

United States Government

Department of Energy

Memorandum

DATE: August 26, 2009

REPLY TO

ATTN TO: IG-30 (A06FN004 and A05FN004)

SUBJECT: Uranium Enrichment Decontamination and Decommissioning Fund's Fiscal Year 2006 and 2005 Financial Statement Audit - Report No.: DOE/OAS-FS-09-06

TO: Assistant Secretary for Environmental Management, EM-1
Deputy Assistant Secretary for Program Planning and Budget, EM-30

The attached report presents the results of the independent certified public accountants' audit of the United States Department of Energy's Uranium Enrichment Decontamination and Decommissioning Fund's (D&D Fund) Fiscal Year (FY) 2006 and 2005 balance sheets and the related statements of net cost, changes in net position (deficit), budgetary resources and financing.

The FY 2006 and 2005 financial statement audit was made under the provisions of the Inspector General Act of 1978 as amended (5 U.S.C. App. 3), the Government Management Reform Act (31 U.S.C. 3515), and Office of Management and Budget implementing guidance. To fulfill the Office of Inspector General's (OIG) audit responsibilities, we contracted with the independent public accounting firm of KPMG LLP (KPMG) to conduct the audit, subject to our review. KPMG is responsible for expressing an opinion on the D&D Fund's financial statements and reporting on applicable internal controls and compliance with laws and regulations. The OIG monitored audit progress and reviewed the audit report and related documentation. This review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted Government auditing standards. The OIG did not express an independent opinion on the D&D Fund's financial statements.

KPMG concluded that the financial statements present fairly, in all material respects, the D&D Fund's financial position as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with U.S. generally accepted accounting principles.

The auditors' review of the D&D Fund's internal controls over financial reporting disclosed two reportable conditions. The two reportable conditions were:

- Financial Management and Reporting Controls (material weakness):
Deficiencies were found in internal controls over the D&D Fund's financial management and reporting controls that delayed the D&D Fund from preparing its FY 2006 and 2005 financial statements and supporting documentation in a complete, accurate and timely manner.

- **Unclassified Network and Information Systems (reportable condition):** Weaknesses in Department-wide network and information systems used by the D&D Fund continue to exist. Despite corrective actions taken by the Department in response to prior year audit findings, network and other security weaknesses persist.

The Department concurs with the recommendations for the reportable conditions and corrective actions have already been taken to address the weakness in financial management and reporting controls. The Office of Chief Financial Officer will continue to work to improve the implementation of cyber security controls.

There were two instances of noncompliance required to be reported under generally accepted Government auditing standards or applicable Office of Management and Budget guidance. The noncompliance instances were:

- **A shortfall of Government appropriations to the D&D Fund:** Government appropriations received by the D&D Fund were below the funding required by the Energy Policy Act for the D&D Fund's first fourteen years. Management concurs with the recommendation that the Department initiate action to resolve funding shortfalls in the D&D Fund. This finding was reported in prior years.
- **Federal Financial Management Improvement Act:** The D&D Fund's financial management systems did not substantially comply with the federal financial management systems and accounting standards requirements, which prevented the D&D Fund from preparing timely and accurate financial statements and supporting data for audit.



Rickey R. Hass
Deputy Inspector General
for Audit Services
Office of Inspector General

Attachment

cc : Chief Financial Officer, CF-1
Director, Office of Financial Control and Reporting, CF-12
Director, Energy Finance and Accounting Service Center, CF-11
Team Leader, Audit Liaison, CF-1.2
Dianne Williams, Office of Internal Review, CF-1.2
Audit Liaison, Environmental Management, EM-33
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**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Reports Thereon)

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

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**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Overview

September 30, 2006 and 2005

The Energy Policy Act of 1992 (Energy Policy Act) established the United States Department of Energy's (Department/DOE) Uranium Enrichment Decontamination and Decommissioning Fund (D&D Fund) to pay for the costs of decontaminating and decommissioning three gaseous diffusion facilities (Diffusion Facilities) located in Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio. The Energy Policy Act also authorized the D&D Fund to pay remedial action costs associated with the U.S. government (Government) operation of the Diffusion Facilities to the extent funds are available and to reimburse uranium and thorium licensees for the costs of decontaminating, decommissioning, reclamation, and other remedial actions, which are incident to sales to the Government.

The Energy Policy Act, as amended, authorizes the collection of revenues for 15 years to pay for the environmental remediation costs. The revenue is to be derived from domestic utility assessments and Government appropriations and is to be adjusted annually for increases in the Consumer Price Index for All Urban Consumers.

The Energy Policy Act, as amended, specifies revenues as follows: \$480.0 million for the period from fiscal year (FY) 1992 to FY 1998; \$488.3 million for the period from FY 1999 to FY 2001; and \$518.2 million for FY 2002 forward. The revenues are to be obtained from:

- An assessment on domestic utilities up to \$150 million annually based on the ratio of their purchases of separative work units to the total purchases from the Department including those for defense; and
- Government appropriations for the difference between the authorized funding required by the Energy Policy Act and the utility assessment.

In addition, the Energy Policy Act provided that balances in the D&D Fund be invested in Treasury securities and any interest earned would be available to pay the costs of environmental remediation.

The Office of Environmental Management (EM) within the Department is responsible for oversight of the resources of the D&D Fund and environmental remediation activities at the Diffusion Facilities. The Diffusion Facilities have approximately 40 million square feet of floor space under 500 acres of roof containing processing and handling equipment, which will be remediated under the D&D Fund. The Oak Ridge Office, Oak Ridge, Tennessee, and the Portsmouth/Paducah Project Office, Lexington, Kentucky, provide day-to-day management of D&D Fund activities. Budgeting, accounting, contracting, and other activities are supported through matrix organizations in the Department.

The Office of Disposal Operations (EM-12) is responsible for managing the Title X Uranium/Thorium Reimbursement Program. The Albuquerque Operations Office is responsible for evaluating claims submitted by the uranium and thorium licensees and making reimbursement recommendations to EM-12. The Defense Contract Audit Agency provides support for financial audits of the claims.

**UNITED STATES DEPARTMENT OF ENERGY
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Overview

September 30, 2006 and 2005

The Department is currently unable to estimate the impact of certain factors on the recorded liabilities and the receipt of Government appropriations by the D&D Fund. More specifically, the following are significant uncertainties impacting the D&D Fund:

- Because the decontamination and decommissioning work is scheduled to be completed in approximately 2016 at the gaseous diffusion facility located in Oak Ridge and the work has yet to be scheduled at the Paducah and Portsmouth gaseous diffusion facilities, the length of time over which the work will be performed creates significant uncertainty as to the actual cost of the work. In addition, because the estimates on which the recorded decontamination and decommissioning and remedial action liabilities are based do not include an estimate of the impact of inflation on such costs, the actual costs may be significantly higher than the recorded liabilities. There is also uncertainty with respect to whether Congressional appropriations will be received at the levels assumed by the estimates, and there is uncertainty inherent in the estimating process.
- The Energy Policy Act provides that the annual cost of remedial action at the Diffusion Facilities will be paid from the D&D Fund to the extent the amount available in the D&D Fund is sufficient. To the extent the amount in the D&D Fund is insufficient to pay remedial action costs, the Energy Policy Act provides that the Department will be responsible for such costs. The majority of current collections in the D&D Fund are being used to pay for remedial action costs at the Diffusion Facilities. The use of the D&D Fund for remedial action activities will impact the availability of funds to accomplish decontamination and decommissioning.

The D&D Fund has incurred various legal actions related to the validity of assessments against domestic utilities. All of the actions decided to date have been in favor of the Government except for a June 2005 decision by the Court of Appeals for the Federal Circuit in favor of two utilities. These two utilities had a unique situation, so other utilities are not expected to file claims as a result of this specific ruling. The Department does not anticipate that domestic utilities will file any additional claims and appeals related to the assessments. Management and counsel expect, however, to prevail in any future litigation, claims, and appeals related to the assessments, and as such, the Department and the D&D Fund have not recorded a liability for potential claims.

- Government appropriations and resulting Government contributions through September 30, 2006 were approximately \$839 million less than authorized by the Energy Policy Act. The ability of the D&D Fund to fulfill its responsibilities is contingent upon the receipt of these contributions. The Department has asked Congress to extend the authorization for Government contributions for three more years to allow the Government more time to meet its obligations to the Fund.

Program Performance Measures

The Department was designated by the Office of Management and Budget as a pilot program under the Government Performance and Results Act of 1993. EM was included in that pilot program.

**UNITED STATES DEPARTMENT OF ENERGY
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Overview

September 30, 2006 and 2005

In 1997, EM developed a single set of program level performance measures that will be used both for internal management and to meet external requirements. These program performance measures are the current metric for evaluating progress in EM. Under these program performance measures, environmental restoration progress is measured as the number of “release sites” completed and the number of “facilities” decommissioned.

A “release site” is defined as a unique location where a hazardous, radioactive, or mixed waste release has occurred or is suspected to have occurred. It is usually associated with an area where wastes or substances contaminated with wastes have been disposed of, treated, stored, and/or used. A “facility” is generally defined as a uniquely identifiable building or structure. Sometimes a facility is a room or part of a building or structure.

A release site is completed or a facility decommissioned when the documentation supporting a “no action” decision or the completion of physical cleanup has been submitted to regulatory authorities.

The following summarizes the performance measures for D&D Fund projects in FY 2006:

	<u>Planned</u>	<u>Completed</u>
Release site completion	8	41
Facility completion	72	83

The Oak Ridge gaseous diffusion facility completed 40 release sites, which significantly exceeded the 7 release sites planned. This acceleration is a result of implementing the Comprehensive Accelerated Baseline in FY 2006, which accelerated completions in Zone 2 of the site. Oak Ridge also completed 83 facilities, which exceeded the 72 facilities planned. Early facility completions occurred due to title transfers to the Community Reuse Organization of East Tennessee in lieu of future actions at the transferred facilities. Acceleration also resulted from implementing the Comprehensive Accelerated Baseline, as discussed earlier. Portsmouth completed the one release site planned for FY 2006 and did not have any facility completions planned or completed. Paducah had no planned release sites or facilities for FY 2006.

Financial Performance Measures

The Department is required to collect assessments from utilities and payments from other appropriations, invest excess cash, and make disbursements from the D&D Fund in accordance with the requirements of the Energy Policy Act. Two financial performance measures are used to assess performance: (1) the amount of interest earnings lost as a result of untimely remittance of assessments by utilities; and (2) excessive uninvested daily cash balances.

- **Timeliness of Receipts**

No late fee assessments were required in FY 2006.

**UNITED STATES DEPARTMENT OF ENERGY
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URANIUM ENRICHMENT DECONTAMINATION AND
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Overview

September 30, 2006 and 2005

- **Uninvested Daily Cash Balances**

There were uninvested daily cash balances during both FY 2006 and FY 2005. Those amounts were \$27 million and \$15 million, respectively. Projected lost interest amounts are immaterial.

During FY 2006 and FY 2005, the D&D Fund earned approximately 3.78% and 3.54%, respectively, from investments in Treasury securities.

Financial Statement Limitations

The accompanying financial statements were prepared to report the financial position and results of operations of the D&D Fund pursuant to the requirement of the Energy Policy Act.

While the statements have been prepared from the books and records of the D&D Fund in accordance with U.S. generally accepted accounting principles, the statements are different from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The statements should be read with the realization that they relate to the D&D Fund owned and managed by the Government, a sovereign entity; that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of appropriations; and that the payment of all liabilities, other than those resulting from contractual obligations, can be abrogated by the Government.



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Independent Auditors' Report

Office of the Inspector General and Decontamination and Decommissioning Fund
United States Department of Energy:

We have audited the accompanying balance sheets of the Decontamination and Decommissioning Fund (D&D Fund) as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, and financing (hereinafter referred to as financial statements) for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our fiscal year (FY) 2006 and FY 2005 audits, we also considered the Fund's internal controls over financial reporting, Required Supplementary Information, and performance measures, and tested the D&D Fund's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on these financial statements.

Summary

As stated in our opinion on the financial statements, we concluded that the D&D Fund's financial statements as of and for the years ended September 30, 2006 and 2005, are presented fairly, in all material respects, in conformity with United States (U.S.) generally accepted accounting principles.

Our consideration of internal control over financial reporting, Required Supplementary Stewardship Information, and performance measures resulted in Financial Management and Reporting Controls and Unclassified Network and Information Systems Security being identified as reportable conditions. We consider the Financial Management and Reporting Controls reportable condition to be a material weakness.

The results of our tests of compliance with certain provisions of laws, regulations, and contracts disclosed one instance of noncompliance with the Energy Policy Act of 1992 (Energy Policy Act) and one instance of noncompliance with the Federal Financial Management Improvement Act (FFMIA) that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin Number (No.) 06-03, *Audit Requirements for Federal Financial Statements*, and disclosed no instances of other matters.

The following sections discuss our opinion on the D&D Fund's financial statements; our consideration of the D&D Fund's internal control over financial reporting, Required Supplementary Stewardship Information, and performance measures; our tests of the D&D Fund's compliance with certain provisions of applicable laws, regulations, and contracts; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying balance sheets of the D&D Fund as of September 30, 2006 and 2005 and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended.



As discussed in note 4 to the financial statements, the D&D Fund has recorded a liability of approximately \$10,060.3 million and \$4,585.6 million at September 30, 2006 and 2005, respectively, to decontaminate and decommission the gaseous diffusion facilities (Diffusion Facilities) located in Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio. However, the Department is presently unable to determine the impact of time and inflation on the liability for decontamination and decommissioning costs. Because the decontamination and decommissioning work is scheduled to be completed in approximately 2016 at the Diffusion Facility located in Oak Ridge and the work has yet to be scheduled at the Paducah and Portsmouth Diffusion Facilities, the length of time over which the work will be performed and the uncertainty inherent in the estimating process create significant uncertainty as to the actual cost of the work. In addition, because the estimate on which the recorded liability is based does not include an estimate of the impact of inflation on such costs, the actual costs may be significantly higher than the recorded liability.

As discussed in note 6 to the financial statements, the Energy Policy Act provides for payment from the D&D Fund of the annual cost of remedial action at the Diffusion Facilities to the extent the amount available in the D&D Fund is sufficient. To the extent the amount available in the D&D Fund is insufficient to pay remedial action costs, the Energy Policy Act provides that the Department, not the D&D Fund, will be responsible for such costs. Because the Department may be responsible for remedial action costs, the D&D Fund's recorded liability for remedial action at September 30, 2006 consists of the funding for such costs provided by Congress in the D&D Fund appropriation for FY 2007, \$179.1 million, plus the unexpended portion of such appropriations for current and previous fiscal years, \$65 million. The D&D Fund's recorded liability for remedial action at September 30, 2005 consists of the funding for such costs provided by Congress in the D&D Fund appropriation for FY 2006, \$218.9 million, plus the unexpended portion of such appropriations for current and previous fiscal years, \$33.3 million. The D&D Fund will make additional accruals of remedial action costs if Congress appropriates additional funds for that purpose. The estimated future cost of remedial action at the Diffusion Facilities, which is only recorded in the accompanying financial statements to the extent described above, is approximately \$4,369 million and \$3,436 million as of September 30, 2006 and 2005, respectively. The remaining liability for the estimated future cost of remedial action at the Diffusion Facilities is recorded by the Department. The estimate includes surveillance and maintenance, infrastructure, site operation, and support costs, but does not include an estimate of the impact of inflation on the cost of the work; therefore, the actual cost may be significantly higher than the estimate. There is also uncertainty with respect to whether Congressional appropriations will be received at the level assumed by the estimate, and there is uncertainty inherent in the estimating process. The Department is presently unable to determine the impact of these factors on the estimated remedial action costs.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the D&D Fund as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with U.S. generally accepted accounting principles.

The information in the Overview, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it.



Internal Control over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect D&D Fund's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

In our FY 2006 and FY 2005 audits, we noted certain matters, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable condition presented in Exhibit I is a material weaknesses. The reportable condition presented in Exhibit II is not considered to be a material weakness. The current year status of the prior year reportable conditions is presented in Exhibit III.

Internal Controls over and Performance Measures

Under OMB Bulletin No. 06-03, the definition of material weaknesses is extended to other controls as follows. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of the design and operation of internal control over the existence and completeness assertions related to key performance measures would not necessarily disclose all matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that might be reportable conditions.

In our FY 2006 and FY 2005 audits, we noted no matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that we considered to be material weaknesses as defined above.

Compliance and Other Matters

The results of our test of compliance with certain provisions of other laws and regulations for FY 2006 and FY 2005, exclusive of those referred to in Federal Financial Management Improvement Act (FFMIA), disclosed no instances of other matters and disclosed one instance of noncompliance with the Energy Policy Act that is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03, and is described below and in more detail in Exhibit IV.

Shortfall of Government Appropriations – The Energy Policy Act requires Government appropriations to the D&D Fund each fiscal year through 2007. Through September 30, 2006, Government appropriations received by the D&D Fund are approximately \$839 million below the required funding.



The results of our tests of FFMIA for FY 2006 and FY 2005 disclosed the D&D Fund's financial management systems did not substantially comply with the federal financial management systems and accounting standards requirements, discussed in the Responsibilities section of this report, which prevented the D&D Fund from preparing timely and accurate financial statements and supporting data for audit. This matter is related to the material weakness in internal control, described in the Internal Control over Financial Reporting section of this report. Our related recommendations are presented in Exhibit I.

The results of our tests of FFMIA disclosed no instances in which the D&D Fund's financial management systems did not substantially comply with requirements of applying the United States Government Standard General Ledger at the transaction level.

* * * * *

Responsibilities

Management's Responsibilities

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the Overview (including the performance measures), and the Required Supplementary Information;
- Establishing and maintaining effective internal controls over financial reporting; and
- Complying with laws, regulations, and contracts applicable to the D&D Fund, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

Auditors' Responsibilities. Our responsibility is to express an opinion on the FY 2006 and FY 2005 financial statements of the D&D Fund based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the D&D Fund's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.



In planning and performing our FY 2006 and FY 2005 audits, we considered the D&D Fund's internal control over financial reporting by obtaining an understanding of the D&D Fund's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982* (Federal Managers' Financial Integrating Act). The objective of our audit was not to provide an opinion on the D&D Fund's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 06-03, in our FY 2006 and FY 2005 audits, with respect to internal control related to performance measures determined by management to be key and reported in the Overview section, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to test and report on the internal control over key performance measures in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion on internal control over reported performance measures, and accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the D&D Fund's FY 2006 and FY 2005 financial statements are free of material misstatement, we performed tests of the D&D Fund's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the D&D Fund. However, providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audit, and accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 and FFMIA, we are required to report whether the D&D Fund's financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The D&D Fund's response to the findings identified in our audit are presented in Exhibit I, II, and IV. We did not audit the D&D Fund's response and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the D&D Fund's management, the D&D Fund's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

April 8, 2009

Independent Auditors' Report
Exhibit I – Material Weakness
Financial Management and Reporting Controls

We identified a material weakness in the D&D Fund's financial management and reporting controls that delayed the D&D Fund from preparing its FY 2006 and FY 2005 financial statements and supporting documentation in a complete, accurate, and timely manner. Under the current financial reporting structure, the D&D Fund is dependent on the Department's office of the Chief Financial Officer (CFO) for preparation of the D&D Fund's financial statements and footnotes through the use of the Department's accounting systems and accounting staff.

The Department encountered a number of challenges resulting from the FY 2005 implementation of its new accounting system, the Standard Accounting and Reporting System (STARS), consolidation and realignment of its financial and accounting services organization, and the adoption of a new chart of accounts. Specifically, in October 2004, the Department centralized certain operations previously performed by multiple Field offices and accounting service centers and restructured its overall financial and accounting services organization. These changes, coupled with higher than normal attrition, had a negative impact on the financial accounting staffing levels and skills mix throughout the Department. Shortly thereafter, in April 2005, the Department implemented STARS and a new chart of accounts.

While the Department conducted extensive STARS predeployment testing, it encountered implementation issues related to converting data from its legacy accounting system, developing new accounting processes to effectively use the new system, and identifying related reporting requirements. The Department's new financial and accounting services organization was unable to fully address many of these implementation issues prior to September 30, 2005. Reports needed for management, control, and audit purposes were not available following STARS deployment, and a number of system reconciliations remained incomplete. Furthermore, new STARS-specific accounting processes had not been fully documented, and operational control procedures were not yet being performed routinely. Problems resulting from the lack of these critical controls significantly delayed preparation of the D&D Fund's FY 2005 financial statements and supporting data, and impacted the ability of management officials to monitor and control their budgets. The Department recognized these issues and classified financial control and reporting as a reportable problem in its *Federal Managers' Financial Integrity Act* assurance statement for FY 2005, and as a noncompliance matter in its FFMIA reporting. Because of the Department's remediation efforts to resolve these issues, the Department was unable to devote personnel specifically to establish policies and procedures that ensure the preparation of the D&D Fund's FY 2005 financial statements and footnotes in a complete, accurate, and timely manner.

We found during our work on the FY 2006 financial statements that the Department had made extensive progress in correcting many of the issues we identified in FY 2005, but still experienced significant delays preparing the D&D Fund's FY 2006 and FY 2005 financial statements and footnotes. We determined that the Department continued to have had limited staff available to devote attention to developing the policies and procedures specific to the preparation of the D&D Fund's financial statements and footnotes.

Specifically, we noted the following issue areas:

Development of Financial Reporting Policies and Procedures – The Department’s office of the CFO experienced a higher than normal attrition rate that significantly impacted its ability to timely prepare the D&D Fund’s FY 2006 and FY 2005 financial statements using information generated by the STARS. Specifically, we found that the Department’s office of the CFO did not have a sufficient number of personnel with the requisite financial accounting background, knowledge, and expertise, to both (i) establish, and (ii) effectively manage the financial reporting needs for the D&D Fund.

Obligations, Budget Execution, and Funds Control – Our work on the FY 2005 obligations found unreconciled differences between the general ledger, subsidiary modules, and various other information systems used to manage obligation and cost data. Some field organizations entered and controlled obligations using separate information systems (feeder systems) that interface with the STARS purchase order module, while others recorded obligation data directly in the purchase order module. Some sites summarized transactions for posting in a manner that prevented the obligation data in STARS from being readily traced or reconciled to source documents. In addition, because the sites had not fully developed control procedures unique to their feeder systems and data entry methods, they could not ensure the accuracy of obligation data through timely reconciliation to the STARS general ledger totals. STARS data is needed for official funds control purposes. Without routine reconciliations, there is significant risk that the obligations reported in the D&D Fund’s financial statements may be misstated and that field office and program managers may be using incomplete or inaccurate data for financial management decisions. Field offices also reported that they could not identify and resolve some differences between STARS and contract file data. Because of the unexplained differences, several field offices expressed concerns regarding the accuracy of their uncosted and unpaid obligations balances, which adversely affected their ability to monitor and control their budgets. These and other program officials also expressed concerns regarding incorrect conversion of legacy system data, potential funds distribution errors, and inappropriate accrual of interest penalties. Finally, a number of program officials said that they needed additional training in using available reporting tools to monitor obligations and expenditures.

Our work on the D&D Fund’s FY 2006 obligations found that the Department had resolved the issues we identified during our test work on the FY 2005 obligations.

Reconciling Disbursements and Collections – The Department had difficulty reconciling its disbursement and collection activity, including that of the D&D Fund, with the U.S. Treasury’s records beginning April 2005 through September 30, 2005. These payment reconciliation issues have significantly complicated and delayed efforts to verify the accuracy of the Fund Balance with Treasury account. Because of these difficulties, the Department’s submissions to Treasury and OMB as of June 30, 2005, were based on estimated disbursement data. In September 2005, corrected SF-224s, *Monthly Statement of Transactions*, were submitted to Treasury for the period April through June 2005. The Department was unable to timely complete its September 2005 Fund Balance with Treasury reconciliation until November 4, 2005.

Our work on the D&D Fund’s FY 2006 financial statements found that the Department had resolved the reconciliation issues discussed above.

Integrated Contractor Trial Balances – A number of unreconciled differences existed between STARS and the separate financial systems maintained by integrated contractors for FY 2005 that related to the D&D Fund. A task force formed to identify and resolve these differences found that they resulted from errors in data conversion and incomplete reconciliation and crosswalk instructions. While the Department believed that substantially all of the remaining differences resulted from misclassifications of data between contractors and field office reporting units – misclassifications that do not affect the accuracy of the consolidated financial statements – it had not completed most of the reconciliations for individual contractors, and the effect of the remaining corrections on the D&D Fund financial statements was not known.

Our work on the D&D Fund's FY 2006 financial statements found that the Department had resolved the identified integrated contractor trial balance reconciliation issues and implemented routine reconciliations.

Reconciliation of Data – Data conversion and operational problems created out-of-balance conditions between the STARS purchase order, accounts payable, and accounts receivable modules and the general ledger. The Department identified a number of reconciling differences and adjustments, but had not completed reconciliations of all modules to the general ledger as of September 30, 2005. In addition, the Department reported that several hundred FY 2005 general ledger posting errors identified by STARS edit routines were unresolved. Although the Department implemented system changes to prevent many of these errors from recurring, it did not complete its review and correction of unresolved errors until after September 30, 2005. The Department requires field offices to resolve many of these errors, but staffing levels were not adequate to complete the work for timely and accurate preparation of the D&D Fund's FY 2005 financial statements. Prompt resolution of data posting errors is an essential component of financial data integrity, and its absence could make the safeguards against misappropriation or unauthorized use of funds less effective.

Our work on the FY 2006 financial statements found that the Department had resolved the above data reconciliation issues.

Recommendations

We recommend that the Department's CFO ensure sufficient personnel are assigned with the requisite financial accounting background, knowledge, and expertise, to both (i) establish, and (ii) effectively manage the financial reporting needs for the D&D Fund.

Management Response

The Department concurs with the recommendation and actions have already been taken to address this condition. Specifically, in December 2006, the CFO assigned an accountant to prepare the D&D Fund Financial Statements and to work closely with a staff member at Oak Ridge and at the Consolidated Business Center who are knowledgeable about the day-to-day D&D Fund programs, operations, and financial reporting at the field site. The CFO will assure that work is appropriately staffed and coordinated internally and across other DOE offices/sites in order to establish controls over the preparation of the statements.

Resolution of the Department's material weakness related to the implementation of a new accounting system in April 2005 and the addition of personnel within the CFO has corrected this financial reporting weakness. The CFO has demonstrated the requisite financial accounting background, knowledge, and expertise to address the D&D Fund's financial reporting with the completion of all required financial reporting for prior years including the FY 2005/2006 financial statements and provided a draft copy of the FY 2006/2007 D&D Fund financial statements to KPMG LLP on March 14, 2008.

Furthermore, the CFO will ensure that clear lines of responsibility for the preparation and review of the financial statements are established and maintained between the Office of Financial Control and Reporting, the Oak Ridge Financial Services Center, the Consolidated Business Center, and the EM program office.

Independent Auditors' Report
Exhibit II – Reportable Condition

Unclassified Network and Information Systems Security

The Department maintains a series of interconnected unclassified networks and information systems. Federal and Departmental directives require the establishment and maintenance of security over unclassified information systems, including financial management systems. Past audits identified significant weaknesses in selected systems and devices attached to the computer networks at some Department sites. The Department has implemented corrective actions to improve network security at the sites whose controls we, and the Department's Office of Health, Safety, and Security (HSS), reviewed in prior years. However, we, and the HSS, continued to identify network security weaknesses at sites reviewed in FY 2006, and the frequency and severity of those weaknesses remained consistent with our prior year findings. The Department recognizes these weaknesses and has classified cyber security as a significant issue in its *Federal Managers' Financial Integrity Act* assurance statement for FY 2006. Significant improvements are still needed in the areas of password management configuration management, and restriction of network services.

Our FY 2006 audit also disclosed weaknesses in access controls at several sites, similar to our prior year findings. Specifically, we noted weaknesses in the review and approval of user access privileges, password security, and monitoring of networks for questionable activity. We also noted weaknesses in the cyber security programs at certain locations in which federal cyber security requirements and Departmental policies and controls were not properly implemented. Further, the Department's Office of Inspector General also reported deficiencies in the Department's network and information system risk management, configuration management, and access controls in its evaluation report on *The Department's Unclassified Cyber Security Program*, dated September 2006. Matters discussed in that report included an examination of nonfinancial systems.

The Department has acknowledged the need to improve its information systems security and other information technology controls. In FY 2006, the Department's Chief Information Officer (CIO) launched a revitalization plan designed to improve the management of its information security program and issued enhanced cyber security guidance to strengthen controls and reduce network vulnerabilities. The Cyber Security Revitalization Plan is a collaborative effort between the Office of the CIO (OCIO), the Under Secretary and other senior management to identify and resolve cyber security problems, provide site assistance, and follow-up on corrective actions. Once fully implemented, these initiatives and new policies and procedures should strengthen the Department's overall cyber security program.

The identified weaknesses and network vulnerabilities and access controls increase the risk that malicious destruction or alteration of data or unauthorized processing could occur. Because of our concerns, we performed supplemental procedures and identified compensating controls that mitigate the potential effect of these security weaknesses on the integrity of the Department's financial systems.

Recommendation

While progress has been achieved, continued focus is needed to resolve the vulnerability and access control weaknesses described above. Therefore, we recommend that the program officials, in conjunction with the CIO, fully implement policies and procedures to ensure that the federal information security standards are met and that networks and information systems are adequately protected against unauthorized access. Detailed recommendations to address the issues discussed above have been separately reported to the program offices and the OCIO.

Management Response

Management concurs with the recommendation, and shares the auditor's concerns that cyber security controls are integral to the integrity of financial and accounting systems. The OCIO will continue to work with the Office of the Inspector General, the CFO and other DOE organizations to improve the implementation of cyber security controls, specifically in the areas of password management, configuration management, and restriction of network services.

As stated in the OCIO comments on the FISMA report, the Department of Energy is committed to improving the protection of its information and information systems through a strong cyber security program. As part of this commitment, the Department's senior management during FY 2006 created the Cyber Security Executive Steering Committee, chaired by the CIO and including as active members the three Under Secretaries as well as the Chief Health, Safety, and Security Officer, the Administrator of the Energy Information Administration and a representative of the Power Marketing Administrations. The Secretary and the Deputy Secretary are personally involved in cyber security management, and they have guided the development of a Cyber Security Revitalization Plan to give more and higher level attention to the management of cyber security.

The Cyber Security Revitalization Plan, developed by the Executive Steering Committee, establishes a governance framework for cyber security management in the Department through a partnership between OCIO and the Under Secretaries and other senior management to provide adequate protection of all DOE information and information systems. The Plan was approved by the Deputy Secretary in March 2006.

Efforts to date implementing the Plan have included cyber security guidance issued by the OCIO addressing:

- Management, Operation, and Technical Controls for Information Systems;
- Certification and Accreditation;
- Risk Management for Information Systems;
- Vulnerability Management;
- Interconnection Agreements;
- Plans of Actions and Milestones;
- Contingency Planning;
- Password Management;
- Wireless Devices; and
- Protection of Personally Identifiable Information.

This guidance also addresses cyber security controls that support configuration management, and the restriction of network services. The CIO is also leading a Corporate Asset Management initiative, which will further mitigate weaknesses identified in these areas.

The Steering Committee has also established a Cyber Security Working Group, which participates actively in the development of cyber security guidance and in other cyber security activities.

**Independent Auditors' Report
Exhibit III – Status of Prior Year Finding**

**Reportable condition from fiscal
year 2005 (with parenthetical
disclosure of year first reported)**

Unclassified Information System
Security (2001)

Status at September 30, 2006

Again reported in Exhibit II as a reportable
condition

Independent Auditors' Report
Exhibit IV – Noncompliance with Laws, Regulations, and Contracts

Shortfall of Government Appropriations

We noted a shortfall of Government appropriations to the D&D Fund.

Finding

In our report on compliance with laws, regulations, and contracts for the year ended September 30, 1994, we reported that the Energy Policy Act requires that deposits into the D&D Fund will total \$480.0 million each fiscal year through 2007, adjusted annually for inflation using the Consumer Price Index for All Urban Consumers, as published by the Department of Labor. The Energy Policy Act provides that up to \$150 million of annual deposits, adjusted annually for inflation, shall be collected from domestic utilities, with the remaining portion of the \$480.0 million to come from Government appropriations. The annual deposit of \$480.0 million remained unchanged until FY 1999 when authorized funding was increased to \$488.3 million. Legislation enacted during FY 2002 increased authorized funding to \$518.2 million per year.

The following is a summary of authorized funding required from Government appropriations but not received by the D&D Fund as of September 30, 2006 (in millions):

	Authorized funding required from Government appropriations	Government appropriations received	Authorized funding not received
Year ended September 30:			
1993	\$ 331.4	—	331.4
1994	342.8	197.2	145.6
1995	348.2	133.7	214.5
1996	357.3	350.0	7.3
1997	367.6	386.6	(19.0)
1998	375.8	398.0	(22.2)
1999	391.4	398.1	(6.7)
2000	400.3	420.0	(19.7)
2001	414.0	419.1	(5.1)
2002	462.7	420.0	42.7
2003	471.0	432.7	38.3
2004	481.2	449.3	31.9
2005	493.9	459.3	34.6
2006	511.9	446.5	65.4
	<u>\$ 5,749.5</u>	<u>4,910.5</u>	<u>839.0</u>

The table above indicates that Government appropriations received by the D&D Fund are \$839 million below the \$5,749.5 million funding required by the Energy Policy Act for the D&D Fund's first fourteen years.

Our 1994 and subsequent reports recommended that the Department consider requesting a supplemental appropriation, including inflation adjustments, to make up the cumulative shortfall in appropriations to the D&D Fund.

In July 2004, the Government Accountability Office (GAO) issued a report (GAO-04-692) to congressional committees entitled *Uranium Enrichment Decontamination and Decommissioning Fund Is Insufficient to Cover Cleanup Costs*. In this investigation, the GAO concluded that the D&D Fund is insufficient to cover cleanup costs at the three facilities located in Oak Ridge, Paducah, and Portsmouth. The GAO recommends that Congress consider reauthorizing the D&D Fund for three additional years (through 2010) and require the Department to reassess the D&D Fund's sufficiency before it expires to determine if further extensions will be necessary.

Recommendation

We recommend that the Department initiate action to resolve audit funding shortfalls in the D&D Fund.

Management Response

Management concurs with the recommendation and will continue to request appropriations needed to make up the Government's shortfall in contributions to the D&D Fund. Even in the absence of authorizing legislation, appropriations for contributions to the Fund can be counted against the shortfall and made available to the Fund due to the self-authorizing nature of the appropriations bills.

Independent Auditors' Report
Exhibit V – Status of Prior Year Noncompliance

Noncompliance from fiscal year 2005 (with parenthetical disclosure of year first reported)	Status at September 30, 2006
Shortfall of Government Appropriations (1994)	Again reported in Exhibit IV as a noncompliance

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Balance Sheets

September 30, 2006 and 2005

(In thousands)

Assets	2006	2005
Entity assets:		
Intragovernmental:		
Fund balance with treasury	\$ 26,547	14,991
Investments, net	4,310,183	4,012,365
Accrued interest receivable	47,464	42,697
DOE interfund accounts receivable	312	10,869
Assessments receivable from domestic utilities:		
Current	213,169	205,333
Long-term	—	205,329
Advances to others	—	9,678
Total entity assets	<u>\$ 4,597,675</u>	<u>4,501,262</u>
Liabilities and Net Position		
Liabilities covered by budgetary resources:		
Decontamination and decommissioning	\$ 38,790	14,019
Remedial action	65,005	33,270
Accounts payable and other accruals	35,936	58,839
Total funded liabilities	<u>139,731</u>	<u>106,128</u>
Liabilities not covered by budgetary resources:		
Decontamination and decommissioning	10,021,539	4,571,582
Uranium and thorium licensee claims	280,359	290,642
Remedial action	179,105	218,913
Other liabilities	—	809
Total unfunded liabilities	<u>10,481,003</u>	<u>5,081,946</u>
Total liabilities	10,620,734	5,188,074
Net position:		
Cumulative results of operations	<u>(6,023,059)</u>	<u>(686,812)</u>
Total liabilities and net position	<u>\$ 4,597,675</u>	<u>4,501,262</u>

See accompanying notes to financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Statements of Net Cost

Years ended September 30, 2006 and 2005

(In thousands)

	2006	2005
Environmental quality program costs:		
Decontamination and decommissioning	\$ 395,695	328,164
Storage and disposition	48,042	91,449
Postclosure liabilities administration	22,532	24,422
Uranium and thorium licensee claims	20,071	79,102
Net program costs	486,340	523,137
Cost applied to the reduction of legacy liabilities	(486,501)	(511,989)
Costs not assigned	5,964,325	409,871
Exchange revenues	(173,059)	(157,191)
Net cost of operations	\$ 5,791,105	263,828

See accompanying notes to financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
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Statements of Changes in Net Position
Years ended September 30, 2006 and 2005
(In thousands)

	2006	2005
Cumulative results of operations:		
Beginning balance	\$ (686,812)	(897,151)
Other financing sources:		
Imputed financing from costs absorbed by others	8,368	14,870
Other – appropriations transferred from DOE, net of adjustments	446,490	459,297
Total financing sources	454,858	474,167
Net cost of operations	(5,791,105)	(263,828)
Ending balance	\$ (6,023,059)	(686,812)

See accompanying notes to financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
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Statements of Budgetary Resources
Years ended September 30, 2006 and 2005
(In thousands)

	<u>2006</u>	<u>2005</u>
Budgetary resources:		
Unobligated balance brought forward, October 1	\$ 153	66
Budget authority, appropriation	562,228	499,007
Temporary not available pursuant to public law	(5,622)	(3,992)
Total budgetary resources	<u>\$ 556,759</u>	<u>495,081</u>
Status of budgetary resources:		
Obligations incurred – direct	\$ 556,525	494,928
Unobligated balance available	234	153
Total status of budgetary resources	<u>\$ 556,759</u>	<u>495,081</u>
Change in obligated balance:		
Unpaid obligations, brought forward, October 1	\$ 82,918	121,649
Obligations incurred	556,525	494,928
Less gross outlays	(502,897)	(533,659)
Unpaid obligations, net, end of period	<u>\$ 136,546</u>	<u>82,918</u>
Outlays:		
Gross outlays	\$ 502,897	533,659
Less distributed offsetting receipts	(640,590)	(582,717)
Net outlays	<u>\$ (137,693)</u>	<u>(49,058)</u>

See accompanying notes to financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
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Statements of Financing

Years ended September 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Resources used to finance activities:		
Budgetary resources obligated:		
Obligations incurred	\$ 556,525	494,928
Less offsetting receipts	<u>(640,590)</u>	<u>(582,717)</u>
Net obligations	<u>(84,065)</u>	<u>(87,789)</u>
Other resources:		
Imputed financing from costs absorbed by others	<u>8,368</u>	<u>14,870</u>
Net other resources used to finance activities	<u>8,368</u>	<u>14,870</u>
Total resources used to finance activities	<u>(75,697)</u>	<u>(72,919)</u>
Resources used to finance items not part of the net cost of operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided	(56,349)	54,592
Resources that finance the acquisition of assets	(12,959)	(27,517)
Resources that fund expenses recognized in prior periods	(485,740)	(519,786)
Budgetary offsetting collections and receipts that do not affect the net cost of operations	441,723	462,781
Other resources and adjustments	<u>(7,840)</u>	<u>(14,284)</u>
Total resources used to finance items not part of the net cost of operations	<u>(121,165)</u>	<u>(44,214)</u>
Total resources used to finance the net cost of operations	<u>(196,862)</u>	<u>(117,133)</u>
Net cost of items that do not require or generate resources in current period:		
Components requiring or generating resources in future periods:		
Increase in unfunded liability estimates	<u>5,955,134</u>	<u>402,862</u>
Total components requiring or generating resources in future periods	<u>5,955,134</u>	<u>402,862</u>
Components not requiring or generating resources:		
Depreciation and amortization	11,395	2,849
Revaluation of assets and liabilities	(809)	2,501
Other	<u>22,247</u>	<u>(27,251)</u>
Total components not requiring or generating resources	<u>32,833</u>	<u>(21,901)</u>
Total net cost of items that do not require or generate resources in current period	<u>5,987,967</u>	<u>380,961</u>
Net cost of operations	<u>\$ 5,791,105</u>	<u>263,828</u>

See accompanying notes to financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Notes to Financial Statements

September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

The Energy Policy Act of 1992 (Energy Policy Act) requires the United States (U.S.) Department of Energy (Department) to retain responsibility for the costs of environmental remediation resulting from the U.S. government's (Government) operation of the three gaseous diffusion facilities (Diffusion Facilities) located in Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio prior to that date.

The Energy Policy Act established the Uranium Enrichment Decontamination and Decommissioning Fund (D&D Fund) within the Department as of October 24, 1992, to pay for the costs of decontaminating and decommissioning the Diffusion Facilities (note 4). The Energy Policy Act further provides that the D&D Fund will reimburse licensees operating uranium or thorium processing sites for the costs of environmental remediation at those sites, subject to maximum reimbursement limits (note 5). The Energy Policy Act, as amended, also provides for payment of the costs of remedial action at the Diffusion Facilities, to the extent that the amount available in the D&D Fund is sufficient (note 6). To pay for these activities, the Energy Policy Act and subsequent legislation authorizes funding over a 15-year period, adjusted annually using the Consumer Price Index for All Urban Consumers (Consumer Price Index), as published by the Department of Labor, over a 15-year period. The funding is to be obtained from Government appropriations (note 8) and from assessments receivable from domestic utilities (note 3).

(b) Basis of Presentation

These financial statements have been prepared from the accounting records of the D&D Fund in conformance with U.S. generally accepted accounting principles and the form and content for financial statements specified by Office of Management and Budget (OMB) in Circular A-136, *Financial Reporting Requirement*.

The Department's expenses are summarized in its statement of net cost by business line. The Environmental Quality business line includes, among other activities, all D&D Fund expenses. The purpose of environmental quality activities is to understand and reduce environmental, safety, and health risks and threats and to develop the technologies and institutions required for solving domestic and global environmental problems.

The Department's headquarters, field offices, and the management and integrating (M&I) contractor (at Oak Ridge) conducting environmental remediation activities at the Department's facilities discussed in note (1)(a) record D&D Fund activity in their accounting systems. The M&I contractor integrates its accounting system with the Department through the use of reciprocal accounts. The M&I contractor is required to comply with Departmental accounting practices and procedures, which provide for the unique identification of D&D Fund transactions. These financial statements are prepared by extracting and adjusting D&D Fund-related data from the financial records of the Department and the M&I contractor.

**UNITED STATES DEPARTMENT OF ENERGY
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Notes to Financial Statements

September 30, 2006 and 2005

(c) *Basis of Accounting*

The D&D Fund's financial statements are prepared using the accrual method of accounting. The accrual method of accounting requires recognition of the financial effects of transactions, events, and circumstances in the periods when those transactions, events, and circumstances occur, regardless of when cash is received or paid. The D&D Fund also uses budgetary accounting to facilitate compliance with legal constraints and to monitor its budget authority at the various stages of execution, including allotment, obligation, and eventual outlay.

(d) *Earmarked Funds*

In fiscal year (FY) 2006, the D&D Fund implemented Statement of Federal Financial Accounting Standards (SFFAS) No. 27, *Identifying and Reporting Earmarked Funds*, which required separate identification of earmarked funds on the balance sheets, statements of changes in net position, and in the notes to the financial statements. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the Government's general revenues. All of the assets, liabilities, net position, and activity within these D&D fund financial statements are a single earmarked fund.

(e) *Investments*

The Energy Policy Act requires the D&D Fund to invest in U.S. Treasury obligations. The D&D Fund's investments in Treasury securities are classified as held-to-maturity. Held-to-maturity securities are those securities that the D&D Fund has the ability and intent to hold until maturity. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective-interest method. Realized gains and losses for securities classified as held-to-maturity are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

(f) *Plant and Equipment*

Plant and equipment acquired by the D&D Fund are charged to operations when purchased, unless the plant or equipment will be used for purposes other than environmental remediation. All plant and equipment held by the D&D Fund at September 30, 2006 and 2005 are used in environmental remediation.

(g) *Environmental Remediation Liabilities*

The D&D Fund's environmental remediation liabilities are recorded at current cost, which is the amount that would be paid if all equipment, facilities, and services included in the related cost estimates were acquired during the current period. Each fiscal year, the liabilities are increased for inflation, reduced by current expenditures, and adjusted for estimated cost increases or decreases.

**UNITED STATES DEPARTMENT OF ENERGY
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URANIUM ENRICHMENT DECONTAMINATION AND
DECOMMISSIONING FUND**

Notes to Financial Statements

September 30, 2006 and 2005

(h) Revenue Recognition

Revenue from assessments against domestic utilities is recognized when such assessments are authorized by legislation. Increases in current and future assessments due to changes in the Consumer Price Index are recognized in each fiscal year as such changes occur.

(i) Government Appropriations

Government appropriations are recognized at the later of the beginning of each fiscal year, when appropriations may be apportioned to the Department by OMB, or the date the appropriations legislation is signed into law.

(j) Imputed Costs and Financing Sources

Certain salaries, employee benefits, and other costs allocable to the D&D Fund are funded under separate appropriations, and are included in the accompanying financial statements through allocations by entities outside the D&D Fund in accordance with SFFAS No. 4, *Managerial Cost Accounting Concepts for the Federal Government*. An equivalent amount is included in imputed financing.

(k) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(l) Tax Status

The D&D Fund, as a federal entity, is not subject to federal, state, or local income taxes. Accordingly, no provision for income taxes is recorded in the accompanying financial statements.

**UNITED STATES DEPARTMENT OF ENERGY
OFFICE OF ENVIRONMENTAL MANAGEMENT
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Notes to Financial Statements

September 30, 2006 and 2005

(2) Investments, Net

The D&D Fund invests in nonmarketable market-based U.S. Treasury securities. All U.S. Treasury securities held at September 30, 2006 and 2005 are classified as held-to-maturity. The components of U.S. Treasury securities held as of September 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Face value	\$ 4,227,982	3,891,077
Unamortized premiums	95,512	133,026
Unamortized discounts	<u>(13,311)</u>	<u>(11,738)</u>
	4,310,183	4,012,365
Unrealized gains (losses)	<u>(68,484)</u>	<u>(45,843)</u>
Total	<u>\$ 4,241,699</u>	<u>3,966,522</u>

The market value of U.S. Treasury securities held as of September 30, 2006 and 2005 is as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Maturity:		
Maturing within 1 year	\$ 620,596	366,863
Maturing after 1 year through 5 years	3,236,579	2,822,925
Maturing after 5 years through 10 years	<u>384,524</u>	<u>776,734</u>
Total	<u>\$ 4,241,699</u>	<u>3,966,522</u>

During FY 2006 and FY 2005, the D&D Fund recognized interest revenue of \$165.2 and \$144.6 million, respectively.

The federal government does not set aside assets to pay for expenditures associated with the funds for which the Department holds Treasury securities. These Treasury securities are an asset to the Department and a liability to Treasury. Because the Department and Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

Treasury securities provide the Department with authority to draw upon the U.S. Treasury to make expenditures, subject to available appropriations and OMB apportionments. When the Department requires redemptions of these securities, the Government finances those expenditures out of accumulated cash balances by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way the Government finances all other expenditures.

**UNITED STATES DEPARTMENT OF ENERGY
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URANIUM ENRICHMENT DECONTAMINATION AND
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Notes to Financial Statements

September 30, 2006 and 2005

The market value of the Departments investments in Treasury securities has declined subsequent to September 30, 2006 reflecting current economic conditions.

(3) Assessments Receivable from Domestic Utilities

The Energy Policy Act authorizes assessments by the D&D Fund against domestic utilities who purchased uranium enrichment services from the Department and its predecessor agencies prior to the Energy Policy Act. The assessments are based on the ratio of such services purchased by domestic utilities to total services provided to domestic and foreign utilities and to the Government. Collections of the assessments are limited to \$150 million each year, and will continue through FY 2007 or until \$2.25 billion, exclusive of indexing adjustments, has been collected. The entire amount of assessments over the 15-year assessment period authorized by the Energy Policy Act was recorded as revenue by the D&D Fund during FY 1993, as no future services were associated with these assessments. Current and future assessments are adjusted annually for inflation using the Consumer Price Index.

The current portion of assessments receivable from domestic utilities as of September 30, 2006 and 2005 is \$213.2 million and \$205.3 million, respectively, which represents the amount due from domestic utilities during the next fiscal year. The long-term portion of assessments receivable from domestic utilities as of September 30, 2006 and 2005 is \$0 and \$205.3 million, respectively. Management believes all assessments receivable from domestic utilities are collectible. The long-term portion of assessments receivable has been adjusted to reflect the June 2005 court ruling discussed in footnote 7.

During FY 2006 and FY 2005, the D&D Fund recognized revenue of \$7.8 million and \$14.3 million, respectively, from the increase in the current and future assessments against domestic utilities resulting from the increase in the Consumer Price Index during the fiscal year.

(4) Decontamination and Decommissioning

The Department's estimate of the costs to decontaminate and decommission the Diffusion Facilities is based on an aggressive contracting strategy intended to maximize cost savings and enhance scheduling through the use of performance-based contracts. Environmental remediation, which includes both decontamination and decommissioning and remedial action (note 6) activities, will be completed through fixed-price contracts where appropriate.

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Changes in the liability for decontamination and decommissioning from October 1, 2004 through September 30, 2006 are summarized as follows (in thousands):

Balance, October 1, 2004	\$	4,623,699
Provision for inflation		119,291
Decontamination and decommissioning costs incurred		(225,295)
Adjustment to new cost estimate		<u>67,906</u>
Balance, September 30, 2005		4,585,601
Provision for inflation		149,389
Decontamination and decommissioning costs incurred		(229,208)
Adjustment to new cost estimate		<u>5,554,547</u>
Balance, September 30, 2006	\$	<u><u>10,060,329</u></u>

Of the total liability of \$10,060.3 million for decontamination and decommissioning as of September 30, 2006, \$38.8 million is covered by appropriations for current and previous fiscal years (budgetary resources) and \$10,021.5 million is not covered by budgetary resources. Of the total liability of \$4,585.6 million for decontamination and decommissioning as of September 30, 2005, \$14.0 million is covered by appropriations for current and previous fiscal years (budgetary resources) and \$4,571.6 million is not covered by budgetary resources.

Because the decontamination and decommissioning work is scheduled to be completed in approximately 2016 at the Diffusion Facility located in Oak Ridge and the work has yet to be scheduled at the Paducah and Portsmouth Diffusion Facilities, the length of time over which the work will be performed and the uncertainty inherent in the estimating process create significant uncertainty as to the actual cost of the work. In addition, because the estimate on which the recorded liability is based does not include an estimate of the impact of inflation on such costs, the actual costs may be significantly higher than the recorded liability. The Department is presently unable to determine the impact of time and inflation on the liability for decontamination and decommissioning costs.

(5) Uranium and Thorium Licensee Claims

The Energy Policy Act, as amended, provides that the D&D Fund will reimburse licensees operating uranium or thorium processing sites for the costs of environmental remediation at those sites, subject to maximum reimbursements of \$350 million for the uranium licensees and \$365 million for the thorium licensee, plus adjustments for inflation. Legislation enacted during FY 2002 increased the maximum reimbursement for the thorium licensee from \$140 million to \$365 million.

As of September 30, 2006 and 2005, the Department has approved for payment \$566.5 million and \$545.2 million, respectively, of uranium and thorium licensee claims, and has paid \$534.2 million and

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\$514.5 million, respectively, to licensees. Approved but unpaid claims will be paid to licensees when additional funds are appropriated for that purpose. The Department receives additional claims from licensees as remediation occurs, and expects that total reimbursements of uranium and thorium licensee claims will reach the limits set by legislation.

The D&D Fund's liability for reimbursement of uranium and thorium licensee claims consists of the maximum reimbursements authorized by legislation less amounts paid, adjusted annually for inflation. Changes in the liability for reimbursement of uranium and thorium licensee claims from October 1, 2004 through September 30, 2006 are summarized as follows (in thousands):

Balance, October 1, 2004	\$	360,306
Provision for inflation		9,296
Claims reimbursed		<u>(78,960)</u>
Balance, September 30, 2005		290,642
Provision for inflation		9,417
Claims reimbursed		<u>(19,700)</u>
Balance, September 30, 2006	\$	<u><u>280,359</u></u>

No portion of the liability of \$280.4 million and \$290.6 million for uranium and thorium licensee claims as of September 30, 2006 and 2005, respectively, is covered by budgetary resources.

(6) Remedial Action

The Energy Policy Act provides that the annual cost of remedial action at the Diffusion Facilities will be paid from the D&D Fund to the extent the amount available in the D&D Fund is sufficient. To the extent the amount in the D&D Fund is insufficient to pay remedial action costs, the Energy Policy Act provides that the Department will be responsible for such costs.

Because the Energy Policy Act places primary responsibility for remedial action costs with the Department if sufficient resources are not available in the D&D Fund, the D&D Fund's recorded liability for remedial action at the end of each fiscal year includes only the funding for such costs provided by Congress in the D&D Fund appropriation for the succeeding fiscal year, plus the unexpended portion of such appropriations for current and previous fiscal years. The D&D Fund will make additional accruals of remedial action costs if Congress appropriates funds for that purpose.

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Changes in the liability for remedial action from October 1, 2004 through September 30, 2006 are summarized as follows (in thousands):

Balance, October 1, 2004	\$	286,929
Provision for inflation and remedial action costs		207,353
Remedial action costs incurred		<u>(242,099)</u>
Balance, September 30, 2005		252,183
Provision for inflation and remedial action costs		245,820
Remedial action costs incurred		<u>(253,893)</u>
Balance, September 30, 2006	\$	<u><u>244,110</u></u>

Of the total liability of \$244.1 million for remedial action as of September 30, 2006, \$65.0 million is covered by budgetary resources and \$179.1 million is not covered by budgetary resources. Of the total liability of \$252.2 million for remedial action as of September 30, 2005, \$33.3 million is covered by budgetary resources and \$218.9 million is not covered by budgetary resources.

The estimated future cost of remedial action at the Diffusion Facilities, which is only recorded in the accompanying financial statements to the extent described above, is approximately \$4,369 million and \$3,436 million as of September 30, 2006 and 2005, respectively. The remaining liability for the estimated future cost of remedial action at the Diffusion Facilities is recorded by the Department. The estimate, which was updated during FY 2006, includes surveillance and maintenance, infrastructure, site operation, and support costs, but does not include an estimate of the impact of inflation on the cost of the work; therefore, the actual cost may be significantly higher than the estimate. There is also uncertainty with respect to whether Congressional appropriations will be received at the level assumed by the estimate, and the uncertainty inherent in the estimating process. The Department is presently unable to determine the impact of these factors on the estimated remedial action costs.

(7) Litigation

The D&D Fund has been involved in various actions related to the validity of assessments against domestic utilities. In August 1994, the Yankee Atomic Electric Company (Yankee) filed a claim in the U.S. Court of Federal Claims (Court of Federal Claims). Yankee's claim alleged that the Government's assessments against Yankee amount to a retroactive price increase for uranium enrichment services, in violation of the fixed-price terms of its contracts. In 1997, Yankee sought review by the U.S. Supreme Court of a previous Court of Appeals decision unfavorable to Yankee, and on June 26, 1998, the Supreme Court denied Yankee's petition. As a result of the Supreme Court's ruling, Yankee has no further recourse and the Government prevailed in this case.

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Following the final ruling in the Yankee case, several domestic utilities filed new or amended complaints in the Court of Federal Claims. In general, these complaints alleged that the assessments constituted a Fifth Amendment Taking or violated the Due Process Clause of the Fifth Amendment of the U.S. Constitution, and unlawfully impaired rights and waived obligations under various contracts fully performed many years ago. Some of these utilities, along with other utilities, also jointly filed complaints in various U.S. District Courts. Although there were many similarities between these cases and the Yankee case, these domestic utilities claimed differentiation from Yankee. On November 20, 2001, the Court of Appeals for the Federal Circuit upheld decisions by the Court of Federal Claims unfavorable to four domestic utilities. Subsequently, these utilities petitioned for review in the Supreme Court. Also, on December 3, 2001, the Supreme Court denied a petition for certiorari filed on behalf of a specific utility and other utilities seeking review of a Court of Appeals decision ordering their district court case transferred to the Court of Federal Claims where their related complaints were pending.

In FY 2002, the Supreme Court denied petitions for certiorari on behalf of the four utilities seeking review of Court of Appeals decisions upholding the validity of the assessments against domestic utilities. Following the Supreme Court's denial of these certiorari petitions, all but three of the numerous other lawsuits challenging the payment of assessments were voluntarily dismissed.

In FY 2004, the Court of Appeals for the Federal Circuit affirmed a judgment in favor of the Government in the Union Electric Company case and a petition for certiorari to the Supreme Court was denied. The two remaining cases were consolidated in the Court of Federal Claims, which initially entered Judgment in favor of the Government. The utilities then appealed to the Court of Appeals for the Federal Circuit, which reversed the lower court ruling in FY 2005. The Court of Appeals held that, in the rare fact situation presented, the utilities should recover their assessments. In FY 2006, the assessments of the two prevailing utilities were refunded from the D&D Fund in accordance with the Court's order.

The Department does not anticipate that domestic utilities will file any additional claims and appeals related to the assessments. Management and counsel expect, however, to prevail in any future litigation, claims, and appeals related to the assessments, and as such, the Department and the D&D Fund have not recorded a liability for potential claims.

(8) Government Appropriations

The Energy Policy Act and subsequent amendments require annual Government appropriations to the D&D Fund through FY 2007, equal to the difference between authorized funding, adjusted annually for inflation using the Consumer Price Index, and the assessment against domestic utilities (note 3). Authorized funding was initially established at \$480.0 million per year by the Energy Policy Act. That amount remained unchanged until FY 1999 when legislation increased authorized funding to \$488.3 million per year. Legislation enacted during FY 2002 increased authorized funding to \$518.2 million per year.

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The ability of the D&D Fund to fulfill its responsibilities is contingent upon receipt of funds from these sources. The D&D Fund received payments of \$452.0 million and \$463.0 million for FY 2006 and 2005, respectively, from Defense Environmental Restoration and Waste Management. Subsequently, budget rescissions reduced the D&D Fund payments to \$446.5 million in FY 2006 and \$459.3 million in FY 2005. Cumulative Government appropriations received of \$4,910.5 million have been less than the full amount authorized by the Energy Policy Act of \$5,749.5 million, resulting in funding authorized but not received of \$839.0 million. In July 2006, the Department submitted a request to Congress to extend the window for Government contributions by three years to allow the Government more time to meet its obligations to the D&D Fund.

(9) Pension and Postretirement Benefit Liabilities

The D&D Fund's primary integrated contractor maintains a defined benefit pension plan and is a party to two defined benefit postretirement (PRB) plans, under which they promise to pay participants specified benefits, such as a percentage of the final average pay for each year of service, or a percentage of actual medical expenses in retirement. The D&D Fund follows multiemployer accounting for these plans in accordance with Statement of Financial Accounting Standards (SFAS) No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. The D&D Fund is required to reimburse the contractor for its share of the annual contractor contributions to those plans based on planned funding between the Department of Defense Funds and the D&D Fund as determined by the Department's budget planning assumptions. Payment of such amounts is included as program cost on the statements of net cost. For the years ended September 30, 2006 and 2005, the D&D Fund provided funding for approximately \$2.9 million and \$5.2 million to the contractor's defined benefit pension plan, and \$13.0 million and \$6.6 million related to PRB plans, respectively.

(10) Subsequent Events

During FY 2007 and FY 2008, the Department conducted several external independent reviews on the environmental liability baseline estimates at Oak Ridge, Portsmouth, and Paducah. As a result of these reviews and lower-than-expected FY 2007 and FY 2008 appropriations, which required cleanup timelines to be extended, the Department has increased its estimate for environmental liabilities related to the D&D Fund to approximately \$14.5 billion summarized as follows:

	<u>2006</u>	<u>2008</u>
Decontamination and decommissioning	\$ 10,060,329	14,319,767
Remedial action	244,110	231,144
	<u>\$ 10,304,439</u>	<u>14,550,911</u>

REQUIRED SUPPLEMENTARY INFORMATION

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Required Supplementary Information

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Deferred Maintenance

Deferred maintenance is maintenance that was not performed when it should have been or was scheduled to be performed and which, therefore, is put off or delayed to a future period. The United States Department of Energy (Department) has developed an estimate for deferred maintenance in the amount of \$26.9 million as of September 30, 2006 for the structures and facilities at the gaseous diffusion facilities (Diffusion Facilities) located in Oak Ridge, Tennessee; Paducah, Kentucky; and Portsmouth, Ohio, and has determined that there is no deferred maintenance with respect to capital equipment at the Diffusion Facilities.

The Department developed its deferred maintenance estimate for buildings and other structures and facilities using the condition assessment survey (periodic inspections) method, except for some structures and facilities, such as underground pipe systems, where physical barriers prevent inspection. In such cases, a deferred maintenance estimate was developed for deficiencies identified during normal operations but not corrected when scheduled. Where complete condition assessments were not available for all assets, estimates were extrapolated from results of condition assessments performed for similar assets. Where appropriate, results from previous condition assessments were adjusted to estimate current conditions. Deferred maintenance for excess property, including structures and facilities awaiting decontamination and decommissioning, was reported only where maintenance is needed for worker and public health and safety concerns. In accordance with standards identified by the *National Association of College and University Business Officers*, the Department has designated the acceptable operating condition standard as a Facility Condition Index of less than or equal to 5%.