TESTIMONY OF WILLIAM S. MAHARAY
DEPUTY INSPECTOR GENERAL
FOR AUDIT SERVICES
U.S. DEPARTMENT OF ENERGY
WASHINGTON D.C.

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

MARCH 20, 2007

Mr. Chairman and members of the Subcommittee, I am pleased to be here at your request to testify on issues associated with the FY 2005 and 2006 Audits of the Department of Energy's Financial Statements. Over the years, the Office of Inspector General has conducted and overseen a number of reviews of the accounting and financial operations of the Department. Our reviews related to the audits of the year-end financial statements have covered accounting information system issues, financial statement reporting, and actions to remediate financial accounting and reporting weaknesses. Prior to discussing these subjects, I would like to provide some background information on the Department's financial information management system.

The Department's system, which is relatively unique in the Federal sector, is a hybrid in that it combines summary data from its major contractors with transaction data generated by the business activities of numerous Departmental organizations and sites. Rather than being included in Departmental records, detailed contractor transaction data is maintained by – and audited at – each of the contractor locations. As a control measure, both contractors and Federal officials are required to ensure that the summary data transmitted

from and accepted by the Department's accounting information system is periodically reconciled to the contractors' systems. Over 70 percent of the Department's budget is ultimately expended by its integrated contractors.

Changes to Accounting Operations

The Department was able to sustain unqualified audit opinions on its financial statements until Fiscal Year (FY) 2005. This changed when the Department embarked on the mid-year implementation of a new financial accounting information system known as the Standard Accounting and Reporting System (STARS). The change in accounting system was necessary to (1) ensure that the Department could implement the U.S. Government Standard General Ledger (SGL) at the transaction level and, (2) prevent operational disruption when the legacy hardware vendor stopped supporting its product, and (3) comply with requirements to establish and maintain a modern financial management system that would permit the systematic measurement of performance; the development of cost information; and the integration of program, budget, and financial information for management reporting.

The Department undertook the system development/replacement effort during a period of significant organizational change associated with a Competitive Sourcing Initiative required by OMB Circular A-76. To conform to the structure established through that initiative, the Department's financial services organization was extensively reorganized during Fiscal Years 2004 and 2005. The reorganization resulted in consolidating the financial recording and reporting processes that were previously performed at many

separate locations into three sites. The centralization had a negative effect on financial accounting staffing levels and skills mix in that many key accounting personnel were reassigned and many others were lost through attrition. Centralization also changed the manner in which the Department's financial accounting system interfaced with its major contractors, budgetary and other ancillary systems.

Pre-Implementation Reviews

Because of concerns with completing these major initiatives simultaneously and potential problems related to planning and system development activities, the Office of Inspector General performed two pre-implementation reviews of STARS. The first of these reviews, completed in August 2004, identified a number of challenges that increased the risk that the Department would not be prepared to launch a fully capable system on schedule. Specifically:

- Demands on existing staff would increase substantially and it was uncertain whether resources would be available to complete implementation and testing;
- Critically important training was behind schedule;
- Integrated contractor interface testing had not been completed; and,
- Proper cleanup and conversion of field site data to STARS were not expected to be completed prior to implementation.

We made a number of suggestions to prioritize and resolve critical issues before implementation of the new system. Based on our review and other factors, the Department made the decision to delay its original October 2004 implementation until April 2005.

During the intervening period, our Office conducted a follow-up review, completed on January 11, 2005, that identified additional challenges. While progress was made on certain fronts, we observed that the "planned mid-year implementation of STARS poses special challenges that could impact successful deployment of the system." In particular, we noted that: two separate accounting systems would have to be used to produce the consolidated financial statements; the accelerated reporting schedule for year-end financial statements would provide only limited time to correct any problems that occurred during implementation; and, the burden of auditing two separate systems of controls (both the legacy system and STARS) would severely stress both accounting and audit resources.

FY 2005 Financial Statement Audit

In April 2005, the Department decided to move forward with the mid-year implementation of its new financial accounting system and the adoption of a new chart of accounts. Following deployment, our FY 2005 financial statement audit revealed implementation issues related to converting data from its legacy accounting system, developing new accounting processes to effectively use the new system, and identifying related reporting requirements. Notably:

- Reports needed for management, control, and audit purposes were not available following system deployment;
- Accounting processes had not been fully documented; and,
- Operational control procedures were not yet being performed routinely.

Despite substantial effort, the Department was unable to correct many of the problems associated with the reorganization of its accounting function and conversion to STARS by 2005 Fiscal Year end. As of September 30, 2005, a number of significant issues and challenges had not been resolved. Reports needed for management, control, and audit purposes were not available and a number of system reconciliations remained incomplete. These problems (1) delayed preparation of the FY 2005 financial statements and supporting data, and, (2) impacted the ability of Department officials to monitor and control their budgets.

On November 9, 2005, the Independent Public Accounting firm (IPA) employed by the Office of Inspector General issued a disclaimer of opinion on the Department's FY 2005 consolidated financial statements and reported a material weakness in financial management and reporting controls. Additionally, because of the control deficiencies, the IPA determined that the Department's financial management systems did not substantially comply with all of the requirements of the Federal Financial Management Improvement Act. Weaknesses in the Department's unclassified information systems security, a reportable condition, also continued from prior years.

Review of Remedial Efforts

Given the significance of the problems with financial management and reporting controls, the Department established a special management team to develop a corrective action plan and oversee remedial actions. To assist the Department in evaluating the status of corrective actions, we initiated a series of reviews in January 2006 to determine whether

the Department's planned and completed corrective actions adequately addressed its critical financial management weaknesses.

Our reviews focused on the Department's corrective action plan and included assessments and tests of many revised controls. Our initial review found that certain corrective actions were not scheduled for completion until late in FY 2006, which would not have provided sufficient time to test the newly established controls. We also noted that in some instances, planned actions did not appear to be sufficient to ensure that weaknesses identified during the FY 2005 audit were fully addressed. Subsequent reviews by my office found that a number of key financial accounting system reconciliations had not been completed and reports were not available to permit testing of certain newly created internal controls. Significant system edit errors remained unresolved and problems with recording obligations had not been corrected. The Office of the Chief Financial Officer concurred with our suggestions and agreed to realign resources and refocus its efforts to address unresolved financial management issues.

FY 2006 Financial Statement Audit

Because of the disclaimer of opinion, it was possible to render an opinion only on the Department's Balance Sheet in FY 2006. During the FY 2006 audit, the Department made significant progress in addressing STARS implementation deficiencies and other problems that surfaced in FY 2005. It was, in our judgment, a significant improvement over the previous year. However, actions necessary to reconcile obligations data converted from the Department's legacy accounting system remained unfinished at year end. Data conversion

differences impacted the accuracy of undelivered orders balances at a number of field offices. In addition, many organizations had not performed periodic reviews of obligations and undelivered order balances. As a result, a number of undelivered order balances did not agree with supporting documentation, old obligations had not been deobligated, and many undelivered orders had negative balances.

The issues with obligations and undelivered orders balances resulted in a material weakness in internal controls and a qualified opinion on the Audit of the Department's FY 2006 Balance Sheet. Additionally, problems with unclassified systems security continued as a reportable condition from prior years, and a new reportable condition related to performance measurement was reported. Consistent with its remedial efforts, except for the issues associated with obligations and undelivered orders, nothing come to our attention to suggest that the Department's systems did not substantially comply with other requirements of the Federal Financial Management Improvement Act.

Since the issuance of our FY 2006 financial statement audit report, we have coordinated with the Department and have begun another focused review of its actions to remediate the problems associated with obligations and undelivered orders. Should this effort be successful at all sites, and barring any new material weaknesses in FY 2007, the Department would be in a position to obtain an unqualified opinion in the FY 2007 Audit. We recently began the FY 2007 consolidated financial statement audit and are presently performing information systems assessment and testing as part of that effort.

In summary, we believe that a strong financial management program is important to the Department of Energy. Based on our experience, the Department's current senior leadership, including both the Secretary and the Deputy Secretary, is committed to maintaining strong controls and has been fully invested in resolving weaknesses related to the change in accounting systems. We will continue to assist the Department in this effort – as we have in the past – by devoting a significant portion of our available resources to providing independent assessments of the accounting and financial management operations of the Department.

Thank you, Mr. Chairman and members of the Subcommittee. That concludes my statement and I am prepared to answer questions.