U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

REPORT ON MATTERS IDENTIFIED AT THE RICHLAND OPERATIONS OFFICE DURING THE AUDIT OF THE DEPARTMENTmS CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF SEPTEMBER 30, 1995

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Report Number: WR-FS-96-01 Western Regional Audit Office
Date of Issue: March 18, 1996 Albuquerque, New Mexico 87185

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Audit Report Number: WR-FS-96-01

SUMMARY

The Government Management Reform Act of 1994 requires that the Department of Energy submit audited financial statements to the Office of Management and Budget annually, beginning with the statements as of September 30, 1996. In preparing for this effort, we planned to audit the Departmentms Consolidated Statement of Financial Position as of September 30, 1995, to determine whether it presented fairly, in all material respects, the Departmentms financial position. We conducted a portion of the Departmentwide audit at the Richland Operations Office and its management and operating contractor, Westinghouse Hanford Company.

The audit disclosed errors, as of September 30, 1995, in three Department accounts maintained by Westinghouse: Construction Work-in-Progress; Completed Property, Plant and Equipment; and Accumulated Depreciation. These errors occurred because Westinghouse had not removed abandoned projects from the Construction Work-in-Progress account and surplus and retired facilities from the Completed Property, Plant and Equipment account. In addition, Westinghouse had not included a telecommunication system, acquired with a capital lease, in the Completed Property, Plant and Equipment account. Westinghouse also had other internal control weaknesses that impacted the account balances.

We recommended that adjustments be made to the accounts and improvements be made to the internal controls. Management agreed to remove a retired building from the property account and agreed to capitalize the lease. However, Richland stated that the close-out process was not complete for the abandoned projects and that Headquarters needed to provide additional information on the removal of surplus facilities before Richland would take any action.

______(Signed)_____________
Office of Inspector General

PART I

APPROACH AND OVERVIEW

INTRODUCTION

The Government Management Reform Act of 1994 significantly expands the provisions of the Chief Financial Officers Act of 1990 and requires that audited financial statements covering all accounts and associated activities of the Department be submitted to the Office of Management and Budget (OMB) annually. The first submission involves financial statements as of, and for the year ended, September 30, 1996. In preparing for this effort, we planned to audit the Departmentms Consolidated Statement of Financial Position as of September 30, 1995, by examining internal controls, assessing compliance with laws and regulations, and testing selected account balances at various Department facilities.

The objective of the Departmentwide audit was to determine whether the Departmentms Consolidated Statement of Financial Position as of September 30, 1995, presented fairly, in all material respects, its financial position. Departmentwide issues are addressed in Audit Report No. IG-FS-96-01.

The purpose of this report is to inform Richland of certain matters that came to the attention of the Office of Inspector General during the audit at Richland and Westinghouse, one of its managing and operating contractors. Westinghouse manages the Hanford Site and maintains an accounting system that is integrated into the Departmentms financial system. Richland is responsible for the account balances entered into the Departmentms core accounting system.

SCOPE AND METHODOLOGY

The audit was conducted from June through December 1995 at Richland, Washington. As part of this effort, we obtained an understanding of the internal control structure to plan the audit, performed tests of control procedures, assessed compliance with laws and regulations, and tested the balances of the following accounts as necessary to achieve the Departmentwide audit objectives: Construction Work-in-Progress; Completed Property, Plant and Equipment; and Accumulated Depreciation.

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 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 exist. Furthermore, because of inherent limitations in any internal control structure, 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 December 29, 1995. Projection of any evaluation of the structure 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 Office of Inspector General, Westinghouse Internal Audit personnel reviewed Accounts Payable and Accrued Expenses at Westinghouse and an independent public accounting firm reviewed Nuclear Material Inventories and Environmental, Pension, and Other Postretirement Liabilities at Richland. The results of the Internal Audit efforts will be reported separately through their normal reporting process. All findings generated as a result of reviews involving Richland and Westinghouse activities were considered in preparing the Audit Report on the Departmentms Consolidated Statement of Financial Position as of September 30, 1995 (Audit Report No. IG-FS-96-01) or in the Management Report referred to in that report.

An exit conference was held with Richland management on February 6, 1996.

OBSERVATIONS

We observed that Westinghouse had not removed abandoned projects and retired or surplus facilities from its accounts. Three abandoned projects totaling $337.3 million remained in Westinghousems Construction Work-in-Progress account. In addition, Westinghouse had not removed a building, with a net value of $12.4 million, from the Completed Property, Plant and Equipment and Accumulated Depreciation accounts when the Fast Flux Test Facility was retired. Richland did not direct Westinghouse to write off or write down other surplus facilities, with an undetermined value, as requested by Headquarters.

In addition, Westinghouse had not capitalized a lease valued at $37.2 million. Although Richland disclosed the capital lease in the footnotes to its consolidated financial statements, Westinghouse had not capitalized this integrated voice/data telecommunication system when it was placed in service in 1993. Since Westinghouse had not included this lease it its accounts, both the Completed Property, Plant and Equipment account and the Accumulated Depreciation account had errors.

Finally, we noted other internal control weaknesses that could quantifiably affect the balances of the Completed Property, Plant and Equipment account and the Accumulated Depreciation account.

Management concurred with some of the recommendations. Management agreed to write off the Fast Flux Test Facility building and to capitalize the telecommunication system. Richland did not agree that Westinghouse had internal control weaknesses; however, Richland stated that it would continue to review and assure that any weaknesses in Westinghousems property accounting procedures would be corrected. Richland agreed to capitalize the occupied buildings that were constructed before a project was canceled, but commented that it would need additional time to close out the abandoned projects. Richland, however, would not agree to write down surplus facilities until it received further guidance from Departmental Headquarters.

Part II of this report provides additional details concerning the audit results and managementms comments.

PART II

AUDIT RESULTS

Westinghouse Hanford Company

1. Plant and Capital Equipment

Westinghousems contract with the Department incorporated DOE Order 2200.6A, which prescribes the accounting policies for the Departmentms plant and capital equipment. According to these policies, capital equipment includes those items purchased, constructed, or otherwise acquired that have an anticipated service life of at least 2 years and that cost at least $5,000. Capitalized assets are recorded on the Departmentms financial records in the Completed Property, Plant and Equipment account and are subject to depreciation. The cost of purchased assets includes invoice cost (less discount), freight charges, and modification and installation costs. The cost of capital assets constructed by an integrated operating contractor includes the costs of material, labor, construction equipment, and overheads. A lease that transfers ownership of the asset to the Department is to be capitalized at the lesser of the present value of the lease payments or the fair market value of the asset at the inception of the lease.

Each accounting entity should record assets purchased with plant and capital funds in the Construction Work-in-Progress account. When it places the assets in service or beneficially occupies them, the accounting entity should transfer the assets from Construction Work-in-Progress to Completed Property, Plant and Equipment. If an entity purchases assets with operating funds, it records the assets directly in the Property, Plant and Equipment account. When the entity abandons a project during construction or plant and equipment becomes prematurely obsolete, the entity is to write down the value in the appropriate accounts.

Account Balances

An uncapitalized lease caused a $37.2 million error in Westinghousems Completed Property, Plant and Equipment account. Specifically, Westinghouse acquired an integrated voice/data telecommunications system through a lease-to-own agreement;

however, Westinghouse did not record this system in the account because of an oversight. By not recording the system, Westinghousems Accumulated Depreciation account was also incorrect.

Westinghousems Completed Property, Plant and Equipment account and the Accumulated Depreciation account were in error by $33.6 million and $21.2 million, respectively. When Westinghouse retired the Fast Flux Test Facility, it did not remove the cost and depreciation of one of the buildings. As a result, the error in the net value of plant and equipment was about $12.4 million.

In addition, Westinghouse incorrectly included $337.3 million in the Construction Work-in-Progress account. This was the cost of three abandoned projects. The Department canceled one of the projects after three buildings were completed and occupied. According to Department policy, Westinghouse should have capitalized the value of the occupied buildings in Completed Property, Plant and Equipment and should have written off the remaining costs of the three abandoned projects. Since Westinghouse had not made these entries, the Construction Work-in-Progress account, the Completed Property, Plant and Equipment account, and the Accumulated Depreciation account were in error.

Internal Controls

It is Westinghousems responsibility to design and implement an internal control structure that provides assurance that transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets. However, the review of current year additions to the Completed Property, Plant and Equipment account and physical observations of assets identified internal control weaknesses that could impact the carrying value of some of the assets. Our review of 15 additions and physical observation of 15 assets disclosed the following conditions:

Westinghouse included overhead in the costs of purchased assets, although Departmental policy stated that overhead costs were to be capitalized only for constructed assets.

Westinghouse did not always use the Departmentms standard service lives when depreciating assets. Our sample disclosed three instances where Westinghouse used different service lives and in two instances Westinghouse used longer service lives. In the third instance Westinghouse used a shorter service life.

Because the conditions described were identified as part of a judgmental sample, we could not statistically evaluate the impact on the balances of the Completed Property, Plant and Equipment and the Accumulated Depreciation accounts.

Recommendations

We recommend that the Manager, Richland Operations Office, direct Westinghouse Hanford Company to:

1. Capitalize the appropriate amount for the integrated voice/data telecommunication system in the Completed Property, Plant and Equipment account and record the applicable Accumulated Depreciation.

2. Remove the cost and associated depreciation of the previously retired Fast Flux Test Facility building from the Completed Property, Plant and Equipment account and the Accumulated Depreciation account.

3. Remove the abandoned projects from the Construction Work-in-Progress account by transferring the costs of occupied assets to the Completed Property, Plant and Equipment account and by writing off the remaining costs to abandoned projects.

4. Adjust the September 30, 1995, financial statements to accurately reflect Construction Work-in-Progress; Completed Property, Plant and Equipment; and Accumulated Depreciation.

5. Review and revise the internal control structure to ensure that amounts are recorded according to Department policy.

Management Comments

Management concurred with Recommendations 1 and 2. Westinghouse is currently reviewing the original lease and subsequent modifications for the telecommunication system to establish the appropriate amount to be capitalized. Target date to accomplish this action was January 31, 1996. Westinghouse also removed the remaining Fast Flux Test Facility assets from the Completed Property, Plant and Equipment account and the Accumulated Depreciation account in November 1995.

Richland partially concurred with Recommendation 3. Richland agreed that buildings constructed and occupied as part of the Vitrification Plant project should be closed from Construction Work-in-Progress to Completed Property, Plant and Equipment. According to Richland, project costs associated with each facility must be fully determined before this can be done. Costs associated with partially completed facilities must be handled in accordance with planned utilization or disposal. Regarding the overstatement of balances in the Construction Work-in-Progress account, Richland believes the Office of Inspector General has not recognized the time required for orderly close-out of abandoned projects.

Management concurred with Recommendation 4 to the extent it concurred with Recommendations 1-3.

Richland nonconcurred with Recommendation 5. However, Richland stated that it would continue its review and assure that weaknesses in Westinghousems property accounting procedures were corrected.

Auditor Comments

Generally, managementms actions are responsive to the recommendations. We believe, however, that Richland needs to correct the Construction Work-in-Progress account as of September 30, 1995, to comply with the May 8, 1995, guidance from the Office of Departmental Accounting and Financial Systems Development. The guidance instructed field elements to remove abandoned facilities from the financial records.

2. Surplus Assets

On September 25, 1995, the Departmentms Deputy Controller issued a memorandum asking that the field offices and contractors write down or write off assets not currently used to support the Departmentms mission and for which there was no anticipated use. This memorandum directed that surplus assets be written down by November 30, 1995, so that the Fiscal Year 1995 Statement of Financial Position could be adjusted. In addition, the memorandum stated that although data supporting the 1995 Baseline Environmental Management Report (BEMR) should be used to identify surplus assets, the decision to write down a facility should not turn on whether the facility was included in the BEMR data.

Because Richland limited its efforts to identify surplus assets to the BEMR supporting data, Westinghouse did not write down or write off facilities. Richland deferred instructing Westinghouse to adjust the accounts for two reasons. First, many of the facilities in the BEMR supporting data were still in use and would be required for continued operation. Second, Richland stated that Departmental Headquarters intended to issue guidance in March 1996 on how to account for facilities used to store, treat, and dispose of legacy waste.

The amount of write-down that should have been made for assets not currently used and for which there is no anticipated use is unknown. However, Hanfordms change in mission in 1989 from production to environmental restoration suggests that there are numerous facilities that should have been written down.

Recommendations:

We recommend that the Manager, Richland Operations Office, direct Westinghouse Hanford Company to:

1. Identify excess facilities that no longer have designated mission requirements and remove them from the Completed Property, Plant and Equipment and Accumulated Depreciation accounts.

2. Adjust Completed Property, Plant and Equipment, and Accumulated Depreciation to properly report the balances as of September 30, 1995.

Management Comments

Management partially concurred; however, it stated that any write-downs would have to await the guidance to be issued by Departmental Headquarters in March 1996.

Auditor Comments

The write-down of facilities that are not currently used to support the mission of the Department and for which there is no anticipated future use need not await the March 1996 guidance. That guidance will deal with the separate issue of writing down legacy waste facilities.

A write-down now would also be consistent with Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets And For Long-lived Assets To Be Disposed Of. SFAS No. 121, which will be mandatory for Fiscal Year 1997 financial statements, requires that assets be reviewed for impairment when there is a significant change in the extent or manner in which an asset is used. The standard states that the impairment loss shall be measured as the amount by which the carrying amount exceeds the fair value of the asset.

OTHER MATTERS

During our review of 40 property transactions, we identified six separate errors that raised concerns about Westinghouse's management controls for capital assets. For example, Westinghouse had correctly recorded an asset of $558,883 in the proper account and subaccount. However, Westinghouse recorded the wrong purchase order number and had recorded the cost in the wrong property unit. In another instance the Completed Property, Plant and Equipment account included the book value of an asset that had been returned to the vendor; however, the account had no cost for the replacement asset. Because these errors were identified as part of a judgment sample, we could not statistically evaluate the impact on the account balances. However, we believe that, considering the small sample size and the number of errors, management controls are not operating as intended. We feel that this is an area that management should address to insure that controls are operating as intended.

Situations similar to those raised in the findings were identified at other locations included in the overall audit, with aggregate amounts considered material to the Departmentms consolidated financial statement. These subjects, therefore, were addressed in the audit report on the Departmentms Consolidated Statement of Financial Position as of September 30, 1995 (Audit Report No. IG-FS-96-01).

Report No. WR-FS-96-01

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