

WR-FS-99-01

# AUDIT REPORT

REPORT ON MATTERS  
IDENTIFIED AT THE  
IDAHO OPERATIONS OFFICE  
DURING THE AUDIT OF THE  
DEPARTMENT'S CONSOLIDATED  
FISCAL YEAR 1998 FINANCIAL  
STATEMENTS



U.S. DEPARTMENT OF ENERGY  
OFFICE OF INSPECTOR GENERAL

REPORT ON MATTERS IDENTIFIED AT THE  
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FISCAL YEAR 1998 FINANCIAL STATEMENTS

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Western Regional Audit Office  
Albuquerque, New Mexico 87185

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TABLE OF CONTENTS

	<u>Page</u>
SUMMARY.....	1
PART I - APPROACH AND OVERVIEW.....	2
Introduction.....	2
Scope and Methodology.....	2
Observations.....	3
PART II - AUDIT RESULTS.....	4
1. Procurement and Accounts Payable Internal Control Deficiencies...	4
2. Incomplete Deferred Maintenance Extrapolation Model.....	6
3. Yearend Accruals.....	7

U.S. DEPARTMENT OF ENERGY  
OFFICE OF INSPECTOR GENERAL  
OFFICE OF AUDIT SERVICES  
WESTERN REGIONAL AUDIT OFFICE

REPORT ON MATTERS IDENTIFIED AT THE  
IDAHO OPERATIONS OFFICE  
DURING THE AUDIT OF THE DEPARTMENT'S CONSOLIDATED  
FISCAL YEAR 1998 FINANCIAL STATEMENTS

Audit Report Number: WR-FS-99-01

SUMMARY

The Government Management Reform Act of 1994 requires that the Department of Energy (DOE) annually submit audited financial statements to the Office of Management and Budget (OMB). A Departmentwide audit was conducted to determine whether there was reasonable assurance that DOE's consolidated Fiscal Year (FY) 1998 financial statements were free of material misstatements. We conducted a portion of the Departmentwide audit at the Idaho Operations Office (Idaho) and its management and operating contractor, Lockheed Martin Idaho Technologies Company (Lockheed).

The audit at Idaho and Lockheed disclosed internal control deficiencies in procurement and accounts payable activities and omissions in the deferred maintenance extrapolation model and yearend accruals. Specifically, Lockheed's procurement agents and accounts payable clerks could override certain internal controls. In addition, Lockheed's deferred maintenance extrapolation model did not include building use in determining the amount of deferred maintenance. Finally, no accruals were made to account for non-payroll transactions that occurred after the Integrated Materials Management System (IMMS) cutoff date of September 25, 1998.

We recommended that Idaho ensure that Lockheed implement and modify its policies, follow guidance regarding building use in the deferred maintenance extrapolation model, and adjust the financial statements as necessary for yearend accruals. Idaho agreed with the findings and recommendations and took corrective actions.

\_\_\_\_\_  
(Signed)  
Office of Inspector General

## PART I

### APPROACH AND OVERVIEW

#### INTRODUCTION

The Government Management Reform Act of 1994 requires that audited financial statements covering all accounts and associated activities of DOE be submitted annually to OMB. A Departmentwide audit of the consolidated FY 1998 financial statements was conducted by examining internal controls, assessing compliance with laws and regulations, evaluating accounting transaction cycles, and testing selected account balances at various DOE facilities.

The objective of the Departmentwide audit was to determine whether the DOE's consolidated financial statements presented fairly, in all material respects, the financial position of the DOE as of September 30, 1998 and 1997, and its consolidated net cost, changes in net position, budgetary resources, financing activities, and custodial activities for the fiscal years then ended in conformity with Federal accounting standards. Departmentwide issues are addressed in Audit Report No. IG-FS-99-01, issued on February 25, 1999.

The purpose of this report is to inform Idaho management of matters that came to the attention of the Office of Inspector General (OIG) during the audit of Idaho and Lockheed. Idaho is responsible for the account balances entered into DOE's core accounting system.

#### SCOPE AND METHODOLOGY

The audit was conducted from May 1998 through January 1999 at Idaho and Lockheed in Idaho Falls, Idaho. Specifically, we examined internal controls, assessed compliance with laws and regulations, and selectively tested account balances reported to DOE Headquarters as necessary to achieve the Departmentwide audit objective.

The audit 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 financial systems and evaluated the reliability of the data on a test basis.

Because the audit was limited, it would not necessarily disclose all of the internal control weaknesses that may have existed. Furthermore, because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. The issues addressed in this report represent our observations of activities through the end of fieldwork on January 5, 1999. Projection of any evaluation of the internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the effectiveness of the design and operation of policies and procedures may deteriorate.

In addition to the audit work conducted by the OIG, an independent public accounting firm reviewed Disbursements, Financing and Revenue, and Fixed Assets at Idaho. The OIG

considered all findings, generated as a result of the review, when preparing the audit report on DOE's Consolidated FY 1998 Financial Statements and the management report referred to in that report. The OIG is addressing issues requiring local management attention in this report.

An exit conference was held with Idaho and Lockheed management on March 2, 1999.

## OBSERVATIONS

We observed various internal control deficiencies in Lockheed's procurement and accounts payable activities. Contrary to Lockheed's policies, procurement agents could issue purchase orders in situations where new requisitions were required or agents' spending limits were exceeded. In addition, accounts payable clerks could override the requirement that a three-way match occur among purchase orders, receiving reports, and invoices before making payments. Furthermore, procurement agents did not receive written verification that items were received before authorizing accounts payable clerks to make payment. We recommended that Idaho ensure that Lockheed implement and modify policies to correct these deficiencies. Management concurred with the finding and recommendations and took corrective actions.

In addition, we determined that Lockheed did not follow DOE guidance for estimating deferred maintenance for buildings at the Idaho National Environmental and Engineering Laboratory (INEEL). Specifically, Lockheed did not include building use in its extrapolation model. We recommended that Idaho direct Lockheed to include building use in the model or perform an analysis to determine if the effect of exclusion would be immaterial. Management concurred with the finding and recommendations and performed an analysis.

Finally, we found that Lockheed did not make yearend accruals to account for FY 1998 non-payroll costs incurred after its September 25 IMMS cutoff date. Accordingly, non-payroll activities occurring after that date were recorded in FY 1999. We recommended that Lockheed determine the amount of the omitted accruals and, if material, correct the FY 1998 financial statements. We also recommended that Idaho direct Lockheed to establish procedures to ensure that future accruals were made through the fiscal yearend. Management concurred with the finding and recommendations and took appropriate actions.

Part II of this report provides additional details concerning the audit results and management's comments.

## PART II

### AUDIT RESULTS

#### 1. Procurement and Accounts Payable Internal Control Deficiencies

There were deficiencies in Lockheed's internal controls that adversely affected Lockheed's ability to safeguard assets against loss from unauthorized acquisition, use, or disposition. Specifically:

1. Contrary to the policies in Lockheed's *Process Descriptions and Approved Thresholds Manual (Manual)*, the computer system had deficiencies that did not prohibit procurement agents from issuing purchase orders that exceeded their purchasing limits. In addition, the computer system allowed the agents to issue purchase orders when the agents should have obtained new requisitions from the requesters. The *Manual* required procurement agents to obtain a new requisition if the purchase order exceeded the requisitioned amount by 10 percent or \$1,000. These weaknesses increased the potential for unauthorized acquisitions.
2. The *Manual* required accounts payable clerks to make payments for goods received only after assuring a three-way match among the invoice, purchase order, and receiving report. However, the computer system permitted the clerks to override this requirement. As a result, unauthorized use of DOE funds could occur.

Idaho had previously recommended that Lockheed correct this deficiency when it was identified during a 1997 Business Management Process Review. However, Lockheed had not corrected the deficiency.

3. Procurement agents gave approval to accounts payable clerks to pay for items not requiring receiving reports, such as services. However, procurement agents did not obtain written verification from the requester that these items had actually been received. This occurred because the *Manual* should have, but did not, specifically require written verification. As a result, there was increased risk that DOE funds could be used to pay for items not received.

#### Recommendations

We recommend that the Chief Financial and Administrative Officer, Idaho, direct Lockheed to:

1. Assure that the policies in its *Manual* are implemented;
2. Complete corrective action identified in the 1997 Business Management Process Review; and,

3. Modify the *Manual* to require that procurement agents obtain written verification that items have been received before giving approval for payment.

#### Management Comments

Management concurred with the finding and recommendations, implemented corrective actions, and cited mitigating controls.

#### Auditor Comments

Management's comments and corrective actions were responsive to the finding and recommendations.

## 2. Incomplete Deferred Maintenance Extrapolation Model

To comply with the deferred maintenance reporting requirement in Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment*, DOE's Office of Project and Fixed Assets Management issued guidance which allowed the use of an extrapolation model. For those buildings that did not have current condition assessment surveys, the sites could extrapolate deferred maintenance from surveys of buildings with similar construction type, age, and use. The model could exclude building use if an analysis showed the effects of this exclusion were immaterial. However, Lockheed excluded building use from its extrapolation model without performing the analysis. Lockheed did not perform such an analysis because it thought building use did not directly impact the deterioration rate.

As a result, the deferred maintenance extrapolation model for 209 of INEEL's 547 buildings was incomplete. Without consideration of building use or an analysis showing that the effects of exclusion were immaterial, DOE had reduced assurance that the deferred maintenance amount reported for INEEL was accurate.

### Recommendations

We recommend that the Chief Financial and Administrative Officer, Idaho, direct Lockheed to:

1. Include building use in its extrapolation model and recalculate deferred maintenance; or,
2. Perform an analysis to determine if building use materially affects the deferred maintenance reported. In the event of a material difference, recalculate deferred maintenance.

### Management Comments

Management concurred with the finding and recommendations. Lockheed's analysis showed that building use did not materially affect the extrapolation model.

### Auditor Comments

Management's comments and corrective actions were responsive to the finding and recommendations.

### 3. Yearend Accruals

DOE's *Accounting Handbook* requires contractors to maintain accounts on an accrual basis. According to the *Handbook*, costs must be identified with and recorded in the period incurred, even if the payment was issued in a subsequent accounting period. However, Lockheed did not accrue non-payroll costs incurred between September 25, 1998, which was the yearend cutoff for its IMMS, and September 30, 1998, which was DOE's fiscal yearend. Accordingly, non-payroll disbursement transactions that occurred after that date were recorded in FY 1999.

These accruals were not made because Lockheed established its accounting year as a 52-week period and instructed Lockheed managers to consider September 25 as the last business day to accrue goods and services for FY 1998. Since Idaho had accepted Lockheed's practice in the past, no procedures were in place to prepare accruals for transactions that occurred between September 25 and September 30. Lockheed management believed that the practice was justified since all its fiscal years contained 52 weeks' worth of transactions. Furthermore, Lockheed did not prepare accruals because it considered the dollar amounts immaterial.

As a result, Lockheed and Idaho's financial statements did not contain all period costs and yearend liabilities.

#### Recommendations

We recommend that the Chief Financial and Administrative Officer, Idaho, direct Lockheed to:

1. Calculate the accruals associated with September 26-30, 1998, transactions and, if material, correct the FY 1998 yearend balances; and,
2. Establish procedures to accrue future IMMS transactions in the proper Government fiscal year.

#### Management Comments

Management concurred with the finding and recommendations and implemented corrective action. Idaho cited the *Handbook's* provision that a balance should be maintained between the effort required to measure accrued costs precisely and the added value of such precision. Lockheed calculated the non-payroll accruals and found they were immaterial. Accordingly, Idaho concluded that the yearend balances did not need correction. In addition, Lockheed established a new procedure that will be implemented in future years. This procedure requires that transactions made between the IMMS cutoff date and September 30 be reviewed and accrued if they are over a \$25,000 materiality threshold.

### Auditor Comments

Management's comments are responsive to the finding and recommendations. However, Lockheed and Idaho need to obtain input from the DOE Headquarters Chief Financial Officer before implementing the planned \$25,000 accrual materiality threshold.

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