OFFICE OF THE INSPECTOR GENERAL

U.S. NUCLEAR REGULATORY COMMISSION

Independent Auditors' Report and
Principal Statements for the
Years Ended September 30, 2001and 2000

OIG-02-A-08 February 11, 2002

AUDIT REPORT

UNITED STATES NUCLEAR REGULATORY COMMISSION

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

February 11, 2002

OFFICE OF THE INSPECTOR GENERAL

MEMORANDUM TO: Chairman Meserve

FROM: Hubert T. Bell
Inspector General

SUBJECT: RESULTS OF THE AUDIT OF THE U.S. NUCLEAR REGULATORY COMMISSION'S FISCAL YEAR 2001 FINANCIAL STATEMENTS (OIG-02-A-08)

Attached is the independent auditors' report on the U.S. Nuclear Regulatory Commission's (NRC) financial statements for the years ended September 30, 2001 and 2000. The Chief Financial Officers Act requires the Office of the Inspector General (OIG) to annually audit NRC's Principal Financial Statements. The report contains: (1) the principal statements and the auditors' opinion on those statements; (2) the opinion on management's assertion about the effectiveness of internal controls; and (3) a report on NRC's compliance with laws and regulations. Written comments were obtained from the Chief Financial Officer (CFO) and are included as an appendix to the report.

Audit Results

The independent auditors issued an unqualified opinion on the balance sheet and the statements of changes in net position, net cost, budgetary resources, and financing.

In the report on management's assertion about the effectiveness of internal controls, the auditors concluded that management's assertion is not fairly stated. The auditors reached this conclusion because management did not identify the lack of managerial cost accounting and inadequate accounting for internal use software as material weaknesses.[1]

The auditors identified two new reportable conditions and closed four prior-year reportable conditions. The new conditions concern accounting for internal use software and contract close-out procedures.

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1 OIG's annual assessment of NRC's implementation of the Federal Manager's Financial Integrity Act will also report the same issues as material weaknesses.

The report on NRC's compliance with laws and regulations disclosed three noncompliances. The first is that NRC did not comply with Executive Order 13103, *Computer Software Piracy.* The second is that NRC's 10 CFR Part 170 license fee rates are not based on full cost, and the third is that is NRC is in substantial non-compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). The specific issues related to FFMIA are that managerial cost accounting was not implemented, as required, and that the agency did not adequately account for internal use software.

The prior year's reportable condition relating to the *Debt Collection Improvement Act* is closed. The condition relating to business continuity plans for the general ledger system remains in substantial noncompliance with FFMIA. However, NRC was dependent on the Department of the Treasury to resolve this condition. During FY 2002, NRC plans to transfer its accounting system to a new provider. Tests of compliance with selected provisions of other laws and regulations disclosed no other instances of noncompliance.

Performance Reporting

Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, requires OIG to "obtain an understanding of the components of internal control relating to the existence and completeness assertions relevant to the performance measures included in the MD&A [Management's Discussion and Analysis]." The Bulletin states that the objective of this work is to report deficiencies in the design of internal control, rather than plan the financial statement audit. On February 23, 2001, OIG issued a separate report on the validity and reliability of NRC's performance information.[2] The report noted that many efforts to improve internal controls and the reliability (e.g. completeness, timeliness) of performance data were underway during FY 2001. These efforts should improve the validity and reliability of NRC's data. During FY 2002, OIG will evaluate the effect of these improvements on specific performance data reported by NRC.

Comments of the Chief Financial Officer

The CFO generally agreed with the auditors' recommendations and stated that corrective action has been taken or is underway. We will follow-up on the CFO's corrective action during FY 2002.

We appreciate NRC staff's cooperation and continued interest in improving financial management within NRC.

Attachment: As stated

cc: Commissioner Dicus
Commissioner Diaz
Commissioner McGaffigan
Commissioner Merrifield

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[2] OIG Report OIG-01-A-03, *Government Performance and Results Act: Review of the Fiscal Year 1999 Performance Report,* February 23, 2001.

cc: R. McOsker, OCM/RAM
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OPA-RIII
OPA-RIV

U.S. NUCLEAR REGULATORY COMMISSION

INDEPENDENT AUDITORS' REPORT AND PRINCIPAL STATEMENTS FOR THE YEARS ENDED SEPTEMBER 30, 2001 AND 2000

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is a high-level overview of the Nuclear Regulatory Commission (NRC). It consists of five sections: *About the NRC,* describes the agency's mission and organizational structure; *Program Performance,* discusses the agency's success in achieving its strategic goals; *Financial Performance,* provides highlights of the financial statements and NRC's financial position; *Financial Condition of the NRC,* provides an overview of sources and uses of funds, prompt payment, and debt collection; and *Systems, Controls, and Legal Compliance,* describes the agency's internal control environment and contains the Chairman's statement regarding the agency's compliance with the Federal Managers' Financial Integrity Act of 1982, and the results of the Chairman's determination regarding the agency's compliance with the Federal Financial Management Improvement Act of 1996.

ABOUT THE NRC

The NRC was established by the U.S. Congress on January 19, 1975, as an independent Federal Government agency to regulate various commercial and institutional uses of nuclear energy. The agency has assumed the Atomic Energy Commission's regulatory function to develop and regulate nuclear activities. The NRC's purpose is defined by the Atomic Energy Act of 1954, as amended, and the Energy Reorganization Act of 1974, as amended. These Acts provide the foundation for regulating the nation's civilian use of nuclear materials.

MISSION

The NRC's mission is to regulate the Nation's civilian use of byproduct, source, and special nuclear materials to ensure adequate protection of public health and safety, to promote the common defense and security, and to protect the environment.

To fulfill the NRC's responsibility to protect the public health and safety, the agency performs three principal regulatory functions: (1) establish standards and regulations, (2) issue licenses for nuclear facilities and users of nuclear materials, and (3) inspect facilities and other uses of nuclear materials to ensure compliance with regulatory requirements. These regulatory functions relate to both nuclear power plants and other uses of nuclear materials, such as nuclear medicine, academic activities, research work, and industrial applications.

Organization

The top leadership of the NRC consists of a five member Commission. The President nominates members to serve 5 year terms with the consent of the U.S. Senate and designates one member as Chairman. The Chairman serves as the principal executive officer and official spokesman for the Commission. The chief operating officer is the Executive Director for Operations who carries out the program policies and decisions made by the Commission.

Approximately 2,800 staff members carried out the agency's mission for FYs 2001 and 2000 utilizing a budget of approximately $490 million for FY 2001 and $470 million for FY 2000. The NRC recovered the majority of its budget from license fees.

The NRC's headquarters is located in Rockville, Maryland. Four regional offices are located in King of Prussia, Pennsylvania; Atlanta, Georgia; Lisle, Illinois; and Arlington, Texas; and a technical training center in Chattanooga, Tennessee. The NRC also has resident inspector offices at each commercial nuclear power plant. An organization chart for the NRC is located at the end of this section.

PROGRAM PERFORMANCE GOALS AND RESULTS

The Government Performance and Results Act (GPRA) requires Federal agencies to provide an annual performance plan to Congress, setting goals with measurable target levels of performance.

STRATEGIC GOALS

- Prevent radiation-related deaths and illnesses, promote the common defense and security, and protect the environment in the use of civilian nuclear reactors.
- Prevent radiation-related deaths and illnesses, promote the common defense and security, and protect the environment in the use of source, byproduct, and special nuclear material.
- Prevent significant adverse impacts from radioactive waste to the current and future public health and safety and the environment, and promote the common defense and security.
- Support U.S. interests in the safe and secure use of nuclear materials and in nuclear non-proliferation.

The NRC evaluates its program performance by using a structured strategic planning process. As such, NRC has organized its strategic goals, performance goals, and strategies for achieving its mission into four strategic arenas. Our highest priority is safety, and our strategic goals focus on the achievement of this priority.

The goal of the first arena, **Nuclear Reactor Safety**, is to ensure that civilian nuclear power reactors, as well as non-power reactors, are operated in a manner that adequately protects public health and safety and the environment. The NRC regulates 103 operating civilian nuclear power reactors and 37 non-power reactors. During FYs 2001 and 2000, the NRC met all five of the strategic goal measures for this arena.

For the past year, the NRC met or exceeded all established schedules for license renewal activities. This is significant given the interest by our licensees whose licenses need to be renewed to continue operations. To date, the NRC has approved 62 requests from licensees to increase the electrical generating capacity of their nuclear reactor power plants (power uprates). Approval of uprates has resulted in an electrical generating capacity gain equivalent to approximately two large nuclear power plants.

The goal of the second strategic arena, **Nuclear Materials Safety**, is to ensure that NRC-regulated activities associated with the use of source, byproduct, and special nuclear materials are conducted in a manner that protects the public health and safety, the environment, and promotes the common defense and security. This arena includes regulatory oversight for 24 fuel facilities, including eight major fuel cycle facilities and two gaseous diffusion plants. It also includes oversight of more than 20,000 specific licenses regulated by the NRC and the Agreement States. During FYs 2001 and 2000, the NRC met all five of its strategic goal measures for this arena.

In addition to achieving our strategic goal measures, it is noteworthy to describe the NRC's progress in reviewing an application to construct a mixed oxide fuel fabrication facility at the Department of Energy's Savannah River site near Aiken, South Carolina. The proposed use of mixed oxide fuel is part of the national non-proliferation effort to dispose of surplus weapons grade plutonium by utilizing it in existing commercial light water reactors. The NRC performed an acceptance review of the application and announced an opportunity for a hearing. Also, three public meetings were conducted at various locations near the proposed site to obtain public opinion on the scope of the proposed environmental impact statement for the license application review.

The goal of the third strategic arena, **Nuclear Waste Safety**, is to prevent adverse impacts from radioactive waste to current and future public health and safety, the environment, and to promote the common defense and security. The Nuclear Waste Safety arena encompasses regulatory activities associated with the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive waste. For FYs 2001 and 2000, the NRC met all four of its strategic goal measures for this arena.

One of the NRC's major accomplishments in the high-level waste program in FY 2001 was the approval of the final regulations for 10 Code of Federal Regulations (CFR) Part 63, providing site-specific criteria for use in a possible licensing decision on a potential waste repository at Yucca Mountain, Nevada. The NRC also reviewed the U.S. Department of Energy's (DOE) Supplemental Draft Environmental Impact Statement for the Yucca Mountain repository. The agency continued technical exchanges with DOE on key licensing issues pertaining to the potential high-level waste repository and also to resolve DOE sub-issues and NRC concerns.

Also during FY 2001, the NRC completed the review of the Trojan Nuclear Plant License Termination Plan. This was a multi-year effort resulting in the first NRC approval of a License Termination Plan submitted in accordance with the NRC's reactor regulation. The NRC also completed its evaluation of previously terminated licenses to determine if the facilities had been adequately decontaminated prior to license termination.

The goal of the fourth strategic arena, **International Nuclear Safety Support**, is to support U.S. interests abroad in the safe and secure use of nuclear materials and in nuclear non-proliferation. This arena encompasses international nuclear policy formulation, export-import licensing for nuclear materials and equipment, treaty implementation, nuclear proliferation deterrence, international safety assistance, and safeguards support and assistance. All three measures established for this arena were met in FYs 2001 and 2000.

During FY 2001, the NRC completed action on a proposed export of highly enriched uranium to Canada for use as target material for medical isotope production. The agency also played a key role in defining criteria for international agreements on exclusion, clearance, and exemption of contaminated and radioactive materials, and for release of commodities for unrestricted use.

The NRC also conducted bilateral assistance activities for nuclear safety and safeguards with Russia, Ukraine, Armenia, Kazakhstan, and countries of Central and Eastern Europe in close coordination with the Departments of State and Energy. Of particular note, the NRC participated in the safe shutdown and decommissioning of the BN-350 sodium-cooled fast breeder reactor near Aktau, Kazakhstan; the closure of the Chernobyl nuclear power plant in Ukraine; and proposals to limit Russia's long-term production of weapons-grade plutonium. The NRC negotiated with appropriate foreign counterparts four bilateral exchange agreements in FY 2001 to ensure an effective framework for the NRC's international exchanges is in place.

FINANCIAL PERFORMANCE

As of September 30, 2001, and 2000, the financial condition of the NRC was sound with sufficient funds to meet program needs and adequate control of these funds in place to ensure NRC obligations do not exceed budget authority. The NRC prepared its financial statements in accordance with the accounting standards codified in the Statements of Federal Financial Accounting Standards (SFFAS) and Office of Management and Budget (OMB) Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended by OMB Bulletin No. 01-09.

Audit Results

The NRC received an unqualified audit opinion on its FY 2001 financial statements. This was the eighth consecutive year the NRC received an unqualified opinion. For FY 2001, the auditors identified two material internal control weaknesses: incomplete implementation of SFFAS Number 10 (SFFAS 10), *Accounting for Internal Use Software*, and, SFFAS Number 4 (SFFAS 4), *Managerial Cost Accounting Concepts and Standards for the Federal Government.* These two weaknesses were also identified as being non-compliant with the Federal Financial Management Improvement Act (FFMIA) of 1996. In FY 2000, the auditors also identified management controls over license fee development as a material weakness. Because improved quality control procedures over fee development were instituted during FY 2001, the auditors closed the finding.

The auditors also identified two new reportable conditions for FY 2001 concerning contract close-out processing procedures and compliance with computer software accountability. In addition, nine reportable conditions were carried over from FY 2000. Four of these nine reportable conditions remained open at the end of FY 2001. These four include the incomplete implementation of managerial cost accounting, lack of a tested business continuity plan for the core accounting system, inadequate controls over the verification of small entity status for fee assessment, and development of the hourly rate for fees. The lack of a tested business continuity plan for the core accounting system was also identified as being non-compliant with FFMIA. The agency has taken action on these audit findings and expects to fully implement corrective action during FY 2002.

Financial Statement Highlights

The NRC's financial statements summarize the financial activity and financial position of the agency. The financial statements, footnotes, and the balance of the required supplementary information, appear in a subsequent section of this report. Analysis of the principal statements follows:

Analysis of the Balance Sheet

The NRC's **assets** were approximately $236.9 million as of September 30, 2001. This is an increase of $11 million from the end of FY 2000, and is mainly due to an increase in Accounts Receivable resulting from mail delays and the late receipt of payments from licensees due to the September 11, 2001, terrorist attack on America. The assets reported in NRC's Balance Sheet are summarized in the accompanying table.

ASSET SUMMARY (in millions)		
	FY 2001	FY 2000
Fund Balance with Treasury	$140.5	$138.7
Accounts Receivable, Net	51.4	44.0
Property, Plant, & Equipment, Net	43.8	41.9
Other	1.2	1.3
Total Assets	$236.9	$225.9

The Fund Balance with Treasury represents the NRC's largest asset of $140.5 million as of September 30, 2001, an increase of $1.8 million from the FY 2000 yearend balance. This balance accounts for approximately 60 percent of total assets and represents appropriated funds, collection of license fees, and other funds maintained at the U.S. Treasury to pay current liabilities.

Accounts Receivable, Net, as of September 30, 2001 was $51.4 million and includes an offsetting allowance for doubtful accounts of $3.1 million. This is a 17 percent increase over the FY 2000 yearend Accounts Receivable, Net, balance of $44.0 million. Accounts Receivable Due from the Public is $48.9 million, representing 21 percent of total assets.

The value of Property, Plant, and Equipment, Net, was $43.8 million, representing 18 percent of total assets. The majority of the balance is comprised of nuclear reactor simulators, leasehold improvements, and computer hardware and software. The Property, Plant, and Equipment line item reflects the adoption of capitalizing the full costs of developing internal use software, as required by SSFAS 10, *Accounting for Internal Use Software*, implemented on October 1, 2000.

LIABILITIES SUMMARY (in millions)		
	FY 2001	FY 2000
Accounts Payable	$ 28.6	$ 26.5
Federal Employee Benefits	10.9	8.2
Other Liabilities	103.9	95.1
Total Liabilities	$143.4	$129.8

The NRC's **liabilities** were $143.4 million as of September 30, 2001. The accompanying table shows an increase in total liabilities of $13.6 million from the FY 2000 yearend balance of $129.8 million. This is mainly due to an increase of $7.4 million in the liability to the U.S. Treasury for assessed license fees, which, when collected, are used to offset NRC's appropriations. Of the agency's liabilities, $39.3 million were not covered by budgetary resources, which represents a $3.7 million increase over the balance as of September 30, 2000. Liabilities not covered by budgetary resources are unfunded pension expenses, accrued annual leave, and future workers' compensation. The Federal budget process does not recognize the cost of future benefits for today's employees. Instead, the Federal budget process recognizes those costs in future years when they are actually paid.

The difference between total assets and total liabilities, **net position**, was $93.5 million as of September 30, 2001. This is a decrease of $2.6 million from the FY 2000 yearend balance. The decrease is mainly the result of a $3.7 million increase in future funding requirements needed to pay for accrued unfunded expenses. Unexpended appropriations is the amount of authority granted by Congress that has not been expended. Cumulative results of operations represent *net* results of operations since the NRC's inception.

NET POSITION SUMMARY (in millions)		
	FY 2001	FY 2000
Unexpended Appropriations	$86.8	$87.0
Cumulative Results of Operations	6.7	9.1
Total Net Position	$93.5	$96.1

Analysis of the Statement of Net Cost

The Statement of Net Cost presents the net cost of NRC's four strategic arenas as identified in the NRC Annual Performance Plan. The statement allows for linking program performance under GPRA reporting to the cost of programs. The NRC's net cost of operations for the year ended September 30, 2001, was $50.6 million, which is an increase of $2.9 million over the FY 2000 net cost of $47.7 million. Net costs by strategic arena are shown in the accompanying table.

NET COST OF OPERATIONS (in millions)		
	FY 2001	FY 2000
Nuclear Reactor Safety	$(57.8)	$(60.0)
Nuclear Materials Safety	29.4	29.0
Nuclear Waste Safety	67.4	65.8
International Nuclear Safety Support	11.6	12.9
Net Cost of Operations	$50.6	$47.7

Total exchange revenue for the year ended September 30, 2001, was $464.0 million, which is an increase of $1 million over the exchange revenue of $463.0 million for the year ended September 30, 2000. Exchange revenue is derived from license fees and fees for inspections and other services, assessed in accordance with 10 CFR Parts 170 and 171.

The net cost of operations is expected to increase in the future due to changes in the statutory fee collection requirements and the addition of non-fee funds appropriated for new homeland security activities. The requirement to recover approximately 100 percent of the agency's new budget authority by assessing fees, less amounts appropriated for the Nuclear Waste Fund and the General Fund, was reduced to 98 percent in FY 2001 and will continue to decrease two percent each year until FY 2005, for a total reduction of 10 percent.

Analysis of Statement of Changes in Net Position

The Statement of Changes in Net Position reports the net results of operations of $2.4 million as the difference between the NRC's financing sources from other than exchange revenue of $48.2 million and the net cost of operations of $50.6 million. At the end of FY 2001, appropriations used represented $31.0 million, or 64 percent, of the total financing sources from other than exchange revenue. This represents a $4.9 million increase from the FY 2000 yearend appropriations used balance of $26.1 million. The NRC's decrease in Net Position of $2.6 million from FY 2000 to FY 2001 represents the net results of operations of $2.4 million and the decrease in unexpended appropriations of $0.2 million.

Analysis of the Statement of Budgetary Resources

The Statement of Budgetary Resources shows the sources of budgetary resources available and the status at the end of the period. It presents the relationship between budget authority and budget outlays, and reconciles obligations to total outlays. For FY 2001, NRC had budgetary resources available of $532.2 million. The majority of which was derived from budget authority. This represents a three percent increase over FY 2000 budgetary resources available of $515.9 million.

For FY 2001, the status of budgetary resources showed obligations of $503.3 million, or 95 percent of funds available. This is comparable to FY 2000 obligations of $485.5 million, or 94 percent of funds available. Total outlays for FY 2001 were $487.0 million, which represents a $3.1 million increase from FY 2000 total outlays of $483.9 million.

Analysis of the Statement of Financing

The Statement of Financing is designed to provide the bridge between accrual-based (financial accounting) information in the Statement of Net Cost and obligation-based (budgetary accounting) information in the Statement of Budgetary Resources by reporting the differences and reconciling the two statements. This reconciliation ensures that the proprietary and budgetary accounts in the financial management system are in balance. The Statement of Financing takes budgetary obligations of $503.3 million and reconciles to the net cost of operations of $50.6 million by deducting non-budgetary resources, costs not requiring resources, and financing sources yet to be provided.

FINANCIAL CONDITION OF THE NRC

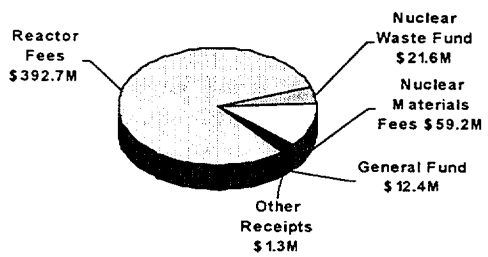
Sources of Funds

The NRC has two appropriations: NRC Salaries and Expenses Appropriation and the Office of the Inspector General Appropriation. Funds for both appropriations are available until expended. The NRC's total new FY 2001 budget authority was $487.2 million, $481.7 million for the Salaries and Expenses Appropriation and $5.5 million for the Office of the Inspector General Appropriation. This represents an overall increase in new budget authority of $17.3 million over FY 2000, $16.8 million for the Salaries and Expenses Appropriation, and $0.5 million for the Office of the Inspector General Appropriation. Additional funds available to obligate in FY 2001 were $32.6 million from prior-year appropriations, $2.5 million from prior-year reimbursable work, $4.8 million from current and prior-year transfer of funds from other Federal agencies, and $5.1 million for new reimbursable work to be performed for others. The sum of all funds available to obligate for FY 2001 was $532.2 million, which is a $16.3 million increase over the FY 2000 amount of $515.9 million.

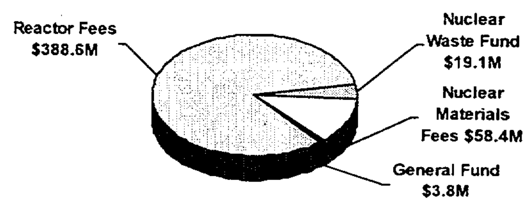
Consistent with the requirements of the Omnibus Budget Reconciliation Act of 1990, as amended, the NRC collected and offset approximately 98 percent of its new budget authority in FY 2001 and approximately 100 percent of its new budget authority in FY 2000, excluding funds derived from the Nuclear Waste Fund, General Fund, and other offsetting receipts. (See Figure 1.)

Figure 1
SOURCES OF FUNDS

FY 2001 Budget Authority $487.2M



FY 2000 Budget Authority $469.9M

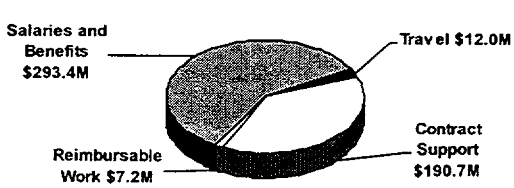


Uses of Funds by Function

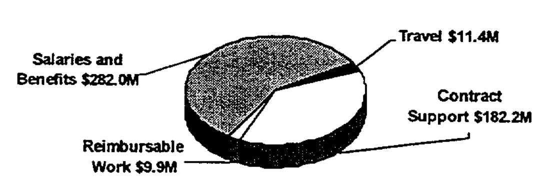
As previously stated, the total budgetary resources available for use by the NRC in FY 2001 was $532.2 million. Of that amount, the NRC incurred obligations of $503.3 million, which was an increase of $17.8 million over FY 2000. Approximately 58 percent of obligations were used for salaries and benefits. The remaining 42 percent was used to obtain technical assistance for the NRC's principal regulatory programs, to conduct confirmatory safety research, to cover operating expenses, (e.g., building rentals, transportation, printing, security services, supplies, office automation, training), staff travel, and reimbursable work. (See Figure 2.) The unobligated budget authority available at the end of FY 2001 was $28.9 million which is a slight decrease over the FY 2000 amount of $30.4 million. Of the $28.9 million in budget authority that was not obligated in FY 2001, $0.6 million of transferred funds expired at the end of the fiscal year, $4.5 million was for reimbursable work, and $23.8 million in budget authority is available to fund critical needs in FY 2002.

Figure 2
USES OF FUNDS BY FUNCTION

FY 2001 Total Obligations $503.3M



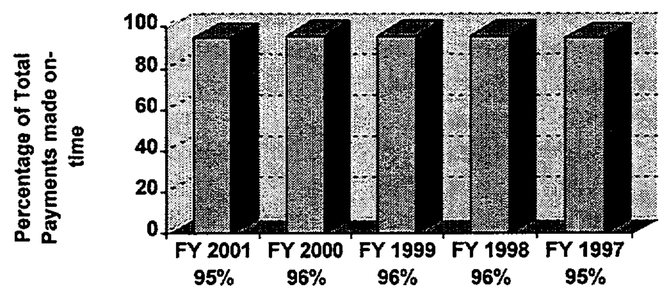
FY 2000 Total Obligations $485.5M



Prompt Payment

The Prompt Payment Act requires Federal agencies to make timely payments to vendors for supplies and services, to pay interest penalties when payments are made after the due date, and to take cash discounts when they are economically justified. From FY 2000 to FY 2001, the NRC had an increase of 508 invoices (from 8,237 to 8,745) that were paid and subject to the Prompt Payment Act. For FY 2001, the NRC made 95 percent of its payments on-time that were subject to the Prompt Payment Act. The amount of interest penalties incurred during FY 2001 were $3,151 which reflects a 51 percent decrease over the FY 2000 amount of $6,400. In addition, the agency made over 99 percent of its vendor payments electronically.

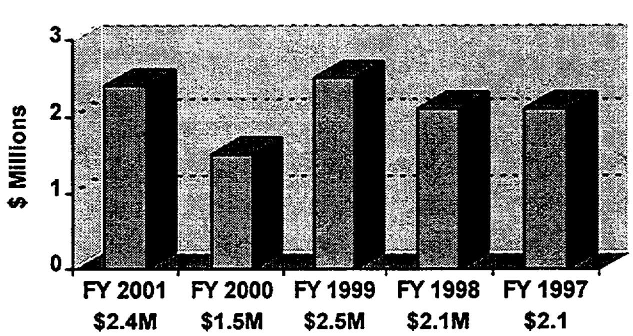
FIGURE 3
PROMPT PAYMENT



Debt Collection

The Debt Collection Improvement Act of 1996 was enacted to enhance the ability of the Federal government to service and collect debts. The agency's goal is to maintain the delinquent debt owed to the NRC at yearend at less than one percent of its annual billings. The NRC continues to meet its goal and has kept delinquent debt at less than one percent for the past 5 years. Delinquent debt at the end of FY 2001 was $2.4 million. This is an increase of $0.9 million over FY 2000; however, it reflects a decrease in the number of outstanding receivables from 254 to 208. The increase in outstanding receivables is due to one licensee filing for bankruptcy ($0.5 million) and a delay in the receipt of some payments because of the disruption to certain financial networks caused by the September 11, 2001, terrorist attack on America. The NRC continues to aggressively pursue the collection of delinquent debt and continues to meet the requirement that all eligible delinquent debt over 180 days is referred to the U.S. Treasury for collection.

FIGURE 4
DELINQUENT DEBT



SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The Federal Managers' Financial Integrity Act of 1982 (Integrity Act) mandates that agencies establish controls that reasonably ensure that: (i) obligations and costs comply with applicable law; (ii) assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (iii) revenues and expenditures are properly recorded and accounted for. This act encompasses program, operational, and administrative areas as well as accounting and financial management. The act requires the Chairman to provide an assurance statement on the adequacy of management controls and conformance of financial systems with Government-wide standards.

INTEGRITY ACT STATEMENT FY 2001

The U.S Nuclear Regulatory Commission evaluated its management controls and financial management systems for FY 2001, as required by the Federal Managers' Financial Integrity Act of 1982. On the basis of the NRC's comprehensive management control program, I am pleased to certify, with reasonable assurance, that the agency is in compliance with the provisions of this act.

Richard A. Meserve
Chairman
U.S. Nuclear Regulatory Commission
January 16, 2002

The Federal Financial Management Improvement Act of 1996 (Improvement Act) requires each agency to implement and maintain systems that comply substantially with: (i) Federal financial management system requirements, (ii) applicable Federal accounting standards, and (iii) the standard general ledger at the transaction level. The act requires the Chairman to determine whether the agency's financial management systems comply with the Improvement Act and to develop remediation plans for systems that do not comply.

Management Controls

A committee of senior agency executives reviewed individual assurance statements prepared by NRC office directors and regional administrators that identified weaknesses and warranted the attention of the executive committee. This committee was comprised of senior executives from Offices of the Chief Financial Officer and the Executive Director of Operations, with the General Counsel and the Inspector General as advisors. These statements were based on various sources:

- Management knowledge gained from the daily operation of agency programs and reviews.
- Management reviews.
- Program evaluations.
- Audits of financial statements.
- Reviews of financial systems.
- Annual performance plans.
- Inspector General and General Accounting Office reports.
- Reports and other information provided by the congressional committees of jurisdiction.

The NRC's ongoing management control program requires, among other things, that management control deficiencies are integrated into offices' and regions' annual operating plans. The operating plan process has provisions for periodic updates and for attention from senior managers. The management control information in these plans, combined with the individual assurance statements discussed previously, provides the framework for monitoring and improving the agency's management controls on an ongoing basis. It also advises the Chairman of any management control deficiencies serious enough to report as a material weakness or material non-compliance.

The NRC evaluated its management control systems for the fiscal year ending September 30, 2001. This evaluation provided reasonable assurance that the agency's management controls achieved their intended objectives. As a result, management concluded that the NRC did not have any material weaknesses in its programmatic or administrative activities. However, the NRC's implementation of accounting for internal use software (SFFAS 10) and managerial cost accounting (SFFAS 4) were identified as significant weaknesses that merit the attention of senior management.

Governmentwide requirements for accounting for internal use software (SFFAS 10) became effective on October 1, 2000. The NRC did not have an adequate system to track labor hours, and staff did not comply with agencywide implementation guidance. In FY 2002, the NRC will implement a new time and labor reporting system in order to resolve the system weakness. In addition, the NRC will continue to monitor the reporting of labor time for internal use software development projects to ensure compliance with established agency procedures and SFFAS 10.

The incomplete implementation of managerial cost accounting was reported as a significant weakness last year and continues to receive the close attention of senior management. Progress has been made over the past year to implement managerial cost accounting. During FY 2001, quarterly cost reports were developed and provided to agency managers as an initial step to implement cost accounting. Cost accounting software was configured to reflect how the agency plans to report direct costs and allocate its indirect costs. Consistent with the remediation plan, the agency expects to fully implement managerial cost accounting and achieve full compliance with SFFAS 4 during FY 2002.

Financial Management Systems

The NRC has five financial systems: the Federal Financial System (FFS), Capitalized Property System, License Fee Bill Generator System, Allotment/Financial Plan System, and a Budget Formulation System. For FYs 2001 and 2000, the NRC also had a mixed system - the Payroll/Personnel System. The NRC evaluated its financial management systems to determine if they comply with Governmentwide standards, as required by the Integrity Act (Section 4), and with applicable Federal requirements and accounting standards required by the Improvement Act. This evaluation disclosed that NRC's major financial management systems are in compliance with the Integrity Act.

However, the evaluation also disclosed three instances of substantial non-compliance with the Improvement Act. Reporting for internal use software development represents an instance of substantial non-compliance because the process did not comply with Federal financial management systems requirements and with the standard general ledger at the transaction level. The NRC expects to implement remediation actions required by the Improvement Act during the first quarter of FY 2002.

The NRC's financial management systems complied substantially with Federal financial management systems requirements and the standard general ledger at the transaction level, but did not comply substantially with applicable Federal standards due to the lack of implementation of SFFAS 4, managerial cost accounting. As discussed previously, the agency continues to address the implementation of SFFAS 4 and expects to complete implementation during FY 2002.

The third instance of substantial non-compliance with the Improvement Act relates to FFS business continuity testing. The FFS is the core accounting system that the NRC uses through an interagency agreement with the Department of the Treasury (Treasury). This system is reviewed annually by Treasury's Financial Management Service (FMS) for its client agencies that utilize the system. FMS performed a vulnerability assessment that disclosed no material or nonmaterial weaknesses. However, FMS has not tested its business continuity plan for FFS because they plan to terminate the cross-servicing agreement at the end of FY 2002. The NRC expects to complete the transition of its cross-servicing of the core accounting system to the National Business Center of the Department of the Interior during FY 2002.

Biennial Review of User Fees

The Chief Financial Officers Act of 1990 requires agencies to conduct a biennial review of fees, royalties, rents, and other charges imposed by agencies, and make revisions to cover program and administrative costs incurred. During FY 2000 and FY 2001, the NRC reviewed each type of fee subject to the biennial review requirement. Each year, the NRC revises the hourly rates for license and inspection fees and adjusts the annual fees to meet the fee collection requirements of the Omnibus Budget Reconciliation Act of 1990. The most recent changes to the license, inspection, and annual fees are described in the *Federal Register* (66 FR 32452, June 14, 2001). The following fees and charges were also revised to more appropriately recognize actual costs: fees for public use of the auditorium, administrative charges imposed on delinquent debt (10 CFR 15.37(f)), fees for search and review time to respond to Freedom of Information Act and Privacy Act requests, and license and inspection fees based on average number of hours. Reviews of other types of fees concluded that fee revisions were not warranted at this time.

Management Decisions and Final Actions on OIG Audit Recommendations

The agency has established and continues to maintain an excellent record in resolving and implementing open audit recommendations presented in Office of the Inspector General (OIG) reports. Section 5(b) of the Inspector General Act of 1978, as amended, requires agencies to report on final actions taken on OIG audit recommendations. Table 1 gives the dollar value of disallowed costs determined through contract audits conducted by the Defense Contract Audit Agency. Because of the sensitivity of contractual negotiations, details of these contract audits are not furnished as part of this report. As of September 30, 2001, there were no outstanding audits recommending that funds be put to better use.

Table 1
Management Report on Office of the Inspector General Audits with Disallowed Costs
For the Period October 1, 2000-September 30, 2001

Category	Number of Audit Reports	Questioned Costs	Unsupported Costs
A. Audit reports with management decisions on which final action had not been taken at the beginning of this reporting period.	0	$0	$0
B. Audit reports on which management decisions were made during this period.	1	$2,422	$0
C. Audit reports on which final action was taken during this report period.	1	$2,422	$0
(i) Disallowed costs that were recovered by management through collection, offset, property in lieu of cash, or otherwise.	1	$2,422	$0
(ii) Disallowed costs that were written off by management.	0	$0	$0
D. Reports for which no final action had been taken by the end of the reporting period.	0	$0	$0

Management Decisions not Implemented within One Year

Management decisions were made before September 2000 for the OIG audit reports discussed in the following paragraphs. As of September 30, 2001, the NRC did not take final action on some issues. However, the OIG did not recommend that funds be otherwise allocated.

Independent Auditors' Report and Principal Statements for the Year Ended September 30, 1998

The OIG determined that the agency's implementation of managerial cost accounting was insufficient to comply with SFFAS 4, which requires Federal agencies to accumulate and report costs of activities on a regular basis for management information purposes. In addition, interim cost management information should be provided to agency managers to support outcomes and outputs realized by the agency.

A cost accounting software package has been installed and is being configured to reflect how the agency initially plans to report costs, including the allocation of indirect costs. During FY 2001, the cost accounting module was used to provide agency managers with interim cost reports at the strategic arena level for labor costs and planned accomplishment level for non-labor costs. In November 2001, the agency implemented the PeopleSoft Human Resources Management System (HRMS), which is an integral component for implementing managerial cost accounting. The HRMS will enable the agency to report labor costs by planned accomplishment. During the first quarter of 2002, the agency expects to issue the first set of cost reports utilizing HRMS data. This will complete the corrective actions to resolve the auditor's material internal control weakness in this area.

Independent Auditors' Report and Principal Statements for the Year Ended September 30, 1999

The OIG recommended that the agency improve management controls over small entity self-certification in order to adequately determine the eligibility of small entity applicants. During FY 2001, the NRC developed a strategy, to be implemented during FY 2002, that includes a 100 percent review of small entity self-certifications. The policy issued December 2001also identifies new sources of information to validate or contradict a claim for small entity status. This will complete the planned corrective actions to resolve this condition.

NRC's License Fee Development Process Needs Improvement ***December 14, 1999***

The OIG recommended that the methodology for calculating the hourly rate be reevaluated to include the full-cost concept as embodied in OMB Circular No. A-25, *User Fees*, and SSFAS 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and that actual billing and cost data be used to refine future rate calculations.

The agency is in the process of implementing a cost accounting system. When cost accounting is implemented, the Office of the Chief Financial Officer will use the cost data as input to review and refine, as appropriate, the existing full cost rate, including identification and assignment of direct and allocated indirect costs. The agency expects to complete corrective action during the third quarter of FY 2002.

Review of NRC's Decommissioning Fund Program ***February 1, 2000***

The OIG recommended: (1) that reviews of decommissioning funds be implemented consistent with the Standard Review Plan on Power Reactor Licensee Financial Qualifications and Decommissioning Funding Assurance to ensure that all reporting requirements are met and that reported data is consistent, and (2) that a lessons learned be conducted to strengthen and enhance the review process.

The agency issued to the power reactor licensees Regulatory Issue Summary 2001-07 entitled "10 CFR 50.75(f)(1) Reports on the Status of Decommissioning Funds (Due March 31, 2001)" on February 23, 2001. The improved quality control process was used during the NRC's review of the biennial trust fund reports which were due March 31, 2001. When reviewing the licensees' reports, the primary reviewers verified that all of the reports met all reporting requirements, clearly identified radiological costs, and did not include non-radiological costs in the licensees' certification amounts. When deficiencies or ambiguities in the licensees' reports were identified, additional information was obtained from the licensees.

Based on the findings of the OIG audit and experience gained from the first biennial review in 1999, the staff completed an evaluation of the lessons learned on December 16, 1999. As part of the March 2001 biennial reviews, another lessons learned study was conducted. As a result, the enhanced quality control measures have been integrated into the review process for evaluating these decommissioning trust fund reports. The agency considers corrective actions for this audit complete.

Review of the Development and Implementation of STARFIRE — ***June 29, 2000***

The OIG recommended that the definition of "significant variation" from approved costs, schedule, and performance goals for major information technology (IT) projects be clarified so that senior agency managers can make informed decisions whether or not to continue, modify, or terminate major IT projects.

As part of the capital planning and investment control (CPIC) process, a lessons learned review is currently underway to determine if "significant variation" of cost, schedule, and performance goals are being further clarified, and alternative approaches for monitoring progress are being considered. The results will be incorporated into Management Directive 2.2, *Capital Planning and Investment Control.* The agency expects to complete correction action during the third quarter of FY 2002.

Review of Audit Follow Up System — ***August 14, 2000***

The OIG recommended that the Management Directive 6.1 Handbook, *Resolution and Follow Up of Audit Recommendations,* be revised to reflect the periodic scheduling standards for conducting analyses of audit recommendations to determine possible trends and system-wide problems and for conducting audit follow-up reviews. Trend analyses will be conducted annually and audit follow-up reviews will be conducted biannually. The agency expects to complete revisions to the Management Directive 6.1 Handbook during the third quarter of FY 2002.

Special Evaluation of the Role and Structure of NRC's Executive Council — ***August 31, 2000***

The OIG recommended that the NRC's management directives and communication mechanisms be updated to reflect the responsibilities and alignment of the Executive Director for Operations, the Chief Financial Officer, and the Chief Information Officer after the Commission decided on a management strategy for the NRC's Executive Council. In January 2001, the Commission announced the abolishment of the Executive Council. The Executive Director for Operations, the Chief Financial Officer, and the Chief Information Officer continued to meet periodically. The agency is currently determining which management directives require revisions. The agency expects to complete corrective action during the second quarter of FY 2002.

Review of NRC's Differing Professional View/Differing Professional Opinion Program
September 20, 2000

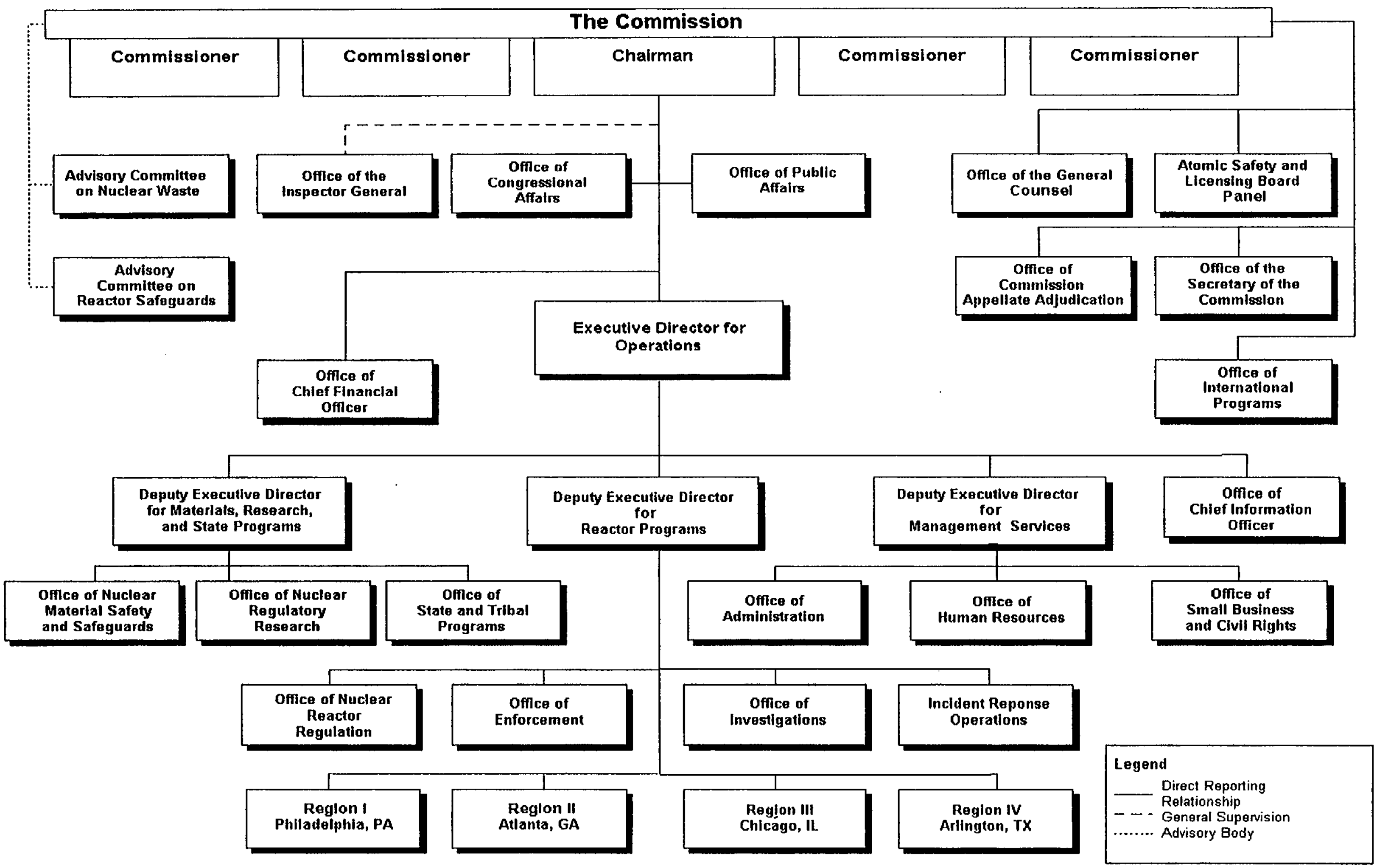
The OIG recommended that Management Directive 10.159 be revised to improve the oversight and timeliness of the Differing Professional View/Differing Professional Opinion (DPV/DPO) processes, that awards be publicized for outstanding issues benefitting the agency that resulted from DPV/DPOs, and that a special review group be convened every 3 years to assess the DPV/DPO program operations.

A Special Review Panel was convened in May 2001. The panel, which is still in session, has completed the initial review of all DPV/DPO cases filed since the last special panel met in 1994. Names of potential interviewees were proposed as a result of this effort. Interviews of all office directors and regional administrators, as well as DPV/DPO filers, ad hoc panel chairs, and panel members selected by the Special Review Panel, were completed in December 2001.

After all the data have been collected, analyzed, and evaluated, the panel will prepare a report recommending any necessary changes to or modifications of the DPV/DPO process. Another of the panel's tasks is to make recommendations regarding the recognition of filers whose contributions to the agency have not been adequately recognized. These recommendations will be made concurrent with the issuance of the report.

Revisions to Management Directive 10.159, *Differing Professional Views or Opinions*, will be made in accordance with the recommendations found in the Special Review Panel's report, as well as other recommendations found in this OIG report. The new directive will include the requirement that a Special Review Panel convene 1 year from the date of its publication and every 3 years thereafter. The agency expects to complete corrective action during the fourth quarter of FY 2002.

NRC ORGANIZATION CHART
as of September 30, 2001



INDEPENDENT AUDITORS' REPORT

R. NAVARRO
& ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

Chairman Richard A. Meserve
U.S. Nuclear Regulatory Commission
Rockville, Maryland

We have audited the accompanying balance sheets of the U.S. Nuclear Regulatory Commission (NRC) as of September 30, 2001 and 2000, and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended, collectively referred to as the financial statements. These financial statements are the responsibility of the management of NRC. Our responsibility is to express an opinion on these financial statements based on our audits.

SCOPE

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

MATTERS FOR EMPHASIS

Classification of Costs

OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, as amended, and applicable sections of OMB Bulletin 01-09, provide guidance to federal agencies for presenting program costs classified by intragovernmental and public components. The basis for classification relies on the concept of who received the benefits of the costs incurred (e.g. private sector licensees versus federal licensees) rather than who was paid. However, following the advice of OMB, NRC classified the costs on the Statement of Net Cost using an underlying concept of who was paid, rather than who received the benefits. This presentation does not entirely incorporate the guidance in the Bulletin, however, OMB's guidance enables the Agency to transition to the required presentation.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. NRC's Statements of Net Cost include reimbursed expenses of approximately \$46.6 and \$57.7 million, respectively for the years ended September 30, 2001 and 2000. Our audits included testing these expenses for compliance with laws and regulations within NRC. The work placed with DOE is under the auspices of a Memorandum of Understanding between NRC and DOE. The examination of DOE National Laboratories for compliance with laws and regulations is DOE's responsibility. This responsibility was further clarified by a memorandum of the General Accounting Office's (GAO) Assistant General Counsel, dated March 6, 1995, where he opined that "...DOE's inability to assure that its contractors' costs [National Laboratories] are legal and proper...does not compel a conclusion that NRC has failed to comply with laws and regulations." DOE also has the cognizant responsibility to assure audit resolution and should provide the results of its audits to NRC.

OPINION

In our opinion, the financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of NRC as of September 30, 2001 and 2000, and its net cost, changes in net position, budgetary resources, and reconciliation of budgetary obligations to net cost for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1.I. to the financial statements, NRC adopted Statement of Federal Financial Accounting Standards No. 10, *Accounting for Internal Use Software*. The adoption of this standard has a material effect on the comparability of the financial statements.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Management Discussion and Analysis, pages 1-17, and the required supplementary information, page 38, are not a required part of the financial statements but are information required by OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended, and applicable sections of OMB Bulletin 01-09. This supplementary information is the responsibility of NRC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, we have also issued our report dated January 16, 2002, on our consideration of NRC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of this engagement to perform an audit in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

R. Navarro & Associates, Inc.

January 16, 2002

PRINCIPAL STATEMENTS

BALANCE SHEET
(Dollars in Thousands)

As of September 30	**2001**	2000
Assets		
Intragovernmental assets:		
Fund balances with Treasury (Note 2)	**$ 140,465**	$ 138,740
Accounts receivable (Note 3)	**2,549**	1,874
Other	**1,144**	1,225
Total Intragovernmental Assets	**144,158**	141,839
Cash and other monetary assets	**20**	20
Accounts receivable, net (Note 3)	**48,905**	42,163
Property and equipment, net (Note 4)	**43,788**	41,853
Other	**15**	51
Total Assets	**$ 236,886**	$ 225,926
Liabilities		
Intragovernmental liabilities:		
Accounts payable	**$ 12,734**	$ 10,591
Other (Notes 5 and 6)	**56,411**	50,157
Total Intragovernmental Liabilities	**69,145**	60,748
Accounts payable	**15,859**	15,860
Federal employees benefits (Notes 1.K. and 6)	**10,849**	8,230
Other (Notes 5)	**47,501**	44,937
Total Liabilities	**143,354**	129,775
Net Position		
Unexpended appropriations (Note 8)	**86,839**	87,073
Cumulative results of operations (Note 9)	**6,693**	9,078
Total Net Position	**93,532**	96,151
Total Liabilities and Net Position	**$ 236,886**	$ 225,926

The accompanying notes to the principal statements are an integral part of this statement.

STATEMENT OF NET COST
(Dollars in Thousands)

For the year ended September 30	2001	2000
Nuclear Reactor Safety		
Intragovernmental	**$101,541**	$ 103,796
With the public	**233,995**	226,621
Total cost	**335,536**	330,417
Less earned revenue	**(393,333)**	(390,401)
Net Cost of Nuclear Reactor Safety	**(57,797)**	(59,984)
Nuclear Materials Safety		
Intragovernmental	**19,851**	17,873
With the public	**59,292**	62,812
Total cost	**79,143**	80,685
Less earned revenue	**(49,778)**	(51,677)
Net Cost of Nuclear Materials Safety	**29,365**	29,008
Nuclear Waste Safety		
Intragovernmental	**24,160**	24,691
With the public	**61,931**	59,010
Total cost	**86,091**	83,701
Less earned revenue	**(18,636)**	(17,882)
Net Cost of Nuclear Waste Safety	**67,455**	65,819
International Nuclear Safety Support		
Intragovernmental	**6,151**	7,892
With the public	**7,695**	8,034
Total cost	**13,846**	15,926
Less earned revenue	**(2,233)**	(3,078)
Net Cost of International Nuclear Safety Support	**11,613**	12,848
Net Cost of Operations	**$ 50,636**	$ 47,691

The accompanying notes to the principal statements are an integral part of this statement.

STATEMENT OF CHANGES IN NET POSITION

(Dollars in Thousands)

For the year ended September 30	2001	2000
Net Cost of Operations	**$ (50,636)**	$ (47,691)
Financing sources other than exchange revenue (Note 12)		
Appropriations used	**31,042**	26,120
Non-exchange revenue	**657**	875
Imputed financing	**17,209**	16,033
Transfers-in	**453,348**	447,000
Transfers-out	**(454,005)**	(447,875)
Total Financing Sources	**48,251**	42,153
Net Results of Operations	**(2,385)**	(5,538)
Increase (Decrease) in unexpended appropriations	**(234)**	(16,177)
Change in Net Position	**(2,619)**	(21,715)
Net Position - Beginning of Period	**96,151**	116,553
Prior-period adjustment (Note 13)	**-**	1,313
Net Position	**96,151**	117,866
Net Position - End of Period	**$ 93,532**	$ 96,151

The accompanying notes to the principal statements are an integral part of this statement.

STATEMENT OF BUDGETARY RESOURCES
(Dollars in Thousands)

For the year ended September 30	2001	2000
Budgetary Resources		
Budget authority	**$490,228**	$ 471,975
Unobligated balances - beginning of period	**30,377**	29,894
Spending authority from offsetting collections	**4,152**	5,517
Adjustments	**7,451**	8,525
Total Budgetary Resources	**532,208**	515,911
Status of Budgetary Resources		
Obligations incurred	**503,304**	485,534
Unobligated balances - available	**28,317**	29,787
Unobligated balances - not available	**587**	590
Total Status of Budgetary Resources	**532,208**	515,911
Outlays		
Obligations incurred	**503,304**	485,534
Less: Spending authority from offsetting collections and adjustments	**(11,630)**	(14,129)
Subtotal	**491,674**	471,405
Obligated balances, net - beginning of period	**104,044**	116,583
Less: obligated balance, net - end of period	**(108,704)**	(104,044)
Total Outlays	**$487,014**	$ 483,944

The accompanying notes to the principal statements are an integral part of this statement.

STATEMENT OF FINANCING
(Dollars in Thousands)

For the year ended September 30	**2001**	2000
Obligations and Nonbudgetary Resources		
Obligations incurred	**$503,304**	$485,533
Less: Spending authority for offsetting collections and adjustments	**(11,630)**	(14,129)
Imputed financing (Note 12)	**17,209**	16,033
Transfers - in (Note 12)	**453,348**	447,000
Transfers - out (Note 12)	**(453,348)**	(447,000)
Exchange revenues not in the budget (Note 10)	**(459,392)**	(457,944)
Total Obligations and Nonbudgetary Resources	**49,491**	29,493
Resources Not Funding Net Cost of Operations		
Change in undelivered orders	**(1,239)**	12,660
Capitalized costs	**(11,072)**	(6,683)
Other	**2,258**	520
Total Obligations and Nonbudgetary Resources	**(10,053)**	6,497
Costs Not Requiring Resources		
Depreciation and amortization	**7,474**	6,536
Total Costs Not Requiring Resources	**7,474**	6,536
Financing Sources Yet to be Provided	**3,724**	5,165
Net Cost of Operations	**$ 50,636**	$ 47,691

The accompanying notes to the principal statements are an integral part of this statement.

NOTES TO PRINCIPAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Reporting Entity*

The U.S. Nuclear Regulatory Commission (NRC) is an independent regulatory agency of the Federal Government that was created by the U.S. Congress to regulate the Nation's civilian use of byproduct, source, and special nuclear materials to ensure adequate protection of the public health and safety, to promote the common defense and security, and to protect the environment. Its purposes are defined by the Energy Reorganization Act of 1974, as amended, along with the Atomic Energy Act of 1954, as amended, which provide the foundation for regulating the Nation's civilian use of nuclear materials.

The NRC operates through the execution of its congressionally approved appropriations for salaries and expenses and the Inspector General, including funds derived from the Nuclear Waste Fund. In addition, transfer appropriations are provided by the U.S. Agency for International Development for the development of nuclear safety and regulatory authorities in Russia, Ukraine, Kazakhstan, and Armenia for the independent oversight of nuclear reactors in these countries.

B. *Basis of Presentation*

These principal statements were prepared to report the financial position and results of operations of the NRC as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These financial statements were prepared from the books and records of the NRC in conformity with accounting principles generally accepted in the United States of America, the requirements of Office of Management and Budget (OMB) Bulletin Nos. 97-01 and 01-09, *Form and Content of Agency Financial Statements,* technical amendments, and NRC accounting policies. These statements are, therefore, different from the financial reports, also prepared by the NRC pursuant to OMB directives, which are used to monitor and control NRC's use of budgetary resources. NRC has not prepared a Statement of Custodial Activity because the amounts involved are immaterial and are incidental to its operations and mission.

The strategic arenas as presented on the Statement of Net Cost are based on the strategic plans and are described as follows:

Nuclear Reactor Safety encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities, as well as non-power reactors, are operated in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

Nuclear Materials Safety encompasses NRC efforts to ensure that NRC-regulation aspects of nuclear fuel cycle facilities and nuclear materials activities are handled in a manner that provides adequate protection of public health and safety.

Nuclear Waste Safety encompasses NRC's regulatory activities associated with uranium recovery, decommissioning, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive wastes.

International Nuclear Safety Support encompasses NRC's efforts of international cooperation to help ensure the safe, secure, and environmentally acceptable uses of nuclear energy.

C. *Budgets and Budgetary Accounting*

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources and facilitates compliance with legal constraints and controls over

NOTES TO PRINCIPAL STATEMENTS

the use of Federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of purchase. Assets and liabilities, which do not consume current budgetary resources, are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

For the past 27 years, Congress has enacted no-year appropriations, which are available for obligation by NRC until expended. The Energy and Water Development Appropriations Act, 2001, required the NRC to recover approximately 98 percent of its new budget authority of $487.2 million by assessing fees less amounts derived from the Nuclear Waste Fund of $21.6 million and $3.2 million from the General Fund. For FY 2000, the NRC recovered approximately 100 percent of its new budget authority of $469.9 million, as required by the Omnibus Budget Reconciliation Act (OBRA) of 1990, as amended, less $19.2 million derived from the Nuclear Waste Fund and $3.8 million from the General Fund.

D. *Basis of Accounting*

Transactions are recorded on both an accrual accounting basis and on a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Interest on borrowings of the U.S. Treasury is not included as a cost to NRC's programs and is not included in the accompanying financial statements.

E. *Revenues and Other Financing Sources*

The NRC is required to offset its appropriations by the amount of revenues received during the fiscal year by assessing fees. The NRC assesses two types of fees to recover its budget authority: (1) fees assessed under 10 Code of Federal Regulations (CFR) Part 170 for licensing, inspection, and other services under the authority of the Independent Offices Appropriation Act of 1952 to recover the NRC's costs of providing individually identifiable services to specific applicants and licensees; and (2) annual fees assessed for nuclear facilities and materials licensees under 10 CFR Part 171. All fees, with the exception of civil penalties, are exchange revenues in accordance with Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

For accounting purposes, appropriations are recognized as financing sources (appropriations used) at the time expenses are accrued. At the end of the fiscal year, appropriations recognized are reduced by the amount of assessed fees collected during the fiscal year to the extent of new budget authority for the year. Collections which exceed the new budget authority are held to offset subsequent years' appropriations. Appropriations expended for property and equipment are recognized as expenses when the asset is consumed in operations (depreciation and amortization).

F. *Fund Balances with Treasury and Cash and Other Monetary Assets*

The NRC's cash receipts and disbursements are processed by the U.S. Treasury. The fund balances with the U.S. Treasury and cash are primarily appropriated funds that are available to pay current liabilities and to finance authorized purchase commitments. Funds with Treasury represent NRC's right to draw on the U.S. Treasury for allowable expenditures. All amounts are available to NRC for current use. Cash balances held outside the U.S. Treasury are not material.

G. *Accounts Receivable*

Accounts receivable consist of amounts owed to the NRC by other Federal agencies and the public. Amounts due from the public are presented net of an allowance for uncollectible

NOTES TO PRINCIPAL STATEMENTS

accounts. The allowance is based on an analysis of the outstanding balances. Receivables from Federal agencies are expected to be collected; therefore, there is no allowance for uncollectible accounts.

H. *Non-Entity Assets*

Accounts receivable include non-entity assets of $133 thousand and $214 thousand at September 30, 2001, and 2000, and consists of miscellaneous penalties and interest due from the public, which, when collected, must be transferred to the U.S. Treasury.

I. *Property and Equipment*

Property and equipment consist primarily of typical office furnishings, nuclear reactor simulators, and computer hardware and software. The agency has no real property. The land and buildings in which NRC operates are provided by the General Services Administration (GSA), which charges NRC rent that approximates the commercial rental rates for similar properties.

Property with a cost of $50,000 or more per unit and a useful life of 2 years or more is capitalized at cost and depreciated using the straight-line method over the useful life. Other property items are expensed when purchased. Normal repairs and maintenance are charged to expense as incurred.

NRC adopted Statement of Federal Financial Accounting Standards No. 10, *Accounting for Internal Use Software*, effective October 1, 2000. The standard requires the capitalization of the costs of internal use software and provides guidance on capitalization thresholds, capitalization timing, and cost elements to capitalize, including the full cost of salaries and benefits for agency personnel involved in software development.

J. *Accounts Payable*

Accounts payable represent vendor invoices for services received by NRC that will be paid in the next fiscal year. Also included in these amounts are contract holdbacks on contracts that have not been fully closed and advances that represent collections received in advance of performing services under a variety of reimbursable agreements. The services will be provided and the revenue earned in a subsequent fiscal year.

K. *Liabilities Not Covered by Budgetary Resources*

Liabilities represent the amount of monies or other resources that are likely to be paid by NRC as the result of a transaction or event that has already occurred. No liability can be paid by NRC absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is no certainty that an appropriation will be enacted are classified as Liabilities Not Covered by Budgetary Resources. Also, NRC liabilities arising from sources other than contracts can be abrogated by the Government acting in its sovereign capacity.

Intragovernmental

The U.S. Department of Labor (DOL) paid Federal Employees Compensation Act (FECA) benefits on behalf of NRC which had not been billed or paid by NRC as of September 30, 2001, and 2000.

Federal Employee Benefits

Federal employee benefits represent the actuarial liability for estimated future FECA disability benefits. The future workers' compensation estimate was generated by DOL from an application of actuarial procedures developed to estimate the liability for FECA, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved

NOTES TO PRINCIPAL STATEMENTS

compensation cases. The liability was calculated using historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These projected annual benefit payments were discounted to present value. The interest rate assumptions utilized for discounting were 5.21 percent in year 1 and 5.21 percent in year 2 and thereafter.

Other

Accrued annual leave represents the amount of annual leave earned by NRC employees but not yet taken.

L. Contingencies

Contingent liabilities are those where the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. The NRC is a party to various administrative proceedings, legal actions, environmental suits, and claims brought by or against it. Based on the advice of legal counsel concerning contingencies, it is the opinion of management that the ultimate resolution of these proceedings, actions, suits, and claims will not materially affect the agency's financial statements.

M. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. To the extent that current or prior year funding is not available to cover annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

N. Retirement Plans

NRC employees belong to either the Federal Employees Retirement System (FERS) or the Civil Service Retirement System (CSRS). During FY 2001, for employees belonging to FERS, the NRC withheld 0.8 percent of base pay earnings, in addition to Federal Insurance Contribution Act (FICA) withholdings, and matched the withholdings with a 10.7 percent contribution. During FY 2000, for employees belonging to FERS, the NRC withheld 1.2 percent of base pay earnings and matched the withholding with a 10.7 percent contribution. The sum was transferred to the Federal Employees Retirement Fund. During FY 2001, for employees covered by CSRS, NRC withheld 7 percent of base pay earnings. This withholding was matched by NRC with an 8.51 percent contribution. During FY 2000, for employees belonging to CSRS, NRC withheld 7.4 percent of base pay earnings. This withholding was matched by NRC with a 8.51 percent contribution, and the sum of the withholding and the match was transferred to the CSRS.

The Thrift Savings Plan (TSP) is a retirement savings and investment plan for employees belonging to either FERS or CSRS. For employees belonging to FERS, NRC automatically contributes one percent of base pay to their account and matches contributions up to an additional four percent. The maximum percentages of base pay that an employee participating in FERS may contribute was 10 percent in calendar year (CY) 2000. In CY 2001 the maximum rate was 10 percent through June 30, 2001 and 11 percent thereafter. Employees belonging to CSRS were able to contribute a maximum of 5 percent during CY 2000. In CY 2001 they were allowed to contribute 5 percent through June 30, 2001, and 6 percent thereafter. CSRS contributions made were of their base pay, and there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan was $10.5 thousand in CY 2001 and CY 2000. The sum of the employees' and NRC's contributions are transferred to the Federal Retirement Thrift Investment Board.

NOTES TO PRINCIPAL STATEMENTS

The NRC does not report on its financial statements FERS and CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the U.S. Office of Personnel Management. The portion of the current and estimated future outlays for CSRS not paid by NRC is, in accordance with Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, included in NRC's financial statements as an imputed financing source.

O. *Leases*

The total capital lease liability is funded on an annual basis and included in NRC's annual budget. The NRC's capital leases are for personal property consisting of reproduction equipment, which is installed in various NRC facilities. The leases are for 3 and 5 years and the interest rates paid were 6.59 percent and 4.75 percent, respectively. The reproduction equipment is depreciated over 5 years using the straight-line method with no salvage value.

Operating leases consist of real property leases with GSA. The leases are for NRC's headquarters offices and regional offices. The GSA charges NRC lease rates which approximate commercial rates for comparable space.

P. *U.S. Department of Energy Charges*

Financial transactions between the Department of Energy (DOE) and NRC are fully automated through the U.S. Treasury's On-Line Payment and Collection (OPAC) System. The OPAC System allows DOE to collect amounts due from NRC directly from NRC's account at the U.S. Treasury for goods and/or services rendered. Project manager verification of goods and/or services received is subsequently accomplished through a system-generated voucher approval process. The vouchers are returned to the Office of the Chief Financial Officer documenting that the charges have been accepted.

Q. *Pricing Policy*

The NRC provides goods and services to the public and other Government entities. In accordance with OMB Circular No. A-25, *User Charges*, and the Independent Offices Appropriation Act of 1952, NRC assesses fees under 10 CFR Part 170 for licensing and inspection activities to recover the full cost of providing individually identifiable services.

The NRC's policy is to recover the full cost of goods and services provided to other Government entities where: (1) the services performed are not part of its statutory mission and (2) NRC has not received appropriations for those services. Fees for reimbursable work are assessed at the 10 CFR Part 170 rate with minor exceptions for programs that are nominal activities of the NRC.

R. *Net Position*

The NRC's net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent appropriated spending authority that is unobligated and has not been withdrawn by Treasury, and obligations that have not been paid. Cumulative results of operations represent the excess of financing sources over expenses since inception.

S. *Use of Management Estimates*

The preparation of the accompanying financial statements in accordance with generally accepted accounting principles requires management to make certain estimates and assumptions that directly affect the results of reported assets, liabilities, revenues, and expenses. Actual results could differ from these estimates.

NOTES TO PRINCIPAL STATEMENTS

NOTE 2. FUND BALANCES WITH TREASURY

(In thousands)	2001	2000
Fund Balances		
Appropriated funds	$ 137,588	$ 134,402
Other fund types	2,877	4,338
Total	$ 140,465	$ 138,740
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 31,194	$ 34,125
Unavailable	587	590
Obligated balance not yet disbursed	108,684	104,025
Total	$ 140,465	$ 138,740

NOTE 3. ACCOUNTS RECEIVABLE

(In thousands)	2001	2000
Intragovernmental		
Receivables and reimbursements	$ 2,549	$ 1,874
Receivables with the Public		
Materials and facilities fees - billed	$ 10,445	$ 5,419
Materials and facilities fees - unbilled	41,300	39,864
Other (Penalties and Interest)	222	359
Total Accounts Receivable	51,967	45,642
Less: Allowance for uncollectible accounts	(3,062)	(3,479)
Accounts Receivable, Net	$ 48,905	$ 42,163

NOTE 4. PROPERTY AND EQUIPMENT, NET

(In thousands)

Fixed Assets Class	Service Years	Acquisition Value	Accumulated Depreciation and Amortization	2001 Net Book Value	2000 Net Book Value
Equipment	5-8	$ 19,191	$ (16,372)	$ 2,819	$ 3,315
ADP software	5	48,712	(34,237)	14,475	18,112
ADP software under development	-	14,708	-	14,708	7,738
Leasehold improvements	20	19,725	(8,096)	11,629	12,593
Leasehold improvements in progress	-	157	-	157	95
		$ 102,493	$ (58,705)	$ 43,788	$ 41,853

NOTES TO PRINCIPAL STATEMENTS

NOTE 5. OTHER LIABILITIES

(In thousands)	2001	2000
Liability to offset net accounts receivable for fees assessed	$ 50,813	$ 43,388
Liability from fees collected which will offset subsequent years' appropriations	1,724	3,173
Liability to offset miscellaneous accounts receivable	133	214
Advances from other Federal agencies	-	22
Accrued workers' compensation	1,780	1,521
Employee benefit contributions	1,961	1,839
Total Intragovernmental Other Liabilities	$ 56,411	$ 50,157

The liability to offset the net accounts receivable for fees assessed represents amounts which, when collected, will be transferred to the U.S. Treasury to offset NRC's appropriations in the year collected.

(In thousands)	2001	2000
Accrued annual leave	$ 26,473	$ 25,627
Accrued salaries	16,143	14,303
Contract holdbacks, advances, and other	4,885	5,007
Total Other Liabilities	$ 47,501	$ 44,937

All other liabilities, except accrued annual leave, contract holdbacks, and advances from others, are current.

NOTE 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

(In thousands)	2001	2000
Intragovernmental		
FECA paid by DOL	$ 1,780	$ 1,521
Federal Employee Benefits		
Future FECA	10,849	8,230
Other		
Accrued annual leave	26,473	25,626
Capital lease liability	167	181
Total Liabilities not Covered by Budgetary Resources	$ 39,269	$ 35,558

NOTE 7. LEASES

Future Lease Payments Due:

Fiscal Year	Capital	Operating	2001	2000
2001	$ -	$ -	$ -	$ 20,170
2002	89	19,509	19,598	19,477
2003	76	19,474	19,550	19,418
2004	2	19,563	19,565	19,457
2005 and thereafter	-	158,255	158,255	158,190
Total	167	216,801	216,968	236,712
Less: imputed interest	(9)	-	(9)	(12)
Total Future Lease Payments	$ 158	$ 216,801	$ 216,959	$ 236,700

NOTE 8. UNEXPENDED APPROPRIATIONS

(In thousands)	2001	2000
Unobligated	$ 18,493	$ 18,711
Undelivered orders	68,346	68,362
Total Unexpended Appropriations	$ 86,839	$ 87,073

NOTES TO PRINCIPAL STATEMENTS

Undelivered orders are amounts which have been obligated but not yet expended. The unobligated appropriations balance does not include $2,933 thousand and $3,054 thousand in unfilled customer orders - unobligated as of September 30, 2001, and September 30, 2000, respectively. The undelivered orders balance does not include $1,966 thousand and $2,886 thousand in unfilled customer orders - obligated as of September 30, 2001, and September 30, 2000, respectively.

NOTE 9. CUMULATIVE RESULTS OF OPERATIONS

(In thousands)	2001	2000
Future funding requirements	$ (39,102)	$ (35,377)
Investment in property and equipment, net	43,788	41,853
Contributions from foreign cooperative research agreements	1,984	2,506
Other	23	96
Cumulative Results of Operations	$ 6,693	$ 9,078

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 2001, and 2000. These accruals are not funded from current or prior-year appropriations and assessments, but rather should be funded from future appropriations and assessments. Accordingly, future funding requirements have been recognized for the expenses that will be paid from future appropriations.

NOTE 10. EXCHANGE REVENUES

(In thousands)	2001	2000
Fees for licensing, inspection, and other services	$ 459,392	$ 457,944
Revenue from reimbursable work	4,589	5,094
Total Exchange Revenues	$ 463,981	$ 463,038

NOTE 11. BUDGET FUNCTIONAL CLASSIFICATION

(In thousands)			2001	2000
Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	Net Cost
276 - Energy Information, Policy, & Regulation	$ 511,644	$ (463,792)	$ 47,852	$ 44,441
150 - AID International Affairs	$ 2,972	$ (188)	$ 2,784	$ 3,249
800 - GSA General Government	-	-	-	1
Total	$ 514,616	$ (463,980)	$ 50,636	$ 47,691

Intragovernmental

(In thousands)			2001	2000
Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	Net Cost
276 - Energy Information, Policy, & Regulation	$ 149,865	$ (29,241)	$ 120,624	$ 121,001
150 - AID International Affairs	1,838	$ (188)	1,650	2,171
Total	$ 151,703	$ (29,429)	$ 122,274	$ 123,172

NOTES TO PRINCIPAL STATEMENTS

NOTE 12. FINANCING SOURCES OTHER THAN EXCHANGE REVENUE

Appropriations Used

Appropriations used is recognized to the extent that appropriated funds have been consumed less the amount collected from fees assessed for licensing, inspections, and other services.

(In thousands)	**2001**	2000
Fees collected	$ 455,044	$ 450,077
Less: collection from fees assessed	(453,348)	(447,000)
Collected Fees Available to Offset Subsequent Years' Appropriations	$ 1,696	$ 3,077

Collections were used to reduce the fiscal year's appropriations recognized:

(In thousands)	**2001**	2000
Appropriated funds consumed	$ 490,434	$ 484,064
Less: collection from fees assessed	(453,348)	(447,000)
Subtotal	37,086	37,064
Amounts to offset subsequent years' appropriations	(6,044)	(10,944)
Appropriations Used	$ 31,042	$ 26,120

Appropriated funds consumed includes $30,377 thousand for FY 2001 and $29,894 thousand for FY 2000 of available funds from prior years.

Non-Exchange Revenue

(In thousands)	**2001**	2000
Civil penalties	$ 345	$ 632
Miscellaneous receipts	312	243
Total Non-Exchange Revenue	$ 657	$ 875

Imputed Financing

(In thousands)	**2001**	2000
Civil Service Retirement System	$ 9,676	$ 9,173
Federal Employee Health Benefit	7,486	6,807
Federal Employee Group Life Insurance	47	45
U.S. Treasury Judgement Fund	-	8
Total Imputed Financing	$ 17,209	$ 16,033

Transfers In/Out

(In thousands)	**2001**	2000
Transfers in from Treasury	$ 453,348	$ 447,000
Transfers out to Treasury		
License Fees	453,348	447,000
Non-exchange revenue	657	875
Total Transfer-Out to Treasury	$ 454,005	$ 447,875

NOTES TO PRINCIPAL STATEMENTS

NOTE 13. PRIOR-PERIOD ADJUSTMENT

The prior-period adjustment reported in FY 2000 of $1,313 thousand consists of the net value of computer hardware components received in FY 1999 by NRC but not capitalized as other assets, equipment not in use. The assets were placed into operation during FY 2000. The impact of this adjustment was to increase property and equipment, net, and cumulative results of operations as of September 30, 1999, by $1,313 thousand.

NOTE 14. RECLASSIFICATIONS

Certain prior-year amounts have been reclassified to conform to the current year presentation.

NOTE 15. SUMMARY OF BUDGETARY RESOURCES

(In thousands)	2001				2000
	X0200	X0300	All Other	Total	Total
Budgetary Resources					
Budget authority	$ 481,766	$ 5,500	$ 2,962	$ 490,228	$ 471,975
Unobligated balances - beginning of period	27,682	898	1,797	30,377	29,894
Spending authority from offsetting collections	4,152	-	-	4,152	5,517
Adjustments	7,156	279	16	7,451	8,525
Total Budgetary Resources	$ 520,756	$ 6,677	$ 4,775	$ 532,208	$ 515,911
Status of Budgetary Resources:					
Obligations incurred	$ 494,730	$ 5,956	$ 2,618	$ 503,304	$ 485,534
Unobligated balances - available	26,026	721	1,570	28,317	29,787
Unobligated balances - not available	-	-	587	587	590
Total Status of Budgetary Resources	$ 520,756	$ 6,677	$ 4,775	$ 532,208	$ 515,911
Outlays:					
Obligations incurred	$ 494,730	$ 5,956	$ 2,618	$ 503,304	$ 485,534
Less: Spending authority from offsetting collections and adjustments	(11,335)	(279)	(16)	(11,630)	(14,129)
Obligated balance, net beginning of period	98,927	1,064	4,053	104,044	116,583
Less: Obligated balance, net end of period	(104,078)	(910)	(3,716)	(108,704)	(104,045)
Total Outlays	$ 478,244	$ 5,831	$ 2,939	$ 487,014	$ 483,943

The adjustments of $7,451 thousand for FY 2001 and $8,525 thousand for FY 2000 to budgetary resources above consist of recoveries to prior-year obligations less $27.3 thousand for FY 2001 and $87 thousand that was rescinded for FY 2000.

REQUIRED SUPPLEMENTARY INFORMATION

As of September 30	2001	2000
Intragovernmental Assets		
Fund Balance with Treasury		
Department of the Treasury	$ 140,465	$ 138,740
Accounts Receivable		
Tennessee Valley Authority	1,283	1,025
Department of Veterans Affairs	162	280
Department of Energy	817	225
Other Agencies	287	344
Total Accounts Receivable	2,549	1,874
Other Assets		
Department of Commerce	29	137
Department of Interior	486	171
Department of the Navy	11	209
Department of Labor	256	267
General Services Administration	329	326
Other Agencies	33	115
Total Other Assets	1,144	1,225
Total Intragovernmental Assets	$ 144,158	$ 141,839

As of September 30	2001	2000
Intragovernmental Liabilities		
Accounts Payable		
General Services Administration	$ 7,841	$ 5,182
Department of Energy	4,082	4,747
Other Agencies	811	662
Total Accounts Payable	12,734	10,591
Other Liabilities		
Department of Labor	1,781	1,521
Department of the Treasury - General Fund	52,670	46,775
Office of Personnel Management	1,960	1,839
Other Agencies	-	22
Total Other Liabilities	56,411	50,157
Total Intragovernmental Liabilities	$ 69,145	$ 60,748

INDEPENDENT ACCOUNTANTS' REPORT ON MANAGEMENT'S ASSERTION ABOUT THE EFFECTIVENESS ON INTERNAL CONTROL AND INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

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INDEPENDENT ACCOUNTANTS' REPORT ON MANAGEMENT'S ASSERTION ABOUT THE EFFECTIVENESS OF INTERNAL CONTROL AND INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Chairman Richard A. Meserve
U.S. Nuclear Regulatory Commission
Rockville, Maryland

INDEPENDENT ACCOUNTANTS' REPORT ON MANAGEMENT'S ASSERTION ABOUT THE EFFECTIVENESS OF INTERNAL CONTROL

We have examined management's assertion that the U.S. Nuclear Regulatory Commission's (NRC) systems of accounting and internal control in place as of September 30, 2001, are in compliance with the internal control objectives defined in Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. The Bulletin states that transactions should be properly recorded, processed, and summarized to enable the preparation of the principal statements in accordance with Federal accounting standards, and assets are to be safeguarded against loss from unauthorized acquisition, use or disposal. Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was made in accordance with the attestation standards established by the American Institute of Certified Public Accountants; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, OMB Bulletin No. 01-02, and accordingly, included obtaining an understanding of the agency's internal controls, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls and other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination was of the internal controls in place as of September 30, 2001.

Because of inherent limitations in internal control, misstatements due to errors or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate due to changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

In our opinion, management's assertion that NRC's accounting systems and the internal controls in place as of September 30, 2001 are in compliance with the internal control objectives defined in OMB Bulletin No. 01-02 is not fairly stated. Management did not identify the lack of managerial cost accounting, nor did they identify an adequate system to monitor the implementation of accounting for internal use software.

Our consideration of management's assertion on internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions made by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted certain matters, discussed in the following paragraphs, involving the internal control and its operation that we consider to be reportable conditions. *Managerial Cost Accounting* and *Accounting for Internal Use Software* are considered material weaknesses. Both conditions are considered a substantial non-compliance with the Federal Financial Management Improvement Act (FFMIA).

Current Year Comments

A. Managerial Cost Accounting

Initially reported for fiscal year (FY) 1998 (Report No. OIG/98A-09) and continuing through FY 2001, the NRC has not implemented Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* to assure that, "Managerial cost accounting... be a fundamental part of the financial management system and, to the extent practicable, ... [to] be integrated with other parts of the system." [Implementation of the standards would provide], "... the costs of ... activities on a regular basis for management information purposes."

Agency management has continued to respond to the FY 1998 condition by revising the remediation plan and outlining the milestones for an integrated resource management system. The remediation plan has undergone various revisions to reflect the tasks planned and accomplished. The most recent revision of the plan was issued May 31, 2001. Management has not made measurable progress in implementing interim techniques or processes to provide useful, routine and reliable cost information for managers as of the end of FY 2001. NRC projects implementation of cost management during FY 2002.

The strategy adopted by management places significant emphasis on changing the culture and practices of the agency. Although managements strategy included plans for interim cost reports at the strategic arena level, this strategy overlooks the immediate benefits of providing managerial cost accounting information to agency managers in order to support their responsibilities for planning, controlling costs, decision-making, and evaluating performance. For example, in the current year, the lack of cost accounting data impacted the agency's ability to transition smoothly to accounting for internal use software. *(See Comment B for details of the condition and recommendation.)*

The Joint Financial Management Improvement Program (JFMIP), *Managerial Cost Accounting System Requirements* (FFMSR-8), states, "Some agencies may find they have existing software, such as the core financial systems software and reporting and data analysis tools, that can support many of their needs for cost accounting capabilities, especially when cost accounting is first being introduced. Not until an agency has some experience with cost accounting and has determined that they truly have a need for more sophisticated capabilities and what those capabilities are, should the agency pursue additional software. Since agencies may use cost finding techniques and cost studies as long as they comply with cost accounting standards ... implementation of a cost accounting system is not necessarily a prerequisite with SFFAS Number 4."

This condition continues to be reported as a material weakness and an FFMIA substantial non-compliance.

Recommendation

1. The Chief Financial Officer (CFO) should give greater priority to implementing a cost management system within the revised milestones. The preparation of routine, useful and reliable cost accounting information for agency managers should become a higher priority. Cost accounting information should enhance the agency's ability to evaluate the cost of outputs.

CFO's Comments

"Agree. A high priority has been and will continue to be placed on implementing a cost management system within the revised milestones of the remediation plan, dated May 31, 2001. These milestones are linked to the implementation of the PeopleSoft payroll, time and labor, and human resources modules. The PeopleSoft modules were implemented on November 4, 2001. Some of the remediation plan milestones have been delayed due to the one month deferral of the implementation of the PeopleSoft modules beyond the time frame projected in May 2001 and by unforeseen increased efforts to resolve issues associated with the interfaces between the PeopleSoft modules and the cost accounting system. Cost management reports will be provided to offices for the first quarter of FY 2002 early in calendar year 2002."

Auditors' Position

We are fully cognizant of the initiatives, which have preceded the implementation of cost accounting and the importance of those initiatives to the agency. However, we continue to urge the CFO to meet the milestone dates in the revised remediation plan, as doing so will expedite and enhance the implementation of a cost management strategy for the agency. During the next audit we will evaluate the full implementation of cost management, and compliance with the remediation plan milestones. The condition is resolved.

B. Accounting for Internal Use Software

In 1998, the Federal Accounting Standards Advisory Board issued standards for agencies to account for the development of internal use software. The Statement became effective October 1, 2000. The guidance prompted the Chief Financial Officers' community to develop policy, redesign systems, designate documentation standards and develop an adoption strategy for the new accounting standard. The NRC, in a very timely and thorough fashion, developed policy guidance for adoption of the standard. However, the management controls needed to ensure compliance were not satisfactorily implemented. Consequently, the agency cannot adequately demonstrate adoption of the accounting standard.

The Financial Accounting Standards Advisory Board Statement of Federal Financial Account Standards No. 10 (SFFAS No. 10) established the accounting standards for the cost of software developed or obtained for internal use. Paragraph 16 requires that, "For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage." For internally developed software, "Such costs include those for new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) . . ." The General Accounting Office's, *Standards for Internal Control in the Federal Government,* states "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continuously and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

The agency's policy is to track and capture labor costs by strategic arena. To separately account for labor costs related to internal use software development, the agency established an "unofficial" information technology (IT) strategic arena, as they did in prior years to track management and support costs. Within the IT arena, job codes were established for each individual software development project. Employees working on software development projects were instructed to charge their time to the IT arena by entering time in the time and labor module of the payroll system. That system contained an IT detail screen for charging time to individual projects.

The new arena was deployed in a software "patch" to the Pay/Pers time and labor module (T&L). However, OCFO failed to include certain functions, thoroughly test the new routine, and develop reports to enable management review and oversight of the new cost accumulation process. For example, when an employee generally charges all time to a single arena, the employee's time defaults to that arena. In this instance, the system generates a one-page time and attendance (T&A) report that the employee and certifying official sign. However, when an employee charges time to more than one arena, the system generates a two-page T&A report so that the employee and certifying official can see the hours charged to each arena. The T&A report also indicates that the default arena was modified. Thus, the hours shown on the T&A report and hours charged in the system agreed.

However, the IT "patch" did not generate a second T&A report page when IT was one of two strategic arenas involved, and the hours shown on the printed T&A reports continued to be charged to the default arena. Consequently, many of the sampled T&A reports, signed by employees and certifying officials, did not agree with the hours reflected in the system. In an effort to address this condition, the agency provided other alternative documentation to support hours charged to the IT arena, such as all T&A reports for selected employees, functional position descriptions, monthly activity reports for IT projects, personal calendars, annual employee performance appraisals, and other documents of varying evidentiary value.

Other examples of the condition identified include:

- Another shortcoming of the "patch" was that a system edit was not provided to require completion of the IT detail screen when hours were charged to the IT arena. Thus, hours could be charged to the general IT arena without specifying the job code to which the costs should be assigned.

- Labor reports were not distributed to the Project Managers until March 2001, and, at that time, the agency did not require them to certify the accuracy of the hours reported.

- OCFO personnel did not timely monitor the implementation of the IT labor time tracking process. During the third quarter of FY 2001, the OCFO performed a review of employee hours charged to IT. OCFO personnel discovered that IT hours were being under reported. Further analysis revealed that some employees were not charging hours to the IT arena because they believed that the projects they were working on did not meet the requirements of SFFAS No. 10. Other employees were not charging the IT arena because of an oversight. In October 2001, OCFO requested the Project Managers to certify the time reported. However, certification at that late date was considered untimely and unreliable.

Because the agency did not have an adequate system to (1) track the labor time incurred or (2) monitor procedures to implement SFFAS 10, the agency is not in compliance with accounting standards.

Recommendation:

2. The Chief Financial Officer should review the agency practices for transitioning to new software applications or routines, which have financial statement impact. The following are essential to the deployment of new applications:
   - adequacy of testing the process controls,

- developing the control activities necessary to ensure reasonable assurance in the process,
- monitoring the implementation of the application and development of managerial reports to assist the review, and
- reconciling the data provided by the new process.

Implementation of business practices of this nature could assist the OCFO with deployment of other applications in the future.

CFO's Comments

"Agree. The OCFO will review the practices for transitioning to new software applications or routines that have financial statement impact. On November 4, 2001, the agency implemented the PeopleSoft Human Resources Management System. This new system integrates human resources, payroll, and time and labor, and is a single-entry system for time, attendance and labor reporting. This new system is expected to correct all of the system weaknesses identified in the Payroll/Personnel System. The staff is currently extracting IT labor data from the new Time and Labor module so we can monitor IT labor reporting. The staff plans to issue first quarter labor data to IT project managers by the end of February 2002 for their review and certification. This completes all remediation actions required by the Federal Financial Management Improvement Act."

Auditors' Position

The activities described by the CFO should enable the agency to evaluate the appropriateness of new software applications implemented. Furthermore, the CFO's planned actions described timeliness of data extracts and related monitoring and analysis may enhance the reliability of financial information provided by the system and provide an early warning system in the event that issues are identified. We concur that such actions should be pursued as means to remediate the FFMIA condition identified. This condition is resolved. Closure is dependent on an evaluation of actions taken and the reliability of data provided by the new application.

C. Contract Close-out Processing Procedures

The Division of Contracts and Property Management (DCPM) performs a review of contracts in close-out and determines the amounts that should remain available for future payments and the amounts that are available for deobligation. This process is normally followed to determine the continued viability of recorded undelivered orders. We noted that DCPM notified OCFO's General Accounting Branch (GAB) of amounts to be expensed without adequate supporting documentation. Subsequently, GAB recognized the expense without adequate supporting documentation such as contractor invoices, receiving reports or project manager certifications that the services had been performed.

Statement of Federal Financial Accounting Standards No. 5, which established accounting standards for federal government liabilities, contains the following definition, "A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. . ." NRC's Accounting Policy Manual, Chapter II. E., Accounting Procedures, states, "The documentation of a financial event shall be purposeful and useful to managers in controlling their operations and to auditors or others involved in analyzing operations. The documentation shall provide a link between the SGL [standard general ledger] and all supporting records for the financial event."

Information provided by DCPM for transaction processing was not reviewed by GAB personnel to ensure the underlying completeness, necessity and propriety of the entry. The present practice used by GAB does not require adequate supporting documentation for the amount proposed as an accrual for contracts in close-out. As a result, the amounts presented on the financial statements for liabilities and expenses may be overstated. The amount in contracts in close-out at year-end was approximately $705,000.

Recommendation:

3. The Chief Financial Officer should instruct the General Accounting Branch of their inherent responsibility to evaluate amounts being recorded as liabilities and expenses. It is essential that the review process include an understanding of the source of the information and the underlying techniques used to develop amounts referred for inclusion in the agency's financial records. At a minimum, OCFO should require DCPM to provide documentation to justify valid expenses and liabilities.

CFO's Comments

"Agree. The General Accounting Branch will ensure that all expenses recorded for contracts in closeout are supported by adequate documentation and will work with DCPM to obtain the necessary documentation."

Auditors' Position:

We commend the CFO for his commitment to the actions described. The condition is resolved. During a subsequent audit we will evaluate the adequacy of actions taken.

Status of Prior Years' Comments

A. Program Cost Accounting

In FY 1999, we reported (Report No. OIG/99A-12) that NRC did not have a general ledger process supporting the preparation of the Statement of Net Cost. The OCFO implemented an interim labor distribution system in FY 2000 by strategic arena in an effort to collect labor data. A follow-up analysis of the data available for allocation and distribution of labor cost was performed in the current year. The analysis showed that the new system sufficiently improved the information collection process. This condition is closed.

B. Documentation of Debt Collection Activities

The License Fee and Accounts Receivable Branch (LFARB) is responsible for collecting NRC receivables generated in the billing of NRC services to the regulated community. Policies provide for the collection actions at specified time periods. In FY 2000, we reported that collection files were generally in poor condition and were incomplete. The results of tests indicated that required collection actions were either not performed, or were not documented for a large portion of the billings. In the current year the agency implemented a "Red Folder" process, whereby tracking and documentation of files can be managed more fully. Thus, the condition is closed.

C. Management Controls over Fee Development

During FY 1999, an audit was conducted by the Office of the Inspector General (OIG) that identified management control issues relating to the development of fees (Report No. OIG/99A-01). The OIG identified several management control weaknesses, including: (1) lack of formal procedures and (2) the lack of quality control over the fee calculations. The report stated that there were no formally documented procedures for calculating fees and preparing the fee rule.

In October 1999 (FY 2000), the agency engaged a contractor to conduct an analysis of the fee development methodology. In a report dated March 27, 2000, the contractor concluded that although NRC's current hourly rate calculation is not as precise as it could be, it is acceptable under SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.* The report also provided suggestions that would improve the current process. Quality controls were not addressed specifically in the report. A subsequent OIG assessment of quality control procedures over fee development disclosed that improved controls were instituted. This condition is closed.

D. Financial Statement Preparation

The FY 1998 management letter included an observation on the Financial Statement Preparation Process, and in FY 1999 this issue was elevated to a reportable condition. During FY 2000, the NRC improved its financial management compilation practices as evidenced by delivering the compiled statements by the agreed-upon milestone. In the current year, the agency further refined its compilation process, as evidenced by timely delivery of the principal statements and notes. More importantly, the agency was able to meet the delivery milestones. The condition is closed.

E. Management Controls Over Small Entity Certifications

As reported in prior years, materials licensees can qualify as small entities and pay reduced annual fees depending on their size (per 10 CFR 171.16). Businesses, nonprofit agencies, educational institutions or local governments may qualify as small entities depending on either average annual gross receipts, number of employees or population jurisdiction. Size standards are based on guidelines prescribed by the Small Business Administration. Licensees qualify for reduced fees by completing and submitting a *Certification of Small Entity Status For The Purposes of Annual Fees Imposed Under 10 CFR Part 171* (NRC Form 526) with the applicable fee.

Licensees self-certify as small entities and corroborating evidence is not required. The OCFO performs a cursory review of NRC Forms 526 received, primarily for completeness. A few certifications are denied each year based on information available to license fee analysts. During FY 1999, the agency granted 1,180 fee reductions totaling \$6.4 million or 83 percent from the originally billed materials fees of \$7.7 million. The agency granted fee reductions of approximately \$5.2 and \$5.8 million for FY 2001 and FY 2000, respectively.

The CFO responded in the prior year that they planned to explore the recommendation provided and that they would advise us of their results by June 1, 2000. As of the end of our FY 2001 field work, a corrective action plan had not been provided for review. On December 7, 2001, the agency issued a memorandum documenting an approach that will be used for FY 2002. Since a plan was not implemented to address this condition in FY 2001, the condition remains unresolved.

Assurance on Performance Measures

With respect to internal controls related to performance measures, the OIG performed those procedures and will report on this issue separately. Our procedures were not designed to provide assurance over reported performance measures, and, accordingly, we do not provide an opinion on such information.

We have audited the principal statements of the U.S. Nuclear Regulatory Commission (NRC) as of and for the year ended September 30, 2001, and have issued our report thereon dated January 16, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the U.S. Nuclear Regulatory Commission is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. Our objective was not to issue an opinion on compliance with laws and regulations and, accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed an instance of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, which is described below.

Current Year Comment

Compliance with Computer Software Accountability

A review was performed by the OIG (Report No. OIG-02-A-02) of the NRC's management controls governing the accountability and control of software and software licensing agreements. The review evaluated the extent of compliance with Executive Order 13103, *Computer Software Piracy*, which requires all executive agencies to ensure compliance with applicable copyright laws.

The report identified two conditions evidencing weaknesses in the agency's current practices:

- NRC Management Directives do not address the full scope of the executive order.
- The agency's software management controls do not implement the Chief Information Officer (CIO) Council's guidelines.

NRC's policies and procedures do not address the full scope of the executive order because the NRC focused its actions on personal use, rather than all uses of software. As a result, the NRC has not conducted an initial assessment of its software, established a baseline for software inventory, or determined if all software on agency computers is authorized. The OIG further concluded that these conditions place the agency, its employees and contractors at risk.

Recommendation:

Refer to the OIG report for detailed description of the conditions and recommendations. Follow-up and resolution actions will be tracked by OIG.

Status of Prior Years' Comments

A. Compliance with the Debt Collection Improvement Act

In the prior year, we reported that the NRC did not comply fully with the referral provisions of the Debt Collection Improvement Act. Uncollected receivables that are over 180 days delinquent are required to be transferred to the U.S. Treasury. The results of our tests of accounts receivable identified a 60 percent exception rate for accounts that were outstanding for more than 180 days. In the current year, the agency implemented a "Red Folder" process, whereby tracking and documentation of files can be managed more fully. Thus, the condition is closed.

B. Part 170 Hourly Rates

As previously reported in fiscal years (FY) 1998 through 2000, the Omnibus Budget Reconciliation Act (OBRA) of 1990 requires the NRC to recover approximately 100 percent of its budget authority by assessing fees. Accordingly, NRC assesses two types of fees to its licensees and applicants. One type, specified in 10 CFR Part 171, consists of annual fees assessed to power reactors, materials and other licensees. The other type, specified in 10 CFR Part 170 and authorized by the Independent Offices Appropriation Act (IOAA) of 1952, is assessed for specific licensing actions, inspections and other services provided to NRC's licensees and applicants.

Each year, the Office of the Chief Financial Officer (OCFO) computes the hourly rates used to charge for the time incurred by NRC personnel in providing Part 170 services. The rates are based on budgetary data and are used to price individually identifiable Part 170 services.

The FY 1998 rates were not developed in accordance with applicable laws and regulations because they were not based on the full cost of providing Part 170 services. For example, the calculations did not include certain contract support costs of approximately $70 million, net of contract support costs directly billable to licensees and applicants. The $70 million represented approximately 15 percent of the FY 1998 NRC appropriation of $472.8 million.

The contract support costs were excluded because, based on the OBRA conference agreement, the OCFO classified these costs as "generic activities" that benefit licensees generally. Thus, NRC recovered these costs through the Part 171 annual fees.

In response to the condition reported in the prior year, the Office of the Inspector General (OIG) performed an audit and issued report (Report No. OIG/99A-01). Subsequent to the issuance of the FY 1999 financial statement report (Report No. OIG/99A-12), the agency provided a report intended to address the issues identified in this observation. The report did not provide for a solution to be implemented during FY 2001. We do, however, understand that the agency is looking to the future implementation of cost accounting to assist them in fully addressing this condition. Planned actions to be taken by the agency have resolved this condition. Closure is dependent on subsequent audit follow-up.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 01-02. The results of our tests provided us the basis to update the status of prior years' instances of noncompliance.

FFMIA - Current Year Comment

Accounting for Internal Use Software

Refer to the Report on Management's Assertion About the Effectiveness of Internal Control, Current Year Comment B - Accounting for Internal Use Software for a detailed discussion of the condition and recommendation. This condition is considered a material weakness and a Federal Financial Management Improvement Act substantial non-compliance.

FFMIA - Status of Prior Year Comments

A. Managerial Cost Accounting

Refer to the Report on Management's Assertion About the Effectiveness of Internal Control, Current Year Comment A - Managerial Cost Accounting for a detailed discussion of the condition and recommendation. This condition continues to be considered a material weakness and a Federal Financial Management Improvement Act substantial non-compliance.

B. Business Continuity

In prior years, we reported conditions resulting from our assessment of NRC's management control program relating to the agency's business continuity practices for major financial management systems. At the end of FY 1999 and FY 2000, the issue identified with the core general ledger - Federal Financial System (FFS) - operated by Treasury's Financial Management Service (FMS) remained an unresolved condition and continues to be an FFMIA substantial non-compliance.

In the prior year, we reported that FMS announced that it would no longer support the FFS system used by the agency. Therefore, NRC is in the process of identifying an alternative provider of such services. We consider this condition resolved and closure depends on the agency migrating from FMS during FY 2002.

Consistency of Other Information

NRC's overview of program performance goals and results, and other supplemental financial and management information contain a wide range of data, some of which is not directly related to the principal statements. We do not express an opinion on this information. We have, however, compared this information for consistency with the principal statements and discussed the measurement and presentation methods with NRC management. Based on this limited effort, we found no material inconsistencies with the principal statements or noncompliance with OMB guidance.

Objectives, Scope and Methodology

NRC management is responsible for (1) preparing the principal statements in conformity with the basis of accounting described in Note 1 of the Notes to Principal Statements, (2) establishing, maintaining, and assessing internal controls to provide reasonable assurance that FMFIA's broad control objectives are met, and (3) complying with applicable laws and regulations, including the requirements referred to in FFMIA.

We are responsible for (1) expressing an opinion on whether the principal statements are free of material misstatement and presented fairly, in all material respects, in conformity with generally accepted accounting principles, and (2) obtaining reasonable assurance about whether management's assertion about the effectiveness of internal control is fairly stated, in all material respects, based upon criteria established by FMFIA and OMB Circular A-123, *Management Accountability and Control*. As of the date of our report, NRC management had completed its evaluation of financial management controls.

We are also responsible for testing compliance with selected provisions of laws and regulations, and for performing limited procedures with respect to certain other information in the principal statements. In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures made in the principal statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the principal statements;
- obtained an understanding of internal controls related to safeguarding of assets, compliance with laws and regulations including execution of transactions in accordance with budget authority and financial reporting in the principal statements;
- assessed control risk and tested relevant internal controls over safeguarding of assets, compliance, and financial reporting, and evaluated management's assertion about the effectiveness of internal control;
- tested compliance with selected provisions of the following laws and regulations: Anti-Deficiency Act (Title 31 U.S.C.), National Defense Appropriation Act (PL 101-510), Omnibus Budget Reconciliation Act of 1990 (PL 101-508), Debt Collection Act of 1982 (PL 97-365), Prompt Pay Act (PL 97-177), Civil Service Retirement Act of 1930, Civil Service Reform Act (PL 97-454), Federal Managers' Financial Integrity Act (PL 97-255), Chief Financial Officers' Act (PL 101-576), Budget and Accounting Act of 1950, Federal Financial Management Improvement Act (PL 104-208); Government Information Security Act (PL 106-398); and
- reviewed compliance and reported in accordance with FFMIA whether the agency's financial management systems substantially comply with the Federal financial management system requirements, applicable accounting standards and the U.S. Standard General Ledger at the transaction level.

We did not evaluate all internal controls relevant to operating objectives as broadly as defined in FMFIA, such as those controls for preparing statistical reports and those for ensuring efficient and effective operations. We limited our internal control tests to those controls necessary to achieve the objectives described in our opinion on management's assertion about the effectiveness of internal controls. We performed our work in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

This report is intended solely for the information and use of the Commissioners and management of the U.S. Nuclear Regulatory Commission, OMB, Congress and the NRC Office of the Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

R. Navarro & Associates, Inc.

January 16, 2002

CHIEF FINANCIAL OFFICERS' RESPONSE TO THE AUDITORS' REPORT

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

CHIEF FINANCIAL OFFICER

January 11, 2002

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

FROM: Jesse L. Funches
Chief Financial Officer

SUBJECT: DRAFT AUDIT REPORT - AUDIT OF THE NUCLEAR REGULATORY COMMISSION'S FISCAL YEAR 2001 FINANCIAL STATEMENTS

I have reviewed the draft audit report of the Nuclear Regulatory Commission's FY 2001 Financial Statements, dated January 9, 2002. Our responses to the recommendations are as follows.

Recommendation 1

The Chief Financial Officer (CFO) should give greater priority to implementing a cost management system within the revised milestones. The preparation of routine, useful, and reliable cost accounting information for agency managers should become a higher priority. Cost accounting information should enhance the agency's ability to evaluate the cost of outputs.

Response

Agree. A high priority has been and will continue to be placed on implementing a cost management system within the revised milestones of the remediation plan, dated May 31, 2001. These milestones are linked to the implementation of the PeopleSoft payroll, time and labor, and human resources modules. The PeopleSoft modules were implemented on November 4, 2001. Some of the remediation plan milestones have been delayed due to the one month deferral of the implementation of the PeopleSoft modules beyond the time frame projected in May 2001 and by unforeseen increased efforts to resolve issues associated with the interfaces between the PeopleSoft modules and the cost accounting system. Cost management reports will be provided to offices for the first quarter of FY 2002 early in calendar year 2002.

Recommendation 2

The CFO should review the agency practices for transitioning to new software applications or routines, which have financial statement impact. Essential to the deployment of new applications is the adequacy of testing the process controls, developing the control activities

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415-6054

necessary to ensure reasonable assurance in the process, monitoring the implementation of the application and development of managerial reports to assist the review and reconciliation of the data provided by the new process. Implementation of business practices of this nature could assist the OCFO with deployment of other applications in the future.

Response

Agree. The OCFO will review the practices for transitioning to new software applications or routines that have financial statement impact. On November 4, 2001, the agency implemented the PeopleSoft Human Resources Management System. This new system integrates human resources, payroll, and time and labor, and is a single-entry system for time, attendance and labor reporting. This new system is expected to correct all of the system weaknesses identified in the Payroll/Personnel System. The staff is currently extracting IT labor data from the new Time and Labor module so we can monitor IT labor reporting. The staff plans to issue first quarter labor data to IT project managers by the end of February 2002 for their review and certification. This completes all remediation actions required by the Federal Financial Management Improvement Act.

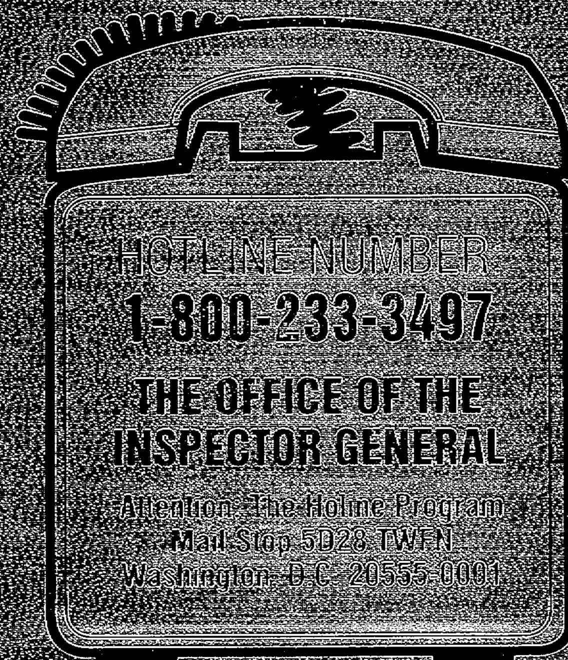
Recommendation 3

The Chief Financial Officer should instruct the General Accounting Branch of their inherent responsibility to evaluate amounts being recorded as liabilities and expenses. It is essential that the review process include an understanding of the source of the information and the underlying techniques used to develop amounts referred for inclusion in the agency's financial records. At a minimum, OCFO should require DCPM to provide documentation to justify valid expenses and liabilities.

Response

Agree. The General Accounting Branch will ensure that all expenses recorded for contracts in closeout are supported by adequate documentation and will work with DCPM to obtain the necessary documentation.

cc: J. Craig, AO/OEDO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