OFFICE OF
THE INSPECTOR GENERAL

U.S. NUCLEAR
REGULATORY COMMISSION

Audit of the Nuclear Regulatory Commission's
FY 2002 Financial Statements

OIG-03-A-04 January 24, 2003

AUDIT REPORT

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

OFFICE OF THE
INSPECTOR GENERAL

January 24, 2003

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 2002 FINANCIAL STATEMENTS (OIG-03-A-04)

Attached is the independent auditors' report on the U.S. Nuclear Regulatory Commission's (NRC) financial statements for the years ended September 30, 2002 and 2001. 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 from the Chief Financial Officer (CFO) 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 managerial cost accounting as a material weakness.[1]

The auditors identified three new reportable conditions and one prior-year reportable condition. The new conditions concern cost accounting implementation, accounting for internal use software use monitoring and external reporting of financial information.

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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 issue as a material weakness.

The report on NRC's compliance with laws and regulations disclosed three prior-year 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 NRC is in substantial non-compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). The specific issue related to FFMIA is that managerial cost accounting was implemented, but did not meet federal accounting and systems requirements.

The prior year's reportable condition relating to business continuity for NRC's general ledger system is closed. 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. With this objective in mind, OIG examined the control process for several performance measures. Our examination concluded that there were no deficiencies to report.

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 actions during FY 2003.

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

cc: R. McOsker, OCM/RAM
B. Torres, ACMUI
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J. Johnson, NRR
H. Miller, RI
L. Reyes, RII
J. Dyer, RIII
E. Merschoff, RIV
OPA-RI
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U.S. NUCLEAR REGULATORY COMMISSION

INDEPENDENT AUDITORS' REPORT AND PRINCIPAL STATEMENTS FOR THE YEARS SEPTEMBER 30, 2002 AND 2001

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The preparation of the Performance and Accountability Report (PAR) represents the culmination of the NRC's program and financial management processes, which began with mission and program planning, continued through the formulation and justification of NRC's budget to the President and the Congress. The PAR was prepared pursuant to the requirements of the Chief Financial Officers Act, as amended by the Reports Consolidation Act of 2000, and covers activities from October 1, 2001, to September 30, 2002.

Management's Discussion and Analysis, provides a high-level overview of the NRC. It consists of six sections: *About the NRC* which describes the agency's mission, organizational structure, and regulatory responsibility; *Future Challenges* which includes forward-looking information; *Program Performance Overview* which discusses the agency's success in achieving its strategic goals; *President's Management Agenda* which describes the agency progress in "Getting to Green" for the five management initiatives; *Financial Performance Overview* which provides highlights of the NRC's financial position and audit results; and *Systems, Controls, and Legal Compliance* which describes the agency's compliance with key legal and regulatory requirements.

ABOUT THE NRC

MISSION

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.

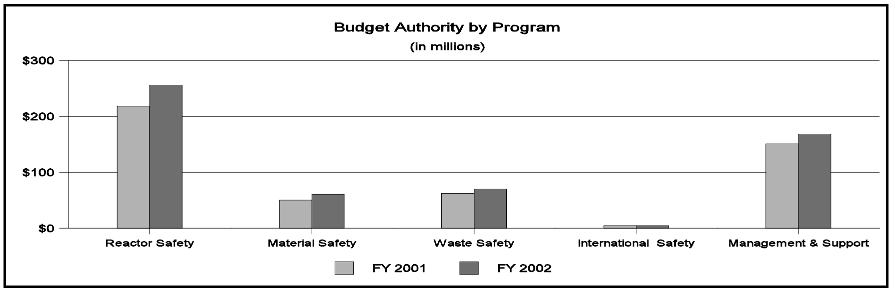
The U.S. Nuclear Regulatory Commission (NRC) was established on January 19, 1975, as an independent Federal Government agency to regulate various commercial and institutional uses of nuclear materials. The NRC's purpose is defined by the Atomic Energy Act of 1954, as amended, and the Energy Reorganization Act of 1974, as amended. These acts provide the foundation for regulating the Nation's civilian uses of nuclear materials.

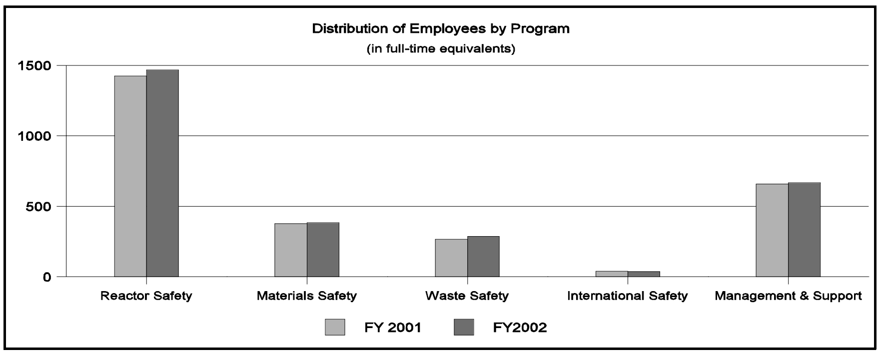
Organization

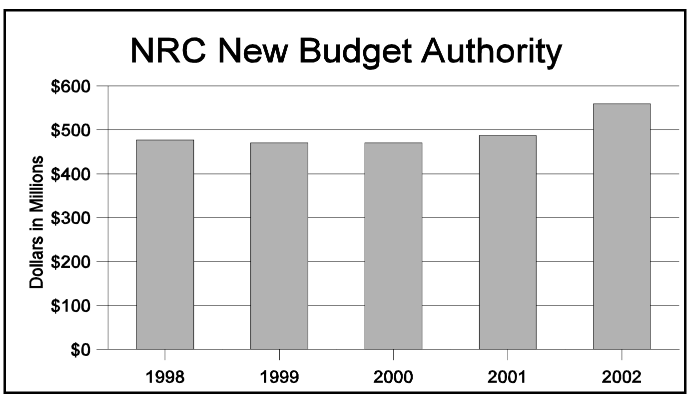
The NRC is headed by a Commission composed of five members, with one member designated by the President to serve as Chairman. Each member is appointed by the President, with the advice and consent of the Senate, and serves a term of 5 years. The Chairman serves as the principal executive officer and 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.

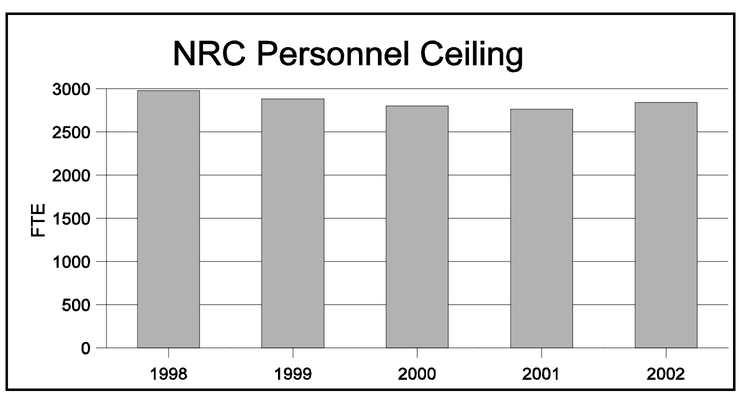
The NRC's headquarters offices are located in Rockville, Maryland. Four regional offices are located in King of Prussia, Pennsylvania; Atlanta, Georgia; Lisle, Illinois; and Arlington, Texas; and a technical training center is located in Chattanooga, Tennessee. The NRC also has resident inspector offices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

The NRC's budget for FY 2002 was $558.6 million and 2,842 full-time equivalent staff. The FY 2001 budget was $487.3 million and 2,763 full-time equivalent staff. The NRC is a fee-based agency that recovers most of its funding from fees paid by those holding NRC licenses. Approximately 46 percent of the budget and 52 percent of the staff are for reactor safety.









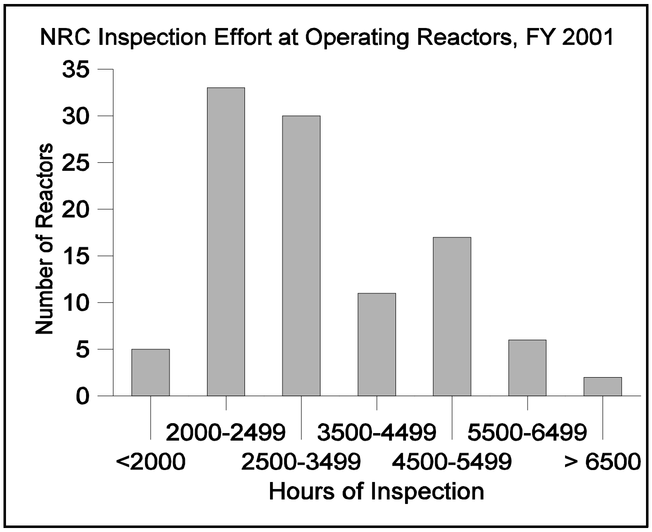
Regulatory Responsibility

To fulfill its responsibility to protect the public health and safety, the NRC 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 users of nuclear materials to ensure compliance with regulatory requirements. These regulatory functions relate to both nuclear power plants and other civilian uses of nuclear materials, such as nuclear medicine programs at hospitals; academic activities at educational institutions; research work; industrial applications, such as gauges and testing equipment; and the transport, storage, and disposal of nuclear materials and wastes. The NRC has aligned its regulatory programs into the following four strategic arenas.

> Nuclear Reactor Safety which encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities, as well as test and research reactors, are operated in a manner that adequately protects public health and safety and the environment, and that safeguards special nuclear materials used in reactors.
>
> Nuclear Materials Safety which encompasses NRC efforts to ensure that nuclear fuel cycle facilities; and academic, industrial, and medical uses of nuclear materials are handled in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion or special nuclear materials.
>
> Nuclear Waste Safety which encompasses NRC efforts to ensure that the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive wastes are handled in a manner that adequately protects public heath and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.
>
> International Nuclear Safety Support which encompasses international nuclear safety and regulatory policy formulation, import-export licensing for nuclear materials and equipment, treaty implementation, and international information exchange.

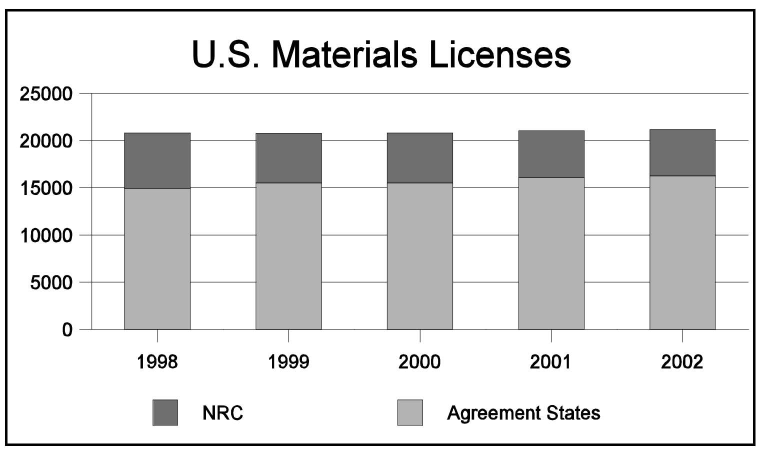
NRC also carries out a corporate management and support function for information technology, financial management, human resources, and other support functions. Efforts in this area are aligned with the President's Management Agenda and focus on the five Government-wide initiatives aimed at improving agency management.

Approximately 20 percent of the Nation's electricity is generated by 104 commercial nuclear reactors which are licensed by the NRC to operate in 31 States. Since 1991, nuclear electric generation has increased by 25 percent. The NRC expends an average of 3,400 hours of inspection effort at each operating reactor and licenses approximately 4,500 reactor operators.



FY 2002 data will be available mid-FY 2003.

The NRC oversees approximately 4,900 licenses for medical, academic, industrial, and general uses of nuclear materials. The NRC conducts approximately 1,500 health and safety inspections of its nuclear materials licensees annually. Additionally, approximately 16,300 licenses are administered by the 32 States that participate in the Agreement States Program, which authorizes the State to regulate the use of radioactive materials within that State. The NRC, Agreement States, and their licensees share a common responsibility to protect public health and safety.



The NRC places a high priority on keeping the public fully informed of its activities. Visit our web site at www.nrc.gov to learn more about who we are and what we do to serve the American people.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FUTURE CHALLENGES

The Commission is focused on addressing a number of significant challenges that will have long-term impact on accomplishment of its mission. The ongoing terrorism threat requires that the NRC invest significant resources on homeland security related activities. In addition, the NRC needs to review applications from industry in preparation for the possibility of new applications to construct nuclear power plants. A third major challenge is preparing for a potential license application for a high-level waste repository.

Homeland Security

Long before September 11, 2001, the NRC required that major NRC licensees maintain rigorous security programs. Although the details are classified, this typically involves a fenced perimeter, intrusion detection devices, access barriers, heavily armed and trained guard forces, and a comprehensive defensive strategy. Nuclear plant operators are subject to comprehensive regulatory requirements and detailed inspection, including periodic force-on-force exercises. However, the events of September 11 have changed the threat profile the industry faces.

Since September 2001, the NRC has been conducting a comprehensive review of its programs and security of the nuclear facilities and activities it regulates. The Commission has made a number of significant changes to its regulatory programs and have enhanced the already robust security of sensitive facilities and activities. A new Office of Nuclear Security and Incident Response was established to focus and coordinate the agency' s efforts and expertise in the security and emergency preparedness areas. The NRC implemented a new homeland security threat advisory system based on guidance from the Department of Homeland Security and has included additional classes of licensees in the threat advisory system. The NRC is studying the potential vulnerability of nuclear power plants, fuel cycle facilities, and nuclear fuel and materials storage and transportation containers, including deliberate aircraft crashes on power reactors and storage and transportation casks. The agency completed a new round of tabletop exercises using expanded threat scenarios for power reactor facilities and selected fuel cycle facilities in November 2002. The lessons learned from these exercises will be incorporated into an expanded force-on-force program. In the course of these efforts, NRC has had the benefit of continuing interaction, consultation, and coordination with several Federal agencies and the State governments.

Next year, the Commission expects to complete its review and revision of the design basis threat that provides the foundation for the security programs of nuclear power plant and category I fuel facility licensees, and will then proceed to revise its safeguards and security requirements. The NRC plans to conduct full security performance reviews, including force-on-force exercises, at each nuclear power plant on a 3-year cycle instead of the 8-year cycle that had been used prior to September 11, 2001. The NRC will complete the vulnerability assessment studies, continue to evaluate vulnerabilities of the facilities, and implement appropriate measures to reduce identified vulnerability to these facilities. The agency is working with the Department of Energy (DOE) and the International Atomic Energy Agency (IAEA) to enhance the control of radioactive material to prevent its use in radiological dispersal devices (dirty bombs), and are involved significantly in a review of controls of radioactive sources with the same objectives.

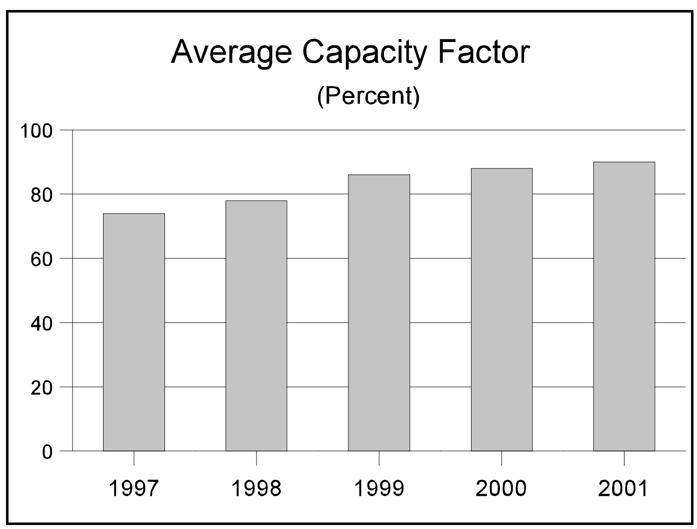
The NRC' activities are part of an integrated, national effort for the protection of the Nation's critical infrastructure. We continue to work closely with the Department of Homeland Security, other agencies, and our licensees to protect our country.

Nuclear Power and National Energy Needs

The question of where and how the United States will obtain the energy it needs, now and in the decades to come, is a matter of national importance. The availability and price of energy continues to play a crucial role in determining the quality of life for Americans now. Nuclear power currently supplies 20 percent of U.S. electricity needs. The President's National Energy Policy has cited nuclear power as a vital component of America's energy portfolio.

The NRC's mission is to ensure the protection of the public health and safety in the use of nuclear materials. The NRC also has an obligation to fulfill its regulatory duties without imposing unnecessary burdens on the industry. The challenge is to allow for innovation and improvements by operators in utilizing their power generation facilities while ensuring that the focus on safety remains the first priority in the use of nuclear power.

Compared to the operating record at the beginning of the 1990s, nuclear power plants today are more efficiently run, with fewer outages and greater reliability. In less than a decade, average capacity utilization in the industry has increased from 70 percent to nearly 90 percent in 2001. At the same time, objective measures of safety performance have also shown considerable improvement. The growth in demand for electric power, improved economic fundamentals for nuclear power generation, and concerns about the supply of energy from other sources and their environmental impact have increased electric utilities' interest in building and operating new nuclear power plants. The NRC is currently reviewing one design certification application and expects to receive up to four additional applications in the next 2 years. Three early site permit applications are also expected within the next year. The NRC is also putting in place the necessary regulatory processes to review an application for a new plant and to monitor its construction. The NRC must meet the challenge of keeping pace with industry plans and schedules for new reactor licensing activities, including early site permit reviews, design reviews, and enhancement to the regulatory infrastructure.



** FY 2002 data will be available mid-FY 2003.*

Despite the overall improvement in safety indicators, the Commission must always be prepared to respond to unexpected events that occur at nuclear power reactors. For example, in March 2002, during NRC-mandated assessment activities, a cavity in the reactor pressure vessel head was discovered at the Davis-Besse Nuclear Power Station by the licensee. The NRC dispatched an inspection team to gather facts surrounding the circumstances associated with the event. As a result, the NRC has required all pressurized-water reactor licensees to ensure that similar degradation has not occurred at other plants and to ensure the continued safety of the reactors. The NRC also formed a task force to assess its regulatory processes as a result of this significant incident. The task force issued its report on September 30, 2002, and the agency is using the report to develop future agency actions. (A copy of the task force's report, as well as a host of other information relating to reactor vessel head degradation and the Davis-Besse event, can be found on the NRC's web site.) The plant remains shut down for replacement of the reactor vessel head and for broad safety reviews and performance improvement activities. NRC approval is required before the plant can restart.

Nuclear Waste

Radioactive waste is a byproduct of generating nuclear power. In April 2002, the President accepted the Secretary of Energy's recommendation that the Yucca Mountain site be developed as a potential repository for the disposal of high-level nuclear wastes and spent nuclear fuel. In July 2002, Congress approved a resolution of siting approval, which authorizes DOE to apply to the NRC for a license to operate Yucca Mountain as a nuclear waste repository. The NRC will be prepared to review a potential license application from DOE which is expected to be filed in late 2004. This includes resolving key technical issues through prelicensing consultations with DOE, observing DOE's quality assurance audits, and communicating extensively with stakeholders. The NRC will also prepare for hearings on the potential license application.

PROGRAM PERFORMANCE OVERVIEW

Federal agencies provide an annual performance plan to Congress, setting goals with measurable target levels of performance based on the Government Performance and Results Act (GPRA). The NRC evaluates its program performance within a structured Planning, Budgeting, and Performance Management 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Nuclear Reactor Safety

The NRC regulates 104 civilian nuclear power reactors licensed to operate and 36 non-power reactors. During FYs 2001 and 2002, 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. In addition, during FY 2002 NRC approved 17 requests from licensees for power uprates, which increase the electrical generating capacity of the licensees' nuclear reactor power plants. To date, the NRC has approved 81 requests from licensees for power uprates. Approval of power uprates has resulted in an electrical generating capacity gain equivalent to approximately three large nuclear power plants. To promote common defense and security, NRC took significant actions requiring licensees to enhance the already robust security at nuclear power plants and other sensitive facilities.

> STRATEGIC GOAL
> Prevent radiation-related deaths and illnesses, promote the common defense and security, and protect the environment in the use of civilian nuclear reactors.

Nuclear Materials Safety

The NRC has regulatory oversight for 44 fuel cycle facilities, including eight major fuel cycle facilities and two gaseous diffusion plants. This strategic arena also includes oversight of approximately 21,000 specific and 150,000 general licenses regulated by the NRC and the 32 Agreement States. During FYs 2001 and 2002, the NRC met all five of its strategic goal measures for this arena.

> STRATEGIC GOAL
> 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.

In addition to achieving our strategic goal measures, it is noteworthy to describe the NRC's progress in reviewing an application from Duke, Cogema, Stone & Webster to construct a mixed oxide (MOX) fuel fabrication facility at the DOE's Savannah River site near Aiken, South Carolina. The proposed use of MOX fuel is part of a national non-proliferation effort to dispose of surplus weapons-usable plutonium by irradiating it in existing commercial light-water reactors. The NRC issued a draft Safety Evaluation Report for construction in April 2002, documenting its preliminary safety conclusions. The NRC discussed its review process and preliminary conclusions at a public meeting held in South Carolina in August 2002. In response to changes in the national non-proliferation effort, the applicant submitted a revised construction authorization request in October 2002. NRC staff have begun review of the revised construction authorization request and plan to complete a revised draft Safety Evaluation Report in the spring 2003.

Nuclear Waste Safety

STRATEGIC GOAL
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.

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 2002, the NRC met all four of its strategic goal measures for this arena.

In 1987, the Nuclear Waste Policy Act (NWPA) was amended directing the DOE to characterize only one site at Yucca Mountain in the State of Nevada. In April 2002, the President accepted the Secretary of Energy's recommendation that the Yucca Mountain site be developed as a potential repository for the disposal of high-level nuclear wastes and spent nuclear fuel. In July 2002, Congress approved a resolution of siting approval, which authorizes DOE to apply to the NRC for a license to operate Yucca Mountain as a nuclear waste repository.

In FY 2002, NRC continued to build and refine the regulatory framework that will be used to evaluate a license application for the proposed Yucca Mountain repository. NRC's final regulation for Yucca Mountain in 10 CFR Part 63 was issued in November 2001. NRC staff also published, for public comment, a proposed rule that addresses "unlikely events" - events that can be excluded from certain required assessments due to their low probability of occurrence - for the proposed Yucca Mountain repository. NRC issued, for public comment, the draft Yucca Mountain Review Plan, Revision 2, an important companion to the rules in 10 CFR Part 63. The Review Plan describes the information the staff is to review in the license application and the criteria for determining whether issues have been satisfactorily addressed.

International Nuclear Safety Support

STRATEGIC GOAL
Support U.S. interests 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 2002.

During FY 2002, the NRC participated in IAEA Operational Safety Review Team activities in the Czech Republic and Hungary; International Regulatory Review Team activities in Armenia, Mexico, Lithuania, the Czech Republic; and Radiation Protection activities in Tajikistan. In addition, bilateral assistance activities were conducted 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. These activities provide an objective international peer review of nuclear power plant operational safety against international standards and practices. The international composition of the review team enables it to provide observations that may not have been previously considered by U.S. industry or regulators.

The NRC also successfully concluded eight bilateral exchange agreements in FY 2002 between NRC and appropriate foreign counterparts, to ensure that an effective framework for NRC's international exchanges is in place.

PRESIDENT'S MANAGEMENT AGENDA

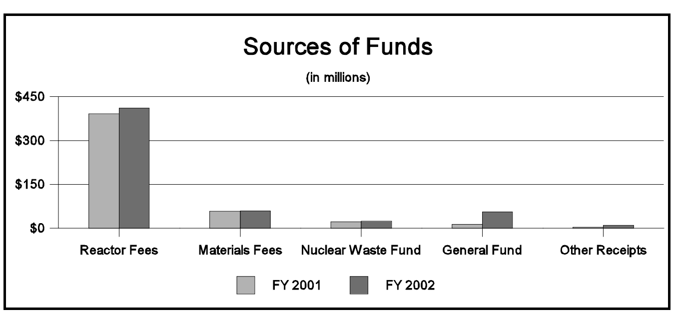
In August 2001, the President launched a management reform agenda targeted to "address the most apparent deficiencies where the opportunity to improve performance is the greatest." The Governmentwide initiatives of the President's Management Agenda are to reform Government to be more citizen-centered, results-oriented, and market-based and to actively promote competition. As a result, the President identified five Governmentwide goals: (1) Strategic Management of Human Capital, (2) Competitive Sourcing, (3) Improved Financial Management, (4) Expanded E-Government, and (5) Budget and Performance Integration. The NRC is actively responding to the call from the President to improve the management and performance of the Federal Government.

FINANCIAL PERFORMANCE OVERVIEW

As of September 30, 2002, and 2001, the financial condition of the NRC was sound with respect to having sufficient funds to meet program needs and adequate control of these funds in place to ensure obligations did 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. 01-09, *Form and Content of Agency Financial Statements*.

Sources of Funds

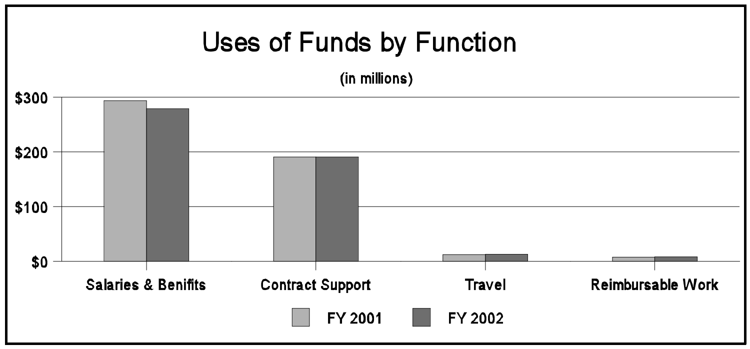
The NRC has two appropriations, Salaries and Expenses and Office of the Inspector General, and funds for both appropriations are available until expended. The NRC's total new FY 2002 budget authority was $558.6 million, of this amount, $552.4 million is for the Salaries and Expenses appropriation, which included $36 million in Emergency Supplemental funding to respond to the terrorist attacks on the United States, and $6.2 million is for the Office of the Inspector General appropriation. This represents an overall increase in new budget authority of $71.3 million over FY 2001 ($70.6 million for the Salaries and Expenses Appropriation and $0.7 million for the Office of the Inspector General Appropriation). In addition, $28.6 million from prior-year appropriations, $2.7 million from prior-year reimbursable work, and $6.1 million for new reimbursable work to be performed for others is available to obligate in FY 2002. The sum of all funds available to obligate for FY 2002 was $596.0 million, which is a $68.7 million increase over the FY 2001 amount of $527.4 million.



Consistent with the requirements of the Omnibus Budget Reconciliation Act of 1990, as amended, the NRC collected fees to offset approximately 96 percent of its new budget authority in FY 2002 and approximately 98 percent of its new budget authority in FY 2001, excluding funds derived from the Nuclear Waste Fund, General Fund, and other offsetting receipts.

Uses of Funds by Function

The NRC incurred obligations of $558.7 million, which was an increase of $58.0 million over FY 2001. Approximately 56 percent of obligations were used for salaries and benefits. The remaining 44 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. The unobligated budget authority available at the end of FY 2002 was $37.3 million, which is an increase over the FY 2001 amount of $26.7 million. Of this $37.3 million total, $3.2 million is for reimbursable work and $34.1 million in budget authority is available to fund critical needs in FY 2003.



Audit Results

The NRC received an unqualified audit opinion on its FY 2002 financial statements. This was the ninth consecutive year the NRC received an unqualified opinion. For FY 2002, the auditors identified one material weakness regarding the implementation of SFFAS Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.* The auditors also identified this as a substantial non-compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996. NRC's management disagrees, in part, with the auditors' assessment. A discussion of this issue can be found in Part III in the auditors' report and management's response to the audit report.

In FY 2001, the auditors also identified incomplete implementation of SFFAS Number 10 , *Accounting for Internal Use Software*, as a material weakness and substantial non-compliance with FFMIA. During FY 2002, the auditors evaluated the NRC's corrective actions and closed this material weakness and substantial non-compliance.

For FY 2002, the auditors also identified two new reportable conditions concerning accounting for internal use software and external financial reporting. In addition, seven reportable conditions were carried over from FY 2001. Two of these reportable conditions remained open at the end of FY 2002 concerning the development of the hourly rate for license fees and processing of contract close-outs. A reportable condition on compliance with computer software accountability, which is also still open, will no longer be reported as part of the principal statements. The agency expects to fully implement corrective action during FY 2004.

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 Part III of this report. Analysis of the principal statements follows.

Analysis of the Balance Sheet

The NRC's assets were approximately $264.3 million as of September 30, 2002. This is an increase of $27.4 million from the end of FY 2001 and is mainly due to an increase in Fund Balance with Treasury. The assets reported in NRC's Balance Sheet are summarized in the accompanying table.

The Fund Balance with Treasury represents the NRC's largest asset of $181.4 million as of September 30, 2002, an increase of $40.9 million from the FY 2001 year-end balance. This balance accounts for approximately 70 percent of total assets and represents appropriated funds, collected license fees, and other funds maintained at the U.S. Treasury to pay current liabilities.

ASSET SUMMARY (in millions)

	FY 2002	FY 2001
Fund Balance with Treasury	$181.4	$140.5
Accounts Receivable, Net	44.8	51.4
Property, Plant, & Equipment, Net	36.9	43.8
Other	1.2	1.2
Total Assets	$264.3	$236.9

Accounts Receivable, Net, as of September 30, 2002, was $44.8 million and includes an offsetting allowance for doubtful accounts of $2.7 million. This is a 13 percent decrease over the FY 2001 year-end Accounts Receivable, Net, balance of $51.4 million. Accounts Receivable Due from the Public is $42.8 million, representing 16 percent of total assets.

The value of Property, Plant, and Equipment, Net, was $36.9 million, representing 14 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 Number 10, *Accounting for Internal Use Software*, implemented on October 1, 2000.

The NRC's liabilities were $136.5 million as of September 30, 2002. The accompanying table shows a decrease in total liabilities of $6.7 million from the FY 2001 year-end balance of $143.2 million. This is mainly due to a decrease of $6.6 million in the liability to the U.S. Treasury for assessed license fees, which, when collected, are used to offset NRC's appropriations. Other liabilities include $44.2 million for recoveries from unbilled accounts receivable, $18.1 million for accrued salaries to employees, and $28.3 million for accrued annual leave. Of the agency's liabilities, $39.3 million were not covered by budgetary resources, which equaled the balance as of September 30, 2001. 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.

LIABILITIES SUMMARY (in millions)

	FY 2002	FY 2001
Accounts Payable	$28.4	$ 28.5
Federal Employee Benefits	9.1	10.8
Other Liabilities	99.0	103.9
Total Liabilities	$136.5	$143.2

The difference between total assets and total liabilities, net position, was $127.9 million as of September 30, 2002. This is an increase of $34.2 million from the FY 2001 year-end balance. The increase is mainly the result of an increase in Unexpended Appropriations, which is the amount of authority granted by Congress that has not been expended. The increase is due to receipt in January 2002 of Emergency Supplemental Appropriation funding of $36.0 million to respond to the terrorist attacks on the United States. Cumulative results of operations represent net results of operations since the NRC's inception. Prior-period adjustments are included in net results of operations.

NET POSITION SUMMARY (in millions)		
	FY 2002	FY 2001
Unexpended Appropriations	$128.3	$87.0
Cumulative Results of Operations	(0.4)	6.7
Total Net Position	$127.9	$93.7

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 purpose of this statement is to link program performance under GPRA reporting to the cost of programs. The NRC's net cost of operations for the year ended September 30, 2002, was $79.2 million, which is an increase of $28.6 million over the FY 2001 net cost of $50.6 million. This increase is due to funding homeland security from the General Fund and a reduction of the NRC budget recovered by license fees. Net costs by strategic arena are shown in the accompanying table.

NET COST OF OPERATIONS (in millions)		
	FY 2002	FY 2001
Nuclear Reactor Safety	$(43.5)	$(57.8)
Nuclear Materials Safety	38.7	29.4
Nuclear Waste Safety	72.1	67.4
International Nuclear Safety Support	11.9	11.6
Net Cost of Operations	$79.2	$50.6

Total exchange revenue for the year ended September 30, 2002, was $473.1 million, which is an increase of $9.1 million over the exchange revenue of $464.0 million for the year ended September 30, 2001. Exchange revenue is derived from fees for licensing inspections, other services, and annual fees assessed in accordance with 10 CFR Parts 170 and 171.

The net cost of operations is expected to decrease in FY 2003 due to the potential appropriation of fee recoverable funds for homeland security activities. The requirement to recover approximately 100 percent of the agency's new budget authority by assessing fees, less amounts appropriated from the Nuclear Waste Fund and the General Fund, was reduced to 96 percent in FY 2002 and will continue to decrease two percent each year until FY 2005, when the fee recovery amount will be 90 percent.

Analysis of Statement of Changes in Net Position

The Statement of Changes in Net Position reports the change in net position during the reporting period. Net position is affected by changes in its two components - Cumulative Results of Operations and Unexpended Appropriations. The increase in Net Position of $34.2 million from FY 2001 to FY 2002 represents the net change in Cumulative Results of Operations of -$7.1 million and an increase in Unexpended Appropriations of $41.5 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 2002, NRC had budgetary resources available of $596.0 million, the majority of which was derived from new budget authority. This represents a 13 percent increase over FY 2001 budgetary resources available of $527.4 million.

For FY 2002, the status of budgetary resources showed obligations of $558.7 million, or 94 percent of funds available. This is comparable to FY 2001 obligations of $500.7 million, or 95 percent of funds available. Total outlays for FY 2002 were $516.1 million, which represents a $32 million increase from FY 2001 total outlays of $484.1 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 $558.7 million and reconciles to the net cost of operations of $79.2 million by deducting non-budgetary resources, costs not requiring resources, and financing sources yet to be provided.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

This section provides information on NRC's compliance with the:

- A. Federal Managers' Financial Integrity Act of 1982.
- B. Federal Financial Management Improvement Act of 1996.
- C. Prompt Payment Act.
- D. Debt Collection Improvement Act of 1996.
- E. Biennial Review of User Fees.
- F. Inspector General Act of 1978.
- G. Other key legal and regulatory requirements.

> INTEGRITY ACT STATEMENT
>
> The U.S Nuclear Regulatory Commission evaluated its management controls and financial management systems for FY 2002, 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
> December 24, 2002

Federal Managers' Financial Integrity Act

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 Governmentwide standards.

Management Control Review Program

Managers throughout the NRC are responsible for ensuring that effective controls are implemented in their areas of responsibilities. Each office director and regional administrator prepared an annual assurance statement that identified any control weaknesses that required the attention of an executive review committee. These statements were based on various sources and included:

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

A committee of agency executives, 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 participating as advisors, met and reviewed these individual assurance statements. The committee then advised the Chairman whether NRC had any management control deficiencies serious enough to be reported as a material weakness or material non-compliance.

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.

FY 2002 Integrity Act Results

The NRC evaluated its management control systems for the fiscal year ending September 30, 2002. 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, NRC's implementation of managerial cost accounting (SFFAS Number 4) was identified as a significant weakness that merits the attention of senior management. A prior-year deficiency on implementation of accounting for internal use software (SFFAS Number 10) was eliminated as a significant weakness.

The implementation of managerial cost accounting was reported as a significant weakness last year and continues to receive the close attention of senior management. Significant progress was made during FY 2002. A cost accounting system was implemented using commercial off-the-shelf software and quarterly internal cost reports were provided to agency managers as additional input to their decision making activities. The agency will continue to refine its use of cost accounting.

Federal Financial Management Improvement Act

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.

FY 2002 Improvement Act Results

As of September 30, 2002, the NRC evaluated its seven financial systems: the Federal Financial System (FFS), Human Resources Management System (HRMS), Managerial Cost Accounting, Capitalized Property System, License Fee Bill Generator System, Allotment/Financial Plan System, and Budget Formulation System. The NRC evaluated its financial management systems to determine if they complied with applicable Federal requirements and accounting standards required by the Improvement Act.

The Chairman of the NRC determined that as of September 30, 2002, NRC financial management systems were in substantial compliance with Federal financial management system requirements, except for instances where the managerial cost accounting system did not fully meet Governmentwide financial management systems requirements. In making his determination, the Chairman considered all the information available to him, including the Executive Committee on Management Control's report on the effectiveness of internal controls and OIG audit reports. He also considered the results of the financial management systems reviews conducted by the agency.

A remediation plan of corrective actions is under development, and it will include the following tasks to improve the managerial cost accounting system:

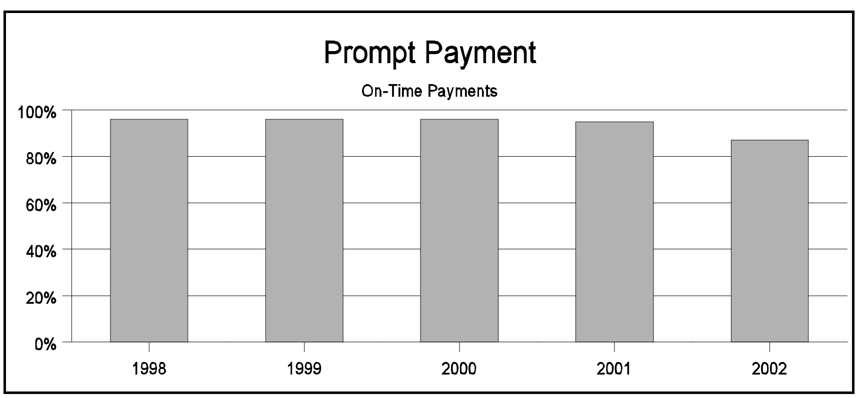
1. Complete correction of deficiencies identified during the development and evaluation of the Security Plan Risk Assessment and Business continuity Plan.

2. Perform a post-implementation assessment of the system, identify areas for improved efficiency and effectiveness, and take appropriate action.

3. Continue with cost management improvement activities related to assessing and refining the agency's needs for cost information.

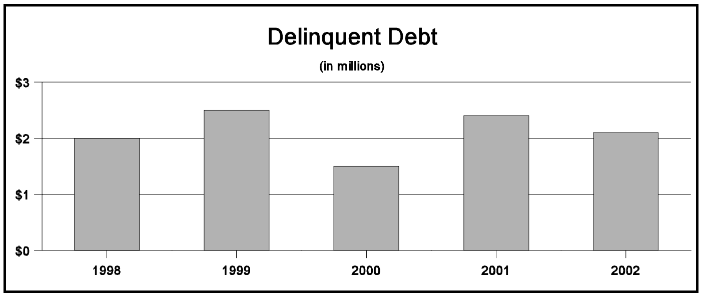
Prompt Payment

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 2001 to FY 2002, the NRC had a decrease of 2,201 invoices (from 8,745 to 6,544) that were paid and subject to the Prompt Payment Act. For FY 2002, the NRC made 87 percent of its payments on-time that were subject to the Prompt Payment Act. The amount of interest penalties incurred during FY 2002 were $6,992, which is an increase over the FY 2001 amount of $3,151. The increase in interest penalties and decrease in prompt payment performance was due to severe mail disruptions caused by the National emergency as a result of the Anthrax contamination of post offices that processed NRC mail. The agency made over 99 percent of its vendor payments electronically.



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 year-end 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 2002 was $2.0 million. This is a decrease of $0.4 million over FY 2001; however, it reflects an increase in the number of outstanding receivables from 208 to 280. 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.



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 2001 and FY 2002, 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, as amended. The most recent changes to the license, inspection, and annual fees are described in the *Federal Register* (67 FR 42612, June 24, 2002). 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 fees based on average number of hours. Reviews of other types of fees concluded that fee revisions were not warranted at this time.

Treasury Performance Measure Summary

Treasury has five key elements for measuring how agencies complied with reporting requirements for FACTS I (trial balance) and intragovernmental activity. Overall for FY 2001, NRC complied with the five reporting elements for timely reporting, reconciliation of beginning and ending net position differences, reliability of FACTS I reporting, consistency of audited financial statements to FACTS I reporting, and intragovernmental activity for elimination of differences. Treasury has not issued its FY 2002 Performance Measure Summary.

Inspector General Act

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.

Improper Payments

The General Accounting Office (GAO) reported that improper payments are a widespread and significant problem in the Federal Government. The NRC was requested to evaluate its own internal controls and to implement those strategies that are appropriate to guard against improper payments. The NRC's evaluation disclosed that its instances of improper payments was minimal and that NRC has effective management controls designed to prevent improper payments.

Payment data for the period October 2001to September 2002 was collected and analyzed to determine the number and dollar value of improper payments compared to total payments made. The results showed that there were 100 improper payments out of 103,724 total payments, or 0.1 percent. The dollar value of improper payments were $135,626 out of $409,728,369 total dollars, or 0.03 percent. This data supports NRC's initial assessment that improper payments are an area of low management control risk. The agency will continue to monitor improper payments.

INDEPENDENT AUDITORS’ REPORT

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, 2002 and 2001, 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 audit provides a reasonable basis for our opinion.

MATTERS FOR EMPHASIS

Classification of Costs

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, provides 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. Furthermore, OMB Bulletin 01-09 requires that the Statement of Net Cost be presented using full program costs by output. The agency uses a program definition referred to as a strategic arena, which does not readily reflect or provide linkage to the NRC's outputs.

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 approximately $54.4 and $46.6 million, respectively for the years ended September 30, 2002 and 2001 of reimbursed expenses. 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, 2002 and 2001, 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.B. of the Notes to the Principal Statements, OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, redefined the form of the principal statements and the content of the entity's budget resources that are includable in the principal statements, thereby causing a change in reporting entity. Accordingly, the principal statements for the period and year ended September 30, 2001, have been restated to conform to the September 30, 2002, presentation.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Management Discussion and Analysis and the required supplementary information on pages 44-45 is not a required part of the financial statements but is information required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.* 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 December 13, 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.

December 13, 2002

FINANCIAL STATEMENTS, ACCOMPANYING NOTES and REQUIRED SUPPLEMENTARY INFORMATION

LIMITATIONS OF THE FINANCIAL STATEMENTS

The principal statements have been prepared to report the financial position and results of operations of the NRC, pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. These statements have been prepared from the books and records of the NRC in accordance with the formats prescribed by the Office of Management and Budget. However, these statements differ from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The principal statements should be read with the realization that they are for a sovereign entity, liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and the payment of all liabilities other than for contracts can be abrogated by the sovereign entity. Other limitations are included in the footnotes to the principal statements.

The NRC's FY 2002 financial statements were audited by R. Navarro and Associates under contract to the NRC's Office of the Inspector General.

BALANCE SHEET

(Dollars in Thousands)

As of September 30,	**2002**	Restated 2001
Assets		
Intragovernmental		
Fund balances with Treasury (Note 2)	**$ 181,449**	$ 140,465
Accounts receivable (Note 3)	**2,031**	2,549
Other	**1,141**	1,144
Total intragovernmental	**184,621**	144,158
Cash and other monetary assets	**20**	20
Accounts receivable, net (Note 3)	**42,774**	48,905
Property and equipment, net (Note 4)	**36,922**	43,788
Other	**20**	15
Total Assets	**$ 264,357**	$ 236,886
Liabilities		
Intragovernmental		
Accounts payable	**$ 8,411**	$ 12,734
Other (Notes 5 and 6)	**49,157**	56,411
Total intragovernmental	**57,568**	69,145
Accounts payable	**19,996**	15,774
Federal employees benefits (Notes 1.K. and 6)	**9,062**	10,849
Other liabilities (Note 5)	**49,869**	47,445
Total Liabilities	**136,495**	143,213
Net Position		
Unexpended appropriations	**128,336**	86,980
Cumulative results of operations (Note 8)	**(474)**	6,693
Total Net Position	**127,862**	93,673
Total Liabilities and Net Position	**$ 264,357**	$ 236,886

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,	**2002**	Restated 2001
Nuclear Reactor Safety		
Intragovernmental gross costs	**$ 102,729**	$ 101,541
Less: Intragovernmental earned revenue	**(22,914)**	(20,820)
Intragovernmental net costs	**79,815**	80,721
Gross costs with the public	**259,855**	233,995
Less: Earned revenues from the public	**(383,157)**	(372,513)
Net costs with the public	**(123,302)**	(138,518)
Total Net Cost of Nuclear Reactor Safety	**(43,487)**	(57,797)
Nuclear Materials Safety		
Intragovernmental gross costs	**21,956**	19,851
Less: Intragovernmental earned revenue	**(4,748)**	(4,555)
Intragovernmental net costs	**17,208**	15,296
Gross costs with the public	**64,852**	59,292
Less: Earned revenues from the public	**(43,375)**	(45,223)
Net costs with the public	**21,477**	14,069
Total Net Cost of Nuclear Materials Safety	**38,685**	29,365
Nuclear Waste Safety		
Intragovernmental gross costs	**22,107**	24,160
Less: Intragovernmental earned revenue	**(1,762)**	(1,119)
Intragovernmental net costs	**20,345**	23,041
Gross costs with the public	**66,609**	61,931
Less: Earned revenues from the public	**(14,793)**	(17,517)
Net costs with the public	**51,816**	44,414
Total Net Cost of Nuclear Waste Safety	**72,161**	67,455
International Nuclear Safety Support		
Intragovernmental gross costs	**4,782**	6,151
Less: Intragovernmental earned revenue	**(329)**	-
Intragovernmental net costs	**4,453**	6,151
Gross costs with the public	**9,470**	7,695
Less: Earned revenues from the public	**(2,034)**	(2,233)
Net costs with the public	**7,436**	5,462
Total Net Cost of International Nuclear Safety Support	**11,889**	11,613
Net Cost of Operations	**$ 79,248**	$ 50,636

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,	**2002**		Restated 2001	
	Cumulative Results	**Unexpended Appropriations**	Cumulative Results	Unexpended Appropriations
Beginning Balances	**$ 6,693**	**$ 86,980**	$ 9,078	$ 87,073
Prior Period Adjustment (Note 13)	-	-	-	141
Beginning balances, as adjusted	**6,693**	**86,980**	9,078	87,214
Budgetary Financing Sources				
Appropriations received	**-**	**535,430**	-	465,800
Appropriations transferred-in/out	**-**	**(448,676)**	-	(428,920)
Other adjustments	**-**	**(430)**	-	(27)
Appropriations used	**44,968**	**(44,968)**	37,087	(37,087)
Non-exchange revenue	**1,354**	**-**	657	-
Transfers-in/out without reimbursement	**(1,354)**	**-**	(657)	-
Other Financing Sources				
Imputed financing from costs absorbed by others	**18,780**	**-**	17,209	-
Other	**8,333**	**-**	(6,045)	-
Total financing sources	**72,081**	**41,356**	48,251	(234)
Net Cost of Operations	**(79,248)**	**-**	(50,636)	-
Ending Balances	**$ (474)**	**$ 128,336**	$ 6,693	$ 86,980

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,	**2002**	Restated 2001
Budgetary Resources		
Budget authority		
Appropriations received	**$ 535,430**	$ 465,800
Net transfers	**23,650**	21,466
Unobligated balances	**-**	-
Beginning of period	**26,747**	28,580
Spending authority from offsetting collections	**-**	-
Reimbursements earned	**5,845**	5,194
Change in unfilled customer orders	**201**	(1,042)
Total Spending Authority from Offsetting Collections	**6,046**	4,152
Recoveries of prior year obligations	**4,634**	7,462
Permanently not available	**(430)**	(27)
Total Budgetary Resources	**$ 596,077**	$ 527,433
Status of Budgetary Resources		
Obligations incurred (Note 12)		
Direct	**$ 553,083**	$ 497,784
Reimbursable	**5,648**	2,902
Unobligated balance	**-**	-
Apportioned	**36,179**	25,695
Exempt from apportionment	**1,167**	1,052
Total Status of Budgetary Resources	**$ 596,077**	$ 527,433
Relationship of Obligations to Outlays		
Obligated balance, net, beginning of period	**$ 104,988**	$ 99,991
Obligated balance, net, end of period		
Accounts receivable	**(539)**	(429)
Unbilled customer orders from Federal sources	**(1,788)**	(2,026)
Undelivered orders	**88,346**	58,484
Accounts payable	**50,880**	48,959
Obligated balance, net, end of period	**$ 136,899**	$ 104,988
Outlays		
Disbursements	**$ 522,314**	$ 488,545
Collections	**(6,175)**	(4,470)
Subtotal	**516,139**	484,075
Less: Offsetting Receipts	**(475,965)**	(453,348)
Net Outlays	**$ 40,174**	$ 30,727

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,	**2002**	Restated 2001
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations incurred (Note 12)	**$558,731**	$ 500,686
Less: Spending authority from offsetting collections and recoveries	**(10,680)**	(11,615)
Obligations Net of Offsetting Collections and Recoveries	**548,051**	489,071
Less: Offsetting receipts	**(475,965)**	(453,348)
Net Obligations	**72,086**	35,723
Other Resources		
Imputed financing from costs absorbed by others	**18,780**	17,209
Allocation transfer	**3,375**	2,602
Other	**8,333**	(6,045)
Net Other Resources Used to Finance Activities	**30,488**	13,766
Total Resources Used to Finance Activities	**102,574**	49,489
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	**(30,493)**	(1,239)
Resources that finance the acquisition of assets	**(2,476)**	(9,409)
Other	**364**	596
Total Resources Used to Finance Items not Part of the Net Cost of Operations	**(32,605)**	(10,052)
Total Resources Used to Finance the Net Cost of Operations	**69,969**	39,437

(Continued)

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

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in the Future Periods		
Increase in annual leave liability	**1,870**	846
(Decrease) Increase Actuarial Workers' Compensation	**(1,787)**	2,619
Increase in Unfunded Workers' Compensation	**28**	260
Increase in Unfunded Unemployment	**22**	-
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	**133**	3,725
Components not Requiring or Generating Resources:		
Depreciation and amortization	**9,146**	7,474
Total Components not Requiring or Generating Resources	**9,146**	7,474
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	**9,279**	11,199
Net Cost of Operations	**$ 79,248**	$ 50,636

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 and Restatement

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 No. 01-09, *Form and Content of Agency Financial Statements,* 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.

In accordance with OMB Bulletin 01-09, NRC made several changes to its principal financial statements and notes. Amounts for FY 2001 were restated for the new formats for the statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing and to reflect only direct, NRC appropriations. 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 which encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities, as well as test and research reactors, are operated in a manner that adequately protects public health and safety and the environment, and that safeguards special nuclear materials used in reactors.

Nuclear Materials Safety which encompasses NRC efforts to ensure that nuclear fuel cycle facilities; and academic, industrial, and medical uses of nuclear materials are handled 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 Waste Safety which encompasses NRC efforts to ensure that the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive wastes are handled in a manner that

NOTES TO PRINCIPAL STATEMENTS

adequately protects public heath and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

International Nuclear Safety Support which encompasses international nuclear safety and regulatory policy formulation, import-export licensing for nuclear materials and equipment, treaty implementation, and international information exchange.

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 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 28 years, Congress has enacted no-year appropriations, which are available for obligation by NRC until expended. The Energy and Water Development Appropriations Act, 2001, requires the NRC to recover approximately 96 percent of its new budget authority of $558.6 million by assessing fees less amounts derived from the Nuclear Waste Fund of $23.7 million, amounts received for Homeland Security of $36 million. The $558.6 million does not include $3.7 million transferred from the U.S. Agency for International Development. In addition, NRC's appropriation was reduced by $430,000 through a recission of funding in accordance with P. L. 107-206. For FY 2001, NRC recovered approximately 98 percent of its new budget authority of $487.3 million less amounts derived from the Nuclear Waste Fund of $21.6 million and $3.2 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

NOTES TO PRINCIPAL STATEMENTS

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 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 $27,000 and $133,000 at September 30, 2002, and 2001, respectively, and consist 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 at a later date. Also included in these amounts are 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 at a later date.

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

NOTES TO PRINCIPAL STATEMENTS

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, 2002, and 2001, respectively.

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 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 benefits was 5.20 percent for FY 2002 and 5.21 percent for FY 2001.

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). For FY 2002 and FY 2001, employees belonging to FERS, the NRC withheld 0.8 percent of base pay earnings, in addition to Federal Insurance Contribution Act

NOTES TO PRINCIPAL STATEMENTS

(FICA) withholdings, and matched the withholdings with a 10.7 percent contribution. The sum is transferred to the Federal Employees Retirement Fund. For employees covered by CSRS, NRC withholds 7 percent of base pay earnings. The NRC matches this withholding with an 8.51 percent contribution.

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 percentage of base pay that an employee participating in FERS may contribute is 12 percent in calendar year (CY) 2002, and 11 percent in CY 2001. Employees belonging to CSRS may contribute up to 7 percent of their salary in CY 2002, but there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan is $11,000 in the CY 2002 portion of FY 2002 and $10,500 in the CY 2001 portion of FY 2002. The sum of the employees' and NRC's contributions are transferred to the Federal Retirement Thrift Investment Board.

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 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 Intra-governmental Payment and Collection (IPAC) System. The IPAC 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.

NOTES TO PRINCIPAL STATEMENTS

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)	2002	2001
Fund Balances		
Appropriated funds	**$ 174,226**	$ 131,716
Allocation transfers	**6,941**	5,872
Other fund types	**282**	2,877
Total	**$ 181,449**	$ 140,465
Status of Fund Balance with Treasury		
Unobligated Balance		
Available		
Appropriated funds	**$ 37,346**	$ 26,747
Allocation transfers	**1,809**	1,570
Unavailable	**612**	587
Obligated balance not yet disbursed	**141,682**	111,561
Total	**$ 181,449**	$ 140,465

NOTE 3. ACCOUNTS RECEIVABLE

(In thousands)	2002	2001
Intragovernmental		
Receivables and reimbursements	**$ 2,031**	$ 2,549
Receivables with the Public		
Materials and facilities fees - billed	**$ 4,166**	$ 10,445
Materials and facilities fees - unbilled	**41,185**	41,300
Other (Penalties and Interest)	**94**	222
Total Accounts Receivable	**45,445**	51,967
Less: Allowance for uncollectible accounts	**(2,671)**	(3,062)
Accounts Receivable, Net	**$ 42,774**	$ 48,905

NOTES TO PRINCIPAL STATEMENTS

NOTE 4. PROPERTY AND EQUIPMENT, NET

(In thousands)

Fixed Assets Class	Service Years	Acquisition Value	Accumulated Depreciation and Amortization	2002 Net Book Value	2001 Net Book Value
Equipment	5-8	$ 18,548	$ (16,552)	**$ 1,996**	$ 2,819
ADP software	5	64,557	(40,839)	**23,718**	14,475
ADP software under development	-	390	-	**390**	14,707
Leasehold improvements	20	19,805	(9,102)	**10,703**	11,629
Leasehold improvements in progress		115	-	**115**	158
		$ 103,415	$ (66,493)	**$ 36,922**	$ 43,788

NOTE 5. OTHER LIABILITIES

(In thousands)	2002	2001
Intragovernmental liability to offset net accounts receivable for fees assessed	**$ 44,177**	$ 50,813
Liability from fees collected which will offset subsequent year's appropriations	**-**	1,724
Liability to offset miscellaneous accounts receivable	**27**	133
Liability for advances from other agencies	**845**	-
Accrued workers' compensation	**1,809**	1,780
Accrued unemployment compensation	**22**	-
Employee benefit contributions	**2,277**	1,961
Total Intragovernmental Other Liabilities	**$ 49,157**	$ 56,411

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)	2002	2001
Accrued annual leave	**$ 28,343**	$ 26,473
Accrued salaries	**18,092**	16,143
Contract holdbacks, advances, and other	**3,434**	4,829
Total Other Liabilities	**$ 49,869**	$ 47,445

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

NOTES TO PRINCIPAL STATEMENTS

NOTE 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

(In thousands)	2002	2001
Intragovernmental		
FECA paid by DOL	**$ 1,809**	$ 1,780
Accrued unemployment compensation	**22**	-
Federal Employee Benefits		
Future FECA	**9,062**	10,849
Other		
Accrued annual leave	**28,343**	26,473
Capital lease liability	**80**	167
Total Liabilities not Covered by Budgetary Resources	**$ 39,316**	$ 39,269

NOTE 7. LEASES

(In thousands)
Future Lease Payments Due:

Fiscal Year	Capital	Operating	2002	2001
2002	$ -	$ -	**$ -**	$ 19,598
2003	78	20,415	**20,493**	19,550
2004	2	20,505	**20,507**	19,565
2005	-	20,372	**20,372**	19,431
2006	-	19,560	**19,560**	18,619
2007 and thereafter	-	132,494	**132,494**	120,205
Total	80	213,346	**213,426**	216,968
Less: imputed interest	(2)	-	**(2)**	(9)
Total Future Lease Payments	$ 78	$ 213,346	**$ 213,424**	$ 216,959

NOTE 8. CUMULATIVE RESULTS OF OPERATIONS

(In thousands)	2002	2001
Future funding requirements	**$ (39,236)**	$ (39,102)
Investment in property and equipment, net	**36,922**	43,788
Contributions from foreign cooperative research agreements	**1,819**	1,984
Other	**21**	23
Cumulative Results of Operations	**$ (474)**	$ 6,693

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 2002, and 2001. 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.

NOTES TO PRINCIPAL STATEMENTS

NOTE 9. EXCHANGE REVENUES

(In thousands)	**2002**	2001
Fees for licensing, inspection, and other services	**$ 467,632**	$ 459,392
Revenue from reimbursable work	**5,480**	4,588
Total Exchange Revenues	**$ 473,112**	$ 463,980

NOTE 10. BUDGET FUNCTIONAL CLASSIFICATION

(In thousands)

Functional Classification	Gross Cost	Earned Revenue	2002 Net Cost	2001 Net Cost
276 - Energy Information, Policy, & Regulation	$ 549,549	$ 472,842	**$ 76,707**	$ 47,852
150 - AID International Affairs	2,811	270	**2,541**	2,784
Total	$ 552,360	$ 473,112	**$ 79,248**	$ 50,636

Intragovernmental

Functional Classification	Gross Cost	Earned Revenue	2002 Net Cost	2001 Net Cost
276 - Energy Information, Policy, & Regulation	$ 148,763	$ 29,483	**$ 119,280**	$ 123,559
150 - AID International Affairs	2,811	270	**2,541**	1,650
Total	$ 151,574	$ 29,753	**$ 121,821**	$ 125,209

NOTE 11. FINANCING SOURCES OTHER THAN EXCHANGE REVENUE

(In thousands)
Appropriated Funds Used

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

	2002	2001
Appropriated funds consumed	**$ 520,933**	$ 490,435
Less: collection from fees assessed	**(475,965)**	(453,348)
Appropriation used	**$ 44,968**	$ 37,087

Appropriated funds consumed includes $26.7 million and $28.6 million through September 30, 2002, and 2001, respectively, of available funds from prior years.

NOTES TO PRINCIPAL STATEMENTS

Non-Exchange Revenue

	2002	2001
Civil penalties	**$ 453**	$ 345
Miscellaneous receipts	**901**	312
Total Non-Exchange Revenue	**$ 1,354**	$ 657

The miscellaneous receipts received during FY 2002 included approximately $554,000 received from the Trust Estate of the Moab Mill Reclamation Trust Agreement. The receipts resulted from an agreement between the State of Utah and NRC where it was agreed that each party would receive 50 percent of the proceeds from the trust.

Imputed Financing

	2002	2001
Civil Service Retirement System	**$ 9,934**	$ 9,676
Federal Employee Health Benefit	**8,788**	7,486
Federal Employee Group Life Insurance	**49**	47
U.S. Treasury Judgment Fund	**9**	-
Total Imputed Financing	**$ 18,780**	$ 17,209

Transfers In/Out

	2002	2001
Transfers out to Treasury		
License Fees	**$ 475,965**	$ 453,348
Non-exchange revenue	**1,354**	657
Total Transfer-Out to Treasury	**$ 477,319**	$ 454,005

NOTE 12. TOTAL OBLIGATIONS INCURRED

(In thousands)

The Total Obligations Incurred consist of the following:

	2002	2001
Direct Obligations		
Category A	**$ 529,517**	$ 476,184
Exempt from Apportionment	**23,566**	21,600
Total Direct Obligations	**553,083**	497,784
Reimbursable Obligations	**5,648**	2,902
Total Obligations Incurred	**$ 558,731**	$ 500,686

Obligations exempt from apportionment are the result of funds derived from the Nuclear Waste Fund. Category A Obligations consist of NRC appropriations only.

NOTES TO PRINCIPAL STATEMENTS

NOTE 13. PRIOR-PERIOD ADJUSTMENT

The prior-period adjustment of approximately $141,000 represents the reversal of previously recorded expended appropriations related to contract close-outs and contract hold-backs. The adjustment increased unexpended appropriations by approximately $141,000, decreased accounts payable by approximately $85,000, and decreased other liabilities by approximately $56,000.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF INTRAGOVERNMENTAL ASSETS AND LIABILITIES
(Dollars in Thousands)

As of September 30	**2002**	2001
Intragovernmental Assets		
Fund Balance with Treasury		
Department of the Treasury	**$ 181,449**	$ 140,465
Accounts Receivable		
Tennessee Valley Authority	**1,197**	1,283
Department of Energy	**412**	817
Other Agencies	**422**	449
Total Accounts Receivable	**2,031**	2,549
Other Assets		
Department of Commerce	**360**	29
Department of Interior	**1**	486
Department of the Navy	**19**	11
Department of Labor	**204**	256
General Services Administration	**520**	329
Other Agencies	**37**	33
Total Other Agencies	**1,141**	1,144
Total Intragovernmental Assets	**$ 184,621**	$ 144,158

As of September 30	**2002**	2001
Intragovernmental Liabilities		
Accounts Payable		
General Services Administration	**$ 3,157**	$ 7,841
Department of Energy	**4,500**	4,082
Other Agencies	**754**	811
Total Accounts Payable	**8,411**	12,734
Other Liabilities		
Department of Labor	**1,831**	1,781
Department of the Treasury - General Fund	**44,177**	52,670
Office of Personnel Management	**2,277**	1,960
Other Agencies	**872**	-
Total Other Liabilities	**49,157**	56,411
Total Intragovernmental Liabilities	**$ 57,568**	$ 69,145

SCHEDULE OF BUDGETARY RESOURCES
(Dollars in Thousands)

For the year ended September 30, 2002

	X0200	X0300	Total
Budgetary Resources			
Budget authority			
Appropriations received	$ 529,250	$ 6,180	**$ 535,430**
Net transfers	23,650	-	**23,650**
Unobligated balances			
Beginning of period	26,027	720	**26,747**
Spending authority from offsetting collections			
Reimbursements earned	5,833	12	**5,845**
Change in unfilled customer orders	201	-	**201**
Total Spending Authority from Offsetting Collections	6,034	12	**6,046**
Recoveries of prior year obligations	4,384	250	**4,634**
Permanently not available	(430)	-	**(430)**
Total Budgetary Resources	$ 588,915	$ 7,162	**$ 596,077**
Status of Budgetary Resources:			
Obligations incurred			
Direct	$ 546,855	$ 6,228	**$ 553,083**
Reimbursable	5,648	-	**5,648**
Unobligated balance			
Apportioned	35,245	934	**36,179**
Exempt from apportionment	1,167	-	**1,167**
Total Status of Budgetary Resources	$ 588,915	$ 7,162	**$ 596,077**
Relationship of Obligations to Outlays:			
Obligated balance, net, beginning of period	$ 104,078	$ 910	**$ 104,988**
Obligated balance, net end of period:			
Accounts receivable	(527)	(12)	**(539)**
Unbilled customer orders from Federal sources	(1,788)	-	**(1,788)**
Undelivered orders	87,808	538	**88,346**
Accounts Payable	50,475	405	**50,880**
Obligated balance, net , end of period	$ 135,968	$ 931	**$ 136,899**
Outlays:			
Disbursements	$ 516,369	$ 5,945	**$ 522,314**
Collections	(6,175)	-	**(6,175)**
Subtotal	510,194	5,945	**516,139**
Less: Offsetting Receipts	(470,032)	(5,933)	**(475,965)**
Net Outlays	$ 40,162	$ 12	**$ 40,174**

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

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

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, 2002, 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. Accordingly, we considered NRC's internal control over financial reporting by 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 control in place as of September 30, 2002.

Because of inherent limitations in internal control, 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, 2002, are in compliance with the internal control objectives defined in OMB Bulletin No. 01-02 is not fairly stated. Management did not identify managerial cost accounting as a material weakness.

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* is considered a material weaknesses and a substantial non-compliance with the Federal Financial Management Improvement Act (FFMIA).

Current Year Comments

A. Managerial Cost Accounting

During fiscal year (FY) 1998, we identified the lack of compliance with the implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards.* At that time, the NRC's Chief Financial Officer (CFO) responded to the condition by developing a remediation plan to implement cost accounting. The plan contained milestones for developing a cost accounting system. The remediation plan strategy has changed to reflect tasks planned and accomplished. The most recent revision of the plan was issued May 31, 2001.

During FY 2002, the agency made progress by issuing preliminary reports to managers, and by initiating a dialogue with agency managers on the adequacy and usefulness of the reports provided. In May 2002, the CFO asserted completion of the remediation actions and implementation of a cost accounting system.

Although the agency has made progress, the cost accounting reporting system does not meet the requirements of SFFAS No. 4. Furthermore, the system does not contain fundamental management controls as required by the Joint Financial Management Improvement Program (JFMIP) guidelines (JFMIP includes the requirements of OMB Circulars A-123, A-127 and A-130) and GAO's *Standards for Internal Control in the Federal Government*.

SFFAS No. 4 Standards

The executive summary of SFFAS No. 4 discusses three key elements to assist Federal managers in implementing the standard and migrating to cost management. Those elements include:

- A discussion of the purposes of cost accounting. The purposes would generally drive the system's objectives and include using cost accounting for budgeting and cost control, performance measurement, setting fees, program evaluation, and making economic choice decisions.

- Five standards that form the framework against which the system should be measured to ensure that all aspects of the Federal Accounting Standards Advisory Board's (FASAB) guidance are considered and incorporated.

- Cost accounting concepts provided by FASAB to enable agencies to gain perspective on the relationships among cost, financial, and budgetary data.

Our assessment of the cost accounting reporting system focused on the adequacy of the reporting system in meeting the five SFFAS No. 4 standards. The table below describes our assessment:

Standard ***(References To SFFAS No. 4 In Italics)***	**Present System Design**	**Conclusion**
Requirement for Cost Accounting: Agencies should accumulate and report the costs of their activities on a regular basis. The standard defines on a "regular basis" as continuously, routinely and consistently for management information purposes. *(Paragraph 68)*	Reports are accumulated and provided to managers. Reports were prepared for quarterly periods. FY 2002 was the first year of implementation.	NRC determined that quarterly reports was an adequate reporting interval. Reports to managers were issued approximately 60 days after each quarter's end, thereby precluding managers from access to timely information for decision-making. Thus, the standard was not met.
Responsibility Segments: Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. *(Paragraphs 78 and 79)*	Management defined responsibility segments as strategic arenas (SA). NRC defines outputs as planned accomplishments (PA). PAs range from activities such as managing diversity to license renewal inspections.	NRC's cost accounting was not designed to link responsibility segments to measurable costs of outputs. Full cost is accumulated at a SA rather than at the output (PA) level. Full cost accumulation for outputs (PAs) is not part of the current system's cost assignment design, thereby precluding compliance with the standard.
Full Cost: Reporting entities should report the full cost of outputs in general purpose financial reports. *(Paragraph 89)*	Management did not develop or report the full cost of outputs. NRC defines outputs as a PA, but accumulates full cost at the SA level.	The system was not designed to assign and distribute full costs to PAs (i.e., NRC outputs). Full cost assignment is performed at a higher level. Thus, the standard was not met.
Inter-Entity Costs: Each entity should incorporate the full cost of goods and services it receives from other entities. *(Paragraphs 105 and 106)*	The costs of programs operated jointly with others are tracked in the general ledger and not specifically in the cost accounting system.	The system does not address inter-entity costs. Presently, inter-entity costs are identifiable at the object class level in the general ledger's source journals. However, inter-entity costs are not a significant activity of the agency. Thus, assessment of this standard was not necessary.
Costing Methodology: The full cost of resources that directly or indirectly contribute to the production of outputs should be assigned through a cost assignment methodology. *(Paragraphs 116, 117, and 120)*	Management uses a hybrid activity based costing (ABC) approach, which includes allocations of support costs. Cost accumulations and assignments are performed for SAs.	The costing methodology used by the agency is a hybrid between cause and effect and ABC, which is acceptable. However, the assignment of full costs is not taken down to the output (i.e., PA) level. Thus, the system design does not accumulate costs of production of outputs, thereby precluding compliance with the standard.

The reporting system did not comply with requirements 1, 2, 3, and 5 of SFFAS No. 4.

In addition, we assessed the extent of the reporting system's compliance with JFMIP's requirements prescribed in Managerial Cost Accounting System Requirements, and the system's management controls as required by GAO's *Standards for Internal Control in the Federal Government*.

JFMIP Requirements

For FY 2002 the cost accounting reporting system does not fully meet JFMIP guidelines, specifically those related to information and functional requirements. For example, 1) the agency did not develop information system controls to minimize manual or ad hoc processes to gather and process files, and 2) the agency did not develop system security, backup or access controls.

The agency's internal system accreditation process, as performed by the Chief Information Officer (CIO), identified 11 "priority" areas associated with the system's information system requirements. Of the 11 issues raised, three were considered "high priority" since they directly impacted on business continuity, security/access controls and documentation and testing of the reporting system. Subsequent to year-end, the agency initiated a project to address the three high priority items. In addition, our review of system documentation and observations of the reporting system processing protocols disclosed that user manuals do not reflect the procedures used to collect and process information. As a result, the reporting system is not in compliance with the JFMIP and the related OMB financial system circulars previously cited.

GAO Standards for Internal Control in the Federal Government.

Our assessment of the cost accounting system in place during the year also considered the design and implementation of sound management controls over the system. We noted that fundamental general and application controls over information processing (previously discussed), audit trails, segregation of duties, access restrictions, accuracy of system operating and user documentation were not in place. The lack of these elements of internal control precludes the agency from meeting the requirements of GAO's *Standards for Internal Control in the Federal Government.*

For example, the NRC's cost accounting reporting system does not have an audit trail to the Statement of Net Cost. As presently designed, the system collects information from the existing general ledger and Human Resources Management System (HRMS), where transactions are traceable to the agency's standard general ledger structure. Once the information is collected, the system performs the strategic arena allocations. Strategic arenas are the NRC's program categories used for preparing the Statement of Net Cost. Approximately 54.5% ($301 million) of the NRC's costs are subject to allocation.

As information moves through the system and is allocated to offices and strategic arenas, the system does not produce reports, matrices, or crosswalks to support the allocation process. There should be three steps in this process. First, there should be linkage to the legacy systems. Second, the system should produce reports, matrices, or crosswalks that show the cost allocation. Third, the system should provide reports showing fully allocated costs to the strategic arena level. The system accomplishes the first and third steps; however, there is no second step (audit trail) to link the cost data to the final allocations in the third step.

GAO's *Standards for Internal Control in the Federal Government,* states, "Internal Control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories...reliability of financial reporting, including reports on ...financial statements, and other reports for internal and external use." Thus, the lack of an audit trail causes undue risk to the agency in demonstrating the reliability of the Statement of Net Cost.

In summary, the agency has made great strides in cost reporting. However, the management control infrastructure necessary to ensure routine, reliable and consistent cost information, as required by accounting standards, JFMIP and OMB circulars was not in place. Despite the reporting system's deficiencies, we employed alternative audit procedures to verify the reasonableness of the allocations used to derive the Statement of Net Cost.

This issue results in a substantial non-compliance with the Federal Financial Management Improvement Act and a material weakness.

Recommendation

1. The CFO should develop a remediation plan to address design and infrastructure improvements needed for the cost accounting system. The CFO's plan should include the basic areas of emphasis which follow:

   – Compliance with the SFFAS No. 4 - each of the five standards should be reassessed separately from both an internal information needs perspective (i.e. special purpose reports to managers) and from a financial reporting perspective (i.e. financial discipline necessary for the preparation of the Statement of Net Cost). These two views may enable the CFO to improve compliance with the standard and demonstrate responsiveness to managers' decision-making needs and improve financial reporting.

   – JFMIP compliance - include an internal assessment of JFMIP compliance. This internal assessment should be performed by a team that was not directly involved in the design or development to provide the CFO an unbiased look at the system's compliance. The independent team might also be well served to have a person from OCIO to assess system limitations.

   – Internal Control - this area of emphasis should have a two-fold approach. First, the documentation related to operating and user manual should be updated, other members of the OCFO staff should be trained on the system's use to serve as backup for the existing personnel, and general and application controls should be revisited for completeness and operating efficiency. Second, electronic tools, databases, reports, etc., should be developed to provide an adequate audit trail to the Statement of Net Cost.

CFO's Comments

While the CFO agrees that more needs to be done to achieve compliance with SFFAS No. 4, he continues to describe the efforts that have taken place to get the agency to this point. The CFO agrees in part with our comment and stated, "The OCFO will prepare a remediation plan describing improvements that will be made to the cost accounting system. In developing the plan, we will look at SFFAS No. 4, JFMIP and OMB financial system guidelines, and GAO internal control standards. The remediation plan will be completed by February 14, 2003."

Auditors' Position

We commend the CFO for proposing to develop remediation actions to address the weaknesses described in our comment regarding managerial cost accounting. The remediation plan should clearly and concisely address each remediation action to assure that the path taken by the CFO to achieve compliance with the standard, JFMIP system requirements, and internal control standards are fully considered and addressed. This condition is unresolved pending development of a remediation plan that meets federal accounting standards and systems requirements.

B. External Reporting

OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires the issuance of interim financial statements. Interim financial statements were required for the six-month period ended March 31, 2002. The bulletin requires the submission of a Balance Sheet, Statement of Net Cost and Statement of Budgetary Resources. The bulletin instructs reporting entities to ensure that information in the financial statements is prepared in accordance with Federal generally accepted accounting principles (GAAP) and the requirements of the Bulletin, and that the underlying records fully support the information. OMB's guidance also advises agency chief financial officers to develop agency policy guidance for the development of financial statements.

The NRC complied with the delivery of financial statements to OMB within the timeframe provided in the bulletin. Furthermore, the agency prepared a more complete financial statement package than required by adding the notes to the financial statements. However, the agency did not have a CFO and CIO accredited or approved financial system to support the interim Statement of Net Cost; the agency developed the interim financial statements using cost accounting data from a developmental, non-production database. This approach to reporting does not meet the OMB's requirements. Interim operational approval of the system was provided by the CFO and CIO on September 27, 2002.

Our assessment of the reliability of the cost accounting data used prior to year-end noted the following flaws impacting the reliability of the Statement of Net Cost issued for March 31, 2002:

- Data validation procedures for system output reports were not fully developed until June 2002.

- Data testing to determine whether system data was valid and reliable was not initiated until mid-July 2002.

In addition to the conditions previously discussed, the general controls over the system were not adequate for the fiscal year. The interim operational approval of the system identified "high" priorities impacting data integrity and reliability. Subsequent to year-end, the agency began addressing the conditions identified by the OCIO during the system accreditation process.

Recommendation

2. The CFO should ensure that external reports of the agency are prepared only from operational and accredited systems and supported by complete financial records.

CFO's Comment

Agree. The OCFO completed corrective actions on the three high-priority issues and received the Chief Information Officer's final certification to operate the cost accounting system on November 12, 2002. A documented audit trail for cost accounting system reports will be completed by February 14, 2003.

Auditors' Position

Although the CFO agrees with the comment made, there was no discussion of new or proposed policies or procedures that will be placed into operation to preclude relying on pre-operational applications. We commend the CFO for continuing to pursue development of an audit trail by mid-February 2003. This condition is unresolved.

C. Internal Use Software Monitoring

In 1998, FASAB issued SFFAS No. 10, *Accounting for Internal Use Software,* effective October 1, 2000. The agency developed internal guidance to implement the standard on time. NRC also developed training for agency personnel to ensure that agency personnel fully understood the policy.

SFFAS No. 10 defines three software life-cycle phases: planning, development and operations. Paragraph 16 requires, "For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the development phase." The Statement defines full cost to include salaries of programmers, project managers, administrative personnel, and associated employee benefits and outside consultants' fees.

NRC's *Internal Use Software Capitalization Policy*, dated September 18, 2000, defines capitalized software costs to include "NRC staff salary and benefit (S&B) costs of direct time spent during the development phase dedicated to managing the specific project, designing software configurations and interfaces, coding, installing on hardware, and testing/debugging."

Our assessment included each project that was in the developmental phase during FY 2002. Although one project entered the development phase during FY 2002, the agency did not capitalize the associated employee costs. We also noted that OCFO did not have proactive monitoring procedures to identify projects that began or completed the development phase. The GAO's *Standards for Internal Control in the Federal Government* state, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations."

According to OCFO policy, before a project can advance from the preliminary design phase to the development phase, OCIO must approve the project. Typically, OCIO sends a memo to the project manager advising that the proposed investment has been approved and the project can move into the development phase. Under NRC policies, it is then the responsibility of the individual offices to (1) inform OCFO that they are going to begin a software development project, and (2) request a labor code for tracking employee hours. The referenced project was approved to move into the development phase on August 9, 2001, and a labor code was created to track employee hours.

Subsequently, the project manager began development activities in February 2002, and other agency personnel began development activities in early July 2002. We began our review in late July 2002, and noted that employees were not charging time to the assigned labor code because the project manager did not believe the activities qualified as development. Our assessment indicates that the activities and associated hours should have been captured and capitalized.

Under the present management control structure, the OCFO relies primarily on project managers to inform them of time and costs expended in the software development phase. OCFO does not have sufficient proactive monitoring procedures in place to ensure the completeness or reasonableness of the information provided.

Recommendation

3. The CFO should implement policy and procedures to independently determine project status for software capitalization purposes. Use of a project tracking mechanism or regular access to project status reports would enhance the awareness of projects and enable the OCFO to improve monitoring activities. This process would enable OCFO to compare those activities to the time and cost being capitalized in the agency's records.

CFO's Comments

Agree. The OCFO will modify its current procedures for monitoring approved software development projects to ensure a more proactive approach is used to monitor project status. Revised procedures will be completed by February 28, 2003.

Auditors' Position

The CFO proposal to modify its policies and procedures resolves this comment. Closure is dependent on the development and issuance of policy enhancements.

Status of Prior Years' Comments

A. Management Controls Over Small Entity Certifications

As reported in prior years, NRC did not have a validation process to ensure that materials licensees that claimed small entity status actually qualified for such status. Licensees that qualify as small entities pay reduced annual fees depending on their size (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. 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.

The CFO responded in prior years that they planned to explore the recommendations provided and that they would advise us of their results. On December 7, 2001, the agency issued a memorandum documenting an approach that would be used for FY 2002. The approach and the practices instituted are acceptable; thus, this condition is closed.

B. Accounting for Internal Use Software

In the prior year, we reported that the NRC did not have the management controls in place to demonstrate that it had satisfactorily implemented SFFAS No. 10, *Accounting for Internal Use Software.*

The CFO responded that the issues related to this condition would be remedied by implementing a new Human Resources Management System in early FY 2002. We reviewed the controls implemented as a component of the new system and have concluded that the specific issues raised in the prior year have been adequately addressed. Therefore, this condition is closed.

C. Contract Close-out Processing Procedures

In the prior year, we reported that 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 also the amounts that should be deobligated. This process is normally followed to determine the continued viability of recorded undelivered orders. We found that DCPM notified OCFO's General Accounting Branch (GAB) of amounts to be expensed. GAB then recognized the expenses without supporting documents such as contractor invoices, receiving reports or project manager certifications that the services had been performed.

In his response, the CFO indicated that GAB would ensure that all expenses recorded for contracts in closeout are supported by adequate documentation. Our follow-up review of this process indicates that GAB has not instituted a process to ensure that amounts are correctly reflected in the agency's records. This condition will be closed when the agency demonstrates that it has reviewed and corrected, as necessary, all expenses recorded for contracts in close-out.

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.

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.

December 13, 2002

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

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

We have audited the principal statements of the U. S. Nuclear Regulatory Commission (NRC) as of and for the years ended September 30, 2002 and 2001, and have issued our report thereon dated December 13, 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.

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 approximately $54.4 and $46.6 million, respectively for the years ended September 30, 2002 and 2001, of reimbursed expenses. 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.

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

Prior-Year Comments

A. 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. Follow-up and resolution actions on this issue will be tracked by OIG and reported under separate cover.

B. Part 170 Hourly Rates

As previously reported in fiscal years (FY) 1998 through 2001, the Omnibus Budget Reconciliation Act (OBRA) of 1990 requires the NRC to recover approximately 100% of its budget authority by assessing fees. (The recovery percentage has been reduced in recent years by 2% each year. During FY 2002, the recovery percentage was 96%.) 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 Part 170 services. Consistent with OBRA of 1990, 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.

The CFO has been awaiting the implementation of cost accounting to fully address this condition. During FY 2002, we performed a preliminary assessment of the OCFO's use of cost accounting information as a means to review the hourly rate calculation methodology. The OCFO stated in a memorandum dated September 30, 2002, that "…in order to use cost accounting data as input to our review, we compared components of the budget included in the hourly rate to the cost accounting data."

Our assessment indicates that the OCFO has made progress by acknowledging the need to make such a comparison. However, the agency needs to refine its approach in order to substantiate the reasonableness of rates developed on a budgetary basis. The following observations were made during our assessment:

- The methodology used to derive the cost-based number did not follow the existing methodology used to build the agency's published fee rates. The agency's normal fee rate methodology derives separate rates for reactors and materials. However, OCFO's comparison used a composite hourly rate. Such a calculation precludes comparing the individual rates.

- The cost-based rate did not use the same identifiable costs elements as those used in the budget-based model. The agency made adjustments to cost-based data for administration, FOIA, and absences using budget estimates rather than using actual cost data. Commingling cost and budgetary elements will not produce results that can be reasonably used as a basis for comparison.

We encourage the agency to reassess the approach used in the analysis provided for review and to refine the process and the cost elements to a level that will achieve comparability. Until an analysis is completed, documented and available for additional audit follow-up, the recommendation related to this condition cannot be closed.

FFMIA - Status of Prior Year Comments

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 year instances of noncompliance.

A. Managerial Cost Accounting

In FY 1998, we reported the agency's lack of implementation of Managerial Cost Accounting as both a material weakness and FFMIA substantial non-compliance. In July 1999, the agency developed a remediation plan, thereby resolving the comment. In the current year, the CFO asserted that the remediation plan had been met and therefore the agency was in compliance with SFFAS No. 4. This action closes the FY 1998 comment.

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 regarding our assessment of the NRC's new system. The system placed into operation during FY 2002 resulted in 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 2001, the issue identified with the core general ledger - Federal Financial System (FFS) operated by Treasury's Financial Management Service (FMS) remained an unresolved condition.

In the current year, NRC changed service providers to the Department of Interior's National Business Center. Therefore, the condition addressing FMS is no longer applicable and is closed.

Consistency of Other Information

NRC's overview of program performance goals and results, and other supplemental financial and management information contains 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), and the Government Information Security Reform Act.

– 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.

December 13, 2002

CHIEF FINANCIAL OFFICER

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

December 24, 2002

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

FROM: Jesse L. Funches
Chief Financial Officer
P Rabideau for

SUBJECT: DRAFT AUDIT REPORT - AUDIT OF THE NUCLEAR REGULATORY COMMISSION'S FY 2002 FINANCIAL STATEMENTS

I have reviewed the draft audit report of the Nuclear Regulatory Commission's FY 2002 Financial Statements, dated December 19, 2002. While I mostly agree with the audit report recommendations, I disagree with the report's conclusion regarding managerial cost accounting. While additional work is needed in cost accounting, it is important to recognize our progress made over the past year to implement a cost accounting program in the agency. My office has aggressively pursued appropriate business solutions for meeting cost accounting requirements associated with financial systems, fulfilling our reporting responsibilities, and meeting accounting standards.

During FY 2002, a cost accounting system was implemented using commercial off-the-shelf software. The system was used to provide agency managers with quarterly internal cost reports as additional input to their decision making activities. The system was also used to support the preparation of the Statement of Net Cost. Lastly, consistent with the flexibility built into SFFAS No.4, *Managerial Cost Accounting Standards*, I believe we have met the intent of the standards and will continue to refine our use of cost accounting in the NRC.

Our responses to the three recommendations follows.

Recommendation 1

The CFO should develop a remediation plan to address design and infrastructure improvements needed for the cost accounting system. The CFO's plan should include the basic areas of emphasis which follow:

- Compliance with the SFFAS No. 4 - each of the five standards should be reassessed separately from both an internal information needs (i.e. special purpose reports to managers) perspective and from a financial reporting (i.e. financial discipline necessary for the preparation of the Statement of Net Cost) perspective. These two views may enable the CFO to improve compliance with the standard and demonstrate responsiveness to managers' decision-making needs and to financial reporting.

- JFMIP compliance - include an internal assessment of JFMIP compliance. This internal assessment should be performed by a team that was not directly involved in the design or development to provide the CFO an unbiased look at the system's compliance. The independent team might also be well served to have a person from OCIO to assess system limitations.

- Internal Control - this area of emphasis should have a two-fold approach. First, the documentation related to operating and user manual should be updated, other members of the OCFO staff should be trained on the system' s use to serve as backup for the existing personnel, and general and application controls should be revisited for completeness and operating efficiency. Second, electronic tools, databases, reports, etc., should be developed to provide an adequate audit trail to the Statement of Net Cost.

Response

Agree in Part. The OCFO will prepare a remediation plan describing improvements that will be made to the cost accounting system. In developing the plan, we will look at SFFAS No. 4, JFMIP and OMB financial system guidelines, and GAO internal control standards. The remediation plan will be completed by February 14, 2003.

Recommendation 2

The CFO should ensure that external reports of the agency are prepared only from operational and accredited systems and supported by complete financial records.

Response

Agree. The OCFO completed corrective actions on the three high-priority issues and received the Chief Information Officer's final certification to operate the cost accounting system on November 12, 2002. A documented audit trail for cost accounting system reports will be completed by February 14, 2003.

Recommendation 3

The CFO should implement policy and procedures to independently determine project status for software capitalization purposes. Use of a project tracking mechanism or regular access to project status reports would enhance the awareness of projects and enable OCFO to improve monitoring activities. Once the project activities underway are known it would enable OCFO to compare those activities to the time and cost being capitalized in the agency's records.

Response

Agree. The OCFO will modify its current procedures for monitoring approved software development projects to ensure a more proactive approach is used to monitor project status. Revised procedures will be completed by February 28, 2003.

cc: J. Craig, AO/OEDO

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