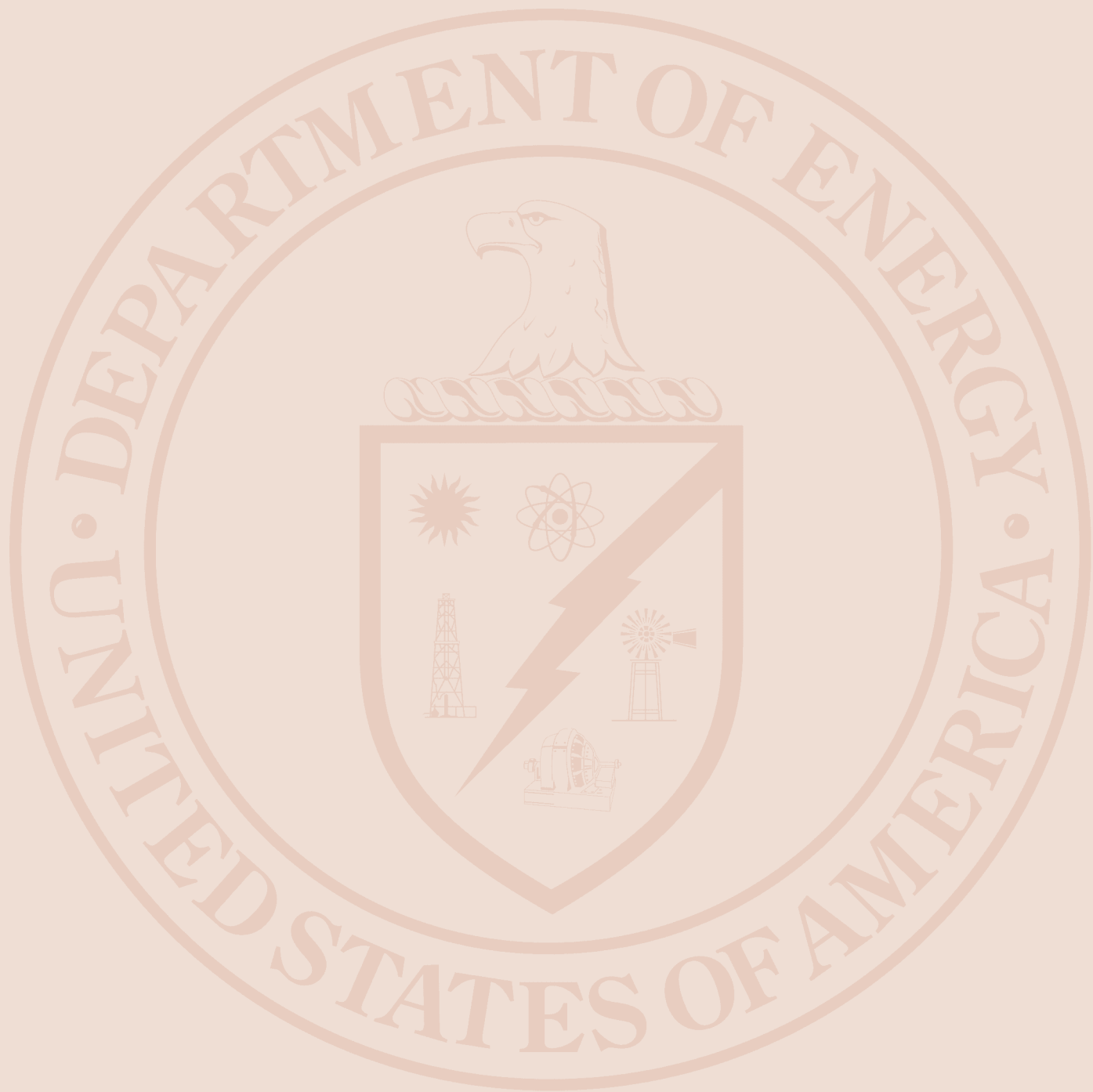




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# INSPECTOR GENERAL'S MANAGEMENT AND PERFORMANCE CHALLENGES

On an annual basis, the Office of Inspector General identifies what it considers to be the most significant management challenges facing the Department of Energy. Now codified as part of the Reports Consolidation Act of 2000, this effort assesses the agency's progress in addressing previously identified challenges and identifies key emerging issues. This process assists the Office of Inspector General in setting internal priorities as it evaluates Department of Energy programs and operations.

Representing risks inherent to the Department's complex operations as well as those related to management operations, the management challenges are, for the most part, not amenable to immediate resolution and must, therefore, be addressed through a concentrated, persistent effort, over time. This year, the Office of Inspector General identified seven management challenges:

- Safeguards and Security
- Environmental Cleanup
- Stockpile Stewardship
- Contract Management
- Project Management
- Cyber Security
- Energy Supply

In addition to identifying the management challenges, we also developed a "watch list," which consists of important issues that do not meet the threshold of being classified as management challenges, yet warrant continued attention by the Department. The watch list includes the following operational and programmatic functions: Financial Management and Reporting; Worker and Community Safety; and, Human Capital Management.

By aggressively addressing these challenges, the Department can enhance program efficiency and effectiveness; prevent fraud, waste, and abuse; and, achieve substantial operational cost savings.

## Safeguards and Security

While the Department has shifted its focus over time, special emphasis on safeguards and security has remained a vital aspect of the Department's mission. The Department plays an important role in the Nation's security by ensuring the safety and reliability of the U.S. nuclear weapons stockpile, advancing international efforts in nuclear non-proliferation and providing safe and efficient nuclear propulsion systems for the United States Navy. Due to the sensitivity of these missions, the Department maintains a substantial security regime, including over 4,000 protective force personnel and various physical safeguards for classified material and other sensitive property.

Over the past year, the Department made strides toward improving safeguards that protect the agency's employees and facilities. While we view this progress as a positive step, during FY 2006, we conducted several reviews which highlighted the need for continued improvement in this area. For example:

- An October 2005 audit of the Department's implementation of the Design Basis Threat (DBT) process, which reflects the most credible threats posed to Departmental assets and operations, revealed that the National Nuclear Security Administration experienced delays in implementing changes to meet the safeguards and security performance requirements contained in the 2003 DBT.
- A recent audit of the Department's management of non-nuclear high explosives found that two National Nuclear Security Administration defense laboratories were not maintaining control, accountability and safety over its inventory of explosives.

Clearly, the Department's core mission must be conducted in a safe and secure environment. The issues disclosed in our work during FY 2006 suggest the need for continued focus by Department management on this crucial challenge.

## Environmental Cleanup

Largely a result of the legacy of the Manhattan Project and subsequent activities, the Department's environmental remediation activities are among its most important programs. The Department is responsible for cleaning contaminated sites and disposing of radioactive, hazardous and mixed waste resulting from over half a century of nuclear weapons production, research and other activities. The projected cost of these remediation efforts is over \$180 billion, which represents the third largest liability on the overall financial statement of the U.S. Government.

During FY 2006, due to the risks and hazards associated with this difficult and costly task, we conducted a series of reviews to assess the progress of the Department's environmental cleanup activities. For example:

- An October 2005 audit disclosed that, in terms of both schedule and cost, the Department will not meet its milestone under the 1989 Tri-Party Agreement between the Department, the Washington State Department of Ecology, and the Environmental Protection Agency, for the retrieval of waste from single-shell tanks located at the Hanford Site's C-Farm.
- A May 2006 audit found that there have been delays in developing and implementing a spent nuclear fuel program at the Savannah River Site. As a result, the current conventional processing facility, known as H-Canyon will have to be maintained in an idle, but operational mode for at least two years, which is projected to cost taxpayers approximately \$300 million.

While the Department made significant remediation progress at a number of contaminated sites over the past year, it continues to experience delays in accelerated cleanup programs and has faced quality assurance concerns at the Yucca Mountain Project. Thus, in our judgment, Environmental Cleanup remains a management challenge that will warrant significant attention into the future.

## Stockpile Stewardship

The Department is responsible for the maintenance, certification and reliability of the Nation's nuclear weapons stockpile. In order to ensure that our nuclear weapons continue to serve their essential deterrence role, the Department maintains stockpile surveillance and engineering capability, refurbishes selected nuclear systems and sustains the ability to restore the manufacturing infrastructure for the production of replacement weapons.

Given the importance and complexity of the Department's role in ensuring the vitality of the U.S. nuclear stockpile, the Office of Inspector General classified Stockpile Stewardship as a significant management challenge. Over the past year, the Office of Inspector General has conducted a series of reviews to examine the Department's activities and management strategies in this crucial area.

- In response to the aging of the Nation's nuclear weapons stockpile, the National Nuclear Security Administration, working with the U.S. Department of Defense, developed strategies, known as Life Extension Programs, to refurbish the weapons stockpile to extend its deployment life. As part of this process, the W76 weapon system will undergo refurbishment at a cost of \$916 million through the first production unit date to address aging concerns and to provide long-term certification of the system. A recent audit concluded that the National Nuclear Security Administration is at risk of not achieving the first production unit for the W76 refurbishment within the scope, schedule, and cost parameters detailed in the project plan.
- The Department's Sandia National Laboratory is refurbishing the Spin Rocket Motor, which is a prime component of the B61 nuclear weapon system. A September 2006 audit found that the National Nuclear Security Administration had not adequately validated key Spin Rocket Motor data provided by Sandia National Laboratory prior to the approval of the new project.

The Department has taken steps to further enhance the safety and reliability of the U.S. weapons stockpile. Most prominently, in FY 2006, the Department announced the details of a comprehensive plan to employ a smaller, safer and more secure weapons stockpile in order to improve our capability to respond to changing security challenges. The goal of the plan, as stated by the Department, is to facilitate an improved research and development infrastructure, modernize production facilities and consolidate nuclear materials. Although in its initial stages, the program is a positive step toward improving the Department's Stockpile Stewardship Program.

## Contract Management

The Department places significant reliance on contractors, employing over 100,000 contractor employees. Contracts are awarded to industrial companies, academic institutions and non-profit organizations that operate a broad range of Department facilities, including its most sensitive national security facilities. In fact, most of the Department's operations are carried out through contracts that consume about three-fourths of its budget. As a result, effective contract management is an essential component of the performance of the Department's programs.

During FY 2006, Office of Inspector General reviews highlighted the need for improved management oversight in the administration of Departmental contracts. For example:

- A December 2005 review determined that the cost of the Mixed Oxide Fuel Fabrication (MOX) Facility at the Savannah River Site will significantly exceed the amounts reported to Congress in 2002. During the course of our review, we found that the Department's estimate for the design and construction of the MOX Facility was approximately \$3.5 billion, which was \$2.5 billion more than previously estimated.
- In FY 2005, the Department and its contractors spent over \$1.2 billion on information technology (IT) infrastructure and support, including activities such as server and network technical services, database management and administration, and desktop support. An April 2005 audit revealed that while the Department had initiated action to consolidate requirements for services provided to Federal employees, it continues to face a number of challenges related to contractor procured IT support services.

To its credit, in response to several of our reviews, the Department has developed strategies and programs to address contract management concerns. However, given the number of contracts awarded and managed by the Department on a yearly basis, combined with the issues raised in our reviews, the area of contract management remains a significant Department challenge.

## Project Management

The Department undertakes numerous unique and complex multi-million dollar projects in order to support its various missions. In recent years, the Department, in responding to identified weaknesses in the area of project management, improved the discipline and structure for monitoring project performance. Further, by employing effective policies and controls to ensure that ongoing projects are evaluated frequently, the Department has focused on improving project management throughout the complex.

Recent Office of Inspector General reviews have identified additional improvements which are necessary to ensure that the Department's efforts to enhance project management throughout the complex are effective and accomplishing its goals. For example:

- In May 2001, the Office of Inspector General reported that the Department's Miamisburg Closure Project would not be completed under current cost and schedule requirements. A recent follow-up audit concluded that the Department is unlikely to achieve revised closure goals on the Miamisburg Closure Project.
- A December 2005 audit found that the curtailment of operations at the Radiological Calibration Laboratory at the Hanford Site, as planned by the Department, would leave the Office of Environmental Management without site capability to perform internal and external dosimetry assessments and radiological calibrations.

While the Department has continued to make progress toward improving project management principles, our reviews over the past year continue to highlight weaknesses in this area. Concerns related to project management within the Department were emphasized in the release of a recent review by the U.S. Army Corps of Engineers pertaining to the estimated cost of the Waste Treatment and Immobilization Plant at the Hanford Site. Given the complexity and importance of the Department's numerous multi-million dollar projects and the results of recent Office of Inspector General reports, Project Management remains a significant management challenge.



## Cyber Security

The Department spends approximately \$2.5 billion a year on information technology. As a result of the importance of information technology on its numerous projects, laboratories and assets, along with the vast array of data that is produced, cyber security has become a crucial aspect of the Department's overall security posture. In 2005, the Department established a Cyber Security Improvement initiative, the goal of which was to identify improvements for cyber security controls within the Department. In recent years, threats to the Government's information systems have become a national security risk. As a result of these risks and in light of recent efforts to intrude into the Department's systems, we have categorized Cyber Security as a significant management challenge.

During FY 2006, the Office of Inspector General conducted various reviews in this area, which highlighted the need for improvements in the overall cyber security program.

- A September 2006 audit disclosed deficiencies in the Department's unclassified cyber security program, which exposed critical systems to an increased risk of compromise. We found that continuing cyber security weaknesses occurred, at least in part, because program and field elements did not always implement or properly execute existing Departmental and Federal cyber security requirements.
- During a June 9, 2006, congressional hearing, Department officials publicly disclosed that an unclassified computer system was compromised at the NNSA Service Center in Albuquerque, New Mexico. As a result, a file containing the names and social security numbers of 1,502 NNSA employees was ex-filtrated. An Office of Inspector General special inquiry concluded that the Department's handling of this matter was largely dysfunctional and that the operational and procedural breakdowns were caused by questionable managerial judgments; significant confusion by key decision makers as to lines of authority, responsibility, and accountability; poor internal communications; and, insufficient follow-up on critically important issues and decisions.

To help address continuing weaknesses, the Department recently launched a revitalization effort designed to improve the management of its cyber security program to ensure that systems and data are secure. Due to the evolving nature of cyber security threats, immediate as well as long-term action is necessary to ensure the protection of the Department's information systems.

## Energy Supply

On August 8, 2005, the Energy Policy Act of 2005 was signed into law at the Department's Sandia National Laboratory in Albuquerque, New Mexico. Intended to establish a comprehensive, long-term energy policy, the Act provides incentives for traditional energy production as well as newer, more efficient energy technologies. The first comprehensive energy legislation in over a decade, the Act focuses on areas such as energy efficient building construction, hybrid vehicles, clean coal, and other renewable and alternative energy sources. The passage of the Energy Policy Act provides the Department with the opportunity to aggressively lead the effort to increase our national commitment to alternative fuels and clean energy technologies. The Department is charged with the task of helping to modernize our national energy infrastructure; expand the Strategic Petroleum Reserve; invest in clean energy technologies such as hydropower, wind, solar, and cellulosic biomass; and, to promote conservation in our homes and businesses.

The energy issues facing the United States today did not develop overnight and, therefore, will require both short-term and long-term solutions to address growing challenges. To combat challenges related to the modernization of the national energy infrastructure, in FY 2006, the Department announced the nomination of the first Assistant Secretary for Electricity Delivery and Energy Reliability. This position supports the Department's objective to improve research and development pertaining to electricity delivery infrastructure; conduct analyses of the physical, regulatory, and institutional barriers that interfere with the efficient and secure operation of electric transmission and distribution systems; and, bring public awareness to the developments that will help ensure the reliable flow of energy to all Americans.

Given the importance of stabilizing the country's energy supply and the challenges that this monumental task requires, we have categorized Energy Supply as a significant management challenge facing the Department.

# IMPROPER PAYMENTS INFORMATION ACT REPORTING DETAILS

(UNAUDITED)

## Improper Payment Outlook

As noted in the chart below, the Department's extremely low improper payment rate minimizes the Department's opportunities for future reductions in erroneous payments.

Improper Payment (IP) Reduction Outlook FY 2006 – FY 2009 (\$ in millions)						
Class of Payment/Program	FY 2006 Outlays/Payments	FY 2006 IP%	FY 2006 IP\$	FY 2007 IP%	FY 2008 IP%	FY 2009 IP%
Payroll	\$ 6,646	0.12	\$ 8.0	<.25	<.25	<.25
Travel	\$ 494	0.09	\$ .4	<.25	<.25	<.25
Vendors	\$ 16,148	0.07	\$ 10.0	<.25	<.25	<.25
Other	\$ 363	0.00	\$ 0.0	<.25	<.25	<.25

Note: Federal payroll not included due to outsourcing of this function. The payroll category in this chart represents payroll paid by DOE's major operating contractors.

## Recovery Auditing

P.L. 107–107, "National Defense Authorization Act for FY 2002," requires agencies that enter into contracts with a total value in excess of \$500 million in a fiscal year to carry out a cost effective program for identifying overpayments to contractors, and for recovering amounts overpaid. OMB memorandum M-03-07, "Programs to Identify and Recover Erroneous Payments," requires agencies to review their contractor payments for errors resulting in overpayments (recovery audit), take action to recover those overpayments, and report the results of these activities to OMB on an annual basis.

Recovery Auditing Statistics FY 2006 (\$ in millions)	
Contractor Payments Reviewed	\$ 9,620.000
Contractor Overpayments Identified	\$ 11.900
Overpayments Recovered	\$ 10.300
Overpayments Pending Recovery	\$ 1.530
Overpayments Not Recoverable	\$ .073
Total Cost of Recovery Audit Program	\$ .159
Departmental Costs	\$ .107
Recovery Auditing Contractor Costs	\$ .052

# OTHER STATUTORY REPORTING

## Management's Response to Audit Reports

Pursuant to the Inspector General Act Amendments of 1988 (Public Law 100-504), agency heads are to report to Congress on the status of final action taken on audit report recommendations. This report complements a report prepared by the Department's Office of Inspector General (IG) that provides information on audit reports issued during the period and on the status of management decisions made on previously issued IG audit reports.

### Inspector General Audit Reports

The Department responds to audit reports by evaluating the recommendations they contain, formally responding to the IG, and implementing agreed upon corrective actions. In some instances, we are able to take corrective action immediately and in others, action plans with long-term milestones are developed and implemented. The audit resolution and follow-up process is an integral part of the Department's effort to deliver its priorities more effectively and at the least cost. Actions taken by management on audit recommendations increase both the efficiency and effectiveness of our operations and strengthen our standards of accountability.

During FY 2006, the Department took final action on 55 IG reports with the agreed upon actions including final action on seven IG operational, financial, and pre-award audit reports with funds put to better use. At the end of the period, 102 reports awaited final action.

### Status of Final Action on IG Audit Reports for FY 2006

The following chart provides more detail on the audit reports with open actions and the dollar value of recommendations and funds "put to better use" that were agreed to by management.

Audit Reports	Number of Reports	Agreed-Upon Funds Put to Better Use (in Millions)
Pending final action at the beginning of the period	96	\$ 683
With actions agreed upon during the period	61	\$ .079
Total pending final action	157	\$ 683
Achieving final action during the period	55	\$ 27 *
Requiring final action at the end of the period	102	\$ 656

\* Reflects a single amount also included in the IG's semi-annual report.

## Inspector General's Contract Audit Reports

To begin this period, final action had not been taken on one IG contract audit report. At the end of the fiscal year, there are no contract audit reports pending final action.

### Contract Audit Reports Statistical Table FY 2006

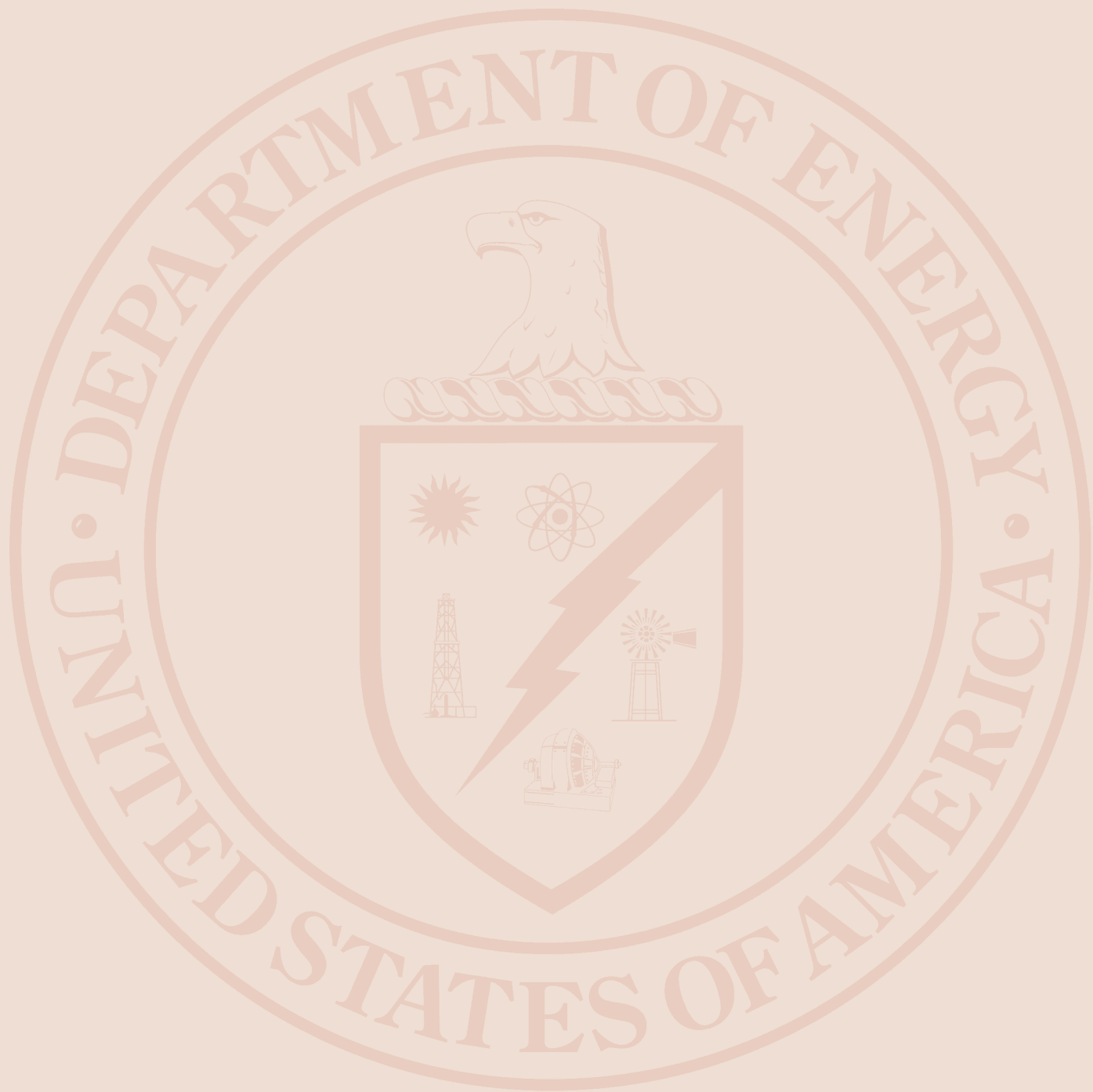
Total Number of IG Contract Audit Reports (Contract and Financial Assistance) and the dollar value of disallowed costs:

	Number of Reports	Disallowed Costs*
Contract audit reports with management decisions on which final action had not been taken at the beginning of the period	1	\$ 151,354
Contract audit reports issued on which management decisions were made during the period	-	-
Total contract audit reports pending final action during the period	-	-
Contract audit reports on which final action was taken during the period:		
Recoveries	1	\$ 151,354
Reinstatements	-	-
Total	1	\$ 151,354
Contract audit reports needing final action at the end of the period	0	0

\* The amount of costs questioned in the audit report with which the contracting officer concurs and has disallowed as a claim against the contract. Recoveries of disallowed costs are usually obtained by offset against current claims for payment and subsequently used for payment of other eligible costs under the contract.

## Government Accountability Office Audit Reports

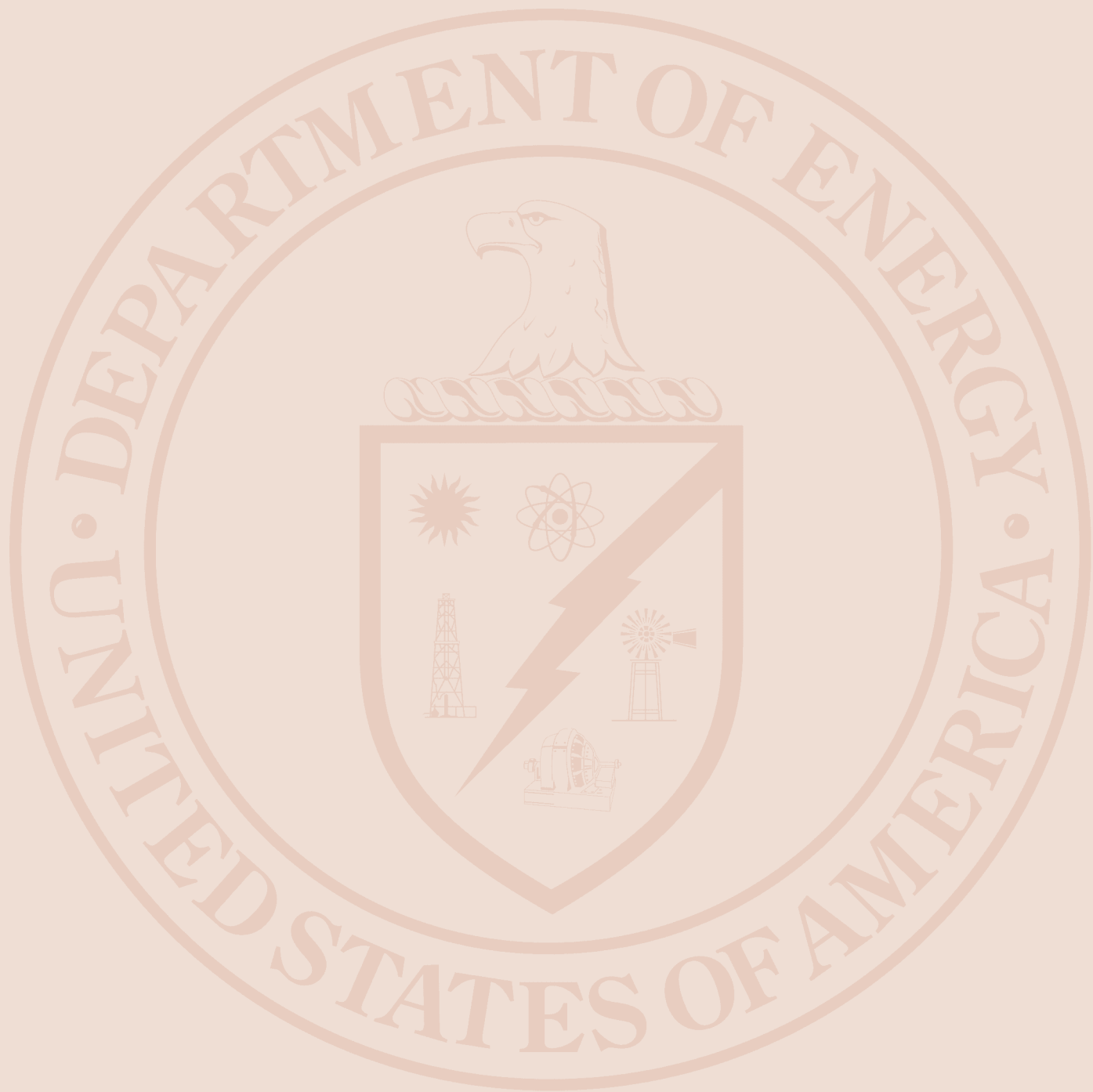
The U.S. Government Accountability Office (GAO) audits are a major component of the Department's audit follow-up program. At the beginning of FY 2006 there were 34 GAO audit reports awaiting final action. During FY 2006, the Department received 36 additional final GAO audit reports, of which 21 required tracking of corrective actions and 15 did not because the reports did not include actions to be taken by the Department. The Department completed agreed-upon corrective actions on 13 audit reports during FY 2006, leaving 42 GAO reports awaiting final action at year-end.





# GLOSSARY OF ACRONYMS

ACI .....	American Competitiveness Initiative	IPIA .....	Improper Payment Information Act
AEI .....	Advanced Energy Initiative	IT .....	Information Technology
AFCI .....	Advanced Fuel Cycle Initiative	ITER .....	in Latin, iter means “the way”
AMP .....	Asset Management Plan	kV .....	Kilovolt
APS .....	Advanced Photon Source	kW .....	Kilowatt
ASCR .....	Advanced Scientific Computing Research	kWh .....	Kilowatt Hour
ATLAS .....	Argonne Tandem Linac Accelerator System	LANL .....	Los Alamos National Laboratory
ATR .....	Advanced Test Reactor	LEU .....	Low Enriched Uranium
BABAR .....	B and B-bar Experiment	LM .....	Office of Legacy Management
BER .....	Biological and Environmental Research	MEO .....	Most Efficient Organization
BES .....	Basic Energy Sciences	MMS .....	Mineral Management Service
BPA .....	Bonneville Power Administration	MNA .....	Monitored Natural Attenuation
CDF .....	Collider	MOX .....	Mixed Oxide
CEBAF .....	Continuous Electron Beam Accelerator Facility	NE .....	Office of Nuclear Energy
CFO .....	Office of the Chief Financial Officer	NEP .....	National Energy Policy
CIO .....	Chief Information Officer	NERC .....	North American Electric Reliability Council
CMS .....	Centers for Medicare and Medicaid Services	NIF .....	National Ignition Facility
COL .....	Construction and Operating License	NNSA .....	National Nuclear Security Administration
CSPT .....	Cyber Security Project Team	NP .....	Nuclear Physics
CSRS .....	Civil Service Retirement System	NRC .....	Nuclear Regulatory Commission
D&D .....	Decontamination and Decommissioning	NREL .....	National Renewable Energy Laboratory
DARHT .....	Dual-Axis Radiographic Hydrotest	NSTX .....	National Spherical Torus Experiment
DBT .....	Design Basis Threat	NWF .....	Nuclear Waste Fund
DNN .....	Defense Nuclear Nonproliferation	NWPA .....	Nuclear Waste Policy Act
DoD .....	Department of Defense	OMB .....	Office of Management and Budget
DOE .....	Department of Energy	P.L. ....	Public Law
EERE .....	Energy Efficiency and Renewable Energy	PAR .....	Performance and Accountability Report
EIA .....	Energy Information Administration	PART .....	Program Assessment Rating Tool
EM .....	Office of Environmental Management	PMA .....	Power Marketing Administrations
EPA .....	Environmental Protection Agency	PMA .....	President’s Management Agenda
EPACT .....	Energy Policy Act	PMA .....	Power Marketing Administration
ERISA .....	Employee Retirement Income Security Act	PRB .....	Postretirement Benefits Other Than Pensions
ES&H .....	Environmental Safety and Health	PV .....	Photovoltaic
ESA .....	Endangered Species Act	R&D .....	Research & Development
ESE .....	Office of Energy, Science and Environment	RHIC .....	Relativistic Heavy Ion Collider
EVMS .....	Earned Value Management System	RRW .....	Reliable Replacement Warhead
FCRPS .....	Federal Columbia River Power System	RSI .....	Required Supplementary Information
FERC .....	Federal Energy Regulatory Commission	RSSI .....	Required Supplementary Stewardship Information
FERS .....	Federal Employees Retirement System	RTG .....	Radioisotope Thermoelectric Generator
FES .....	Fusion Energy Sciences	RW .....	Office of Civilian Radioactive Waste Management
FFMIA .....	Federal Financial Management Improvement Act	SAVs .....	Site Assistance Visits
FISMA .....	Federal Information Security Management Act	SC .....	Office of Science
FMFIA .....	Federal Managers’ Financial Integrity Act	SCADA .....	Supervisory Control and Data Acquisition
FSU .....	Former Soviet Union	SCE .....	Southern California Edison Company
FY .....	Fiscal Year	SciDAC .....	Scientific Discovery through Advanced Computing
GAAP .....	Generally Accepted Accounting Principles	SEPA .....	Southeastern Power Administration
GAO .....	Government Accountability Office	SFAS .....	Statement of Financial Accounting Standards
GE .....	General Electric	SFFAS .....	Statement of Federal Financial Accounting Standard
GMRA .....	Government Management Reform Act	SLAC .....	Stanford Linear Accelerator Center
GNEP .....	Global Nuclear Energy Partnership	SNF .....	Spent Nuclear Fuel
GPRA .....	Government Performance and Results Act	SNS .....	Spallation Neutron Source
GWh .....	Gigawatt Hour	SP .....	Office of Security and Safety Performance Assurance
HEP .....	High Energy Physics	SSP .....	Stockpile Stewardship Program
HEU .....	Highly-Enriched Uranium	STARS .....	Standard Accounting and Reporting System
HRIBF .....	Holifield Radioactive Ion Beam Facilities	SWPA .....	Southwestern Power Administration
HSS .....	Office of Health, Safety and Security	TRU .....	Transuranic
IG .....	Inspector General	TTC .....	Transformational Technology Core
IOU .....	Investor Owned Utilities	USEC .....	United States Enrichment Corporation
IP .....	Improper Payment	WIPP .....	Waste Isolation Pilot Plant



**We welcome your comments on how we can improve the Department of  
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