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United States Government **Department of Energy**

Memorandum

DATE: December 22, 2009

REPLY TO
ATTN OF: IG-322 (A09FN006)

SUBJECT: Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2009

TO: Chief Financial Officer, CF-1

Attached is the subject letter prepared by KPMG LLP, our contract auditors. The letter contains 21 new findings (see letter, Exhibit A) and 5 repeat findings (see letter, Exhibit B) that were issued during the course of the Fiscal Year 2009 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, Corporate,
and Financial Audits Division
Office of Inspector General

Attachment

Audit Report No.: OAS-FS-10-03

cc w/attachment:

Assistant Secretary, Nuclear Energy, NE-1
Acting Director, Office of Civilian Radioactive Waste Management, RW-1
Acting Director, Office of Legacy Management, LM-1
Principal Deputy Assistant Secretary, Environmental Management, EM-1
Deputy Assistant Secretary for Fossil Energy, FE-1
Chief Health, Safety and Security Officer, HS-1
Deputy Director for Field Operations, Office of Science, SC-3
Deputy CFO, 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
Acting Director, Policy and Internal Controls Management, NA-66
Deputy Assistant Secretary for Program Planning and Budget, EM-30
Assistant Project Manager, Strategic Petroleum Reserves Project Office, FE-445
Director, Office of Internal Review, CF-1.2
Director, Office of Finance and Accounting, CF-10
Director, Energy Finance and Accounting Service Center, CF-11
Director, Office of Finance and Oversight, CF-12
Director, Office of Program Analysis and Evaluation, CF-20
Director, Office of Financial Policy, CF-50
Director, Office of Procurement and Assistance Management, MA-60
Director, Naval Reactors Laboratory Field Office
Audit Liaison, CF-1.2

Audit Liaison, Environmental Management, EM-33
Audit Liaison, National Nuclear Security Administration, NA-66
Audit Liaison, Office of Civilian Radioactive Waste Management, RW-3
Audit Liaison, Fossil Energy, FE-3
Audit Liaison, 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-10.3 and 10.1
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

U.S. Department of Energy
Office of Inspector General
Office of Audit Services

Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2009

OAS-FS-10-03 December 2009

KPMG LLP
2001 M Street, NW
Washington, DC 20036

MANAGEMENT LETTER

December 17, 2009

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, 2009, and have issued our report thereon dated November 12, 2009. 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 would not necessarily identify all weaknesses in policies or procedures that may exist or all deficiencies in internal control that might be significant deficiencies or material weaknesses. 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 2009 Agency Financial Report*, we identified certain deficiencies in property, plant, and equipment (PP&E) and information technology (IT) that we consider to be significant deficiencies.

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 misstatements on a timely basis. 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 deficiencies to be significant deficiencies in internal control:

- ***Accounting for property, plant, and equipment*** – We identified deficiencies in the Department's internal controls over recording PP&E accurately, completely, and timely. The Department should take steps to address the deficiencies in its accounting policies and procedures and to direct that its contractors follow the proper accounting policies for recording PP&E, including ensuring that all assets are capitalized timely and transferred from construction work in process to completed PP&E when a project is completed or placed into service.

• ***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 issued a separate management letter dated December 17, 2009, 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 controls or result in other operating efficiencies.

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

The maintenance of adequate internal control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the Department.

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)

COMMENTS

<u>Environmental Liabilities</u>

Background: The Department of Energy (Department) has several categories of environmental liabilities, including the 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. The CFO issues annual guidance, which, in addition to Federal regulations, provide field sites with methods and standards required for proper preparation and reporting of financial information.

Finding 1: Landlord and Safeguard & Security – Out-Year Planning Estimates (**09-ID9-REL-01**)

The Department's Idaho Operations Office is responsible for estimating a liability for the Landlord (LL) and Safeguard and Security (SS) costs related to the site's EM cleanup mission. As part of this process, Idaho conducts an annual review of its LL and SS liabilities.

During Fiscal Year (FY) 2008, as a result of an external independent review (EIR) over Idaho's out-year planning estimate range (OPER) estimates, Idaho extended the OPER estimates for two of its major projects (PBS ID-0014 and ID-0040) from FY 2035 to FY 2037. However, Idaho's annual review failed to extend the corresponding LL and SS liabilities to FY 2037, the new end date.

As a result of failing to extend these liabilities and to detect this error during its review, Idaho's environmental liability was understated by $77.9 million as of September 30, 2008.

Recommendation:

1. We recommended that the Manager, Idaho Operations Office, implement policies and procedures to ensure that the assumptions underlying each project are consistent across the site and that changes in assumptions for any of the projects be reviewed to determine if there is a potential impact to another project(s).

Management Reaction:

The Department concurs with the recommendation. Policies and procedures are already in place to adequately assess the environmental liability each year. This includes reviewing the latest available information such as cost estimates, assumptions, and subsequent events, as well as expertise provided by project personnel.

Finding 2: Excess Materials Prior Period Error (**09-NSQ-REL-01**)

Per the CFO's annual guidance, the Pantex Plant is responsible for estimating a liability for the disposition costs related to the site's legacy environmental excess materials, which is included in the Department's REL. In addition, the National Nuclear Security Administration's (NNSA) Pantex Site Office (PXSO) is responsible for overseeing the activities at the Pantex Plant and coordinates with NNSA's Office of Field

Financial Management (OFFM) to record the environmental liability in the Department's financial statements.

During FY 2008, Pantex recorded only three years of disposition costs in its excess materials liability, rather than all known, estimable disposition costs, within the 75-year accrual period, specified by the Department's *Unfunded Liabilities Accounting Guide*. Pantex officials stated that they were not aware that the environmental liabilities for excess materials were to be estimated over a 75-year accrual period. NNSA's OFFM did not fully review Pantex's estimate before submitting it to Headquarters for inclusion in the Department's financial statements.

As a result, Pantex's excess materials environmental liability was understated by $67.9 million as of September 30, 2008.

Recommendation:

2. We recommended that NNSA's Field Chief Financial Officer implement policies and procedures to ensure that the REL estimates developed by their site offices and integrated contractors are valid, supported, and capture all known and estimable costs as of the balance sheet date.

Management Reaction:

The Department concurs with the recommendation. The NNSA Field Chief Financial Officer will direct the integrated contractors to comply with the published guidance on environmental liabilities. During FY 2009, Pantex revised its excess material environmental liability estimate to account for all known and estimable costs over a 75-year accrual period.

Finding 3: Cost and Schedule Variance Misstatement (**09-RL9-EL-01**)

The Department manages the environmental cleanup program at the Richland Operations Office (Richland) through the Plateau Remediation Contract (PRC), Mission Support Contract (MSC), and River Corridor Closure Project (RCCP). Work is performed each year by the contractors at varying rates and as a result, Richland records a cost and schedule variance adjustment at the beginning of each FY to reflect the remaining scope of work in the baseline estimates. Historically, this adjustment has been a de minimis amount across all projects.

During FY 2008, Richland received an additional appropriation of approximately $30 million for RL-0030 (Groundwater/Vadose Zone Remediation Project) that included additional work scope that was not recorded in the project baseline estimate. Richland initiated a baseline change request (BCR) for the additional funding. However, other matters took priority and the BCR was overlooked until reviews during FY 2009 identified the error.

As a result of failing to adjust the liability to account for the additional work scope, Richland's environmental liability was understated by $30 million as of September 30, 2008. During FY 2009, Richland recorded a cost and schedule variance adjustment for RL-0030, which included the additional work scope amount.

Recommendation:

3. We recommended 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:

The Richland Operations Office concurs with the recommendation and will establish a process to annually assess whether additional work scope has been assigned and/or the project schedule has changed due to additional appropriations. If so, the Richland Operations Office will make the corresponding adjustments to the baseline liability.

Finding 4: Inaccuracies in the Savannah River Site's (SRS) Environmental Liability Estimates (**09-SR9-EL-01**)

In October 2008, SRS made significant adjustments to its environmental liabilities that were recorded in the Department's FY 2008 consolidated financial statements. These adjustments were handled in accordance with Office of Financial Policy (OFP) and EM guidance. During FY 2009, SRS did not submit a baseline change request to incorporate these adjustments into the approved Integrated Planning, Accountability and Budgeting System (IPABS) baseline, nor were the adjustments entered into the environmental liability module in IPABS. SRS continued to carry forward the FY 2008 adjustment in the liability calculation, without revision, in FY 2009.

Late in FY 2009, SRS began revising major portions of the lifecycle baseline including site overhead, contractor fee, and pension contributions. Given the number of revisions being made, along with the complexity of the FY 2008 carry-forward adjustments, the site was not able to produce a current, reasonable, and auditable site environmental liability estimate in a timely manner.

We determined that SRS had not followed OFP and EM guidance in determining the site environmental liability and that SRS management had not reviewed the liability estimate to ensure it was current, reasonable and auditable, before submitting balances and adjustments to Headquarters for consolidation purposes.

As a result, the Department's ability to produce a consolidated environmental liability estimate in accordance with accounting standards and internal guidance was negatively impacted. Significant efforts by EM headquarters management, SRS site management, and the Department's Office of Chief Financial Officer were needed to address the weaknesses in environmental liability accounting at SRS.

Consequently, the SRS environmental liabilities were overstated by $2.4 billion as of September 30, 2009, before corrective adjustments resulting from Headquarters initiated actions were taken.

Recommendation:

4. We recommended that the Office of Environmental Management, in conjunction with the Savannah River Site, perform the following:
   (a) Instruct the field sites to follow the guidance issued by EM and the Office of Financial Policy regarding the recording of environmental liability adjustments within IPABS; and

(b) Develop and implement site procedures to ensure a current, reasonable and auditable environmental liability is produced within the required timeframe at fiscal year end. The procedures should require federal management review of the liability.

Management Reaction:

EM concurs with both recommendations. EM stated that it will emphasize in the FY 2010 Environmental Liability guidance and management cover memo the importance of following the guidance. EM also stated that it will conduct a conference call with SRS staff and managers to ensure that site personnel have a clear understanding of the guidance, the schedule of deliverables, the importance of meeting the deliverable due dates and the importance of communication between SRS staff from the CFO and the programmatic side.

In addition, EM stated it will work with SRS personnel and the Department's CFO to ensure that SRS has clear, concise and stringent procedures in place to ensure that a current, reasonable and auditable environmental liability is produced within the required timeframe at fiscal year end and that the procedures will also require federal management review of the liability.

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. 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 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 2009, we performed detailed tests of data at five 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. We identified errors at the following three sites, the Idaho Operations Office in Idaho, the NNSA Service Center in New Mexico, and the Sandia National Laboratory in New Mexico.

Finding 5: Active Facilities – Structures Liability (**09-ID9-AF-01**)

The Idaho Operations Office is responsible for estimating a liability for the future remediation of its active facilities, which includes remediation costs for the stabilization, decontamination, and decommissioning for facilities and structures that are currently in use or “active”. As previously noted, the Department's active facilities estimate is largely based upon a cost-estimating model run out of the Department's Office of CFO at Headquarters. However, other appropriate cost-modeled estimates or site-specific estimates, such as Idaho, are used when available.

During FY 2009, Idaho's Office of Nuclear Energy (NE) transferred ownership of several buildings and structures to EM as a result of American Recovery and Reinvestment Act (ARRA) funds received. In reviewing the documentation over the transfers, it was noted that several transferring structures did not have a previous remediation liability recorded. Idaho performed an analysis and determined that it did not record a liability for the future remediation of 276 contaminated structures in FY 2008 due to an oversight that was not identified until Idaho performed an analysis in FY 2009 as a result of the pending ARRA transfers to EM.

As a result, Idaho's environmental liability was understated by approximately $123 million as of September 30, 2008.

Recommendation:

5. We recommended that the Manager, Idaho Operations Office, implement a process for evaluating its active facilities liability to ensure that the estimates are complete.

Management Reaction:

Management concurs with the recommendation and the Idaho National Laboratory contractor, Batelle Energy Alliance, LLC, has implemented a review and evaluation process to ensure that all appropriate facilities and structures are included in developing the active facilities environmental liability estimate.

Finding 6: Inaccuracies in the Active Facilities Liability (**09-NS9-AF-01**)

In FY 2004, NNSA transferred the General Atomics Hot Cell Facility to the Office of Legacy Management (LM) for inclusion in the LM liability. However, NNSA continued to account for this facility in the active facilities non-modeled liability, resulting in a duplication of this environmental liability. Because NNSA did not properly review the components of the non-modeled liability, they did not remove the General Atomics Hot Cell Facility from the non-modeled Active Facilities liability when they transferred the facility to LM in 2004. In FY 2009, NNSA identified this duplication during their routine liability evaluation process and removed this facility from the NNSA non-modeled active facilities liability.

Additionally, in FY 2009, with guidance from the HQ OFP, NNSA identified that the “Nevada areas reserved for future testing” was not an environmental liability. Nevada originally recorded the liability in FY 1999 based upon the available information regarding future clean-up activities. NNSA carried the estimate until FY 2009 when the site reviewed the estimate and it was determined that, under existing conditions, the areas would not require future clean-up work. Testing requirements drive the need for future remediation. If testing were to resume at the site, NNSA would need to perform clean-up work and would make a determination at the time to record a liability.

The combined effect of the errors detailed above is an overstatement of the September 30, 2008 active facilities liability by approximately $290 million. Because NNSA corrected these errors in 2009, there is no misstatement of the recorded active facilities liability as of September 30, 2009.

Recommendation:

6. We recommended that the NNSA Field Chief Financial Officer ensure that NNSA sites perform reviews over existing active facility balances to ensure that estimates are current and account for any transfers of liabilities between programs.

Management Reaction:

Management concurs with the audit recommendation. The NNSA CFO will monitor like kind cases, with a subject matter expert point of contact, should future liabilities of this nature arise.

Finding 7: Inaccuracies in the Active Facilities Data Collection System (**09-NSH-AF-01**)

Our review of a statistically selected sample of 35 facilities and structures from Sandia's AFDCS report disclosed that Sandia had assigned the incorrect model code to one facility. Sandia incorrectly coded building 6583 (property sequence 87895) as a code G-building contaminated with hazardous waste. However, based on our tour of the facility and discussions with the Sandia Environmental Safety & Health (ES&H) Coordinators and Building Managers, this building should have been coded as a code N-No Liability-building containing no contamination. The incorrect coding occurred because Sandia had not reevaluated and changed the existing model code after residual contamination in the facility had been removed.

As a result of the improper inclusion of this building in the liability, Sandia's interim active facilities liability was overstated by approximately $1 million. However, because testing occurred prior to year-end, Sandia was able to correct the error prior to the final liability calculation. Therefore, no adjustment to the active facilities liability as of September 30, 2009 was required.

Recommendation:

7. We recommended that NNSA's Field CFO, in conjunction with the Manager of the Sandia Site Office, direct Sandia to ensure that the employees responsible for assigning model types and facility footprints to facilities and structures are fully aware of the AFDCS guidance to reevaluate model codes after environmental restoration work has been performed.

Management Reaction:

Management concurs with this recommendation. During FY 2010, Sandia will continue to perform training sessions with applicable Subject Matter Experts to ensure an accurate understanding of the AFDCS guidance. This intensified training will ensure that personnel are fully aware of the AFDCS guidance. Sandia will also continue to seek guidance from DOE/Headquarters personnel, where applicable.

<u>Grants</u>

Finding 8: Grant Closeout (**09-CH9-GL-01**)

The *Code of Federal Regulations* (CFR) requires grantees to submit a final expenditure report within 90 days of the completion of the grant term (10 CFR 600.171). After the final expenditure report is filed with the Department, the grantee must retain grant documentation for three years (10 CFR 600.153), providing the Department with a three-year window of opportunity to review and close out grant awards should it need to request supporting cost information from the grantee.

During FY 2009, our audit test work determined that the Chicago Office failed to close out a grant award (ER45862) that had expired almost five years ago. The grant period for this award ended on October 31, 2004 and the grantee had filed the final expenditure report. We were informed that Chicago did not have personnel available to identify and closeout grant files within the required time period.

As a result of the failure to close out the grant award in a timely manner, the Department will not be able to request supporting cost information from the grantee. Therefore, the Department will be unable to complete an audit of potential unallowable costs.

Recommendation:

8. We recommended that the Manager, Chicago Office direct the Deputy 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:

Management concurs with the recommendation and stated that closeout of inactive awards has been difficult due to the magnitude of the current workload in comparison to available government full-time equivalent (FTE) resources. In addition, funding for adequate contractor support to assist in this effort has been limited. To address this recommendation, the Office of Acquisition and Assistance will review policies and procedures in this area and revise them as necessary to emphasize the need to closeout expired grant files in the required time period. In addition, the Chicago Office will continue to work to identify alternative resources to devote to the grant closeout effort.

<u>Human Resources</u>

Finding 9: Off-Cycle Payroll Disbursements (**09-NS3-HR-01**)

Our review of a sample of 25 off-cycle payroll disbursements (i.e., severance, expense reimbursements, etc.) during the audit discovered than Lawrence Livermore National Laboratory operated by Lawrence Livermore National Security, LLC (LLNS) failed to maintain proper documentation of management review and approval for nine transactions. For two of the nine exceptions in the sample, the payroll supervisor initiated, processed and approved the off-cycle checks in a short amount of time to pay the LLNS employees before the Christmas holiday. We were told that LLNS did not have enough payroll staff scheduled before the holiday to initiate and process the checks. LLNS informed us that the remaining seven exceptions were due to off-cycle audit packets being lost as a result of inadequate resources to scan and archive the hard copies to an electronic format.

LLNS conducted further review of these disbursements and determined that they were appropriate. However, LLNS's lack of an appropriate segregation of duties increases the potential for an individual to fraudulently process these types of payroll transactions.

Recommendation:

9. We recommended that NNSA's Field Chief Financial Officer, in conjunction with the Manager, Livermore Site Office, direct LLNS to:
   (a) Appropriately schedule the payroll department staffing to enable adequate separation of duties and effective management review; and
   (b) Implement procedures to ensure that approvals are tracked and properly filed.

Management Reaction:

The Livermore Site Office (LSO) concurs with the recommendation and in coordination with the NNSA Chief Financial Officer will direct LLNS to (1) appropriately schedule payroll department staff to assure adequate separation of duties and effective management review and (2) implement procedures to ensure that approvals are tracked and properly maintained.

Finding 10: Missing TSP-1 Form, Inaccurate Retention Incentive Payment, and Inaccurate FEGLI Withholding (**09-NS9-HR-01**)

During FY 2009, the Department's Office of Inspector General (OIG) performed audit procedures on Federal employee payroll transactions processed by the Defense Finance and Accounting System (DFAS) for the Department. The procedures were performed in accordance with Office of Management and Budget (OMB) guidance for the purpose of determining whether health benefits, life insurance, and retirement contribution withholdings for selected DOE employees were reasonable and accurate. The results of the OIG's procedures were used as part of our audit.

This test work identified three exceptions involving NNSA employees:

(1) One NNSA employee's retention incentive payment was inaccurate. The retention incentive payment rate had been changed from 15% to 11.5% for this employee. However, this change was never processed, resulting in an overpayment to the employee. It was determined there was an administrative oversight in processing the SF-50 to reduce the employee's retention incentive rate causing it never to be entered into the Defense Civilian Payroll System (DCPS) of the DFAS.

(2) For a second NNSA employee, the withholding for a life insurance premium under the Federal Employees Group Life Insurance (FEGLI) program was inaccurate. The employee elected FEGLI Basic, as well as Options B and C for five multiples of coverage. However, the employee's withholding was based upon inaccurate data in the employee's SF-50, which indicated that the employee had elected FEGLI Basic, as well as Option A, Option B for four multiples of coverage, and Option C for five multiples of coverage. It was determined the inaccurate FEGLI withholding was for an employee who transferred from another Federal agency. The inaccurate FEGLI withholding was processed by the previous Federal agency and the incorrect withholding amount existed at the time the employee was transferred to DOE.

(3) For a third NNSA employee, the electronic Official Personnel File (eOPF) was incomplete. The employee's Thrift Savings Plan (TSP)-1, authorizing a change to the employee's TSP withholdings could not be located by NNSA Office of Human Capital Management personnel in the eOPF. According to an NNSA Human Resources official, the change to TSP withholdings was processed at the request of the employee. The employee made the request via telephone to correct an error in the previous pay period where the employee had submitted a TSP-1 form authorizing 100% of gross pay to be withheld instead of 0% as intended.

The above exceptions had the following results:

(1) The inaccurate retention incentive payment overpayments began on February 3, 2008. At the date this error was discovered, overpayments aggregating to approximately $5,928 had been made.

(2) The inaccurate FEGLI withholding began on April 23, 2000. For the pay-period reviewed, approximately $29 had been under-withheld from the employee's pay. However, due to the age bracket and salary changes occurring across more than nine years, an aggregate dollar amount has not yet been calculated for this exception.

(3) The change in the employee's TSP participation was not supported by properly authorized forms. However, we have no indication that the election and withholding amount in effect during the pay

period under review were inaccurate nor that there was a significant deficiency in controls that could have an adverse effect on payroll expenses.

Recommendation:

10. The OIG recommended that the Associate Administrator for Management and Administration, direct the Director, Office of Human Capital Management Program, to:
    (a) *Exception 1* – Correct the erroneous retention incentive payment rate and ensure that the employee is paid the proper amount going forward, and recover any prior overpayments;
    (b) *Exception* 2 – Correct the erroneous life insurance election and ensure that the proper FEGLI amount is withheld from the employee's pay going forward;
    (c) *Exception 2* – Implement procedures to ensure that, at the time of transfer, payroll records are complete and accurate for employees transferred from other federal agencies; and
    (d) *Exception 3* – Ensure that the unsupported TSP withholding for the employee is properly supported and that the eOPF is complete by obtaining a signed TSP-1 form from the employee.

Management Reaction:

With regards to recommendation (a), NNSA noted that the employee was being paid at the proper rate, 11.5%. However, this transaction failed to flow from the DCPS to DFAS due to a systems error. The DOE's Office of Corporate Information Systems is researching this issue to determine if it is an isolated case or if additional corrective actions are necessary.

NNSA concurs with recommendations (b) and (c). Existing procedures to review the Official Personnel Folder/eOPF of all new and/or transferred employees to ensure employee benefits are correctly processed are being strengthened.

With regards to recommendation (d), NNSA noted that the employee made a change to their TSP contribution through the Employee Self-Service system (ESS). In doing so, the employee intended to cancel their current contributions, but erroneously entered an update to contribute 100%. The employee contacted the Human Capital Program Analyst, requesting this error be corrected. As such, this was an ESS action and a TSP-1 form is not required.

Auditor Comment: With regards to recommendation (d), NNSA provided additional information to support the employee's authorization of the adjustment to the TSP withholding, which was processed by the Human Capital Program Analyst in ESS. Based upon review of this information, this recommendation is closed.

Finding 11: Incomplete Electronic Official Personnel Files (**09-XN9-HR-01**)

As described in **Finding 10** above, audit procedures were performed by the Department's OIG to determine whether the health benefits, life insurance, and retirement contribution withholdings processed by DFAS for selected DOE employees were reasonable and accurate.

The procedures performed identified exceptions regarding incomplete eOPF for three Headquarters employees. The following documents could not be located by Headquarters' Human Resources Operations Division personnel in three employees' eOPFs: (1) a SF-2817 authorizing one employee's FEGLI withholdings; (2) a SF-2817 authorizing another employee's waiver of FEGLI coverage; and (3) a TSP-1 authorizing a third employee's TSP withholdings. Headquarters officials noted that two of the missing forms were for employees who were transferred from another federal agency and the forms had not been included in the eOPF by the previous federal agency at the time of transfer, while the third form appears to have been misfiled.

As a result of these exceptions, the election of certain employees' FEGLI coverage and TSP participation was not supported by properly authorized forms. However, we have no indication that the benefit elections and withholding amounts were inaccurate nor that there was a significant deficiency in controls that could have an adverse effect on payroll expenses.

Recommendation:

11. The OIG recommended that the Headquarters' Human Resources Operations Division:
    (a) Ensure that the FEGLI and TSP withholdings for the three employees are properly supported and that the eOPFs are complete by obtaining signed SF-2817s and the TSP-1 form from the employees; and
    (b) Implement procedures to ensure that, at the time of transfer, payroll records are complete and accurate for employees transferred from other federal agencies.

Management Reaction:

The Headquarters Human Resources Operations Division concurs with these recommendations. The Human Resources Operations Division will ensure that the FEGLI and TSP withholdings for the three employees are properly supported and that the eOPFs are complete by obtaining signed SF-2817s and TSP-1 forms from the employees. In addition, the Human Resources Operations Division implemented a review process of the OPF to ensure that all appropriate payroll/benefits records are obtained when an employee transfers from another Federal agency.

<u>**Inventory**</u>

Finding 12: Internal Controls over Production Work in Progress (PWIP) (**09-NSQ-NM-01**)

The Pantex PWIP inventory balance included completed disassemblies from prior years that needed to be closed with the associated quantities and values removed from the PWIP inventory balance. The Pantex Plant did not take sufficient, timely action to remediate findings from an FY 2007 Internal Audit report that indicated deficiencies in materials management caused an overstatement in the financial statements. The Pantex Plant did not have internal controls in place to detect or prevent errors in the PWIP inventory balance. Management noted the current the manufacturing resource planning system (MRP) is comprised of 196 interfacing points and 3.43 million lines of programming code. The complexity of Pantex's PWIP inventory accounting process made it difficult to identify MRP errors during prior evaluations by both the Contractor and external auditors. The B&W team concluded in the report entitled, "B&W Corporate Review AIM Team, Pantex Production Work in Progress (PWIP)," the PWIP inventory errors were caused by a lack of coordination between the materials management process and the interface with financial reporting. The B&W team determined there were inadequate internal controls that incorrectly focused on completing a process rather than performing account analysis. In addition, the design of the MRPII system is to do assembly work, not disassembly work, so the system does not optimally function for disassembly work. The MRPII system does not systematically communicate with the accounting system (PeopleSoft), resulting in a manual system for recording PWIP adjustments into the site's accounting records.

As a result, the Pantex Plant overstated the FY 2009 beginning balance of nuclear materials inventory on the balance sheet by $763 million. These errors were corrected as of September 30, 2009.

Recommendation:

12. We recommended that the NNSA Field Chief Financial Officer (FCFO), in conjunction with the Manager, Pantex Site Office, direct the Pantex Plant Office Chief Financial Officer, to:
    (a) Determine and implement needed process improvements to ensure timely, sufficient remediation of Internal Audit findings.
    (b) Evaluate the best practices and suggestions of the B&W team to determine needed process improvements and continue implementing the corrective actions included in the A-123 Corrective Action Plan. In addition, consider devoting resources to update the MRP system with modern manufacturing technology.

Management Reaction:

Management concurs with the recommendations. B&W Pantex and NNSA FCFO organization have been aggressively pursuing the resolution of this issue. In addition to the B&W Internal Audit report, another review was performed at the request of the NNSA FCFO to further assess the internal control issues contributing to the problem. To date, the root causes of the problem have been tentatively identified via aggressive review and analysis by B&W Internal Audit. NNSA FCFO has reviewed the draft report and recommendations for corrective actions and agreed with the findings. They will work with the Site Office, B&W Pantex, and Headquarters/CFO to ensure that all identified corrective actions and internal control issues are completed in accordance with the timelines in the draft report.

Pantex is currently engaged with NNSA senior management to replace the Pantex MRP system and the project is in progress. Pantex believes that the replacement of this system is a key element to implementing best manufacturing business practices. This effort, coupled with NNSA's Office of Field Financial Management's oversight of Pantex's financials, and future audits by both the Office of Inspector General and B&W Pantex's Internal Auditors should continue to ensure strong internal controls in these areas.

Finding 13: Miscalculation of the Standard Transfer Value for Tritium (**09-XN9-NM-01**)

DOE records each nuclear material at average historical production cost called standard transfer value (STV). The average cost or STV is determined when a site initially produces nuclear materials. Upon shipment of material to another site, the value of the transferred material is the STV. If there is production of more of the nuclear material, the Department records the quantity produced at the STV. The Department records any difference in the cost of new production and the STV to a production cost variance account. In November 2007, the Department began producing tritium at the Savannah River site. This was the first production of any nuclear material in the Department for the past several years. The current cost of tritium production exceeded the STV and consequently, the production generated a significant cost variance. In November 2008, the Department decided to incorporate the production variance into the STV by recalculating the STV.

The tritium production process includes the procurement of tritium producing (TP) bars, irradiation of the TP bars in a Tennessee Valley Authority (TVA) nuclear power reactor, and extraction of the tritium produced in the TP bars at the Savannah River Tritium Extraction Plant. The Chicago Office accumulates the cost of TP bar procurement and irradiation by TVA, as well as the associated transportation cost. When TVA ships the TP bars to Savannah River, the Chicago Office transfers the cost associated with that production run to Savannah River.

The standard operating procedures developed by the Office of Financial Policy provide that the total dollars of the material from the Departmental Inventory Management System (DIMS) is added to the balance in the cost variance account and then divided by the total number of finished grams from DIMS. However, the value in the DIMS account includes the Chicago Office's cost for work in process, which has not been finished and should not be included in the calculation. When the Office of Financial Policy calculated the new STV for tritium, the calculation included the cost accumulated by the Chicago Office on work in process that had not yet been completed; thus overstating the STV calculation for completed product.

Furthermore, due to untimely entries made by other sites to revalue the inventory at the new STV, Savannah River's entry to clear the entire September 30, 2008 balance related to tritium production in the variance account incorporated into the STV was delayed until the fourth quarter of FY 2009. This entry was made by Savannah River without considering their previous timely entry made to clear the Savannah River portion of the balance. Thereby, Savannah River removed its portion of the variance account twice.

These two errors resulted in the Department overstating tritium inventory by $14 million, and understating the variance account by $34 million. The net effect is an understatement of nuclear materials inventory of $20 million.

Recommendation:

13. We recommended that the Office of Financial Policy:
    (a) Revise the standard operating procedures to exclude those nuclear materials costs for which no quantity has been assigned from the calculation of the STV;
    (b) 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; and
    (c) Correct or direct Savannah River to correct the variance account for the duplicate entry.

Management Reaction:

The Office of Financial Policy concurs with the recommendations and stated the following corrective actions have been taken or are in progress:
(a) The standard operating procedures have been revised per recommendation (a);
(b) Recommendation (b) is in progress with an expected completion date of March 31, 2009; and,
(c) Recommendation (c) has been completed.

<u>Procurement</u>

Finding 14: Unauthorized Reimbursement of Relocation Expense (**09-NS1-PRO-01** Revised)

A review of a sample of 25 Los Alamos National Laboratory (LANL) disbursements disclosed that LANL paid a relocation reimbursement of $5,834, which was in excess of the approved amount of $5,000. We were informed that the travel department group leader failed to follow-up and obtain reimbursement. As a result, LANL paid excess relocation expenses of $834 as of June 30, 2009.

Recommendation:

14. We recommended that the NNSA Field Chief Financial Officer, in conjunction with the Revitalization Manager, Los Alamos Site Office, direct LANL's Chief Financial Officer to emphasize to travel personnel the importance of adequate review of relocation expenses to ensure that

expenses are appropriate and within the approved limitations set forth by the Federal Travel Regulation (FTR), the LANL Relocation Policy, and/or offer letters, which may restrict funding to a lesser amount than the FTR or LANL Relocation Policy.

Management Reaction:

The Department concurs with the recommendation. However, management states that with regards to this situation, the $5,000 limit was an arbitrary limit imposed by the program due to funding constraints. Upon becoming aware of the additional costs for relocation, the program agreed to raise the funding limit, rather than seek reimbursement from the employee.

Finding 15: Invalid Accounts Payable Balances (**09-XN9-PRO-01**)

Our review of 105 purchase orders (POs) with accounts payable balances as of June 30, 2009 disclosed that 2 balances totaling $475.52 did not represent valid liabilities, as follows:

(1) One PO related to an invoice for an employee's permanent change of station. This invoice was originally logged under one PO number and then moved to a different PO number belonging to the same employee. However, when the invoice was re-logged under a different PO number, the unpaid balance under the original PO was never fully canceled, leaving a balance in Accounts Payable. The unpaid balance on the invoice related to the permanent change of station payment could not be cancelled at the time the invoice was moved to a different PO number because of a system error. The Energy Finance and Accounting Service Center (EFASC) was unable to fully cancel the invoice without assistance from the Standard Accounting and Reporting System (STARS) Team and Oracle to resolve the update error. The effect of this error overstated accounts payable by $275.52 as of June 30, 2009.

(2) A second PO related to an invoice that was part of a zero payment request to move costs and payments from the PO that had been referenced on the Intra-governmental Payment and Collection (IPAC) system to a PO later provided by the Enterprise Training Center. The zero payment request that the Energy Finance and Accounting Service Center (EFASC) received was incorrect due to human error. Consequently, EFASC was only able to record a portion of the required entry. The effect of this error overstated accounts payable by $200 as of June 30, 2009.

Recommendation:

15. We recommended that Department's Chief Financial Officer direct the EFASC:
    (a) Continue to collaborate with the STARS systems team to determine the specific cause when update errors occur and, once determined, obtain and implement a system fix.
    (b) Emphasize to all EFASC personnel the importance of completely processing zero pay transactions to ensure the accuracy of account balances.

Management Reaction:

Management concurs with the recommendations. EFASC stated that the first error cited above occurs sporadically and inconsistently and that it will continue to work with the STARS systems team to determine the specific cause when an update error occurs and implement the corrective action deemed most appropriate. Furthermore, EFASC stated that they were working to resolve this error prior to its identification by the auditors.

Regarding the second error cited above, EFASC stated that it had implemented a month-end procedure to check for unpaid invoices and notify the appropriate office to take action when needed. Furthermore, EFASC stated it will also issue periodic reminders to STARS users to complete the processing of zero pay transactions to ensure the accuracy of account balances.

Property, Plant, and Equipment (PP&E)

Background: PP&E are tangible assets acquired or constructed by an entity to be used, or available for use, to produce goods, services, and support for the entity's mission.

OFP, through the Office of CFO, issued the Department's *Accounting Handbook* on October 17, 1995. The purpose of the *Accounting Handbook* is to present the Department's standards, procedures, and operational requirements in support of the accounting policies, principles, and applicable legal requirements. It also provides general guidance for accounting and financial management policies for functions and responsibilities not otherwise covered, that may be unique to the Department. The provisions of the *Accounting Handbook* apply to all Departmental integrated contractors under the terms of the related contracts. The Department owns many government facilities and laboratories, which are operated by management and operating (M&O) contractors. The Department refers to most of its M&O contractors as "integrated" contractors because their financial systems are integrated with the Department's financial systems. Nonintegrated contractors are also required to follow the applicable standards and procedures as specified in the *Accounting Handbook*, if provided in their contracts.

Finding 16: Construction Work in Process (CWIP) (**09-CH3-PPE-01**)

During our active facilities testwork, we noted that the Brookhaven National Laboratory (BNL) did not transfer Building 0098 from construction work in process to completed PP&E at the date the facility was put in service, August 11, 2008. We determined that BNL's Plant Engineering division had not sent the Transfer to Fixed Assets (TFA) memorandum to the Fiscal Services Division for the building. The Plant Engineering Division did not resolve an open project associated with the facility timely preventing the completion and transmission of the TFA memo.

As a result, BNL's completed PP&E was understated by $3.1 million and its CWIP was overstated by $3.1 million as of September 30, 2009. In addition, prior year depreciation expense and accumulated depreciation were also understated for this facility.

Recommendation:

16. We recommended that the Manager of the Brookhaven Site Office direct BNL's Assistant Laboratory Director of Finance to:
    (a) Emphasize to the Fiscal and Plant Engineering divisions the importance of properly recording the timely transfer of CWIP to completed PP&E;
    (b) Develop procedures to ensure that assets are transferred from CWIP to completed PP&E when a project is completed or when assets are placed into service; and
    (c) Transfer completed building 0098 from CWIP to completed PP&E

Management Reaction:

The Department concurs with these recommendations.

Finding 17: Construction Work in Process (**09-CH9-PPE-01**)

As of March 31, 2009, the Chicago Office reported $30.1 million of CWIP. The majority of these assets had in-service dates prior to FY 2005. During the three months ended June 30, 2009, as part of the follow-up to our audit inquiries, Chicago increased CWIP by $5.6 million for corrections identified from grantee responses, transferred $21.6 million of completed CWIP to PP&E, and wrote-off $9.7 million of CWIP that either did not exist or did not meet the capitalization threshold. As of June 30, 2009, the remaining CWIP balance included 22 stale CWIP assets totaling $3.6 million that need further research and disposition and 2 valid CWIP assets totaling $.8 million. We determined that many of the grantees responsible for reporting on the PP&E that they hold did not respond to the inventory inquiry requests sent by Chicago's property accountants. We also found that the property accountants did not aggressively follow up with the grantees, and, therefore, did not obtain updated records of the CWIP assets on a timely basis.

The total effect of these errors understated PP&E by $21.6 million and overstated CWIP by $29.1 million as of March 31, 2009. In addition, as of June 30, 2009, CWIP included 22 assets totaling $3.6 million that Chicago should have likely transferred or written-off. Finally, Chicago had also understated prior year depreciation expense for assets not placed into service timely.

Recommendation:

17. We recommended that the Manager, Chicago Office, direct its Chief Financial Officer to emphasize to its Property Accounting department the importance of properly and timely recording the transfer of CWIP to completed PP&E and the importance of detailed record keeping of the property held by the grantees. Chicago should also complete the transfer or retirement of the remaining stale CWIP.

Management Reaction:

The Chicago Office concurs with the recommendation. Chicago noted that the site has been working to improve its process for reconciling the financial records for federally-owned property held by grant recipients. As a result of these efforts, Chicago had corrected approximately 93% of the stale CWIP as of September 30, 2009. The Chicago Office intends to continue its reconciliation and corrective efforts during FY 2010 through the following steps:

(1) The Chicago Office CFO will work with the Office of Acquisition and Assistance to ensure that all required inventory reports are received in a timely manner from the grantees with copies provided to the Property Accountant.
(2) The Property Accountant will ensure that inventory reports received include all necessary information, including in-service dates and acquisition costs, for each asset type reported.
(3) The Property Accountant will continue to submit adjustments promptly to EFASC for processing, as well as continue to reconcile the STARS Fixed Asset module report to the general ledger on a quarterly basis.

Finding 18: Construction Work In Process (**09-NS1-PPE-01**)

A review of the project balances in LANL's CWIP account identified 19 projects totaling $57 million as of June 30, 2009 which had been identified as complete. LANL failed to transfer these projects from CWIP to completed PP&E because the current process relies on Project Management to notify Property Accounting that a project is complete by issuing a Final Cost Report (FCR). However, during FY 2009 Property Accounting did not receive FCRs from Project Management to prepare vouchers to capitalize completed assets.

These errors resulted in CWIP being overstated by $57 million and completed PP&E understated by $57 million as of June 30, 2009. In addition, because some of the projects were completed in prior years, depreciation expense and accumulated depreciation in prior years was understated as of June 30, 2009.

Recommendation:

18. We recommended that NNSA's Chief Financial Officer, in conjunction with the Revitalization Manager, Los Alamos Site Office, direct LANL to:
    (a) Develop procedures to ensure that assets are transferred from CWIP to fixed assets when a project is completed or when assets are placed into service; and
    (b) Clear the CWIP account of completed projects or assets previously placed into service to correct the overstated CWIP balance and the incorrect recording of depreciation expense.

Management Reaction:

The Department concurs with the recommendations and is in the process of developing procedures for the timely submittal of the FCRs from all Laboratory divisions. In addition, LANL has created a project to manage the backlog of project needing final cost reports. As of September 30, 2009, this project had resulted in the completion of FCRs for 13 of the 21 projects needing these reports. Finally, LANL has updated the Project Management Policy to clearly outline the roles and responsibilities for the timely completion of FCRs.

Finding 19: Timeliness of Capitalization (**09-NS1-PPE-02**)

A review of capital and operating lease contracts at LANL disclosed that one asset acquired through a purchase option exercised on October 3, 2008 had not been recorded as an asset in LANL accounting records as of September 1, 2009. At the time LANL exercised the purchase option, management was aware of the need to capitalize the asset but Property Accounting had not received the required FCR from the Department responsible for the purchased asset. Based on discussions with management, the Department responsible for issuing the FCR had not responded to Property Accounting's request for the information needed to capitalize the purchased asset.

As a result of the failure to capitalize this asset, as of June 30, 2009 PP&E was understated by $2.8 million and depreciation expense was understated by approximately $57,000.

Recommendation:

19. We recommended that the NNSA Field Chief Financial Officer, in conjunction with the Revitalization Manager, Los Alamos Site Office, direct responsible personnel in LANL's Department of the Chief Financial Officer to:
    (a) Implement effective procedures requiring LANL Project Management to submit FCRs in a timely manner to Property Accounting for the capitalization of purchased assets; and
    (b) Properly capitalize the asset purchased under the lease purchase option.

Management Reaction:

Management concurs with our recommendations and is in the process of developing procedures for the timely submission of FCRs from all Laboratory divisions.

Finding 20: Capitalization of Fixed Assets (**09-NS3-PPE-01**)

Since the mid 1990s, LLNL has been overseeing the construction of the National Ignition Facility (NIF). This project was funded by both operating and line-item construction funding. Over the years, LLNL capitalized, as CWIP, the line-item construction costs, which primarily related to constructing the building and related structures. Beginning in 2002, LLNL began transferring discrete components of the project into completed PP&E, and began depreciating them, even though NIF was not projected to be a productive facility until 2012. Further, in FY 2009, LLNL determined that much of the operating funded costs incurred since the inception of the project were capitalizeable in accordance with the Department's Accounting Handbook, and recorded $852 million of those costs into completed PP&E. LLNL had previously recorded $789 million of these costs as expenses in FY 2001 through FY 2008, the years in which they were incurred.

Additionally, LLNL had not capitalized $803 million of operating funded costs for the National Ignition Campaign (NIC), an integral part of the NIF. LLNL also capitalized $79 million related to the Advanced Simulation and Computing Program in FY 2009. LLNL has previously recorded $41 million of these costs as expenses prior to FY 2009.

DOE Accounting Handbook Chapter 10, Section 2.g., Experimental and Demonstration Projects, states in part:

(1) When such projects as full-scale test facilities or other prototype facilities are undertaken to obtain data related to specific investigations and to demonstrate the feasibility of a particular process, the costs incurred for design, procurement, or fabrication of components, the cost of assembly, and all costs of operations during the experiment may be budgeted and accounted for under an appropriate operating expense program activity. However, when the construction and final testing of such prototype or demonstration facilities are completed, the head of the field element should determine if the completed facility meets the capitalization criteria in paragraph 1d. If it does, then the cost of the completed project should be capitalized and recorded in the financial accounts for completed PP&E.

(2) When a facility is expected to continue to operate as an experiment or demonstration, or when it is expected that the experiment or demonstration will become a productive facility even though primarily constructed for experimental or demonstration purposes, it shall be treated as a capital construction project for budgeting as well as for accounting purposes.

LLNL relied on the guidance in paragraph 1 to conclude that costs should be expensed until construction is complete; however, the governing guidance should have been paragraph 2 resulting in the capitalization of the operating costs. Paragraph 1 of the Accounting Handbook is not compliant with generally accepted accounting principles (GAAP) and their reliance on the Accounting Handbook was a contributing factor to LLNL's incorrect accounting treatment of the NIF project. The premature transfer of some NIF costs to completed PP&E resulted from the site considering components of the facility separately, instead of as one integrated facility that is not yet fully operational.

DOE recorded a correcting post-closing entry in 2009 to capitalize the prior year costs that were improperly expensed, transferred all balances related to the NIF/NIC facility into CWIP, and reversed depreciation that was prematurely recorded. The net effect of these corrections is an understatement of current year operating expense of $1.4 billion.

Recommendation:

20. We recommended:
    (a) NNSA Field Chief Financial Officer, in conjunction with the Manager, Livermore Site Office, ensure that the LLNL Chief Financial Officer implements revised policies and procedures so that all projects that are expected to continue to operate as a productive facility be treated as capital construction projects for accounting purposes, and be recorded in CWIP until completed.
    (b) DOE's Office of the Chief Financial Officer address the deficiencies in the Department's accounting policies and procedures.

Management Reaction:

Management concurs with the recommendations.

Finding 21: Gain/Loss Recognition on Disposal of Fixed Assets (**09-NSL-PPE-01**)

A sample of seven current year fixed asset disposals at National Security Technologies, Nevada Test Site (NSTec) identified one exception. NSTec traded-in an asset and received less than book value in the exchange for the traded-in asset. NSTec properly did not capitalize the new asset because it did not meet the capitalization threshold. However, NSTec recorded the loss on the trade-in to a depreciation account rather than to a loss on disposal account.

NSTec's financial system does not record losses to a loss SGL for disposition of assets traded-in for items at a lower cost value. NSTec believed that it was proper to record the loss to depreciation based on guidance in an updated version of the DOE Accounting Handbook. During FY 2009, the Department updated the DOE Accounting Handbook, but omitted an amendment that was previously made on January 31, 2005, requiring the recognition of a gain or loss in the period of disposal.

There is no net effect on the Department's consolidated financial statements, because the Department combines loss on disposition of property with depreciation expense into the same financial statement line. However, this expense is incorrectly classified in the general ledger.

Recommendation:

21. We recommended:
    (1) The National Nuclear Security Adminisration's Field Chief Financial Officer, in conjunction with the Manager, Nevada Site Office, direct NSTec's Office of the Chief Financial Officer to revise its standard template and related SGL accounts used for recording the trade-in of a capitalized asset for an item not meeting capitalization requirements to ensure that any difference between the recorded value and the net book value of retired assets is recorded to the proper account.
    (2) The Department's Director, Office of Financial Policy Update the Department's Accounting Handbook regarding recording gains and losses on disposal of fixed assets, in accordance with Federal accounting guidance, specifically SFFAS No. 6, paragraph 38 and notify and direct all Departmental elements to follow the revised guidance when issued.

Management Reaction:

Management concurs with the recommendations.

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, 2009**
Budget	
1) Invalid Obligation (**08-SR9-BUD-01**)	Closed in FY 2009
Engagement Matters	
2) Incomplete Representation and Recordation of Interim Legal Contingent Liabilities (**08-XN9-GB-01**)	Closed in FY 2009
Environmental Liabilities	
3) Escalation of Waste Isolation Pilot Plant's (WIPP) Long-Term Stewardship Liability (**08-CCY-EL-01**)	Closed in FY 2009
4) Remote-Handled Waste Disposition Project (**08-ID9-REL-01**)	Closed in FY 2009
5) Allocation of General Infrastructure and Safeguards and Security Costs (**08-ID9-REL-02**)	Closed in FY 2009
6) Long-Term Stewardship Estimate (**08-NSH-REL-01**)	Closed in FY 2009
7) Misstatement of the Interim Fiscal Year 2008 Environmental Liabilities Estimated Balance (**08-RL9-EL-01**)	Reissued in FY 2009 - See repeat finding number 1.
8) Misstatement in WIPP's Long-Term Stewardship Liability (**08-XN9-EL-01**)	Closed in FY 2009
9) Pension Costs in the Environmental Management Liability (**08-XN9-EL-02**)	Closed in FY 2009
10) Errors in Calculation of Prior Year Surplus Plutonium Liability (**08-XN9-REL-01**)	Reissued in FY 2009 – See repeat finding number 2.
Environmental Liabilities for Active Facilities	
11) Inaccuracies in the Active Facilities Data Collection System (**08-CH3-AF-01**)	Closed in FY 2009
12) Inaccuracies in the Active Facilities Data Collection System (**08-NS1-AF-01**)	Closed in FY 2009
13) Inaccuracies in the Active Facilities Data Collection System (**08-NS3-AF-01**)	Closed in FY 2009
14) Inaccuracies in the Active Facilities Data Collection System (**08-NS3-AF-02**)	Closed in FY 2009
15) Inaccuracies in the Active Facilities Data Collection System (**08-NSH-AF-01**)	Closed in FY 2009
Financial Reporting	
16) Misclassification between Cumulative Results of Operations and Unexpended Appropriations (**08-XN9-FR-01**)	Closed in FY 2009
Grants	
17) Costing of Grant Awards (**07-CH9-GL-01**)	Closed in FY 2009
18) Accrued Expenses (**08-XN9-GL-01**)	Reissued in FY 2009 – See repeat finding number 3.

Human Resources

19) Time Card Approvals (**07-NSH-HR-01**)	Closed in FY 2009
20) Time Card Approval (**08-NS1-HR-01**)	Closed in FY 2009
21) Health Benefits Election Form Not Signed (**08-NS9-HR-01**)	Closed in FY 2009
22) Travel Compensatory Time Approval (**08-NS9-HR-02**)	Closed in FY 2009
23) Incomplete Official Personnel File (**08-XN9-HR-01**)	Closed in FY 2009

Intragovernmnetal

24) Intra-governmental Transactions (**08-XN9-INTG-01**)	Closed in FY 2009

Inventory

25) Nuclear Materials Control Environment (**08-NS9-NM-01**)	Closed in FY 2009
26) Capitalization of Stockpile Life Extension Program (SLEP) Costs (**08-NS9-NM-02**)	Reissued in FY 2009 – See repeat finding number 4.
27) Nuclear Materials Control Environment (**08-NS1-NM-01**)	Closed in FY 2009

Procurement

28) Other Party Identifier or Trading Partner Codes (**08-CHF-PRO-01**)	Closed in FY 2009
29) Invalid Accounts Payable Balances (**08-OR4-PRO-01**)	Closed in FY 2009
30) Interface Programming Error (**08-XN9-PRO-01**)	Closed in FY 2009

Property, Plant, and Equipment (PP&E)

31) Retroactive Depreciation Expense (**07-XN9-PPE-01**)	Closed in FY 2009
32) Capitalization of Fixed Assets (**08-NS3-PPE-01**)	Closed in FY 2009
33) Timeliness of Capitalization (**08-OR4-PPE-01**)	Reissued in FY 2009 – See repeat finding number 5.
34) Inaccuracies in Property Records (**08-XN9-PPE-01**)	Closed in FY 2009
35) Inaccuracies in Property Records (**08-XN9-PPE-02**)	Closed in FY 2009

Revenue

36) Aged Accounts Receivable (**08-NSH-REV-01**)	Closed in FY 2009

Reissued Findings in FY 2009

Environmental Liabilities

Repeat Finding 1: Misstatement of the Interim Fiscal Year 2008 Environmental Liabilities Estimated Balance (**08-RL9-EL-01**)

In FY 2008, we reported that Richland modified the indirect work scope estimate and re-allocated the indirect amounts to the various detailed project baseline estimates. Due to errors in the calculation of the indirect allocation percentages, Richland over-allocated $273 million of the Plateau Remediation Contract's (PRC) indirect work scope to the project baseline estimates. Due to a similar miscalculation, Richland under-allocated $52 million of the Mission Support Contract's (MSC) indirect work scope to the project baseline estimates. These errors resulted in a net overstatement of Richland's environmental liability of $221 million.

In FY 2009, our follow-up found that Richland completed a reconciliation of the direct and indirect baseline estimates to the recorded environmental liability as of March 31, 2009 and modified the calculation in the modeling tool used to allocate the indirect costs across all activities in the life-cycle baseline. The updated modeling tool was implemented for FY 2011 budget formulation planning case but not over the current year project baseline estimates because of the anticipated changes from the American Reinvestment and Recovery Act (ARRA) scheduling and estimating activities. Richland plans to implement the updated modeling tool over the project baseline estimates in FY 2010.

Additionally, Richland's Financial Management Division evaluated, documented, and reported the environmental liability cost estimate process, which consists of a series of internal controls that ensure proper reconciliation of indirect costs occurs, during the 3rd quarter of FY 2009. KPMG noted, however, that the process had not been implemented over this year's EM baseline estimates but is scheduled to be implemented during FY 2010.

Finally, our FY 2009 follow-up indicated that Richland planned to perform an effectiveness review by September 30, 2009 to determine if 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 performed the effectiveness review and this review is not planned to occur until the second quarter of FY 2010.

Because Richland has not fully-implemented the recommended corrective actions, the finding remains open.

Recommendation:

1. We continued to recommend that 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. 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:

Richland concurs with the recommendations and noted that they have established procedures for the management review of new and revised environmental liability cost and schedule estimates to identify errors and omissions. In addition, Richland had planned to conduct an effectiveness review by September 30, 2009 to determine if the completed actions provided reasonable assurance that the corrective actions were successful. However, it was necessary to delay the assessment to evaluate the effectiveness of the completed actions due to the additional estimating and scheduling activities required by EM implementation of the ARRA and their impact on the resources that would have implemented the action. The ARRA activities continued through the 4th quarter of Fiscal Year 2009. The assessment of effectiveness of completed corrective actions is now planned for second quarter of FY 2010.

Repeat Finding 2: Errors in Calculation of Prior Year Surplus Plutonium Liability (**08-XN9-REL-01**)

In FY 2008, we reported that NNSA's Business Case component estimates that were carried forward from FY 2007 to FY 2008 required adjustments to include additional costs and exclude certain costs. Such costs to derive a complete estimate include major components such as storage costs, construction costs, and contingency. In FY 2008, the Headquarters OCFO office made adjustments to update these costs, and in addition, we recommended that the OCFO's Office of Financial Policy, in conjunction with NNSA, establish procedures requiring a thorough review of the documentation and calculations supporting the surplus plutonium disposition liability amounts recorded in the Department's consolidated financial statements.

In FY 2009, our follow up indicated additional errors in the estimation of the surplus plutonium liability, as follows:

- The Mixed Oxide (MOX) Fuel Facility and the Pit Disassembly and Conversion Plant (PDCF) total project costs included prior period costs from 1999 through 2007 that were not deducted from the liability.
- The liability estimate did not have any unfunded contingency recorded, similar to other remediation projects throughout the Department.
- The liability estimate did not include increased maintenance and operations costs assessed within the prior fiscal year.
- The liability estimate did not decrease the escalation costs for the portion of the FY 2007 Business Case component estimates no longer carried forward in the liability.

The errors above resulted in a net understatement of $882 million to the surplus plutonium liability as of September 30, 2008.

Given the current status, the finding remains open until Headquarters, in conjunction with NNSA, fully implements the recommended corrective actions.

Recommendation:

2. We continued to recommend that the OCFO's Office of Financial Policy, in conjunction with NNSA, establish procedures requiring a thorough review of the documentation and calculations supporting the surplus plutonium disposition liability amounts recorded in the Department's consolidated financial statements.

Management Reaction:

The Department concurs with the finding and will take further corrective actions in FY10.

Grants

Repeat Finding 3: Accrued Expenses (**08-XN9-GL-01**)

In FY 2008, our review of a sample of 71 financial assistance award accruals identified eight award accruals that had negative balances totaling $342,831.

During FY 2009, our review of a sample of 43 financial assistance award accruals as of September 30, 2009, identified seven award accruals that had negative balances totaling $417,815.

The EFASC recorded receipt/cost entries manually through the STARS PO Module after running the September 30 month-end automated accrual program. Manual adjustments after the automated accrual program run caused the negative balance on the seven award accruals noted in our sample.

The Vendor Invoice Approval System (VIAS) Accrual Adjustment process should rely on the STARS General Ledger Module (rather than the PO Module) in pulling data and delivering results to VIAS users. Because the PO Module is real-time, the VIAS Accrual Adjustment process is pulling current period data in some cases which can lead to abnormal balances.

Recommendation:

3. We continued to recommend that the Department's Chief Financial Officer ensure:
   (a) EFASC assess their processes and timing of recording manual accruals in conjunction with the automated accrual process, and implement corrective action to ensure that accruals are properly recorded in STARS; and
   (b) The Office of Financial Control and Reporting (OFCR) takes corrective action to ensure that approving official adjustments to the automated accrual does not reduce the accrual amount to a negative balance.

Management Reaction:

The Department concurs with the recommendations. OFCR will work with the Oak Ridge Payment Center during FY 2010 to modify the automated and VIAS accrual processes to eliminate the underlying problems resulting in negative accrual balances. These changes include using the GL module data rather than the PO module data to generate automated accruals and implementing controls to preclude VIAS de-accrual adjustments in excess of accrued cost balances.

Inventory

Repeat Finding 4: Capitalization of Stockpile Life Extension Program (SLEP) Costs (**08-NS9-NM-02**)

In FY 2008, our review of the cost capitalization procedures and discussions with program personnel revealed that the Department has undercapitalized the costs related to weapons systems being refurbished in SLEP. This error was the result of certain sites failing to capitalize a proper allocation of indirect costs. These costs include production support costs, safeguards and security support costs, and certain Readiness in Technical Base and Facilities (RTBF) costs that may not relate to excess capacity, and therefore, should be capitalized as part of SLEP.

During FY 2009, NNSA's Field Chief Financial Officer directed the contractor sites to review cost capitalization procedures and, where necessary, change the capitalization procedures to ensure that the correct allocation of indirect costs associated with the SLEP are capitalized into weapons product inventory. NNSA made a summary level adjustment to correct the September 30, 2009 nuclear materials balance and has developed a Plan of Action to correct these site-level errors during FY 2010.

Because the corrective action relating to this finding is ongoing at the end of FY 2009, this finding remains open.

Recommendation:

4. We continued to recommend that the NNSA Field Chief Financial Officer continue to implement capitalization procedures to ensure the proper recording of all indirect costs for the SLEP.

Management Reaction:

Management concurs with the recommendation.

Property, Plant, and Equipment (PP&E)

Repeat Finding 5: Timeliness of Capitalization (**08-OR4-PPE-01**)

In FY 2008, our review of a sample of 18 fixed asset additions at the Oak Ridge National Laboratory (ORNL) disclosed that 12 had delays ranging from 6 months to 7 years between the time the assets were placed in service and the time the assets were transferred from CWIP to completed PP&E.

During FY 2009, we determined that ORNL had begun implementing procedures to identify all estimated completion dates for each fixed asset in CWIP and that 20 fixed assets with a value of approximately $6 million still do not have an estimated completion date.

Recommendation:

5. We continued to 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 procedures to ensure that assets are capitalized in a timely manner when acquired or placed in service. Such procedures should include the requirement that project managers report asset acquisition dates either when acquired or, if used in construction, when placed in service.

Management Reaction:

Management concurs with the recommendation and stated that the corrective action plan for PP&E fixed assets has been completed, with the exception of the formal addition of capital policies and procedures to the Standards-Based Management System (SBMS) for which ORNL is currently operating under revised interim procedures. It plans to implement the SBMS policy and procedure changes by March 31, 2010.

Exhibit C

ACRONYMS

AFDCS	Active Facilities Data Collection System
ARRA	American Reinvestment and Recovery Act
BCR	Baseline Change Request
BNL	Brookhaven National Laboratory
CFO	Chief Financial Officer
CFR	Code of Federal Regulations
CWIP	Construction Work in Process
DCPS	Defense Civilian Payroll System
Department or DOE	Department of Energy
DFAS	Defense Finance and Accounting System
EFASC	Energy Finance and Accounting Service Center
EIR	External Independent Review
EM	Environmental Management
eOPF	Electronic Official Personnel File
ES&H	Environmental Safety and Health
ESS	Employee Self-Service System
FCR	Final Cost Report
FEGLI	Federal Employee Group Life Insurance
FTE	Full-Time Equivalents
FTR	Federal Travel Regulation
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GL	General Ledger
HQ	Headquarters
HR	Human Resources
IPAC	Intra-Governmental Payment and Collection
IT	Information Technology
LANL	Los Alamos National Laboratory
LL	Landlord
LLNS	Lawrence Livermore National Security
LSO	Livermore Site Office
M&O	Management and Operating
MSC	Mission Support Contract
NE	Office of Nuclear Energy
NNSA	National Nuclear Security Agency
OFCR	Office of Financial Control and Reporting
OFFM	Office of Field Financial Management
OFP	Office of Financial Policy
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPER	Out-Year Planning Estimate Range
OPI	Other Party Identifier
ORNL	Oak Ridge National Laboratory
PBS	Project Baseline Summary
PO	Purchase Order
PP&E	Property, Plant, and Equipment
PRC	Plateau Remediation Contract
PWIP	Production Work in Progress

PXSO	Pantex Site Office
RCCP	River Corridor Closure Project
REL	Restructured Environmental Liabilities
RL	Richland
RTBF	Readiness in Technical Base and Facilities
SBMS	Standards-Based Management System
SF	Standard Form
SFFAS	Statement of Federal Financial Accounting Standards
SGL	Standard General Ledger
SLEP	Stockpile Life Extension Program
SS or S&S	Safeguards and Security
STARS	Standard Accounting and Reporting System
STV	Standard Transfer Value
TSP	Thrift Savings Program
VIAS	Vendor Invoice Approval System
WIPP	Waste Isolation Pilot Plant