OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

OAI-FS-17-05 JANUARY 2017

MANAGEMENT LETTER ON THE AUDIT OF THE DEPARMENT OF ENERGY'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 2016

KPMG LLP
Suite 12000
1801 K Street, NW
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MANAGEMENT LETTER

December 14, 2016

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, 2016, 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.

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 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 reconciliation of environmental liabilities that we consider a significant deficiency, and communicated this in writing in our audit report on November 14, 2016. Management's response and the auditor comments to this significant deficiency are included at Finding 10 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: Cost of Delay and Repository Delay Prior Period Errors (**16-HQ-EL-01**)

During EM's preparation and review of the cost of delay and repository delay estimates for the Fiscal Year (FY) 2016 Consolidated Financial Statement Audit, EM identified errors in the cost of delay and repository delay estimates recorded as of September 30, 2015. Specifically, the cost of delay estimate was not calculated for the West Valley site and certain safeguards and security costs for years 2048 through 2054 were not included in the repository delay estimate calculation related to the Richland Operations Office cost of storage of spent nuclear fuel. As a result, the cost of delay contingency was understated by approximately $95 million and the repository delay contingency was understated by approximately $254 million, as of September 30, 2015.

The weaknesses identified were due, at least in part, because West Valley had an adjustment to the liability that was recorded outside of EM's Integrated Planning, Accounting, and Budgeting System (IPABS). The amounts in IPABS are used to compare to the reduced funding targets. Because the adjustment was recorded outside of IPABS, it was not factored into the cost of delay analysis. Also, for the repository delay error, the Richland Operations Office assumptions for storage of spent nuclear fuel were appropriately documented; however, the calculation failed to include the cost factor for safeguards and security for years 2048 to 2054 due to an oversight.

Recommendation:

1. We recommend that the Director, Office of Program Planning, strengthen procedures to ensure all factors, such as significant liability adjustments, assumptions, and related variables, are included in the cost of delay calculations and fully documented; and comprehensive reviews of contingency estimates that include field site personnel are performed.

Management Response:

Management concurs with the recommendation. Management has implemented processes to ensure that all factors are included and documented regarding the cost of delay estimates. We consider this finding closed upon issuance.

Finding 2: Error in Los Alamos's Long-Term Stewardship Estimate (**16-HQ-EL-02**)

The FY 2016 long-term stewardship (LTS) estimate for Los Alamos National Laboratory (LANL) was recorded to FY 2108, which is 17 years past the Department's 75 year accrual period. However, there is no existing regulatory requirement for work to be performed past FY 2091.

There was confusion among EM personnel over the Department's 75 year accrual assumption prior to transferring the LTS estimate to the National Nuclear Security Administration (NNSA). Rather than use the current fiscal year as the starting date for the 75 year period, it was believed that the LTS estimate should cover the period of 72 years past the EM closure date, which is FY 2036. As a result, the LTS estimate for LANL was overstated by $78 million as of September 30, 2016, prior to an adjustment to correct the error.

Recommendation:

2. We recommend that the Office of Environmental Management's Director, Office of Program Planning implement procedures to ensure that environmental liability estimates are correct before they are transferred to another program office.

Management Response:

Management concurs with the recommendation. Management will ensure that environmental liability estimates are correct before transfer out of EM by implementing procedures to properly formulate and account for LTS liabilities.

Environmental Liabilities for Active Facilities

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

Finding 3: Inaccuracies in the Active Facilities Liability (**16-LANL-A-01**)

Our review of a statistically selected sample of 30 facilities and structures from LANL's AFDCS population as of June 30, 2016 identified instances where LANL recorded incorrect gross square footage in AFDCS for 3 of the 30 samples selected for testing. As a result of the initial errors noted above, LANL reviewed its AFDCS data and determined that site personnel recorded incorrect gross square footage in AFDCS for an additional 15 facilities (18 facilities in total).

LANL officials did not perform procedures to verify the completeness and accuracy of gross square footage information entered into the Facilities Information Management System (FIMS), the Department's property, plant, and equipment database, via Archibus, LANL's subsidiary facilities database. Consequently, during the annual update of AFDCS, LANL uploaded square footage incorrectly for certain facilities.

Based on the Office of Finance and Accounting (OFA) and LANL analysis of the 18 errors noted in LANL's AFDCS data as of June 30, 2016, OFA and LANL determined that LANL's active facilities liability estimate was overstated by $2,134,800. Subsequently, LANL corrected the square footage errors and OFA posted a correcting entry to ensure LANL AFDCS was not significantly misstated as of September 30, 2016.

Recommendation:

3. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Los Alamos Field Office Manager, direct LANL officials to develop and implement policies and procedures to ensure the completeness and accuracy of information entered into AFDCS via FIMS.

Management Response:

Management concurs with the recommendation. The National Nuclear Security Administration will direct Los Alamos National Laboratory to develop and implement policies and procedures to verify the completeness and accuracy of information entered into AFDCS via FIMS.

Finding 4: Inaccuracies in the Active Facilities Liability (**16-INL-A-01**)

The Idaho National Laboratory (INL) improperly accrued approximately $186 million related to Other Structures and Facilities (OSF) that were not contaminated. In addition, the Idaho Operations Office and INL completed a review of the active facilities in their site-specific model and found that, in prior years, INL improperly accrued approximately $33 million related to facilities that were not contaminated.

The Idaho Operations Office and INL did not properly interpret accounting guidance issued by OFA in FY 2016 related to the Department's active facilities modeled liability. Based on review of the guidance, INL incorrectly recorded a liability for OSFs in the non-modeled estimate that were not contaminated. In addition, INL did not properly implement OFA guidance to ensure only facilities that were contaminated were included in the active facilities liability. INL's active facilities liability was overstated by $186 million as of June 30, 2016, prior to an adjusting entry to correct the error. INL's active facilities liability was overstated by approximately $33 million, as of September 30, 2015.

Recommendation:

4. We recommend that the Manager, Idaho Operations Office, implement policies and procedures to ensure that accounting entries are made following the relevant guidance and Department policies for recording environmental liabilities.

Management Response:

Management concurs with the recommendation. Policies and procedures are in place to accurately record environmental liabilities in accordance with Departmental guidance. As a result, the INL has already made the necessary adjustments to the restructured environmental liability so that FY 2016 ending liability balances reflect accurate values. Management considers this finding to be closed.

Fund Balance with Treasury

Finding 5: Unreconciled Fund Balance with Treasury Accounts (**16-HQ-S-01**)

The Department had not implemented adequate controls to ensure that all Treasury accounts were included and reconciled when performing the June 30, 2016 Government-Wide Accounting (GWA) Reconciliation. Our test work over the Department's June 30, 2016 GWA Reconciliation identified one unreconciled Treasury Account Fund Symbol (TAFS) (0892247) totaling $114,243,087.88. The omission was not identified during the managerial review process.

The Department's process to prepare the monthly GWA Reconciliation did not include the necessary procedures to ensure the completeness and accuracy of the information included within the reconciliation process. In addition, the precision of the managerial review for the GWA Reconciliation was insufficient to detect the omission. As a result, The GWA Reconciliation was not properly performed for the period ending

June 30, 2016, causing the TAFS to remain unreconciled and excluded from the Fund Balance with Treasury (FBwT) Financial Statement balance. After our testwork identified this exception, we were able to obtain assurance over the unreconciled items through follow-up with the Department's Cash Management teams and the Financial Reports Division. Even though we determined that this particular TAFS (0892247) is returned to Treasury as of the end of the fiscal year and would have no balance included on the Department's fiscal year-end FBwT, the improper execution of the interim reconciliation could lead to unreconciled differences between the Department's FBwT balance and the Treasury balance.

Recommendation:

5. We recommend that the Director, Office of Finance and Accounting, re-evaluate and strengthen the design of the internal controls over the GWA Reconciliation procedure and train both the preparer and reviewer on the necessary steps to ensure the reconciliation is complete, accurate, and inclusive of all relevant TAFSs.

Management Response:

Management concurs with the above finding; however, management does not believe that unreconciled differences could occur between the Department's FBwT balance and the Treasury balance as other internal controls and GWA statements serve as control totals to alert of any discrepancies. Additionally, GTAS (Governmentwide Treasury Account Symbol Adjusted Trial Balance System) edits trigger OFA staff to ensure all hard edits be passed through the reconciliation of FBwT and the Treasury balance.

The OFA staff record manual general ledger entries to zero out the cash balances related to regular Department allottees. The Power Marketing Administrations and the Federal Energy Regulatory

Commission send year-end entries to zero out any cash in miscellaneous receipt funds related to Power Marketing Administration and the Federal Energy Regulatory Commission allottees. The OFA will re-evaluate and strengthen the design of the internal controls over the GWA Reconciliation procedure by developing and implementing a corrective action plan to ensure updates of the Cash Reconciliation procedures are made and training conducted with the preparer and reviewer on the necessary steps and internal controls to ensure the reconciliation is complete, accurate, and inclusive of all relevant TAFSs.

Procurement

Finding 6: Inappropriate Classification of Fixed Assets (**16-SNL-D-01**)

While performing procedures to determine the status of the prior year finding 15-SNL-F-01, *Property, Plant and Equipment Incorrectly Expensed*, we were informed by management that the root cause of the misclassification errors identified in the prior year finding continue to exist, despite the completion of the Corrective Action Plan associated with the prior year finding. Specifically, a current year asset was incorrectly expensed in the fixed asset module; however, it was properly reflected in the financial system in Construction Work-in-Process (CWIP). Also, a bulk acquisition was not identified as such and capitalized, but rather incorrectly expensed in the fixed asset module and within the financial reporting system.

Sandia National Laboratory's (SNL's) Property Management personnel in the Procurement department had not properly reviewed the classification of asset acquisitions to determine whether an acquisition met the requirements for capitalization. The classification errors in the fixed asset module and the financial reporting system resulted in an overstatement of expenses and an understatement of CWIP in the amount of $135,000.

These errors were corrected in the September 30, 2016, financial statements.

Recommendation:

6. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Sandia Field Office Manager, direct Sandia National Laboratories' management to revise the current control procedures related to the Procurement department's property management processes surrounding the review and classification of fixed asset additions and bulk acquisition asset additions. Specifically, these revisions should include guidance as to the proper accounting for recording fixed assets as capitalized versus expensed to ensure that these assets are properly classified in both the fixed asset module and the financial reporting system.

Management Response:

Management concurs with the recommendation. NNSA will direct Sandia National Laboratory to revise the current control procedures related to the Procurement department's property management processes surrounding the review and classification of fixed asset additions and bulk acquisition asset additions. NNSA will verify that these revisions include guidance for the proper accounting and recording of fixed assets as capitalized versus expensed and that assets are properly classified in both the fixed asset module and the financial reporting system.

Finding 7: Inaccurate Fiscal Year End Accrued Liability (**16-SNL-D-02**)

As a result of our testing over the Search for Unrecorded Liabilities, we identified two invoices for medical claims occurring during the week September 17, 2016 through September 23, 2016 that were not properly accrued. In addition, we determined that costs associated with prior year claims were incorrectly expensed in the current year as the prior year accrual was under-accrued.

SNL's post retirement welfare benefits personnel were not properly reviewing and accounting for expenses and liabilities associated with invoices occurring between the close of the accounting system and the fiscal year end. As a result, Accounts Payable was understated by $1,451,994 as of September 30, 2016. In addition, current year expenses were overstated by approximately $329,043 as a result of the error in the current year and prior year accrual.

Recommendation:

7. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Sandia Field Office Manager, direct Sandia National Laboratories' management to train and re-enforce requirements to employees on the proper accrual of costs within the appropriate fiscal year reporting period.

Management Response:

Management concurs with the recommendation. NNSA will direct Sandia National Laboratories to train and re-enforce requirements to employees on the proper accrual of costs within the appropriate fiscal year reporting period.

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

Finding 8: Inaccurate Disclosure of Future Operating Lease Payments (**16-NNSA-F-01**)

As a result of our request for a detailed listing of all operating leases as of September 30, 2015, the Department performed additional procedures to prepare a complete and accurate population of operating leases. Our review of the Department's analysis of the listing of operating leases for disclosure of future payments identified lease agreements that were non-cancellable and that had not been appropriately included in the FY 2015 future operating lease disclosure. These include two lease agreements in Kansas City and one in Nevada that are managed by NNSA.

We determined that the issues identified occurred, at least in part, because NNSA did not have the proper procedures in place during FY 2015 to ensure that the future minimum lease payments for all Federal and non-Federal operating leases were properly included within the FY 2015 footnote disclosure. As a result, there is an increased risk of material misstatement related to required lease disclosures. We determined that the Department's future operating lease payments disclosure as of September 30, 2015, was understated by approximately $1.1 billion for the three omitted leases.

Recommendation:

8. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer implement a process to validate that future operating lease payments for all applicable Federal and non-Federal operating leases are properly reported for the year; and train employees on the proper disclosure requirements.

Management Response:

Management concurs with the recommendation. NNSA (NA-MB) will implement a process to validate that future operating lease payments for all applicable Federal and non-Federal operating leases are properly reported for the year; and train employees on the proper disclosure requirements.

<u>Nuclear Materials</u>

Finding 9: Lack of Readily Available Transaction Detail (**16-Y12-N-01**)

The Y-12 National Security Complex (Y-12) was unable to provide transaction-level detail that reconciled to the inventory costs recorded in ABC Financials for Weapons Inventory Losses (Summary Class Code (SCC) 69) as of May 31 and September 30, 2016. Timing differences existed between the transaction-level detail available in Y-12's local nuclear materials control and accountability system and the amount that was recorded in ABC Financials. The current year activity in SCC 69 was not financially significant as of September 30, 2016

The issues identified occurred, at least in part, because historical point-in-time reports were not readily available in Y-12's local nuclear materials control and accountability system. A summary-level report, which reflects the inventory activity for the month as of the point-in-time that the report is created, was provided on a monthly basis by the Nuclear Materials Control and Accountability group to the Financial Accounting group to record the weapons inventory losses in ABC Financials. However, the Nuclear Materials Control and Accountability group did not save transaction-level detail populations at the time when the summary-level reports were created. Due to access restrictions, the financial accounting group did not have access to the transaction-level detail in Y-12's nuclear materials control and accountability system. As a result, the transaction-level detail was not reconciled to ABC Financials. The inventory balance in SCC 69 may be misstated if it is not supported by a reconciled detail.

Recommendation:

9. We recommend that the National Nuclear Security Administration's Field Chief Financial Officer, in conjunction with the Y-12 Field Office Manager, direct Consolidated National Security to implement policies and procedures to ensure that adequate transaction level detail is retained for all balances recorded in ABC Financials; and reconciliations of transaction level detail are performed to ensure that the inventory activity captured in ABC Financials is complete and accurate.

Management Response:

Management concurs with the recommendation. NNSA will direct Consolidated National Security to implement policies and procedures to verify that adequate transaction level detail is retained for all balances recorded in ABC Financials; and reconciliations of transaction level detail are performed to verify that the inventory activity captured in ABC Financials is complete and accurate.

Financial Reporting

Finding 10: Errors in Environmental Liability Reconciliation Process (**16-HQ-FR-01**)

- We determined that errors existed in the OFA's environmental liability reconciliation process as of September 30, 2016. Specifically, we found:

- The Washington Note 3, which lists the components of the environmental liability estimate, did not include an adjustment to the Surplus Plutonium liability estimate of $2.454 billion. Upon further review during the process of vetting the finding, the Department, with additional information presented by the National Nuclear Security Administration, determined that the entry was not required;

- The Washington Note 3 did not include the correct balance for the EM Headquarters project costs for FY 2016. The Note 3 listed the change in costs for the fourth quarter of $192 million instead of the total costs for all of FY 2016 of $750 million;

- The EM cost of delay contingency estimate for the Idaho Operations Office reported on the Idaho Note 3 did not agree to the final cost of delay contingency calculated by EM. Although the amount recorded was $731 million, the final contingency estimate was $752 million; and

- The EM repository delay contingency estimate for West Valley reported on the Consolidated Business Center's (CBC) Note 3 did not agree to the final repository delay contingency calculated by EM. Although the amount recorded was $47 million, the final contingency estimate was $32 million.

The issues identified occurred, at least in part, because the individuals preparing the environmental liability reconciliation as of September 30, 2016 were new to the process due to turnover in OFA personnel in the fourth quarter of FY 2016. We determined that OFA did not have a complete set of procedures for the new individuals to follow, which resulted in staff not fully reconciling the Note 3s to the final balances. As a result, we determined the absolute value of the errors identified amounted to $3.05 billion as of September 30, 2016, prior to adjustments to correct the errors.

Recommendation:

10. We recommend that the Director, Office of Finance and Accounting, implement controls to ensure that all entries related to the environmental liability estimates are recorded appropriately in the Standard Accounting and Reporting System (STARS) and that the amounts recorded on the Note 3s are accurate and agree to supporting documentation.

Management Response:

The US Army Corps of Engineers (USACE) provided a revised estimate of the Mixed Oxide Fuel Fabrication Facility (MOX) in mid-August 2016, which extended the timeline for an additional 19 years. This revised estimate did not include costs for additional items such as storage for the additional time period. An EM staff member provided a rough (everyone agrees that this was a "back of the envelope") estimate of $2.454 billion for this storage. On October 20, 2016, The Office of the Chief Financial Officer (OCFO) suggested for the $2.454 billion to be disclosed as a footnote due the uncertainty of the cost alignment, but KPMG proposed that OCFO book this $2.454 billion. The requirement to align costs and to book the contingency was originally identified by KPMG during discussions between EM, NNSA and OCFO regarding the timing and scope of a new estimate provided by NNSA and prepared by USACE for MOX. As of October 28, 2016 the OCFO did not record the additional estimated contingent liability.

Subsequent to October 28, 2016 OCFO recorded the $2.454 billion estimated contingent liabilities. The estimated contingent liability was recorded with EM's confirmation it was only to be posted as a contingent liability and not a life cycle cost liability. The rough estimate submitted by EM had yet to go through the full review process by NNSA and EM offices.

However, during the exit conference on November 10, 2016, it was confirmed by the NNSA MOX Program Executive that the $2.454 billion is an uncertain cost to the program and should not have been included as part of the MOX cost alignment. This is also noted [in the finding above]. As a result of the exit conference discussion, the OCFO reversed the $2.454 billion and footnoted the uncertainty of the cost alignment as originally had planned prior to the conversation with KPMG LLP.

OCFO disagrees with KPMG's determination that this issue is a significant deficiency for the following reasons:

- **Procedures and internal controls are and were in place. OCFO has a process in place to review the statements and Agency Financial Report (AFR) before it is finalized and published.** OCFO has provided the procedures and evidence of the review activity for FY 2015 and FY 2016 to KPMG. OCFO originally wanted this $2.454 billion cost to be disclosed in the footnote. This approach was subsequently confirmed by the NNSA MOX Program Executive that this cost involved too much uncertainty and it shouldn't be included as a liability on our Balance Sheet. Therefore, there is no breakdown in the process controls over the preparation of the financial statements. The measurability and the probability of this cost does not meet the conditions within Statement of Federal Financial Accounting Standards (SFFAS) 5 on contingencies.

- **The amount is not information that management will rely on and will not form a basis for decision-making.** The Government Accountability Office (GAO) Financial Audit Manual (FAM) 540.02 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. Due to the uncertainty of the program direction/ approach and the associated cost alignment, the entry should not be included in the liability on the Balance Sheet because the MOX approach of the surplus plutonium disposition is facing potential termination of its project. By disclosing the cost alignment information in the footnote, this will ensure that information is presented as accurately reasonable for management decision-making.

- **Even if the adjustment was needed to align with the USACE MOX, it is immaterial** because it was only 0.66% of the total Environmental Cleanup and Disposal Liabilities and makes up 0.48% of the Department's $510.721 billion total liability.

- **Even if the adjustments noted in the Conditions section of the Notification of Findings and Recommendations (NFR) were needed, the amounts are significantly below materiality of total liabilities.** American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards and Related Auditing Interpretations (Clarified) (AU-C) 265.A06 provides the factors that identify the magnitude of a misstatement that might result from a deficiency in internal controls as follows:

- The financial statement amounts or total of transactions exposed to the deficiency - The DOE error was 4 transactions for an absolute value of $3.05 billion, which is significantly below materiality of the total liabilities of $510.721 billion.

- **The amount in contention is not material to result in a finding of a significant deficiency.** The Gross Costs on the FY 2016 Statement of Net Cost is $79 billion. The errors from the Headquarters (HQ) reconciliation of Note 3 was a net adjustment of $1.90 billion or 2.4% of Gross Costs (GC).

- **The finding on the HQ Note 3 reconciliation process does not rise to the materiality factors in AU-C312.04.**

  - 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 (FASB) 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".

The 4 noted transactions under the Condition section of the NFR occur once a year and 3 of the 4 transactions were placeholders or contingent liabilities. Given that the Environmental Cleanup and Disposal Liabilities includes subjective judgments on estimates, uncertainty on the future path of the approach currently undertaken, uncertainty of reliability of some of the details of the estimates in calculating certain contingencies related to environmental liabilities as a whole based on current knowledge, experience and technology regarding clean-up activities in consideration of future events, the qualitative characteristics involved does not meet a supportable judgment process of this materiality test.

Procedures and internal controls are and were in place. DOE has an established process in place to review the statements and AFR before it is finalized and published. It is management's judgment that Conditions noted in this NFR would have been identified by DOE before the final statements were delivered. In addition it is also management's judgment that [the situation related to MOX] should have been disclosed in the footnote and was confirmed by NNSA from a programmatic perspective. Thus, there was no omission in reporting liabilities that would mislead the reader of the financial statements nor would lead to incorrect management decision- making.

For the above reasons, and on the basis of reasonableness and management professional judgment, we do not concur that the finding rises to a significant deficiency.

Auditor Comments:

Management did not agree that improved controls were needed to address the four identified errors. While management asserted that it would have identified the errors prior to the issuance of the financial statements, our review of the documentation provided in response to the finding did not find that the management review referred to in their response operated at a level of precision to identify the errors in a timely manner. A majority of the documentation evidenced reviews that were contemporaneous with the errors and as such did not demonstrate a compensating review. The documentation that evidenced a final review did not demonstrate a level or precision to compensate for the errors we noted. We maintain our recommendation that the Department implement improved controls over the environmental liability reconciliation process.

GAO's Financial Audit Manual identifies a significant deficiency to include a misstatement on the entity's financial statement that is more than inconsequential. We maintain our position that errors aggregating to $3.05 billion, representing 4.8 percent of the Department's net costs, although not material is more than inconsequential.

Finding 11: Misclassification in Disposition of Custodial Revenue (**16-HQ-FR-02**)

The Southeastern Power Administration (SEPA) and Southwestern Power Administration (SWPA) incorrectly recorded custodial disposition of revenue to standard general ledger code 5991, causing $83 million and $25 million, respectively, to appear in the Decreases/(Increases) in Amounts to be Transferred line instead of the agency to which the collections were transferred. In addition, SWPA entered an incorrect other party identifier (OPI) code, causing $105 million transferred to the Army Corps of Engineers to appear in the Department of Treasury line.

We determined that this error occurred because SEPA and SWPA misunderstood guidance from OFA and used an incorrect standard general ledger code to record the disposition of custodial revenue and SWPA entered an incorrect OPI code. In addition, OFA and SEPA/SWPA were not able to resolve these errors in a timely manner. As a result, in the Disposition of Revenue section of the consolidated Statement of Custodial Activities, the Department of Treasury line was overstated by $22 million, the Army Corps of Engineers line was understated by $130 million, and the Decrease/Increase in Amounts to be Transferred was overstated by $108 million, prior to adjustments to correct the errors.

Recommendation:

11. We recommend that the Chief Financial Officers of SEPA and SWPA provide additional accounting training to their employees for recording custodial activity and implement controls to ensure that correct accounting entries are submitted to OFA for posting.

    We also recommend that the Director, Office of Finance and Accounting, implement controls to ensure PMA custodial amounts are properly reported.

Management Response:

Management at SEPA/SWPA/OFA concurs with these recommendations. OFA will work closely with SWPA and SEPA in fiscal year 2017 and meet in person to better understand their custodial accounting and how they crosswalk their data from their local accounting systems to the entries they submit to OFA for posting in STARS. SWPA and SEPA will ensure that both the preparer and the reviewer of the accounting entries at their sites have proper Federal accounting training, understand any related OFA guidance and that all journal entries submitted to OFA will be reviewed by a second party prior to submitting entries to OFA for posting. OFA will also start performing a more in-depth quarterly analysis of custodial activity by PMAs to include significant balance changes and a general review for reasonableness.

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, 2016**
Environmental Liabilities	
1. Miscalculation of Environmental Management Program Direction, Mission Support, and Technology Development Estimates (**15-HQ-EL-01**)	Closed in FY 2016
2. Misstatement in West Valley's Prior Year Environmental Liability (**15-HQ-EL-02**)	Closed in FY 2016
3. Misstatement in Oak Ridge's Prior Year Environmental Liability (**15-HQ-EL-03**)	Closed in FY 2016
4. Unauthorized Baseline Change Request Approval (**15-HQ-EL-04**)	Closed in FY 2016
5. Misstatement in Portsmouth Paducah Project Office's Prior Year Environmental Liability (**15-PPPO-EL-01**)	Closed in FY 2016
6. Misstatement in Portsmouth Paducah Project Office's Contingency (**15-PPPO-EL-02**)	Closed in FY 2016
Environmental Liabilities for Active Facilities	
7. Improper Recognition of Leased Facilities within the Active Facilities Data Collection System (**15-LBNL-A-01**)	Closed in FY 2016
8. Facilities Incorrectly Omitted from the Prior Year Liability Estimate (**15-ORNL-A-01**)	Closed in FY 2016
Human Resources	
9. Improper Segregation of Duties over Timecard Approvals (**15-LANL-H-01**)	Closed in FY 2016
10. Calculation of Federal Employee Benefit Cost Factors (**15-HQ-H-01**)	Closed in FY 2016

Procurement

11. Inaccurate Fiscal Year End Accrued Liability (**15-LBNL-D-01**) Closed in FY 2016

Property, Plant, and Equipment (PP&E)

12. Property, Plant and Equipment Incorrectly Expensed (**15-SNL-F-01**) Closed in FY 2016

13. Inappropriate Classification of Lease Agreements (**15-LANL-F-01**) Closed in FY 2016

14. Property, Plant and Equipment Untimely Capitalization (**15-LANL-F-02**) Closed in FY 2016

Nuclear Materials

15. Standard Transfer Value Application Error (**15-LLNL-NM-01**) Closed in FY 2016

Financial Reporting

16. Manual Calculation of Imputed Costs (**15-HQ-FR-01**) Closed in FY 2016

ACRONYMS

AFDCS	Active Facilities Data Collection System
AFR	Agency Financial Report
AICPA	American Institute of Certified Public Accountants AU-C Statements on Auditing Standards and Related Auditing Interpretations (Clarified)
CWIP	Construction Work in Progress
Department	Department of Energy
EM	Office of Environmental Management
FAM	Financial Audit Manual
FASB	Financial Accounting Standards Board
FBwT	Fund Balance with Treasury
FIMS	Facilities Information Management System
FY	Fiscal Year
GAO	Government Accountability Office
GC	Gross Costs
GWA	Government-Wide Accounting
HQ	Headquarters
INL	Idaho National Laboratory
LANL	Los Alamos National Laboratory
LM	Office of Legacy Management
LTS	Long-Term Stewardship
MOX	Mixed Oxide Fuel Fabrication Facility
NFR	Notification of Findings and Recommendations
NNSA	National Nuclear Security Administration
OFA	Office of Finance and Accounting
OCFO	Office of the Chief Financial Officer
OPI	Other Party Identifier
OSF	Other Structures and Facilities
PP&E	Property, Plant, and Equipment
SEPA	Southeaster Power Administration
SFFAS	Statement of Federal Financial Accounting Standards
SNL	Sandia National Laboratory
SCC	Summary Class Code
SWPA	Southwestern Power Administration
STARS	Standard Accounting and Reporting System
TAFS	Treasury Account Fund Symbol
USACE	U.S. Army Corps of Engineers
Y-12	Y-12 National Security Complex