U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

MANAGEMENT REPORT
AUDIT OF THE DEPARTMENT OF ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 1998

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SUMMARY

As required by the Government Management Reform Act of 1994, we audited the U.S. Department of Energy's (Department) consolidated financial statements as of and for the years ended September 30, 1998 and 1997 to determine whether they presented fairly, in all material respects, the Department's financial position, net cost, changes in net position, budgetary resources, financing activities, and custodial activities in conformity with Federal accounting standards. As part of this Departmentwide effort, we examined internal controls, assessed compliance with applicable laws and regulations, and tested selected account balances at Headquarters and at a number of field activities. The results of our audit are included in Audit Report No. IG-FS-99-01 issued February 25, 1999. Additional management-level reports addressing local issues are being issued to field elements.

During our audit, we identified several issues within the purview of the Chief Financial Officer (CFO) and selected Headquarters program offices. A number of miscellaneous problems were identified in the areas of deferred maintenance, delinquent accounts, compliance with cost accounting standards, accounting for heritage assets, disbursements record-keeping, environmental liabilities estimates, financial system logic, presentation and disclosure, and computer and network access controls.

Management generally concurred with the findings and recommendations and acknowledged that corrective actions were needed. Part II of this report discusses our results and management's comments.

Office of Inspector General

PART I

APPROACH AND OVERVIEW

INTRODUCTION

In compliance with The Government Management Reform Act of 1994, we audited the balance sheets of the Department as of September 30, 1998 and 1997, and the related consolidated statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the fiscal years then ended. We examined internal controls, assessed compliance with laws and regulations, and tested selected account balances at various Departmental facilities.

The objective of the Departmentwide audit was to determine whether the Department's consolidated financial statements presented fairly, in all material respects, the financial position of the Department as of September 30, 1998 and 1997, and its consolidated net cost, changes in net position, budgetary resources, financing activities, and custodial activities for the fiscal years then ended in conformity with Federal accounting standards. Departmentwide issues developed during our audit were addressed in Audit Report No. IG-FS-99-01. Additional management-level reports are being issued to various field activities.

The purpose of this report is to inform the CFO of matters that came to the attention of the Office of Inspector General during the audit that were within the purview of the CFO and selected Headquarters program offices. The findings and recommendations included in this report did not impact the overall opinion on the Department's consolidated financial statements and have not been included in other audit reports. They are, however, matters that need to be addressed and should strengthen the Department's system of internal controls or result in operating efficiencies.

SCOPE AND METHODOLOGY

Fieldwork was conducted from May 1998 through January 1999 at various Headquarters components of the CFO. Those components included the Capital Accounting Center and the Office of Financial Control and Reporting. Audit work at the Department's field elements was also substantially completed during the same period and included both Departmental and contractor accounting entities. As part of this effort, we obtained an understanding of the system of internal controls, performed tests of control procedures, assessed compliance with applicable laws and regulations, and tested selected account balances as necessary to achieve the Departmentwide audit objective.

Audit work was performed in accordance with generally accepted Government auditing standards. Since we relied on computer-generated data, we evaluated the general and application control environment of certain systems and evaluated the reliability of the data on a test basis.

In conjunction with our review of general and application controls, we performed a review of the automated system security control environment for network system operations from January 19 to January 27, 1999. The work concentrated on the Headquarters network and selected devices and included information systems processing financial data required for the Department's financial statements. We used network security software to scan for network and active modem vulnerabilities. We considered information technology related policies and procedures and performed other procedures as necessary to satisfy our audit objective.

Because the audit was limited, it would not necessarily have disclosed all internal control weaknesses that exist. Furthermore, because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Issues addressed in this report represent our observations of activities through the end of fieldwork. Projection of any evaluation of the system of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

The Office of Chief Financial Officer waived an exit conference.

OBSERVATIONS

During our audit, we identified issues within the purview of the CFO and selected Headquarters program offices. These issues related to deferred maintenance, delinquent accounts, compliance with cost accounting standards, accounting for heritage assets, disbursements record-keeping, environmental liabilities estimates, financial system logic, presentation and disclosure, and computer and network access controls. A brief description of each follows:

- Headquarters guidance regarding deferred maintenance was not implemented consistently across the complex resulting in incomplete and inaccurate amounts being reported.

- Some sites did not refer delinquent receivables from other Federal agencies to the Attorney General's office.

- The Department did not fully comply with cost accounting standards because it did not document corporate cost accounting activities, processes, and procedures.

- Some Heritage Asset balances were found on the records.

- Supporting documentation for the accrual of accounts payable was unclear and poorly documented.

- Departmental estimates did not completely and accurately capture the Department's active facility environmental liability as of year-end.

- The Department did not fully document the logic behind its crosswalk of balance sheet accounts to standard general ledger accounts.

- The Department did not adequately disclose the reasons behind some changes to the Fiscal Year (FY) 1997 comparative data presented in the FY 1998 consolidated financial statements.

- The Department's computer access verification process was not sufficient to prevent unauthorized users from gaining access to the Department's financial accounting systems and applications.

- Headquarters did not adequately protect its systems from unauthorized access from remote locations or through its network.

Management generally concurred with the findings and recommendations and acknowledged that corrective actions were needed. Part II of this report provides additional details concerning the audit results and management's comments.

PART II

AUDIT RESULTS

Finding 1: Deferred Maintenance Estimates

Federal accounting standards require the Department to report the condition and the estimated cost to remedy deferred maintenance of property, plant and equipment. To comply with accounting standards, the Department adopted the Condition Assessment Survey Method to measure deferred maintenance on personal property having an acquisition value greater than $100,000 and real property including other structures and facilities.

The Department's controls to ensure the proper collection of deferred maintenance information were not entirely effective. Deferred maintenance problems were identified at Albuquerque, Idaho, and Richland.

- The Inhalation Toxicology Research Institute did not provide Albuquerque operations office with deferred maintenance data for 77 buildings valued at $23.9 million.

- Idaho National Engineering and Environmental Laboratory (INEEL) did not include building use when it developed its building deferred maintenance extrapolation model. This model was used to estimate deferred maintenance for 209 of INEEL's 547 buildings.

- Richland did not use condition assessment surveys (CAS) to estimate deferred maintenance for real property except at Pacific Northwest National Laboratory.

These problems occurred because the Department did not ensure that Headquarters' guidance was properly applied. As a result, the Department could not provide adequate assurance that its deferred maintenance estimate is consistent and accurate.

Recommendation

We recommended that the Office of Field Management (FM) ensure that deferred maintenance estimates are being developed consistently and in accordance with the Headquarters guidance.

Management Comments

Management concurred with the recommendation. FM agreed to clarify guidance relating to methods for calculating deferred maintenance estimates and to instruct field offices to ensure that methods used are consistent with the guidance.

Auditor Comments

Management's proposed actions are responsive to the recommendation.

Finding 2: Debt Collection Strategy

The Department's Accounting Handbook describes the Department's strategy for collecting receivables. It requires field CFOs to aggressively follow up on all delinquent receivables. Both Albuquerque and Oakland had outstanding delinquent receivables from other Federal agencies. This occurred in part because there was no definitive guidance on how to collect other Federal agency receivables through the Attorney General. As a result, the Department may have been using its own funds to cover the costs of other Federal agencies.

Recommendation

We recommended that the CFO issue specific guidance addressing collection of delinquent interagency claims and work with the field CFOs in the collection of delinquent receivables.

Management Comments

The CFO concurred with the findings and agreed to implement the recommendations.

Auditor Comments

Management's proposed actions are responsive to our recommendations.

Finding 3: Cost Accounting Standards

Federal accounting standards require entities to establish procedures to accumulate and report costs continuously, routinely, and consistently for managerial purposes. The Department did not fully comply with cost accounting standards that are critical to the collection of reliable and timely full cost information. For example, the CFO had not fully documented its cost accounting activities, processes, and procedures. This condition existed because management considered current financial system information sufficient to facilitate routine analysis and decision-making. As a result, economies and efficiencies were lost due to inconsistent application of procedures and practices for accumulating, measuring, analyzing, interpreting, and reporting cost information.

Recommendation

We recommended that the CFO update the Department's Accounting Handbook to include the managerial cost accounting system information. This update to the handbook should explain the Department's procedures and practices from a corporate perspective for the implementation of all requirements explained in the managerial cost accounting standards.

It is suggested that the document follow the implementation guidance contained in the CFO Counsel/Joint Financial Management Improvement Program's (JFMIP) Cost Accounting Implementation Guide and the JFMIP Managerial Cost Accounting System Requirements Guide.

Management Comments

The CFO generally concurred with the recommendation. However, they disagreed with the potential effects described in the finding.

Auditor Comments

Management's proposed actions are responsive to our recommendation.

Finding 4: Heritage Assets

According to Federal accounting standards, no asset amount should be shown on the balance sheet for Heritage Assets. While Departmental analysis disclosed that most of its 29 identified Heritage Assets were either not on the Department's balance sheet or had no net value, at the time of our review, the Departmental analysis was not yet finalized. Therefore, complete determinations had not been made on all of the properties, and at least two properties had a recorded balance on the books. As a result, assets on the balance sheet are overstated to the extent that Heritage Assets with positive book values remain on the records.

Recommendations

We recommended that:

1. The Department complete the analysis it started and determine whether any other Heritage Assets continue to have recorded balances on the financial records.

2. Remove all asset balances for Heritage Assets shown on the Department's balance sheets, charging amounts removed to Net Position.

Management Comments

Management generally concurred with the finding. The Department completed its analysis of Heritage Assets and confirmed that there were only two properties with a recorded balance on the books at September 30, 1998. Due to the immateriality of the amounts involved, they instructed the applicable offices to remove the asset balances for Heritage Assets in FY 1999.

Auditor Comments

Management's proposed actions are responsive to our recommendations.

Finding 5: Disbursements

The DOE Accounting Handbook requires that liabilities recorded in the financial statements reflect both invoices received, and accruals for any costs incurred, or assets received for which progress billings, grant reimbursements requests, and other billings have not been received. Further it requires the accounts payable control account(s) to be supported by unpaid invoice files, subsidiary ledgers, or other forms of subsidiary records. The Capital Accounting Center's (CAC) support for the accrual of accounts payable was unclear and not well documented. This occurred because CAC implemented new, unwritten procedures for manually accruing invoices at yearend. As a result, there was increased risk that transactions would not be properly recorded.

Recommendation

We recommended that CAC develop formal documented procedures relating to the proper treatment of accrued liabilities.

Management Comments

CAC management concurred with the finding and committed to implement the recommendation.

Auditor Comments

Management's proposed actions are responsive to our recommendation.

Finding 6: Environmental Liabilities for Active Facilities

As a component of its overall system of internal controls, the Department is responsible for establishing controls to provide reasonable assurance that environmental liabilities estimates for Active Facilities are complete, accurate, and reliable. The Department's system for estimating environmental liabilities for active facilities did not completely and accurately capture the Department's liability as of September 30, 1998. For example, we found duplicative facilities in the Oak Ridge Operations Office active facilities estimate, and at Savannah River, square footage estimates used as the basis for the estimate were not properly updated. This occurred because the sites involved did not have an adequate system of internal controls in place to ensure the Active Facilities environmental liabilities estimates were complete, accurate, and reliable. As a result, there is an increased risk that misstatements in the Department's environmental liabilities estimate for Active Facilities exist and have not been detected.

Recommendation

The CFO should clarify guidance on updating the Active Facilities estimate input data. This guidance should include an additional explanation on what square footage amounts should be used and that those amounts should be documented.

Management Comments

The CFO concurred with our recommendations. Clarifying guidance will be issued during Fiscal Year 1999.

Auditor Comments

Management's proposed actions are responsive to our recommendations.

Finding 7: Financial System Logic

Office of Management and Budget Circular No. A-127 – Revised requires agencies to clearly document financial management systems and processing instructions in accordance with the requirements contained in the Federal Financial Management System Requirements documents. The Department's financial management system did not fully implement Federal Financial Management System Requirements. Specifically, the Department's documentation supporting conversion of Departmental Balance Sheet Code (BSC) accounts into Federal Standard General Ledger (SGL) accounts and the rationale behind the inclusion/exclusion of specific SGL accounts in the financial statements was not adequate. This occurred because the Department did not consider this matter to be of high priority. As a result, the Department increases the risk of reporting a misstatement in its financial statements resulting from incorrect conversion and/or crosswalk of Departmental account balances, and sustaining interruptions in its ability to issue reliable internal and external financial information in the event of key personnel changes.

Recommendation

We recommended that the CFO:

1. Update and maintain the Department's Chart of Accounts to:

    - Reflect the current definitions, restrictions, related codes, edits, SGL account, Departmental sub-accounts, SGL account titles, associated Management Analysis Reporting System (MARS) elements used in the operation of the financial system, and

    - Include detailed explanations of the rationale for converting BSC accounts to SGL accounts and the subsequent crosswalk to the financial statements for each account; or

2. Implement use of SGL accounts at the transaction level.

Management Comments

Management concurred with the recommendation and agreed to update the Department's Chart of Accounts and to consider use of the SGL at the transaction level.

Auditor Comments

Management's proposed actions are responsive to our recommendation.

Finding 8: Presentation and Disclosure

Financial statements should fully disclose an agency's financial position and results of operations and provide information with which readers can assess management performance and stewardship. Information pertinent to specific financial statement items should be explained in the footnotes. However, the Department did not adequately disclose the reasons behind some of the changes to FY 1997 comparative data from the prior year. This occurred because the Department did not adequately account for all differences between FY 1997 and 1998. Specifically, the observed differences were researched by the Department on a case-by-case basis in response to auditor inquiries. As a result, readers of the FY 1998 financial statements may not be aware that some comparative data does not tie to that reported in the prior year.

Recommendations

The Office of Financial Control and Reporting should:

1. Expand its footnote disclosure to ensure that readers are aware of all reclassifications affecting each line item balance; and

2. Perform a reconciliation between current and prior year reporting of data for the same period.

Management Comments

The CFO concurred with the recommendations. Footnotes were expanded, where appropriate, to alert readers to reclassifications of line item balances. In addition, a reconciliation process will be implemented during the FY 1999 financial statement process to ensure all restated balances are promptly identified and properly disclosed in the statements.

Auditor Comments

Management's proposed actions are responsive to our recommendation.

Finding 9: Automated Data Processing Access Controls

Good management practices dictate that access controls should be in place over financial and financial-related systems and applications to limit access to computer resources (data, facilities, and equipment) thereby protecting these resources against unauthorized modification, loss, and disclosure. We found that access controls at Headquarters for removing terminated employees and inactive users from certain information systems were insufficient. In addition, application controls at Headquarters for limiting access to the financial accounting applications (i.e. DISCAS, MARS, FIS and FDS) were ineffective. These problems existed because Headquarters did not have adequate policies and procedures in place to identify and remove terminated employees from the financial accounting systems, monitor and remove inactive user accounts, and evaluate current user needs for system applications. As a result, Headquarters has an increased risk of unauthorized users gaining access to the Department's financial accounting systems and applications.

Recommendation

We recommended that Headquarters CFO work with the Office of the Chief Information Officer (CIO) to implement policies and procedures for (1) identifying and removing terminated employees, (2) removing inactive user accounts from the system, and

(3) determining the needs of the application users and ensuring that access to financial-related applications corresponds with job responsibilities.

Management Comments

Management concurred with the findings and agreed to identify and remove terminated employees and inactive user accounts. In addition, they agreed to review current procedures for adding and removing specific application user capabilities and strengthen guidance where necessary.

Auditor Comments

Management's proposed actions are responsive to our recommendation.

Finding 10: Controls Over Network Access

Headquarters has a number of local area networks (LANs) that are geographically dispersed throughout the Washington metropolitan area. These LANs are interconnected by a wide area network link. This link provides a backbone for Headquarters to communicate regardless of physical location. Most Headquarters program elements have separate network systems that use the Headquarters backbone for interconnectivity. The CFO, for example, uses this backbone as a medium to communicate financial data and other information between the Forrestal building, located in Washington D.C., and the Department's offices in Germantown, Maryland.

The CIO is responsible for the maintenance and operation of the network backbone, while the individual program elements are responsible for the operation, security, and maintenance of their individual network components. The CIO is also responsible for establishing, implementing, and maintaining policies, procedures, manuals, and guidelines relative to DOE's telecommunication security and unclassified computer security programs for all Departmental elements, including Headquarters. Departmental program offices are responsible for implementing these policies, procedures, manuals, and guidelines relative to telecommunications and unclassified computer security.

Federal and Departmental directives require that procedures be developed and implemented to prevent misuse and abuse of unclassified computer resources. The Headquarters network backbone and various network components were not adequately protected and were vulnerable to unauthorized access or malicious attack. This occurred because the CIO and Headquarters program officials did not ensure implementation of controls sufficient to prevent or detect unauthorized access to the Headquarters network, including its data, applications programs, and systems software. The observed control weaknesses could result in breaches in the security of data and programs. For example, the Headquarters network is vulnerable to unauthorized use. Moreover, such weaknesses could allow an intruder to introduce viruses and other malicious programs to Headquarters systems.

Recommendations

The CIO, in conjunction with Headquarters program offices, should take action to strengthen computer network security.

Note: Details regarding vulnerabilities discovered and recommendations for corrective action were communicated to the CIO and various program offices, but are not included in this finding due to security considerations.

Management Comments

The CIO for Operations provided written comments on a draft of this finding. We have incorporated those comments into our finding as appropriate. Management generally concurred with our finding and stated that specific actions had been or were being taken to correct high-risk weaknesses. The Associate CIO for Operations also stated that certain vulnerabilities or risks for which the CIO was responsible were known to exist and had been assumed by management. He suggested that the OIG develop a case, from a risk management perspective, addressing why assumption of such risks was not appropriate.

The Associate CIO for Operations also stated that his office did not have the authority to control the entire Headquarters network in the current decentralized environment and suggested that our recommendation be directed to program elements with vulnerabilities. CIO officials have however indicated that discussions regarding a proposal to strengthen network security by establishing a Headquarters Configuration Control Board are in process. Among other things, that Board would be responsible for ensuring that network components meet security standards.

Auditor Comments

The comments provided by the CIO are generally responsive to our recommendation. While the assumption of certain risks may be appropriate for operational purposes, the burden is upon management to analyze the risks and associated benefits of such an assumption. Management was unable to furnish us with documentation to support the assumption of risks associated with network vulnerabilities.

We recognize that the Office of the CIO is not responsible for security on the entire network and believe efforts to form a Headquarters Configuration Control

Board are a step in the right direction. In the absence of a strong centralized authority over the network, the establishment of a configuration control board offers the opportunity to implement needed security changes. Specifically, the Board, when established, should have responsibility for planning and implementing controls that are essential in a volatile information security management environment. As suggested by our recommendation, we believe the CIO should work with Headquarters program offices to improve network security.

We plan to conduct follow-up reviews of management's efforts to correct the conditions described and assess their effectiveness in conjunction with our Audit of the Department's Fiscal Year 1999 Consolidated Financial Statements.

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