



U.S. Department of Energy
Office of Inspector General
Office of Audits & Inspections

Audit Report

Department of Energy's Fiscal Year 2012 Consolidated Financial Statements

OAS-FS-13-04

November 2012



Department of Energy
Washington, DC 20585

November 15, 2012

MEMORANDUM FOR THE SECRETARY

FROM: 
Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Report on the Department of Energy's Fiscal Year 2012 Consolidated Financial Statements

Pursuant to requirements established by the *Government Management Reform Act of 1994*, the Office of Inspector General (OIG) engaged the independent public accounting firm of KPMG, LLP (KPMG) to perform the audit of the Department of Energy's (Department) Fiscal Year 2012 Consolidated Financial Statements.

KPMG audited the Department's consolidated balance sheets as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statement of budgetary resources, for the years then ended. KPMG concluded that these consolidated financial statements are presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles and has issued an unqualified opinion based on its audits and the reports of other auditors for the years ended September 30, 2012 and 2011.

As part of this review, auditors also considered the Department's internal controls over financial reporting and tested for compliance with certain provisions of applicable laws, regulations, contracts and grant agreements that could have a direct and material effect on the consolidated financial statements. The audit revealed certain deficiencies in internal control over financial reporting related to unclassified network and information systems security that were considered to be a significant deficiency. The following significant deficiency in the Department's system of internal controls is not considered a material weakness:

- **Unclassified Network and Information Systems Security:** Network vulnerabilities and weaknesses in access and other security controls in the Department's unclassified computer information systems continue to exist. The Department has taken steps to enhance its unclassified cyber security program, including oversight of cyber security reform efforts, issuing guidance, and the development of a notational cyber security management architecture framework to support the Department's mission-related risk management approach.

The audit disclosed no instances of noncompliance or other matters that are required to be reported under applicable audit standards and requirements.

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

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

Attachment

cc: Deputy Secretary
Associate Deputy Secretary
Under Secretary for Nuclear Security
Acting Under Secretary of Energy
Office of the Under Secretary for Science
Acting Deputy Chief Financial Officer
Chief of Staff

Audit Report: OAS-FS-13-04

<http://www.cfo.doe.gov/cf12/2012parAFR.pdf>



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

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the United States (U.S.) Department of Energy (Department) as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2012 audit, we also considered the Department's internal control over financial reporting and tested the Department's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements.

As discussed in this report, a Power Marketing Administration of the Department, whose Department-related financial data is included in the accompanying consolidated financial statements, was audited by other auditors whose report has been furnished to us and was considered in forming our overall opinion on the Department's consolidated financial statements.

Summary

As stated in our opinion on the consolidated financial statements, based upon our audits and the report of the other auditors, we concluded that the Department's consolidated financial statements as of and for the years ended September 30, 2012 and 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our Opinion on the Financial Statements, the Department changed its presentation for reporting the combined statements of budgetary resources in fiscal year 2012.

Our opinion emphasizes that: (1) the Department has direct loans and loan guarantees issued under the *Federal Credit Reform Act of 1990* and that subsidy costs of the loans and loan guarantees include interest rate differentials, delinquencies, defaults, fees, and other cash flow items; (2) the cost estimates supporting the Department's environmental cleanup and disposal liabilities are based upon assumptions regarding funding and other future actions and decisions, many of which are beyond the Department's control; and (3) the Department is involved as a defendant in several matters of litigation relating to its inability to accept commercial spent nuclear fuel by January 31, 1998, the date specified in the *Nuclear Waste Policy Act of 1982*, as amended.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies related to unclassified network and information systems security that we consider to be a significant deficiency, as defined in the Internal Control Over Financial Reporting section of this report.

We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined in the Internal Control Over Financial Reporting section of this report.



The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin Number (No.) 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The following sections discuss our opinion on the Department's consolidated financial statements; our consideration of the Department's internal control over financial reporting; our tests of the Department's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the United States Department of Energy as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position, and custodial activity, and the combined statements of budgetary resources for the years then ended.

We did not audit the financial statements of the Bonneville Power Administration as of and for the years ended September 30, 2012 and 2011, whose Department-related financial data reflect total assets constituting 12.7 percent and 12.2 percent and total net costs constituting (0.5) percent and (0.6) percent, respectively, of the related consolidated totals. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Bonneville Power Administration, is based solely upon the report of the other auditors.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the United States Department of Energy as of September 30, 2012 and 2011, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1.Q. to the consolidated financial statements, the Department changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, the Department's combined statement of budgetary resources for fiscal year 2011 has been adjusted to conform to the current year presentation.

As discussed in Note 7 to the consolidated financial statements, the Department has total direct loans and loan guarantees, net, of \$13 billion and \$7 billion as of September 30, 2012 and 2011, respectively, which are issued under the *Federal Credit Reform Act of 1990*. Subsidy costs of the direct loans and loan guarantees are intended to estimate the long-term cost to the U.S. Government of its loan program and include interest rate differentials, delinquencies, defaults, fees, and other cash flow items. A subsidy re-estimate is performed annually at September 30. Any adjustment resulting from the re-estimate is recognized as subsidy expense.

As discussed in Note 15 to the consolidated financial statements, the cost estimates supporting the Department's environmental cleanup and disposal liabilities of \$268 billion and \$251 billion as of



September 30, 2012 and 2011, respectively, are based upon assumptions regarding funding and other future actions and decisions, many of which are beyond the Department's control.

As discussed in Note 18 to the consolidated financial statements, the Department is involved as a defendant in several matters of litigation relating to its inability to accept commercial spent nuclear fuel by January 31, 1998, the date specified in the *Nuclear Waste Policy Act of 1982*, as amended. The Department has recorded liabilities for likely damages of \$20 billion and \$19 billion as of September 30, 2012 and 2011, respectively.

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

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The September 30, 2012 consolidating information in the Consolidating Schedules section of the Department's 2012 *Agency Financial Report* is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. The September 30, 2012 consolidating information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the basic consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the September 30, 2012 consolidating information is fairly stated in all material respects in relation to the basic consolidated financial statements as a whole. The information in the Message from the Chief Financial Officer and Other Accompanying Information section of the Department's 2012 *Agency Financial Report* are presented for the purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Internal Control Over Financial Reporting

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or



detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. This report also includes our consideration of the results of the other auditors' testing of internal control over financial reporting that are reported on separately by those auditors. However, this report, insofar as it relates to the results of the other auditors' testing, is based solely on the report of the other auditors.

In our fiscal year 2012 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting related to unclassified network and information systems security, as described below and in more detail in Exhibit I that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

- *Unclassified network and information systems security* – We noted network vulnerabilities and weaknesses in access and other security controls in the Department's unclassified computer information systems. The identified weaknesses and vulnerabilities increase the risk that malicious destruction or alteration of data or unauthorized processing could occur. The Department should fully implement policies and procedures to improve its network and information systems security.

Exhibit II presents the status of the prior year significant deficiency.

We noted certain additional matters involving internal control over financial reporting and internal control over financial management systems that we will report to management in separate letters.

Compliance and Other Matters

The results of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended. This report also includes our consideration of the results of the other auditors' testing of compliance and other matters that are reported on separately by the other auditors. However, this report, insofar as it relates to the results of the other auditors' testing, is based solely on the report of the other auditors.

The results of our tests of FFMIA disclosed no instances in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.



Responsibilities

Management's Responsibilities. Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control over financial reporting; and complying with laws, regulations, contracts, and grant agreements applicable to the Department.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2012 and 2011 consolidated financial statements of the Department based on our audits and the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04, as amended, require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2012 audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting. Furthermore, we did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether the Department's fiscal year 2012 consolidated financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Department. However, providing an



U.S. Department of Energy
November 14, 2012
Page 6 of 6

opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

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

This report is intended solely for the information and use of the Department's management, the Department's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2012

Independent Auditors' Report
Exhibit I – Significant Deficiency

Unclassified Network and Information Systems Security
(Finding numbers reported in separate management letter)

The United States Department of Energy (the Department or DOE) uses a series of interconnected unclassified networks and information systems. Federal and Departmental directives, included in DOE Order 205.1B, *Department of Energy Cyber Security Program*, require the establishment and maintenance of security over unclassified information systems, including financial management systems. Past audits identified significant weaknesses in selected systems and devices attached to the computer networks at some Department sites. The Department has implemented corrective actions to address many of the identified weaknesses at the sites whose security controls we, and the Department's Office of Health, Safety and Security, reviewed in prior years. However, at the time of our testing, these corrective actions had not been completed. The frequency of network security weaknesses reported by KPMG has decreased when compared to the prior year weaknesses, but remains slightly higher than fiscal year (FY) 2010. The severity of these weaknesses remains consistent with prior year weaknesses. The Department recognizes the need to enhance its unclassified cybersecurity program and has categorized unclassified cybersecurity as a leadership challenge in its *Federal Managers' Financial Integrity Act* assurance statement for FY 2012. Improvements are still needed in the areas of system and application access and related access privileges, password management, configuration and vulnerability management, restriction of network services, and integrity of web applications.

Our FY 2012 audit disclosed information system security deficiencies similar in type and risk level to our findings in prior years. We identified similar weaknesses at sites where we had not reviewed security controls in the prior year. Specifically, we noted weaknesses within layered security controls for network servers and devices, desktop systems and business applications. We identified multiple instances of easily guessed login credentials or unrestricted access controls on network systems that could permit unauthorized access to those systems and their data. We also found weak account management and monitoring controls for review, approval, provisioning and termination of administrative and user accounts that may increase the risk of malicious or unauthorized access to systems and data.

In the area of configuration and vulnerability management, we identified deficiencies in the patch management process for timely and secure installation of critical software patches, with numerous instances in which security patches had not been applied to correct known vulnerabilities more than three months after the patches became available. The affected systems included workstations used by financial application users and system administrators with privileged levels of access to financial systems and other network systems. We also noted numerous weaknesses in web application integrity as a result of design flaws in those applications. We identified web applications that did not properly validate the form or content of input data against an application's database, which could result in unauthorized access to application functionality, sensitive data stored in the applications, and other network systems and applications.

While many of these cybersecurity weaknesses were corrected immediately after we identified and reported them to site management, deficiencies in the process and procedures for identifying, monitoring and remediating such deficiencies have continued from prior years. We also identified inconsistent risk management practices at several sites and noted that site management had not established a risk acceptance process to fully document acceptance of risk. We further noted that multiple sites were continuing to

develop and implement site-level Implementation Plans in accordance with the Department's Risk Management Approach (RMA) to address these weaknesses. However, these risk management enhancements were incomplete at the time of our testing.

The Department's Office of Inspector General (OIG) reported on these deficiencies in its evaluation report on *The Department's Unclassified Cyber Security Program - 2012*, dated November 2012. The OIG noted that identified weaknesses occurred, in part, because Departmental entities had not ensured that cybersecurity requirements were fully developed and implemented. The OIG reported that programs and sites had not always effectively monitored performance to ensure that appropriate controls were in place. The OIG noted that the Department's Plans of Action and Milestones were not always effectively used to report, prioritize and track cybersecurity weaknesses through remediation. The OIG also reported deficiencies in physical and logical access controls and configuration management at several sites where, even when policies and procedures were established, implementation of those policies and procedures were not aligned with the Federal requirements.

The identified vulnerabilities and control weaknesses in unclassified network and information systems increase the possibility that malicious destruction or alteration of data or unauthorized processing could occur. Because of our concerns, we performed supplemental procedures and identified compensating controls that mitigate the potential effect of these security weaknesses on the integrity, confidentiality and availability of data in the Department's financial applications.

During FY 2012, the Department had taken steps to enhance its unclassified cybersecurity program under the collaborative leadership of the DOE Information Management Governance Council (IMGC) and IMGC Working Group. The Joint Cybersecurity Coordination Center (JC3) Governance Model was approved in May 2012 to implement the requirements of DOE Order 205.1B related to continuous monitoring and risk management. The Department also continued ongoing efforts to improve awareness of Cybersecurity initiatives, including role-based training and workforce development, and to promote effective channels of communication and collaboration.

Recommendation:

While progress has been made, continued efforts are needed to effectively manage the evolving nature of cybersecurity threats, including strengthening the management review process and monitoring of field sites to ensure the adequacy of cybersecurity program performance; fully implementing revised and ongoing risk management processes; and expanding the use of automated tools in the resolution of the vulnerabilities and control weaknesses described above to ensure that systems are properly configured, implemented and updated throughout the lifetime of those systems.

Therefore, we recommend that the Under Secretary for Nuclear Security, Under Secretary of Energy, and Under Secretary for Science, in coordination with the Department and National Nuclear Security Administration (NNSA) Chief Information Officers, fully implement policies and procedures to meet Federal cybersecurity standards, protect networks and information systems against unauthorized access, and implement an adequate performance monitoring program, such as the use of periodic evaluations by Headquarters management, to improve the effectiveness of sites' cybersecurity program implementation. Detailed recommendations to address the issues discussed above have been separately reported to the cognizant management officials.

Management's Response:

The Department of Energy's Chief Information Officer (CIO) appreciates the opportunity to comment on the OIG's recognition of the Department's continued progress in addressing weaknesses and enhancing its unclassified cybersecurity program. The information in this report will enable the Department to take appropriate follow-up action on specific findings, as well as to continue to work in the most effective way to improve the Department's cybersecurity posture.

Throughout FY 2013, the Department will continue to enhance policies and procedures that define and implement the cybersecurity program and maintain the risk management approach.

Independent Auditors' Report
Exhibit II – Status of Prior Year Significant Deficiency

Fiscal Year 2011 Significant Deficiency	Status at September 30, 2012
Unclassified Information Systems Security	Not fully implemented – Unclassified network and information systems security issues continue to be reported in Exhibit I as a significant deficiency.

CUSTOMER RESPONSE FORM

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We wish to make our reports as responsive as possible to our customers' requirements, and, therefore, ask that you consider sharing your thoughts with us. On the back of this form, you may suggest improvements to enhance the effectiveness of future reports. Please include answers to the following questions if applicable to you:

1. What additional background information about the selection, scheduling, scope, or procedures of the inspection would have been helpful to the reader in understanding this report?
2. What additional information related to findings and recommendations could have been included in the report to assist management in implementing corrective actions?
3. What format, stylistic, or organizational changes might have made this report's overall message more clear to the reader?
4. What additional actions could the Office of Inspector General have taken on the issues discussed in this report that would have been helpful?
5. Please include your name and telephone number so that we may contact you should we have any questions about your comments.

Name _____ Date _____

Telephone _____ Organization _____

When you have completed this form, you may telefax it to the Office of Inspector General at (202) 586-0948, or you may mail it to:

Office of Inspector General (IG-1)
Department of Energy
Washington, DC 20585

ATTN: Customer Relations

If you wish to discuss this report or your comments with a staff member of the Office of Inspector General, please contact our office at (202) 253-2162.

This page intentionally left blank.

The Office of Inspector General wants to make the distribution of its reports as customer friendly and cost effective as possible. Therefore, this report will be available electronically through the Internet at the following address:

U.S. Department of Energy Office of Inspector General Home Page
<http://energy.gov/ig>

Your comments would be appreciated and can be provided on the Customer Response Form.