OFFICE OF INSPECTOR GENERAL
U.S. Department of Energy

AUDIT REPORT

DOE-OIG-18-30 May 2018

THE DEPARTMENT OF ENERGY'S FISCAL YEAR 2017 CONSOLIDATED FINANCIAL STATEMENTS

Department of Energy
Washington, DC 20585

May 21, 2018

MEMORANDUM FOR THE SECRETARY

April Stephenson

FROM: April G. Stephenson
Principal Deputy Inspector General

SUBJECT: INFORMATION: Audit Report on "The Department of Energy's Fiscal Year 2017 Consolidated Financial Statements"

Pursuant to requirements established by the *Government Management Reform Act of 1994*, the Office of Inspector General engaged the independent public accounting firm of KPMG LLP (KPMG) to perform the audit of the Department of Energy's Fiscal Year 2017 Consolidated Financial Statements.

KPMG audited the consolidated financial statements of the Department as of September 30, 2017, and 2016, and the related consolidated statements of net cost, changes in net position, custodial activity, and combined statement of budgetary resources for the years then ended. KPMG concluded that these consolidated financial statements are presented fairly, in all material respects, in conformity with United States generally accepted accounting principles and has issued an unmodified opinion based on its audits and the reports of other auditors for the years ended September 30, 2017, and 2016.

As part of this audit, auditors also considered the Department's internal controls over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on the consolidated financial statements. The audit revealed a certain deficiency in internal controls related to the accounting of environmental liabilities. The following significant deficiency in the Department's system of internal controls is not considered a material weakness:

> **Accounting for Environmental Liabilities:** The Department had not implemented effective internal controls over identifying and recording environmental liabilities accurately, completely, and in a timely manner. Misstatements were identified that resulted from management basing estimates on assumptions that were incorrect and inadequate field office management reviews of cost estimates, including contingency estimates. Most of the errors described above resulted from control deficiencies at field offices. However, one Headquarters estimate was based on information that was outdated, due to insufficient coordination and inconsistency of assumptions between the Office of Standard Contracts Management and the Office of Environmental Management. The control deficiencies resulted in current year misstatements of environmental liabilities and errors in the opening

balance, caused by recording adjustments to the liability in the improper accounting period, that were corrected as of September 30, 2017. The current year adjustments to the overall environmental liabilities aggregated to approximately $2 billion (absolute value basis).

The audit also identified one potential instance of non-compliance that is required to be reported under applicable audit standards and requirements. The Department is reviewing a potential *Anti-Deficiency Act* violation from the over-obligation of approximately $16 million related to the apportionment of funding for a specific Departmental program. A final determination has not yet been made, and therefore, the outcome of the matter is not presently known. The Office of Inspector General recently issued a report, *Inquiry into an Alleged Anti-Deficiency Act Violation at the Department of Energy* (DOE-OIG-18-29), on the allegations related to this matter, which ultimately resulted in delaying the issuance of *The Department of Energy's Fiscal Year 2017 Consolidated Financial Statements*.

The Office of Inspector General issued numerous notices of findings and recommendations to management during the course of the audit. In nearly all instances, management concurred with the findings and recommendations. However, responses to three non-information technology-related findings indicated two non-concurrences and one partial concurrence. All findings will be detailed in management letters and a management decision will be requested, as appropriate.

KPMG is responsible for the attached auditors' report and the opinions and conclusions expressed therein. The Office of Inspector General is responsible for technical and administrative oversight regarding KPMG's performance under the terms of the contract. Our review was not intended to enable us to express, and accordingly we do not express, an opinion on the Department's financial statements, management's assertions about the effectiveness of its internal controls over financial reporting, or the Department's compliance with laws and regulations. Our monitoring review disclosed no instances where KPMG did not comply with applicable auditing standards.

I would like to thank all participating Department elements for their courtesy and cooperation during the review.

Attachment

cc: Deputy Secretary
Chief of Staff
Administrator for the National Nuclear Security Administration
Under Secretary of Energy
Under Secretary for Science
Chief Financial Officer

Report Number: DOE-IG-18-30

Department financial reports are available for download on the Office of the Chief Financial Officer Web site: http://www.energy.gov//cfo/reports/agency-financial-reports

INDEPENDENT AUDITORS' REPORT

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Attachment

Independent Auditors' Report

The Principal Deputy Inspector General, United States Department of Energy and
The Secretary, United States Department of Energy:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States (U.S.) Department Energy (Department), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin Number (No.) 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Energy as of September 30, 2017 and 2016, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of Matters

As discussed in Note 7 to the consolidated financial statements, the Department has total direct loans and loan guarantees, net, of $16 billion and $17 billion as of September 30, 2017 and 2016, respectively, which are issued under the *Federal Credit Reform Act of 1990*. Subsidy costs of the direct loans and loan guarantees are intended to estimate the long-term cost to the U.S. Government of its loan program and include interest rate differentials, delinquencies, defaults, fees, and other cash flow items. A subsidy re-estimate is performed annually at September 30. Any adjustment resulting from the re-estimate is recognized as subsidy expense. Our opinion is not modified with respect to this matter.

As discussed in Note 15 to the consolidated financial statements, the cost estimates supporting the Department's environmental cleanup and disposal liabilities of $384 billion and $372 billion as of September 30, 2017 and 2016, respectively, are based upon assumptions regarding funding and other future action and decisions, many of which are beyond the Department's control. Our opinion is not modified with respect to this matter.

As discussed in Note 18 to the consolidated financial statements, the Department is involved as a defendant in several matters of litigation relating to its inability to accept commercial spent nuclear fuel by January 31, 1998, the date specified in the Nuclear Waste Policy Act of 1982, as amended. The Department has recorded liabilities for likely damages of $27 billion and $25 billion as of September 30, 2017 and 2016, respectively. Our opinion is not modified with respect to this matter.

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the Agency Financial Report to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The consolidating information in the Consolidating Schedules section and Other Information section of the Department's Fiscal Year 2017 Agency Financial Report are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements.

The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the basic consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the basic consolidated financial statements as a whole.

The information in the Other Information section of the Department's Fiscal Year 2017 Agency Financial Report has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide an assurance on it.

Other Reporting Required by *Government Auditing Standards*

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2017, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated 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. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described below and in more detail in Exhibit I, that we consider to be a significant deficiency.

- **Accounting for Environmental Liabilities**. We identified deficiencies in the Department's internal controls over identifying and recording environmental liabilities accurately, completely, and timely.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 17-03.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

- **Potential Instance of Noncompliance**. The Department is reviewing a potential Anti-Deficiency Act violation from the over-obligation of approximately $16 million related to the apportionment of funding for a specific Departmental program. A final determination has not yet been made, and therefore, the outcome of the matter is not presently known.

The Department's Response to Findings

The Department's response to the findings identified in our audit is described in Exhibit I. The Department's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
May 17, 2018

Attachment

Exhibit I – Significant Deficiency

Accounting for Environmental Liabilities

The United States (U.S.) Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book) Section 2 – *Establishing an Effective Internal Control System OV2.01,* defines the standards for internal control in the Federal government states:

- *Principle 10.1* – "Management should design control activities to achieve objectives."
- *Principle 12.01* – "Management should implement control activities through policies."
- *Principal 14.01* – "Management should internally communicate the necessary quality information to achieve the entity's objectives."

The U.S. Department of Energy (Department) has not implemented effective internal controls over identifying and recording environmental liabilities accurately, completely, and timely. We identified misstatements that resulted from management basing estimates on assumptions that were incorrect, and inadequate field office management reviews of cost estimates, including contingency estimates. The control deficiencies resulted in current year misstatements of environmental liabilities and errors in the opening balance, caused by recording adjustments to the liability in the improper accounting period, that were corrected as of September 30, 2017. The current year adjustments to the overall environmental liabilities aggregated to approximately $2 billion (absolute value basis).

The Office of Environmental Management (EM) and the various field offices are responsible for reviewing the field office environmental liability estimates and ensuring the timely and accurate recording of the EM liability in the Department's consolidated financial statements. In addition to environmental liabilities that originate from the field offices, certain liabilities are accounted for at the headquarters level. Most of the errors described above resulted from control deficiencies at field offices. However, one headquarters estimate was based on information that was outdated, due to insufficient coordination and inconsistency of assumptions between the Office of Standard Contracts Management (OSCM) and EM.

Recommendations:

We recommend that EM issue guidance and provide training to field offices regarding management reviews of estimates and recording adjustments to the EM liability in the proper period. The guidance and training should focus particular attention on ensuring that new cost estimates are evaluated in time for adjustment of the liability during or prior to year-end financial reporting. EM should also develop procedures to ensure the contingency estimates are based on assumptions consistent with the baseline estimates. We also recommend that OSCM and EM develop procedures for adequate coordination between these offices to ensure that annual updates to the estimates are based upon current information and consistent assumptions.

Management's Response:

The Department concurs with the recommendations to strengthen internal controls over the EM environmental liabilities. To address the recommendation, EM will issue guidance and provide training to EM field offices regarding management reviews of estimates and recording EM liability adjustments in the proper reporting period. The EM training will specifically focus on ensuring that new cost estimates are evaluated in time to adjust the liability in the current reporting period or prior to year-end financial reporting. Furthermore, EM agrees to develop procedures, and provide training, for ensuring contingency estimates are based on assumptions consistent with the baseline estimates. Lastly, to ensure the accuracy of EM Headquarters estimates, EM will develop a coordination process with OSCM to ensure that the most current assumptions associated with a geologic repository are included in the EM Headquarters estimates.

FEEDBACK

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions, and feedback to OIG.Reports@hq.doe.gov and include your name, contact information, and the report number. You may also mail comments to:

Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 253-2162.