U.S. Department of Energy

Office of Inspector General

Office of Audits and Inspections

AUDIT REPORT

Management Letter on the Audit of the Department of Energy's Consolidated Financial Statements for Fiscal Year 2015

OAI-FS-16-06 January 2016

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

MANAGEMENT LETTER

December 16, 2015

Mr. Rickey R. Hass
Acting Inspector General
U.S. Department of Energy
1000 Independence Avenue, S.W.
Washington, DC 20585

Dear Mr. Hass:

In planning and performing our audits of the consolidated financial statements and closing package financial statements of the United States Department of Energy (the Department), as of and for the year ended September 30, 2015, 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. 15-02, *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 opinions on the consolidated financial statements and closing package financial statements, but not for the purpose of expressing an opinion on the effectiveness of Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented in Exhibit A for your consideration. 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.

In addition, we identified a deficiency in internal control related to the calculation of imputed costs that we consider a significant deficiency, and communicated this in writing in our audit report on November 16, 2015. Management's response and the auditor comments to this significant deficiency are included at Finding 16 in Exhibit A of this letter. We issue a separate management letter addressing information technology control deficiencies.

Our audit procedures are designed primarily to enable us to form opinions on the consolidated financial statements and closing package financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Department's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The Department's responses to the deficiencies identified in our audit are described 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.

The purpose of this letter is solely to describe comments and recommendations intended to improve internal control or result in other operating efficiencies. 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)* **Exhibit A**

OPEN FINDINGS – INTERNAL CONTROLS AND OTHER OPERATIONAL MATTERS

Environmental Liabilities

Background: The Department of Energy (Department) has several categories of environmental liabilities. The Office of Environmental Management (EM) program estimates include 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 Cold War. The Office of Legacy Management (LM) estimates include long-term surveillance and maintenance of Department sites and other sites involved in the nuclear weapons program where remediation measures have been substantially completed. Restructured environmental liabilities include cleanup projects and facilities that are not addressed in the EM or LM liabilities. Active facilities estimates, which are addressed later in this letter, include the stabilization, deactivation, and decommissioning of facilities that are still used in ongoing operations.

Finding 1: Miscalculation of EM Program Direction, Mission Support, and Technology Development Estimates **(15-HQ-EL-01**)

EM incorrectly calculated the Program Direction, Mission Support, and Technology Development estimates. EM calculated the estimates based upon percentages derived from a 14-year range instead of a 10-year range, which also included percentages with incorrect base years. Additionally, EM incorrectly hard coded certain amounts in the spreadsheet that should have been formulas, which resulted in the adjustment not equaling the amount that would have been calculated based on the formulas in the spreadsheet.

EM did not perform a detailed review over the calculations used to develop the Program Direction, Mission Support, and Technology Development estimates to ensure that the estimates include valid inputs and were properly calculated. As a result, the Program Direction, Mission Support, and Technology Development estimates were overstated by $931 million prior to an adjustment to correct these errors.

Recommendation:

1. We recommend that the EM Program Office's Acting Director, Office of Strategic Planning & Analysis, implement procedures to perform a detailed review over the calculations used to develop the Program Direction, Mission Support, and Technology Development estimates to ensure that the estimates include valid inputs and are properly calculated.

Management Response:

Management concurs with the recommendation and is performing a full review of the estimation methodology, calculations, and assumptions used for the Program Direction, Mission Support, and Technology Development estimates. This review and the implementation of any resulting changes will be completed by March 31, 2016.

Finding 2: Misstatement in West Valley's Prior Year Environmental Liability (**15-HQ-EL-02**)

As of September 30, 2014, certain cost estimates in the West Valley Demonstration Project's (West Valley) environmental liability were recorded in fiscal year (FY) 2014 current dollars, i.e., escalated dollars, instead of in FY 2014 constant dollars.

During the fourth quarter of FY 2014, West Valley updated its environmental liability estimate, but did not enter the adjustment into EM's Integrated Planning, Accountability, and Budgeting System (IPABS) based on direction from EM Headquarters. Instead, the adjustment was listed directly on the site's Note 3 in current FY 2014 escalated dollars instead of FY 2014 constant dollars. The prior period error was discovered during the Department's routine review of the FY 2015 third quarter environmental liability balances. West Valley's environmental liability was overstated as of September 30, 2014 by approximately $796.6 million.

Recommendation:

2. We recommend that the EM Program Office's Acting Director, Office of Strategic Planning & Analysis:

   a. Implement procedures to ensure that environmental liability cost estimates for the West Valley Demonstration Project are appropriately recorded in constant dollars; and

   b. Implement review procedures to ensure the correct reporting of liabilities in constant dollars, to include entering all adjustments in IPABS, thereby ensuring that all errors are identified that involve current and constant dollars.

Management Response:

Management concurs with the recommendations and will continue to ensure that all environmental liability adjustments are entered into IPABS consistent with current procedures, which will clearly identify and thereby prevent simple errors in reporting estimates in current instead of constant dollars. As this prior period error was self-identified and corrected (the liability estimate for West Valley was correctly reported in constant dollars at both third quarter and year-end), and consistent with our procedures the environmental liabilities adjustments were input into IPABS for FY 2015, management considers these recommendations closed.

Finding 3: Misstatement in Oak Ridge's Prior Year Environmental Liability (**15-HQ-EL-03**)

As of September 30, 2014, the cost estimate for Oak Ridge's Outfall 200 Mercury Treatment Facility did not include an estimate for the cost of operations and deactivation and decommissioning (D&D).

In FY 2014, the Critical Decision (CD)-0 was approved for the construction of the Outfall 200 Mercury Treatment facility. The CD-0 estimate did not include the cost of operations or D&D. At the end of FY 2014, there was uncertainty regarding the length and scope of operations of the facility. As such, Oak Ridge did not record an adjustment for the operations and D&D. Instead, Oak Ridge disclosed on its September 30, 2014 Note 3 that the CD-2 estimate, which would include costs for operations and D&D, was pending. Furthermore, EM did not review Oak Ridge's Note 3 during FY 2014 and was unaware of the uncertainty regarding the operations and D&D estimate. As such, a placeholder estimate was not recorded for the operations and D&D estimate as of September 30, 2014. There was a potential understatement of Oak Ridge's environmental liability of up to $125 million, including contingency, as of September 30, 2014.

Recommendation:

3. We recommend that the EM Program Office's Acting Director, Office of Strategic Planning & Analysis implement procedures to review all sites' Note 3s to ensure the environmental liability includes all costs that can be reasonably estimated as of the balance sheet date.

Management Response:

Management concurs with the recommendation and has expanded the Headquarters review of the site's environmental liability estimates and disclosures to include an assessment of all disclosed liabilities to determine whether disclosure is appropriate, or if a placeholder estimate can and should be done and reported.

Finding 4: Unauthorized Baseline Change Request Approval (**15-HQ-EL-04**)

From December 2014 to May 2015, three Integrated Site Team (IST) members that did not have approval authority per Standard Operating Policies and Procedures (SOPP) 74 approved 17 pending change requests (CRs) within the IPABS cost module.

Prior to the new change control process and implementation of SOPP 74, the three IST team members that approved the 17 CRs did have the authority to approve CRs within IPABS. When their roles and authorities regarding CRs changed, EM did not terminate their access to approve CRs in IPABS. The 17 Baseline Change Proposals that were outside of the current change control process did not have an effect on the FY 2015 environmental liability, as all the CRs were appropriate. However, the ability of unauthorized individuals to approve CRs can result in incorrect and/or inaccurate changes to EM program life cycle scope, cost, and schedule data, which could result in a misstated environmental liability being recorded in the Department's consolidated financial statements.

Recommendation:

4. We recommend that the EM Program Office's Acting Director, Office of Strategic Planning & Analysis implement a process to remove access and authority of users in IPABS that have changed roles and perform periodic reviews over the authorized users to verify their authorization is necessary and reasonable.

Management Response:

Management concurs with the recommendation and has implemented a process that has limited access and authority for final change request approvals to Office of Strategic Planning and Analysis staff and added approver's names to weekly IPABS activity reporting to further ensure only appropriate users are approving the change requests. These actions were fully implemented prior to FY 2015 year-end and management considers this recommendation closed.

Finding 5: Misstatement in Portsmouth Paducah Project Office's Prior Year Environmental Liability (**15-PPPO-EL-01**)

As of September 30, 2014, the cost estimate for the Portsmouth Paducah Project Office's (PPPO) Depleted Uranium Hexafluoride Conversion Project did not include all estimated costs for the disposal of oxide.

PPPO developed an estimate for the disposal of oxide in FY 2008. However, PPPO did not coordinate with the disposal site to determine if the estimate included the correct disposal costs for the volume of waste to be disposed. Therefore, the baseline estimate did not properly account for the disposal costs in FY 2008 or subsequent years. As a result, PPPO's environmental liability was understated by approximately $377 million as of September 30, 2014.

Recommendation:

5. We recommend that the Manager, Portsmouth Paducah Project Office implement procedures to ensure the environmental liability includes all costs that can be reasonably estimated as of the balance sheet date.

Management Response:

Management concurs. PPPO will, as part of the liability update process, emphasize to the project managers that all available information should be considered annually to ensure liability estimates are updated in accordance with accounting standards.

Finding 6: Misstatement in Portsmouth Paducah Project Office's Contingency (**15-PPPO-EL-02**)

PPPO incorrectly calculated contingency for a portion of its environmental cleanup cost. In previous years, PPPO performed three separate contingency calculations for Paducah: one calculation for decommissioning and demolition; and two calculations for environmental remediation (50 percent confidence and 80 percent confidence). The combination of the three calculations resulted in the total contingency estimate for Paducah. During FY 2015, the contingency for environmental remediation was consolidated into one calculation, essentially eliminating the 50 percent confidence contingency. However, PPPO added the 50 percent confidence amount, thereby overstating the contingency by $561 million as of September 30, 2015.

Recommendation:

6. We recommend that the Manager, Portsmouth Paducah Project Office implement procedures to ensure the contingency calculations are properly updated and reviewed.

Management Response:

Management concurs. Paducah anticipates approval of a life-cycle plan in FY 2017 that establishes an initial baseline for the Gaseous Diffusion Plant activities (e.g. utility operations, deactivation, and decommissioning and demolition). Once this plan is approved, Paducah will enter the complete Lifecycle Cost, including contingency, into IPABS. Until the life-cycle plan approval, PPPO will ensure that the spreadsheet used to combine Environmental Remediation (current work scope) and Gaseous Diffusion Plant contingency is updated appropriately.

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 stabilization, deactivation, and decommissioning costs from facilities included in EM's baseline estimates to those active and surplus facilities with similar characteristics owned by other (non-EM) programs. 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, square footage, and footprint for each building, from which the liability is calculated. Data collection for each facility includes the square footage or gallons and the assignment to one of 16 facility contamination model codes. In addition, AFDCS collects data regarding asbestos contamination in order to calculate a liability for affected facilities that would otherwise not require remediation. 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 7: Improper Recognition of Leased Facilities within the Active Facilities Data Collection System (**15-LBNL-A-01**)

Our review of a statistically selected sample of 20 facilities and structures disclosed that Lawrence Berkeley National Laboratory's (LBNL) active facilities population improperly included a liability related to asbestos for a leased facility. The lease does not provide for the transfer of the facility liability to LBNL; therefore, the liability is the responsibility of the lessor and should not have been included in LBNL's liability. To determine if any other leased buildings had similar errors, LBNL performed a review of all leased property and determined that two other facilities had the same error.

The miscoding of the facility resulted from a lack of sufficient review by the facility manager and subject matter expert assigned to review the model coding. As a result, LBNL overstated its active facilities liability by $1,817,597 as of June 30, 2015.

Recommendation:

7. We recommend that the Manager, Berkeley Site Office, direct Lawrence Berkeley National Laboratory to develop and implement policies and procedures to ensure that the employees responsible for assigning model types to facilities also perform sufficient review to ensure leased facilities, for which the Department has no clean up responsibility, are excluded from the Active Facilities Data Collection System.

Management Response:

Management concurs with the recommendation. The Berkeley Site Office (BSO) directed LBNL to establish appropriate policies and procedures to comply with all Federal laws, regulations and policies regarding categorizing leased facilities in the AFDCS. As of September 15, 2015, the AFDCS was updated with the appropriate coding of liabilities related to the Leased facilities. An adjustment to the General Ledger was made on September 25, 2015 to accurately state balances for the September 30, 2015 year-end financials. Communication on coding leased facilities procedures has been completed, and its effectiveness will be reviewed by the Federal Cognizant Officer prior to next year's submission.

Finding 8: Facilities Incorrectly Omitted from the Prior Year Liability Estimate (**15-ORNL-A-01**)

Based on the Oak Ridge Office of Environmental Management (OREM) exclusions list provided to ORNL, ORNL removed four facilities from its September 30, 2014 AFDCS modeled liability. The OREM estimate assumed these facilities would be re-used by the Office of Science (Science) upon facility cleanout and rerouting of process waste lines. However, the OREM non-modeled liability did not include the demolition cost for the four facilities. OREM discovered the error during FY 2015. The four facilities were included back in ORNL's modeled liability as of June 30, 2015.

Due to a miscommunication about the scope of work covered by the non-modeled liability, OREM informed Science that the non-modeled liability was inclusive of the demolition costs for four facilities at ORNL; however, the OREM estimate did not include demolition estimates for the four facilities. As a result, as of September 30, 2014, the Department understated its active facilities liability by $525.2 million, including contingency.

Recommendation:

8. We recommend that the Manager of the Oak Ridge Office of Environmental Management review its non-modeled estimates to determine if demolition of facilities is included or excluded

and work with the facility owner to ensure facilities are accordingly excluded from or included in the modeled estimate.

Management Response:

Management concurs. For FY 2015, OREM reviewed its list of non-modeled facilities to determine those that have a demolition estimate. This process identified four facilities owned by ORNL that did not have a demolition estimate but were inadvertently excluded from the FY 2014 modeled estimate. OREM re-categorized these four facilities and properly recorded them in the modeled estimate for FY 2015. Corrective entries were completed in the Department's accounting system, Standard Accounting and Reporting System, to address this in the fourth quarter of FY 2015. Going forward, OREM will perform this reconciliation between the non-modeled and modeled estimates by the end of the third quarter of each fiscal year.

<u>Human Resources</u>

Finding 9: Improper Segregation of Duties over Timecard Approvals (**15-LANL-H-01**)

During our control testwork over the design and implementation of payroll controls, we determined that the control in place to ensure that self-approved time cards were appropriately reviewed and approved by someone other than the employee submitting the timecard was not implemented and performed during FY 2015. Management within the Los Alamos National Laboratory (LANL) payroll department did not reassign responsibility for the performance of the monitoring control over self-approved timecards to a new control owner during FY 2015. After we identified the control weakness, LANL generated weekly self-approved time card reports upon the auditor's request. These reports included instances that appeared to be employees with self-approved time. However, the absence of implemented monitoring controls over the review of self-approved time sheets could result in accurate program costs being incurred and reported resulting in costs ultimately being determined to be unallowable and required to be recovered.

Recommendation:

9. We recommend that National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Los Alamos Site Office Manager, direct Los Alamos National Laboratory management to ensure that controls over the review of self-approved time sheets is implemented in accordance with current policies and procedures.

Management Response:

Management concurs. The National Nuclear Security Administration will direct LANL management to ensure that controls over the review of self-approved time sheets is implemented in accordance with current policies and procedures.

Corrective actions have already been implemented and status updates will be provided in the Departmental Audit Report Tracking System.

Finding 10: Calculation of Federal Employee Benefit Cost Factors (**15-HQ-H-01**)

During our substantive testwork over the calculation of the imputed costs related to benefit programs for the fourth quarter of FY 2015, we identified that the Department did not follow the instructions included in the Office of Personnel Management (OPM) Benefits Administration Letter Number 15-304.

The Department did not adequately review the calculation of imputed costs. During the calculation of the imputed costs related to pensions for the fourth quarter, the Department inadvertently did not use the updated Pension Cost Benefit Factor rates for Civil Service Retirement System and Federal Employees Retirement System employees, and this error was not identified in the Department's review of the calculation. The use of incorrect pension program cost factors resulted in an overstatement of $2.4 million in FY 2015 imputed costs and imputed financing sources.

Recommendation:

10. We recommend that the Director, Office of Finance and Accounting, ensure the Department thoroughly reviews imputed cost calculations for consistency with the instructions in OPM's Benefit Administration Letters.

Management Response:

Management concurs with the recommendation. Management will strengthen the payroll review process with regard to OPM's Benefit Administration Letters.

<u>Procurement</u>

Finding 11: Inaccurate Fiscal Year End Accrued Liability (**15-LBNL-D-01**)

Our review of a sample of subsequent cash disbursements and invoices received and processed at LBNL after September 30, 2015 identified one invoice that was under accrued by $597,648 as a result of the project manager not identifying the need for an accrual. The error resulted from a lack of sufficient review by the project manager at the time the accruals were recorded at year end. As a result, accounts payable and program costs were understated by $597,648 for the misstated accrual as of September 30, 2015.

Recommendation:

11. We recommend that the Manager, Berkeley Site Office direct Lawrence Berkeley National Laboratory to train and remind employees on the proper procedures for the accrual of costs dependent on completed work.

Management Response:

Management concurs with the recommendation. The Berkeley Site Office Manager will direct LBNL to train and remind employees on proper procedures for the accrual of costs dependent on completed work. Training to be completed by February 29, 2016.

<u>Property, Plant and Equipment (PP&E)</u>

Finding 12: Property, Plant and Equipment Incorrectly Expensed (**15-SNL-F-01**)

During our substantive testwork over capital asset additions, we discovered that two asset additions were purchased together to generate the required combined power output needed for a facility. The combined cost of the assets was approximately $260,000, but when combined with the additional building modifications necessary to put the assets into service, the total cost of the project exceeded the capitalization threshold in total. However, irrespective of the need for the two units to work together to generate the required power output, the Sandia National Laboratories (SNL) property management department incorrectly concluded that because the assets were separately tagged, and that their individual values were less than the capitalization threshold, that the assets should be expensed.

The lack of appropriate review of the assets intended usage by the SNL property management department failed to identify that the assets were purchased for a combined use which would support assessing the total cost of the assets for capitalization purposes as opposed to looking at the assets individually. The incorrect assessment of these two assets resulted in the total cost being allocated between the individual units, which resulted in the incorrect decision to expense the individual assets. As a result, there was an overstatement of expense by $532,788, and an understatement of property, plant and equipment, accumulated depreciation, and depreciation expense in FY 2015.

Recommendation:

12. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Sandia Site Office Manager, direct Sandia National Laboratories to develop training and remind employees of the existing policies and procedures related to whether incurred costs should be capitalized or expensed.

Management Response:

Management concurs. The National Nuclear Security Administration will direct SNL to develop training and remind employees of the existing policies and procedures related to whether incurred costs should be capitalized or expensed.

Finding 13: Inappropriate Classification of Lease Agreements (**15-LANL-F-01**)

During our dual purpose test work over leases for the interim period ending June 30, 2015, we discovered that LANL entered into a master lease-to-own (LTO) agreement in FY 2014 for the purchase of information technology hardware over a term of 103 months. The LTO met the criteria of Statement of Federal Financial Accounting Standards No. 5 to be classified as a capital lease, but was inappropriately accounted for as an operating lease.

Management within the LANL property accounting department did not perform an adequate review for appropriate application of accounting literature related to accounting for leases. As a result, the error in the classification of the capital lease resulted in the understatement of net property, plant and equipment, lease liability, and depreciation expense, and the overstatement of lease expense.

Recommendation:

13. We recommend that National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Los Alamos Site Office Manager, direct Los Alamos National Laboratory to train and remind employees of the appropriate accounting literature and existing policies and procedures in place to ensure the appropriate review and classification of leases.

Management Response:

Management concurs. The National Nuclear Security Administration will direct LANL to train and remind employees of the appropriate accounting literature and existing policies and procedures in place to ensure the appropriate review and classification of leases.

Finding 14: Property, Plant and Equipment Untimely Capitalization (**15-LANL-F-02**)

During our substantive test work over construction work in process (CWIP), we discovered that project P72G, a real property betterment, was completed and placed in service on September 4, 2014, but was not capitalized until August 12, 2015, which is not deemed to be timely capitalization of the project.

The untimely submission of the approved final cost report by the LANL Project Management department to the LANL Property Accounting department resulted in the untimely recording of the capitalization transaction. The delay in transferring assets from CWIP to a category of completed property, plant and equipment following their in-service date resulted in the understatement of accumulated depreciation and depreciation expense in the financial statements. As of March 4, 2015, LANL's property, plant and equipment for this asset was misclassified by overstating CWIP and understating structures and facilities by $8,905,531. This classification was corrected as of September 30, 2015.

Recommendation:

14. We recommend that National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Los Alamos Site Office Manager, direct Los Alamos National Laboratory to develop training and remind employees of the existing policies and procedures to ensure the timely recording of constructed assets.

Management Response:

Management concurs. The National Nuclear Security Administration will direct LANL to develop training and remind employees of the existing policies and procedures to ensure the timely recording of constructed assets.

<u>Nuclear Materials</u>

Finding 15: Standard Transfer Value Application Error (**15-LLNL-NM-01**)

From a sample of 15 items, we noted one item from Lawrence Livermore National Laboratory (LLNL) to be in error. LLNL incorrectly applied the standard transfer value (STV) to the transaction's nuclear materials quantity.

The particular nuclear material involved in this transaction can have more than one STV applied to its transactions, depending on its material characteristics. LLNL incorrectly input an amount when recording a characteristic of the nuclear material involved in this transaction. The incorrect value of the material characteristic consequently caused the incorrect STV to be applied to the transaction in LLNL's local nuclear materials control and accountability system, Local Area Network Material Accounting System (LANMAS). The error went undetected in the review of the transaction prior to it being recorded in LANMAS. As a result, the Department's nuclear materials inventory balance was misstated by a small amount as of June 30, 2015.

Recommendation:

15. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Lawrence Livermore Site Office Manager, direct Lawrence Livermore National Laboratory to ensure that persons responsible for the review of nuclear materials transactions are adequately trained and properly review standard transfer values for data entry errors.

Management Response:

Management concurs. The National Nuclear Security Administration will direct LLNL to ensure that persons responsible for the review of nuclear materials transactions are adequately trained and properly review standard transfer values for data entry errors.

<u>Financial Reporting</u>

Finding 16: Manual Calculation of Imputed Costs (**15-HQ-FR-01**)

The Department incorrectly calculated the imputed cost and imputed financing source for the Energy Employees Occupational Illness Compensation Program Act (EEOICPA). Specifically, officials incorrectly overstated these amounts related to the EEOICPA in the amount of $2.28 billion. The error in calculation was not identified during the review process and the incorrect amount was posted to the general ledger. As a result of our testwork, the Department corrected the error in the September 30, 2015 financial statements.

The Department has a documented process for calculating the imputed costs and the imputed financing source related to EEOICPA. Although the Department used a workbook with spreadsheet calculations to prepare and calculate the imputed cost for the entry, the 2015 workbook was not designed to calculate an amount in a decreasing liability scenario. In addition, a review of the journal entry prior to posting did not identify that the liability was decreasing.

Recommendation:

16. We recommend that the Director, Office of Finance and Accounting, modify the process to include the calculation of an amount in a decreasing liability scenario to support the calculation of the EEOICPA imputed costs and imputed financing source, and train both the preparer of the calculation and the reviewer of the journal entry on the modified process.

Management Response:

Management concurs with the recommendation; however, management does not concur that the EEOICPA error is a significant deficiency for the following reasons:

- The Federal Audit Manual Section 230.11 states that the auditor should set planning materiality at 3 percent. The Gross Costs (GC) on the FY 2015 Statement of Net Cost is $81 billion. The EEOICPA calculation error was $2.28 billion or 2.8 percent of GC. The error was .2 percentage points below the level of materiality for the Statement of Net Cost, and therefore, the amount alone is not sufficient to drive a significant deficiency.

- The Government Accountability Office (GAO) Financial Audit Manual states that consideration should be given to whether the information that was misstated was something that someone would have used for management decision-making purposes. The Department's imputed cost amount for the EEOICPA is not used for decision-making or management purposes.

- The amount of the error could not have been significantly higher without triggering additional review activity. KPMG has agreed that the look back process employed by the Department would have triggered additional analysis if the amount had been significantly different from previous years.

- The calculation error resulted from a single transaction and was not systemic.

- Procedures and internal controls are and were in place. We agree that the process used in the posting of the imputed costs needs to be strengthened. We do not agree that the internal controls were significantly deficient.

  - American Institute of Certified Public Accountants AU-C 265.A06 states the factors that affect the magnitude of a misstatement that might result from a deficiency in internal controls include:

    - The financial statement amounts or total of transactions exposed to the deficiency. The Department's error was one transaction for $2.28 billion, which is significantly below materiality of GC.

    - The volume of activity (in the current period or expected in future periods) in the account or class of transactions exposed to the deficiency. This single Department transaction occurs once a year and is posted to imputed cost and imputed financing.

- The finding on the EEOICPA posting does not rise to the materiality factors in AU-C312.04 on internal control deficiencies:

  - The auditor's consideration of materiality is influenced by the auditor's perception of the needs of users of financial statements. The perceived needs of users are recognized in the discussion of materiality in Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, which defines materiality as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

  - Given that no one relies on the Department imputed cost amounts for the EEOICPA for any purpose, the error does not meet this materiality test.

- The EEOICPA liability is on the Department of Labor's (DOL) books and the amount is an "imputed cost and financing" entry on the Department's books. It is not a cost entry for which the Department makes payments nor is it subject to fraud. This is a critical fact that must be considered. A reader who understands Federal Government financial statements would not be concerned by this incorrect imputed entry because DOL, not the Department, is responsible for EEOICPA payments.

For the above reasons, this was an error of no consequence below what we understand to be the materiality threshold, and therefore, a significant deficiency is unjustified.

Auditor Comments:

We appreciate management's response and concurrence to the recommendation. If fully implemented, management's corrective actions will improve the Department's internal controls over the manual calculation of imputed costs. However, we noted that GAO's Financial Audit Manual identifies a significant deficiency to include a misstatement of the entity's financial statements that is more than inconsequential. We maintain our position that a $2.3 billion error, representing 4.5 percent of the Department's 5-year average of net costs, although not material, is significant.

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, 2015**
Environmental Liabilities	
1. Legacy Management Estimates (**14-HQ-LM-01**)	Closed in FY 2015
2. Misstatement in the Recorded Surplus Plutonium Liability (**14-HQ-SP-01**)	Closed in FY 2015
3. Misstatements in Richland's Environmental Liability Due to Escalation (**14-RL-EL-01**)	Closed in FY 2015
Environmental Liabilities for Active Facilities	
4. Misstatement in Active Facilities Non-Modeled Estimate (**14-ORO-AF-01**)	Closed in FY 2015
5. Inaccuracies in the Active Facilities Liability (**14-LLNL-AF-01**)	Closed in FY 2015
6. Inaccuracies in the Active Facilities Liability (**14-NS1-AF-01**)	Closed in FY 2015
7. Improper Recognition of Leased Facilities within the Active Facilities Data Collection System **(14-NS1-AF-02)**	Closed in FY 2015
Human Resources	
8. Leave Approval Forms (**11-HQ-H-01**)	Closed in FY 2015
9. Lack of Documentation for Payroll Records (**14-HQ-H-01**)	Closed in FY 2015
10. Pension Assets Valuation Review (**14-Y12-P-01**)	Closed in FY 2015
11. Census Data Error (**14-SNL-P-01**)	Closed in FY 2015
12. Pension Assets Valuation Review (**14-SNL-P-02**)	Closed in FY 2015
Procurement	
13. Accounts Payable - Invalid Accounts Payable Balances **(13-NS1-PRO-01)**	Closed in FY 2015

14. Inaccurate Fiscal Year End Accrued Liability **(14-PRO-SNL-01)**	Closed in FY 2015
Property, Plant and Equipment (PP&E)	
15. PP&E Inaccurate Capitalization (**14-NS1-F-01**)	Closed in FY 2015
16. PP&E Asset Additions (**14-SNL-F-01**)	Closed in FY 2015
17. PP&E Accuracy of Transfers (**14-SNL-F-02**)	Closed in FY 2015
18. PP&E Useful Life Changes (**14-SNL-F-03**)	Closed in FY 2015
19. Lease Capitalization (**14-CH2-PPE-01**)	Closed in FY 2015

ACRONYMS

AFDCS	Active Facilities Data Collection System
AU-C	Statements on Auditing Standards and Related Auditing Interpretations (Clarified)
BSO	Berkeley Site Office
CD	Critical Decision
CR	Change Request
CWIP	Construction Work in Progress
D&D	Deactivation and Decommissioning
Department	Department of Energy
DOL	Department of Labor
EEOICPA	Energy Employees Occupational Illness Compensation Program Act
EM	Office of Environmental Management
FY	Fiscal Year
GC	Gross Costs
GAO	Government Accountability Office
IPABS	Integrated Planning, Accountability, and Budgeting System
IST	Integrated Site Team
LANL	Los Alamos National Laboratory
LANMAS	Local Area Network Material Accounting System
LBNL	Lawrence Berkeley National Laboratory
LLNL	Lawrence Livermore National Laboratory
LM	Office of Legacy Management
LTO	Lease-to-Own
OREM	Oak Ridge Office of Environmental Management
ORNL	Oak Ridge National Laboratory
OPM	Office of Personnel Management
PP&E	Property, Plant, and Equipment
PPPO	Portsmouth Paducah Project Office
SOPP	Standard Operating Policies and Procedures
STV	Standard Transfer Value