U.S. Department of Energy

Office of Inspector General

Office of Audits and Inspections

AUDIT REPORT

Department of Energy's Fiscal Year 2015 Consolidated Financial Statements

OAI-FS-16-01

November 2015

Department of Energy
Washington, DC 20585

November 16, 2015

MEMORANDUM FOR THE SECRETARY

FROM: Rickey R. Hass
Acting Inspector General

SUBJECT: INFORMATION: Audit Report: "Department of Energy's Fiscal Year 2015 Consolidated Financial Statements"

Pursuant to requirements established by the *Government Management Reform Act of 1994*, the Office of Inspector General (OIG) engaged the independent public accounting firm of KPMG LLP (KPMG) to perform the audit of the Department of Energy's Fiscal Year 2015 Consolidated Financial Statements.

KPMG audited the consolidated financial statements of the Department as of September 30, 2015 and 2014, and the related consolidated statements of net cost, changes in net position and custodial activity, and combined statement of budgetary resources for the years then ended. KPMG concluded that these consolidated financial statements are presented fairly, in all material respects, in conformity with United States generally accepted accounting principles and has issued an unmodified opinion based on its audits and the reports of other auditors for the years ended September 30, 2015 and 2014.

As part of this audit, auditors also considered the Department's internal controls over financial reporting and tested for compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on the consolidated financial statements. The audit revealed a certain deficiency in internal control related to the manual calculation of imputed costs. The following significant deficiency in the Department's system of internal control is not considered a material weakness:

> **Manual Calculation of Imputed Costs:** The Department had not implemented effective controls to properly calculate the imputed cost and imputed financing for the *Energy Employees Occupational Illness Compensation Program Act*. Due to an improperly designed spreadsheet and the lack of an effective review process, the Department initially recorded an overstatement of this liability of $2.28 billion. Although management agreed with the weakness, it did not concur that the issue warranted a significant deficiency.

The audit also identified one instance of noncompliance that is required to be reported under applicable audit standards and requirements. During fiscal year 2015, the Department reported an *Antideficiency Act* violation in which appropriated funds were used for the payment of services to an individual carrying out the responsibilities of a position that required Senate advice and consent in an acting or temporary capacity after the second submission of a nomination for that individual to the position had been withdrawn or returned to the President.

The OIG issued numerous notices of finding and recommendation to management during the course of the audit. In the vast majority of instances, management concurred with the findings and recommendations. However, responses to three information technology–related findings indicated either a partial concurrence or a nonconcurrence. All findings will be detailed in forthcoming management letters, and a management decision will be requested, as appropriate.

KPMG is responsible for the attached auditor's report and the opinions and conclusions expressed therein. The OIG is responsible for technical and administrative oversight regarding KPMG's performance under the terms of the contract. Our review was not intended to enable us to express, and accordingly we do not express, an opinion on the Department's financial statements, management's assertions about the effectiveness of its internal control over financial reporting, or the Department's compliance with laws and regulations. Our monitoring review disclosed no instances where KPMG did not comply with applicable auditing standards.

I would like to thank each of the Departmental elements for their courtesy and cooperation during the review.

Attachment

cc: Deputy Secretary of Energy
Administrator for the National Nuclear Security Administration
Under Secretary for Science and Energy
Deputy Under Secretary for Management and Performance
Chief of Staff
Chief Financial Officer

Department financial reports are available for download on the Office of the Chief Financial Officer Web site: http://www.energy.gov//cfo/reports/agency-financial-reports.

Attachment

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Independent Auditors' Report

The Inspector General, United States Department of Energy and
The Secretary, United States Department of Energy:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the United States Department of Energy (Department), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the United States Department of Energy as of September 30, 2015 and 2014, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matters

As discussed in Note 7 to the consolidated financial statements, the Department has total direct loans and loan guarantees, net, of $17 billion and $16 billion as of September 30, 2015 and 2014, respectively, which are issued under the *Federal Credit Reform Act of 1990*. Subsidy costs of the direct loans and loan guarantees are intended to estimate the long-term cost to the U.S. Government of its loan program and include interest rate differentials, delinquencies, defaults, fees, and other cash flow items. A subsidy re-estimate is performed annually at September 30. Any adjustment resulting from the re-estimate is recognized as subsidy expense. Our opinion is not modified with respect to this matter.

As discussed in Note 15 to the consolidated financial statements, the cost estimates supporting the Department's environmental cleanup and disposal liabilities of $340 billion and $300 billion as of September 30, 2015 and 2014, respectively, are based upon assumptions regarding funding and other future actions and decisions, many of which are beyond the Department's control. Our opinion is not modified with respect to this matter.

As discussed in Note 18 to the consolidated financial statements, the Department is involved as a defendant in several matters of litigation relating to its inability to accept commercial spent nuclear fuel by January 31, 1998, the date specified in the *Nuclear Waste Policy Act of 1982*, as amended. The Department has recorded liabilities for likely damages of $24 billion and $23 billion as of September 30, 2015 and 2014, respectively. Our opinion is not modified with respect to this matter.

Other Matters

Management has elected to reference to information on websites or other forms of interactive data outside the *Agency Financial Report* to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly, we do not express an opinion or provide any assurance on it.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The consolidating information in the Consolidating Schedules section, the Message from the Secretary, the Message from the Chief Financial Officer, and Other Information section of the Department's Fiscal Year 2015 *Agency Financial Report* are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements.

The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the basic consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the basic consolidated financial statements as a whole.

The information in the Message from the Secretary, the Message from the Chief Financial Officer, and Other Information section of the Department's Fiscal Year 2015 *Agency Financial Report* has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2015, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described below and in more detail in Exhibit I, that we consider to be a significant deficiency.

- **Manual Calculation of Imputed Costs.** The Department had not implemented effective controls to properly calculate the imputed cost and imputed financing for the *Energy Employees Occupational Illness Compensation Program Act* (EEOICPA).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 15-02.

- ***Antideficiency Act*** – During our fiscal year 2015 audit, the Department informed us that it had reached a conclusion that a violation of section 1341 of Title 31, United States Code, occurred in the Departmental Administration account in the amount of $29,880.67. The violation resulted from the use of appropriated funding for the payment of services to an individual carrying out the responsibilities of a position requiring Senate advice and consent in an acting or temporary capacity after the second submission of a nomination for that individual to the position had been withdrawn or returned to the President. Accordingly, the Department has reported this violation of the Antideficiency Act, as required by Section 1351 of Title 31, United States Code.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of FFMIA disclosed no instances in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

The Department's Response to Findings

The Department's response to the findings identified in our audit is described in Exhibit I. The Department's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

November 16, 2015

Independent Auditors' Report
Exhibit I – Significant Deficiency

Manual Calculation of Imputed Costs

Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control*, indicates that management should have control activities in place to help ensure that agency objectives are met. The Department had not implemented effective controls to properly calculate the imputed cost and imputed financing for the EEOICPA. Due to an improperly designed spreadsheet and lack of an effective review process, the Department initially recorded the amount approximately $2.3 billion higher than the correct amount. As a result of our testwork, the amount was corrected prior to the issuance of the Agency Financial Report.

Recommendation

We recommend that the Department update the process 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 in the proper calculation.

Management's Response

We agree with the recommendation, however, we do 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 on the fiscal year 2015 Statement of Net Cost is $81 billion. The EEOICPA calculation error was $2.28 billion or 2.8 percent of Gross Costs (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 (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."
  - Given that no one relies on the Department's 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 Department 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

Management agreed with our recommendation. If fully implemented, management's corrective actions will improve the Department's internal controls over the manual calculation of imputed costs. 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.

FEEDBACK

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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

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