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Report to the Secretary of Energy

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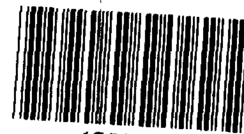
FINANCIAL MANAGEMENT

Energy's Material Financial Management Weaknesses Require Corrective Action



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-247002

September 30, 1993

The Honorable Hazel R. O'Leary
The Secretary of Energy

Dear Madam Secretary:

This report presents the results of the financial management portion of our general management review of the Department of Energy. The report discusses issues that Energy faces as it works to improve financial control and accountability over its integrated contractors and correct the financial management-related material weaknesses cited in its Federal Managers' Financial Integrity Act report.

This report contains recommendations to you and the Inspector General. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should send the statement to the Senate Committee on Governmental Affairs and the House Committee on Government Operations within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

We are sending copies of this report to Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs; the House Subcommittee on Environment, Energy and Natural Resources, Committee on Government Operations; other interested congressional committees; the Director of the Office of Management and Budget; and other interested parties. Copies will be made available to others on request.

This report was prepared under the direction of Jeffrey C. Steinhoff, Director, Civil Audits, who may be reached at (202) 512-9454 if you or your staff have any questions. Other major contributors are listed in appendix IV.

Sincerely yours,

Donald H. Chapin
Assistant Comptroller General

Executive Summary

Purpose

This report discusses financial management issues that the Department of Energy faces as it works to improve financial control and accountability while moving from a policy of least interference to one of greater control and accountability. In fiscal year 1992, Energy obligated over $25 billion, of which about 63 percent, or about $16 billion, went to private firms and universities (referred to as integrated contractors) to operate government-owned, contractor-operated facilities for such purposes as research and development. Over the years, serious weaknesses in managing the integrated contractors' operations led to widespread mismanagement of federal property and funds; consequently, the Office of Management and Budget (OMB) and GAO identified this area as highly susceptible to risk. Since 1989, Energy has cited contract management as a material weakness in its Federal Managers' Financial Integrity Act reports; in fiscal year 1991, it also cited financial management as a weakness. As part of a series of GAO management reviews of major federal departments and agencies, GAO examined Energy's efforts to (1) oversee its integrated contractors' financial operations and (2) correct the financial management-related material weaknesses cited in Energy's Federal Managers' Financial Integrity Act report.

Background

Historically, Energy and its predecessor agencies gave integrated contractors wide latitude and virtual independence from government involvement, in what was referred to as a policy of "least interference." In September 1989, the Department changed its policy to one of greater control and accountability through increased oversight of integrated contractors. Key factors in achieving effective contractor oversight are (1) useful and adequate financial information, systems, and controls, (2) audits of allowable costs under the terms of the contracts, which are negotiated through Energy's procurement process, and (3) reviews of contractor financial practices and procedures. Most of the Department's financial management activities are carried out by (1) the 44 integrated contractors, (2) the 22 finance offices at Energy's field offices and power marketing administrations, (3) the Office of the Chief Financial Officer (CFO) at headquarters, and (4) various officials responsible for Energy's numerous programs. In May 1993, the new Secretary declared a commitment to quality financial management.

The Chief Financial Officers Act of 1990 established requirements for overall agency financial systems and controls and for financial statement audits for specified agency activities. The Federal Managers' Financial

Integrity Act requires agencies to identify and report progress in correcting material control systems weaknesses.

Results in Brief

Energy has made important strides in establishing a culture that emphasizes financial control and accountability. It has completed some actions and has been working on various other initiatives to increase contractor oversight and break the cycle of least interference. However, at the time of GAO's review, these actions had not yet been completed, and several material weaknesses continued to hamper Energy's efforts to reduce the risk associated with its integrated contractors and tighten management and financial control over them. These weaknesses included (1) contract provisions that did not fully protect the government's interests or permit Energy to exercise adequate oversight and financial management control, (2) a financial system that could not provide all the financial information that program managers believed was needed to effectively oversee integrated contractors as they move away from the philosophy of least interference, (3) insufficient staffing levels in Energy's field finance offices to perform needed reviews of contractors' financial management practices and procedures, and (4) difficulty in promptly completing required audits of contractors' allowable costs. These problems must be overcome to ensure adequate oversight of contractors' financial activities.

In its December 1992 Federal Managers' Financial Integrity Act report, the Department disclosed that it had deficiencies in contract management practices, inadequacies in the audit coverage of contractors' expenditures, and problems in deploying staff, including financial management and audit staff. However, Energy reduced the perceived seriousness of its overall financial management problems by upgrading its status from material to nonmaterial. GAO believes that this upgrading was premature because Energy had not fully completed the reforms it undertook to resolve these problems.

Principal Findings

Oversight of Contractors' Financial Operations Not Effective

Energy's CFO and the Inspector General (IG) have not yet fully carried out important aspects of improving the Department's fiscal accountability. As a result, Energy cannot yet effectively oversee the integrated contractors'

financial management operations. This oversight is necessary to overcome the inadequate control and excessive contractor cost problems Energy's "least interference" policy contributed to.

A major way Energy facilitates oversight of contractors' financial management is through the use of standard contract provisions for accounting and cost recovery, which are designed to help ensure adequate financial reporting and control. However, many of Energy's contracts with its 44 integrated contractors did not have these standard clauses or contained weak substitutes for them. Also, instead of including Energy's standard cost recovery provisions, which are aimed at prescribing allowable costs, many contracts provided for blanket recovery of costs or for recovery of specific costs, such as the cost of certain penalties and fines, which are unallowable costs under the standard allowable cost clause. In the past, GAO found instances, for example, where Energy paid contractors $800,000 for penalties and related legal costs they incurred because they violated environmental laws. Recently, the Office of the CFO has started to review the integrated contractors' contracts when they are renewed to ensure that they contain the standard financial management provisions. This will be a long-term process that will involve contract renewals over time.

Another way for Energy to oversee integrated contractors' financial operations is through the financial information contractors provide. In addition to overall program cost information, which was provided by the financial system developed under the old management approach, Energy's managers believe they now need cost information that is broken down into lower level categories of costs which comprise a program. While the CFO required integrated contractors to provide the additional, more detailed cost data, the lack of standardization in contractors' financial systems—a key by-product of the old policy of least interference—resulted in inconsistent and unreliable integrated contractor reports. Consequently, these reports were of limited use to managers who conduct contractor oversight activities, such as comparing program category costs between contractors.

To strengthen contractor oversight, the Office of the CFO required that integrated contractors' financial management practices be reviewed initially over a 5-year period. Energy's field offices may not have, however, assigned enough staff to fully carry out the requirement. Reports to the Secretary by 6 of the field finance managers at Energy's 10 major field offices and by the CFO cited concerns about the impact field finance office

staff shortages would have on reviews of contractors' financial operations. The CFO did not have the authority to see that staff levels are sufficient to carry out this important new work. Consequently, the CFO did not have assurance that the integrated contractors' financial management practices and systems were operated properly and the contractors accurately reported their financial condition.

In addition to the financial management reviews, Energy also provides contractor oversight through audits of allowable costs. However, Energy's IG has had difficulty auditing, in a timely manner, whether costs claimed by integrated contractors are allowable and have been recorded in accordance with Energy's accounting policies. In April 1990, the Office of the Inspector General (OIG) reported to the Congress that audit coverage of contractors' allowable costs was inadequate because of staff shortages. In May 1992, the IG adopted a strategy to overcome this problem through increased reliance on the work of integrated contractors' internal auditors, which the former Secretary of Energy had approved. Although actions are planned to monitor the work of the contractors' internal auditors, the OIG adopted this strategy without first adequately considering alternatives, such as relying more on Defense Contract Audit Agency auditors or independent external auditors, to audit integrated contractors. Energy also did not consider requiring integrated contractors to prepare financial statements and have them subjected to audits that incorporate steps to ensure costs are allowable and accurately reported.

Serious Financial Management Problems Prematurely Upgraded

In December 1992, 1 year after it reported financial management as a material internal control weakness under the Federal Managers' Financial Integrity Act, Energy upgraded the status of this weakness to nonmaterial. Several near-term corrective actions were cited as complete. For example, the former Secretary of Energy reported that a CFO organizational structure had been implemented to provide a dual reporting relationship whereby finance office managers report to the CFO as well as to their respective field office managers.

However, GAO found that this relationship had not been established for 12 of Energy's 22 finance offices at field offices and power marketing administrations. A dual reporting relationship with the CFO was adopted for 10 finance offices that had significant financial management problems, even though CFO officials acknowledged that the remaining finance offices were also susceptible to financial management problems.

Overall, Energy's financial management problems persist. Thus, GAO believes it was premature for Energy to upgrade the status of its financial management problems to nonmaterial. This action could reduce Energy's emphasis on long-term solutions to financial management problems.

Recommendations

GAO is making several recommendations to the Secretary of Energy to strengthen oversight of integrated contractors' financial management and to accurately report the status of financial management problems in Energy's Federal Managers' Financial Integrity Act reports. GAO is also recommending that the IG identify and assess alternatives to increased reliance on integrated contractors' internal auditors to perform allowable cost audits.

Agency Comments

Energy's Acting CFO (referred to as the CFO) agreed with the thrust of GAO's recommendations to improve the Department's financial control and accountability and stated that efforts to correct all issues identified in the report were underway and would continue. The CFO did not agree that Energy had prematurely upgraded the status of its financial management problems to nonmaterial. However, Energy's actions to improve financial control and accountability notwithstanding, its financial management weaknesses, as described throughout the report, are material and thus warrant being portrayed as such in the Department's Federal Managers' Financial Integrity Act reports.

The OIG's Assistant Inspector General for Audits disagreed with GAO's recommendation to identify and assess alternatives to increased reliance on integrated contractors' internal auditors to perform allowable cost audits and GAO's discussion on the OIG's planned strategy for these audits. The OIG maintained that its proposed new audit strategy represented the best available option for providing enhanced audit coverage of Energy and that its goal was to utilize the limited audit resources available in the most effective manner possible. However, the audits being discussed involve over $16 billion, representing about 63 percent of Energy's fiscal year 1992 obligations, and are a cost to the government whether performed by contractors' internal auditors or OIG staff. GAO continues to believe that the alternatives to the OIG's strategy are viable and would be compatible with the OIG's goal; thus, they warrant the OIG's further consideration.

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Abbreviations

CFO	Chief Financial Officer
DCAA	Defense Contract Audit Agency
GAO	General Accounting Office
IG	inspector general
OIG	Office of the Inspector General
OMB	Office of Management and Budget
VANEA	Voucher Accounting for Net Expenditures Accrued

Introduction

Fundamental weaknesses in managing Energy's integrated contractors' contracts caused widespread mismanagement of federal property and funds. These weaknesses also caused the Office of Management and Budget (OMB) and us to identify this area as highly vulnerable to fraud, waste, and abuse. Since fiscal year 1989, Energy has reported in annual reports under the Federal Managers' Financial Integrity Act that contract management is a material weakness in the Department's internal control structure. Integrated contractors' activities accounted for the majority, over $16 billion, of Energy's fiscal year 1992 budget. Because of serious problems in managing integrated contractors, the former Secretary initiated major reform efforts, which included improved fiscal accountability.

This report is one in a series examining management of the Department of Energy and is also part of our review of management of major federal agencies and departments. It discusses Energy's efforts to oversee the financial information and systems of the private firms and universities, referred to as integrated contractors,[1] that operate government-owned facilities for such purposes as research and development. The report also discusses Energy's efforts to carry out other agency financial management operations.

Background

The Department of Energy's major missions are (1) national defense needs (weapons production), (2) energy-related activities (energy supply and distribution), (3) environmental restoration and waste management, (4) science and technology, and (5) management and other activities (such as international affairs). However, as we reported in December 1992,[2] Energy's mission is evolving as it copes with the nation's changing defense needs in the post Cold War environment and Energy's own devastating environmental contamination and safety problems related to nuclear weapons activities.

Energy receives funding from over 30 appropriation accounts and from other federal agencies and nonfederal sources for reimbursable work. In

[1]Usually, these are also management and operating contractors, which have agreements with the government to operate, maintain, and support government-owned research, development, production, or testing facilities, both nuclear and nonnuclear. The principal distinction between these contracts and other government contracts is that they contemplate a long-term relationship for the operation of government-owned facilities in a spirit of partnership rather than the typical arm's-length relationship between buyers and sellers of products and services.

[2]Energy Issues (GAO/OCG-93-13TR, December 1992).

fiscal year 1992, Energy obligated about $25.7 billion. About 63 percent of this amount was for contracts with integrated contractors.

Energy supports its missions through an extensive and complex organizational and reporting network of headquarters program offices, field offices, power marketing administrations, and integrated contractors. Its financial management structure has three primary organizational tiers: (1) the Office of the Chief Financial Officer (CFO) at headquarters, (2) the finance offices at field offices and power marketing administrations, and (3) the integrated contractors. Each tier is critical to ensuring sound financial management and lawful, efficient, and effective financial operations. Additionally, Energy's program officials are responsible for ensuring that the Department's programmatic goals are met within the approved funding levels and have the primary responsibility for evaluating performance in the program areas.

Energy Financial Structure Developed in Late 1940s

In the past, Energy and its predecessor agencies provided its integrated contractors wide latitude and virtual independence. This management approach was referred to as a policy of "least interference" from government involvement in the management of government-owned facilities. Energy's financial management operations were designed to accommodate this policy.

The financial concepts under which Energy operates were developed in the late 1940s by the Atomic Energy Commission, which was one of the Department's primary predecessor agencies. The Commission set up a financial management system based on two major concepts. First, the Office of the Controller (now the Office of the CFO) developed and maintained an integrated system of budgeting, accounting, and program cost reporting. Second, the Commission, recognizing its dependence on private contractors, treated its major contractors as subsidiaries for financial management purposes. Also, the Commission established a system of integrated financial accounts for major cost-type contracts under which it consolidated and reported contractors' financial information without the Commission keeping separate, duplicate records.

Allowable Cost Audits

Also in the late 1940s, the Atomic Energy Commission created what it considered to be a streamlined process for reimbursing integrated contractors. Under this process, a contractor was required to segregate its financial records between those related to a government contract and to

other contractor business. The government-related records were to be subjected to comprehensive field audits, including a review of allowable costs. This was the advent of the Voucher Accounting for Net Expenditures Accrued (VANEA) audits which are currently the Inspector General's (IG) responsibility.

The IG's April 1990 semiannual report to the Congress stated, however, that due to existing audit staffing and resource limitations, the progress on completing the required audits did not measure up to the original plan of providing audit coverage on a 5-year cycle. At that time, the IG reported that the audit cycle was 10 to 12 years, and thus Energy's managers lacked adequate IG assurance that the agency's major contractors were operating economically, efficiently, and in the federal government's best interest. In July 1992, the Senate Governmental Affairs Subcommittee on Oversight of Government Management reported that Energy's audit of 20 integrated contractors needed strengthening because of missing, limited, and untimely audits of contractor-operated research and development centers. In December 1992, Energy reported under the Federal Managers' Financial Integrity Act that there was inadequate audit coverage of the Department's contract expenditures and that, as a result, Energy lacked adequate assurance that contractors were only being reimbursed for reasonable and allowable costs.

Contractors' Problems Caused Oversight Philosophy Change

The philosophy of "least interference" caused Energy severe problems in managing integrated contractors, as our past reviews and those of Energy's IG and of the Department itself have demonstrated. The following examples present some of the problems that resulted from this policy.

- A March 1991 IG report showed that the contractor operating the Savannah River facility, which received almost $2 billion in fiscal year 1991, improperly charged a construction account (1) $13 million to fund a warehouse complex, directly circumventing congressional funding authorization and headquarters oversight, (2) $33 million to purchase unauthorized capital equipment, and (3) $13 million to cover a shortfall in operating funds. Further, a July 1991 Energy study found no indication that the Department had previously analyzed the financial aspects of operating programs and construction projects at Savannah River. The situation at Savannah River, in particular, underscored the need for Energy to change its management philosophy and to strengthen contractor oversight.

- In August 1991, we stated that integrated contractors' poor procurement practices, coupled with inadequate oversight by the Department, led to contractors' incurring excessive subcontract costs.[3] In April 1992, we reported[4] that the "least interference" policy was no longer appropriate.
- Reviews conducted by field finance offices in fiscal years 1991 and 1992 of integrated contractors, which the former Secretary directed in response to the growing financial problems, such as those at Savannah River, identified a wide range of improper and inconsistent financial management practices by integrated contractors. These reviews disclosed (1) improper charges to contractor overhead accounts, (2) use of suspense accounts or temporary charges to inappropriate programs or functions pending receipt of work authorizations and funding documents, (3) overfunding or underfunding of contractor pension plans and vacation accruals, and (4) inappropriate use of general plant project funds. Energy's field offices were also implicated in some of these improprieties, which resulted in fiscal year 1991 and 1992 accounting adjustments of over $300 million.

New Course Set by Energy Secretary

The former Secretary put the Department on a new course in September 1989 to achieve significant management reform and what he called a badly needed cultural change. In May 1991, the former Secretary enhanced the initiative with a financial and project management program designed to improve Energy's business management practices. Both of these reform efforts charged agency leadership, including Energy's Controller (now the CFO), with exercising greater control over contractors. In particular, the Controller was tasked with (1) ensuring that field financial managers have the capability to direct reviews of financial management practices at all sites and (2) increasing the frequency of the Office of the CFO's reviews of the field finance offices' activities.

Other parts of this initiative also affected the Office of the CFO. For example, the Director of Procurement, Assistance, and Program Management was tasked with developing a contractual control process to establish more effective fiscal accountability on the part of both Energy's management team and the Department's contractors for performance and costs. Effective implementation of this control process will hinge, in large

[3] DOE Management: DOE Needs to Improve Oversight of Subcontracting Practices of Management and Operating Contractors (GAO/T-RCED-91-79, August 1, 1991).

[4] Energy Management: Vulnerability of DOE's Contracting to Waste, Fraud, Abuse, and Mismanagement (GAO/RCED-92-101, April 10, 1992).

part, on the capability of Energy's and the contractors' financial systems to provide useful and reliable cost data.

In May 1993, in announcing a series of short- and long-term initiatives to improve contract management, the new Secretary stated that Energy is not adequately in control of its contractors and as a result, the contractors are not sufficiently accountable to the Department. At that time, the new Secretary also declared a commitment to quality financial management.

CFO Act Is a Mandate for Federal Financial Management Reform

The Chief Financial Officers Act of 1990 (Public Law 101-576) is a mandate for federal financial management reform. The act requires agencies' financial systems and controls to be developed and maintained under a strong CFO organization and calls for long-range planning. The act further requires agencies' financial systems to provide managers useful and relevant financial information. The act also requires agencies to prepare financial statements for specific activities, such as trust and revolving funds and commercial operations. Accordingly, CFOs are expected to develop and maintain financial systems which provide complete, reliable, consistent, and timely information that responds to management's needs.

Financial Management Weaknesses Required to Be Reported

The Congress enacted the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) to strengthen internal control systems. The act specifies that the systems of internal accounting and administrative controls should provide management with reasonable assurance that

- obligations and costs are in compliance with applicable laws;
- assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures are properly accounted for and recorded to permit the preparation of accounts and reliable financial and statistical reports, and accountability of assets maintained.

Agencies are required by the act to prepare annual reports which describe the progress made during the year in correcting any material control systems weaknesses previously reported, identify new weaknesses, and identify any uncorrected material weakness remaining at the end of the year.

Objectives, Scope, and Methodology

The objectives of our work, which was part of a broader general management review of the Department, were (1) to assess whether Energy has ensured effective oversight of integrated contractors' financial management operations and (2) determine the progress Energy has made on correcting financial management weaknesses previously reported under the Federal Managers' Financial Integrity Act.

To assess Energy's oversight of integrated contractors' financial operations, we reviewed Energy's September 27, 1991, order to establish departmentwide policies and procedures governing oversight of integrated contractors' financial management activities. We interviewed Energy headquarters and field finance office personnel to determine the number and types of reviews that were performed prior to this order and the changes (such as increased staffing levels) that had taken place or were expected in the future. However, we did not assess whether overall field finance office staffing levels were appropriate or whether Energy was effectively utilizing current field staff.

In addition, we examined internal reviews of field offices' and integrated contractors' financial management policies and procedures. We also interviewed headquarter and field office administrative and programmatic personnel to further our understanding of Energy's financial management system and its strengths and weaknesses. We reviewed applicable budget and accounting requirements, financial system documentation, and other documents, including prior GAO and IG reports. We also reviewed a proposed IG integrated contractor audit strategy and interviewed appropriate Office of the Inspector General (OIG) staff on this matter.

Further, we reviewed each of the 44 contracts with integrated contractors that was in place as of October 1, 1991, to determine if they contained the standard Energy and federal financial management contract clauses in force at the time of award. Where appropriate, we reviewed pre-award and post-award negotiation memoranda and other documents and interviewed Energy contracting officers and other officials. Appendix I further discusses the methodology used to review these contracts.

To determine the specific duties and responsibilities expected of Energy's CFO, we examined the CFO Act and OMB's implementing guidance, which sets forth the CFO's authorities. To assess the CFO's activities to carry out the CFO Act's requirements and whether these activities appeared consistent with the act and related OMB guidance, we reviewed Energy's Secretarial Notice implementing the CFO Act. We also reviewed other

Secretarial directives to determine whether the authorities of Energy's CFO allowed the CFO to effectively direct the agency's financial management activities.

In addition, we interviewed Energy's Acting CFO (referred to as the CFO), the CFO's staff, and other headquarters and field finance office officials to (1) clarify our understanding of Energy's lines of authority and (2) determine the nature of the CFO's authority over Energy's financial management activities at all levels. We also reviewed Energy's policies for preparing and auditing the Department's financial statements required by the CFO Act and discussed these audits with the Office of the CFO and OIG officials.

To determine whether Energy has accurately reported the status of its financial management weaknesses, we examined the Federal Managers' Financial Integrity Act's provisions and OMB's implementing guidance. We also reviewed Energy's 1989 through 1992 reports to the President and the Congress under the act.

We performed our work primarily at Energy's headquarters in Washington, D.C., and Germantown, Maryland. We also performed work at Energy's Albuquerque, New Mexico, and Oak Ridge, Tennessee, field offices. Additionally, we visited the Energy integrated contractors that manage and operate the Los Alamos National Laboratory, Los Alamos, New Mexico; the Lawrence Livermore National Laboratory, Livermore, California; the Oak Ridge National Laboratory, Oak Ridge, Tennessee; the Pinellas Plant, Largo, Florida; and the Savannah River Site, Aiken, South Carolina. We conducted this review between February 1991 and January 1993 in accordance with generally accepted government auditing standards.

The Department of Energy's Acting Chief Financial Officer and the Department's Office of the Inspector General provided comments on a draft of this report. These comments are discussed in chapters 2 and 3 and are reprinted in appendixes II and III. We have incorporated their views where appropriate.

Effective Oversight of Contractors' Financial Management Was Not Ensured

The Department had not yet fully carried out important aspects of initiatives to improve fiscal accountability. Specifically, because its contracts are long-term, Energy continued to have contracts containing provisions that significantly undermined its ability to exercise adequate financial management oversight. Also, its financial system, which was developed under the old management approach, did not provide program managers the financial information they believed necessary to effectively oversee contractors in today's environment. In addition, the field finance officers reported to the Secretary that they were not adequately staffed to review integrated contractors' financial management procedures, and the OIG reported to the Congress that it could not audit contractors' costs in a timely manner. These problems will have to be overcome through Energy's ongoing initiatives to reduce the risk associated with and gain better control over integrated contractors' financial management.

Many Contracts Did Not Include Standard Financial Control Provisions

More than 80 percent of Energy's contracts with its 44 integrated contractors in force at the time of our review either did not include important standard contract clauses designed to help ensure adequate financial reporting and control or contained weak substitutes. This situation undermined Energy's financial control over contractors and exposed the government to increased costs. Energy has begun various efforts to strengthen its contract terms. However, since most of the contracts were multiyear agreements, Energy elected to address these issues as contracts expire. Thus, the success of this initiative will not be known for some time.

To protect the government's interests, federal contracts are to incorporate all of the relevant standard clauses contained in the Federal Acquisition Regulation which is prescribed jointly by the General Services Administration, the National Aeronautics and Space Administration, and the Department of Defense. Energy has significantly supplemented these requirements with its own acquisition regulations, which provide, for example, that a contractor is to follow generally accepted accounting principles and maintain control over government assets.

Under Energy's acquisition regulations, contracting officers, with the approval of the Department's Office of Procurement Assistance and Program Management, can authorize use of nonstandard contract clauses. For example, the Department has authorized deviations from standard financial management contract clauses in circumstances such as when a contractor is a nonprofit organization or to indemnify (hold harmless) a

contractor if losses occur. Historically, Energy's CFO has not had a strong role in ensuring that the Department's contracts with integrated contractors contain clauses in the following financial management areas.

1. Accounting Requirements. Standard clauses covering contractor accounting requirements were omitted from four integrated contractor contracts involving about $4 billion in fiscal year 1992. These provisions would have required integrated contractors to follow generally accepted accounting principles, which encompass the conventions, rules, and procedures of accepted accounting practices and provide a standard to measure fairness of financial presentation. Also omitted from these contracts was a requirement that a contractor's system of accounts be satisfactory to the Department. This requirement, based on Energy regulations, is important to ensure that a contractor's financial management is sound and financial reporting is reliable and consistent.

2. Property Management Clauses. The standard contract provision requiring contractors to have property management systems that are approved by the Department was omitted from the contracts of five integrated contractors which had government assets valued at about $5 billion at the end of fiscal year 1992. This provision helps to assure Energy that integrated contractors are adequately safeguarding government assets in their custody. We have previously reported[1] that the lack of this standard provision hindered Energy's ability to resolve disputes with a contractor that we found could not account for about $45 million in government-owned property.

3. Cost Accounting Standards Requirements. Under the Federal Acquisition Regulation's standard cost accounting clause, a contractor must agree to bear any increased costs (and any applicable interest) resulting from the contractor's failure to comply with applicable cost standards. However, 10 contracts, involving about $3.9 billion in fiscal year 1992, omitted entirely, or significantly altered, Energy's standard cost accounting contract clauses.

An additional 12 contracts, involving about $5 billion in fiscal year 1992, did not hold the contractor liable for increased costs resulting from the failure to follow cost accounting standards. In these cases, Energy could not seek reimbursement for the excess costs if a contractor's violation of a cost accounting standard resulted in increased cost to the government.

[1]Nuclear Security: DOE Oversight of Livermore's Property Management System Is Inadequate (GAO/RCED-90-122, April 18, 1990) and DOE Management: Management Problems at the Three DOE Laboratories Operated by the University of California (GAO/T-RCED-91-86, July 31, 1991).

Another 15 contracts, involving about $7.4 billion in fiscal year 1992, included nonstandard clauses that limited a contractor's liability in cases where (1) the contractor followed Energy's accounting policies or (2) a subcontractor did not follow the cost accounting standards, as long as the cost accounting standards clause was included in the subcontract. While it is reasonable to hold a contractor harmless for following Energy's required accounting policies, under the Federal Acquisition Regulation cost accounting standards clause, an integrated contractor could be held liable for costs arising from the subcontractor's nonuse of the cost accounting standards. Thus, a contract clause which limits an integrated contractor's liability with respect to its subcontractor's failure to follow cost accounting standards is inconsistent with the Federal Acquisition Regulation and unnecessarily exposes the government to costs that are appropriate to be borne by a contractor or its subcontractor.

4. Allowable Cost Provisions. Instead of Energy's standard contract provisions that address the costs contractors are allowed to recover from the government, many contracts provided either for general, blanket recovery of costs or for contractors to be indemnified for specific types of activities, such as environmental, safety, and health penalties and fines. When the standard provisions are not used, contractors can be compensated for some costs which Energy may otherwise not allow under its standard allowable cost provisions. In the past, we found instances, for example, where Energy paid contractors $800,000 to reimburse them for penalties and related legal costs arising because the contractors violated the Resource Conservation and Recovery Act.[2] In another instance, under a plea agreement with the Department of Justice related to violations of environmental laws, a contractor agreed to pay criminal fines of $18.5 million and to not seek reimbursement from the government under the indemnification clause in its contract with Energy, which may have permitted reimbursement of such fines.

Further, five contracts did not include the standard allowable cost clause which would have required that contract costs be reasonable or that prudent business judgment be applied. We stated in August 1991,[3] that a contractor charged Energy almost $1 million for leasing vehicles. This billing was 2.5 times greater than the $396,000 which would have been paid had the contractor leased similar vehicles from the General Services

[2]Hazardous Waste: Contractors Should Be Accountable for Environmental Performance (GAO/RCED-90-23, October 30, 1989).

[3]DOE Management: DOE Needs to Improve Oversight of Subcontracting Practices of Management and Operating Contractors (GAO/T-RCED-91-79, August 1, 1991).

Administration, as the contract's terms would have allowed. Also, during the first 4 months under another lease contract, this contractor paid $35 a month per vehicle, or approximately $5,000, for tire insurance; during this time three flat tires were repaired at a reported cost of $159.95.

Energy Is Attempting to Strengthen Contract Terms

To direct contractors' activities more effectively and gain more control over costs, Energy is attempting to change future contract terms and conditions. For example, Energy is incorporating a new accountability rule into its contracts with profit-making organizations. We have reported[4] that, under this rule, Energy will (1) hold contractors liable for costs that could have been avoided by proper contract performance and (2) increase contractors' potential fees to offset the increase in their financial risk. Also, consistent with OMB's regulations implementing the CFO Act,[5] Energy's Office of the CFO is taking a more active role in decisions involving the Department's major procurements. For example, in early 1991, the Office of the CFO started reviewing integrated contractor acquisition actions.

Further, in September 1991, Energy established a policy that standard financial management clauses are to be included verbatim in all integrated contractor contracts unless the CFO concurs in writing with a proposed deviation. However, Energy's list of standard financial management clauses did not include the cost accounting standard clause because the Office of the CFO considered it to be a procurement rather than a financial management clause. We believe that the clause is financial in nature since requiring integrated contractors to follow cost accounting standards is fundamental to Energy's maintaining financial control and accountability over the contractors' operations and ensuring that the government does not incur unnecessary or inappropriate costs.

Standard Financial Management Contract Provisions Facilitate CFO Act Implementation

Including all standard financial management clauses in integrated contractor contracts is central to Energy's meeting the CFO Act's requirements. For example, the CFO Act requires a CFO to develop and maintain an integrated accounting and financial system which complies with applicable accounting principles and requirements. Also, the CFO Act requires a CFO to implement asset management systems. The act's

[4]GAO/RCED-92-101.

[5]Office of Management and Budget Memorandum for the Heads of Selected Executive Departments and Agencies, M-91-07, Guidance for Preparing Organization Plans Required by the Chief Financial Officers Act of 1990, February 27, 1991.

requirements are directed at providing agency managers and others relevant and useful financial information that facilitate the systematic measurement of performance, developing cost information, and controlling government-owned property.

Energy's CFO must rely on the financial information reported by the integrated contractors because they account for most of the Department's funds and are responsible for over $28 billion in government property. To help ensure that the contractors' financial reports are consistent and property is safeguarded, Energy has to know that the contractors are using applicable accounting principles uniformly and ensure that contractors are using approved property management systems.

Energy's Financial Information Was Inadequate for Contractor Oversight

Energy's financial system was designed to provide overall program cost data to meet program managers' information requirements in a culture of "least interference." Today, however, the system cannot provide Energy's program managers some of the essential data they believe is necessary to oversee integrated contractors' operations under the current philosophy of greater accountability and oversight. To correct this situation, the Office of the CFO requested the integrated contractors to provide the additional cost data the program managers need. But the data the contractors reported was of limited use because it was inconsistent and its reliability was questionable. In addition, some of the financial information needs of external users were not met.

The CFO Act sets out the expectations that CFOs will develop and maintain financial systems which provide complete, reliable, consistent, and timely information that is responsive to management's needs. Accordingly, CFOs are expected to develop and maintain a financial system that provides useful and relevant financial information so that internal users (program managers) and external users (the Congress and others) can rely on a range of financial information to effectively manage programs and oversee contractors.

Contractors Could Not Provide Consistent Cost Information

Unlike many other agencies' financial management systems, Energy's system integrates budget formulation and execution and accounting data and captures information on the overall costs of the Department's programs, which is important data for the Congress and program officials. However, Energy's managers have requested more refined cost information to facilitate evaluation of individual contractor performance.

Specifically, in moving from a policy of "least interference," Energy managers now believe they need not only overall program cost data, but information on program costs that is also broken down in lower level categories including (1) human resources management, (2) legal support, and (3) financial management operations, as well as direct costs such as labor.

The CFO acknowledged that Energy had no formal systematic mechanism to provide management with program costs in such categories and that this was a significant change from the type of financial information Energy managers previously required. Accordingly, the CFO required the integrated contractors to report program category costs so that the managers could evaluate whether these costs were reasonable and contractors were operating programs efficiently.

To meet this requirement and report both overall program cost information and data in program cost categories, the integrated contractors used their own unique financial systems. These systems should have reported overall program costs consistently because Energy has long required standard reporting of these costs. However, the financial systems contractors used were not uniform. The lack of uniformity, although not affecting reporting of total program cost data, resulted in inconsistent cost information by categories within programs. This inconsistency hampered Energy managers' ability to oversee contractor operations through, for example, comparisons of program category costs among contractors.

At an April 1991 meeting with some of Energy's integrated contractors, the Office of the CFO determined that, while some contractors would have few problems converting to a more detailed cost structure, others could have difficulty converting their systems to accommodate such a change. Since then, some of Energy's integrated contractors have further expressed concern that their systems cannot provide the additional cost data. For example, in September 1991, the Brookhaven National Laboratory, which had $370 million in fiscal year 1992 obligations, advised Energy that the laboratory's current systems appeared to be incapable of providing the detailed cost information requested.

Another contractor, with $1.3 billion in fiscal year 1992 obligations, reported to an Energy field finance office that it could not provide all of the requested cost data because its system was not designed to capture this data and the contractor acknowledged that the information that it had

provided was not of sufficient quality to use in any decision-making process. In April 1992, this contractor and the controllers from two other facilities having fiscal year 1992 obligations of $2.5 billion, advised the CFO that (1) their accounting records could not provide the program category cost information the CFO requested and (2) they could not capture this data without very costly modifications to their accounting systems. According to the contractors, modifying their systems could conceivably take several years. In October 1992, the Albuquerque Field Officer Manager told Energy's Assistant Secretary for Defense Programs that the seven integrated contractors for which the field office was responsible did not maintain accounting systems able to respond to the agency's changing requirements, including cost reporting for program category costs.

We reported in December 1992,[6] that Energy's financial system could not reliably produce certain cost information; therefore, Energy lacked the data necessary to gauge the status and the costs of all contractor activities. Further, according to a January 1993 OIG report, Energy had only limited assurance that the contractors' cost records were accurate and reliable and that financial reports fairly and accurately presented costs incurred.

External Users' Financial Information Needs Not Met

The lack of detailed reliable data also lessens the ability of the Congress and other external users to effectively achieve their oversight and budgetary responsibilities. Recognizing this, the House Appropriations Committee asked Energy to submit reports detailing the spending of Environmental Restoration and Waste Management funds for fiscal years 1991 and 1992 and to begin tracking these expenditures at the task levels established by Energy's 5-year plan.[7] Consequently, Energy now requires integrated contractors that perform environmental restoration and waste management work to report financial data on the tasks involved in performing this work. However, the reported task-level information cannot be effectively used because Energy's integrated contractors accumulate and report costs using different financial systems, and some of these systems are not designed to report task-level information.

[6] Department of Energy Contract Management (GAO/HR-93-9, December 1992).

[7] House Appropriations Committee reports accompanying the Energy and Water Development Appropriations Bills for fiscal years 1992 and 1993.

Insufficient Staff Assigned to Monitor Contractors' Financial Operations

Energy's field finance offices have not yet fully carried out a CFO initiative that the integrated contractors' financial management practices be reviewed periodically as part of the new policy of greater control and accountability. The field offices may not have assigned enough staff to complete contractor reviews, and the CFO does not have the authority to see that enough staff are assigned to carry out this important new work. Consequently, the CFO is not assured that the integrated contractors' financial management practices and systems are operated properly or that the contractors accurately report their financial conditions.

The CFO Act sets out the expectation that agency CFOs will have the responsibility for agencywide recruiting, selecting, and training of personnel to carry out financial management functions. Further, OMB's February 27, 1991, guidance for implementing the act states that agency CFOs are to have authority to provide agencywide policy advice on financial management staffing matters. Given both the present authority that the former Secretary of Energy delegated to the CFO and Energy's organizational structure, a greater role for the CFO with respect to regional financial staff levels would be more consistent with the CFO Act's expectations and OMB's guidance. In this regard, staffing resources, including the deployment of financial management staffing, was reported as a material weakness in Energy's December 1992 report under the Federal Managers' Financial Integrity Act.

In September 1991, for the first time, Energy established departmentwide policies and procedures governing oversight of integrated contractors' financial management activities. The CFO required field offices to plan for and conduct formal reviews of integrated contractors' financial management activities initially over a 5-year period. Specifically, the CFO directed that the field finance offices independently review integrated contractors' financial management practices; validate contractors' accounting transactions in selected areas; and review the efficiency and effectiveness of contractors' financial management systems. The types of activities to be reviewed included a contractor's (1) financial systems, policies, and procedures, (2) budgeting and asset management systems, and (3) transactions with related parties.

Field Managers Cited Staff Shortages as a Problem

According to several field finance managers and the Office of the CFO, field office staffing allocations were not adequate to fully carry out the new field office financial responsibilities, including the critical financial management reviews at integrated contractors. Eight field finance

managers at Energy's 10 major field offices cited staff shortages in reports to the Secretary, and 6 field managers reported particular concerns about the impact these shortages would have on reviews of contractors' financial operations. For example, in October 1992, the Albuquerque and the Rocky Flats field office managers reported to the Assistant Secretary for Defense Programs that an insufficient number of staff at their field offices would significantly affect their ability to effectively oversee contractor activities to preclude waste, loss, or misappropriated funds or other assets.

Further, as we reported in December 1992 as part of a series of reports involving high risk areas,[8] the Albuquerque field office had only four accountants assigned to perform financial reviews of its seven integrated contractors, which, in fiscal year 1991, received about $4.1 billion. We also reported that, recognizing the inadequacy of staff resources to oversee contractors, Energy has begun hiring additional staff to improve its monitoring efforts. For example, to more fully staff its work load to oversee its contractor's financial management, the Albuquerque office planned to hire six additional accountants for fiscal years 1992 and 1993.

Consistent with the CFO Act and effective with the fiscal year 1993 budget request, Energy's CFO began to review field finance office staffing and funding levels. The CFO, however, does not have direct control of Energy's field finance offices' staffing levels. At the time of our review, these levels were controlled by field office managers and were based on Program Secretarial Officers'[9] staffing allocations, considering the field finance office's needs and initiatives. The designated lead Program Secretarial Officer for each field office generally controlled the administrative staffing levels for that organization. Subsequent to our review, the new Energy Secretary approved a departmental organization structure that will change the relationship between the headquarters offices and the field offices and eliminate the Program Secretarial Officers' concept. However, we were also advised by Energy officials that while the plans for implementing the new organization structure were incomplete, Energy's CFO will still not have direct control over field finance office staffing levels.

[8] Department of Energy Contract Management (GAO/HR-93-9, December 1992).

[9] A Program Secretarial Officer is a senior manager who budgets for and provides funding for program activities conducted at field sites. In addition to these responsibilities, a lead Program Secretarial Officer can have line management responsibility for institutional oversight of designated field sites and laboratories, or other field locations.

CFO-Approved Staffing Levels Not Achieved

The CFO requested additional staff for particular field offices, but some of these requests were rejected by the Program Secretarial Officers. For example, after a fiscal year 1992 agencywide staff-level cut, the CFO requested that the Program Secretarial Officer responsible for the Chicago and San Francisco field offices restore the staff allocations for these field offices' finance staffs to those levels OMB endorsed. In rejecting the CFO's request, the Office of Energy Research Director stated that, while recognizing the importance of the CFO's initiative and trying to be responsive without neglecting other key secretarial initiatives, staffing resources were not available for all the initiatives at the level expected.

According to the CFO's 1992 5-year plan, in May 1991, the former Secretary directed that highly qualified financial personnel be recruited to fill vacancies at all of the Department's financial management organizations. In January 1993, the CFO reported to the former Secretary that the field finance organizations had not received the additional staffing the CFO intended. The CFO had approved 645 field office staff for fiscal year 1993, whereas only 547 staff had been allocated by Program Secretarial Officers.

A Financial Staff Training Program Is Underway

In addition to staffing level problems, Energy's CFO has identified critical training needs for Energy's financial management staff. In this regard, Energy reported to OMB that the need is high to train its CFO personnel in a range of key financial management areas, including financial policy, systems, and operations. To help address this problem, the CFO designated a training coordinator and developed a departmentwide financial management training program, which is now being implemented.

Contractors' Allowable Cost Audits Not Performed Promptly

Required examinations of Energy's 44 integrated contractors' accounts and records, a critical aspect of Energy's contractor oversight responsibility, had not been carried out promptly. In March 1992, Energy's IG reported that its 5-year cycle for completing these audits had stretched to 14 years, far too long to provide effective audit coverage and ensure that the costs contractors claimed were allowable and recorded in accordance with Energy accounting policies. Upon adoption of a new audit strategy in May 1992, the OIG no longer estimated how long it would take to complete these audits since the OIG no longer considered the 5-year criteria appropriate.

Energy's integrated contractors are required to annually prepare and certify that the net expenditures accrued were incurred and are allowable

under the contract, in accordance with the Voucher Accounting for Net Expenditures Accrued (VANEA) process established for this purpose over 40 years ago. Under the VANEA process, the OIG is to periodically examine the reliability of the internal controls used by the contractors and the applicable field organizations to ensure that only costs allowable under the terms of the contracts are claimed and reimbursed.

The Congress authorized an OIG budget increase of 25 percent for fiscal years 1992 and 1993, which according to the Department's budget request, Energy planned to use to increase its OIG staffing levels by 43 percent. According to the OIG's budget request, about one-half of this increase was planned for its Office of Audits, which is responsible for the VANEA audits, and was to help the OIG achieve its 5-year VANEA audit goal.

In the House Report accompanying the Energy and Water Development Appropriations Bill of 1993, the Committee on Appropriations stated that the Committee was proposing funding for the 50 additional OIG employees requested. This report stated that, with these additional resources, the IG was expected to be able to achieve its 5-year goal. According to Energy's fiscal year 1994 detailed budget justification, the OIG planned to assign about one-half of the increased resources to the Office of Audit, which would be consistent with the staffing increase the OIG requested. However, the OIG told us in October 1992, that for fiscal year 1993, the OIG staff level for VANEA audits was expected to remain steady at about 53 staff years, which was inconsistent with the Committee on Appropriations' stated expectation that the OIG was to use these additional resources to attain the 5-year VANEA audit cycle.

IG Will Rely on Contractors' Internal Auditors for VANEA Audits

In October 1991, we reported[10] that Energy's OIG had not achieved the 5-year audit cycle coverage necessary to effectively audit contractor allowable costs. In December 1991, the OIG established an audit strategy task force, which was composed of OIG, integrated contractor, and CFO representatives. The task force, recognizing the importance of the VANEA audits, concluded that, to conduct these audits within an acceptable cycle, the OIG needed to rely on the work of others, and the task force recommended that the OIG follow a strategy that would increase reliance on audits done by integrated contractor internal auditors. Specifically, the task force reported that the integrated contractor internal audit staffs would be the most efficient means since most of the contracts require the

[10]Energy Management: Contract Audit Problems Create the Potential for Fraud, Waste, and Abuse (GAO/RCED-92-41, October 11, 1991).

integrated contractors to conduct an annual internal audit of allowable costs.

The former Secretary approved and, in May 1992, the OIG adopted the task force's strategy, stating that this approach would result in (1) increased audit coverage, (2) a tracking system which documents audit planning and performance, and (3) enhanced communications which will result in a better understanding of contractor operations. Energy established a steering committee on quality auditing to help ensure successful implementation of the strategy. Also, a contractor audit peer review process was established to help ensure that contractors' internal audits meet professional standards. Further, the OIG said that the strategy will require the OIG to annually test contractor allowable costs audit work and that the OIG plans to make reviews for unallowable costs in all of its audits. While these actions are positive steps in carrying out the OIG's strategy for auditing contractors' allowable costs, they were taken subsequent to our review and involve future practices; thus, we could not evaluate their effectiveness.

The OIG estimated that the current internal audit function at the integrated contractors consists of 180 auditors and costs Energy $13 million annually.[11] The OIG envisioned that to implement the new strategy, the current level of internal audit support would have to be expanded by over 100 additional internal auditors, or over 50 percent. Therefore, we estimate that, at the level of increase planned, the internal audit function would cost about $20 million annually. While the internal auditors are not employed by the federal government or under the government's direct control in carrying out the audits, their costs are fully paid for by the government through the contracts. Therefore, these costs are borne by the government whether paid for as OIG or contractor costs.

In July 1992, the Senate Committee on Governmental Affairs Subcommittee on Oversight of Government Management questioned the cost-effectiveness of the OIG's policy of relying on contractors' internal auditors. At the request of this Subcommittee, the Office of Federal Procurement Policy is to complete an assessment of the cost-effectiveness of Energy's policy of relying on contractor internal auditors.

[11]This amount does not include the cost of off-site auditors hired by the integrated contractors, who also perform internal audit work.

Alternatives for Auditing Contractors Not Adequately Assessed

Before deciding to adopt the audit strategy task force's plan, the OIG did not adequately consider options other than having the contractors' internal auditors do this work. Based on their experience, the OIG staff told us that they strongly believed that using the contractors' internal auditors was the best approach to perform VANEA audits. However, in an October 1992 letter, the OIG advised us that it had not performed a cost analysis of alternatives.

Although a policy of having a contractor's own internal auditors do the audit work does not violate applicable government auditing standards and, if properly implemented, can be useful, it nevertheless must be approached carefully. First, the OIG must be sensitive to the appearance of conflicts of interest in using internal auditors to review costs. In this regard, subsequent to our review, the OIG has taken positive steps to help ensure quality auditing. Second, the OIG must be careful that the government, not internal auditors, determine whether contract costs are allowable. In a September 1992 policy letter, OMB's Office of Federal Procurement Policy stated that the determination of whether contract costs are reasonable, allocable, and allowable is an inherently governmental function to be performed by executive branch officials rather than by private sector entities that have contracts with the government. When this policy was issued, OMB stated that in making such determinations, neither the use of contract audit services nor basing decisions on recommendations made by contract auditors is prohibited.

Alternatives the IG could explore include (1) reallocating OIG staff to have additional staff do VANEA audits, (2) having the audits conducted by the Defense Contract Audit Agency (DCAA), which performs similar audit work involving defense contractors, and (3) contracting with independent external auditors, or (4) a combination of any of these alternatives. Energy already uses DCAA to audit, for example, the costs charged by nonintegrated contractors and by the integrated contractors' subcontractors.

Previously, Energy contracted with independent external auditors for most of its VANEA audits. However, beginning with its fiscal year 1992 budget, Energy began to replace its contract auditors with OIG staff. The OIG stated that it adopted this change to avoid the criticism surrounding the use of contract auditors to perform inherently governmental functions and to eliminate the appearance of conflicts of interest. Although we understand the OIG's concerns, we believe that the integrated contractors

internal auditors are more subject to the appearance of conflicts of interest than independent external auditors.

Another option that warrants serious consideration is to require that, in lieu of or as an extension of VANEA audits, integrated contractors prepare financial statements and subject them to audits that incorporate steps to ensure that costs are allowable and accurately reported. Despite its intention to move from a policy of least interference, the Department does not require Energy's integrated contractors to prepare auditable financial statements for the over $16 billion, or about 63 percent of Energy's fiscal year 1992 obligations, that they accounted for.

In the CFO Act, the Congress required that specified agencies, revolving and trust funds, and activities which are substantially commercial in nature have audited financial statements. This requirement does not apply to Energy's integrated contractor operations nor has Energy, on its own, required such additional financial statements. As a result, Energy presently prepares audited financial statements covering less than 25 percent of its budget resources. A requirement that integrated contractors prepare audited financial statements would expand Energy's coverage of the vast amount of funds for which the Department is responsible. It would also be consistent with the CFO Act's stated purpose of providing for improvement in agency accounting and financial management controls and the production of complete and reliable financial information to deter fraud, waste, and abuse of government resources.

As part of a program of financial audits of the integrated contractors, Energy could further improve accountability and safeguarding of governmental resources by having integrated contractors retain independent external auditors to review, in conjunction with the IG, contractor operations. Such a program would help Energy to oversee its contractors' performance and pinpoint changing conditions that require increased attention.

Energy already has the framework for implementing this approach since the contractors are required to follow the departmental orders that govern the various programs and these orders outline the desired program objectives. An additional step would be for Energy to require its contractors (1) to specify how Energy's objectives are being satisfied and (2) to contract with an independent external auditor, as part of the financial audit, for an opinion on whether the objectives are being met.

Under this concept, Energy would have to ensure that its needs are included in a provision of the audit contract between the integrated contractor and the independent external auditor. The independent external auditor would have to understand that the government has required the audit work to assist in meeting its need for contractor program oversight.

The independent auditor's opinion would include a discussion on (1) whether the contractor implemented adequate policies and procedures to fulfill Energy's objectives and (2) whether each program objective was achieved. The contractor would contract for the audit, the report would be addressed to the contractor, and Energy would receive a copy.

The benefits of this approach would multiply over time. The initial reports would assist Energy in overseeing the contractors' diverse operations by providing an objective and rigorous basis to assess the contractor's effectiveness in implementing Energy's objectives. This would also allow Energy to regularly evaluate and update the objectives. For example, if all contractors failed to achieve certain objectives, those objectives could be reassessed or redefined. Successful contractors could be used as models to improve the performance of all contractors. Energy would also need to reassess the program annually to determine additional areas where accountability and safeguarding could be enhanced.

Conclusions

Energy's effective oversight of its integrated contractors' financial management systems and information and allowable costs is the key to strong Energy financial management and accountability. Understandably, it is no longer acceptable that Energy's financial resources be managed in a culture where most agency appropriations are obligated to integrated contractors without also ensuring that the government's resources are controlled and used as intended. Energy has an ongoing program to increase its contractor oversight and strengthen financial management. Efforts to oversee integrated contractor financial operations have not yet been fully effective in several areas. If problems in these areas are not resolved through Energy's ongoing improvement initiatives, efforts to improve control of and accountability over contractors' work may be seriously undermined. Energy's initiatives to curb the financial management problems stemming from its "least interference" policy will be hampered without more businesslike contractual provisions, useful financial information, prompt oversight of contractors' financial

management information and systems, and adequate audit coverage of contractors' allowable costs.

Recommendations

We recommend that the Secretary of Energy

- direct the Office of Procurement Assistance and Program Management to (1) include all pertinent standard financial management clauses in future integrated contractor contracts, with exceptions approved in advance by the CFO, and (2) with respect to the cost accounting standards, eliminate the use of contract clauses that limit contractor liability;
- direct the CFO to require that the cost accounting standards clause be included in the CFO's list of standard contract clauses related to financial management;
- direct the CFO to improve financial information that managers use to oversee integrated contractor operations by (1) defining the financial information program managers and the Congress need and (2) developing ways to gain more consistency in integrated contractors' program category cost data; and
- provide the CFO authority over field finance office staffing allocations and direct the CFO to develop strategies to achieve adequate staffing levels.

Further, we recommend that the IG consider alternatives to increased reliance on the integrated contractors' internal auditors to perform allowable cost audits. The IG should review the alternatives presented in this report, identify other alternatives, and choose an approach that best protects the government's interest.

Agency Comments and Our Evaluation

Energy's CFO agreed with the thrust of our recommendations to improve Energy's financial control and accountability. Overall, the CFO stated that efforts to correct all issues identified in the report were underway and would continue. In separate comments, Energy's Assistant Inspector General for Audits disagreed with one recommendation. It was to identify and assess alternatives to increased reliance on integrated contractors' internal auditors to perform allowable cost audits. The Assistant Inspector General for Audits also took issue with several points in our discussion on the OIG's planned strategy for these audits.

Energy's CFO Comments

Regarding our recommendations involving standard financial management contract clauses, the CFO commented that steps have been initiated to

ensure that all appropriate standard financial management clauses are included in future integrated contractor contracts, with any deviations requiring CFO approval. Further, the CFO commented that efforts are underway to make cost accounting standards applicable to all integrated contractors. When completed, these actions would be consistent with our recommendations and provide Energy greater assurance of adequate financial reporting and control over integrated contractors.

The CFO correctly interpreted our recommendation that Energy eliminate the use of contract clauses that limit contractor liability for failure to follow cost accounting standards as intending to (1) limit the liability of contractors when Energy specifically directs them to deviate from cost accounting standards and (2) not limit contractors' liability when their subcontractors fail to follow cost accounting standards. Regarding the first situation, the CFO said that Energy is developing a standard nonliability clause, which would be consistent with the recommendation. The CFO also said that Energy planned to review the implications and act appropriately with respect to the second situation.

The CFO commented that Energy plans to address our recommendations for improving financial information through task groups to identify needed improvements. The task force to address financial management information requirements, for example, will examine Energy's budget structure, reporting structure, and requirements for performance measures. In addition, Energy established a Financial Management Systems Improvement Council to recommend improvements to the integrated contractors' financial management systems, processes, policies, and procedures. These are positive steps consistent with the CFO Act and the new Secretary's commitment to quality financial management.

While not specifically disagreeing with our recommendation that the CFO have authority over field finance office staffing allocations and developing strategies to achieve adequate staffing levels, the CFO commented that she is involved in determining field office financial management staffing allocations. She further commented that strategies to achieve these staffing levels would involve multiple organizations and must be completed within the scope of overall departmental priorities. We agree with the CFO's assertions, however, the review of integrated contractors' financial management practices by Energy's field offices is key to strong contractor oversight. We found substantial evidence that several field offices believed that not enough staff had yet been assigned to fully carry out these reviews. As the CFO stated, additional staffing to review

contractor financial operations is essential to achieving the Department's goal of increasing oversight of contractors' financial operations. Also, a greater role for the CFO with respect to regional financial staff levels would not be inconsistent with the CFO Act's expectations and OMB's implementing guidance.

Energy's OIG Comments

Energy's OIG maintained that its strategy of auditing contractor allowable costs by using contractors' internal auditors represented the best available option for enhanced audit coverage of Energy. The OIG said that its goal was to utilize limited available audit resources in the most effective manner possible and expressed concern that our report was not consistent with this goal. We believe that our recommended alternatives to the OIG's adopted strategy are viable and would be compatible with the OIG's goal.

According to the OIG, however, the alternatives we recommended were not workable for reasons such as the following. While not giving the basis for its opinion, the OIG stated that it was not appropriate for DCAA to audit contractors' accounting records, which are integrated with those of the Department. However, we found that Energy used DCAA to audit the allowable cost of integrated contractors' subcontractors and, in at least one instance, used DCAA to perform a final cost audit of a former integrated contractor. We believe that DCAA staff has the technical knowledge and is well-suited to perform these audits.

Also, the OIG said that the alternative of reallocating OIG personnel is not practical considering the overall shortage of audit resources. However, the audits being discussed involve over $16 billion and represent about 63 percent of Energy's fiscal year 1992 obligations. Thus, it seems reasonable that the OIG would not hesitate to allocate or reallocate OIG staff, at the possible expense of other competing work, to ensure that the allowable cost audits that cover the majority of Energy's funding are done promptly.

Further, the OIG said the alternatives we suggested would require the taxpayers to incur costs for duplicate audit services, assuming the internal audit clause is retained in contracts. We do not agree. Since Energy can determine the level at which the internal audit staffs are funded, if an alternative other than using internal auditors were selected, Energy could elect to reduce the internal auditor staffs, which would free up additional funds. Under the strategy the OIG adopted, the government's costs are not a part of the OIG's budget. Instead, they are part of the integrated

contractors' overhead accounts, which are distributed to Energy's programs and ultimately borne by Energy. To the OIG budget, these are free resources. Nevertheless, Energy is paying for contractor allowable cost audits whether they are performed by the contractors' internal auditors or under any of the alternatives we have proposed. The government pays about $13 million annually for the contractors' internal audit staff versus about $24 million in fiscal year 1992 for the OIG's Office of Audit. Since the OIG indicated a need to increase the contractors' internal audit staff from 180 staff to 280 to complete the VANEA work, we expect the cost of the contractor internal audit staff to increase to about $20 million annually. Thus, we believe that alternatives to having the contractors own internal auditors conduct these reviews should be considered.

Material Financial Management Problems Prematurely Upgraded to Nonmaterial

In its December 1991 Federal Managers' Financial Integrity Act report, Energy's former Secretary disclosed financial management as a material internal control weakness. However, 1 year later, in the December 1992 report under the act, the former Secretary upgraded the status of the Department's overall financial management problems from material to nonmaterial. The former Secretary cited several corrective actions as the basis for the upgrade; but these actions have not fully resolved Energy's serious financial management problems. We believe that the change in status was premature in light of the problems discussed in chapter 2 of this report, which Energy is presently attempting to address.

Financial Management Problems Reported as No Longer Material

In December 1992, the Department reported that it had completed accounting and reprogramming actions necessary to correct specific instances of improprieties and that, collectively, the corrective actions had significantly strengthened the controls over the Department's financial management practices. Accordingly, the Department's overall financial management problems were reported as no longer a material weakness. OMB has specified that the agencies must report material weaknesses and has established the criteria for federal agencies to use in determining whether an internal control weakness is to be reported to the President and the Congress. According to OMB, a weakness is material if, for example, it significantly weakens safeguards against waste, loss, unauthorized use, or misappropriation of funds, property, or other assets.

The former Secretary's 1991 report under the act cited deficiencies in the Department's financial management which were considered to result in an overall material weakness in financial management. The report described problems involving (1) inadequate financial management oversight, (2) inconsistent financial policy, (3) failure to properly budget for infrastructure requirements, and (4) a lengthy and complicated process to reprogram funds. Further, Energy reported a need to ensure that managers were provided the financial management information they require. According to the report, these deficiencies contributed to financial improprieties that caused the Department to initiate financial reform efforts.

Corrective Actions Cited Have Not Fully Resolved Problems

Energy has made important strides in establishing a culture that emphasizes financial control and accountability. However, the Department's overall financial management problems remain material. Further, these problems contribute to the internal control weaknesses that

cause Energy's contract management to be highly vulnerable to fraud, waste, and abuse.

Energy has taken actions, in the near term, to resolve problems, such as those involving reprogramming funds and construction projects, stemming from the specific financial improprieties identified by the IG and other internal reviews. Energy reported, for example, that it had made financial policies consistent and streamlined the reprogramming process. These are important steps to build a sound financial management environment at Energy and have contributed to changing the agency's culture to one that stresses greater fiscal accountability.

Further, the former Secretary's 1992 Federal Managers' Financial Integrity Act report stated that to address the root causes of its financial management deficiencies, it had completed actions such as the following.

- The former Secretary's report said that Energy implemented improvements to strengthen its management practices through increased oversight and greater fiscal accountability. For example, the former Secretary reported that the Department developed and published a policy on financial oversight of integrated contractors and established a schedule of increased reviews of contractor operations. We found, however, that effective oversight of integrated contractors was not ensured, as discussed in chapter 2.
- According to the former Secretary's report under the act, the Department implemented a program to ensure what it called a sufficient cadre of well-qualified financial professionals knowledgeable in budgeting and fiscal management techniques. In this regard, the Department reported that it had developed and implemented a financial management training program for budget analysts, accountants, and financial managers. However, as chapter 2 points out, while a financial staff training program is underway, Energy has reported to OMB that the need is still high for this training in a range of areas. It will take time for the Department to ensure that its new financial management training program provides the correct type of curriculum to a broad spectrum of financial managers and that the quality of training can be assessed as being effective.
- The former Secretary's report said that the Department had established a new organizational structure involving the Office of the CFO and Energy's finance offices which, according to the report, strengthened lines of responsibility and authority for managing the Department's financial operations and, for the field finance offices. Under the new structure, field finance managers report to the CFO in addition to field office managers,

creating a dual reporting responsibility. However, as the next section discusses further, our work showed that many of the Department's finance offices at field offices and power marketing administrations did not report to the CFO who, consequently, cannot ensure consistent or proper implementation of financial management policies and procedures.

- To address financial management information needs, the former Secretary's report said that meetings were held between program office representatives and CFO staff. Further, to help ensure appropriate allocation of overhead costs, Energy directed the field offices to assess contractors' cost accumulation and distribution systems and initiated independent reviews of these systems at selected contractors. However, as we discussed in chapter 2, the managers' lack of financial information they believed they need is a problem that cannot be easily or quickly overcome as long as contractors cannot report program cost category data consistently without having to significantly modify their nonstandard systems.

The former Secretary reported that as a result of completed actions, such as those just described, field offices could oversee contractors through on-site financial reviews more effectively. Our review showed that this is contrary to the views on staffing shortages expressed to the former Secretary by several field finance offices and as disclosed by the former Secretary in a December 1992 Federal Managers' Financial Integrity Act report. Further, as recently as January 1993 and subsequent to the latest Federal Managers' Financial Integrity Act report, the CFO reported to the former Secretary that the field finance organizations had not received the staffing increases the CFO had proposed, which will adversely affect the level of effort placed on reviewing integrated contractors' financial management.

Many Finance Offices Do Not Report to the CFO

While Energy's CFO organization has been strengthened and the CFO responsibilities enumerated by the former Secretary for Energy's CFO provide the basic structure expected by the CFO Act, the CFO does not have the direct authority necessary to carry out all of the Department's financial activities. Consequently, Energy cannot ensure that financial management receives the priority envisioned by the CFO Act and cannot ensure that adequate financial management policies are implemented fully and consistently throughout the Department.

The CFO Act sets out key responsibilities for agency CFOs that include directing, managing, and providing policy guidance and oversight of

agency financial management personnel, activities, and operations. Under OMB's guidance to agencies for organizing under the act,[1] agency CFOs are to be responsible for financial management activities relating to agency programs and operations.

In June 1991, the former Secretary directed that the finance offices at the Department's major field offices (currently there are 10 such offices) assume a dual reporting relationship and report to Energy's CFO as well as to their respective field office managers on financial matters. Finance managers at 12 other finance offices, however, are not subject to this dual reporting requirement; rather, they continue to be responsible solely to managers at their sites and not the CFO. When strengthening the reporting relationship between finance managers and the CFO, the former Secretary stated that "recent instances of improper financial management practices within the Department have demonstrated the inadequacy of our current management oversight to insure [sic] that Departmental guidance and regulations are followed."

The CFO told us that certain finance offices do not report to the CFO because they were not involved in improprieties which prompted the change in the reporting relationship for other finance organizations. Although these finance offices were not part of the review that disclosed the improprieties, they do have financial management problems. For example, in early 1992, the Office of the CFO discovered that the Schenectady Naval Reactor Office had knowingly reported incorrect uncosted obligation[2] data since the early 1980s. A Schenectady finance official told us that the field finance office had not corrected the problem because it had accurate information available for its own use and that amending the error for headquarters reporting purposes was not a high priority.

Although this finance office corrected this discrepancy subsequent to our discussions, the present CFO organizational arrangement with many of the Department's finance offices does not ensure that similar problems will be avoided in the future and that consistent and adequate financial management policies and procedures will be carried out departmentwide.

[1]Office of Management and Budget Memorandum for the Heads of Selected Executive Departments and Agencies, M-91-07, Guidance for Preparing Organization Plans Required by the Chief Financial Officers Act of 1990, February 27, 1991.

[2]Uncosted obligations are obligations that Energy has made to contractors for goods and services they have not yet provided and, as a result, for which Energy has not incurred a cost. Uncosted obligations need to be analyzed as part of the budget formulation process to determine the extent to which uncosted amounts may be used to reduce future appropriation requests.

Thus, extending the dual reporting relationship to these additional finance offices would seem appropriate, but some flexibility may be warranted. In determining whether to strengthen the CFO's role with respect to individual finance offices, several factors could be considered. These include whether the finance office (1) is responsible for a significant portion of Energy's expenditures, (2) has a history of financial system and control problems, as evidenced by reports from the OIG or others, (3) has a designated CFO with sufficient authority for the field office's overall financial management, (4) has routinely sought the advice and guidance of the Office of the CFO and the OIG on the form and content of financial statements and other financial reporting, systems, and control matters, and (5) prepares annual financial statements and has them audited. Also, such determinations could consider the extent to which the Office of the CFO has recently reviewed a finance office's operations and the results of the reviews, as well as the results of financial statement audits.

We have previously reported that Energy's indirect reporting structure impedes the Department's ability to effectively carry out its functional responsibilities, such as financial management, as well as its program activities. Specifically, as far back as 1981, we recommended that the Secretary of Energy give to headquarters office managers direct authority over all of their respective field functional office staffs.[3]

Energy's Internal and External Reports Cited Serious Control Problems

In assessing its progress during 1992 to improve financial management, Energy deemed financial management problems to be significant, although nonmaterial. Further, Energy's reports to the President and the Congress under the Federal Managers' Financial Integrity Act continued to disclose several of the material control weaknesses our report discusses. Like the former Secretary's December 1991 report, the 1992 report disclosed as separate material weaknesses (1) deficiencies in contract management practices, (2) inadequacies in the audit coverage of contractor expenditures, and (3) problems in deploying staff in critical areas, including financial management and audit.

Conclusions

Energy's completed actions notwithstanding, persistent problems continue to hamper the Department's effective financial management. The former Secretary prematurely portrayed the Department's financial management problems as nonmaterial in the December 1992 Federal Managers'

[3]A New Headquarters/Field Structure Could Provide a Better Framework for Improving Department of Energy Operations (GAO/EMD-81-97, September 3, 1981).

Financial Integrity Act report. While important corrective actions have been initiated and are underway, they have not yet effectively resolved Energy's overall financial management problems. For example, even though the former Secretary reported that a strengthened CFO organizational structure was in place, many of Energy's finance offices at field offices and power marketing administrations do not report directly to the CFO. Consequently, the present Secretary has no assurance that the CFO's policies and procedures are followed fully and consistently departmentwide. By upgrading the status of its financial management problems in its latest report under the act, Energy impaired the report's accuracy and lessened its usefulness in monitoring these weaknesses. Until corrective actions are verified as effective, it is important that the Secretary's Federal Managers' Financial Integrity Act reports disclose overall financial management problems as a material weakness.

Recommendations

We recommend that the Secretary of Energy direct Energy's Chief Financial Officer to ensure that Federal Managers' Financial Integrity Act reports disclose financial management as a material weakness until such time as corrective actions and their effectiveness are validated.

We also recommend that the Secretary of Energy extend the CFO's authority to the remaining 12 finance offices. Exceptions may be appropriate for individual offices based on CFO assessments that confirm whether an office is adhering to CFO financial management and reporting policies.

Agency Comments and Our Evaluation

Energy's CFO neither concurred nor disagreed with our recommendations in this chapter. However, the CFO expressed a concern that expanding the use of a dual reporting relationship between Energy's CFO and finance offices may not strengthen financial management.

The CFO commented further that in preparing its 1993 report under the Federal Managers' Financial Integrity Act, Energy would consider including areas of concern discussed in this report which Energy did not previously report as material weaknesses. However, the CFO disagreed with our assessment that the Department's 1992 report under the act prematurely upgraded the material financial management weaknesses to a nonmaterial status. The CFO stated that with one exception—increasing oversight of contractor financial management—actions had been taken

and validated to correct the specific financial management weaknesses identified as material.

As this chapter points out, Energy has made important strides toward improved financial control and accountability and has taken specific actions to correct identified deficiencies. These actions notwithstanding, Energy's financial management weaknesses, as described throughout this report, are material; thus, the weaknesses warrant being portrayed as such in the Department's Federal Managers' Financial Integrity Act reports.

Regardless of other actions reported as completed, Energy's inability to adequately increase oversight of contractor financial management operations alone would, in our view, have given Energy sufficient cause to report its overall financial management as having a fundamental and material weakness. Energy's CFO commented that this weakness, which involves the inability to adequately oversee almost two-thirds of the Department's $25.7 billion budget, stems from the need for additional staffing and was reported as a material weakness involving staffing deployment.

While this is accurate, the former Secretary's report also stated that the previously reported financial management problem involving oversight of contractors was corrected by the Department's developing and publishing a policy on financial oversight of integrated contractors and establishing a schedule of increased reviews of contractor operations. We believe that the failure to recognize that the problem relates to the Department's overall financial management, as Energy reported the previous year, as well as the premature report that the problem has been corrected, misleads the Congress and other users of the report as to the severity and status of Energy's financial management weaknesses.

Regarding the establishment of a dual reporting relationship involving additional finance offices, Energy's CFO remained unconvinced that this would significantly contribute to sound financial management. However, in December 1992, the former Secretary reported to the President and the Congress that the dual reporting relationship was part of a new organizational structure that strengthened lines of responsibility and authority for managing the Department's financial operations.

The CFO commented that rather than dual reporting, the key to financial management excellence is having top management commitment and the tools provided by the CFO Act which provide for the CFO's involvement in

the selection and performance appraisals of subordinate CFOs. The CFO added that she believes Energy's top management is committed to financial management excellence. We agree that several factors, including those the CFO mentioned, are important to improved financial management. As provided for by the CFO Act and OMB's implementing guidance, another factor is the CFO's agencywide responsibility to direct, manage, oversee, and provide policy guidance on financial management personnel, activities, and operations. We believe the CFO's agencywide responsibilities include finance office operations and, as envisioned by the former Secretary and supported in Energy's latest Federal Managers' Financial Integrity Act report, dual reporting is a viable means of carrying out these responsibilities.

Methodology Used to Assess Financial Management Clauses in Integrated Contractor Contracts

We reviewed each of the 44 contracts with integrated contractors that were in place as of October 1, 1991, to determine whether they included the standard Energy and federal financial management contract clauses in force at the time the contracts were awarded. We compared certain financial management or related clauses contained in these contracts to the standard contract clauses contained in the Department of Energy Acquisition Regulation and the Federal Acquisition Regulation.

The standard contract clauses that our comparison considered follow.

1. Department of Energy Acquisition Regulation.

970-5204.9	Accounts, Records and Inspection
970-5204.13	Allowable Costs and Fixed Fees
970-5204.15	Obligation of Funds
970-5204.16	Payments and Advances
970-5204.17	Legislative Lobbying Cost Prohibition
970-5204.21	Property
970-5204.31	Litigation and Claims
970-5204.54	Basic Fee and Award Fee
970-5204.55	Ceiling on Certain Liabilities for Profit Making Contractors
970-5204.56	Determining Avoidable Costs

2. Federal Acquisition Regulation.

52.230-3	Cost Accounting Standards
52.230-4	Administration of Cost Accounting Standards

When we found a nonstandard clause (or identified a missing clause), we assessed whether the deviation or omission was significant. We judged a nonstandard or omitted clause as a significant deviation if the clause

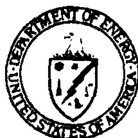
(1) reduced Energy's control over the contractor or (2) could increase the government's cost.

We did not consider a nonstandard or omitted clause a significant deviation in cases where (1) the nonstandard clause provided at least the same level of control as the standard clause, (2) another clause in the contract provided at least the same level of control that the standard Department of Energy Acquisition Regulation or Federal Acquisition Regulation clause intended, or (3) parts or the whole clause did not apply due to the nature of the work under the contract.

Our review found a number of special clauses (where there were no applicable Department of Energy Acquisition Regulation or Federal Acquisition Regulation standard clauses) with financial management implications. We assessed the impact of these special clauses against the criteria outlined above. To help in determining whether a nonstandard or omitted clause was a significant deviation, we also reviewed pre-award and post-award negotiation memoranda and other documents, where applicable, and interviewed Energy contracting officers and other officials.

Comments From the Department of Energy

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Department of Energy
Washington, DC 20585

SEP 0 1 1993

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial
Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Chapin:

The Department of Energy appreciates the opportunity to review and comment on the General Accounting Office draft report entitled "FINANCIAL MANAGEMENT: Energy's Material Financial Weaknesses Require Corrective Action." The draft report contains six recommendations for improving the Department's financial control and accountability. The Department essentially agrees with all recommendations and will continue its efforts to correct all issues identified in the draft report. In addition, the following general comments are provided for each of the recommendations.

The draft report recommended that the Secretary direct the Office of Procurement Assistance and Program Management to include all pertinent standard financial management clauses in future integrated contractor contracts, unless approved in advance by the Chief Financial Officer (CFO). The Department has already initiated steps to ensure that all appropriate standard financial management clauses are included in future integrated contractor contracts. These steps include the issuance of Acquisition Letter No. 93-2 on March 5, 1993, which contains the financial management clauses for contracts and provides guidance to contracting activities for the inclusion of the clauses in all new and renewal management and operating (M&O) contracts. Any deviations from these clauses must be approved by the CFO.

See comment 1.

With respect to the cost accounting standards, the draft report recommended that the Secretary direct the CFO to require that the cost accounting standards clause be included in the CFO's list of standard contract clauses related to financial management. The CFO has commenced efforts to make cost accounting standards applicable to M&O contractors. A draft memorandum which stipulates that cost accounting standards are applicable to all M&O contractors has been prepared and is currently under departmental review. The report also recommended that DOE eliminate the use of contract clauses that limit contractor liability for failure to follow cost accounting standards. We believe the intent of the recommendation is for the Department (1) to limit the liability of our M&O contractors only when we specifically direct them to deviate from cost accounting standards, and (2) to not limit our M&O contractors liability with respect to their subcontractors failure to follow cost accounting standards. The Department would agree with the first part of a revised recommendation and is taking steps to develop a standard non-liability clause to this effect. The Department will review the implications of the second part of the revised recommendation and take appropriate action.

The draft report recommended that the Secretary direct the CFO to improve financial information managers use to oversee integrated contractor operations by (1) defining the financial information program managers and the Congress need, and (2) developing ways to gain more consistency in integrated contractors' program category cost data. In addressing these issues, the Department has already organized task groups to identify recommendations for improvement. A task force to address financial management information requirements will examine the Department's budget structure, reporting structure, and requirements for performance measurements. The Department has also established a task force comprised of over 20 M&O contractors and senior DOE representatives from both the field and Headquarters to specifically address the issue of obtaining consistent reporting of the lower level program category cost data referred to in this report. In addition to the above task groups, the Department has established a Financial Management Systems Improvement Council to recommend improvements to the financial management systems, processes, policies, and procedures of the M&O contractors for gains in budget and accounting efficiency and economy. The primary goal of this group is to identify systems that lend themselves to common processes and to pursue standardization where opportunities exist. While the efforts of these working groups have already resulted in improvements, the Department recognizes that additional steps remain.

In a fourth recommendation, the draft report recommended that the Secretary provide the CFO authority over field finance office staffing allocations and direct the CFO to develop strategies to achieve these levels. The Department does involve the CFO in determining the field finance office staffing allocations; however, the strategies to achieve those levels will involve multiple departmental organizations and the strategy must be completed within the scope of overall departmental priorities.

Now on page 36.

See comment 2.

A fifth recommendation stated that the Secretary direct the CFO to ensure that Federal Managers' Financial Integrity Act reports disclose financial management as a material weakness until such time as corrective actions and their effectiveness are validated. The draft report further states, on page 53, that the Department "prematurely upgraded" the material financial management weakness to a non-material status. The Department understands and shares the General Accounting Office concern that we not diminish our efforts directed toward improving financial management. However, we believe that we did not "prematurely upgrade" the financial management weakness and consider the issue to be one of judgment. The financial management material weakness identified the need for correction of specific accounting errors related to a number of general plant and construction projects, increased financial management oversight, consistent financial policy, improved budgeting of infrastructure, and a simplified reprogramming process. The Department moved aggressively to correct these deficiencies. Actions include the correction of all identified accounting errors, the issuance of a new policy on financial management oversight, the issuance of guidance on general plant projects, the highlighting of infrastructure requirements in the budget, and the implementation of a streamlined reprogramming process. The correction of these deficiencies was validated through the performance of on-site CFO compliance reviews. We believe that all of these issues have been corrected, with the exception of increasing oversight of the contractors financial management. While we have established financial review divisions at all of our Operations Offices, accelerated CFO compliance reviews, and increased

staffing, we agree that additional staffing of the financial review divisions is essential to achieving our goal of increasing oversight of the contractors' financial operations. To this end, we included these staffing requirements in another material weakness entitled "Staffing Deployment." However, to the extent that the draft report identifies additional areas of concern, such as the need for improved contract provisions, which were not included in prior weaknesses, the Department will ensure that these issues are considered in determining material weaknesses included in the FY 1993 Federal Managers' Financial Integrity Act Report.

See comment 2.

The draft report recommended, in a sixth recommendation, that the Secretary extend the CFO's dual reporting authority to the 12 finance offices not currently covered and that exceptions be considered for individual offices based on CFO assessments that confirm whether an office is adhering to CFO financial management and reporting policies. I am not convinced that direct reporting is a key to sound financial management. I believe the real key to obtaining excellence in financial management is commitment of top management (which we have) and the tools provided by the CFO Act to ensure the CFO is actively involved in the selection and performance appraisals of subordinate CFOs. In fact, I am concerned that the resentment created by extending dual reporting may be a detriment rather than an asset to achieving strong financial management.

See comment 3.

Comments from the Office of Inspector General have been provided to the General Accounting Office under separate cover. The Department hopes that the comments provided will be helpful in the preparation of the final report.

Sincerely,

Elizabeth E. Smedley
Acting Chief Financial Officer

The following are GAO's comments on the Department of Energy's letter dated September 1, 1993.

GAO Comments

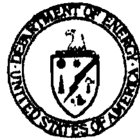
1. Discussed in Agency Comments and Our Evaluation section of chapter 2.

2. Discussed in Agency Comments and Our Evaluation section of chapter 3.

3. Comments from Energy's Office of the Inspector General are included in appendix III.

Comments From Energy's Office of the Inspector General

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Department of Energy
Washington, DC 20585

July 15, 1993

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial
Management Division
511 G. Street NW
Washington, DC 20548

Dear Mr. Chapin:

We appreciate the opportunity to comment on the U. S. General Accounting Office (GAO) draft report on "Energy's Financial Management," dated June 15, 1993. These written comments supplement comments provided to Jeff Steinhoff and other members of your staff in a meeting on July 7, 1993.

The draft report is critical of the "Cooperative Audit Strategy" which we have worked to implement within the Department of Energy (DOE). It is our view that the draft report presents a somewhat misleading view of the audit strategy and of the thought process which was used to conclude that it represents the best available option for providing enhanced audit coverage of DOE. The draft report contains outdated information and recommendations which are unworkable. The Office of Inspector General (OIG) has proactively taken steps to improve audit coverage of the Department. Our goal is to utilize the limited available audit resources in the most effective manner possible. We are concerned that GAO's position will undermine our efforts, without presenting practical recommendations for alternative actions.

See comment 1.

In the draft report, GAO implies that the Cooperative Audit Strategy violates Generally Accepted Government Auditing Standards (GAGAS). However, in fact, the Audit Strategy is based on strict compliance with these and other professional audit standards. On October 6, 1992, the GAO staff was so advised. Furthermore, in the draft report GAO fails to recognize the fact that, with OIG prodding, DOE Acquisition Letter 90-3R was issued in November 1992 which specifically requires M&O internal audit staffs to meet professional audit standards. Based on the history of internal audit at DOE's contractors, this in itself is a major step forward.

See comment 2.

Further during the course of GAO field work:

- The Secretary of Energy formally expressed approval of the audit strategy.

- A Steering Committee for Quality Auditing was established. The membership includes the Department's, Chief Financial Officer; Procurement Executive; Assistant Inspector General for Audits; senior executives representing programmatic and field offices; as well as, a representative of an M&O contractor. The purpose of the Committee is to ensure successful strategy implementation.

- An M&O contractor audit peer review process was established. The procedures for this process, which parallel those established by the American Institute of Certified Public Accountants, serve to ensure that all M&O internal audit staffs meet professional standards. This process was recently endorsed by the Institute of Internal Auditors, and is the first endorsement of any industry's peer review process by this organization.

These steps, individually and collectively, signify the commitment of those involved in the audit strategy to live up to the letter and the spirit of all professional standards applicable to this work.

We have several specific concerns regarding the conclusions in the draft report:

See comment 3.

- The report indicates that M&O internal audit staffs are solely responsible for identifying unallowable costs. In actuality the strategy requires an annual testing of contractor allowable cost audit work by the OIG. In addition, the OIG makes reviews for unallowable costs in all of its audits. The OIG is <u>not abandoning</u> its significant audit role at the M&O contractors.

See comment 3.

- The report states that currently the OIG 5 year audit cycle has stretched to 14 years. The OIG announced the termination of the 5 year audit cycle in May 1992 and initiated the Audit Strategy on October 1, 1992. GAO previously reported on the status of the audit cycle. This appears to rehash old news. The new audit strategy is predicated on a "risk based" evaluation of DOE's functions. We believe this is a better methodology than the former cyclical approach.

See comment 4.

- The report indicates that alternatives to increased reliance on internal auditors of M&O contractors were not considered. This is simply not the case. We have thoughtfully addressed all of the proposed alternatives included in your report. For example, as previously indicated to the Director, Civil Audits and Accounting Financial Audits Division, on October 6, 1992, the OIG and the Department do not consider it appropriate for DCAA to perform audits of M&O contractors' accounting records that are "integrated" with those of the Department. Similarly, reshuffling available personnel is not practical considering the overall shortage of

audit resources in DOE. Further all of the so-called alternatives suggested by GAO would require the taxpayers to incur costs for duplicative or redundant audit services, assuming the internal audit clause is retained in DOE's M&O contracts.

See comment 5.

o The GAO appears to be using the draft report as a vehicle for venting its concern about the scope of CFO auditing within DOE. The Office of Inspector General did not set the parameters for CFO financial statement preparation and audit. It was our understanding, and this is supported by a reading of the CFO legislation, that DOE was to focus its CFO audit attention on a list of commercial, trust fund and revolving fund activities. This list was approved by OMB. Further, we discussed our activities in this matter extensively with GAO on several occasions prior to implementing the CFO Audits within the DOE. The GAO representatives, expert in CFO matters, never raised a concern regarding audit scope or the planned application of the CFO legislation to the DOE. Further expansion of the CFO audit universe in DOE is dependent upon congressional action. To the best of my knowledge this has not occurred. Without providing the necessary resources to do the audit work, we believe a recommendation to expand the CFO financial statement audit concept is not realistic at this time. Let me emphasize that our position on this matter should not be interpreted as being contrary to the goals of the CFO program, of which we are totally supportive.

See comment 6.

o The GAO presents the position espoused by a number of Members of Congress that government auditing may be an inherently governmental function for which contractors should not be used. It then goes on to suggest that the OIG explore the alternative of using independent external auditors as an option to the audit strategy. It seems to me that these suggestions are incompatible. We recognize the concerns regarding contracting for audit service and we have tried to implement a balanced approach to this problem based on the resources provided to the OIG.

See comment 3.

o The text and the recommendations presented in GAO's Executive Summary and the body of its report differ in tone and flavor. A reader who only focuses on the Executive Summary would likely get a much different view of GAO's findings than if the reader studied the body of the report as well.

See comment 7.

o Finally, the report refers to a disparity in the use of 50 additional Federal positions provided by the Congress. In the Office of Inspector General budget request, it was specifically noted that only 29 of the 50 positions would be assigned to the Office of Audits. The balance was to be provided to other Inspector General offices, as specified in the budget request. GAO incorrectly asserts that these positions were "diverted," and that

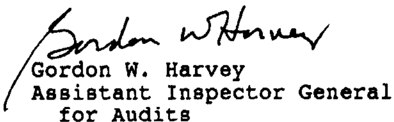
this was done in contravention to the will of Congress. However, 29 additional positions were assigned to the Office of Audits. Thus, the commitment made in the budget request was honored in every respect.

Over the last year we have spent a considerable amount of time in developing the Audit Strategy. We have nine months of experience with 15 pilot M&O contractors and, based on early results, have started taking steps for full implementation by all M&O contractors. This second phase will begin on October 1, 1993. We view GAO recommendations, i.e. to give consideration to other alternatives, as inappropriate given the realities of the current situation. To replace the Audit Strategy based on generic concerns expressed by GAO without the provision of workable alternatives does not seem prudent.

See comment 1.

We strongly urge the GAO to take a more responsible position and endorse the Cooperative Audit Strategy or, in the alternative, avoid the use of language that can only serve to impede improvements in audit coverage at the DOE. If you have any questions on the above comments please call me (202-586-1943).

Sincerely,



Gordon W. Harvey
Assistant Inspector General
for Audits

cc: Members, Steering Committee for Quality Auditing

The following are GAO's comments on Energy's Office of the Inspector General letter dated July 15, 1993.

GAO Comments

1. Discussed in Agency Comments and Our Evaluation section in chapter 2.

2. Our report specifically stated in chapter 2 that the OIG's policy does not violate applicable government auditing standards.

3. Report modified to reflect OIG comments.

4. As stated in the report, the OIG advised us in an October 1992 letter that it had not performed a cost analysis of alternatives. Therefore, we disagree with the OIG's statement that all the proposed alternatives had been adequately addressed.

5. Our discussion of financial statement audits in chapter 2 does not express concern about the present scope of Energy's audits under the CFO Act, and we have not specifically recommended that Energy undertake additional financial statement audits. However, in lieu of VANEA audits, we have put forth, as a viable option, the possibility of administratively requiring integrated contractors to prepare financial statements and subject them to audits that incorporate steps to ensure costs are allowable and accurately reported.

6. Report modified to clarify discussion of inherently governmental functions in chapter 2.

7. Our report indicated neither that OIG positions were diverted nor the will of the Congress contravened. We have, however, clarified the report to fully recognize that the OIG assigned staff to the Office of Audits at a level consistent with that requested in its budget request.

Major Contributors to This Report

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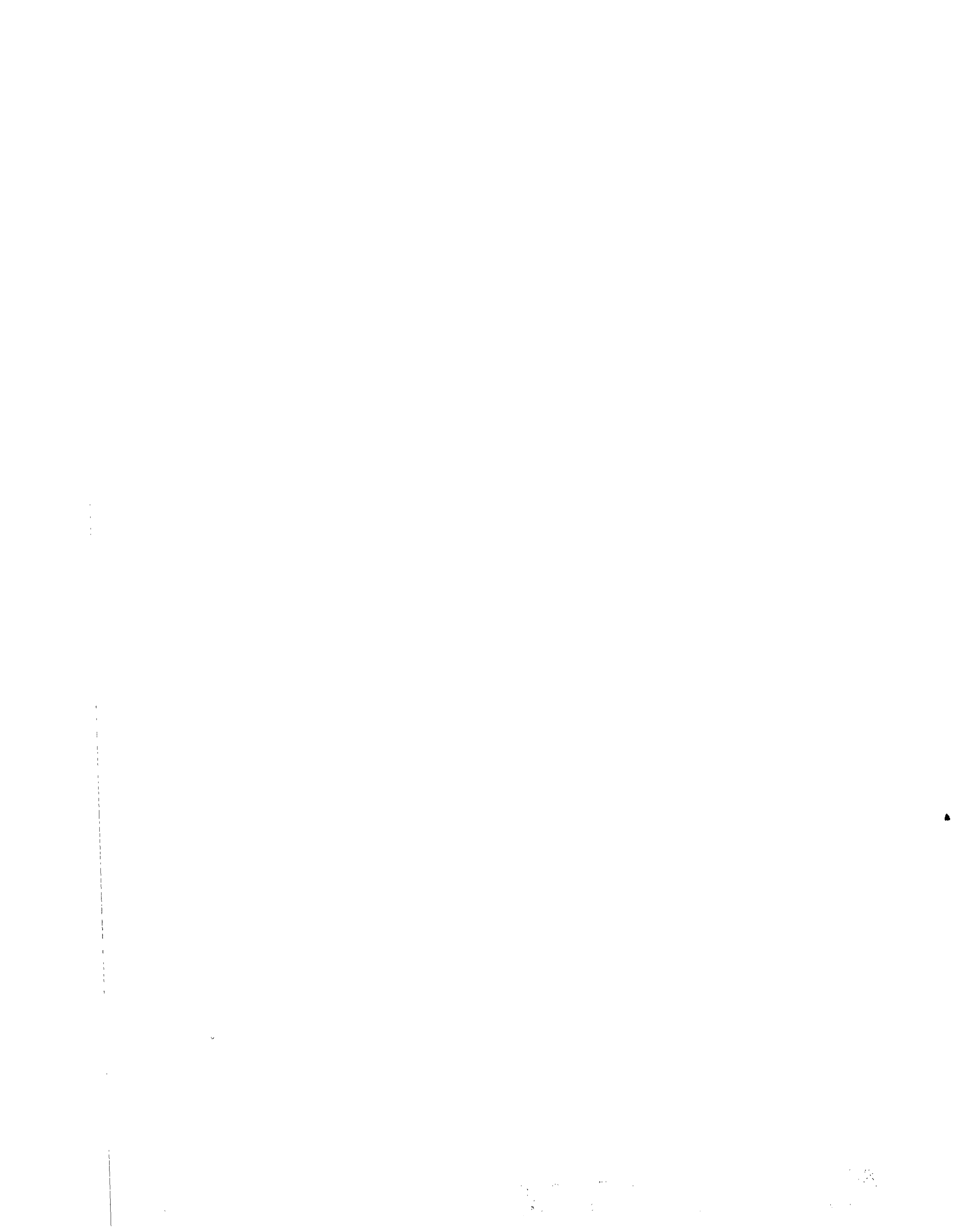

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