

Audit work at the Strategic Petroleum Reserve and DynMcDermott 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 audit work was limited, it would not necessarily disclose all the internal control weaknesses that may exist. Furthermore, because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. This report covers our observations of activities through the end of fieldwork on January 5, 1999. Projections of any evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operations of policies and procedures may deteriorate.

In addition to the audit work conducted by the Office of Inspector General, an independent public accounting firm was engaged to perform agreed-upon audit procedures of the Oil Inventory account. Also, another independent public accounting firm performed overview procedures and reviewed Finance and Revenue.

The Office of Inspector General considered the result of these reviews when preparing the audit report on the Department's consolidated Fiscal Year 1998 financial statements (Audit Report No. IG-FS-99-01) and the management report referred to in that report.

An exit conference was held with the Project Office on December 3, 1998.

OBSERVATIONS

No exceptions, material at the operations office or Departmental level, were noted as a result of applying the specified audit procedures for the Strategic Petroleum Reserve and DynMcDermott. However, we did note a matter regarding the accrual of lease revenues that was brought to management's attention.

The Project Office leases several idle site facilities, such as holding tanks and pipelines, to commercial organizations. The Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financial Sources*, requires revenue to be recognized as services are performed. However, the Project Office recorded lease revenue as cash was received, not as services were performed. As a result, lease revenues were overstated by \$2,500 and \$17,139 during the years ended September 30, 1997 and 1998, respectively. The Project Office has agreed to update its accounting closeout procedures to include proper timing, cutoff, and accrual of lease revenues.

In addition, we noted that a finding contained in the prior year's report, *Matters Identified at the Strategic Petroleum Reserve During the Audit of the Department's Consolidated Fiscal Year 1997 Financial Statements* has not been resolved. We reported that DynMcDermott did not allocate an appropriate share of indirect costs to Construction Work-in-Progress (CWIP) projects. According to the Department's Accounting Handbook, capitalized costs should include all costs to convert or to make facilities or equipment ready for use. The cost of construction work performed by the Department and its integrated contractors should include an appropriate share of indirect or overhead costs. As a result, the CWIP, Completed Plant and Equipment, and Accumulated Depreciation accounts were understated and the Cumulative Results of Operations and the Net Cost of Operations were overstated. We were unable to determine the extent of these misstatements. We recommended that DynMcDermott establish procedures to allocate an appropriate share of indirect costs to CWIP. Management had not concurred with our recommendation and stated that the amount of indirect costs to be allocated to CWIP projects would not be material but would require a major change in accounting systems and introduce substantial discontinuity to the program's financial history. Management also stated that present and future capital projects would be nominal as compared to the overall history of the program. The Project Office has requested an interpretation and a possible waiver from the Department's Chief Financial Officer.

Since no new recommendations are being made, a formal response is not required. We appreciate the cooperation of your staff throughout the audit.

(Signed)
Terry L. Brendlinger, Manager
Eastern Regional Audit Office
Office of Inspector General

cc: Director, Audit Liaison Division

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