OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-18-40 July 2018

MANAGEMENT LETTER ON THE AUDIT OF THE DEPARTMENT OF ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 2017

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

June 20, 2018

Ms. April Stephenson
Acting Inspector General
U.S. Department of Energy
1000 Independence Ave, S.W.
Washington, DC 20585

Ms. Stephenson:

In planning and performing our audit of the consolidated financial statements of the United States Department of Energy (Department) as of and for the year ended September 30, 2017, 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 the Office of Management and Budget Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, we considered the Department's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and/or significant deficiencies and therefore, material weaknesses and/or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a significant deficiency.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. The significant deficiency described below is not considered to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We identified a deficiency in internal control related to internal controls over identifying and recording environmental liabilities accurately, completely, and timely that we consider a significant deficiency, and communicated this in writing in our audit report. The findings that led to the significant deficiency are included in Exhibit A as findings 1 through 4.

Although not considered to be significant deficiencies or material weaknesses, we also noted items during our audit which we would like to bring to your attention in Exhibit A as findings 5 through 12. We have also presented the status of prior year findings in Exhibit B. These findings and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. We issued a separate management letter addressing information technology control deficiencies.

The Department's responses to the deficiencies identified in our audit are included in Exhibit A. The Department's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

This communication is intended solely for the information and use of the OIG and management and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Management Letter

Index to Exhibits

OPEN FINDINGS – INTERNAL CONTROLS AND OTHER OPERATIONAL MATTERS *(with parenthetical references to findings and recommendations issued during the engagement)* **Exhibit A**

OPEN FINDINGS – INTERNAL CONTROLS AND OTHER OPERATIONAL MATTERS

<u>Environmental Liabilities for Environmental Management</u>

Background: The Office of Environmental Management's (EM) liability includes estimates for the cleanup of contaminated soil, groundwater, and facilities; the treatment, storage, and disposal of wastes; and the management of nuclear materials generated by the nuclear weapons complex during the Manhattan Project and the Cold War.

Finding 1: Understatement of Contingency (**17-ID-EL-01**)

The Idaho Operations Office did not have adequate controls in place in fiscal year (FY) 2017 to document the completeness and accuracy of all applicable risks relating to the calcine project. In FY 2017, the Idaho Operations Office revised the baseline estimate and contingency for treating calcine waste based on the project manager's analysis of the project. While the Idaho Operations Office did include additional cost in the liability for mock-up, pre-planning, and testing of Hot Isostatic Pressing (HIP) technology, it did not include any specific risks related to sufficient design and technology maturity in the risk register. However, additional risks were added for general storage risks associated with potential problems related to the project because the additional costs added to the liability were to mitigate risk. The addition of the estimated cost did not eliminate all uncertainty related to design and the possible difficulties with the HIP technology that the Department has not utilized but is a proven technology in commercial settings.

During the preparation of the FY 2017 baseline estimates, there were differing technical opinions as to the risks of the calcine project. The Idaho Operations Office did not adequately document a comprehensive assessment to ensure all applicable risks for the calcine project were included in the calculation of the contingency estimate. As a result of excluding contingency for design and technology for the calcine project, the Idaho Operations Office environmental liability was understated by $564 million as of September 30, 2017, prior to an adjustment to correct the balance.

Recommendation:

1. We recommend that the Manager, Idaho Operations Office, direct the Deputy Manager for the Idaho Cleanup Project to:

   A. Strengthen/enhance policies and procedures to identify potential risks or uncertainty that are not addressed by the assumptions included in the baseline estimates; and

   B. Ensure the risks are appropriately documented and reviewed to include all risks related to the baseline estimates.

Management Response:

Management concurs with the recommendation. As noted to the auditors, the Idaho Operations Office did follow an established process for assessing risks on the calcine, but this did not result in a fully defensible and documented conclusion. The Deputy Manager for the Idaho Cleanup Project accepts the recommendations and commits to the following actions:

- The Department will conduct a causal analysis to determine how risk changes were made and to better understand the differing technical opinions. This action will be completed by January 25, 2018.

- Based on the results of the analysis, the Idaho Operations Office will review its risk management process and procedures and strengthen and enhance these policies and procedures as necessary. This action will be completed by February 28, 2018.

- The Department will then perform its annual risk review of all baseline risks prior to its FY 2018 booking of the environmental liability, and will document any changes in risks with the associated basis for the change.

Finding 2: Environmental Management Liability Preparation Errors (**17-SR-EL-01**)

The Savannah River Operations Office did not have adequate controls in place during the FY 2016 and FY 2017 audits related to the recording of the EM liability estimate. During FY 2017, the Savannah River Operations Office identified two errors in the EM liability recorded as of September 30, 2016. Specifically, the Savannah River Operations Office used the incorrect rate to de-escalate the liability for one project from current dollars (i.e., escalated dollars) to constant dollars (i.e., de-escalated dollars); and double counted the estimate related to the operations scope of four capital projects with the 4th quarter FY 2016 environmental liability adjustments. However, the FY 2016 change proposals approved in March 2017 corrected the double count for three of the capital asset projects. Thus, one of the future capital projects in operations scope remained overestimated and was therefore included in the liability recorded as of June 30, 2017. In addition, during our review of the June 30, 2017, EM liability, we found that the liability as of June 30, 2017, excluded work scope that should have been included in the estimate.

We determined that this error occurred, in part, due to inadequate time for proper transitioning of the responsibilities of managing the EM liability to new personnel. Specifically, the errors in the liability recorded as of September 30, 2016, and June 30, 2017, occurred because the individual responsible for managing the Savannah River Site's environmental liability did not fully understand the role and responsibilities of the position. More specifically, the individual did not have adequate knowledge of the system and calculations used to accurately record the EM liability.

Additionally, in accordance with Principle 7.01 and 10.01 of the Green Book, the Savannah River Operations Office does not have controls in place to prevent or detect and correct misstatements in the environmental liability.

We determined that for the two errors in the EM liability recorded as of September 30, 2016, resulted in a net overstatement of $5 million from the two errors. The two errors in the EM liability recorded as of June 30, 2017, resulted in a net overstatement of $25 million.

Recommendation:

2. We recommend that the Manager, Savannah River Operations Office:

   A. Develop and implement a strategy to ensure adequate transition of the Environmental Liability function to other personnel to include training and cross training; and

   B. Implement controls that are designed and implemented to prevent or detect and correct errors in the environmental liability.

Management Response:

Management concurs with the recommendation. The Savannah River Operations Office will perform the following:

- Develop a required annual reading and training list (including Environmental Management Standard Operating Process and Procedure 35 – DOE Annual Environmental Liability Estimate, Savannah River Implementation Procedure 400, Chapter 413.3 Rev 1 – Savannah River Site Environmental Liability Estimate, Headquarters Environmental Management Environmental Liability (EMEL) annual training presentation and desktop guide and Savannah River Site desk-top user's guide for EMEL) to be signed and dated when read by the Integrated Lifecycle Estimate (ILCE)/EMEL personnel (lead and backup).

- The ILCE/EMEL personnel will attend the annual Headquarters EMEL teleconference training, and will develop familiarity with the Integrated Planning, Accounting, and Budgeting System (IPABS) - data entry and report generation - to acquire IPABS system ADMIN authorization.

- Attend any complex-wide conference on EMEL best practices and lessons learned.

- Designate backup personnel to shadow and be cross trained on the EMEL responsibilities and process for one year. Demonstrate how the ILCE information is represented for IPABS data entry and the Environmental Liability Note 3.

- Develop an EMEL desktop user's guide describing required source information and to document control of finalized reports to ensure accurate and verifiable data used for the EMEL Note 3 entries and associated EMEL IPABS reporting. This will include a section in the user's guide that describes/clarifies how the ILCE information is represented in the Environmental Liability. Also, the Savannah River Operations Office will add a section on how to track and manage the EMEL audit review requests for information and Provided by Client questions/responses.

- In addition to the EMEL desktop user's guide, a verification checklist will be utilized and will include a column for the *Description* of each reference data source item used; a column for *Date Verification Completed* - verifying that source information is final, accurate and complete; and a column *Initialed By* for the person who verified completion of the checklist item.

- The Savannah River Operations Office will work with DOE-IPABS to incorporate an extra verification step in the EMEL data entry process by adding a request validation for any changes to the escalation rates. Specifically, the Savannah River Operations Office will recommend the addition of a system control edit/validation check in the IPABS change request module to reduce the risk of errors during site field entry of the EMEL adjustments to capture the impacts the escalation rate changes, if any, before the EMEL adjustments are submitted.

- The Savannah River Operations Office will develop an interim report for the ILCE Cost Profile that will identify each Capital Project and provide an operations component for a one to one correspondence with the IPABS reporting structure at the sub-sub project level.

Finding 3: Repository Opening Date Assumption (**17-HQ-EL-01**)

EM and the Office of Standard Contract Management had not established policies and procedures for effective communication of key assumptions between offices within the Department relating to the opening of a geological repository. Specifically, in FY 2017, EM assumed that there had been no change in the assumption of the opening of the geological repository. As such, EM used an outdated assumption for the opening date of the geological repository for the liability estimate. However, the Office of Standard Contract Management had determined a new opening date for the geological repository and used the new date for the calculation of the SNF litigation liability. Therefore, EM should have used the updated opening date of the geological repository for the environmental liability estimates.

The previous Administration closed the Department's Office of Civilian Radioactive Waste Management (OCRWM). OCRWM was designated by the *Nuclear Waste Policy Act of 1982* to carry out radioactive waste disposal activities (i.e. Yucca Mountain), including coordinating with other Department offices on the projected opening date of the repository. In the absence of OCRWM, EM did not ask and the Office of Standard Contract Management did not inform EM of the revised assumption in the opening date of Yucca Mountain. Therefore, EM used the assumption based on the previous Administration's policy as the basis for the EM liability.

As of September 30, 2017, the environmental liability was overstated by $1.1 billion prior to an adjustment to correct the balance.

Recommendation:

3. We recommend that the Acting Director for EM's Office of Program Planning coordinate with the Director, Office of Standard Contract Management, to develop procedures for adequate coordination between offices to ensure consistency in the assumptions used for the opening date of Yucca Mountain.

Management Response:

Management concurs with the recommendation. EM Headquarters will develop procedures to ensure adequate coordination with the Office of Standard Contract Management to ensure that the EM assumption regarding the assumed opening date for a repository are consistent with those of the Office of the General Counsel. These procedures will be implemented by June 30, 2018. Additionally, the Office of Standard Contract Management will develop procedures to ensure the assumptions regarding the assumed opening date for a repository are communicated to the Office of Environmental Management. These procedures will be in implemented by June 30, 2018.

Finding 4: Energy Technology Engineering Center and Separations Process Research Unit Prior Period Errors (**17-EMCBC-EL-01)**

The Environmental Management Consolidated Business Center (EMCBC) did not have adequate controls in place during the prior year's FY 2016 audit related to the review and preparation of the environmental management liability estimate. During EMCBC's preparation and review of the Energy Technology Engineering Center (ETEC) and Separations Process Research Unit (SPRU) estimates for the FY 2017 Consolidated Financial Statement Audit, EMCBC identified errors in the ETEC and SPRU environmental management liability estimates recorded as of September 30, 2016. Specifically, a draft Environmental Impact Study (EIS) was completed in August 2016 for ETEC. Excluding the No Action Alternative, the draft EIS identified three alternatives with a life cycle cost range from $124 million to $468 million. The draft EIS was released in January 2017; however, EMCBC had knowledge of the EIS in FY 2016. In FY2016, EMCBC did not update the ETEC liability for the draft EIS. In addition, SPRU originally developed its estimate based upon direction that costs associated with characterization, packaging, and certification of transuranic waste would be included in the work scope for the Waste Isolation Pilot Plant (WIPP). However, in 2015, SPRU identified that this waste would require additional characterization and packaging at another Department site before final disposition at WIPP. The costs associated with the additional characterization and packaging of this waste was not included in the environmental liability.

During the preparation of the FY 2016 environmental liability estimate, EMCBC did not perform a thorough analysis of changes in assumptions and estimates related to the most current available information associated with SPRU and ETEC. We determined that the ETEC environmental management liability estimate was understated by approximately $176 million as of September 30, 2016. Additionally, we determined that the SPRU environmental management liability estimate was understated by $66 million as of September 30, 2016.

Recommendation:

4. We recommend that the Manager, EMCBC, revise EMCBC's policies and procedures to review assumptions and newly available estimates each year for potential changes that could impact the liability.

Management Response:

Management concurs with the recommendation. EMCBC will institute a comprehensive and collaborative environmental liability review process for its field operations by June 30, 2018.

Environmental Liabilities for Active Facilities

Background: The Department's liability for remediation of active facilities includes anticipated remediation costs for active and surplus facilities managed by the Department's ongoing program operations, which will ultimately require stabilization, deactivation, and decommissioning. The estimated costs are largely based on a cost-estimating model, which extrapolates remediation costs from facilities included in EM's baseline estimates to those active and surplus facilities with similar characteristics. The Department's methodology for calculating an environmental liability estimate for active facilities relies on a web-based system managed by the Headquarters Office of the Chief Financial Officer. This system, known as the Active Facilities Data Collection System (AFDCS), relies on field site personnel to input an appropriate cost model code and facility size, which is used to calculate an estimated liability for each facility. Field site personnel review and make necessary revisions to the facility data each year before certifying the data in AFDCS. A limited number of sites use other appropriate cost-modeled estimates or site-specific estimates.

Finding 5: Inaccuracies in the Fiscal Year 2016 Active Facilities Liability (**17-NNL-A-01**)

During FY 2015, the Facilities Information Management System (FIMS) lead at the Naval Reactors Facility, one of the sites that comprise the Naval Nuclear Laboratory (NNL), identified inconsistencies in square footage for a number of facilities at the site. As a result, the site undertook a re-baselining effort to ensure that the square footage in FIMS for all facilities at the site was correct. This process started in FY 2015 but the updates to FIMS were not fully validated and approved for addition to the FIMS database until FY 2016. Per the methodology used for NNL, if updates are made to FIMS which result in a change to an asset's square footage value of more than +/- 10 percent and at least 1,500 square feet, then the revised FIMS information may be used in the estimate rather than the data taken from the FIMS Snapshot.

As part of our review of the Environmental Liabilities, we selected a sample of 31 facilities and structures from NNL's facilities' population for its four sites as of June 30, 2017. The explanation provided for significant changes in three facilities at the Naval Reactors Facility were adjustments to the square footage inputs. Two of the facilities (#96970 and #96972) met the thresholds for updates based on methodology used for NNL. The third building (#96969) represented a $141 million change; however, the change in square footage did not meet the thresholds set by methodology used for NNL.

In FY 2015, the Naval Reactors Facility identified that the square footage was inconsistent with the source documentation they were relying on to develop the liability. The methodology used for NNL is the FIMS Historical Snapshot, with FY 2015 data as a starting point to develop the liability for FY 2016. However, based on Generally Accepted Accounting Principles, the liability should have been updated when the site determined that the square footage change resulted in a significant change to the liability.

Based on the increase in scope and uncertainty for each of these facilities, the Environmental Liability estimate was understated by approximately $131 million as of September 30, 2016. Based on this calculation, the overall Naval Reactor Laboratory Field Office (NRLFO) estimate was understated by approximately 1.8 percent. We noted that as of September 30, 2017, these updates had been made and that there is no understatement related to these facilities in the FY 2017 Environmental Liability estimate at NRLFO.

Recommendation:

5. We recommend the Manager, Naval Reactors Laboratory Field Office, direct appropriate personnel to clarify the methodology used for Naval Nuclear Laboratory to ensure that revised FIMS information is used for any significant change in square footage once it becomes known.

Management Response:

Management does not concur. NRLFO agrees with the condition as described above. However, NRLFO does not agree with the conclusion of the cause, which states “based on Generally Accepted Accounting Principles, the liability should have been updated when the site determined that the square footage change resulted in a significant change to the liability,” and therefore does not consider there is a basis for the finding.

Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment*, provides additional guidance on the recognition of cleanup costs due to the nature of the liability and the timing associated with cleanup costs. Specifically, section 96 of Statement of Federal Financial Accounting Standards No. 6 states that “new cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.” While the square footage changes for facilities #96970 and #96972 were above the threshold in the methodology used to create NRLFO’s liability estimate, the resulting impacts to the value of the liability were minimal; $69 million for #96970 and $62 million for #96972 representing 0.9% and 0.8%, respectively, of the overall estimate. Neither change, either individually or in aggregate, is material given the overall value of the liability ($7.4 billion) nor the nature of the liability. In addition, the updates were accounted for in the FY 2017 liability estimate.

NRLFO also disagrees with the recommendation to “ensure that revised FIMS information is used for any significant change in square footage once it becomes known.” A significant change in square footage for a facility does not necessarily indicate a significant change to the liability. For example, category F facilities have a $0 value in the estimate, and so updating the liability estimate immediately to account for a change to square footage would have no effect.

Generally Accepted Government Auditing Standards (GAGAS) sections 4.10 and 5.20 provide the definition of a finding for financial and attestation engagements, respectively. Both definitions are consistent in that a finding is a significant deficiency and material weakness in internal controls or noncompliance with provisions of laws or regulations that have a material effect on the subject matter. GAGAS A.06 provides examples of control deficiencies; applicable examples include “control systems that did not prevent, or detect and correct material misstatements so that it was necessary to restate previously issued financial statements” and “control systems that did not prevent, or detect and correct material misstatements identified by the auditor.” NRLFO does not consider there is any noncompliance with Generally Accepted Accounting Principles nor a significant internal control deficiency as there was no material misstatement.

Auditor’s Comment:

We appreciate NRLFO management’s agreement with the condition described in the finding. However, we noted that NRLFO did not concur that the change in the liability estimate resulted in an error large enough to merit a finding. GAGAS section 4.10 states that “In a financial audit, findings may involve deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, or grant agreements; fraud; or abuse.” We maintain that not adjusting the liability estimate in a timely manner to update the square footage is a deficiency in internal control over the financial process and believe our recommendation to NRLFO management is still relevant. Furthermore, NRLFO management acknowledged that the change in square footage was known in February 2016 and that a decision was made to not update the liability until FY 2017, as the change to the liability was not significant enough to warrant an immediate change. We believe that the internal control process could have been enhanced had management documented its consideration of the potential changes to the liability and conclusions as to when the liability estimate should be updated.

Budget:

Finding 6: Inadequate Review of Stale Undelivered Orders (**17-SR-B-01**)

During our walkthrough review for stale undelivered orders (UDO), we identified an internal control deficiency related to the timeliness review of stale UDOs. Our review of the April 2017 stale UDO report discovered there was a UDO listed that was not reviewed and updated within the quarter. Specifically, we noted the status of Purchase Order (PO) #M5Z0889 had not been updated since June 2015 and was not properly reviewed after more than six months of inactivity, as required per the Obligation Reconciliation and 2108 certification Standard Operating Procedure distributed by the Department. The last date of activity for PO# M5Z0889 was April 21, 2016.

The Savannah River Operations Office has not established adequate policies and procedures for assignment of responsibilities in the absence of the Savannah River Operations Office Budget Director for review of stale UDO analyses obtained from the budget analysts. Specifically, there was a period of time when the Savannah River Operations Office Budget Director position was vacant and no one reviewed the work performed by the budget analysts. Additionally, the responsible budget analyst that should have reviewed and provided a status update of the UDO was new and did not possess the adequate knowledge related to the process and the systems.

The UDO balance could be misstated. Not following up on UDOs in a timely manner could result in untimely UDO close-outs, thereby affecting the UDO balance recorded in the Department's consolidated financial statements.

Recommendation:

6. We recommend that the Manager, Savannah River Operations Office, direct the Chief Financial Officer, Savannah River Operations Office, to:

   A. Establish policies and procedures to ensure that the assignment of controls for review of stale UDOs is performed in the absence of key personnel, including the Budget Director; and

   B. Provide sufficient training to individuals responsible for the processing and review of stale UDOs.

Management Response:

Management partially concurs with comments related to the recommendation to establish policies and procedures to ensure the assignment of controls is performed in the absence of key personnel. The Savannah River Operations Office notes that a higher-level review of the stale UDO did take place, the exception was noted, and the correction was made prior to KPMG testing. Based on the timing of the correction, the Savannah River Operations Office believes this should be categorized as an 'exception' by KPMG rather than a finding because a single exception does not rise to the level of a finding or a control deficiency.

Therefore, the Savannah River Operations Office concurs with the recommendation and non-concurs with the categorization of this issue as a "finding," but concurs there is a single "exception." The Savannah River Operations Office notes that an attempt to deobligate funding on the PO was made in December 2016, but the incorrect financial system was used, which delayed the deobligation from occurring. The exception was corrected by the Savannah River Operations Office in May 2017 prior to being tested by KPMG. Also, the Savannah River Operations Office notes that the new Office of Management and Budget A-123 guidance incorporates Enterprise Risk Management and a "Risk Based Approach" to internal controls. A checklist will be developed and incorporated into local procedures to ensure guidance is provided regarding control accountability and responsibility for the review of stale UDOs. The estimated completion date is January 31, 2018.

Management concurs with recommendation related to providing sufficient training; however, this action is already completed. No additional action required for this recommendation.

Finding 7: Inadequate Review of General Ledger to Purchase Order Reconciliation Report **(17-SR-B-02)**

During our roll-forward walkthrough review for the General Ledger to Purchase Order reconciliation, we identified an internal control deficiency related to the inadequate review of the General Ledger to Purchase Order reconciliation report. Our review of the September 2017 General Ledger to Purchase Order reconciliation report and the fourth quarter 2108 Checklist identified an error in the reconciliation of the General Ledger to Purchase Order that was not identified by management before the preparation and submission of the fourth quarter 2108 Checklist.

The Savannah River Operations Office had not established adequate policies and procedures for reviewing the General Ledger to Purchase Order reconciliations before submitting the data in the quarterly 2108 Checklist. The General Ledger to Purchase Order reconciliation was generated from the Department's Standard Accounting and Reporting System's Business Intelligence system on October 3, 2017, prior to the completion of year-end activities. As a result, a second General Ledger to Purchase Order reconciliation was generated from the Department's Standard Accounting and Reporting System's Business Intelligence system on October 10, 2017. However, the review of the 2108 Checklist performed by the Savannah River Operations Office Finance Director and Chief Financial Officer did not identify that the reconciliation included was incorrect, which was based on the October 3, 2017 reconciliation, and did not display the most accurate information as of the October 10, 2017 reconciliation prior to submission.

The General Ledger to Purchase Order reconciliation was misstated on the quarterly 2108 Checklist. Misstated data on the quarterly 2108 Checklist affects the validity of the Field Chief Financial Officer's analysis of the 2108 report which is identified by management as a key internal control in support of the Department's financial statement reporting process. This internal control is designed to ensure that the Department's budgetary obligations and resources are properly reported.

Recommendation:

7. We recommend that the Manager, Savannah River Operations Office, direct the Chief Financial Officer, Savannah River Operations Office to:

   A. Establish policies and procedures to ensure that a proper review of the General Ledger to Purchase Order reconciliation is performed each month to include the most recent available data and that a proper review of the 2108 Checklist is performed each quarter; and

   B. Provide sufficient training on all applicable guidance and requirements to individuals performing the General Ledger to Purchase Order reconciliation.

Management Response:

Management concurs with the recommendation. The Savannah River Operations Office will develop a Quality Review Checklist to include the review of the General Ledger to Purchase Order Reconciliation. Additionally, the Savannah River Operations Office has already completed sufficient training on all applicable guidance to individuals performing the General Ledger to Purchase Order Reconciliation.

<u>Procurement</u>

Finding 8: Timely Performance of Account Reconciliations (**17-ANL-D-01**)

Argonne National Laboratory (ANL) was unable to complete all monthly general ledger account reconciliations between April 2017 and July 2017. Furthermore, the balance on the August 2017 Accounts Payable reconciliation was not reconciled to the balance in the Department's Standard Accounting and Reporting System (STARS). As a result, KPMG LLP was unable to select a statistical sample of Accounts Payable balances as of June 30, 2017 or August 31, 2017. ANL was unable to demonstrate that sufficient controls were in place to support the monthly certification of its Trial Balance during this period.

ANL implemented a new financial management system, Workday Financials (Workday), in April 2017. Because resources were prioritized toward the completion of year-end activities, ANL officials commented that they did not have time to complete all necessary monthly general ledger account reconciliations from April 2017 through July 2017. In addition, policies and procedures were not sufficient related to effectively reconciling Workday accounts to STARS (specifically the August 2017 Accounts Payable reconciliation).

Accounts Payable (recorded balance of $67 million at June 30, 2017) and other material account balances may be misstated due to unreconciled differences between the ANL general ledger balances and STARS.

Recommendation:

8. We recommend that the Manager, Argonne Site Office, direct Argonne National Laboratory to update and expand policies and procedures to ensure that all account reconciliations, both internal within Workday as well as between Workday and STARS, are performed and reviewed in a timely manner to support the preparation of accurate financial statements and provide necessary supporting documentation in response to audit requests.

Management Response:

The Office of Inspector General was informed that ANL was implementing a new financial system, Workday, before site selections were made. After ANL was selected for audit, the Argonne Site office requested the Office of Inspector General bypass ANL in FY 2017, understanding that the time and focus on bringing up the new system could impact ANL's ability to provide material in a timely manner. The Office of Inspector General informed the Argonne Site Office that unless ANL was audited as selected, a qualified audit opinion on the Department's financial statements would result.

The Argonne Site Office concurs with the recommendation to direct ANL to update and expand policies and procedures to ensure that all account reconciliations, both internal within Workday as well as between Workday and STARS, are performed and reviewed in a timely manner to support the preparation of accurate financial statements and provide necessary supporting documentation in response to audit requests.

Although ANL's policies and procedures require the preparation of reconciliations within its internal financial system, these reconciliations have not been performed timely since the change to Workday. Despite the resource constraints imposed by the new system implementation and to ANL's credit, the majority of these reconciliations (within Workday) had been completed timely for the fiscal year end. The Argonne Site Office will direct ANL to complete the remainder of the reconciliations within Workday by December 31, 2017.

In addition, regarding the reconciliations between Workday and STARS, the Argonne Site Office will direct ANL to:

- Update their policies and procedures to require reconciliations between Workday and STARS to be completed within 15 working days after the close of each month;
- Provide monthly Workday balances in a format conducive for comparison with STARS; and
- Reconcile and resolve monthly any differences between Workday and STARS.

The reconciliation of differences between Workday and STARS (April 2017 to December 2017) should be completed by January 31, 2018. The reconciliation of differences pre-Workday to STARS is more involved and should be completed by August 31, 2018.

Finding 9: Improper Accrual for Prepaid Assets (**17-LANL-D-01**)

During our interim statistical sample test work over accounts payable, we identified two misstatements in the financial records as a result of recording accruals and prepaid assets for unpaid invoices for future services at June 30, 2017. As the invoices were unpaid and related to future services beyond June 30, 2017, accruals and prepaid assets were overstated as of June 30, 2017.

Management did not have a process in place to review prepaid assets at period-end to ensure that accruals for unpaid invoices associated with future services are adjusted to remove the resulting gross up of prepaid assets and accounts payable. We determined that prepaid assets and accounts payable were overstated by $137,024.12.

Recommendation:

9. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Manager, Los Alamos Site Office, direct Los Alamos National Laboratory to ensure policies or procedures are established to properly record prepaid assets and accounts payable based on consideration of when the invoice is paid and the services/goods are to be received.

Management Response:

Management concurs with the recommendation. The National Nuclear Security Administration (NNSA) will direct Los Alamos National Laboratory (LANL) to ensure that by December 22, 2017, policies or procedures are established to properly record prepaid assets and accounts payable based on consideration of when the invoice is paid and the services/goods will be received. LANL has already begun implementing the corrective action plan by adding a specific review of accounts payable to the month-end close checklist. LANL will review all new and previously identified unpaid invoices in the pre-paid asset account for payment status. Invoices that will remain unpaid at the time of close will be removed from the pre-paid asset account and re-allocated to a holding account. The invoices identified are placed in the pre-paid asset account after payment has been issued.

Property, Plant, and Equipment (PP&E)

Finding 10: Property, Plant and Equipment Untimely Abandonment **(17-LANL-F-01)**

During our substantive test work over construction work in progress (CWIP), we identified project costs of $362,100,789 that were determined to provide no future benefit by LANL in FY 2016. Congress terminated project funding for one of the three project phases in early FY 2016. LANL's final proposed adjustment to write-off the costs was submitted to NNSA's Los Alamos Field Office in September 2016. However, the cognizant LANL contracting officer retired in October 2016. However, the cognizant LANL contracting officer retired in October 2016 and there was no audit evidence provided to us that demonstrated a transition of responsibility for the required review and approval of this transaction by the successor contracting officer, who started in March 2017. Based upon the approval of the program's successor contracting officer on April 18, 2017, the project costs, as proposed by LANL, were then approved for removal by the NNSA Los Alamos Field Office and recorded in May 2017. LANL did not notify the NNSA Field Chief Financial Officer for approval prior to recording the write-off of project costs.

We determined that this error occurred because effective monitoring of proposed accounting adjustments that require review and approvals was not conducted by the contracting officer for the program and the NNSA Field Chief Financial Officer. We determined that FY 2017 costs were overstated by $362,100,788.82. In addition, FY 2016 costs were understated and CWIP was overstated by the same amount.

Recommendation:

10. We recommend that the NNSA's Field Chief Financial Officer, in conjunction with the Manager, Los Alamos Site Office, direct LANL to develop policies and procedures to monitor proposed accounting adjustments that are unusual and or infrequent, such as for abandoned costs. This may include appropriate training on procedures for transitioning internal control operators to reduce the risk that accounting transactions are not reviewed and approved for recording in a timely manner.

Management Response:

Management does not concur. LANL and NNSA management disagree that the Chemistry and Metallurgy Research Building Replacement Abandoned Project was not written off in a timely manner. Abandonments of this size ($362 million) are not common and require complex analysis. The Contracting Officer's approval is required before the accounting write-off of the project.

The Contracting Officer's approval of the write-off was a formal contract decision based on programmatic considerations. The cited Green Book principle states in its first sentence: "Management should design control activities to achieve objectives and respond to risks." There is no evidence the time taken by the Contracting Officer to issue a formal contract decision impaired any programmatic objective or could be viewed as a failure to perform duties in the most prudent way to meet organizational objectives and respond to a risk.

The Federal Accounting Standards Advisory Board Technical Release 14, Implementation Guidance on the Accounting for the Disposal of General Property Plant, and Equipment, paragraph 10, states that "Two business events are necessary for the permanent removal from service: 1) asset's use is terminated; and 2) there is documented evidence of management's decision to permanently remove the asset from service. If only one of the two business events has occurred, permanent removal from service has not occurred and there is no change in the general PP&E reported value."

Accounting transactions are made to reflect operational management decisions and actions. Operational decisions are not made in order to accommodate accounting transactions.

Auditor Comments:

We maintain our recommendation as noted above. Management has not provided evidence that any substantive action was taken on this matter between September 2016 and late March 2017. The final determination was made on April 18, 2017 after LANL followed up with the NNSA Los Alamos Field Office on March 22, 2017. The delay was caused, at least in part, by the retirement of a contracting officer. Thus, it appears that with effective plans to transition the processes and controls of the retiring contracting official, the analysis could have been completed in advance of when the Department issued its FY 2016 financial statements. This would be expected by the guidance in The Green Book, Principle 10.3, which requires that transactions are promptly recorded.

Nuclear Materials

Finding 11: Capitalizing Stockpile Life Extension Program Costs in the Incorrect Accounting Period (**17-HQ-N-01**)

NNSA identified two sites, LANL and Sandia National Laboratories (SNL), which were not following the cost capitalization guidance for Stockpile Life Extension Program (SLEP) costs set forth in the NNSA Production Accounting Handbook. Instead of capitalizing the costs, LANL and SNL were expensing SLEP production costs.

We found that the issues identified occurred, in part, because LANL and SNL officials did not fully understand the requirements of the NNSA Production Accounting Handbook. Furthermore, NNSA's review of the SLEP cost data was not performed at a level of detail sufficient to identify that LANL and SNL were not following the NNSA Production Accounting Handbook. The relevant parties did not request and/or share pertinent information necessary to assess the propriety of SLEP cost capitalization.

Prior to correcting the amounts in FY 2017, LANL and SNL had not properly capitalized costs over the past 15 years, resulting in an understatement of the Department's nuclear materials inventory of approximately $871 million as of September 30, 2016. NNSA is in the process of completing its analysis of the errors made by LANL and SNL in recording and reporting its SLEP costs. The Department will be evaluating whether to record approximately $30 million of indirect costs associated with production after completion of the analysis in early FY 2018.

Recommendation:

11. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer:

    A. Direct nuclear materials accounting personnel at the NNSA Albuquerque Complex to implement internal controls designed with a sufficient level of precision to verify that Department field sites adhere to the NNSA Production Accounting Handbook for all significant accounts.

    B. In conjunction with the Chief Financial Officers at Stockpile Life Extension Program field sites, direct nuclear material field sites to implement policies and internal controls to ensure that Stockpile Life Extension Program cost data reported to the NNSA Albuquerque Complex and recorded in ABC Financials is properly following the NNSA Production Accounting Handbook with respect to cost capitalization.

Management Response:

The NNSA agrees with the conditions and cause but does not concur that this warrants a finding. NNSA initiated the review of the NNSA Production Accounting Handbook and self-discovered the cost capitalization issue. The recommendations noted are the actions that NNSA developed and were in progress prior to the KPMG LLP audit.

Auditor Comments:

We appreciate management's response to our finding. We believe that a finding is warranted given that the errors occurred over the last 15 years. NNSA initiated corrective incremental controls, but the controls were not finalized and fully implemented at the time of our review. We acknowledge that NNSA identified the error when it was in the process of updating the NNSA Production Accounting Handbook and has provided correcting adjustments. NNSA has represented to us that it will finalize the adjustments in FY 2018. NNSA also represented to us that it will provide stronger guidance to field sites and that additional controls will be implemented in FY 2018, including modifying the SLEP reconciliation.

As NNSA's corrective actions are still in progress and expected to be implemented in FY 2018, we will follow-up on this matter during the course of the Department of Energy's FY 2018 Consolidated Financial Statement Audit to verify that final corrections were made. We continue to emphasize the importance of controls that are designed and operate at a sufficient level of precision to verify that field sites adhere to the NNSA Production Accounting Handbook for all significant accounts on an ongoing basis. The incremental controls should also be designed and operate to prevent or detect errors on a timely basis.

<u>Payroll</u>

Finding 12: Improper Review of Self-Approved Timecards (**17-LANL-H-01)**

During our test work over the design and implementation of payroll controls, we discovered that the control in place to ensure that self-approved time cards were subsequently reviewed and approved by someone other than the employee submitting the timecard (a second reviewer) was not properly designed during FY 2017. Specifically, the review was not performed at regular intervals, nor were any intervals defined in policies and procedures. For example, the reviews for March 2017 time charges did not occur until July 2017. In addition, we identified evidence of a self-approved timecard from October 2016 that was not submitted for approval by a second reviewer until August 2017. We also found that when the control was performed, documentation was not always retained to support the operation of the control.

We determined that the issues identified occurred, in part, because there was a lack of policies that required evidence of the control's operation be retained and that the control be performed at regular intervals, including a definition of what management considers regular intervals. The absence of a properly designed and implemented monitoring control over the review of self-approved timecards could result in the payment of incorrect payroll expenses, the untimely identification of inaccurate program costs, and reporting resulting in costs ultimately being determined to be unallowable and required to be recovered.

Recommendation:

12. We recommend that the NNSA's Field Chief Financial Officer, in conjunction with the Manager, Los Alamos Site Office, direct LANL to ensure that policies and procedures for controls over the review of self-approved time cards is properly designed and implemented, and that the timing of the controls operation is set forth in the site's policies and procedures.

Management Response:

Management concurs with the recommendation. Although the manual internal control used by LANL to identify self-approved time cards was not performed at consistent intervals and evidence was not always retained for null results, all eight self-approved timecards identified throughout the audit period were corrected.

In October 2017, an automated and preventive control was implemented in the Oracle Time & Labor module to prevent employees from approving their own timecard. As this new automated control replaces the previous manual control, updating policies and procedures for the previous manual control will not be required.

STATUS OF PRIOR YEAR FINDINGS

Prior Year Findings Related to Internal Controls and Other Operational Matters *(with parenthetical references to findings)*

	Status at September 30, 2017
Environmental Liabilities	
1. Cost of Delay and Repository Delay Prior Period Errors (**16-HQ-EL-01**)	Closed in FY 2017
2. Error in Los Alamos's Long-Term Stewardship Estimate (**16-HQ-EL-02**)	Closed in FY 2017
Environmental Liabilities for Active Facilities	
3. Inaccuracies in the Active Facilities Liability (**16-LANL-A-01**)	Closed in FY 2017
4. Inaccuracies in the Active Facilities Liability (**16-INL-A-01**)	Closed in FY 2017
Fund Balance with Treasury	
5. Unreconciled Fund Balance with Treasury Accounts (**16-HQ-S-01**)	Closed in FY 2017
Procurement	
6. Inappropriate Classification of Fixed Assets (**16-SNL-D-01**)	Closed in FY 2017
7. Inaccurate Fiscal Year End Accrued Liability (**16-SNL-D-02**)	Closed in FY 2017
Property, Plant, and Equipment (PP&E)	
8. Inaccurate Disclosure of Future Operating Lease Payments (**16-NNSA-F-01**)	Closed in FY 2017
Nuclear Materials	
9. Lack of Readily Available Transaction Detail (**16-Y12-N-01**)	Open in FY 2017
Financial Reporting	
10. Reconciliation of Environmental Liabilities (**16-HQ-FR-01**)	Closed in FY 2017
11. Misclassification in Disposition of Custodial Revenue (**16-HQ-FR-02**)	Closed in FY 2017

REISSUED FINDINGS IN FY 2017

<u>Nuclear Materials</u>

Repeat Finding 1: Lack of Readily Available Transaction Details (**16-Y12-N-01**)

During FY 2016, we were unable to obtain from the Y-12 National Security Complex (Y-12) a transaction-level detail that reconciled to the inventory costs recorded in ABC Financials for Weapons Inventory Losses (Summary Class Code (SCC) 69) as of May 31 and September 30, 2016. Timing differences existed between the transaction-level detail available in Y-12's local nuclear materials control and accountability system and the amount that was recorded in ABC Financials. The current year activity in SCC 69 remains financially insignificant as of September 30, 2017.

Y-12 management began to implement corrective action during FY 2017. Specifically, Y-12 management drafted edits to standard operating procedures to require designated personnel to retain all transaction-level detail to support nuclear materials balances recorded in ABC Financials and to perform reconciliations to verify that the transaction-level detail agrees to the summary-level report of inventory activity for the month, which is used to record the weapons inventory losses in ABC Financials. We reviewed certain supporting documentation to indicate that Y-12 was performing these reconciliations on a monthly basis during FY 2017. However, as of September 30, 2017, the aforementioned proposed standard operating procedure edits remained in "draft" status until such time that Y-12 management performs its final review and codifies the document retention and ABC Financials reconciliation requirements. Y-12 management indicated that it intended to complete the final review of the draft standard operating procedure edits by December 31, 2017. As a result, this finding will remain open and be re-evaluated during the FY 2018 financial statement audit.

Recommendation:

13. We continue to recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the National Nuclear Security Administration's Production Office's Field Office Manager, direct Consolidated Nuclear Security to implement policies and procedures to ensure that:

    A. Adequate transaction level detail is retained for all balances recorded in ABC Financials; and

    B. Reconciliations of transaction level detail are performed to ensure that the inventory activity captured in ABC Financials is complete and accurate.

Management Response:

Management concurs with the recommendation. The NNSA Production Office will direct Consolidated Nuclear Security to implement policies and procedures to verify that adequate transaction level detail is retained for all balances recorded in ABC Financials; reconciliations of transaction level detail are performed to verify that the inventory activity captured in ABC Financials is complete and accurate; and Consolidated Nuclear Security completes its final review of the draft standard operating procedure edits by December 31, 2017.

ACRONYMS

AFDCS	Active Facilities Data Collection System
ANL	Argonne National Laboratory
CWIP	Construction Work in Progress
Department or DOE	Department of Energy
EIS	Environmental Impact Statement
EM	Office of Environmental Management
EMCBC	Environmental Management Consolidated Business Center
EMEL	Environmental Management Environmental Liability
ETEC	Energy Technology Engineering Center
FIMS	Facilities Information Management System
FY	Fiscal Year
GAGAS	Generally Accepted Government Auditing Standards
HIP	Hot Isostatic Pressing
HQ	Headquarters
ILCE	Integrated Life-Cycle Estimate
INL	Idaho National Laboratory
IPABS	Integrated Planning, Accounting, and Budgeting System
LANL	Los Alamos National Laboratory
NNL	Naval Nuclear Laboratory
NNSA	National Nuclear Security Administration
NRLFO	Naval Reactors Laboratory Field Office
OCRWM	Office of Civilian Radioactive Waste Management
PP&E	Property, Plant, and Equipment
SLEP	Stockpile Life Extension Program
SNL	Sandia National Laboratory
SPRU	Separations Process Research Unit
STARS	Standard Accounting and Reporting System
UDO	Undelivered Order
WIPP	Waste Isolation Pilot Plant