U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

REPORT ON MATTERS IDENTIFIED AT THE RICHLAND OPERATIONS OFFICE DURING THE AUDIT OF THE DEPARTMENT'S CONSOLIDATED FISCAL YEAR 1996 FINANCIAL STATEMENTS

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Audit Report Number: WR-FS-97-04

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 issued as of September 30, 1996. A Departmentwide audit was conducted to determine whether there was reasonable assurance that the Department's consolidated Fiscal Year 1996 financial statements were free of material misstatements. We conducted a portion of the Departmentwide audit at the Richland Operations Office (Richland) and two of its integrated management and operating contractors, Westinghouse Hanford Company (Westinghouse) and Battelle-Pacific Northwest National Laboratory (Battelle).

The audit at Westinghouse disclosed errors, as of September 30, 1996, in the balances of three Department accounts: Completed Property, Plant and Equipment; Accumulated Depreciation; and Unfunded Liabilities. The audit also disclosed possible unallowable costs in Battelle's Fiscal Year 1996 costs.

We recommended that adjustments be made to the accounts to correct deficiencies noted and that unallowable costs be identified and reimbursed to the Department. Management agreed to our recommendations and plans to implement corrective action.

___________(Signed)_____________

Office of Inspector General

PART I

APPROACH AND OVERVIEW

INTRODUCTION

The Government Management Reform Act of 1994 significantly expanded the provisions of the Chief Financial Officers Act of 1990 and required that audited financial statements covering all accounts and associated activities of the Department be submitted annually to the Office of Management and Budget. The first submission involves financial statements as of September 30, 1996. A Departmentwide audit of consolidated Fiscal Year 1996 financial statements was conducted by examining internal controls, assessing compliance with laws and regulations, evaluating accounting transaction cycles, and testing selected account balances at various Department facilities.

The objective of the Departmentwide audit was to determine whether the Department's Consolidated Statement of Financial Position as of September 30, 1996, and Statement of Operations and Changes in Net Position for Fiscal Year 1996 presented fairly, in all material respects, its financial position and results of operations in conformity with applicable accounting standards. Departmentwide issues are addressed in Audit Report No. IG-FS-97-01.

The purpose of this report is to inform management at Richland of matters that came to the attention of the Office of Inspector General during the audit at Richland, Westinghouse, and Battelle. Richland is responsible for the account balances entered into the Department's core accounting system.

SCOPE AND METHODOLOGY

The audit was conducted from April through December 1996 at the Richland Operations Office in Richland, Washington, and Westinghouse and Battelle at the Hanford Site, Washington. Specifically, we examined internal controls, assessed compliance with applicable laws and regulations, and selectively tested account balances reported to Departmental Headquarters as necessary to achieve the Departmentwide audit objective.

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 may 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 27, 1996. 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, internal audit personnel and an independent accounting firm reviewed certain cycles. Westinghouse internal audit personnel reviewed the Payroll and Disbursements cycles and Battelle internal audit personnel reviewed the Payroll cycle at their respective locations. Internal Audit made recommendations for corrective actions to their own management in separate reports.

An independent public accounting firm reviewed Nuclear Materials and Environmental Liabilities at Richland and Pension and Other Post-Retirement Liabilities at Westinghouse.

The Office of Inspector General considered all findings, generated as a result of the reviews, when preparing the audit report on the Department's Consolidated Fiscal Year 1996 Financial Statements (Audit Report No. IG-FS-97-01; February 24, 1997) and the management report referred to in that report. Furthermore, the Office of Inspector General is also addressing issues requiring local management's attention in this report.

Richland waived an exit conference on April 24, 1997.

BACKGROUND

Fluor Daniel Hanford, Inc., an integrating contractor, replaced Westinghouse effective October 1, 1996, as the contractor operating the Hanford Site. Therefore, while conditions noted in this report were the responsibility of Westinghouse, corrective action will be the responsibility of Richland and Fluor Daniel.

OBSERVATIONS

We observed errors in account balances at Westinghouse. We previously reported that Westinghouse had not capitalized a telecommunications system and had not used the Department's standard service lives for all assets. (See Report on Matters Identified at the Richland Operations Office During the Audit of the Department's Consolidated Statement of Financial Position as of September 30, 1995, Report No. WR-FS-96-01; March 18, 1996). In the current review, we observed that although Westinghouse had capitalized the telecommunications system, it had not followed the methology prescribed by the Department for establishing the book value. Also, we observed that Westinghouse had not used the Department's standard service lives for all assets. In addition, Westinghouse improperly wrote down capital assets that should not have been written down, and did not write down legacy waste assets that should have been written down.

We also noted possible unallowable costs and an internal control weakness at Battelle. Eight part-time employees were paid hourly rates greater than the equivalent full-time salaries authorized by Battelle's contract. Additionally, Battelle employees did not always submit timecards in a timely manner.

Management concurred with our recommendations and planned to implement corrective action.

Part II of this report provides additional details concerning the audit results and management's comments.

PART II

AUDIT RESULTS

Westinghouse Hanford Company

1. Legacy Waste Related Assets

On October 25, 1995, the Department's Deputy Controller issued a memorandum instructing field offices to evaluate each of their facilities and determine if the facility's primary purpose was for legacy wastes or ongoing activities. On April 18, 1996, the Director, Office of Departmental Accounting, directed all field offices to write down capital assets associated with the treatment, storage, and disposal of the Department's legacy waste.

Although Westinghouse identified and wrote down legacy waste facilities at Richland's direction, some facilities that should have been written down were not, while others that should not have been written down were written down. Specifically, we identified assets associated with six legacy waste facilities that were not written down. Conversely, Westinghouse incorrectly wrote down seven other facilities used for storing and handling special nuclear materials but not used for legacy waste. These errors understated the net book value of Completed Property, Plant and Equipment by $2,775,040.

Recommendations:

We recommend that the Chief Financial Officer, Richland Operations Office, direct Fluor Daniel to:

1. Review each facility and its related property units in the property records and write down those units which are primarily used for the treatment, storage, or disposal of legacy waste; and,

2. Identify the facilities previously written down that are not primarily involved with the treatment, storage, or disposal of legacy waste and reverse the accounting entries.

Management Comments

Management concurred with our recommendations and plans to complete corrective action by July 31, 1997.

Auditor Comments

Management's planned actions are responsive to the recommendations.

2. Asset Valuation

There are several accounting practices that the Department intends be used when valuing capital assets. One of those practices, found in the Department's Accounting Handbook, specifies that a capital lease shall be recorded at the lower of the property's fair value or the present value of the minimum lease payments. The accounting entry includes a nonfund debit to the Completed Property, Plant and Equipment Account and an offsetting nonfund credit to a liability account. Another practice is the use of the standard service lives found in Department of Energy Order 2200.6A, Attachment VI-1, for determining the depreciation of Department-owned capital assets.

Capital Lease

Westinghouse had not properly valued an asset acquired through a capital lease. Our prior audit report (Report on Matters Identified at the Richland Operations Office During the Audit of the Department's Consolidated Statement of Financial Position as of September 30, 1995, Report No. WR-FS-96-01, March 18, 1996), disclosed that Westinghouse had acquired an integrated voice/data telecommunications system through a lease-to-own agreement but had not capitalized the system. The report recommended that the system be capitalized. Although Westinghouse capitalized this system in Fiscal Year 1996, it determined neither the property's fair value nor the present value of the minimum lease payments. Instead, Westinghouse relied upon information provided by the lessor to determine the asset value. By not properly capitalizing the system, Westinghouse understated its Completed Property, Plant and Equipment Account by $1,312,225.

Our review also determined that when Battelle paid its share of the lease liability ahead of schedule, Westinghouse did not prepare an adjusted amortization schedule that would show the reduced amount of monthly payments to be made in the future. By not adjusting the liability amount for the prepayment, the Unfunded Liability Account was in error by an undetermined amount.

Service Lives

Westinghouse did not consistently use the Department's standard service lives for depreciating capital assets. Our review of 18 property unit additions disclosed two assets with service lives different from the Department's standard service lives. The two assets with nonstandard service lives were part of Subaccount 902501 (Buildings) where we identified an additional 17 assets (for a total of 19 assets) that had different service lives than those established by the Department. Nonstandard service lives were used because Westinghouse's Construction and Property Accounting used an outdated list to determine service lives for some assets. For most assets, Westinghouse correctly used a list of the Department's standard service lives from DOE Order 2200.6A. For some assets, however, Westinghouse used a list of service lives developed in February 1963 that differs from the current standard service lives. As a result of using improper service lives to compute depreciation on assets, the Accumulated Depreciation Account contained errors.

Recommendations

We recommend that the Chief Financial Officer, Richland Operations Office, direct Fluor Daniel to:

Determine the proper value of the Telecommunications System as of the beginning of the lease period. This should be the lower of either the fair value of the system or the present value of the minimum lease payments;

Adjust the Completed Property, Plant and Equipment; Accumulated Depreciation; and Unfunded Liabilities accounts to reflect the proper value of the lease. Additionally, Fluor Daniel should reduce the unfunded liability by the amount of the principal portion of the lease payments to date;

Determine the effect of Battelle's early payment on the Unfunded Liabilities Account and the lease payments and adjust them accordingly; and,

Review the recorded service lives of all capital assets and ensure that they are consistent with the Department's established service lives.

Management Comments

Management concurred with all four recommendations. Richland will direct Fluor Daniel to perform a complete review to determine the proper asset value for the telecommunications system. The review should also address validation of principal and interest to date and the effects of the early payment by Battelle. Richland will record any necessary changes to the associated accounting records. These actions are scheduled to be completed by the end of June 1997.

Richland will also direct Fluor Daniel to perform a complete review of capital assets under their responsibility to ensure that all service lives are based on the Department's standard service lives. Planned completion of this review is also the end of June 1997.

Auditor Comments

Management's planned actions are responsive to the recommendations.

Battelle-Pacific Northwest National Laboratory

Battelle's contract requires Department approval for any salary in excess of the maximum for an established salary range. If excess salary is paid without Department approval, the excess amount is potentially an unallowable cost. Additionally, Battelle's internal policies and procedures establish certain requirements for reporting and processing payroll. For nonexempt staff, Battelle's policy requires that each employee submit a timecard in order to receive payment for that time period.

A review by Battelle's Internal Audit of all Battelle part-time employees' rates of pay revealed that 8 part-time employees had hourly rates that, if multiplied by 40 hours a week, exceeded the maximum full-time salaries for their respective job codes. These excess amounts ranged from $12.65 ($40.00 minus the established rate of $27.35) to $0.47 ($14.05 minus $13.58). As of August 23, 1996, these excess salaries resulted in potential unallowable costs of $34,900.

Battelle's Internal Audit also determined that employees were not always submitting timecards in a timely manner. As of August 23, 1996, Internal Audit found 58 instances where timecards had not been submitted. Twenty-seven of these delinquent timecards involved time periods greater than a month, with two going back to January 1996. Without the timecards, Battelle has no assurance the employees actually worked. If there is no timecard, Battelle inputs default hours. Because Battelle is not recording actual time worked for the delinquent timecards, there could be effects on individual projects if the actual hours differ from the default hours. To correct the problem, Battelle proposed to initiate a time card follow-up procedure to inform supervisors of missing time cards. Battelle also planned changes to its information system which would allow supervisors to review the status of staff time cards.

Recommendations

We recommend that the Chief Financial Officer, Richland Operations Office:

Determine the total payroll costs that exceeded the contract limits and direct Battelle to reimburse the Department for unallowable amounts; and,

Monitor Battelle to ensure its proposed corrective actions regarding time cards are taken.

Management Comments

Management concurred with the recommendations. By June 1997, Richland planned to determine the allowability of the excess salary costs and verify that Battelle is receiving timecards in a timely manner.

Auditor Comments

Management's planned actions are responsive to the recommendations.

OTHER MATTERS

Conditions similar to those raised in the Legacy Waste Related Assets finding were identified at other locations included in the overall audit. These conditions, therefore, were addressed in the audit report on the Department's Consolidated Fiscal Year 1996 Financial Statements (audit Report No. IG-FS-97-01).

IG Report No. WR-FS-97-04

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