Chief Financial Officer (CFO) relies upon field or operations offices to collect, report, and reconcile financial statement data. In addition to Federal regulations, the CFO issues annual guidance, which provides field sites with methods and standards required for proper preparation and reporting of financial information.

Finding 1: Omission of Contaminated Facilities (**10-SR9-EL-01**)

The Department's Savannah River Site (Savannah River) is responsible for estimating a liability for the cleanup of contaminated legacy facilities as well as the future remediation of facilities that are still in use. The Department's active facilities estimate is largely based upon a cost-estimating model.

Savannah River's cleanup mission includes the decontamination and decommissioning (D&D) of excess facilities. EM currently manages 1,054 major facilities at Savannah River. Of these facilities, 985 will undergo D&D, and the remaining 69 facilities will be transferred to a non-EM organization prior to the end of the EM mission in fiscal year (FY) 2038. Of the 69 facilities, 11 are contaminated and will require D&D.

As a result of audit inquiries, Savannah River discovered during FY 2010 that a provision for D&D of the 11 facilities was not included in Savannah River's EM or active facilities liabilities as of September 30, 2009. Savannah River assumed that the next site landlord would be responsible for all of the 69 facilities at the end of the EM mission, including any remediation of contaminated facilities. As a result, the liability for the 11 contaminated facilities was not recorded in either the EM or active facilities liabilities as of September 30, 2009. Savannah River's environmental liability was understated by approximately $238 million as of September 30, 2009.

Recommendation:

1. We recommend that the Office of Environmental Management, in conjunction with the Savannah River Site, establish a process to ensure that all cleanup work scope at the site is included in the site's environmental liabilities. The process should ensure that a liability is recorded regardless of which program is responsible for the cleanup work.

Management Reaction:

Savannah River concurs with the finding. Savannah River stated a programmatic decision was made in 2007 to defer inclusion of the 69 (11 contaminated) facilities from the project baseline summary (PBS) 40 lifecycle baseline based on the assumption that they would have an enduring mission and would be transferred to a non-EM organization prior to the end of the EM mission. The decision point for the D&D program, as reflected in the integrated schedule since 2007, was slated for FY 2010. The D&D program's Risk Management Plan included a Risk (#15) that recognized that these facilities would potentially be decommissioned by EM. The program's decision at the end of FY 2010 was to include the 69 facilities back into the lifecycle baseline during the SR FY 2011 Lifecycle Baseline update. Savannah River stated that upon issuance of the FY 2011 Lifecycle Baseline, the 11 contaminated facilities will be removed from the Active Facilities Database. Subsequent revision of the existing Risk Management Plan will address changes to the referenced Risk.

Savannah River stated it has already drafted the Environmental Liability Procedure, which emphasizes inclusion of all facilities in the environmental liability regardless of which program is responsible for the cleanup. This procedure will be finalized before the FY 2011 environmental liability audit begins and will integrate any lessons learned from this year's audit process.

Finding 2: Errors in the Prior Period Environmental Liabilities for NNSA Sites (**10-NS9-EL-01**)

Significant changes in the National Nuclear Security Administration's (NNSA) environmental liabilities that occurred in FY 2009 were not recorded until FY 2010. We have issued a separate finding for an error related to an increase of $959 million in Los Alamos National Laboratory's (LANL) EM liability (See finding 3).

We also identified the following FY 2009 adjustments not recorded until FY 2010:

- A decrease of $173 million in Lawrence Livermore National Laboratory's (LLNL) active facilities liability, of which $76 million is contingency;
- A decrease of $953 million in Kansas City's active facilities liability, of which $161 million is contingency;
- An increase of $121 million in LANL's REL, of which $26 million is contingency;
- An increase of $61 million in LLNL's REL, of which $13 million is contingency;
- An increase of $83 million in Nevada's REL, of which $18 million is contingency; and
- An increase of $17 million in the Y-12 Plant's (Y-12) REL, of which $4 million is contingency.

The NNSA Field Chief Financial Officer, NNSA Site Offices, and contractors did not follow established guidance for identifying and recording environmental liability estimates. NNSA did not adequately distribute and/or emphasize Office of Financial Control and Reporting (OFCR) annual guidance and EM standard operating policies and procedures (SOPP). Furthermore, NNSA and the NNSA Site Offices did not perform adequate reviews of the contractor-prepared environmental liability cost estimates.

The Department's NNSA FY 2009 environmental liability estimates did not include adjustments totaling approximately $2.34 billion (absolute value). As a result, the liabilities for some individual NNSA sites were understated by $1.24 billion and the liabilities for others were overstated by $1.1 billion.

Recommendation:

2. The NNSA Field Chief Financial Officer, in conjunction with all the NNSA Site Offices, should distribute OFCR's annual guidance and EM's SOPP to appropriate personnel within the NNSA enterprise in a timely manner and ensure the NNSA contractors are appropriately following environmental liability guidance, specifically OFCR's annual guidance and EM's SOPP, and applicable accounting standards. We also recommend the development and implementation of policies and procedures that clearly define the roles and responsibilities at all levels of the environmental liabilities estimating and reporting to provide for appropriate review and monitoring of the various environmental liability estimates.

Management Reaction:

The NNSA Field CFO concurs with the recommendations. Management stated that the NNSA Field CFO will distribute all OFCR annual financial guidance and EM's SOPP to the appropriate personnel at the NNSA Site Office and management and operating (M&O) contractors responsible for developing environmental liability estimates. The NNSA Field CFO will issue environmental liabilities guidance promptly upon receipt from OFCR. The NNSA Field CFO requests that Final OFCR and EM Guidance be issued earlier in the process to ensure timely distribution and provide training to appropriate personnel.

Management stated NNSA Office of Environmental Projects and Operations (NA-56) has responsibility for issuing guidance received from EM. NNSA Field CFO and NA-56, in cooperation with NNSA Site Office technical personnel, will ensure that NNSA M&O contractors are following environmental liabilities guidance issued by OFCR and EM. NNSA Field CFO, NA-56, and NNSA Site Offices will develop policies and procedures that define roles and responsibilities for development and reporting of environmental liabilities. In September 2010, the NNSA Field CFO hosted an environmental liabilities workshop to address environmental liabilities issues and to broaden the NNSA Service Center, NNSA Site Offices, and M&O contractors' understanding of environmental liabilities.

Finding 3: Errors in the Prior Period Los Alamos Environmental Liability (**10-NS1-EL-01 (Revised)**)

In FY 2009, Los Alamos National Security (LANS) identified an increase to the cost and schedule estimate that was probable and estimable, but did not record the related $959 million increase in the liability.

LANS prepared a baseline change proposal for the expected increase in the cost and schedule estimate caused by reduced funding for the cleanup work at LANL. EM Headquarters requested that LANS revise the change request to be consistent with EM's project restructuring. LANS could not complete the project restructuring process by the end of FY 2009, and therefore, a revised change request to EM Headquarters was not submitted during the FY 2009 reporting period. EM Headquarters did not account for this pending change request or record an increase in its liability, since a revised change request was not submitted. In addition, NNSA's Los Alamos Site Office, which has oversight responsibility of the work performed by LANS, failed to follow applicable guidance and did not review LANS' cost estimates to ascertain whether the contractor was following established guidance. As a result, the increase in the environmental liability resulting from the revised cost and schedule estimate was not recorded in the FY 2009 financial statements even though it was probable and estimable, and LANL's environmental liabilities were understated by $959 million as of September 30, 2009.

Recommendation:

3. We recommend that:

   a) The Associate Administrator for Infrastructure and Environment, in conjunction with the NNSA's Field Chief Financial Officer:

      i. Instruct the NNSA sites to follow the guidance issued by EM Headquarters and the Department's Office of Financial Control and Reporting regarding the annual recording of environmental liability adjustments within the appropriate reporting period; and

ii. Develop and implement procedures to require the NNSA offices to review the environmental liability adjustments for accuracy, timeliness and compliance with environmental liability guidance.

b) The Office of Environmental Management ensure that pending change requests that could have an impact on the liability are recorded in the appropriate accounting period.

Management Reaction:

NNSA management generally concurs with the findings and recommendations recognizing, however, that: (1) the site misinterpreted the guidance; (2) an adjustment has been made for the FY 2009 under reporting of the environmental liability estimate by LANL; and (3) NNSA conducted a workshop in September 2010 to review and reinforce the existing EM guidance and procedures that NNSA transmits to its sites annually. Management stated the workshop has addressed Recommendations 3.a) i. and ii. NNSA management considers this recommendation closed.

The Office of Environmental Management agrees with Recommendation 3.b). Management stated EM currently reports approved costs, pending change requests submitted to EM for review and approval, and all EM-reviewed adjustments to the CFO and to KPMG, as part of its third and fourth quarter environmental liability cost estimate submissions. EM prepared written guidance for all of the DOE sites conducting EM legacy cleanup scope in support of the FY 2010 environmental liability process and will ensure that clear guidance is provided to all sites in early calendar year 2011.

Finding 4: Liabilities Recorded in Improper Accounting Period (**10-ID9-REL-01**)

During FY 2010, Idaho Operations Office (Idaho) recorded liabilities for the treatment and disposition of various fuels and materials determined by the Idaho National Laboratory (INL) to be surplus. Based on its discussions with the Office of Nuclear Energy (NE), Idaho concluded that these liabilities should have been recorded during or prior to FY 2009 and therefore should have been included in REL as of September 30, 2009.

The liabilities were not recorded in the proper accounting period for three reasons. First, although NE and its management and operating contractor for the INL had designated a variety of materials as surplus to Departmental needs, they did not take measures to estimate and record a disposition liability in the period in which they were identified as surplus. Second, NE received a notification that the EM liability would exclude costs to manage certain spent nuclear fuel generated through FY 2005, but did not take action until FY 2010 to record a liability for costs to manage fuel generated after FY 2005. Finally, due to an oversight NE and its contractor omitted costs to transfer reactor fuel bottles and to dispose of their contents from a spent fuel disposition estimate prepared prior to FY 2010.

As a result, Idaho's REL were understated by $258 million, exclusive of contingency, as of September 30, 2009. The correction of this misstatement during FY 2010 caused Idaho's cost of operations for the current fiscal year to be overstated by a corresponding amount.

Recommendation:

4. We recommend that the Manager, Idaho Operations Office, direct Idaho National Laboratory and the Office of Nuclear Energy to establish accounting policies and internal controls to ensure that

environmental cleanup and disposal liabilities for surplus fuels and nuclear materials associated with the Idaho National Laboratory are appropriately identified and recorded.

Management Reaction:

Management concurs with the recommendation that policies and internal controls need to be established to ensure that environmental liabilities are appropriately identified and recorded including accounting for surplus materials. Management stated actions have already been taken and policies and internal controls have already been implemented in the environmental liability estimation process to appropriately account for these activities.

Environmental Liabilities for Active Facilities

The Department's liability for remediation of active facilities includes anticipated remediation costs for active and surplus facilities managed by the Department's ongoing program operations, which will ultimately require stabilization, deactivation, and decommissioning. The estimated costs are largely based on a cost-estimating model, which extrapolates stabilization, deactivation, and decommissioning costs from facilities included in EM's baseline estimates to those active and surplus facilities with similar characteristics owned by other (non-EM) programs. The Department's methodology for calculating an environmental liability estimate for active facilities relied on a web-based system managed by the Headquarters Office of the CFO and operated by a contractor. This system, known as the Active Facilities Data Collection System (AFDCS), relies on field site personnel to input an appropriate cost model code, square footage, and footprint for each building, from which the liability is calculated. Data collection for each facility includes the square footage or gallons and the assignment to one of 15 facility contamination model codes. Field site personnel review and make necessary revisions to the facility data each year before certifying the data in AFDCS. A limited number of sites use other appropriate cost-modeled estimates or site specific estimates.

To test the reliability and accuracy of the AFDCS data in FY 2010, we performed detailed tests of data at four locations. We also inquired as to the existence of newly contaminated facilities and verified their inclusion in the AFDCS database and performed other limited procedures at other sites. Of four sites where we performed detailed tests of the AFDCS data, we identified errors at the following three sites, the Oak Ridge National Laboratory in Tennessee, the Pantex Plant in Texas, and the Los Alamos National Laboratory in New Mexico. We also identified errors at the Idaho Operations Office, which calculates its estimate using an Idaho-specific cost estimating model. In addition, we identified errors at Headquarters and the Chicago Operations Office through our Headquarters-level work.

Finding 5: Inaccuracies in the Active Facilities Data Collection System (**10-OR4-AF-01**)

Our review of a statistically selected sample of 44 facilities and structures from Oak Ridge National Laboratory's (ORNL) FY 2010 AFDCS population disclosed that ORNL incorrectly recorded the square footage for Building 7863 and the footprint for Buildings 4500S, 7863, 7600, and 8520. For properties 7863 and 7600, ORNL did not update AFDCS with measurements from the most recent facility blueprints. For properties 4500S and 8520, ORNL did not comply with AFDCS guidance and used the first floor of the building as the footprint size rather than the largest floor.

As a result of these errors, ORNL understated the interim active facilities liability estimate by $190,093 as of June 30, 2010. Site personnel corrected the errors prior to the final liability calculation as of September 30, 2010.

Recommendation:

5. We recommend that the Oak Ridge Office's Field Chief Financial Officer, in conjunction with the ORNL Site Office Manager, direct ORNL employees responsible for updating AFDCS to develop and implement an internal control procedure to ensure ORNL obtains the most recent facility blueprints or computer assisted drawings and uses these measurements to update AFDCS data and review and adhere to AFDCS guidance regarding footprint calculations.

Management Reaction:

Office of Science and Nuclear Energy management, as it relates to facilities operated by UT-Battelle (Buildings 4500S, 7600, and 8520), concurs with the recommendations. Management stated that UT-Battelle will review processes associated with facility data management as it relates to AFDCS. A new internal operating procedure addressing document control of master floor plans is being developed. The due date associated with this action is January 31, 2011. A review of AFDCS guidance is on-going. A review of UT-Battelle processes involving footprint calculations will be performed. The due date associated with this action is January 31, 2011.

EM management, related to its responsibility for Building 7863, concurs with the recommendations. EM will work in cooperation with the ORNL Site Office and review its processes for ensuring compliance with AFDCS guidance and that accurate information is provided to the AFDCS. The due date associated with this action is January 31, 2011.

Finding 6: Inaccuracies in the Active Facilities Data Collection System (**10-NSQ-AF-01**)

Our review of a statistically selected sample of 43 facilities and structures from the Pantex Plant's (Pantex) AFDCS population disclosed that Pantex assigned the incorrect model type to one facility. Pantex incorrectly assigned to Facility 12-042, "Component Warehouse," the model code E - building with radioactive contamination, instead of code F - building with mixed contamination. The facility does contain radiological contamination, but the subject matter experts (SMEs) also noted that this facility contains potential hazardous contamination within its structural components. As such, Pantex should have coded the facility F – building with mixed contamination.

Field site personnel did not appropriately collaborate with SMEs when assigning the model code to Facility 12-042 in order to gather the most accurate facility information available. As a result, Pantex overstated the interim active facilities liability estimate by $8,499,513 as of June 30, 2010 related to Facility 12-042. Site personnel corrected the error prior to the final liability calculation as of September 30, 2010.

Recommendation:

6. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Manager, Pantex Site Office, direct Pantex employees who are responsible for assigning model codes to follow the policies of Pantex by collaborating with SMEs on a consistent basis regarding the contamination status of all facilities in order to assign the proper model codes.

Management Reaction:

Management concurs with this recommendation. Pantex has changed the contamination from code E (buildings with radiological contamination) to code F (buildings with mixed contamination) in accordance with the recommendation to reclassify facility 12-042 (component warehouse). This change resulted in the AFDCS system adjusting and reducing the active facilities liability estimate by $8,499,513. Pantex management stated it will continue to coordinate with the subject matter expert to ensure buildings are accurately coded. Pantex management considers this recommendation closed.

Finding 7: Inaccuracies in the Active Facilities Data Collection System (**10-NS1-AF-01**)

Our review of a statistically selected sample of 44 facilities and structures selected from LANL's AFDCS population disclosed that LANL incorrectly assigned model code G – building with hazardous contamination to Facility 22-0173, "Detonator Storage Facility," instead of code N - facility with no liability. The facility is new and not contaminated, although potential hazardous contamination is possible in the future. Since the facility is not contaminated, LANL should have coded this facility as N – facility with no liability.

Field site personnel did not collaborate with SMEs when assigning the model code to Facility 22-0173 in order to gather the most accurate facility information available. As a result, LANL overstated the interim active facilities liability estimate by $17,204 as of June 30, 2010. Site personnel corrected the error prior to the final liability calculation as of September 30, 2010.

Recommendation:

7. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Los Alamos Site Office's Manager, ensure that employees responsible for assigning model codes to LANL facilities are aware of both the historical and current use of the facilities in order to assign the proper model codes.

Management Reaction:

Management concurs with this recommendation. LANL management stated it will review their training for AFDCS updates and assure that it reinforces the requirement to enter a facility's current model code, not anticipated or known future model code. LANL management considers this recommendation closed.

Finding 8: Inaccuracies in the Active Facilities Liability (**10-ID9-AF-01**)

INL has both EM projects and Active Facilities projects. Battelle Energy Alliance, LLC (BEA) operates INL for the Department and develops the Idaho Operations Office active facilities estimate based on physical dimensions and activity-based conceptual estimating methods. The Idaho Operations Office oversees the operations of INL. As of June 30, 2010, BEA recorded an environmental liability for seven facilities in both the Active Facilities liability and the EM Baseline liability. Additionally, BEA had not removed the Active Facilities liability for five facilities the site demolished prior to June 30, 2010.

BEA did not appropriately reconcile the active facilities detail to the Facilities Inventory Management System (FIMS) and Space Occupancy Web Pages databases as of June 30 and September 30, 2010. In addition, BEA personnel were unaware of the requirements of Statement of Federal Financial Accounting

Standards (SFFAS) No. 6 and did not apply the standard to active facilities placed into service after September 30, 1997.

As a result, BEA overstated the Active Facilities liability as of June 30, 2010 by $7,950,082 but corrected the errors prior to September 30, 2010. As of September 30, 2010, BEA overstated the Active Facilities liability by $1,120,249 for the seven demolished facilities but did not adjust the site's Active Facilities liability as of September 30, 2010.

Recommendation:

8. We recommend that the Manager of the Idaho Operations Office direct BEA to:

   a) Perform timely reconciliations of FIMS and Space Occupancy Web Pages to the Active Facilities liability detail prior to the quarterly and annual financial statement submissions; and .
   b) Develop and implement policies and procedures to ensure that asset retirement and remediation liabilities associated with newly contaminated or newly added active facilities are recorded in accordance with SFFAS 6 and appropriately pro-rated over the useful life of the asset.

Management Reaction:

Management concurs with the recommendation to perform timely reconciliations of FIMS and Space Occupancy Web Pages to the Active Facilities liability prior to recording of such estimates. The contractor has developed practices and processes to ensure an accurate accounting of structures and facilities in recording an active facilities liability estimate. Management also concurs with the recommendation to implement policies and procedures that ensure newly contaminated or newly added active facilities are recorded in accordance with SFFAS 6. The contractor has already implemented policies and procedures to ensure compliance with SFFAS 6.

Finding 9: Prior Period Inaccuracies in the Active Facilities Liability (**10-CH9-AF-01 (Revised)**)

The Office of Science is the Lead Program Secretarial Office at the Brookhaven National Laboratory (BNL), which funds and oversees BNL's research activities and facilities. In addition to Office of Science programs, BNL has responsibility for EM projects and Active Facilities projects, both requiring an estimate for related environmental liabilities. Brookhaven Science Associates (BSA), a partnership between Battelle and Stony Brook University, is the legal entity responsible for the management and operation of BNL for the Department. BNL reports all financial data, including environmental liabilities, to the Chicago Office (Chicago).

In FY 2009, BSA excluded the High Flux Beam Reactor (HFBR) from AFDCS using the exclusion reason of "Facility in EM estimate." However, EM's Brookhaven Site Office (BHSO) recorded the liability for only the current EM work scope relating to the HFBR. EM-BHSO did not record, nor did the BSA Active Facilities liability include, an additional liability amount for future required D&D of the HFBR. In FY 2010, Chicago determined that BSA did not record the additional piece of the environmental liability associated with the D&D of the HFBR. Chicago identified the omitted liability when EM-BHSO added the D&D of the HFBR to the long-term stewardship baseline. As a result, in FY 2010, the Office of Science in Chicago recorded a prior year adjustment of approximately $127 million in FY 2009 constant dollars.

In addition, EM-BHSO estimated a liability of approximately $26 million including a related contingency amount for the D&D of the building that housed the Brookhaven Graphite Research Reactor (BGRR) in April 2009. However, EM-BHSO did not provide this estimate to the Office of Science at BHSO until the end of FY 2009. As a result, the Office of Science at BHSO did not have the estimate in time to provide it to BSA for inclusion in the FY 2009 environmental liability estimates. Chicago recorded the estimate in FY 2010 as a prior year adjustment.

BSA and BHSO (EM and Office of Science) did not timely coordinate and reconcile their respective liabilities in order to identify and report a complete and accurate environmental liability in FY 2009. As a result of the errors described above, there was an understatement of the environmental liability at September 30, 2009 of approximately $194 million.

Recommendation:

9. We recommend that the Manager of the Brookhaven Site Office, in conjunction with the Chicago Office Chief Financial Officer, direct BSA to develop and implement internal control processes that include:

   a) Periodic coordination between BSA and BHSO (EM and Office of Science) to compile and reconcile all environmental liabilities, including those created as a result of changes to their facility inventory and program activities; and

   b) Year-end reviews of environmental liabilities to ensure the amount reported to and recorded by Chicago is complete, accurate, and reported timely in the appropriate fiscal year.

Management Reaction:

The Brookhaven Site Office concurs with the recommendations and will request BSA, in FY 2011, to develop and implement internal control processes, to include periodic coordination between BSA and BHSO (EM and Office of Science) to compile and reconcile all environmental liabilities, including those created as a result of changes to their facility inventory and program activities, and year-end reviews of environmental liabilities to ensure the amount reported to and recorded by Chicago is complete, accurate, and reported timely in the appropriate fiscal year.

Finding 10: Duplicate Property Records in AFDCS (**10-XN9-AF-01**)

Field site personnel at the Fermi National Accelerator Laboratory (Fermi) recorded the NuMI Beamline and NuMI Tunnel as two separate assets in AFDCS. However, the NuMI Beamline runs inside the NuMI Tunnel occupying the same physical space.

The OFCR did not issue guidance to the sites to address the treatment of beam lines and accelerators where the equipment, tunnels and structures are separate capital property assets but occupy the same space. As a result, Fermi overstated the Active Facilities liability estimate as of June 30, 2010 by approximately $10 million. However, site personnel corrected the error prior to the final liability calculation as of September 30, 2010.

Recommendation:

10. We recommend that the DOE OFCR issue supplemental AFDCS guidance that provides field sites with additional decision rules regarding the exclusion of facilities sharing the same physical space.

Management Reaction:

Management concurs with the recommendation. Management stated that new guidance clarifying the treatment of accelerators and similar facilities where assets share the same physical footprint will be added to existing guidance in AFDCS no later than January 31, 2011. Further, this guidance will be presented in the February 2011 opening conference for the annual AFDCS update.

<u>Financial Reporting</u>

Finding 11: Internal Control Environment – Standard General Ledger Account Reconciliations (**10-ORS-FR-01 (Revised)**)

SLAC National Accelerator Laboratory (SLAC) personnel did not reconcile standard general ledger (SGL) balances to supporting ledgers and detail. Based upon inquiry of SLAC management, significant emphasis was placed on the review of the Analytical Reporting Facility database, which is used as a source for reporting into the DOE Standard Accounting and Reporting System (STARS), as opposed to the reconciliation and review of SGL account balances. SLAC did not have procedures in place to review the SGL account balances. The lack of internal controls surrounding the periodic reconciliation and review of SGL accounts could result in the misstatement of account balances.

Recommendation:

11. We recommend that the Oak Ridge Chief Financial Officer in conjunction with the SLAC Site office Manager direct the SLAC Chief Financial Officer to design and implement internal control procedures over periodic SGL account reconciliations including review by an appropriate individual.

Management Reaction:

Management concurs with the recommendation and stated that a letter to the SLAC National Accelerator Laboratory directing them to establish the policies and procedures and to identify any subsequent corrective action in response to this finding will be sent. Targeted milestone dates for completion are January 31, 2011 for the checklist of all required reconciliations and June 30, 2011 for accounts to be reconciled. All account reconciliations are performed according to the policies and procedures thereafter.

Finding 12: Lack of Control to Ensure Management Review over Manual Journal Entries before Posting (**10-XN9-FR-01**)

We noted 71 users with "DOE GL Entry and Posting" responsibilities and 37 users with "GL Posting Superuser" responsibilities in the Department's STARS who could enter and post general ledger journal entries without the intervention of a separate STARS user. We also noted certain instances in which a user entered and posted journal entries without prior or subsequent manual review by management.

STARS user responsibilities do not preclude certain users' ability to both enter and post the same manual journal entry in STARS. Additionally, DOE policies and procedures do not adequately minimize the risks that entries prepared and posted by the same individuals are improper or incorrect. As a result, Headquarters and field office accountants can post unapproved, unreviewed journal entries in STARS in the current manual journal entry process. Erroneous or fraudulent journal entries could go undetected and uncorrected as a result, leaving the potential for the Department's general ledger to be misstated.

Recommendation:

12. We recommend that the Director, Office of Financial Control and Reporting, improve controls that minimize the risk of unauthorized or erroneous entries that result when users prepare and post the same journal entry.

Management Reaction:

Management concurs with this recommendation. Management stated that actions will be taken to improve the controls and minimize the risks of unauthorized and erroneous entries. These actions include reducing the number of individuals with access to both entering and posting capabilities, implementing an automated alert generated from STARS whenever an individual both enters and posts his or her own journal, and issuing guidance to require reviews of those journals at high risk as a result of the same individuals both entering and posting the same transactions.

<u>Human Resources</u>

Finding 13: Leave Approval Form(**10-NS9-H-01**)

In our sample of 25 payroll disbursements, NNSA was unable to provide evidence of a completed "Request for Leave or Approved Absence," Office of Personnel Management (OPM) Form 71, or other acceptable method of approval for one individual's administrative leave.

NNSA provided the Standard Form 71 form that was completed and approved for the 32 hours of sick leave taken by the employee during the pay period sampled; however, it did not include documentation and approval of the 26 hours of administrative leave. As a result, the Department's payroll records may be inaccurate and employees may be paid an incorrect amount.

Recommendation:

13. We recommend that the Associate Administrator for Management and Administration direct the Office of Human Capital Management Programs, to reinforce DOE Order 535.1 through training and monitoring to ensure that leave approvals at each office are completed and approved each time an employee requests leave exceeding one hour.

Management Reaction:

NNSA management concurs with the recommendation. NNSA management stated it will issue an NNSACAST reminding all employees of their responsibilities for requesting and approving excused absences, including administrative leave. In addition, a pilot for supervisory training is being developed by the Talent and Leadership Development Division, which includes a module on a supervisor's leave administration responsibilities.

Finding 14: Leave Approval Forms (**10-XN9-H-01**)

In our sample of 25 payroll disbursements, the Department was unable to provide evidence of a completed "Request for Leave or Approved Absence," OPM Form 71, or other acceptable method of approval for two sample items.

We noted that an employee in the Office of Fossil Energy charged 18 hours of sick leave on a timesheet. The Office of Fossil Energy provided a handwritten timesheet which was the office local policy at the time of the leave; however, the timesheet did not include an approver's name/signature. We also noted that an employee in the Office of Fossil Energy charged 36 hours of sick leave on a timesheet. The Office of Fossil Energy provided a handwritten timesheet which was the office local policy at the time of the leave; however, the timesheet did not include an approver's name/signature. As a result, the Department's payroll records may be inaccurate and employees may be getting paid an incorrect amount.

Recommendation:

14. We recommend that the Director of Legacy Management, Office of Fossil Energy reinforce DOE Order 535.1 through training and monitoring to ensure that leave approvals at each office are completed and approved each time an employee requests leave exceeding one hour.

Management Reaction:

Management concurs with the recommendation. Management stated the Fossil Energy Office of Management and Field Operations will be issuing an FE CAST that restates the DOE requirements and will assure that all organizations are made fully aware of time and attendance procedures.

Inventory

Finding 15: Incorrect Application of Standard Cost to No-Cost Inventory (**10-NR9-NM-01**)

Nuclear Fuel Services (NFS) is a contractor of the Naval Reactors Laboratory Field Office (NRLFO). Y-12 and Savannah River Site (SRS) transferred Government-furnished special nuclear material to NFS beginning in the early 2000s. NFS blended down the off-specification highly enriched uranium (off-spec HEU) for use by Tennessee Valley Authority (TVA). As of September 30, 2010, NFS is no longer receiving off-spec HEU to be downblended for TVA.

The Office of Financial Policy (OFP) at the DOE Headquarters (HQ) issued a memo dated March 18, 2002, entitled "Valuation of Unallocated Off-Specification Highly Enriched Uranium." OFP distributed the memo to those field sites in possession of such off-spec material, instructing them to write-down off-spec HEU material to zero value. However, between FY 2002 and FY 2009, NRLFO reported $120 million of off-specification HEU in its nuclear materials inventory balance when it should have been recorded at zero value. NRLFO identified the error in the inventory balance and wrote it off in FY 2010.

The following factors contributed to this condition:

a) NRLFO had a nuclear materials transfer confirmation control in place to verify its transfer activity with other sites. However, NRLFO provided evidence that Y-12 and SRS incorrectly confirmed some transfer costs with NRLFO as being at standard cost versus zero value;

b) DOE HQ did not provide NRLFO with the memo instructing field sites to write down the value of their off-spec HEU material to zero value because NRLFO did not have cognizance over any off-spec HEU material in FY 2002 at the time the memo was distributed. Consequently, upon transfer of the off-spec HEU material to NRLFO, NRLFO recorded the material at the relevant standard cost; and,

c) Y-12 does not separately record its inventory in STARS complicating the reconciliation of the value of transfers.

As a result of the error, NRLFO wrote off the inventory in FY 2010. The correcting entry in FY 2010 overstated FY 2010 costs by $120 million.

Recommendation:

15. We recommend that the NNSA CFO assess the adequacy of nuclear materials reporting by Y-12 in STARS for reconciling Departmental balances.

    We also recommend that the Office of Financial Policy:

    a) Direct all field site CFOs to instruct relevant field site accounting personnel to run and review an ending inventory report at fiscal year end from the sites' local nuclear materials accountability systems to determine if standard transfer values (or standard cost curve values) are correctly applied to the nuclear materials on hand;

    b) Direct all field site CFOs to instruct relevant field site accounting personnel to cross check standard transfer value (or standard cost curve value) calculations with all current nuclear materials guidance issued by DOE Headquarters to ensure values were correctly captured in the general ledger for all nuclear material quantities under the sites' cognizance; and

    c) Distribute nuclear materials guidance to all offices with nuclear materials, not just those with the particular type of material addressed in the guidance.

Management Reaction:

Management concurs with the recommendations. Management stated the NNSA Field CFO will work with the OFP and Y-12 to assess the feasibility of nuclear materials reporting in STARS.

The Office of Financial Policy concurs with the finding and recommended actions. OFP stated that their office will issue guidance directing Field CFO's to review nuclear materials values for consistency with current guidance starting in FY 2011. Actions were taken prior to year end to ensure that there were no other instances where off-spec HEU or plutonium, the only two applicable materials, were being carried at incorrect values. All future guidance related to inventory valuation will be disseminated to all offices responsible for nuclear materials regardless of specific material type.

Procurement

Finding 16: Accounts Payable – Transaction Code Errors (**10-OR9-PRO-01**)

We selected a statistical sample of 105 accounts payable balances recorded by the Department. The results of our test work identified two recorded accounts payable balances that did not represent valid liabilities as of June 30, 2010.

Department management stated that the Department entered incorrect transaction codes in STARS when recording prepayments for two Permanent Change of Station vouchers. Because an incorrect transaction code was entered, the STARS application did not apply the prepaid amounts to offset the voucher claim amounts when paid. As a result, the Oak Ridge Financial Service Center overstated SGL 2110, Accounts Payable, by $20,545 at June 30, 2010.

Recommendation:

16. We recommend that the Manager, Oak Ridge Office, direct the Chief Financial Officer, Oak Ridge Office, to implement policies and procedures to ensure that errors in transaction codes are identified and corrected.

Management Reaction:

Management concurs with this recommendation. Management stated that Oak Ridge Financial Service Center (ORFSC) staff members have reviewed the policies and procedures in place regarding the recording of prepayments for Permanent Change of Station vouchers and have determined the procedures need to be modified. ORFSC management will also ensure the appropriate staff members have the menu items necessary to properly record the transactions. Changes will be made to the policies and procedures and these changes will be communicated to the staff no later than September 30, 2010.

Finding 17: Invalid Accounts Payable Balances (**10-NSG-PRO-01**)

We reviewed 25 accounts payable balances as of June 30, 2010 recorded by Babcock & Wilcox Technical Services (B&W) Y-12. We identified two recorded accounts payable balances totaling $17,639 that did not represent valid liabilities and one recorded accounts payable balance that was understated by $55,357.

Department management stated that the exceptions were caused by human error as noted below:

a) Purchase Order (PO) 4300073359 in the amount of $17,638 posted on May 19, 2010 represents an over-accrual because the related IT service contract is pre-paid on a quarterly basis at the beginning of each calendar-year quarter. The accrual entered by the Subcontract Technical Representative (STR) for May was a 100% error as the service had been pre-paid in April (for an invoice which covered April – June). Therefore, no accrual was necessary.

b) PO 4300073969 in the amount of $1 posted on June 16, 2010 was a place holder for an invoice and did not relate to a liability.

c) PO 4300070595 in the amount of $14,000 posted on June 16, 2010 represents an under-accrual based on the payment of $69,357 for invoice 7 dated July 1, 2010 from the vendor. Management underestimated the construction progress of the vendor when they posted the accrual.

As a result of these errors, B&W Y-12 understated SGL 2110, Accounts Payable, by $37,717 at June 30, 2010.

Recommendation:

17. We recommend that the NNSA Field Financial Officer, in conjunction with the Manager, Y-12 Site Office, direct the Chief Financial Officer, B&W Y-12 to implement policies and procedures to ensure that STRs are properly trained in estimating, documenting and recording accruals.

Management Reaction:

Management concurs with this recommendation. Management stated the Y-12 CFO will work with the Procurement organization to develop an action plan aimed at the review of the accrual process, existing policies, procedures and training requirements to improve the accrual process.

Finding 18: Invalid Accounts Payable Balances (**10-OR2-PRO-01**)

We reviewed 25 accounts payable balances as of June 30, 2010 recorded by Pacific Northwest National Laboratory (PNNL). We identified three recorded accounts payable balances totaling $15,607 that did not represent valid liabilities.

PNNL management stated that, due to a system error, the accruals did not reverse appropriately when the vendor invoice was paid resulting in an overstatement of SGL 2110, Accounts Payable, by $15,607 at June 30, 2010.

Recommendation:

18. We recommend that the Pacific Northwest Chief Financial Officer in conjunction with the Manager of the Pacific Northwest Site Office, direct PNNL Battelle to implement policies and procedures to identify and correct all invalid balances caused by the system error and work with information management services to correct the system error.

Management Reaction:

Management concurs with the recommendations. The Pacific Northwest Site Office/PNNL management stated they have reversed the three receipts accruals that KPMG identified. Management stated that two of the issues were the result of a system error and the third is still being reviewed. The Pacific Northwest Site Office/PNNL will perform a review of their policies and procedures that will identify and correct all invalid balances caused by the system and identify a path forward and any associated action items related to this situation. They stated they will complete this review and establish a corrective action plan by November 3, 2010.

Property, Plant, and Equipment (PP&E)

Finding 19: Addition and Retirement of Fixed Assets (**10-ORO-PPE-01**)

The Oak Ridge Office (Oak Ridge) uses FIMS to track and control real property and the Asset Management System (AMS) to track and control personal property. As of June 30, 2010, the balances in STARS did not agree to the information in FIMS and AMS. The PP&E balance in STARS at June 30, 2010 was $17,188,025 compared to the balance recorded in the FIMS and AMS databases of $12,125,478. Additionally, the site was unable to produce reports reconciling the activity within the accounts for the nine-month period ending June 30, 2010.

The site did not have procedures in place to ensure that account balances reconciled with the FIMS and AMS supporting databases. The site is implementing new reconciliation procedures, but the site had not fully implemented the procedures at the time of our testwork. As a result, Oak Ridge potentially overstated the gross PP&E balance by approximately $5 million as of June 30, 2010. Oak Ridge is unable to verify the difference due to the lack of reconciliation procedures. Furthermore, the site is unable to fully support the activity within PP&E for the nine-month period ended June 30, 2010.

Recommendation:

19. We recommend that the Oak Ridge Field Chief Financial Officer direct responsible personnel to (a) implement effective procedures requiring timely reconciliation of PP&E account balances to the underlying asset management systems, and (b) properly support activity within the account including additions, disposals and depreciation.

Management Reaction:

Management concurs with the recommendations. Management stated procedures have been put in place to conduct a reconciliation of PP&E account balances to the underlying asset management systems on a monthly basis.

Finding 20: Property, Plant and Equipment Capitalization (**10-NS3-PPE-01**)

In our sample of 25 asset additions, LLNL did not timely capitalize 14 assets when they placed the assets in service. Except as noted below, LLNL capitalized these assets at a later date using the correct in-service date. LLNL also did not capitalize and depreciate eight assets using the correct in-service date, including six of the items above and the two abandoned assets below. LLNL capitalized eight separate assets using placed in-service dates that did not agree to the documentation supporting the date on which they physically placed the asset in service.

Furthermore, Livermore acquired two assets as abandoned property but did not capitalize these assets using the correct in-service date, acquisition basis or useful life. LLNL did not estimate a new basis and useful life for the assets at the time of transfer. Rather, LLNL capitalized the abandoned assets using data from the original asset acquisition supporting documentation.

The property management division at Livermore was unaware of the need to use the physical in-service date, rather than the purchase date, as the basis for capitalization when they entered assets in their property tracking system. The property accounting division at LLNL was also unaware of the requirement to estimate the cost basis and useful life of assets acquired through abandonment at the time of the transfer. As a result, as of June 30, 2010, LLNL overstated accumulated depreciation and understated net book value of completed PP&E by $260,822 related to the sampled items.

Recommendation:

20. We recommend that the NNSA Field Chief Financial Officer, in conjunction with the Manager of the Livermore Site Office, direct LLNL to implement policies and procedures to:

    a) Ensure that they timely capitalize assets when they physically place assets in service; and

    b) Ensure that they capitalize assets acquired via donation, abandonment, or any method other than construction or purchase, using the correct basis, in-service date and useful life in accordance with SFFAS No. 6.

Management Reaction:

The Livermore Site Office (LSO) concurs with the finding and recommendation. LSO has determined that Lawrence Livermore National Security, LLC (LLNS) has taken the following corrective actions:

a) Prior to the end of FY 2010, adjusted the capitalization dates, asset values, and accumulated depreciation for those assets identified as exceptions during the audit;

b) Now uses the date that assets are placed in service as the capitalization date; and

c) Now uses the standards prescribed in SFFAS No. 6 for assigning the basis, in service date, and useful life of assets acquired by methods other than construction or purchase.

In addition, management stated that LSO, in coordination with the NNSA Field Chief Financial Officer, will direct LLNS to modify its applicable policies and procedures no later than March 31, 2011 to ensure they incorporate the requirements that:

a) LLNS timely capitalizes assets when they physically place assets in service; and

b) LLNS capitalizes assets acquired via donation, abandonment, or any method other than construction or purchase, using the correct basis, in-service date, and useful life in accordance with SFFAS No. 6.

Finding 21: Property, Plant and Equipment Capitalization(**10-ORS-PPE-01**)

We identified 12 errors related to asset additions at SLAC for the 9 months ended June 30, 2010. Those errors are as follows:

a) SLAC fully depreciated seven assets at the time they placed them in service rather than depreciating the assets over their remaining useful life;

b) SLAC capitalized three asset additions using the date SLAC entered the asset records into PeopleSoft as the date placed in service rather than the actual date placed in service; and

c) SLAC incorrectly classified two asset additions as non-depreciable property in PeopleSoft.

We also identified two errors for asset additions during the three months ended September 30, 2010. SLAC placed completed assets in service in a prior fiscal year but did not transfer them from Construction Work in Process (CWIP) to capitalized PP&E until FY 2010.

SLAC did not conduct timely periodic reconciliations or reviews of the asset additions to ensure correct capitalization in PeopleSoft. Also, SLAC did not conduct timely reviews of projects in CWIP to ensure timely transfer to completed PP&E. As a result, SLAC overstated accumulated depreciation and understated net book value of completed PP&E by approximately $5.2 million for the 12 items in error as of June 30, 2010. SLAC also overstated FY 2010 depreciation expense for the two assets not timely capitalized from CWIP. However, net book value for these two assets is correct as of September 30, 2010.

Recommendation:

21. We recommend that the Oak Ridge Office Chief Financial Officer in conjunction with the Manager of the SLAC Site Office, direct SLAC National Accelerator Laboratory to establish policies and procedures to ensure SLAC personnel (a) capitalize and depreciate assets over the appropriate useful life using the correct in-service date and (b) capitalize assets when physically placed in service.

Management Reaction:

Management concurs with the recommendations and stated that a letter to the SLAC National Accelerator Laboratory directing them to establish the policies and procedures and to identify any subsequent corrective actions in response to this finding will be sent. Targeted milestone date for completion is February 28, 2011.

Finding 22: Timeliness of Capitalization (**10-NSH-PPE-01**)

In our sample of 25 asset additions, Sandia did not record depreciation using the correct capitalization date for 4 assets. Sandia transferred assets into the Microsystems and Engineering Science Applications complex but did not capitalize the cost of the assets at the time they placed the assets into service. Sandia identified the assets as part of a subsequent physical count of assets and capitalized the assets at the time of the count. However, Sandia did not record depreciation based on the actual date they placed the assets into service, but rather the date of the physical count.

For assets identified through fixed asset counts as in service but not capitalized, Sandia did not have the procedures in place to identify and calculate depreciation using the correct capitalization date. As a result, Sandia did not calculate the correct amount of accumulated depreciation for four assets included in our sample. As of June 30, 2010, Sandia understated accumulated depreciation and overstated net book value of completed PP&E by $371,456 related to the sampled items.

Recommendation:

22. We recommend that the NNSA Field Chief Financial Officer, in conjunction with the Manager of the Sandia Site Office, implement policies and procedures (a) to ensure that SNL capitalize

transferred assets at the time of the transfer and (b) to record the actual in-service date for assets identified during physical observations.

Management Reaction:

Management concurs with the recommendations. Management also clarified that the finding in this case has nothing to do with assets transferred in from another site. It deals with a piece of equipment transferred from a capitalized building and recorded separately. The building had a fifty-year life and the equipment had a ten-year life. Sandia has a system that automatically calculates catch-up depreciation when an asset is capitalized after the fact. It was assumed that this program would also work with assets broken out from an existing asset, but it did not. Management stated that desk procedures have been implemented to ensure this does not happen again. Management stated that programmers are reviewing to make sure this is integrated into their R12 implementation. The original in-service dates for the assets were the purchase dates, not the date of the physical count. Therefore, the dates originally in Oracle were older than the correct in-service date. Management stated they changed the in-service dates to the date of beneficial occupancy for the Microsystems and Engineering Sciences Applications complex to better reflect the correct in-service date. The depreciation was properly recorded in August of FY 2010.

Finding 23: Property, Plant and Equipment Capitalization (**10-OR4-PPE-01**)

We identified six errors for asset additions at ORNL operated by UT-Batelle during the three months ended September 30, 2010. Those errors were as follows:

a) UT-Battelle did not enter the correct in-service date into ORNL's general ledger (SAP) for four asset additions to the Spallation Neutron Source;

b) UT-Battelle did not enter the correct in-service date into SAP for one asset addition and calculated the catch up depreciation amount for this addition using the incorrect acquisition cost; and

c) UT-Battelle did not record the correct depreciation entry for one asset addition due to the incorrect exclusion of depreciation for one work breakdown structure.

UT-Battelle did not conduct timely periodic reconciliations or reviews of the asset additions to ensure correct capitalization in SAP. As a result, UT-Battelle overstated ORNL's depreciation expense and accumulated depreciation while understating ORNL's net book value of completed PP&E by approximately $6.4 million as of September 30, 2010 related to these six errors.

Recommendation:

23. We recommend that the Oak Ridge Office Chief Financial Officer, in conjunction with the Manager of the ORNL Site Office, direct UT-Battelle to implement effective review procedures to ensure that they properly record depreciation expense and accumulated depreciation for all fixed asset additions.

Management Reaction:

Oak Ridge management concurs with the recommendation. Management stated that a letter to UT-Battelle directing them to develop the review procedure and to identify any subsequent corrective actions in response to this finding will be sent. Targeted milestone date for completion is January 31, 2011. Additionally, UT-Battelle has corrected all of the entry errors associated with this finding.

Exhibit B

STATUS OF PRIOR YEAR FINDINGS

Prior Year Findings Related to Internal Controls and Other Operational Matters (with parenthetical references to findings)	**Status at September 30, 2010**
Environmental Liabilities	
1) Landlord and Safeguard & Security – Out-Year Planning Estimates (**09-ID9-REL-01**)	Closed in FY 2010
2) Excess Materials Prior Period Error (**09-NSQ-REL-01**)	Closed in FY 2010
3) Cost and Schedule Variance Misstatement (**09-RL9-EL-01**)	Reissued in FY 2010 - See repeat finding number 1.
4) Inaccuracies in the Savannah River Site's Environmental Liability Estimates (**09-SR9-EL-01**)	Closed in FY 2010
5) Misstatement of the Interim Fiscal Year 2008 Environmental Liabilities Estimated Balance (**08-RL9-EL-01**)	Reissued in FY 2010 - See repeat finding number 2.
6) Errors in Calculation of Prior Year Surplus Plutonium Liability (**08-XN9-REL-01**)	Closed in FY 2010
Environmental Liabilities for Active Facilities	
7) Active Facilities – Structures Liability (**09-ID9-AF-01**)	Closed in FY 2010
8) Inaccuracies in the Active Facilities Liability (**09-NS9-AF-01**)	Closed in FY 2010
9) Inaccuracies in the Active Facilities Data Collection System (**09-NSH-AF-01**)	Closed in FY 2010
Grants	
10) Grant Closeout (**09-CH9-GL-01**)	Reissued in FY 2010 – See repeat finding number 3.
11) Accrued Expenses (**08-XN9-GL-01**)	Closed in FY 2010
Human Resources	
12) Off-Cycle Payroll Disbursements (**09-NS3-HR-01**)	Closed in FY 2010
13) Missing TSP-1 Form, Inaccurate Retention Incentive Payment and Inaccurate Federal Employee Group Life Insurance Withholding (**09-NS9-HR-01**)	Closed in FY 2010
14) Incomplete Official Personnel Files (**09-XN9-HR-01**)	Closed in FY 2010
Inventory	
15) Internal Controls over Production Work in Progress (**09-NSQ-NM-01**)	Closed in FY 2010
16) Miscalculation of Standard Transfer Value for Tritium (**09-XN9-NM-01**)	Reissued in FY 2010 – See repeat finding number 4.
17) Capitalization of Stockpile Life Extension Program Costs (**08-NS9-NM-02**)	Closed in FY 2010
Procurement	
18) Unauthorized Reimbursement of Relocation Expense	

(**09-NS1-PRO-01 (Revised)**)	Closed in FY 2010
19) Invalid Accounts Payable Balances (**09-XN9-PRO-01**)	Closed in FY 2010

Property, Plant, and Equipment (PP&E)

20) Construction Work in Process (**09-CH3-PPE-01**)	Closed in FY 2010
21) Construction Work in Process (**09-CH9-PPE-01**)	Closed in FY 2010
22) Construction Work in Process (**09-NS1-PPE-01**)	Closed in FY 2010
23) Timeliness of Capitalization (**09-NS1-PPE-02**)	Closed in FY 2010
24) Capitalization of Fixed Assets (**09-NS3-PPE-01**)	Closed in FY 2010
25) Gain/Loss Recognition on Disposal of Fixed Assets (**09-NSL-PPE-01**)	Closed in FY 2010
26) Timeliness of Capitalization (**08-OR4-PPE-01**)	Closed in FY 2010

<u>Reissued Findings in FY 2010</u>

<u>Environmental Liabilities</u>

Repeat Finding 1: Cost and Schedule Variance Misstatement (**09-RL9-EL-01**)

During the FY 2009 audit, we reported that the Richland Operations Office (Richland) recorded an increase of approximately $30 million in the RL-0030 project baseline estimate resulting from a change in work scope related to an appropriation received during FY 2008. We recommended that Richland establish a process to identify changes in work scope resulting from appropriations and to record the corresponding adjustments to its environmental liabilities.

Our follow-up in FY 2010 indicates that Richland has implemented corrective actions, but has not completed its review to verify that the mitigating actions will be effective. This finding will remain open until Richland management reviews and approves the corrective actions.

Recommendation:

1. We continue to recommend that the Manager, Richland Operations Office, establish a process to identify when additional work scope has been assigned via additional appropriations and make the corresponding adjustments to the baseline liability.

Management Reaction:

Management concurs with the recommendation. Management stated the Richland Operations Office has established a process to annually assess if additional work scope has been assigned and/or the project schedule has changed due to additional appropriations. The effectiveness assessment and close out of the finding is in process and expected to be completed by the end of the first quarter FY 2011.

Repeat Finding 2: Misstatement of the Interim Fiscal Year 2008 Environmental Liabilities Estimated Balance (**08-RL9-EL-01**)

In FY 2008, we reported that Richland modified its indirect work scope estimate and re-allocated indirect costs to the various cleanup project baselines. Due to errors in the calculation of the indirect allocation percentages, Richland over-allocated $273 million of indirect work scope from the Plateau Remediation

Contract to the cleanup project baselines. Due to a similar miscalculation, Richland under-allocated $52 million of the Mission Support Contract indirect work scope to the project baselines. The errors resulted in a net overstatement of $221 million in Richland's environmental liability. We recommended, and Richland recorded, an audit adjustment to correct this misstatement as of September 30, 2008. Additionally, we recommended that:

a) The Manager, Richland Operations Office, establish procedures for the management review of new and revised environmental liability cost and schedule estimates, to identify errors and omissions.
b) Richland perform a periodic reconciliation of direct and indirect baseline estimates to the recorded environmental liability.

In FY 2009, our follow-up found that Richland had completed a reconciliation of direct and indirect baseline estimates to the recorded environmental liability as of March 31, 2009, and modified the modeling tool used to allocate indirect costs across all activities in the project baselines. The updated modeling tool was implemented for the FY 2011 budget formulation planning case but not for the current year project baselines because of changes expected to result from American Recovery and Reinvestment Act (ARRA) scheduling and estimating activities. Management planned to apply the updated modeling tool to the project baselines in FY 2011.

Additionally, Richland's Financial Management Division evaluated and documented its environmental liability cost estimating process during FY 2009. This process includes internal controls to ensure proper reconciliation of indirect costs. However, Richland will not implement this process for EM baseline estimates until FY 2011.

Our FY 2009 follow-up indicated that Richland planned to perform an effectiveness review by September 30, 2009, to determine whether the completed actions provide reasonable assurance that the corrective actions have been successful. However, the additional estimating and scheduling activities required by the implementation of ARRA have absorbed the resources that would have been used to perform the effectiveness review and this review will not occur until FY 2011.

This finding will remain open until Richland fully implements the recommended corrective actions.

Recommendation:

2. We continue to recommend that the Manager, Richland Operations Office, establish procedures for management review of new and revised environmental liability cost and schedule estimates, to identify errors and omissions. We also continue to recommend that Richland perform a consistent periodic reconciliation of the direct and indirect baseline estimates to the recorded environmental liability.

Management Reaction:

Management concurs with the recommendations. Richland management stated that they have reevaluated the process for distribution of indirects to directs. Richland has modified the modeling tool used to allocate the indirects across all the activities in the life-cycle baseline. This was implemented for the FY 2011 Budget formulation planning case providing verification that the process addressed the corrective action. In FY 2011 life-cycle updates to the baseline are anticipated so implementation of the new process will also be incorporated by third quarter of FY 2011. The assessment of effectiveness of completed corrective actions is planned for first quarter of FY 2012. Richland management stated that the completion of the assessment will complete finding 08-RL9-EL-01.

Grants

Repeat Finding 3: Grant Closeout (**09-CH9-GL-01**)

In FY 2009, during our review of a randomly selected sample of 25 grants, we identified one grant (ER45862) with a project period that ended October 31, 2004. At the time of our testwork, Chicago had not yet closed out this grant. During our FY 2010 testwork, we noted that the Chicago Office closed this grant on September 15, 2010.

In FY 2010, during our review of a randomly selected sample of 25 non-ARRA grants, we identified the following four instances where the grant expired over three years ago:

a) ER15265 - The grant project period ended March 14, 2004; the grantee has not submitted a final expenditure report;

b) ER45963 – The grant project period ended May 31, 2006; the grantee submitted a final expenditure report on May 29, 2009;

c) ER45835 - The grant project period ended August 14, 2004 and the grantee submitted a final expenditure report dated January 31, 2005. In addition, Chicago should de-obligate the remaining balance of $250 prior to closeout, per review of the final expenditure report; and

d) ER84205 - The grant project period ended June 26, 2006; the grantee submitted a final expenditure report dated March 23, 2007.

In addition, during our FY 2010 review of a randomly selected sample of 12 uncosted obligations (undelivered orders) at June 30, 2010, we identified one grant (ER15418) that had a $228 uncosted obligation. The grant project period ended on May 14, 2009. Therefore, this uncosted balance is stale as of June 30, 2010. As a result, the Chicago Office overstated uncosted obligations by $228 as of June 30, 2010.

Recommendation:

3. We continue to recommend that the Manager, Chicago Office, direct the Assistant Manager, Office of Acquisition and Assistance, to implement policies and procedures to ensure that grant files are closed in the required time period after receipt of the final expenditure report.

Management Reaction:

The Chicago Office concurs with the recommendation. Management stated that a corrective action plan was developed and implemented in response to the prior year's finding 09-CH9-GL-01 dated October 7, 2009, which began addressing the subject finding effectively. The policy and procedure for close-out procedures was revised March 2010 to address the issue of closing out expired grants within the required time period after receipt of the final expenditure reports. The utilization of a support services contractor for closeout services was a critical component of the corrective action plan. Due to a lack of financial resources, management stated that they have not been able to award a follow-on support services contract for closeout support. Currently, various options are being considered; however, it is expected that the finding will remain open until sufficient resources are obtained. When adequate resources are obtained, a realistic completion/resolution date can be established. Management's current estimate is that they will be able to resolve this finding on or around September 30, 2013. Once adequate resources become available, management will revise the estimated completion date accordingly.

Inventory

Repeat Finding 4: Miscalculation of Standard Transfer Value for Tritium (**09-XN9-NM-01**)

During FY 2009, our review of the recalculation of the standard transfer value (STV) for tritium identified two errors in the calculation. First, the calculation included the cost accumulated by the Chicago Office, which was inappropriate to include, as this cost is work in process and has no related tritium quantity assigned. Second, Savannah River removed its portion of the variance account twice.

During FY 2010, our test work determined that the Department corrected the Savannah River variance account error, but did not fully correct the error from the prior year related to Chicago's costs when the Department recalculated the STV in FY 2010. In addition, we identified another error in both the FY 2009 and FY 2010 STV recalculations explained further in our classified workpapers.

The total impact of the errors noted in FY 2010 amounts to an understatement of the Department's tritium inventory of $37.5 million as of September 30, 2010. The Department recorded an adjustment to correct the inventory balance in the September 30, 2010 consolidated financial statements.

Recommendation:

4. We recommend that the Office of Financial Control & Reporting revise the STV for tritium to correct the error in the current STV and exclude Chicago Office's work in process. Then, revalue the tritium inventory using the revised STV.

Management Reaction:

Management concurs with the recommendation. The tritium STV for FY 2011 has been calculated and reviewed by the auditors. The new STV corrects for the inclusion of in-process costs and other needed adjustments. It also eliminates the need for a year-end headquarters adjustment to correct the ending inventory balance.

Exhibit C

ACRONYMS

AFDCS	Active Facilities Data Collection System
AMS	Asset Management System
ARRA	American Reinvestment and Recovery Act
BEA	Battelle Energy Alliance, LLC
BGRR	Brookhaven Graphite Research Reactor
BHSO	Brookhaven Site Office
BNL	Brookhaven National Laboratory
BSA	Brookhaven Science Associates
B&W	Babcock & Wilcox Technical Services
CFO	Chief Financial Officer
CWIP	Construction Work in Process
D&D	Decontamination and Decommissioning
Department or DOE	Department of Energy
EM	Office of Environmental Management
FIMS	Facilities Inventory Management System
FY	Fiscal Year
HEU	Highly Enriched Uranium
HFBR	High Flux Beam Reactor
HQ	Headquarters
HR	Human Resources
INL	Idaho National Laboratory
IT	Information Technology
LANL	Los Alamos National Laboratory
LANS	Los Alamos National Security
LLNL	Lawrence Livermore National Laboratory
LLNS	Lawrence Livermore National Security
LSO	Livermore Site Office
M&O	Management and Operating
NA-56	National Nuclear Security Administration Office of Environmental Projects and Operations
NE	Office of Nuclear Energy
NFS	Nuclear Fuel Services
NNSA	National Nuclear Security Administration
NRLFO	Naval Reactors Laboratory Field Office
OFCR	Office of Financial Control and Reporting
OFP	Office of Financial Policy
OPM	Office of Personnel Management
ORFSC	Oak Ridge Financial Service Center
ORNL	Oak Ridge National Laboratory
PBS	Project Baseline Summary
PNNL	Pacific Northwest National Laboratory
PO	Purchase Order
PP&E	Property, Plant, and Equipment
REL	Restructured Environmental Liabilities
SFFAS	Statement of Federal Financial Accounting Standards
SGL	Standard General Ledger

SLAC	SLAC National Accelerator Laboratory
SMEs	Subject Matter Experts
SOPP	Standard Operating Policies and Procedures
SRS	Savannah River Site
STARS	Standard Accounting and Reporting System
STR	Subcontract Technical Representative
STV	Standard Transfer Value
TVA	Tennessee Valley Authority
Y-12	Y-12 Plant