OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-19-15 February 2019

MANAGEMENT LETTER ON THE AUDIT OF THE DEPARTMENT OF ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 2018

Department of Energy
Washington, DC 20585

February 6, 2019

MEMORANDUM FOR THE ACTING CHIEF FINANCIAL OFFICER

FROM: Sarah B. Nelson
Assistant Inspector General
for Technology, Financial, and Analytics
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2018"

Pursuant to requirements established by the *Government Management Reform Act of 1994*, the Office of Inspector General engaged the independent public accounting firm of KPMG LLP to perform the audit of the Department of Energy's Fiscal Year 2018 Consolidated Financial Statements. During the audit, KPMG LLP considered the Department's internal controls over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on the consolidated financial statements.

During the course of the audit, KPMG LLP identified deficiencies in internal controls that are included in the attached management letter. Specifically, the attached letter contains 10 new findings and 15 recommendations that were issued during the Fiscal Year 2018 Audit of the Department of Energy's Consolidated Financial Statements. One prior year finding and recommendation was also re-issued. Management fully or partially concurred with all but two recommendations included in the management letter and had taken or planned to take corrective actions. Management did not concur with two findings and recommendations. Management's responses are included with each finding. The audit did not identify any deficiencies in internal controls over financial reporting that are considered material weaknesses.

I would like to thank all participating Department elements for their courtesy and cooperation during the review.

Attachments

cc: Deputy Secretary
Chief of Staff
Under Secretary of Energy
Under Secretary for Science

Administrator, National Nuclear Security Administration
Administrator, Energy Information Administration
Administrator, Western Area Power Administration

Report Number: DOE-OIG-19-15

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

MANAGEMENT LETTER

January 25, 2019

Ms. Teri Donaldson
Inspector General
U.S. Department of Energy
1000 Independence Ave, S.W.
Washington, DC

Dear Ms. Donaldson:

In planning and performing our audit of the financial statements of the United States Department of Energy (the Department) as of and for the year ended September 30, 2018, in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget Bulletin No. 19-01, *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. In accordance with *Government Auditing Standards*, we issued our report dated December 14, 2018 on our consideration of the Department's internal control over financial reporting.

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. During our audit, we identified deficiencies in internal control that are included in Exhibit A. We issued a separate management letter addressing information technology control deficiencies.

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

The purpose of this letter is solely to describe the deficiencies in internal control identified during our audit. Accordingly, this letter is not suitable for any other purpose.

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)*

MANAGEMENT LETTER

EXHIBIT A

OPEN FINDINGS – INTERNAL CONTROLS AND OTHER OPERATIONAL MATTERS

Procurement

18-SRNS-D-01 – Untimely Adjustments to Accounts Payable

The inventory receipts account is a holding account for inventory transactions to be recorded until approved for payment. If additional charges or changes to the invoice occur, the payment amount will differ from the purchase order impacting the original inventory transaction. Examples of additional charges or changes to the invoice include added freight fees or changes to the cost of the good on the purchase order or invoice. The debit entry to clear the accounts payable would be a different amount from the original credit entry to record the accounts payable, resulting in reconciling differences. As a result, adjusting entries are required to reconcile the accounts payable.

During our test work over accounts payable, we identified that six of seven transactions selected for testing from the inventory receipts account were incorrectly recorded as of June 30, 2018. An adjustment must be made to reconcile this difference, but no adjustments were made for these six transactions. For example, two samples had a change in fuel price between when the original purchase order was entered and when the invoice was received and paid. As the gas price increased between the two dates, the original accounts payable entry was understated. An adjusting entry needed to be made to reconcile the purchase order and invoice amount. Additionally, for one sample item, a refund check was incorrectly credited to accounts payable instead of the inventory account. This caused both inventory and accounts payable to be overstated.

The errors identified above occurred due to inadequate and untimely reviews of the inventory receipts account to determine needed adjusting journal entries. Accounts payable was understated by $5,032.34, which projects to an estimated understatement of $369,034.05, as of June 30, 2018. Two of the transactions occurred before fiscal year (FY) 2018; therefore, there is also a prior year impact of $1,754.

RECOMMENDATION:

1. We recommend that the Manager, Savanah River Operations Office, direct Savannah River Nuclear Solutions (SRNS) to implement controls to ensure the inventory receipts account is reconciled in a timely manner to support the preparation of accurate financial statements.

MANAGEMENT RESPONSE:

Concur. Savannah River Nuclear Solutions is analyzing the data to determine root causes resulting in unmatched inventory. Once root causes are identified, controls for each process will be implemented as appropriate.

Grants

18-NETL-G-01 – Inadequate Review of Federal Financial Reports

During our interim statistical sample test work over grants and cooperative agreements at the National Energy Technology Laboratory (NETL), we reviewed nine unique awards and identified four that reported positive cash on hand greater than $10,000 on their June 30, 2018, SF-425. NETL could not provide documentation that the cash on hand was adequately reviewed at the time the SF-425s were received from the recipient. In addition, during our interim statistical sample test work over grants and cooperative agreements at the Golden Field Office, we reviewed 17 unique awards and identified 5 that reported positive cash on hand greater than $10,000 on their June 30, 2018, SF-425. The Golden Field Office could not provide documentation that the cash on hand was adequately reviewed at the time the SF-425s were received from the recipient.

NETL and the Golden Field Office had not established adequate policies and procedures to review the SF-425s in a timely manner and ensure recipient compliance with the requirement that cash balances maintained at the recipient level are kept to the minimum amount necessary to meet immediate recipient disbursement needs or were not in excess of actual costs incurred. The inadequacy could cause Program Costs to be overstated. As financial assistance awards are costed as they are paid, not following up on positive recipient cash balances in a timely manner could result in costs being recorded when the recipient has not incurred cost, thereby affecting the Program Cost balances recorded in the Department's consolidated financial statements.

RECOMMENDATIONS:

2. We recommend that the Acting Director, NETL, direct the Chief Financial Officer, NETL, to establish SF-425 review policies and procedures to ensure recipient compliance with the requirement that cash balances maintained at the recipient level are kept to the minimum amount necessary to meet immediate recipient disbursement needs or are not in excess of actual costs incurred.

3. We recommend that the Director, Golden Field Office, direct the Manager, Financial Assistance Office, to establish SF-425 review policies and procedures to ensure recipient compliance with the requirement that cash balances maintained at the recipient level are kept to the minimum amount necessary to meet immediate recipient disbursement needs or are not in excess of actual costs incurred.

MANAGEMENT RESPONSE:

Management concurs with the recommendations. NETL and the Golden Field Office will establish Federal Financial Report (SF-425) review policy and procedures to ensure recipient compliance with SF-425 reporting instructions as well as with the requirement that cash balances maintained at the recipient level are kept to the minimum amount necessary to meet immediate recipient disbursement needs or are not in excess of actual costs incurred. Consistent with the Department's Chicago Field Office, NETL and the Golden Field Office will utilize a three-tier system (based on the size of active financial awards) to determine whether the amount of reported cash on hand needs to be investigated. The tiered approach will allow NETL and the Golden Field Office to prioritize the various awards with cash on hand and contact the financial assistance award recipients that hold material amounts of cash on hand. NETL and the Golden Field Office have already begun implementing the corrective action plan and as such, formal SF-425 review policies and procedures will be finalized during the first quarter of FY 2019, with quarterly implementation to initially occur during the second quarter of FY 2019.

Pensions

BACKGROUND:

The Department is a Federal agency with the largest civilian contractor workforce in the Federal government. The Department enters into large contracts with civilian commercial entities to operate the laboratories and other Department facilities. Most of these contractors sponsor defined benefit pension and postretirement benefits other than pensions (PRB) plans. The Department approves these contractors pension and PRB plans and is ultimately responsible for the allowable costs of funding the plans based on the contracts with the commercial entities that are operating the Department's facilities. As the Department is contractually obligated for reimbursing the allowable costs of the contractor contributions to the defined benefit pension and PRB plans, the Department's financial statements reflect the assets, liabilities, and related costs relating to these plans. The contractors invest in a variety of securities and financial instruments to fund these plans.

18-PNNL-P-01 – Pension Asset Valuation Review

Battelle Memorial Institute (Battelle) is the contractor that performs day-to-day operations at the Pacific Northwest National Laboratory (Pacific Northwest). Battelle operates Pacific Northwest as an integrated contractor whose financial information is included in the Department's consolidated financial statements. Battelle is responsible for Pacific Northwest's pension investment assets valuation. Battelle subcontracts with various parties to assist with investments custody and valuation functions.

Battelle did not maintain sufficient and appropriate documentation of the performance of existing control activities over the valuation of pension plan investments as a means to allow external parties to re-perform and test the control and come to the same conclusion as the control operator. Specifically, as part of the control activities addressing the independent challenges of the valuation of pension asset investments, Battelle carries out reviews of relevant periodic and annual investment fund manager reports and memoranda, as well as maintains ongoing dialogue and correspondence with the investment fund managers. However, Battelle was unable to present formalized documentation substantiating these control activities.

The weaknesses identified occurred because Battelle did not have policies and procedures in place to require sufficient and appropriate documentation of its performance of existing control activities over the valuation of pension plan investments. As a result, Battelle was unable to demonstrate that it performed an effective review of the pension investment valuations and disclosures at an appropriate level of precision to prevent or detect errors. As such, the valuation of the Department's pension investments may be incorrectly valued in the consolidated financial statements and disclosures.

RECOMMENDATION:

4. We recommend that the Manager, Pacific Northwest Site Office, ensure that Battelle, Pacific Northwest's operating contractor, strengthens internal control policies and procedures to maintain sufficient and appropriate evidence of the control activities performed.

MANAGEMENT RESPONSE:

Concur. The Department's Contracting Officer will direct Battelle to strengthen internal control policies and procedures to maintain sufficient and appropriate evidence of the control activities performed that address the Office of Inspector General's cited condition. Estimated Completion Date: July 26, 2019.

18-RL-P-01 – Pension Asset Valuation Review

The Hanford Pension Plan Committee is the Plan Administrator and named fiduciary for the Hanford Multi-Employer Pension Plan (HSPP). The Hanford Pension Plan Committee is responsible for Richland-Hanford's pension asset valuation. The Hanford Pension Plan Committee contracts with various parties to assist with investment custody and valuation functions.

While HSPP contracts with a third party valuation service to perform asset valuation work, we were unable to identify documented evidence of the performance of the management level review required by Section H of the Department's Office of Finance and Accounting's *Pension and Postretirement Benefits Information Requests*. We were able to identify one contractor employee that performed a reconciliatory review of the valuation per the investments custodians to the valuation per a third-party investment consultant. However, this review is carried out at the aggregate portfolio level, and does not perform the evaluation at a level of precision to address the potential of unreasonable fluctuations at the individual investment or asset class level. The review does not demonstrate that "management has sufficient information to evaluate and independently challenge a fund's valuation and has sufficient understanding of the nature of the investments, the portfolio strategy of the investments, and the methods and significant assumptions used to value the investments." The contractor employee also does not maintain documentation to sufficiently substantiate that the performance of the aforementioned control activity as a means to allow external parties to re-perform and test the control and come to the same conclusion as the control operator.

HSPP is a Multi-Employer Pension Plan that provides pension benefits to several Department contractors. Unlike single employer pension plans, there is not a single employer that is identified as the plan's sponsor that would normally fulfill the management review control functions. The HSPP committee contracts with a third party to perform valuation services for their assets; however, none of the contractors that participate in the plan nor anyone else within the Department fulfills the internal control responsibilities required of management by Department policy and the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book) at a level of precision necessary to properly monitor the asset values that are reported in the Department's financial statements.

The Hanford Pension Plan Committee was unable to demonstrate that an effective review of the pension asset valuations and disclosures was performed at an appropriate level of precision to prevent and detect errors, if any. Although we identified no errors, implementing these controls would mitigate the potential risk that the valuation may result in the Department's pension investments being incorrectly valued in the consolidated financial statements and disclosures.

RECOMMENDATIONS:

5. We recommend that the Richland Site Manager work with the Hanford Prime Contractor responsible for the administration of the Hanford Pension Plan Committee to develop internal control policies and procedures to:

   A. Expand its existing control activities to include a sufficiently precise analysis that evidences a review at an appropriate level of precision needed to prevent or detect a material misstatement; and

   B. Maintain sufficient documentation of the control activities performed.

MANAGEMENT RESPONSE:

Concur. The Manager, Richland Operations Office, will work with the Hanford Prime Contractor responsible for the administration of the Hanford Pension Plan Committee to develop internal control policies and procedures. The Hanford Pension Plan Committee has committed to perform the following activities:

1. The Hanford Multi-Employer Pension Plan Committee has expanded its existing control activities to include a comparison of the Trustee statements investment values used for financial statement reporting, the investment values reported in the Investment Manager statements, and the investment analysis spreadsheet provided by the Investment Advisor. The comparison will be performed at the Investment Manager account level. Additional research, substantiation, and assessment will be performed when variances exceed appropriate thresholds. The comparison will occur monthly and will be provided to the Hanford Pension Plan Committee on a quarterly basis.

2. The comparison and the Investment Advisor analysis will be reviewed and signed by the Committee Chair or Vice Chair monthly.

The Department is assured of the Hanford Pension Plan Committee's commitment to address the concerns identified during the audit because the Department has been provided the committee's enhanced internal procedure for Asset Valuation which has been implemented by the Hanford Pension Plan Committee. Completed as of November 2018.

18-SRNS-P-01 – Pension Assets Valuation Review

SRNS is a contractor that performs day-to-day operations at the Savannah River Site. SRNS operates the Savannah River Site as an integrated contractor whose financial information is included in the Department's consolidated financial statements. SRNS subcontracts with various parties to assist with investments custody and valuation functions.

SRNS did not maintain sufficient and appropriate documentation of the performance of existing control activities over the valuation of pension plan investments as a means to allow external parties to re-perform and test the control and come to the same conclusion as the control operator. Specifically, as part of the control activities addressing the independent challenges of the valuation of pension asset investments, SRNS carried out reviews of relevant monthly and annual investment fund manager reports and memoranda, as well as maintains ongoing dialogue and correspondence with the investment fund managers. However, SRNS was unable to present formalized documentation substantiating these aforementioned control activities.

SRNS did not have policies and procedures in place to require sufficient and appropriate documentation of SRNS's performance of existing control activities over the valuation of pension plan investments. SRNS was unable to demonstrate that it performed an effective review of the pension investment valuations and disclosures at an appropriate level of precision to prevent or detect errors, if any. As such, the valuation of the Department's pension investments may be incorrectly valued in the consolidated financial statements and disclosures.

RECOMMENDATION:

6. We recommend that the Manager, Savannah River Operations Office, direct SRNS to strengthen internal control policies and procedures over pension and financial management to maintain sufficient and appropriate evidence of the control activities performed.

MANAGEMENT RESPONSE:

Concur. The Manager of the Savannah River Operations Office will direct SRNS to strengthen the internal control policies and procedures over pension and financial management and to record the processes and results of those control activities.

Accrued Expenses

18-EMCBC-D-01 – Review of Accruals for the Comprehensive Field Financial Review and Certification

Accountants at the Environmental Management Consolidated Business Center (EMCBC) perform various tasks as part of the Comprehensive Field Financial Reporting and Certification (CFFR) process to ensure internal controls are operating effectively for the second, third, and fourth quarters. There are a total of 35 tasks that are performed for the certification, some of which include performing monthly general ledger to purchase order reconciliations, Strategic Integrated Procurement Enterprise System to Standard Accounting and Reporting System reconciliations, performing stale balance reviews, performing abnormal balance reviews, and performing accrual reviews. The Field Chief Financial Officers are required to certify that the tasks have been completed and reviewed. According to Department procedures, supporting documentation for these quarterly reviews should be maintained at the field office and be available for subsequent review.

The EMCBC Field Chief Financial Officer certified the completion of the September 30, 2018 CFFR process on October 16, 2018. However, three of the six accrual balances selected for testing as part of task 30 of the CFFR checklist were not appropriately verified. Specifically, we selected task 30 of the CFFR process, which is the review of a random sample of costs accruals, manual accruals and Financial Accounting Support Tool accruals, to perform test work over controls. We noted that EMCBC's Office of Financial Management (OFM) selected six samples to review as part of task 30. Three of the six samples were properly accrued with supporting documentation. However, three samples did not have adequate supporting documentation. For two sample items, the approving official did not respond to EMCBC's OFM's request for support for the accruals. Additionally, for one sample item, an adjustment to the default accrual was recorded by an approving official who left employment with the Department and the new approving official was unable to provide support for the accrual.

The errors identified occurred because three of the accrual balances were not appropriately verified prior to the certification of the September 30, 2018 CFFR process. For two of the accrual samples, the approving officials disregarded the initial and follow-up requests from EMCBC's OFM for supporting documentation. For the remaining accrual, the approving official who recorded the accrual adjustment left employment with the Department without transitioning the supporting documentation to the new approving official. As a result, accrued expenses may be misstated due to the lack of adequate documentation to support accrued totals reported.

RECOMMENDATIONS:

7. We recommend that the Director, EMCBC, direct EMCBC to:

    A. Implement controls to ensure that accrual balances selected for testing as part of the CFFR process are appropriately reviewed; and

    B. Provide training to EMCBC Approving Officials so they can better understand the accrual process.

MANAGEMENT RESPONSE:

Concur. We will implement controls to ensure we receive adequate responses for all accruals selected for review. We will have these additional controls in place for the cost accruals reviewed to support the second quarter CFFR process by April 30, 2019. We will provide training on the accrual process to EMCBC Approving Officials by May 31, 2019.

Active Facilities

18-ORO-AF-01 – Misstatement in Active Facilities Non-Modeled Estimate

Environmental liabilities for active facilities represent anticipated remediation costs for contaminated facilities still in active use, and for retired contaminated facilities awaiting transfer to the Office of Environmental Management (Environmental Management) program, collectively. The estimate is largely based on a cost-estimating model which extrapolates stabilization, deactivation, and decommissioning costs from facilities included in the Environmental Management baseline estimates to those active and surplus facilities with similar characteristics. Site-specific estimates are used when available (non-modeled). The Oak Ridge Office of Environmental Management (OREM) prepares a site-specific, non-modeled, liability estimate.

In our review of the June 30, 2018 non-modeled estimate calculations, we identified a mathematical error in the spreadsheet calculation which resulted in an understatement of the total liability. One of the general procedures in preparing the non-modeled estimate is the escalation of the prior year amounts to the current year amounts. Rather than escalating the amounts to current year amounts, OREM continued to use the prior year amounts.

The mathematical error made in the June 30, 2018 non-modeled estimate was not detected and corrected because Environmental Management internal management not having a policy in place for the review of the calculation. As a result, the non-modeled estimate recorded in the June 30, 2018 financial statements was understated by $24.6 million.

RECOMMENDATION:

8. We recommend that the Manager, OREM, develop and implement policies and procedures to ensure that errors in the non-modeled estimate calculations are identified and corrected.

MANAGEMENT RESPONSE:

OREM concurs with the finding and recommendation and is developing a procedure which will institute checks to eliminate spreadsheet errors such as this. Data to support the checks that will be instituted will be available for auditor review in the 2019 Environmental Liabilities audit.

Environmental Management

18-SR-EL-01 – Ineffective Review of the Input Data in Two Risk Sheets

Environmental Management is responsible for developing cost estimates for environmental cleanup. The cost estimates are updated annually due to changes in technological improvements and challenges, regulatory requirements, or other circumstances. The cost estimates represent the anticipated cost of the work required to perform cleanup activities as of September 30, 2018. To account for risk and uncertainty associated with Environmental Management's remaining cleanup responsibilities, Environmental Management models the risk and uncertainty to estimate and record an appropriate amount of unfunded contingency as part of the environmental liability.

The Savannah River Operations Office did not have adequate controls in place during the FY 2018 audit cycle related to updating risk sheets for two of the Savannah River Operations Office managed risks used in the modeling performed to estimate an appropriate amount of Environmental Management unfunded contingency for the liability estimate. Specifically, information used in the FY 2018 unfunded contingency modeling related to Savannah River Operations Office risks 20-10 and 20-07 was not from the most current version of the risk sheets for these two risks.

For one project baseline summary (PBS), specifically PBS 20, there was inadequate communication to new personnel during the transitioning of the responsibilities associated with the Environmental Management Savannah River Operations Office managed risks used for unfunded contingency modeling, which led to the error in their process. Specifically, the breakdown in the process occurred because the individual previously responsible for managing PBS 20's Savannah River Operations Office managed risks in FY 2017 did not communicate updates/changes for the two risks mentioned above to his/her successor. Additionally, in accordance with Principle 7.01 and 10.01 of the Green Book, the Savannah River Operations Office did not have controls in place to prevent or detect and correct misstatement of the risk input data associated with these two risks. This allowed the wrong input data for these two risks to be included as part of the larger set of cumulative risk input data used by the Savannah River Operations Office for the risk modeling performed to estimate an appropriate amount of unfunded contingency for the Savannah River Operations Office environmental liability.

The Savannah River Operations Office did not have adequate controls in place to ensure the correct revision of the risk sheets containing the input data for these two risks was being used as part of the larger set of cumulative risk input data used by the Savannah River Operations Office for the risk modeling performed to estimate an appropriate amount of unfunded contingency for the Savannah River Operations Office environmental liability. This had the potential to cause an understatement of approximately $37 million of unfunded contingency associated with the environmental liability, as of September 30, 2018.

RECOMMENDATIONS:

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

   A. Develop and implement a strategy to ensure adequate transition of the Savannah River Operations Office managed risk function for each PBS to other personnel, including communication of the current version of the risk sheet(s) to use for the risk input data.

   B. Strengthen internal control policies and procedures to ensure the control operators are knowledgeable about the process to perform the controls effectively.

MANAGEMENT RESPONSE:

Recommendation 1: Concur.

Action Plan: By April 30, 2019, Department of Energy-Savannah River will:

1. Revise Savannah River Operations Office Environmental Management Environmental Liability Desktop Guide to provide direction for:

   A. Configuration control for Department of Energy risk sheets/database; and

   B. Conduct of transition and turnover, when changes to Office of Integration and Planning Integrated Life-Cycle Cost Estimate/Environmental Management Environmental Liability support team personnel, and/or roles and responsibilities, will take place during the year, to include turnover of correct version of all applicable documentation for personnel to perform their new/reassigned roles and responsibilities.

Recommendation 2: Concur.

Action Plan: By April 30, 2019, Department of Energy-Savannah River will:

2. Revise Savannah River Operations Office Environmental Management Environmental Liability Desktop Guide to provide direction for conduct of transition and turnover when changes to Office of Integration and Planning Integrated Life-Cycle Cost Estimate/Environmental Management Environmental Liability support team personnel, and/or roles and responsibilities, will take place during the year, to include turnover of correct version of all applicable documentation for personnel to perform their new/reassigned roles and responsibilities.

Nuclear Materials

18-Y12-N-01 – Incorrectly Calculated Inter-Project Shipping Entity Rate

The National Nuclear Security Administration's (NNSA) nuclear weapons production complex involves numerous Department sites around the country. Certain sites are responsible for manufacturing select parts of nuclear weapons that the Department ultimately assembles into a complete nuclear weapon.

Per NNSA's *Production Accounting Handbook*, "The Inter-Project Shipping Entity (IPSE) is the piece-part, sub-assembly, or assembly that is packaged and shipped from a DOE/NNSA facility. The IPSE is the level at which the receiving production contractor maintains inventory control, physical and cost, of system furnished material from other production contractors." The Department site that manufactures a part is responsible for providing a revised IPSE price for that part once each year so long as that part is still in production at that site. All Department sites that have these parts on hand must re-value their quantity on hand at the revised IPSE price for that year.

IPSE prices effective for a fiscal year consider actual costs of production, inception to date, through the prior fiscal year end as well as anticipated costs and production output for the current fiscal year. Department field sites revise their IPSE prices annually in late October and they become effective in November.

The Y-12 National Security Complex produces a part for the Stockpile Life Extension Program. The IPSE recorded cost was substantially lower in FY 2017 than in FYs 2016 and 2018 even though the actual production costs per unit did not fluctuate significantly during these years. The Y-12 National Security Complex's *Desktop Procedure for Establishing Transfer Price* served as the basis for the FY 2017 IPSE price.

Prior to FY 2018, the Y-12 National Security Complex made certain variance adjustments when calculating IPSE prices to account for differences between units shipped and units produced from the prior year. These variance adjustments resulted in a lower IPSE price for the part in FY 2017. The methodology intends to approximate historical cost over the life of the program with variances adjusted to inventory in the following year. However, *Statement of Federal Financial Accounting Standards No. 3* has no provision to defer variances into a subsequent accounting period. In FY 2018, the Y-12 National Security Complex removed these variance adjustments from its IPSE pricing calculation for the particular part based on its own review and analysis to eliminate the fluctuations in the standard caused by differences between units shipped and units produced. As a result, the Department valued its nuclear materials inventory associated with the part substantially lower in FY 2017 than in FY 2016 and FY 2018.

RECOMMENDATION:

10. We recommend that the NNSA's Field Chief Financial Officer direct field site personnel to review inventory-costing methods to ensure that the Department records inventory at historical cost on an annual basis.

MANAGEMENT RESPONSE:

NNSA does not concur with the statements in the Cause, Effect, and Recommendation sections of this finding. The Y-12 National Security Complex has consistently followed its documented process for costing the IPSE component produced in addition to the guidance from the *Production Accounting Handbook* and SFFAS No. 3. Prior to FY 2018 the calculation was based on units shipped. In FY 2017 a labor strike occurred that affected shipments out of the plant. Variance adjustments were made in the following year to account for this anomaly and the overall cost for the life of the program will have no impact. In FY 2018, a new process was implemented where the variance calculation is based on units produced, and the variance is adjusted in one entry rather than dividing it over all the units planned to ship in the subsequent year. This is an enhancement to the prior process and eliminates uncertainties caused by such factors that are not within our control, such as a labor strike.

With the implementation of the new process in FY 2018, the recommendation has been completed and no corrective actions are needed.

AUDITOR COMMENT:

Management stated in its response that "variance adjustments were made in the following year to account for this anomaly and the overall cost for the life of the program will have no impact." SFFAS No. 3 does not provide for variance adjustments to be made in the following year. Inventory costs are required to be accurate each year. We agree with management that it completed the corrective action for the issue identified. However, we maintain our recommendation that a review of inventory-costing methods should be performed to ensure that all inventory is recorded at historical cost each year including timely adjustments for production variances in accordance with accounting standards.

Legacy Management

18-NFO-EL-01 – Incorrect Escalation Rate Usage in Long-Term Stewardship Estimate

The Department's environmental liability estimate includes Long-Term Stewardship (LTS) estimates for active cleanup sites. These estimates represent the maintenance costs that the site will incur after the Environmental Management cleanup work is complete. The cost estimates are updated annually due to changes in technological improvements and challenges, regulatory requirements, or other circumstances. The baseline estimates are developed in escalated costs and then subsequently de-escalated in Integrated Planning, Accounting, and Budgeting System (IPABS). The cost estimates represent the anticipated cost of the work required to perform as of September 30, 2018.

The Nevada Field Office (Nevada) originally developed the Nevada LTS estimate in FY 2013 using a 2.3 percent escalation rate to project the cost of work in out years (i.e., in escalated or current dollars). Nevada has historically used the same 2.3 percent de-escalation rate to calculate the cost of work in today's dollars (i.e., constant dollars) for inclusion in the Department's consolidated financial statements.

In FY 2018, Nevada submitted baseline changes, which were approved by EM Headquarters, in IPABS for project baseline summaries VL-NV-0030.O1 (Soil and Water Remediation), VL-NV-0080.O1 (Operate Low-Level Waste Facility), and VL-NV-0100 (Agreements in Principle and Grants). These changes used a new escalation rate of two percent based on budget guidance from EM Headquarters for the development of the FY 2020-2024 budget process. However, baseline changes were not submitted or approved for Nevada's LTS estimate at this time and Nevada mistakenly used the two percent rate to de-escalate the LTS estimates in the approved baseline in IPABS. Therefore, the LTS estimate was de-escalated to constant dollars using an incorrect rate which resulted in an overstatement of the LTS estimate reported in the Department's financial statements as of September 30, 2018.

The personnel at Nevada did not have an adequate understanding that updating the escalation rate used for the Environmental Management portion of the liability should not have been used to update the LTS. The Office of Finance and Accounting has a control that is designed to address the risk of material errors in the LTS estimates. The change in Nevada's LTS estimate from the prior year met the control operator's threshold for inquiry. The site personnel provided the control operator with an explanation that the change occurred due to a change in the escalation rate. However, the control operator did not identify that the explanation was incorrect. The use of different rates to escalate and de-escalate the estimate resulted in an overstatement of approximately $258 million of the Nevada LTS liability as of September 30, 2018.

RECOMMENDATIONS:

11. We recommend that the NNSA's Field Chief Financial Officer direct the Manager, Nevada Field Office, to train Nevada personnel on using correct escalation rates for the environmental liability portion of the

Department's financial statements, including procedure to address changes in escalation rates and the site's review process for the LTS estimate.

12. In addition, we recommend that the Director, Office of Finance and Accounting, strengthen internal control policies and procedures to ensure the control operators are knowledgeable about the baseline update process to perform their control effectively.

MANAGEMENT RESPONSE:

NNSA concurs with the finding and recommendation.

Nevada personnel completed training on November 27, 2018 for using correct escalation rates including procedures to address changes in escalation rates. Since Environmental Management is the owner of the IPABS system, NNSA's Field Chief Financial Officer and Environmental Management will coordinate IPABS training for LTS by May 30, 2019.

The Office of Finance and Accounting does not concur with the recommendation.

Sites are responsible for their own environmental liability estimates. The Office of Finance and Accounting properly inquired about the change to NNSA that was flagged during the flux analysis, which was the control objective and NNSA confirmed that the change was as intended and correct through multiple conversations and supporting evidence. It was the program's decision to make the change in IPABS to update their estimate. The Office of Finance and Accounting does not have the detailed site-specific knowledge and expertise on the programmatic estimates and should not direct changes to the estimates. While the Office of Finance and Accounting does not concur on the recommendation, we will assist Environmental Management where necessary to enhance guidance and communication about escalation changes to the field offices by June 15, 2019.

AUDITOR COMMENT:

We did not recommend that the Office of Finance and Accounting direct changes to the estimates. We did note that the Office of Finance and Accounting's review of the change in the estimate did not identify the site's error. By improving the control operator's knowledge of the baseline update process, the Office of Finance and Accounting's control would be more effective in identifying errors in the environmental liability. We continue to recommend that the Office of Finance and Accounting strengthen internal control policies and procedures to ensure the control operators are knowledgeable about the baseline update process to perform their control effectively.

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, 2018
Environmental Liabilities	
1. Environmental Management Liability Preparations Errors (**17-SR-EL-01**)	Closed in FY 2018
2. Understatement of Contingency (**17-ID-EL-01**)	Closed in FY 2018
3. Repository Opening Date Assumption (**17-HQ-EL-01**)	Closed in FY 2018
4. Prior Period Errors (**17-EMCBC-EL-01**)	Closed in FY 2018
Budget	
5. Inadequate Review of Stale Undelivered Orders (UDOs) (**17-SR-B-01**)	Closed in FY 2018
6. Inadequate Review of GL to PO Reconciliation Report (**17-SR-B-02**)	Closed in FY 2018
Active Facilities	
7. Inaccuracies in the Active Facility Liability (**17-NRLFO-A-01**)	Closed in FY 2018
Procurement	
8. Improper accrual for prepaid assets (**17-LANL-D-01**)	Closed in FY 2018
9. Timely Performance of Account Reconciliations (**17-ANL-D-01**)	Open in FY 2018
Property, Plant, and Equipment	
10. Property, Plant and Equipment Untimely Abandonment (**17-LANL-F-01**)	Closed in FY 2018
Payroll	
11. Improper Review of Self Approved Timecards (**17-LANL-H-01**)	Closed in FY 2018
Nuclear Materials	
12. Prior Period Errors (**17-NNSA-N-01**)	Closed in FY 2018
13. Classified Finding (**17-Y12-N-01**)	Closed in FY 2018

REISSUED FINDINGS IN FY 2018

Procurement

17-ANL-D-01 – Timely Performance of Account Reconciliations

During FY 2017, Argonne National Laboratory (Argonne) 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 Standard Accounting and Reporting System (STARS). As a result, we were unable to select a statistical sample of accounts payable balances as of June 30, 2017 or August 31, 2017. Argonne was unable to demonstrate that sufficient controls were in place to support the monthly certification of its trial balance during this period.

Argonne's management began to implement corrective action during FY 2018. Specifically, Argonne completed the remainder of the FY 2017 year-end general ledger reconciliations. Argonne also updated its 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. However, Argonne has not been able to provide a cumulative trial balance out of Workday for comparison with STARS and the reconciliation between Workday and STARS is not complete.

Because Argonne cannot provide a cumulative trial balance in the Accounting Flex-Field format, the Department has implemented an interim process to reconcile Argonne's monthly trial balance with STARS and document the differences. A significant number of differences between Workday and STARS are due to adjustments being recorded outside of Workday on a monthly basis. The estimated completion date for acceptable reconciliations between Workday and STARS is December 31, 2018.

Argonne is currently working on a plan to reconcile differences between Argonne's ledger and STARS, from contract conversion up through the point of Workday implementation. Argonne expects to submit the plan by March 30, 2019, with a targeted completion date for reconciling the differences by September 30, 2019. As Argonne is still in the process of remediating the issues noted in the prior year, this finding will remain open and be re-evaluated during the FY 2019 financial statement audit.

RECOMMENDATION:

13. We continue to recommend that the Manager, Argonne Site Office, direct Argonne 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 Argonne Site Office concurs with the repeat recommendation directing Argonne 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. The Argonne Site Office and the Office of Science Integrated Support Center remain engaged with Argonne leadership to facilitate progress toward account reconciliations; however thus far, reconciliations between Argonne trial balances and STARS remain challenging. The Argonne Site Office will formally transmit the Department's expectation to the Lab, that all corrective actions necessary to effectively address the recommendation and closure of the repeat audit finding are to be completed by September 30, 2019.

ACRONYMS

Argonne	Argonne National Laboratory
Battelle	Battelle Memorial Institute
CFFR	Comprehensive Field Financial Reporting and Certification
Department/DOE	Department of Energy
Environmental Management	Office of Environmental Management
EMCBC	Environmental Management Consolidated Business Center
FY	Fiscal Year
HSPP	Hanford Multi-Employer Pension Plan
IPABS	Integrated Planning, Accounting, and Budgeting System
IPSE	Inter-Project Shipping Entity
LTS	Long-Term Stewardship
NETL	National Energy Technology Laboratory
NNSA	National Nuclear Security Administration
OFM	Office of Financial Management
OREM	Oak Ridge Environmental Management
PBS	Project Baseline Summary
Pacific Northwest	Pacific Northwest National Laboratory
PRB	Postretirement Benefits Other Than Pensions
SFFAS	Statement of Federal Financial Accounting Standards
SRNS	Savannah River Nuclear Solutions
STARS	Standard Accounting and Reporting System

FEEDBACK

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