

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

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

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

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CONSOLIDATED FISCAL YEAR 1998 FINANCIAL STATEMENTS

Audit Report Number: WR-FS-99-03

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 Richland Operations Office, its management and integrating contractor, Fluor Daniel Hanford, Incorporated, and one of its integrated management and operating contractors, Battelle-Pacific Northwest National Laboratory.

The audit disclosed errors, as of September 30, 1998, in property, liability, and net cost of operations accounts. Richland overstated its Construction Work in Progress (CWIP) account and understated its Completed Property, Plant, and Equipment (CPP&E) and Accumulated Depreciation accounts because completed assets remained in the CWIP account after the assets were placed in service. Richland also misstated the Accrued Expenses and Net Cost of Operations accounts because a contractor had not accrued costs for materials received. Finally, Richland had not completed corrective actions on prior findings concerning write-downs of legacy waste related assets and transfers of assets held by grantees from CWIP to CPP&E.

We recommended that the appropriate accounts be adjusted and controls be established to correct deficiencies noted. Management generally agreed with the recommendations and planned to implement 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 DOE's consolidated financial statements presented fairly, in all material respects, the financial position of 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. DOE/IG-FS-99-01, issued February 25, 1999.

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

SCOPE AND METHODOLOGY

The audit was conducted from April 1998 through January 1999 at the operations office in Richland, Washington, and at Fluor Daniel and Battelle at the Hanford Site, Washington. Specifically, we examined internal controls, assessed compliance with applicable laws and regulations, and selectively tested account balances reported to DOE Headquarters to satisfy departmentwide audit objectives.

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 and application 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 that the effectiveness of the design and operation of policies and procedures may deteriorate.

In addition to the audit work conducted by the OIG, internal audit personnel and an independent public accounting firm reviewed certain audit cycles. Fluor Daniel internal audit personnel reviewed the Payroll Cycle at Fluor Daniel and recommended corrective actions to its management in a separate report. An independent public accounting firm reviewed the Overview Cycle and Financing and Revenue Cycle at Richland; the Fixed Assets and Disbursements Cycles at Richland, Fluor Daniel, and Battelle; and the Pension and Other Post-Retirement Liabilities Cycle at Fluor Daniel.

The OIG considered all findings generated as a result of the reviews when preparing the departmentwide report and the management report referred to in that report. The OIG is addressing issues requiring local management's attention in this report.

An exit conference was held with the Director, Financial Management Division, on April 9, 1999.

OBSERVATIONS

We found misstated accounts and internal control deficiencies. Specifically, Fluor Daniel had not transferred an asset from CWIP to CPP&E when the asset was placed in service, which caused CWIP to be overstated and CPP&E and Accumulated Depreciation to be understated. In addition, Battelle's Accrued Expenses and Net Cost of Operations accounts were understated by \$330,000 because it had not accrued an expense for materials received. Furthermore, Richland's deferred maintenance amount may be inaccurate because Richland had not calculated its deferred maintenance according to DOE guidance. We recommended that Richland adjust the appropriate accounts and establish controls to correct the deficiencies. Management concurred with the findings and recommendations and developed plans to correct the deficiencies disclosed.

Finally, we noted that Richland had not completed corrective actions on two findings contained in the prior year's report.

Part II of this report provides additional details concerning the audit results and management's comments. Part III provides the status of prior year open findings and recommendations.

PART II

AUDIT RESULTS

1. Construction Work in Progress

DOE's *Accounting Handbook* requires that assets be transferred from CWIP to CPP&E "as close to the date of beneficial occupancy as possible, but generally not to exceed six months after each operative unit is placed in full service." However, project T-100, which was occupied in October 1997, was not transferred from CWIP to CPP&E as of September 30, 1998. This occurred because Fluor Daniel personnel responsible for CWIP tend to wait until an entire project is complete or all financial adjustments are made to individual cost accounts prior to completing the necessary paperwork to close assets to CPP&E. As a result, Richland's CWIP account was overstated and the CPP&E account was understated by approximately \$25.5 million and the Accumulated Depreciation account was understated by the amount of the applicable depreciation.

Recommendations

We recommend that the Chief Financial Officer, Richland, direct Fluor Daniel to:

1. Make the necessary adjustments to its CWIP, CPP&E, and Accumulated Depreciation account balances to properly reflect the status of assets; and,
2. Implement procedures to periodically review the status of all CWIP projects and cost accounts with and without recent activity to ensure that CWIP assets are closed within six months of beneficial occupancy or of placing the asset into service.

Management's Comments

Management concurred with the finding and recommendations. Richland stated that it would direct Fluor Daniel to make the necessary accounting adjustments. Richland also stated that it would request the contractor to implement procedures to periodically review the status of all open projects and assure the timely closing of completed project and equipment acquisition costs. The target completion date is May 31, 1999.

Auditor Comments

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

2. Accrued Expenses

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 period. Battelle had not recorded an accrued expense for materials received. After rejecting an invoice for materials received from an international vendor, a Battelle contract manager did not determine the amount owed and did not notify accounts payable of the requisite accrual. As a result, Battelle understated its accrued expenses and net cost of operations by \$330,000 at September 30, 1998.

Recommendations

We recommend that the Chief Financial Officer, Richland:

1. Determine whether this was an isolated instance and require Battelle to establish an accrued expense for all materials received before September 30, 1998; and,
2. Direct Battelle to revise its procedures for accruals and approvals for invoices from international vendors to ensure appropriate accruals are made.

Management Comments

Management concurred with the finding and recommendations. Management determined that the above noted condition was an isolated situation. Management also made the accounting adjustments and directed Battelle to review its accrual procedures. The review should be completed by June 30, 1999.

Auditor Comments

Management's response and corrective actions are responsive to the finding and recommendations.

3. Deferred Maintenance

DOE directed Field Offices to use Condition Assessment Surveys to estimate deferred maintenance on real property, including other structures and facilities (OSF), and to use periodic inspections to estimate deferred maintenance for personal property having acquisition values greater than \$100,000. However, except for Battelle, Richland used maintenance building information rather than Condition Assessment Surveys to estimate deferred maintenance for real property. Although Richland started performing Condition Assessment Surveys and had a goal to expand their use in FY 1999, it had not completed all assessments by the end of FY 1998. In addition, Richland did not use periodic inspections to determine the amount of deferred maintenance for any personal property having acquisition values greater than \$100,000. Instead, Richland used the maintenance backlog information or assumed there was no deferred maintenance. Furthermore, Richland included only electrical and water systems and roads in its deferred maintenance estimate for OSFs. As a result, DOE and Richland have reduced assurance that the deferred maintenance amount is accurate.

Recommendations

We recommend that the Chief Financial Officer, Richland, assure that all contractors:

1. Perform Condition Assessment Surveys for all real property and periodic inspections for all personal property with acquisition values greater than \$100,000; and,
2. Include all OSFs in the deferred maintenance estimate.

Management's Comments

Management concurred with the finding and recommendations. However, management wanted to analyze alternatives before developing a corrective action plan. Management set a target completion date of March 31, 1999.

Auditor Comments

Management has indicated that it concurs with our recommendations. However, management also indicated that it still may use methods other than those directed to calculate deferred maintenance. Accordingly, we cannot determine if management's response properly addresses the reported conditions.

PART III

STATUS OF PRIOR YEAR OPEN FINDINGS AND RECOMMENDATIONS

This section provides the status of two open findings shown in the *Report on Matters Identified at the Richland Operations Office During the Audit of the Department of Energy Consolidated Fiscal Year 1997 Financial Statements* (Report Number WR-FS-98-02; June 8, 1998). These findings are still pending resolution or require further attention.

1. Legacy Waste Related Assets

Fluor Daniel had not written down legacy waste related personal property in the 700 series assets. In its Management Decision, Richland stated that it would direct Fluor Daniel to first review equipment with values greater than \$100,000. When this portion is completed June 30, 1999, Fluor Daniel would expand its review to equipment valued at less than \$100,000.

Status

During the FY 1998 audit, Management stated that it will continue to review 700 series assets with values greater than \$100,000 and write down those assets that primarily support legacy waste activities. We are concerned, however, that Management does not now intend to address assets with values less than \$100,000. Richland should continue with the established action plan that covered all 700 series assets and assure that all property primarily used for legacy waste activities is written down to a net zero value.

2. Construction Work In Progress

Richland had not transferred CWIP, held and placed in service by grantees, to CPP&E.

Status

Richland took action to review its grants and make the necessary accounting adjustments. However, Richland had not completed its review as of September 30, 1998, and set a completion date of March 31, 1999.

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