United States Government **Department of Energy**

memorandum

DATE: April 7, 1999

REPLY TO
ATTN OF: IG-35 (A98AL004)

SUBJECT: "Report on Matters Identified at the Albuquerque Operations Office During the Audit of the Department of Energy's Consolidated Fiscal Year 1998 Financial Statements."

TO: Manager, Albuquerque Operations Office

Attached is the subject report. A Management Decision is not required because the proposed actions to be taken meet the intent of the recommendations. The details of management and auditor comments can be found in the report.

Some recommendations are open and should be tracked in the Departmental Audit Report Tracking System. The recommendations that require tracking are shown in the "DARTS" column in the attached schedule. In addition, Part III of the report identified seven findings which are still pending resolution or require further attention and should continue to be tracked in DARTS.

We appreciate the cooperation of your staff during this audit, including the attention given to resolving the findings.

Lawrence R. Ackerly, Regional Manager (Signed)
Western Regional Audit Office
Office of Inspector General

Attachments

cc: Len Raab, Management Review Division, Albuquerque Operations Office (3)

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

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

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Office of Scientific and Technical Information
P.O. Box 62
Oak Ridge, Tennessee 37831

Report Number: WR-FS-99-02
Date of Issue: April 7, 1999

Western Regional Audit Office
Albuquerque, New Mexico 87185

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

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

Audit Report Number: WR-FS-99-02

SUMMARY

The Government Management Reform Act of 1994 requires that the Department of Energy (DOE) annually submit audited financial statements to the Office of Management and Budget (OMB). A DOE-wide audit was conducted to determine whether there was reasonable assurance that DOE's consolidated Fiscal Year (FY) 1998 financial statements were free of material misstatements. We conducted a portion of the DOE-wide audit at the Albuquerque Operations Office (Albuquerque) and its management and operating contractors.

The audit at Albuquerque and its contractors disclosed deficiencies, as of September 30, 1998, in the property, liability, and receivable accounts. In addition, the audit disclosed unconfirmed unpaid obligations and differences with the amount of funds on hand reported by the Department of Treasury (Treasury). Finally, Albuquerque had not completed corrective actions on prior findings related to nuclear materials, reimbursable work, delinquent receivables, and grant reconciliations.

We recommended that adjustments be made to the accounts and improvements be made to the internal controls. Management generally agreed with the findings and recommendations and initiated corrective actions.

(Signed)

Office of Inspector General

PART I

APPROACH AND OVERVIEW

INTRODUCTION

The Government Management Reform Act of 1994 requires that audited financial statements covering all accounts and associated activities of DOE be submitted annually to OMB. A DOE-wide audit of the consolidated FY 1998 financial statements was conducted by examining internal controls, assessing compliance with laws and regulations, evaluating accounting transaction cycles, and testing selected account balances at various DOE facilities.

The objective of the DOE-wide audit was to determine whether the DOE consolidated financial statements presented fairly, in all material respects, the financial position of DOE as of September 30, 1998 and 1997, and its consolidated net cost, changes in net position, budgetary resources, financing activities, and custodial activities for the fiscal years then ended in conformity with federal accounting standards. DOE-wide issues are addressed in Audit Report No. DOE/IG-FS-99-01, issued on February 25, 1999.

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

SCOPE AND METHODOLOGY

The audit was conducted from April 1998 through January 1999 at Albuquerque and Sandia Corporation, Albuquerque, New Mexico; Los Alamos National Laboratory, Los Alamos, New Mexico; Mason & Hanger Corporation, Amarillo, Texas; and AlliedSignal Federal Manufacturing & Technologies/Kansas City, in Kansas City, Missouri. Specifically, we examined internal controls, assessed compliance with applicable laws and regulations, and selectively tested account balances reported to DOE Headquarters as necessary to achieve DOE-wide audit objectives.

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

Because the audit was limited, it would not necessarily disclose all of the internal control weaknesses that may have existed. Furthermore, because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. The issues addressed in this report represent our observations of activities through the end of fieldwork on January 5, 1999. Projection of any evaluation of the internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In addition to the audit work conducted by the OIG, internal audit personnel and an independent public accounting firm reviewed certain cycles. Los Alamos and Sandia internal audit personnel reviewed the Payroll Cycle at their respective locations. Internal Audit reported issues needing corrective actions to their management in separate reports. An independent public accounting firm reviewed the Nuclear Material Inventories Cycle at Albuquerque, AlliedSignal, and Mason & Hanger; the Disbursements Cycle and the Financing and Revenue Cycle at Albuquerque, Sandia, and Los Alamos; and the Pension and Other Post-Retirement Liabilities Cycle at Sandia and Los Alamos.

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

An exit conference was held with Albuquerque management on January 14, 1999.

OBSERVATIONS

We observed misstated accounts and internal control deficiencies. Specifically, Albuquerque had not completed its investigation of nine items that were not located during a FY 1997 physical inventory; therefore, it was uncertain whether net property, plant, and equipment should be adjusted. In addition, deferred maintenance data was unavailable for 80 buildings. There were errors in Albuquerque's accounts payable and accrued expenses. Sandia had payroll deficiencies, including overpayments, that impacted the accuracy of its payroll costs. Los Alamos understated its salaries payable. Furthermore, Albuquerque had not reviewed its unpaid obligations or reconciled its funds with Treasury.

We recommended that adjustments be made to the accounts and improvements be made to the internal controls. Management generally concurred with the recommendations and planned to adjust the accounts, improve internal controls, and implement corrective actions.

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

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

PART II

AUDIT RESULTS

1. Discrepancies in Albuquerque's Physical Inventory

DOE's *Accounting Handbook* requires the Head of the Field Element, the property administrator, and the Field Chief Financial Officer (CFO) to investigate all significant discrepancies identified through the physical inventory and reconciliation process, determine the causes, and take remedial measures where possible to safeguard against waste, theft, and misuse of property. As of September 30, 1998, however, Albuquerque had not completed its investigation of nine discrepancies identified during the FY 1997 physical inventory. Albuquerque cited resource limitations, other priorities, and its belief that the unlocated items were incorporated into other systems as reasons for not completing its investigation. Without completing the investigation, however, Albuquerque cannot assure that the unlocated items were incorporated into other systems. As a result of the discrepancies, Albuquerque's property, plant, and equipment could be overstated by about $574,000, less the applicable accumulated depreciation.

Recommendations

We recommend that the Manager, Albuquerque, direct the property administrator and the Field CFO to:

1. Complete the investigation of the nine discrepancies; and,
2. Adjust the accounting records as appropriate.

Management Comments

Management concurred and stated that it had found three of the items. On March 23, 1999, management granted approval for write-off of the remaining items from the financial records.

Auditor Comments

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

2. Deferred Maintenance

The Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment,* requires federal agencies to report deferred maintenance. However, Lovelace Biomedical and Environmental Research Institute (LBERI) did not provide Albuquerque with deferred maintenance data for 80 buildings. According to Albuquerque personnel, LBERI refused to provide the data because LBERI said it was not a requirement of its cooperative agreement with DOE. As a result, the deferred maintenance amounts reported in the notes to the financial statements will not be accurate.

Recommendation

We recommend that the Director, Technology Development Division, Albuquerque, take the appropriate action to obtain the necessary deferred maintenance data from LBERI.

Management Comments

Management concurred with the finding and recommendation and initiated corrective action. LBERI provided the deferred maintenance data for all but two items in January 1999 and will provide the remaining data by April 6, 1999.

Auditor Comments

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

3. Yearend Liability Balances

DOE's *Accounting Handbook* requires liabilities, which include accrued expenses and payables, to be measured and recorded as accurately as possible. However, we found three instances where Albuquerque had not accurately recorded liabilities as of September 30, 1998. In the first instance, $3.1 million for services received in August 1998 was not accrued because the invoice was not received before yearend and the program manager overlooked including the cost in the accrual worksheet. In the second instance, an accounts payable had about a $604,000 debit balance because payment to the vendor was recorded before the liability was recorded. In the third instance, an accounts payable had about a $165,000 credit balance because an advance account was debited rather than the payable account when the payment was made. As a result, Albuquerque's liabilities were understated by about $3.5 million, assets were overstated by about $165,000, and expenses were understated by about $3.7 million.

Recommendations

We recommend that the CFO, Albuquerque:

1. Make the necessary accounting entries to correct the account balances;

2. Review all accounts payable as of September 30, 1998, to ensure that the payables represent valid liabilities; and,

3. Assure that program managers establish yearend accruals for program costs incurred for which they have not received a bill.

Management Comments

Albuquerque partially concurred with the first recommendation. Management stated that the underaccrual of $3.1 million was less than one percent of the total FY 1998 accrued expenses and therefore did not warrant an adjustment to FY 1998 balances. Management agreed to correct the accounts for the second and third instances by March 30, 1999.

Although it concurred with the second recommendation, Albuquerque stated that it was impractical to review all accounts payable as of September 30, 1998, as there were over 2,500 accounts. However, Albuquerque dedicated an accountant full time to review and resolve debit liability balances.

In commenting on the third recommendation, management stated that it had taken actions to assure that program managers established yearend accruals. For example, the Albuquerque Financial Services Center (AFSC) and the Budget and Resources Management Division (BRMD) conducted two training sessions in FY 1998 designed specifically for yearend accruals. Twenty-one program managers or financial analysts were briefed on the importance of costs and the accrual process and provided detailed instructions on how to prepare yearend accruals.

Additionally, all yearend cost accrual entries were reviewed and approved by BRMD prior to AFSC processing.

Auditor Comments

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

4. Payroll Deficiencies at Sandia

It is DOE's policy that integrated contractors' customary accounting practices produce accurate results. However, Sandia had payroll deficiencies that impacted the accuracy of its payroll costs. Sandia overpaid unused vacation and long-term sickness benefits and did not reconcile all payroll accounts. For example:

- Sandia Internal Audit examined payroll data for 5 of 349 terminated employees and determined that 2 were overpaid for unused vacation by approximately $800. This occurred because of improper calculations. Since it did not review the remaining 344 terminated employees, Internal Audit did not determine if there were additional overpayments.

- In addition, Internal Audit determined that long-term sickness benefits were overpaid. These overpayments occurred because Sandia's software program incorrectly replenished the sick hours available in the three categories of sickness absence: short-term at full pay, long-term at full pay, and long-term at half pay. Internal Audit did not show the amount due Sandia.

- A Sandia self-assessment reported that not all payroll accounts had been reconciled by the end of FY 1998. In addition, our review of the self-assessment group's working papers showed that Sandia had "other unidentified differences" as high as $11.5 million. The self-assessment report noted that reconciliation responsibilities had not been properly delegated.

The self-assessment identified numerous indicators of a breakdown in the payroll environment's internal control structure beginning with the FY 1998 implementation of a new integrated payroll, human resources, and benefits program. When Sandia identified the deficiencies, it pursued corrective actions; however, these actions were not completed as of September 30, 1998.

As a result of these deficiencies, DOE has reduced assurance that Sandia accurately reported payroll costs for FY 1998. Furthermore, some accounts may be improperly stated because of overpayments to terminated employees and employees collecting long-term sickness benefits.

Recommendations

We recommend that the CFO, Albuquerque, direct Sandia to:

1. Determine the total amount of overpayments made to terminated employees and employees collecting long-term sickness benefits and reimburse DOE;

2. Reconcile the payroll accounts and make the necessary accounting adjustments; and,

3. Complete corrective actions to ensure the accuracy of the software program.

Management Response

Management concurred with the finding and recommendations and Sandia initiated corrective actions. Sandia will complete a review of employees terminated on dates subject to the overpayment error by April 30, 1999, and will initiate collection of any moneys owed to DOE. Sandia stated that the system deficiencies regarding sickness absences had been corrected and the net effect of corrections for Fiscal Year 1998 was about $1,000. Sandia also plans to complete the final payroll account reconciliation by September 30, 1999, and stated that all material deficiencies in the software noted in the report have been corrected, with the exception that the software does not accurately accrue vacation days earned. This deficiency will be corrected by April 30, 1999.

Auditor Comments

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

5. Understated Salaries Payable at Los Alamos

The contract between DOE and the University of California requires Los Alamos to maintain effective management control systems. It also requires that financial reports necessary to maintain accountability and managerial control be accurate, reliable, and timely. However, Los Alamos' Internal Audit reported that the Los Alamos salaries payable account was understated by about $70,000 at the end of FY 1998. According to a payroll accountant, the understatement involved improper accounting for payroll adjustments for refunds due Los Alamos. Los Alamos did not reconcile the general ledger accounts to the subsidiary ledgers or other supporting documentation to assure that the general ledger accounts were accurate. As a result, Los Alamos' salaries payable was understated by about $70,000 at the end of FY 1998.

Recommendations

We recommend that the CFO, Albuquerque, direct Los Alamos to:

1. Correct the salaries payable account balance; and,

2. Reconcile all general ledger accounts to subsidiary ledgers or other supporting documentation before completing the annual reconciliation of the general ledger accounts to DOE's financial statements.

Management Comments

Management concurred with the finding and recommendations and developed a corrective action plan. Los Alamos identified the adjustments to correct the salaries payable account and recorded the adjustments in February 1999. Los Alamos will also reconcile all subsidiary ledgers or other supporting documentation to its trial balance on a monthly basis and prior to completing the quarterly reconciliations of the general ledger balances to the DOE trial balance.

Auditor Comments

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

6. Unpaid Obligations

The DOE *Accounting Handbook* requires Field CFOs to regularly review unpaid obligations, with emphasis on large-dollar, inactive, prior-year obligations; to independently evaluate and confirm unpaid obligations; and to promptly deobligate excess balances. However, out of six inactive unpaid obligations that we tested, we found five, totaling about $73,000, that were no longer valid and should have been deobligated. AFSC had not evaluated and confirmed its FY 1998 yearend unpaid obligation balances; rather, AFSC assumed that program managers would review their unpaid obligations and inform it of any needed deobligations. However, not all program managers reviewed their unpaid obligations. Therefore, Albuquerque did not know if its unpaid obligations balances were valid or if deobligations were warranted.

Recommendation

We recommend that the CFO, Albuquerque, review, independently evaluate, and confirm unpaid obligations, and assure that excess balances are promptly deobligated.

Management Comments

Management concurred with the finding and recommendation. Albuquerque stated that it would develop, by June 30, 1999, an operational plan in which financial plan holders are notified of unpaid obligations quarterly and requested to confirm balances, with negative responses required. Unpaid obligations would be confirmed by August 31, 1999. Albuquerque also stated that it would emphasize to program managers, in yearend workshops, the importance of verifying unpaid obligations.

Auditor Comments

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

7. Differences with Treasury Balances

Treasury requires that all differences between its monthly report of funds on hand and an entity's accounting records be reconciled within six months. However, we found that Albuquerque had not reconciled differences that date back to at least FY 1988. As of September 30, 1998, Albuquerque showed a net $7.6 million more in funds on hand than reported by Treasury (that is, Albuquerque showed $17.1 million less disbursed and $9.5 million less collected than Treasury). Since that time, Albuquerque identified $1.2 million of the collection differences but indicated that it does not have the staff needed to reconcile the remaining differences. As a result, Albuquerque's accounts payable may be overstated by $17.1 million and accounts receivable may be overstated by $9.5 million.

Recommendations

We recommend that the CFO, Albuquerque:

1. Continue to research disbursements and collections to reconcile the differences; and,

2. Make the journal entries necessary to properly record the $1.2 million collection.

Management Comments

Management concurred with the finding and recommendations and indicated that it will complete action on recommendation 1 in December 2000. Albuquerque plans to prepare journal entries by March 30, 1999, for the $1.2 million identified in recommendation 2.

Auditor Comments

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

PART III

STATUS OF PRIOR YEAR OPEN FINDINGS AND RECOMMENDATIONS

This section provides a status of seven findings reported in the *Report on Matters Identified at the Albuquerque Operations Office During the Audit of the Department's Consolidated Fiscal Year 1997 Financial Statements* (Report Number WR-FS-98-06; July 10, 1998). These findings are still pending resolution or require further attention.

1. AlliedSignal Inventory Valuation Should Approximate Historical Cost

AlliedSignal valued parts obtained from other DOE facilities at the current transfer price and parts purchased from outside vendors at the latest purchase price, rather than at historical cost. This occurred because AlliedSignal's cost accounting system could track only one unit cost for each inventory category. As a result, DOE's inventory was overstated. We recommended that Albuquerque direct AlliedSignal to modify its accounting system to an historical cost valuation method or any other valuation method that approximated historical cost. Albuquerque agreed with the recommendation but stated that AlliedSignal would be in noncompliance until implementation of its new cost accounting system in March 1999.

Status:

During the current audit, we found that AlliedSignal's revaluations for the past 7 years had resulted in a net overstatement of existing inventories by about $19 million. In January 1999, AlliedSignal indicated that it had increased the inventory valuation allowance by $19 million. Albuquerque stated that it directed AlliedSignal to ensure that its new cost accounting system complies with this accounting standard.

2. AlliedSignal Inventory Valuation Includes Excess Capacity

AlliedSignal had capitalized a portion of its excess capacity costs into inventory rather than charging the costs as current period costs, as required by generally accepted accounting principles. We recommended that Albuquerque direct AlliedSignal to (1) write off the amount of inventory overhead costs associated with excess capacity, and (2) establish an overhead application rate based on the inclusion of only production-related costs and actual labor hours, and ensure that policies were in place requiring periodic (at least annual) reviews of the appropriateness of the rate. Albuquerque agreed with the recommendations.

Status:

During the FY 1998 audit, we determined that if AlliedSignal had calculated the amount to write off using the methodology it employed in responding to the 1997 recommendation, it would have written off an additional $11 million of excess capacity costs. Albuquerque directed AlliedSignal to make the $11 million dollar adjustment and stated that the adjustment amount was attributable to differences in estimating methodologies. AlliedSignal stated that establishing the overhead application rate recommended in the prior year's report was tied to the new production costing methodology to be introduced during FY 1999.

The OIG intends to review AlliedSignal's new production cost accounting system in FY 1999 to verify that the overhead application rate is based on the inclusion of only production-related costs and actual labor hours.

3. AlliedSignal Excess Inventory Allowance

AlliedSignal had not identified all excess inventories associated with retired weapons and valued those inventories at expected net realizable value. We recommended that Albuquerque direct AlliedSignal to identify excess inventory associated with retired weapons and determine the correct allowance. Albuquerque concurred with the recommendation.

Status:

Although AlliedSignal adjusted its inventory valuation allowance during FY 1998, we found that it was overstated by $72 million because the allowance did not reflect a FY 1998 reduction in the amount of inventories excess to production needs. While stating that there was a difference of opinion regarding definitions, Albuquerque agreed to make the $72 million adjustment.

4. Mason & Hanger Inventory Valuation of Retired Weapons Systems

Mason & Hanger was not in compliance with federal accounting standards because it had not written down inventories of parts and components associated with retired weapons. We recommended that Albuquerque direct Mason & Hanger to reduce the inventory to net realizable value. Albuquerque concurred and stated that Mason & Hanger would adjust the allowance account on an annual basis.

Status:

During the current audit, we found that the inventory valuation allowance was overstated by $70 million because Mason & Hanger had incorrectly classified parts currently needed for program use as obsolete. Albuquerque stated that Mason & Hanger made post closing entries in December 1998 to reduce the allowance by about $70 million as of September 30, 1998. In order to prevent a recurrence of this condition, Albuquerque stated that Mason & Hanger's Accounting Section would, at fiscal yearend, request confirmation from the Planning and Scheduling Department that the production status of each weapon system shown in the program summary cost report was correct.

5. Deobligations of Completed Reimbursable Work

Albuquerque was not initiating timely deobligations of customer funds for completed reimbursable work performed by its contractors. We recommended that Albuquerque (1) provide timely notification to the ordering agency regarding the amount of funds to be deobligated; (2) revise internal procedures to include timeframes for budget, accounting, and program offices to complete closeout requirements; and (3) clarify the closeout procedures so contractors understand their responsibilities. Albuquerque agreed to modify its processes and requirements and to clarify contractor responsibilities.

Status:

As of September 30, 1998, Albuquerque was (1) evaluating ways to improve the process for timely notification to ordering agencies concerning unneeded funds committed to reimbursable work; (2) assessing the responsibilities of budget, accounting, and program offices and determining the most efficient sequence for timely closeout of reimbursable work orders; and (3) meeting with its contractors to clarify their duties for closing completed reimbursable work orders. Albuquerque was also monitoring the adequacy of ongoing changes to closeout procedures before making a formal revision. Subsequently, Albuquerque updated the procedures and issued guidance to its contractors.

6. Collection of Delinquent Receivables from Other Federal Agencies

Albuquerque had not implemented DOE's debt collection procedures for collecting delinquent accounts receivable from other federal agencies. We recommended that Albuquerque implement the debt collection strategy as outlined in the *Accounting Handbook*.

Status:

Although Albuquerque implemented aggressive collection procedures during FY 1998 and collected $31 million of delinquent receivables, it still had $29 million of outstanding delinquent receivables at yearend. Albuquerque had not referred any delinquent accounts to, or sought assistance from, the Attorney General during FY 1998 because the *Accounting Handbook* did not contain definitive guidance on how to collect other federal agency receivables through the Attorney General. We contacted the DOE CFO's Office of Financial Policy, which stated that unresolved interagency claims should be referred through the DOE CFO to the Attorney General for resolution. Because this was omitted from DOE's policy, the CFO agreed to correct the policy and assist Field CFOs in their collection efforts.

7. Grant Advances in Excess of Authorized Amounts

Albuquerque was not monitoring grant recipient withdrawals and three recipients had drawn $407,000 in excess of advance funds authorized by Albuquerque. We recommended that Albuquerque reconcile all grants and initiate appropriate collection actions. Albuquerque concurred with the recommendation.

Status:

During FY 1998, Albuquerque began the grant reconciliation process and recovered unauthorized advances from twelve recipients. Albuquerque estimated that it would complete the grant reconciliation process by December 2000.

IG Report No. WR-FS-99-02

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