OFFICE OF THE INSPECTOR GENERAL

U.S. NUCLEAR REGULATORY COMMISSION

REVIEW OF NRC'S IMPLEMENTATION OF
THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT
FOR FISCAL YEAR 1999

OIG/00A-04 March 9, 2000

AUDIT REPORT

DF03

March 9, 2000

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM TO: Chairman Meserve

FROM: Hubert T. Bell
Inspector General

SUBJECT: REVIEW OF NRC'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT FOR FISCAL YEAR 1999

Attached is the Office of the Inspector General's (OIG) report on the Nuclear Regulatory Commission's (NRC) implementation of the Federal Managers' Financial Integrity Act (FMFIA). The FMFIA requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. The FMFIA requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities. As part of an Office of Management and Budget (OMB) sponsored pilot program to streamline financial reporting, NRC issues its FMFIA report as part of its annual "Accountability Report."

OMB Circular A-123, Revised, *Management Accountability and Control*, is the implementing guidance for FMFIA. The term "internal controls," as envisioned by the FMFIA, is synonymous with "management controls" and encompasses program and administrative areas, as well as the accounting and financial management areas.

NRC redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and OMB's 1995 revision to OMB Circular A-123. The redesigned program required offices designated as highest risk (with respect to programmatic and administrative activities) to submit management control plans and reasonable assurance statements to NRC's Executive Committee for Management Controls.

In FY 1999, NRC again revised its program and required NRC offices to address management control issues in their operating plans (instead of a separate management control plan) and annual reasonable assurance statements. An extended Executive Council, chaired by the Executive Director for Operations, provides oversight of this process. During FY 1999, OIG examined NRC's compliance with FMFIA and followed up on agency responses to our 1998 report[1] that addressed NRC's implementation of its management control program.

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1 OIG Report 98A-08, *NRC Should Reconsider The Methodology and Implementation of the Management Control Program*, December 9, 1998.

We found that NRC has complied with FMFIA for FY 1999, and the Agency took corrective action to address our 1998 recommendations. However, we are reporting two material weaknesses for FY 1999.

First, we disagree with the Agency's determination that the absence of a managerial cost accounting process, including the inability to aggregate pay transactions to the strategic arena level, is not a material weakness. Managerial cost accounting is intended to be an integral process for managing Government operations, and it is a vital component for implementing the Government Performance and Results Act.

Second, we disagree with the agency's determination that inadequate controls over NRC's license fee development process is not a material weakness. NRC's process lacks formal procedures and a quality control process, which are basic management control objectives. These control objectives are found in OMB Circular A-123, "Management Accountability and Control," which represents the implementing guidance for FMFIA.

Attachment: As stated

cc: Commissioner Dicus
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Commissioner McGaffigan
Commissioner Merrifield

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REPORT SYNOPSIS

Continuing disclosures of Federal waste, loss, unauthorized use, and misappropriation of funds or assets associated with weak internal controls and accounting systems resulted in the passage of the Federal Managers' Financial Integrity Act (FMFIA) in September 1982. The FMFIA requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal controls and accounting systems for which they are responsible.

In 1995, the Nuclear Regulatory Commission (NRC) redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and the Office of Management and Budget's 1995 revision to Circular A-123, *Management Accountability and Control.* The redesigned program required offices designated as the highest risk to submit management control plans and reasonable assurance letters to an Executive Committee for Management Controls. In FY 1999, NRC again revised its program and required designated offices to address management control issues in their operating plans and annual reasonable assurance statements. An extended Executive Council provides oversight of this process.

To assist NRC in evaluating its management control program, the Office of the Inspector General annually reviews NRC's program. We found that NRC has complied with the procedural requirements of the FMFIA during FY 1999, and that the Agency has taken action on the recommendations contained in our December 1998 [1]report on FMFIA implementation. However, we are reporting two material weaknesses for FY 1999, (1) the continued lack of managerial cost accounting, including the inability to aggregate pay transactions to the strategic arena level, and (2) inadequate controls over NRC's license fee development process.

We disagree with the Agency's determination that the absence of a managerial cost accounting process, including the inability to aggregate pay transactions to the strategic arena level, is not a material weakness. Managerial cost accounting is intended to be an integral process for managing Government operations, and it is a vital component for implementing the Government Performance and Results Act.

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1 OIG Report 98A-08, *NRC Should Reconsider The Methodology and Implementation of the Management Control Program*, December 9, 1998.

We also disagree with the agency's determination that inadequate controls over NRC's license fee development process is not a material weakness. This process lacks formal procedures and a quality control process, both of which are basic management control objectives. These control objectives are found in Office of Management and Budget (OMB) Circular A-123, which represents the implementing guidance for FMFIA.

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INTRODUCTION

The Federal Managers' Financial Integrity Act (FMFIA) was enacted on September 8, 1982, in response to continuing disclosures of waste, loss, unauthorized use, and misappropriation of funds or assets associated with weak internal controls and accounting systems. Congress felt such abuses hampered the effectiveness and accountability of the Federal Government and eroded the public's confidence. The FMFIA requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal controls and accounting systems for which they are responsible.

Office of Management and Budget (OMB) Circular A-123, Revised, *Management Accountability and Control*, is the implementing guidance for FMFIA. The term "internal controls," as envisioned by the FMFIA, is synonymous with "management controls" and encompasses program and administrative areas, as well as the accounting and financial management areas. OMB defined management controls in Circular A-123 as the controls used to ensure that: (1) the organization, policies, and procedures are reasonable to ensure that programs achieve their intended results; (2) resources are used consistent with an agency's mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and, (5) reliable and timely information is obtained, maintained, reported, and used for decision making.

See Appendix I for the objective, scope, and methodology of our review.

BACKGROUND

The FMFIA requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities.

In Fiscal Year (FY) 1995, the Nuclear Regulatory Commission (NRC) redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and the 1995 revision to OMB Circular A-123. The redesigned program required offices designated as the highest risk (with respect to programmatic and administrative activities) to submit management control plans and reasonable assurance letters to the Executive Committee for Management Controls.

In FY 1999, NRC again revised its program and required all offices to address management control deficiencies in their operating plans. An extended Executive Council (EC)[1], which is chaired by the Executive Director for Operations, provides oversight of this process. The Extended Executive Council is responsible for reviewing management control deficiencies as part of the offices' operating plans, reviewing their statements of reasonable assurance, and providing feedback as required.

To assist NRC in evaluating its management control program, OIG annually reviews NRC's program. FY 1998 was the fourth year of NRC's revised management control program. Our review of the first year (FY 1995) not only examined management control plans and reasonable assurance letters, but also evaluated the implementation of NRC's process. Over the next two years, we focused on issues raised by the offices in their control plans and reasonable assurance letters. For FY 1998, OIG issued two reports related to NRC's FMFIA activities. We issued the first report, which examined the FMFIA implementation process, in December 1998[2]. That report made three recommendations to strengthen and improve NRC's management control program. Our second report[3], issued on March 3, 1999, discussed FMFIA compliance, and reported a material weakness, and made no recommendations.

As part of our FY 1999 review, OIG followed up on agency actions taken in response to the recommendations in the December 1998 report. We found that the Agency has taken corrective actions and, in particular, now requires offices to report management control issues in their operating plans rather than a separate management control plan.

NRC is one of the agencies granted permission to streamline financial reporting pursuant to the Government Management Reform Act (GMRA). GMRA permits the Director, OMB, to consolidate or adjust the frequency and due dates of certain

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1 The extended EC consists of the Executive Director for Operations; the Chief Financial Officer, Office of the Chief Financial Officer, (OCFO); the Chief Information Officer, Office of the Chief Information Officer (OCIO); the Senior Assistant for Budget, Planning, and Communications, Office of the Chairman; the Deputy Executive Director for Reactor Programs, Office of the Executive Director for Operations (OEDO); Deputy Executive for Materials, Research, and State Programs, OEDO; Deputy Executive Director for Management Services, OEDO; Assistant for Operations, OEDO; Deputy CFO, OCFO; and the Deputy CIO, OCIO.

2 OIG Report 98A-08, *NRC Should Reconsider The Methodology and Implementation of the Management Control Program*, December 9, 1998.

3 OIG Report 99A-11, *Review of NRC's Implementation of the Federal Managers' Financial Integrity Act for Fiscal Year 1998*, March 3, 1999.

statutory financial management reports after consultation with Congress. NRC streamlined its reporting requirements and issues its FMFIA analysis in its annual Accountability Report.

RESULTS OF AUDIT

NRC has implemented the recommendations contained in our December 9, 1998, report and reevaluated and revised its management control program methodology to include: (1) eliminating the requirement for NRC offices to submit individual management control plans, (2) requiring that NRC offices use their operating plans as a vehicle for identifying and addressing management control issues, (3) assigning responsibilities to the Chief Financial Officer (CFO) to provide oversight, and (4) revising of Management Directive (MD) 4.4, "Management Controls," to formalize these changes. The above improvement actions were implemented late in 1999. Because the process needs time to mature, FY 2000 will provide more comprehensive experience to fully evaluate the effectiveness of these actions.

Although NRC is not reporting any material weaknesses for FY 1999, OIG is reporting two material weaknesses: (1) the absence of a managerial cost accounting process, including the inability to aggregate pay transactions to the strategic arena level, and (2) inadequate controls over NRC's license fee development process. These are the same material weaknesses referenced in OIG's 1999 report on NRC's financial statements.[4] The inability to aggregate pay transactions issue is described as a program cost deficiency in that report.

Without managerial cost accounting, NRC does not comply with Federal accounting standards, which require that cost accounting be performed on a regular and consistent basis. Further, the Federal Accounting Standards Advisory Board (FASAB) stated that "reliable and relevant cost information is indispensable for implementing the requirements of the Government Performance and Results Act [GPRA]." Strong management controls are needed for the license fee development

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4 OIG Report 99A-12, *Independent Auditors Report and the Principal Statements for the Year Ended September 30, 1999*, February 28, 2000.

process to ensure its integrity, credibility, and continuity. While NRC is in compliance with FMFIA, we believe these weaknesses are material to the Agency as a whole and meet the threshold for a material weakness as defined in NRC MD 4.4.[5]

THE LACK OF A MANAGERIAL COST ACCOUNTING PROCESS IS A MATERIAL WEAKNESS

OIG first reported this issue as a material weakness in our FY 1998 assessment of NRC's FMFIA implementation.[6] Although NRC is actively pursuing a resolution to this issue, we will continue to report it as a material weakness until NRC successfully implements managerial cost accounting.

In July 1993, Congress passed the GPRA, which mandates Federal agencies to measure performance. In September of that year, the Vice President recommended an action that required the FASAB to issue a set of cost accounting standards for all Federal entities. Those standards were intended to provide a method for identifying the unit cost of all Government activities.

On July 31, 1995, FASAB issued Statement of Federal Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Standards*. This statement establishes the requirement for cost accounting. It states that each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. It adds that costs may be accumulated by using cost accounting systems or by using cost finding techniques. Management should define and establish responsibility segments and use managerial cost accounting to measure and report the cost of each segment's outputs.

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5 NRC MD 4.4 states, "A deficiency that the Chairman determines to be significant enough to be reported in the annual Integrity Act report [FMFIA] (included as part of the NRC Accountability Report issued by the Office of the CFO) shall be considered a 'material weakness.' This designation requires a judgment as to the relative risk and significance of the deficiency and whether it merits the attention of the Executive Office of the President or the relevant congressional oversight committees." The Directive also states that "the extended Executive Council (EC) will make recommendations to the Chairman as to which 'significant weaknesses' are deemed material to the agency as a whole and should be considered for inclusion in the annual Integrity Act report to the President and the Congress."

6 OIG Report 99A-11, *Review of NRC's Implementation of the Federal Managers' Financial Integrity Act for Fiscal Year 1998*, dated March 3, 1999.

SFFAS Number 4 required that NRC and other Federal agencies have a cost accounting process in place for FY 1998. By the end of that fiscal year, NRC had no such process in place. NRC has delayed implementing a cost accounting methodology and has only recently begun a process to develop one. As a result, NRC cannot provide agency-wide cost data for its responsibility segments and meet the requirements for the GPRA.

SFFAS Number 4 recognizes the need for consistent cost accounting on a regular basis. To perform cost accounting on a regular basis means that "entities should establish procedures to accumulate and report costs continuously, routinely, and consistently for management purposes." The statement also ties together legislative actions designed to demonstrate the need for cost accounting:

> The requirement for managerial cost accounting on a regular and consistent basis supports recent legislative actions. The CFO [Chief Financial Officers] Act of 1990 states that agency CFOs shall provide for the development and reporting of cost information and the periodic measurement of performance. In addition, the GPRA of 1993 requires each agency, for each program, to establish performance indicators and measure or assess relevant outputs, service levels, and outcomes of each program as a basis for comparing actual results with established goals. The nature of these legislative mandates requires reporting entities to develop and report cost information on a consistent and regular basis.

In July 1997, the FASAB received a request from the CFO Council for a two year deferral of the effective date for SFFAS Number 4. The Statement's original implementation date was for FY 1997. The Board considered the request and decided to delay implementation for one year, to FY 1998. In denying the CFO Council's request, FASAB stated in part:

> The Board cannot agree with this request. It believes that cost accounting capability must be developed in time to fully support GPRA reporting. The Board thus urges Federal entities to give implementation of SFFAS No. 4 a high priority and take immediate actions to define and structure responsibility segments and develop costing methodologies.

The CFO advised us that for FY 1999 the Executive Council recognizes that the Agency has a significant weakness concerning managerial cost accounting, including the inability to aggregate pay transactions to the strategic arena level. The CFO noted that (1) the current payroll system was modified to correct this issue (aggregating pay transactions) for FY 2000, and (2) that the "implementation of a new integrated resource management system (STARFIRE) will include cost and labor distribution modules, which will provide the necessary capability to report costs at the appropriate level, and fully comply with SFFAS 4." The EC did not refer managerial cost accounting issues to the Chairman for consideration as a material weakness.

INADEQUATE MANAGEMENT CONTROLS OVER THE LICENSE FEE DEVELOPMENT PROCESS IS A MATERIAL WEAKNESS

During FY 1999, OIG reviewed NRC's license fee development process[7]. Our review disclosed management control weaknesses that we believe can undermine the continuity, credibility and integrity of the process. These weaknesses include the lack of formal procedures for developing license fees and a lack of quality control over fee calculations. In its statement of reasonable assurance for FY 1999, OCFO did not report either of these issues or refer them to the EC.

Management controls, in the broadest sense, include the organization, methods, and procedures adopted by management to ensure that its goals are met. As stated previously, OMB Circular A-123 revised, asserts that "management controls are the organization, policies, and procedures used by agencies to reasonably ensure that: (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported, and used for decision making."

We found that there are no formally documented procedures for calculating fees and preparing the fee rule. A few informal procedures, accumulated over the years in a piecemeal fashion, do exist. However, most of the methodologies for fee calculation were passed verbally from individual to individual. Formalized policies and procedures are needed to ensure process integrity and continuity.

We also believe a significant management control weakness exists due to the lack of a quality control process or procedures for the fee calculations. Since FY 1998, NRC has not performed an objective review of the calculations to detect errors and ensure they were prepared correctly. One of the errors we disclosed caused each Power Reactor annual fee to be approximately $11,000 more per license than it

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7 OIG Report 99A-01, *NRC's License Fee Development Process Needs Improvement*, dated December 14, 1999. We completed field work during FY 1999 and advised NRC management of our findings at that time.

should have been. While the amount of the overcharge does not seem significant in relation to the total reactor annual fee (about $3 million), we believe it reflects negatively on NRC's integrity and process. Furthermore, a basic quality control process would have disclosed this error.

In response to our report on this issue, the CFO advised that he would begin developing any necessary criteria and procedures for the fee development process. However, the CFO's response to our quality assurance concern states that "OCFO already provides quality assurance reviews for fee calculations commensurate with available staff resources and the short time frame for fee rule development." As stated in our report, some of the errors were obvious. No intricate calculations or computations were required. Further, an OCFO official told us that license fee calculations *were not* reviewed prior to placing them in the public document room with the fee rule package.

CONCLUSION

We found that NRC complied with the requirements of the FMFIA for FY 1999. However, as we did in FY 1998, OIG disagrees with NRC's assessment that the absence of managerial cost accounting is not a material weakness. Legislative mandates support the need for cost accounting and SFFAS Number 4 and the FASAB's deferral conclusion stress the high priority and management attention that managerial cost accounting deserves. This activity is intended to be an agency-wide function to better manage NRC's resources. NRC is now giving priority attention to this issue.

We also believe inadequate management controls over the license fee development process is a material weakness. We believe that formal procedures and a quality control process for developing NRC's fee rates are basic management control objectives as espoused in OMB Circular A-123. Our concern about these issues is heightened because of their fundamental nature and that OCFO did not report them in its statement of reasonable assurance for FY 1999.

We believe these issues are material to the Agency as a whole, and therefore "merits the attention of the Executive Office of the President," as stated in MD 4.4.

RECOMMENDATION

A recommendation addressing NRC's need for managerial cost accounting was contained in OIG's report on NRC's financial statements for FY 1998 and is also being carried as an open item for the FY 1999 financial statement audit.[8] Further, our December 14, 1999, report on NRC's license fee process contains recommendations to address the weakness discussed here. Therefore, we are not making recommendations in this report.

8 OIG Report 98A-09, *Independent Auditors' Report and the Principal Statements for the Year Ended September 30, 1998,* dated March 1, 1999.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine whether the U.S. Nuclear Regulatory Commission (NRC) complied with the provisions of the Federal Managers' Financial Integrity Act, which requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal controls and accounting systems for which they are responsible.

We conducted our review at NRC headquarters from December 1999 through January 2000. We reviewed applicable laws, implementing guidance, and the operating plans and reasonable assurance letters submitted by NRC offices for fiscal year 1999. Our review included discussions with Office of the Chief Financial Officer (OCFO) and Office of the Executive Director for Operations (OEDO) staff.

Our review was conducted in accordance with generally accepted Government auditing standards and included such tests of the data and records and other auditing procedures as we considered necessary.

MAJOR CONTRIBUTORS TO THIS REPORT

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GLOSSARY: OFFICE OF THE INSPECTOR GENERAL PRODUCTS

INVESTIGATIVE

1. *INVESTIGATIVE REPORT - WHITE COVER*

An Investigative Report documents pertinent facts of a case and describes available evidence relevant to allegations against individuals, including aspects of an allegation not substantiated. Investigative reports do not recommend disciplinary action against individual employees. Investigative reports are sensitive documents and contain information subject to the Privacy Act restrictions. Reports are given to officials and managers who have a need to know in order to properly determine whether administrative action is warranted. The agency is expected to advise the OIG within 90 days of receiving the investigative report as to what disciplinary or other action has been taken in response to investigative report findings.

2. *EVENT INQUIRY - GREEN COVER*

The Event Inquiry is an investigative product that documents the examination of events or agency actions that do not focus specifically on individual misconduct. These reports identify institutional weaknesses that led to or allowed a problem to occur. The agency is requested to advise the OIG of managerial initiatives taken in response to issues identified in these reports but tracking its recommendations is not required.

3. *MANAGEMENT IMPLICATIONS REPORT (MIR) - MEMORANDUM*

MIRs provide a "ROOT CAUSE" analysis sufficient for managers to facilitate correction of problems and to avoid similar issues in the future. Agency tracking of recommendations is not required.

AUDIT

4. *AUDIT REPORT - BLUE COVER*

An Audit Report is the documentation of the review, recommendations, and findings resulting from an objective assessment of a program, function, or activity. Audits follow a defined procedure that allows for agency review and comment on draft audit reports. The audit results are also reported in the OIG's "Semiannual Report" to the Congress. Tracking of audit report recommendations and agency response is required.

5. *SPECIAL EVALUATION REPORT - BURGUNDY COVER*

A Special Evaluation Report documents the results of short-term, limited assessments. It provides an initial, quick response to a question or issue, and data to determine whether an in-depth independent audit should be planned. Agency tracking of recommendations is not required.

REGULATORY

6. *REGULATORY COMMENTARY - BROWN COVER*

Regulatory Commentary is the review of existing and proposed legislation, regulations, and policies so as to assist the agency in preventing and detecting fraud, waste, and abuse in programs and operations. Commentaries cite the IG Act as authority for the review, state the specific law, regulation or policy examined, pertinent background information considered and identifies OIG concerns, observations, and objections. Significant observations regarding action or inaction by the agency are reported in the OIG Semiannual Report to Congress. Each report indicates whether a response is required.

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