OFFICE OF THE INSPECTOR GENERAL

U.S. NUCLEAR REGULATORY COMMISSION

Review of Materials Licensee Fees

OIG-02-A-07 December 26, 2001

AUDIT REPORT

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UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D.C. 20555-0001

December 26, 2001

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM TO: Jesse L. Funches
Chief Financial Officer

William D. Travers
Executive Director for Operations

FROM: Stephen D. Dingbaum
Assistant Inspector General for Audits

SUBJECT: REVIEW OF MATERIALS LICENSEE FEES (OIG-02-A-07)

Attached is the Office of the Inspector General's (OIG) audit report titled, *Review of Materials Licensee Fees.*

Overall, OIG found that NRC has made some adjustments in direct program staff to reflect the continuing loss of materials licensees. However, NRC has not adequately addressed its non-direct cost components: program overhead, management and support costs, and surcharge costs, which comprise approximately 60 percent of the materials fees. Without significant reductions in both direct and non-direct costs, the agency will not be able to stabilize or reduce materials fees. As a result, NRC needs to ensure that its cost accounting capabilities can directly trace overhead costs to all agency programs, and that NRC offices conduct a disciplined evaluation to determine that their activities are necessary, efficient, and effective in support of the agency's mission.

At an exit conference on November 7, 2001, agency managers generally agreed with the report's findings and recommendations. Agency comments provided prior to, and subsequent to, the exit conference have been incorporated where appropriate. In addition, on December 20, 2001, the Chief Financial Officer submitted a formal, written response for inclusion in this report (see Appendix D).

If you have any questions, please contact Bill McDowell at 415-5974 or me at 415-5915.

Attachment: As stated

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EXECUTIVE SUMMARY

BACKGROUND

A 1959 amendment to the Atomic Energy Act of 1954 allowed states to regulate most radioactive materials by entering into an agreement with the U.S. Atomic Energy Commission (AEC). Today, the U.S. Nuclear Regulatory Commission (NRC), a successor to AEC, oversees 32 Agreement States. As a result of the increase in the number of Agreement States, the number of materials licensees regulated by NRC has decreased from more than 9,000 to about 5,000.

The Independent Offices Appropriation Act of 1952 states that independent Federal agencies should be self-sustained by establishing "fair" fees for the services they provide. In 1990, Congress passed the Omnibus Budget Reconciliation Act (OBRA) that required NRC to recover approximately 100 percent of its budget, which the agency recoups by charging direct and annual fees to its licensees. A recent amendment to OBRA reduces NRC's fee recovery requirement to 98 percent for fiscal year (FY) 2001, and authorizes a 2 percent recovery decrease each year until FY 2005, when NRC's fee recovery requirement will be approximately 90 percent.

Licensees, industry representatives, and NRC staff have expressed a number of concerns about materials fees. For instance, the financial impact on licensees if materials fees significantly increase could have a spiral effect. In other words, higher fees may cause more licensees to forego their licenses, thereby increasing the financial impact on those who remain which, in turn, may lead to additional losses of licensees.

PURPOSE

The objective of this audit was to determine whether NRC is adjusting its resources and operations to reflect the projected loss of additional materials licensees.

RESULTS IN BRIEF

NRC has made some adjustments in direct program full-time equivalents to reflect the continuing loss of materials licensees. However, NRC has not adequately addressed its non-direct cost components: program overhead, management and support costs, and surcharge costs. Two primary factors contribute to this situation. First, because NRC's cost accounting process does not directly trace overhead costs to its programs, the true costs of NRC's materials program cannot be identified. Second, most agency offices have not thoroughly examined the need for their activities that support the materials arena. Implementation of these two actions would provide added assurance that materials fees reflect services that benefit only materials licensees.

RECOMMENDATIONS

OIG recommends that the Chief Financial Officer:

1. Continue to develop and implement NRC's cost accounting capabilities to enable the direct tracing of overhead costs to all agency programs.

and, that the Executive Director for Operations and the Chief Financial Officer:

2. Require NRC offices to conduct the Planning, Budgeting, and Performance Management process, or similar disciplined evaluation, to determine that their activities are necessary, efficient, and effective in support of the agency's mission.

AGENCY COMMENTS

At an exit conference on November 7, 2001, agency managers generally agreed with the findings and recommendations contained in the draft report. On December 20, 2001, the Chief Financial Officer submitted written comments to OIG's draft report (see Appendix D). The CFO generally agreed with the report and provided additional perspectives that are discussed on page 13.

ABBREVIATION AND ACRONYM LIST

Act	Atomic Energy Act of 1954
AEC	U.S. Atomic Energy Commission
CFO	Chief Financial Officer
CRDS	Controller Resource Database System
EDO	Executive Director for Operations
FASAB	Federal Accounting Standards Advisory Board
FTE	full-time equivalent
FY	fiscal year
G&A	general & administrative
GPRA	Government Performance and Results Act of 1994
HR	Office of Human Resources
IOAA	Independent Offices Appropriation Act of 1952
NMPWG	National Materials Program Working Group
NMSS	Office of Nuclear Material Safety and Safeguards
NRC	U.S. Nuclear Regulatory Commission
OBRA-90	Omnibus Budget Reconciliation Act of 1990
OCFO	Office of the Chief Financial Officer
OEDO	Office of the Executive Director for Operations
OIG	Office of the Inspector General
PBPM	Planning, Budgeting, and Performance Management
RES	Office of Nuclear Regulatory Research
SFFAS	Statement of Federal Financial Accounting Standards

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I. BACKGROUND

Under the Atomic Energy Act of 1954 (Act), Congress gave the U.S. Atomic Energy Commission (AEC) the authority to regulate the use of source material, by-product material, and special nuclear material in the United States. These materials are used for a multitude of medical, academic, and industrial purposes. A 1959 amendment to the Act allowed states to regulate the use of most radioactive material by entering into an agreement with the AEC. The U.S. Nuclear Regulatory Commission (NRC), a successor to AEC, retains an oversight role to ensure the consistent protection of public health and safety.

NRC's Licensees Reduced by Addition of Agreement States

In 1962, Kentucky became the first Agreement State. Today, NRC has agreements in place with 32 states. The addition of Agreement States significantly impacted the size of NRC's materials program by reducing the number of material licensees to be regulated by the agency. For example, in 1965, AEC regulated more than 9,000 licensees. Currently, NRC exercises regulatory authority over about 5,000 materials licensees throughout the U.S., as well as the territories of Puerto Rico, Guam, and the Virgin Islands. The 32 Agreement States currently regulate more than 16,000 material licensees. Three more States (Pennsylvania, Wisconsin, and Minnesota) have stated their intent to become Agreement States. If all three achieve Agreement State status, the number of materials licensees regulated by NRC will decline another 20 percent to about 4,000.[1]

Legislation Requires Fee Recovery

The Independent Offices Appropriation Act (IOAA) of 1952 states that services provided by independent Federal agencies should be self-sustaining to the extent possible. IOAA further states that agencies may prescribe regulations establishing fees for its services based on: fairness, the costs to the Government; the value of the service or thing to the recipient; public policy or interest served; and other relevant facts.

The Omnibus Budget Reconciliation Act of 1990 (OBRA-90) required NRC to recover approximately 100 percent of its budget authority through user fees. A recent amendment to OBRA-90 reduces NRC's fee recovery requirement to 98 percent for fiscal year (FY) 2001.[2] The amendment also authorizes a 2 percent recovery decrease each year until FY 2005, when NRC's fee recovery requirement will be approximately 90 percent.[3]

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1 NRC retains regulatory authority over certain categories of materials licenses within the Agreement States, such as licenses held by other Federal facilities and special nuclear materials.

2 Less the Nuclear Waste Fund and General Fund appropriations.

3 NRC will request increased appropriations from the General Fund each year to offset the eventual 10% reduction.

To meet these legislative requirements, NRC assesses two types of fees: fees for services, established at 10 CFR[4] Part 170; and annual fees established at 10 CFR Part 171 (see Appendix B). However, for streamlining purposes, materials users class of licensees pays only annual fees, with the exception of an application fee assessed under 10 CFR Part 170. Therefore, annual fees for most materials licensees include both Part 170 and 171 charges.

Impact of Fee Recovery Requirement

The OBRA-90 requirement to collect fees resulted in a significant reduction in the number of materials licenses as licensees consolidated multiple licenses and terminated others rather than retain them for a fee. The fee recovery requirement continues to impact materials licensees today. For example, licensees express concerns to agency managers and industry representatives about (1) the negative financial impact of current fees and (2) the potential added financial strain on their operations if fees increase in the classes or subclasses of materials licenses which continue to lose licensees. Also, an industry group considers the agency's fee methodology to be non-transparent. As a result, the group questions how NRC allocates the non-direct[5] portion of the annual fees. For further discussion of these costs, see Appendix B.

Finally, agency staff have expressed concerns about the spiral impact on the materials program if agency costs affecting fees cannot be controlled or reduced. Specifically, materials licensees bear a portion of the agency's costs. The number of licensees in a class is one factor in determining the annual fees for individual licensees. Therefore, if agency costs continue to increase, the financial impact may cause licensees in certain classes to forego their licenses, thereby increasing the fees of the remaining licensees and further reducing the materials program.

Since 1999, the agency has undertaken several assessments of the fees charged to its materials licensees. Three of these reports are summarized in Appendix C. NRC found that increases in the number of Agreement States, and subsequent reductions in the number of fee-paying licensees, are significant factors that can increase annual fees charged to materials licensees. Additionally, two of the three assessments concluded that significant reductions would be needed in direct and/or non-direct costs to control or reduce materials fees. However, the Office of the Inspector General (OIG) believes that, to date, overall agency costs have not been adequately scrutinized.

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4 CFR stands for *Code of Federal Regulations*.

5 Because NRC staff use various terms in discussing budget components, this report uses the term "non-direct" to mean all costs affecting materials fees other than direct program costs (i.e., program overhead, management and support costs, and surcharge).

Nuclear Materials Safety Arena

The agency's materials program falls primarily within the scope of the Nuclear Materials Safety strategic arena, which encompasses NRC's fuel cycle and other nuclear materials activities. For FY 2001, there were 377 full-time equivalents (FTE) and approximately $52 million budgeted for the materials arena. The Office of Nuclear Material Safety and Safeguards (NMSS) has the primary responsibility for carrying out the mission of the agency's materials program.

II. PURPOSE

OIG conducted this review due to the continued importance of NRC's materials program. Additionally, in their January 2001 report on major management challenges, the U.S. General Accounting Office identified a number of questions NRC needs to address regarding its future role in overseeing materials licensees given the expected increase in the number of Agreement States. Around the same time, a member of the Commission asked OIG to provide input on this issue.

The objective of this audit was to determine whether NRC is adjusting its resources and operations to reflect the projected loss of additional materials licensees. Appendix A contains additional information regarding the scope[6] and methodology of this review.

III. FINDINGS

NRC has made some adjustments in direct program FTE to reflect the continuing loss of materials licensees. However, NRC has not adequately addressed its non-direct cost components: program overhead, management and support costs, and surcharge. Two primary factors contribute to this situation. First, because NRC's cost accounting process does not directly trace overhead costs to its programs, the true costs of NRC's materials program cannot be identified. Second, most agency offices have not thoroughly examined the need for their activities that support the materials arena. Implementation of these two actions would provide added assurance that materials fees reflect services that benefit only materials licensees.

6 Contract and Nuclear Waste Safety arena costs are not addressed in this review.

A. NRC PROJECTS SOME ADJUSTMENTS IN DIRECT FTE TO REFLECT ANTICIPATED LOSSES OF MATERIALS LICENSEES

Program direct charges[7] are for duties performed in pursuit of the agency's principal mission, including licensing, inspections, investigations, and legal reviews. NMSS is the primary office allocating direct staff, from Headquarters and the Regions, to the materials arena. However, offices external to NMSS, such as Investigations, Enforcement, Nuclear Regulatory Research (RES), General Counsel, and Human Resources (HR), also allocate direct FTE to NRC's materials arena.

The level of NMSS direct program FTE in the materials arena has declined as a result of the loss of several thousand materials licensees, primarily to Agreement States, over the last decade. NRC expects the addition of three more Agreement States over the next 3 years, resulting in an additional loss of approximately 1,000 licensees. NMSS managers contend that the number of licensees clearly affects certain direct program activities, such as inspections and processing licensing actions. As a result, NMSS can anticipate and plan for expected decreases in its workload resulting from the projected loss of additional materials licensees. Additionally, NMSS credits the use of the agency's Planning, Budgeting, and Performance Management (PBPM) process for identifying efficiencies and prioritizing activities in the materials program. The agency's PBPM process is discussed further in Section C of this report.

Certain materials program direct activities, e.g., rulemaking, must be performed regardless of the number of total materials licensees. However, other activities carried out by these offices, such as investigations, legal reviews, and enforcement actions, could be expected to decrease due to a reduced number of materials licensees. Overall, offices external to NMSS do not expect reductions in FTE commensurate with a shrinking materials program. The materials program is a complex area with many interrelationships between the number of materials licensees and the costs of provided services. Thus, the agency should continue to develop and implement its cost accounting capabilities to enable direct tracing of all costs associated with the materials program, and implement the PBPM process, or a similar disciplined evaluation of office activities.

B. NRC CANNOT IDENTIFY THE ACTUAL TIME SPENT SUPPORTING THE MATERIALS PROGRAM BY NON-DIRECT STAFF

The number of FTE allocated to the materials arena continues to decline, primarily from reductions in NMSS direct FTE. Consequently, program overhead that support the direct FTE should also decline. In addition, significant

7 Includes non-supervisory professional FTE, and direct contractor costs.

reductions in the amount of management and support costs allocated to materials fees are needed to stabilize or reduce materials fees. However, few, if any, reductions are occurring in these non-direct costs.

Need for Cost Accounting

According to the Federal Accounting Standards Advisory Board (FASAB), reliable and relevant cost information is indispensable for implementing the requirements of the Government Performance and Results Act (GPRA).[8] Additionally, FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards,* states that cost information is an important basis for setting fees. Assignment of costs could be developed by directly tracing costs to outputs or by allocating costs on a reasonable and consistent basis in order to promote efficient distribution of resources. This standard also states that each agency should accumulate and report the costs of its activities on a regular basis for management information purposes.

For FY 1998 through FY 2000, OIG reported[9] that NRC had not implemented a managerial cost accounting system as required by SFFAS No. 4. In response to these reports, the agency developed a remediation plan, which has been revised to establish FY 2002 as the date for full implementation of its managerial cost accounting system.

Examination of Overhead Charges Needed

NRC's FY 2000 Strategic Plan states, "Costs associated with the regulatory infrastructure must be fair, equitable, and shared by all users." In FY 1999, NRC allocated $65 million in budgeted costs to be recovered through fees for services and annual fees from the various classes of materials licensees. As shown in Chart 1, 60 percent ($39 million) of these fees were for non-direct costs, of which approximately 16 percent represented program overhead (indirect FTE and related costs). The other 44 percent represented management and support FTE [agency overhead and general & administrative (G&A) costs], and the surcharge.[10] See Appendix B for further explanation of non-direct costs.

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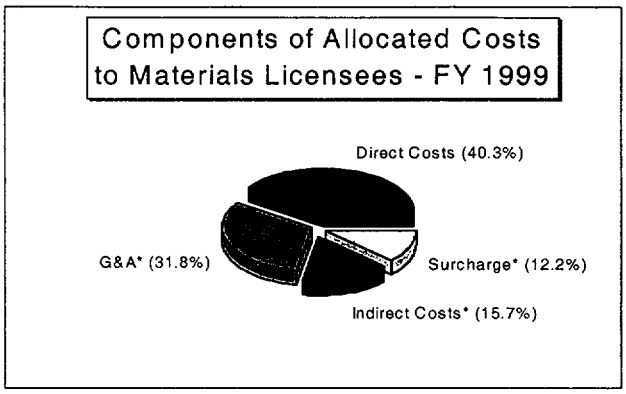
8 In 1993, Congress passed GPRA which mandates Federal agencies to measure performance.

9 OIG/98A-09, dated March 1, 1999, OIG/99A-12, dated February 28, 2000, and OIG/01A-06, dated March 1, 2001, re: Independent Auditors' Report and Principal Statements

10 Surcharge costs are for activities which do not directly benefit agency licensees (see p. 10).

CHART 1



*Components of non-direct charges
Data Source: SECY-01-0104, June 12, 2001

NMSS managers assert their sensitivity to the issue of fairness and reasonableness of materials fees. Their concerns prompt a continual search for further efficiencies in performing activities and processes, and for possible reductions of program overhead staff. However, NMSS managers do not expect a reduction in the overall number of overhead FTE in the materials arena.

Given projected reductions in the number of materials licensees and direct program FTE, it is reasonable to expect downward adjustments in the rest of the agency's offices supporting the materials arena unless they can demonstrate new responsibilities. Although portions of agency-wide FTE costs are apportioned to materials licensees in their annual fees, no projected overall decreases in management and support FTE by are expected by FY 2004.

In order for the agency to systematically stabilize or reduce materials licensees' fees, all components that affect the fees must be examined. However, NRC has not fully implemented a cost accounting process that would provide needed data for such a review. Consequently, the agency does not have information necessary to determine whether the efforts of non-direct staff allocated to the materials program bear a reasonable relationship to program outputs and objectives. Absent an effective cost accounting process, the agency cannot assess the effect of non-direct costs on, or ensure that costs billed to, materials licensees reflect the actual costs of NRC's materials program. Without stabilizing these costs, an increase in the non-direct components of the annual fees is expected, which will be borne by fewer materials licensees.

C. MOST AGENCY OFFICES HAVE NOT THOROUGHLY EXAMINED THE EFFICIENCY AND EFFECTIVENESS OF THEIR ACTIVITIES

According to the agency's *Principles of Good Regulation*, licensees are entitled to the best possible management and administration of regulatory activities. This guidance also states that NRC must establish a means to evaluate and continually upgrade its regulatory capabilities and use minimal resources where possible. Because portions of the agency's non-direct costs are allocated to materials licensees' fees, NRC needs to ensure that these costs are thoroughly examined. However, most agency offices have not conducted a thorough, disciplined examination of their activities. As a result, while agency overhead and surcharge costs have been reviewed to a limited extent, they have not been scrutinized to identify maximum efficiencies.

Size of Infrastructure Impacts Materials Fees

Multiple factors significantly impact materials fees. For example, the number of staff allocated to the materials arena, as well as the costs associated with the size of the agency's infrastructure (i.e., agency overhead and operational expenses) are factored into materials fees. As previously stated, the declining number of materials licensees, and identified efficiencies, have resulted in a significant reduction of direct materials program FTE. However, there has been no comparable review of management and support offices, whose costs are apportioned to the materials program.

Agency executives state that it is important to know how the services provided by the agency's management and support offices are linked to the agency's mission. Therefore, there should be a mechanism that enables management and support office employees to identify their efforts to support the materials program. Such a mechanism would provide senior agency managers with valuable planning information to identify opportunities for increased efficiencies.

Some efficiencies have been gained in individual offices through informal assessments. However, there have been no agency-wide, systematic reviews of activities and organizational structures to identify ways to reduce costs for the materials program. According to a senior official in the Office of the Executive Director for Operations (OEDO), to make intelligent adjustments and gain efficiencies, the agency needs an overall picture of all tasks being performed and a determination of how critical each task is to the agency's mission. Other senior managers agree it is important for evaluations of the activities conducted by each office to identify opportunities for increased efficiencies and link agency support office activities to the mission of the strategic arenas. Although the agency has a mechanism to conduct such evaluations, its use has been limited. Without such scrutiny, the agency cannot ascertain the appropriate level of effort necessary to support a smaller number of direct program staff.

Agency's PBPM Process Not Fully Implemented

GPRA mandates that Federal agencies measure performance. Additionally, NRC's FY 2000 Strategic Plan states that the agency will ensure that goals, measures, strategies, and the work to be accomplished for the agency are aligned and logically linked. The PBPM process is NRC's primary tool for assessing its performance management and fiscal accountability. The PBPM process provides a disciplined, integrated method for identifying how program activities are linked to NRC's strategic goals and what resources are necessary to accomplish those activities. However, agency managers acknowledge that PBPM could use further refinements and that it may not provide sufficient levels of detail. Even with these limitations, PBPM provides valuable planning information for agency managers.

In a 1999 study,[11] the Office of the Chief Financial Officer (OCFO) recommended the agency staff use the PBPM process to analyze materials and waste arenas costs, as well as agency management and support costs, that affect materials license annual fees to determine whether these costs could be reduced. The Chief Financial Officer (CFO) noted that, absent legislative relief, it appears that only reductions in overall agency costs that are included in materials fees would result in mitigating user fee consequences of a shrinking licensee universe. According to the CFO, overseer of the PBPM process, eventually all agency offices need to embrace the concepts of the PBPM process.

When initiated in 1997, it was anticipated that agency-wide implementation of PBPM would be accomplished in 2 to 3 years. Subsequently, NRC listed the full implementation of the PBPM process as a corporate management strategy in its FY 2000 Strategic Plan. However, as of today, only the Offices of NMSS, Nuclear Reactor Regulation, and RES, have conducted PBPM reviews and the PBPM process was recently piloted by HR, a support organization. In addition, there is no date for agency-wide implementation of the PBPM process.

NMSS' use of the agency's PBPM process has been credited for identifying efficiencies in the materials program and providing effective resource management. According to NMSS managers, the use of the PBPM process requires a detailed, structured analysis and prioritization of each activity included in a program office. The PBPM process has provided NMSS management with valuable information resulting in a more efficient justification and allocation of their budget and resources and should result in a decrease in program direct FTE by FY 2004.

In contrast, there will be an overall increase in direct FTE charged by the nine offices external to NMSS, despite continued reductions in the number of

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11 OCFO report, *Alternatives to Escalating Fees Associated with Decreasing Numbers of Licensees,* dated December 1999

materials licensees. Of these nine, only two, RES and HR,[12] have implemented the PBPM process to any degree. Additionally, despite having less direct materials staff to support, NRC projects an FTE decrease in only one of the four management and support functions. Despite HR's recent pilot of PBPM, other management and support offices have not implemented the PBPM process. As stated above, HR recently finished a PBPM pilot program. Senior HR managers found the process valuable for a number of reasons. For example, the PBPM process prompted thorough discussions of HR activities and has resulted in process reviews. In fact, HR staff found that they were able to identify performance efficiencies for some activities and mark other activities for elimination. In addition, each activity was prioritized from the perspective of how tasks performed support the agency's mission or fulfills other requirements. HR managers encountered some difficulty in applying the process to their support organization. One senior manager considers PBPM a "work-in-progress," yet still strongly recommends implementing the PBPM process for all management and support offices to determine how each enhances the agency's mission.

Some offices which have not yet implemented the PBPM process have identified efficiencies through informal assessments. However, senior OEDO officials agree that all agency offices should implement the PBPM process because it is a more structured, thorough examination and prioritization of activities. In addition, performance indicators are needed to assess how well support organizations are performing. According to management, a PBPM-type review should define the true costs of doing business by forcing offices to answer penetrating questions such as: 'What is the minimum cost of doing business at NRC?' and, 'Why do we need to continue certain low priority functions?' In addition, for higher ranked or required tasks, the question is, 'Can we do it more efficiently?'

Agency Overhead and Surcharge Costs Need Scrutiny

As previously stated, a percentage of the agency's overall management and support and surcharge costs are incorporated into materials licensees' fees. For fee purposes, these costs are allocated to the materials program at a percentage equal to the percentage the program receives from the agency's total budget appropriation. Therefore, in order to stabilize or reduce materials fees, it is especially important to thoroughly examine these costs.

Agency Overhead Costs

Agency overhead consists of most of the FTE within the Management and Support arena, a program's overhead (indirect) FTE, and general operational costs. For fee purposes, Management and Support arena costs are allocated to agency programs and to the surcharge based on the percentage of the program

12 The Office of Human Resources budgets both direct FTE in the Nuclear Materials Safety arena and non-direct resources in the Management and Support arena.

budgeted resources allocated to each. Additionally, program overhead costs are allocated based on the program direct FTE allocated to agency programs and to the surcharge.

In an August 2000 Staff Requirements Memo,[13] the Commission directed the CFO to conduct an agency-wide analysis of NRC's "29% typical overhead" rate for the next budget cycle. This study had two objectives: (1) determine and compare the types of positions that are considered overhead within the programs among the four strategic arenas in order to identify consistencies/ inconsistencies and trends, and (2) examine governmental and non-governmental studies and data on overhead to compare to NRC findings. In answering the first objective, the study concluded that NRC classifies overhead positions consistently, and that arena overhead rates have been, and are projected to, remain fairly stable through FY 2003.

However, the second objective of the CFO's study was not adequately answered. The study concluded that comparing NRC's overhead rate to other entities could not be accomplished because it would take an intensive effort just to reconcile how Federal agencies define and apply overhead. Additionally, it concluded that no comparative literature was available. In disagreement with the study's conclusion, a number of agency officials told us that benchmarking the agency's overhead against other Federal agencies could be accomplished by establishing the question parameters and then asking other agencies what their overhead rates would be given those parameters. NRC's overhead costs grow proportionately with the budget. Because these costs are included as a component of the materials fees, an examination of the reasonableness of the agency's overhead rate is a necessary part of controlling agency costs.

Surcharge Costs

Surcharge costs are the costs for activities that do not directly benefit those agency licensees who pay the costs through annual fees, such as fee exemptions for other Federal entities.[14] As previously stated, NRC's budget recovery requirement, through fee collection, will be reduced by 2 percent a year over a 5-year period beginning in FY 2001. Agency financial managers said that the increased appropriations the NRC will request from the General Fund each year, as an offset to the reduction in fees collected, will be applied to the surcharge, effectively relieving the licensees of the surcharge burden by FY 2005. However, OIG found that surcharge costs apportioned to materials licensees typically average more than 10 percent of the agency's total surcharge costs. Additionally, surcharge costs could increase as more States attain

13 COMSECY-00-0030, FY 2002-FY 2003 Budget Proposal, August 24, 2000

14 Deeming the requirement to recover these costs from agency licensees as unfair, NRC called on Congress to address the perceived inequity. As a result, NRC's budget recovery requirement has been reduced.

Agreement State status. Therefore, because any positive impact on fees from the eventual 10 percent reduction in NRC's budget recovery requirement could be minimal, the elements included in the surcharge need continual review.

IV. CURRENT MANAGEMENT ACTION

A tasking memo, dated August 9, 2001, from Chairman Meserve to the Executive Director for Operations (EDO) and the CFO, requested an assessment of business practices affecting materials fees. The memo indicates that NRC should have effective processes for recognizing changes in the materials industries in order to adjust NRC resources assigned and ultimately billed to the materials licensees. Among other things, the EDO and CFO are tasked to:

- Examine methods to build cost effectiveness into the regulatory strategy for generic activities
- Determine what work needs to be done and the minimal levels of effort required
- Review the management and support services within NMSS, and the corollary resources in other support offices and the Regions that support the materials and waste programs to ensure that these resources are applied in a fashion commensurate with the actual workload in a particular program and to identify efficiencies that will reduce program costs
- Integrate information from recent reviews of the materials program
- Consider ways of reducing the administrative costs of the fee program as part of developing the FY2002 Fee Rule

The Chairman has requested that the EDO and CFO provide options for addressing these issues by December 31, 2001.

Based on discussions with senior OEDO, NMSS, and OCFO executives, there is disagreement on the intent of the Chairman's memo regarding the scope of activities to be reviewed. On November 21, 2001, another discussion took place between the principles involved in this tasking. As of November 30, 2001, there has been no action plan developed to respond to the Chairman's assignment.

V. CONCLUSION

The number of materials licensees has significantly dropped and is projected to decline another 20 percent by FY 2004. With a shrinking base of materials licensees to bear the costs of agency operations, annual fees for licensees could increase. There have been some reductions, with more projected, in NMSS

direct program FTE budgeted in NRC's materials arena. However, overall expected program direct FTE in the materials arena for offices external to NMSS do not include FTE reductions commensurate with a declining number of NRC materials licensees. In addition, there are no overall downward adjustments proposed to non-direct program resources, even though these costs comprise approximately 60 percent of the materials fees. If fees are to be reduced, significant reductions in both direct and non-direct costs are needed.

NRC must ensure that costs assessed to materials licensees bear a reasonable relationship to the services provided. However, because the agency's cost accounting process does not directly trace overhead costs to its programs, the true costs of NRC's materials program cannot be identified. Furthermore, there has been no systematic, agency-wide evaluation of the efficiency and effectiveness of office activities to determine whether they are appropriately adjusted to support a smaller materials program.

VI. RECOMMENDATIONS

OIG recommends that the Chief Financial Officer:

1. Continue to develop and implement NRC's cost accounting capabilities to enable the direct tracing of overhead costs to all agency programs.

and, that the Executive Director for Operations and the Chief Financial Officer:

2. Require NRC offices to conduct the Planning, Budgeting, and Performance Management process, or similar disciplined evaluation, to determine that their activities are necessary, efficient, and effective in support of the agency's mission.

VII. AGENCY COMMENTS

At an exit conference on November 7, 2001, agency managers generally agreed with the findings and recommendations contained in the draft report. Comments were provided by OEDO and OCFO prior to, and subsequent to, the exit conference. OIG incorporated suggested changes where appropriate.

On December 20, 2001, the CFO submitted a written response to our draft report (see Appendix D). The CFO had two primary comments: (1) offices have scrutinized their budgets and activities through other existing processes and progress is being made in implementing the PBPM process, and (2) other agency responsibilities that support the materials program are not necessarily affected by the reduction in materials licensees. These factors may lead to FTEs remaining constant or increasing.

VIII. OIG RESPONSE TO AGENCY COMMENTS

OIG agrees that offices review their budgets and activities and that, in many cases, there is not a direct link between the number of materials licensees and FTE in support offices. However, the true costs of NRC's materials program cannot be identified through the current cost accounting process. In addition, NRC has not completed a detailed, systematic evaluation of all agency activities to determine if they are necessary, efficient, and effective. OIG believes that enhanced cost accounting and a thorough evaluation of NRC activities will have a beneficial impact on materials licensee fees by reducing agency overhead costs.

SCOPE AND METHODOLOGY

The objective of this review was to determine whether NRC is adjusting its resources and operations to reflect the loss of materials licensees.

To accomplish this objective, OIG interviewed cognizant staff within NRC, including staff from the Offices of the Executive Director for Operations, Nuclear Material Safety and Safeguards, Human Resources, State and Tribal Programs, the Chief Information Officer and the Chief Financial Officer. We met with an industry group, Agreement State representatives, agency and non-agency members of the National Materials Program Working Group, the Chair of the Phase II Byproduct Material Review working group, and attended the annual Conference of Radiation Control Program Directors.

OIG reviewed regulatory and program criteria governing NRC's collection of fees and agency regulation of the Agreement State program. Also, agency FTE and budget information from the Controller Resource Database System (CRDS)[15] and the 1998-2001 volumes of NUREG-1100, *BUDGET ESTIMATES AND PERFORMANCE PLAN,* were examined.

This audit was conducted from May 2001 to August 2001 in accordance with generally accepted Government auditing standards and included a review of management controls related to the objectives of the audit. The major contributors to this report were William McDowell, Team Leader; Catherine Colleli, Senior Management Analyst, and Yvette Russell, Auditor.

15 Data for FY 2001 was obtained from the "current" column of CRDS, instead of the "enacted" column.

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MATERIALS PROGRAM COSTS

NRC assesses licensees two types of fees: fees for services and annual fees.

- ❑ Fees for Services: (referred to as 'direct charges' in this report) Licensing and inspection fees, established at 10 CFR Part 170,[16] that are directly attributable to a specific applicant or licensee and are assessed under the authority of IOAA.

- ❑ Annual fees: (referred to as 'non-direct costs' in this report) Charges to licensees, established at 10 CFR Part 171 under OBRA-90, to recover generic and other regulatory costs not recovered through 10 CFR Part 170[17] fees.

According to OCFO, for the materials users class of licensees, the costs for inspections, license amendments, and license renewals (which were previously recovered in Part 170) are now included in the Part 171 annual fees for streamlining purposes. As a result, materials users licensees pay only annual fees, with the exception of an application fee billed under 10 CFR Part 170. Some Part 171 costs are distributed among all licensees while other Part 171 costs are spread among only the licensees within a specific class (or subclass) of materials license. Therefore, the number of licensees in each class (or subclass) is one factor in determining the annual fee obligation to be assessed to each licensee in the class or subclass.

Non-Direct Costs - Definitions

Non-direct costs are for FTE needed to support direct programs and other agency operations. For purposes of this report, non-direct costs will include the following three components:

- Program Overhead costs - (otherwise known as program indirect costs) - activities that support direct program and staff. Examples of indirect charges include program travel, supervisory and other overhead positions, such as clerical support, and information technology.

- Management and Support - (otherwise known as general & administrative costs) - overhead and administrative activities that benefit the whole agency, e.g., policy, financial, legal, information technology, rent, etc. Offices whose costs fall under this category comprise the agency's Management and Support arena. They include the Offices of the

16 Part 170 - *Fees for Facilities, Materials, Import and Export Licenses, and Other Regulatory Services Under the Atomic Energy Act of 1954, as Amended.*

17 Part 171 - *Annual Fees for Reactor Licenses and Fuel Cycle Licenses and Materials Licenses, Including Holders of Certificates of Compliance, Registrations, and Quality Assurance Program Approvals and Government Agencies Licensed by the NRC.*

Commission, Executive Director for Operations, Administration, Human Resources, Chief Financial Officer, and Chief Information Officer.

- Surcharge - an agency term for efforts that are not attributable to any one class of license. Examples of efforts covered through surcharge costs include: international activities, Agreement State oversight and support, and fee exemptions for non-profit educational institutions and other Federal entities.

  Surcharge is an agency cost distributed among all classes of licensees at a percentage equal to the percentage of the remaining NRC budget allocated to each class. These costs raise fairness and equity concerns because they are for services which do not directly benefit the agency's licensees who pay these costs as part of their annual fees.

RECENTLY COMPLETED AGENCY FEE ASSESSMENTS

The projected loss of an additional 20 percent of materials licensees to future Agreement States, and the resulting impact of those losses on materials fees, have prompted several agency actions over the last 2 years. The Commission asked staff to analyze the future direction of the materials program, analyze costs affecting materials fees, and identify how NRC can stabilize or reduce fees charged to a shrinking number of materials licensees without compromising the health and safety of the public. A summary of the findings pertinent to this review follows:

- National Materials Program Working Group

In November 1999, NRC commissioned the National Materials Program Working Group (NMPWG) to address the impacts of the increased number of Agreement States and to provide advice to the NRC on a "National Materials Program." The working group's final report,[18] issued in May 2001, reported that, "The continuing shift in licensee population has implications for both NRC and Agreement State programs." For example, NRC may find it more difficult to maintain a regulatory infrastructure, and the decreasing number of licensees increases the licensee fee burden. Also, NMPWG's report projects a 20 percent decrease in direct resources by FY2004, but very little change in other resources charged to materials licensees.

- SECY-01-0104, *Analysis of Costs Affecting Annual Fees for Materials Licenses*

This study, conducted by OEDO and OCFO, examined past and current efforts to determine whether costs affecting fees can be reduced without negatively affecting public health and safety. The report, dated June 12, 2001, concluded that significant reductions in components that make up materials fees (e.g., NMSS resources, agency-wide general & administrative activities) would be needed to keep annual fees relatively constant. The report also concluded that NRC's PBPM process provides a mechanism to ensure that the materials program is being carried out in an efficient and effective manner. It advocates that the PBPM process should be fully implemented for all agency programs, including offices in the Management and Support arena, since many of the agency's activities fall under this area.

- Phase II Byproduct Material Review

One objective of this working group was to review the nuclear byproduct materials program and make recommendations to help control or reduce user fees charged to these licensees. The report, issued in August 2001, disclosed that a 20 percent decline in materials licensees over the next 3 years poses a significant challenge in terms of

18 SECY 99-250, "Options and Recommendations," *Final Report of the Working Group, Volume I*, May 2001.

users' fees. In addition, the report states that direct resources in NMSS are projected to decline to reflect fewer inspections, licensing, etc. However, the projected decrease in direct resources would not be enough to offset an increasing amount of overhead, general and administrative costs, and surcharge costs allocated to the byproduct materials program. Additionally, the 2 percent annual reduction in the agency's fee recovery requirement will not have a noticeable positive impact because increases in the fees of up to as much as 18 percent can be expected. These increases will place a heavy burden on the remaining materials licensees.

COMMENTS FROM THE CHIEF FINANCIAL OFFICER

December 20, 2001

MEMORANDUM TO: Stephen D. Dingbaum
Assistant Inspector General for Audits
Office of the Inspector General

FROM: Jesse L. Funches **/RA/**
Chief Financial Officer

SUBJECT: COMMENTS ON DRAFT AUDIT REPORT, "REVIEW OF MATERIALS LICENSEE FEES"

As requested, the Office of the Chief Financial Officer (OCFO) has reviewed the Office of the Inspector General's (OIG's) Draft Audit Report, "Review of Materials Licensee Fees." I appreciate your efforts to address our previous comments in this draft audit report.

We agree with the report's recommendations. However, both the Executive Director for Operations and I agree that the introduction to Recommendation 2 should be revised to "... and, that the Executive Director for Operations and (emphasis added) the Chief Financial Officer:..."

Additionally, we still have two important comments on the report. First, the report implies that NRC offices, excepting those that have used the Planning, Budgeting, and Performance Management process, have not scrutinized their budgets and activities. We believe that offices have scrutinized their budgets and activities through other existing processes. Second, the report implies that offices other than NMSS have not reduced their full-time equivalents (FTE) due to a reduction in the number of materials licensees. We note that a number of agency responsibilities in support of the materials program are not affected by a reduction in the number of materials licensees. Examples of activities that do not depend on the number of licensees are the development of rules, information system upgrades, and investments in human capital. These two comments are discussed in more detail in the attachment.

Attachment: As stated

cc w/att: W. Travers, EDO

CONTACT: Rachel Hesselink, OCFO/DPBA/PAB
415-6223

ATTACHMENT

Comments on Draft Inspector General Report -- "Review of Materials Licensee Fees"

1.The report implies that NRC offices, other than those that have used the Planning, Budgeting, and Performance Management (PBPM) process, have not scrutinized their budgets and activities. We believe that offices have scrutinized their budgets and activities through other existing processes and that progress is being made in implementing PBPM, as described below.

- *Reviews for the budget cycle:* Annually, each office performs a review of their activities in preparation for that year's budget cycle. Each office director and regional administrator is instructed to ensure that:

    - Resources are planned to meet the strategic and performance goals and measures, and resources are consistent with budget assumptions.

    - All resource estimates are consistent with program requirements, and anticipated expenditures have been considered.

    - Efficiencies which reduce program and support costs have been identified and incorporated into resource estimates.

  Following office preparation and review, the Program Review Committee, Executive Director for Operations and CFO, and the Commission review, comment on, and ultimately approve the budget.

- *PBPM reviews:* Offices with the largest budgets have conducted PBPM reviews.

- *Office prioritization reviews:* Four major management and support offices–the Offices of Administration, Human Resources (HR), Chief Information Officer (OCIO), and OCFO--conducted prioritization reviews of their activities prior to developing their draft budgets. This information is also presented to the Program Review Committee for their review.

- *Efforts to implement PBPM in additional offices:* Efforts are underway to identify lessons learned in HR's implementation of PBPM, and these lessons will help other support offices implement the PBPM process in the near future. OCIO, for example, plans to utilize the PBPM process this coming year and in the development of their FY 2004 budget proposal. While PBPM provides a structured process for such an evaluation, it may not be feasible to apply PBPM in all agency offices.

2. The report implies that offices other than NMSS have not reduced their full-time equivalents (FTEs) due to a reduction in the number of materials licensees. We note that other agency responsibilities that support the materials program are not affected by the reduction in the number of materials licensees, and these factors may lead to FTEs remaining constant or increasing. For example:

- The number of investigations and enforcement actions, which are direct activities associated with the materials program, are not affected by a reduction in the number of materials licensees if the problems are with the licensees remaining under NRC's jurisdiction.
- If a major hearing is expected regarding an application for a particular materials license, budgeted resources for legal reviews could increase, even if some of the existing licensees in that particular licensee class terminated their licenses.
- Resources required to develop rules, prepare annual financial statements, establish agency policy, and perform inspector general reviews do not decrease with a reduction in the number of licensees or with a decrease in the number of program direct FTE.
- Similarly, increased staff training, additional investments in human capital, changes in the mix of CSRS/FERS employees, pay raises, number of regional offices, and development of new information systems are not a function of the number of licensees.
- While materials direct FTE are expected to decrease, NRC's total direct FTE are expected to increase. The additional direct staff would need services from management and support functions, affecting the total number of FTE in the Management and Support arena.