CHAPTER 3

Financial Statements and Auditors' Report


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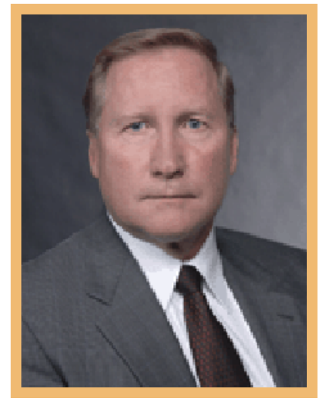

A MESSAGE FROM THE CHIEF FINANCIAL OFFICER

I am pleased to present the Nuclear Regulatory Commission's (NRC) Performance and Accountability Report for Fiscal Year 2007. Our independent auditors have once again rendered an unqualified ("clean") opinion for our financial statements, which demonstrates a continued commitment to being good stewards of taxpayers' dollars and ensuring resources are appropriately applied in support of the agency's mission.

As of September 30, 2007, the financial condition of the NRC is sound with respect to having sufficient funds to meet its mission and having adequate control of these funds to ensure our budget authority is not exceeded. As the Chief Financial Officer of the NRC, I take my responsibility for the financial health of the agency very seriously, and I am committed to continuous improvement in our financial management.

Fiscal Year 2007 was a year of great progress for two major initiatives that strengthened financial management. First and foremost, the auditors removed the material weakness finding for the legacy License Fee Billing System. This is primarily due to the extensive effort the agency has made to put in place compensating controls over the past two years that mitigate the risks inherent in the current system. Second, the NRC continued to execute OMB's revised Circular A-123, Appendix A, *Internal Control Over Financial Reporting*. NRC's FY 2007 assessment of Appendix A compliance, while conducted in greater depth with more testing than in FY 2006, again did not identify any material weaknesses. A detailed discussion of the assessment results is included in this report.

Looking to the future, we will continue to be engaged in additional initiatives designed to improve day-to-day operations and achieve long-term strategic planning goals in financial management. The most significant effort entails the replacement of several legacy systems with an integrated, Web-enabled financial management system based on commercial off-the-shelf (COTS) software. The new system will integrate the functionality of a number of current systems including: core accounting, billing, time and labor, cost accounting, and capitalized property systems into a single enterprise-wide system. NRC is currently evaluating and streamlining agency business processes to support a smooth transition to the COTS software. The process changes and replacement systems will improve efficiency and effectiveness while providing agency managers with substantially greater access to timely financial information on which to base their decisions.

To ensure that the NRC's financial assets are adequately protected and reported, the agency's goals for improved financial management include providing reliable, transparent, useful, and timely information to stakeholders and for management decisionmaking; maintaining adequate controls; and implementing integrated and flexible systems to meet the agency's reporting needs. I look forward to the upcoming year to further improve financial management at the NRC, as we make progress in achieving our goals.

William M. McCabe
Chief Financial Officer
November 15, 2007

PRINCIPAL STATEMENTS

BALANCE SHEET
(IN THOUSANDS)

As of September 30,	**2007**	2006
Assets		
Intragovernmental		
Fund balance with Treasury (Note 2)	**$ 356,399**	$ 281,715
Accounts receivable (Note 3)	**5,228**	3,904
Other - Advances and prepayments	**3,244**	2,247
Total intragovernmental	**364,871**	287,866
Accounts receivable, net (Note 3)	**88,666**	71,287
Property and equipment, net (Note 4)	**31,832**	26,915
Other	**39**	19
Total Assets	**$ 485,408**	$ 386,087
Liabilities		
Intragovernmental		
Accounts payable	**$ 9,038**	$ 8,225
Other (Note 5)	**110,797**	81,023
Total intragovernmental	**119,835**	89,248
Accounts payable	**18,672**	22,940
Federal employee benefits (Note 6)	**6,833**	7,434
Other (Note 5)	**58,877**	53,872
Total Liabilities	**204,217**	173,494
Net Position		
Unexpended appropriations	**254,027**	193,694
Cumulative results of operations (Note 8)	**27,164**	18,899
Total Net Position	**281,191**	212,593
Total Liabilities and Net Position	**$ 485,408**	$ 386,087

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

STATEMENT OF NET COST
(IN THOUSANDS)

For the years ended September 30,	**2007**	2006
Nuclear Reactor Safety		
Gross costs	**$ 582,212**	$ 515,374
Less: Earned revenue	**(612,769)**	(562,502)
Total Net Cost of Nuclear Reactor Safety (Note 9)	**(30,557)**	(47,128)
Nuclear Materials and Waste Safety		
Gross costs	**204,495**	205,221
Less: Earned revenue	**(80,490)**	(77,539)
Total Net Cost of Nuclear Materials and Waste Safety (Note 9)	**124,005**	127,682
Net Cost of Operations	**$ 93,448**	$ 80,554

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

STATEMENT OF CHANGES IN NET POSITION
(IN THOUSANDS)

For the years ended September 30,	2007	2006
Cumulative Results of Operations		
Beginning Balance	**$ 18,899**	$ (13,353)
Budgetary Financing Sources		
Appropriations used	**46,646**	50,542
Non-exchange revenue	-	590
Transfers-in/out without reimbursement	**45,826**	45,067
Other Financing Sources		
Imputed financing from costs absorbed by others	**27,627**	28,022
Other - Revenue from excess collections	**(18,386)**	(11,415)
Total Financing Sources	**101,713**	112,806
Net Cost of Operations	**(93,448)**	(80,554)
Net Change	**8,265**	32,252
Cumulative Results of Operations	**$ 27,164**	$ 18,899
Unexpended Appropriations		
Beginning Balance	**$ 193,694**	$170,836
Adjustment:		
Change in accounting principle (Note 14)	**(2,838)**	-
Beginning Balance, as adjusted	**190,856**	170,836
Budgetary Financing Sources		
Appropriations received	**109,817**	72,532
Appropriations transferred-in/out	-	1,587
Appropriations used	**(46,646)**	(50,542)
Other adjustments	-	(719)
Total Budgetary Financing Sources	**63,171**	22,858
Total Unexpended Appropriations	**254,027**	193,694
Net Position	**$ 281,191**	$ 212,593

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

STATEMENT OF BUDGETARY RESOURCES
(IN THOUSANDS)

For the years ended September 30,	2007	2006
Budgetary Resources		
Unobligated balance, brought forward, October 1	**$ 74,255**	$ 57,349
Recoveries of prior year unpaid obligations		
Actual	**5,691**	6,642
Budget authority		
Appropriation	**824,893**	742,686
Spending authority from offsetting collections		
Reimbursements earned - Collected	**4,381**	6,758
Reimbursements earned - Change in receivables	**371**	(277)
Change in unfilled customer orders - Advance received	**1,433**	(2,615)
Change in unfilled customer orders - Without advance	**(93)**	(358)
Subtotal - Spending authority from offsetting collections	**6,092**	3,508
Temporarily not available pursuant to public law	**-**	(461)
Permanently not available	**-**	(719)
Total Budgetary Resources	**$ 910,931**	$ 809,005
Status of Budgetary Resources		
Obligations incurred (Note 12)		
Direct	**$ 834,126**	$ 730,902
Reimbursable	**4,645**	3,848
Subtotal	**838,771**	734,750
Unobligated balance		
Apportioned	**45,438**	48,558
Exempt from apportionment	**26,722**	25,697
Subtotal	**72,160**	74,255
Total Status of Budgetary Resources	**$ 910,931**	$ 809,005
Change in Obligated Balance		
Obligated balance, net		
Unpaid obligations brought forward, October 1	**$ 202,446**	$ 160,291
Obligations incurred, net	**838,771**	734,750
Gross outlays	**(764,354)**	(686,588)
Recoveries of prior year unpaid obligations, actual	**(5,691)**	(6,642)
Change in uncollected customer payments, from Federal sources	**(278)**	635
Obligated balance, net, end of period		
Unpaid obligations	**274,745**	206,019
Uncollected customer payments, from Federal sources	**(3,851)**	(3,573)
Total unpaid obligated balance, net, end of period	**$ 270,894**	$ 202,446
Net outlays		
Gross outlays	**$ 764,354**	$ 686,588
Offsetting collections	**(5,814)**	(4,143)
Distributed offsetting receipts	**(669,245)**	(624,042)
Net Outlays	**$ 89,295**	$ 58,403

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

NOTES TO THE PRINCIPAL STATEMENTS

Note 1. Summary of Significant Accounting Policies
(All Tables are Presented in Thousands)

A. Reporting Entity

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

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

B. Basis of Presentation

These principal statements were prepared to report the financial position and results of operations of the NRC as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These financial statements were prepared from the books and records of the NRC in conformity with accounting principles generally accepted in the United States of America, the requirements of Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and NRC accounting policies. These statements are, therefore, different from the financial reports, also prepared by the NRC pursuant to OMB directives, which are used to monitor and control NRC's use of budgetary resources.

NRC has not presented a Statement of Custodial Activity because the amounts involved are immaterial and incidental to its operations and mission.

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 33 years, Congress has enacted no-year appropriations, which are available for obligation by NRC until expended. For FY 2007, the Revised Continuing Appropriations Resolutions Act 2007 requires the NRC to recover approximately 90 percent of its new budget authority of $824.9 million by assessing fees less amounts derived from the Nuclear Waste Fund of $45.8 million, waste incidental to reprocessing of $2.5 million, and generic homeland security of $33.0 million from P.L. 110-5. The $824.9 million does not include any amounts transferred from the U.S. Agency for International Development.

For FY 2006, NRC recovered approximately 90 percent of its budget authority of $741.5 million less amounts derived from the Nuclear Waste Fund of $45.7 million and waste incidental to reprocessing of $2.5 million.

D. Basis of Accounting

These financial statements reflect both accrual and budgetary accounting transactions. 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. Budgetary accounting is also used to record the obligation of funds prior to the accrual-based transaction. 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 from the assessment of fees. The NRC assesses two types of fees to recover its budget authority: (1) fees assessed under 10 CFR Part 170 for licensing, inspection, and other services under the authority of the Independent Offices Appropriation Act of 1952 to recover the NRC's costs of providing individually identifiable services to specific applicants and licensees; and (2) annual fees assessed for nuclear facilities and materials licensees under 10 CFR Part 171. All fees, with the exception of civil penalties, are exchange revenues in accordance with Statement of Federal Financial Accounting Standards No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

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

F. Fund Balance with Treasury

The NRC's cash receipts and disbursements are processed by the U.S. Treasury. The fund balances with the U.S. Treasury 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.

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 nonentity assets of $22 thousand and $5 thousand at September 30, 2007 and 2006, 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 costs of internal use software include the full cost of salaries and benefits from agency personnel involved in software development. 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 thousand 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.

J. Accounts Payable

Accounts payable represent vendor invoices for services received by NRC that will be paid 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 appropriation. Liabilities for which an appropriation has not been 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, 2007, and 2006, 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 were 5.17 percent for both FY 2007 and FY 2006.

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 the 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. There were no contingent liabilities in FY 2007 or FY 2006.

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 2007 and FY 2006, employees belonging to FERS, the NRC withheld 0.8 percent of base pay earnings, in addition to Federal Insurance Contribution Act (FICA) withholdings, and matched the withholdings with a 11.2 percent contribution in FY 2007 and in FY 2006. 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 matched this withholding with a 7 percent contribution in FY 2007 and FY 2006.

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 unlimited in fiscal years 2007 and 2006. Employees belonging to CSRS may contribute an unlimited percent of their salary in calendar year 2006, but there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan is $15.5 thousand in calendar year 2007 and $15.0 thousand in the calendar year 2006. 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 at NRC headquarters. For FY 2007, there are seven capital leases with terms of 5 years, consisting of: two capital leases that were added in FY 2007 with an interest rate of 4.58 percent, one capital lease that was added in FY 2006 with an interest rate of 4.25 percent, and four capital leases for FY 2005 with an interest rate of 4.18 percent. 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 Intragovernmental 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.

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 the U.S. 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.

T. Appropriation Transfer

The NRC is a party to allocation transfers with another federal agency (parent) as a receiving (child) entity. Allocation transfers are legal delegations by one agency of its authority to obligate budget authority and outlay funds to another agency. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. All financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity from which the underlying legislative authority, appropriations and budget apportionments are derived. The NRC receives allocation transfers, as the child, from U.S. Agency for International Development (USAID). These transfers are for the international development of nuclear safety and regulatory authorities in Russia, Ukraine, Kazakhstan, Georgia and Armenia for the independent oversight of nuclear reactors in these countries.

Note 2. Fund Balance With Treasury

	2007	2006
Fund Balances		
Appropriated funds	**$ 301,751**	$ 237,956
Allocation transfers	-	3,025
Nuclear Waste Fund	**41,300**	38,747
Other fund types	**13,348**	1,987
Total	**$ 356,399**	$ 281,715

Status of Fund Balance with Treasury		
Unobligated balance		
Available		
Appropriated funds	**$ 72,160**	$ 74,255
Allocation transfers	-	1,767
Unavailable	-	2,146
Obligated balance not yet disbursed	**270,894**	203,547
Non-budgetary funds with Treasury	**13,345**	-
Total	**$ 356,399**	$ 281,715

Note 3. Accounts Receivable

	2007	2006
Intragovernmental		
Receivables and reimbursements	$ 5,228	$ 3,904
Receivables with the Public		
Materials and facilities fees - billed	$ 2,533	$ 2,094
Materials and facilities fees - unbilled	90,718	72,131
Other	86	109
Total Accounts Receivable	93,337	74,334
Less: Allowance for uncollectible accounts	(4,671)	(3,047)
Accounts Receivable, Net	$ 88,666	$ 71,287

Note 4. Property And Equipment, Net

Fixed Assets Class	**Service Years**	**Acquisition Value**	**Accumulated Depreciation and Amortization**	**2007 Net Book Value**	**2006 Net Book Value**
Equipment	5-8	$ 11,957	$ (10,819)	**$ 1,138**	$ 825
Leased equipment	5-8	1,638	(797)	**841**	469
IT software	5	47,767	(43,081)	**4,686**	7,688
IT software under development	-	12,988	-	**12,988**	5,953
Leasehold improvements	20	25,019	(15,461)	**9,558**	11,158
Leasehold improvements in progress	-	2,621	-	**2,621**	822
Total		$ 101,990	$ (70,158)	**$ 31,832**	$ 26,915

Note 5. Other Liabilities

	2007	2006
Intragovernmental		
Liability to offset net accounts receivable for fees assessed	**$ 93,434**	$ 75,047
Liability from fees collected which will offset current year's appropriations	**13,340**	495
Liability to offset miscellaneous accounts receivable	**22**	5
Liability for advances from other agencies	**88**	74
Accrued workers' compensation	**1,659**	1,836
Accrued unemployment compensation	**6**	15
Employee benefit contributions	**2,248**	2,060
Liability for clearing account	-	1,491
Total Intragovernmental Other Liabilities	**$ 110,797**	$ 81,023

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.

	2007	2006
Accrued annual leave	**$ 38,327**	$ 35,989
Accrued salaries	**15,962**	13,815
Contract holdbacks, advances, and other	**4,588**	4,068
Total Other Liabilities	**$ 58,877**	$ 53,872

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

Note 6. Liabilities Not Covered By Budgetary Resources

	2007	2006
Intragovernmental		
FECA paid by DOL	**$ 1,659**	$ 1,836
Accrued unemployment compensation	**6**	15
Federal Employee Benefits		
Future FECA	**6,833**	7,434
Other		
Accrued annual leave	**38,327**	35,989
Total Liabilities not Covered by Budgetary Resources	**$ 46,825**	$ 45,274

Balance Sheet amounts represent ending balances of worker's compensation and annual leave.

Note 7. Leases

	2007	2006
Assets Under Capital Leases:		
Copiers and booklet maker	**$ 1,638**	$ 1,224
Accumulated depreciation	**(797)**	(755)
Net assets under capital leases	**$ 841**	$ 469

Future Lease Payments Due:

Fiscal Year	Capital	Operating	2007	2006
2007	$ -	$ -	**$ -**	$ 23,676
2008	214	23,233	**23,447**	16,665
2009	206	20,572	**20,778**	14,373
2010	198	20,638	**20,836**	14,421
2011	125	20,412	**20,537**	14,207
2012 and thereafter	107	41,708	**41,815**	24,419
Total	850	126,563	**127,413**	107,761
Add: Imputed Interest	86	-	**86**	32
Total Future Lease Payments	$ 936	$ 126,563	**$ 127,499**	$ 107,793

Note 8. Cumulative Results of Operations

	2007	2006
Future funding requirements	**$ (46,825)**	$ (45,274)
Investment in property and equipment, net	**31,832**	26,915
Contributions from foreign cooperative research agreements	**3,184**	2,110
Change in Nuclear Waste Fund	**38,933**	35,107
Other	**40**	41
Cumulative Results of Operations	**$ 27,164**	$ 18,899

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 2007, and 2006. These accruals are not funded from current or prior-year appropriations and assessments, but rather should be funded from future appropriations and assessments. Accordingly, future funding requirements have been recognized for the expenses that will be paid from future appropriations.

Note 9. Statement of Net Cost

The programs as presented on the Statement of Net Cost are based on the annual Performance Budget and are described as follows:

Nuclear Reactor Safety encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities and research and test reactors are licensed and operated in a manner that adequately protects the public health and safety, the environment and protects against radiological sabotage and theft or diversion of special nuclear materials. The Nuclear Reactor Safety program contains three activities – New Reactors, Reactor Licensing and Rulemaking, and Reactor Oversight and Incident Response.

Nuclear Materials and Waste Safety encompasses all NRC efforts to protect the public health and safety and the environment and ensures the secure use and management of radioactive materials. The Nuclear Materials and Waste Safety program contains five activities – Fuel Facilities, Nuclear Materials Users, High-Level Waste Repository, Decommissioning and Low-Level Waste, and Spent Fuel Storage and Transportation.

For "Intragovernmental gross costs," the buyers and sellers are both Federal entities. For "Earned revenues from the public," the buyers of the goods or services are non-Federal entities.

Note 9. Statement of Net Cost (continued)

For the years ended September 30,	**2007**	2006
Nuclear Reactor Safety		
Intragovernmental gross costs	**$ 157,582**	$ 147,028
Less: Intragovernmental earned revenue	**(36,519)**	(32,789)
Intragovernmental net costs	**121,063**	114,239
Gross costs with the public	**424,630**	368,346
Less: Earned revenues from the public	**(576,250)**	(529,713)
Net costs with the public	**(151,620)**	(161,367)
Total Net Cost of Nuclear Reactor Safety	**$ (30,557)**	$ (47,128)

Nuclear Materials and Waste Safety		
Intragovernmental gross costs	**$ 45,287**	$ 48,414
Less: Intragovernmental earned revenue	**(7,154)**	(6,901)
Intragovernmental net costs	**38,133**	41,513
Gross costs with the public	**159,208**	156,807
Less: Earned revenues from the public	**(73,336)**	(70,638)
Net costs with the public	**85,872**	86,169
Total Net Cost of Nuclear Materials and Waste Safety	**$ 124,005**	$ 127,682

Earned revenue for decommissioned reactors was improperly classified under Nuclear Reactor Safety rather than Nuclear Materials and Waste Safety in the prior year. A reclassification has been made to the reported amounts for the first quarter FY 2006 to conform to the current year presentation. Total earned revenue for that period did not change.

	Reported FY 2006	Reclassifications	Reclassified FY 2006
Intragovernmental Earned Revenue			
Reactor Safety	$ (33,121)	$ 332	$ (32,789)
Materials and Waste Safety	(6,569)	(332)	(6,901)
Earned Revenue from Public			
Reactor Safety	(532,661)	2,948	(529,713)
Materials and Waste Safety	(67,690)	(2,948)	(70,638)
Total	$ (640,041)	$ -	$ (640,041)

Note 10. Exchange Revenues

	2007	2006
Fees for licensing, inspection, and other services	**$ 687,632**	$ 635,457
Revenue from reimbursable work	**5,627**	4,584
Total Exchange Revenues	**$ 693,259**	$ 640,041

Note 11. Financing Sources Other Than Exchange Revenue

Appropriated Funds Used

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

	2007	2006
Funds consumed	**$ 757,892**	$ 685,134
Less: Collection from fees assessed	**(669,246)**	(624,042)
Less: Nuclear Waste Funding Used	**(42,000)**	(10,550)
Appropriated Funds Used	**$ 46,646**	$ 50,542

Funds consumed includes $74.3 million and $59.6 million through September 30, 2007, and 2006, respectively, of available funds from prior years.

Non-Exchange Revenue

	2007	2006
Civil penalties	**$ 450**	$ 461
Miscellaneous receipts	**1,681**	129
Contra-Revenue	**(2,131)**	-
Total Non-Exchange Revenue	**$ -**	$ 590

Imputed Financing

	2007	2006
Civil Service Retirement System	**$ 10,593**	$ 11,256
Federal Employee Health Benefit	**16,956**	14,912
Federal Employee Group Life Insurance	**71**	66
Judgements Awards	**7**	1,788
Total Imputed Financing	**$ 27,627**	$ 28,022

Transfers In/Out

	2007	2006
Transfers out to Treasury		
License Fees	**$ 69,245**	$ 624,042
Non-exchange revenue	**-**	590
Total Transfers-Out to Treasury	**$ 669,245**	$ 624,632

Note 12. Total Obligations Incurred

	2007	2006
Direct Obligations		
Category A	**$ 788,875**	$ 687,201
Exempt from Apportionment	**45,251**	43,701
Total Direct Obligations	**834,126**	730,902
Reimbursable Obligations	**4,645**	3,848
Total Obligations Incurred	**$ 838,771**	$ 734,750

Obligations exempt from apportionment are the result of funds derived from the Nuclear Waste Fund. Category A Obligations consist of NRC appropriations only. Undelivered orders for the Nuclear Waste Fund are $12.2 million and $9.4 million, Salaries and Expenses $215.0 million and $148.1 million, and the Office of the Inspector General $1.7 million and $1.0 million through September 30, 2007, and 2006, respectively.

Note 13. Nuclear Waste Fund (NWF)

Included in NRC's budget for FY 2007 and 2006 are $45.8 million and $45.7 million, respectively, provided from the NWF. Statement of Federal Financial Accounting Standards No. 27, Identifying and Reporting Earmarked Funds, lists three defining criteria for an earmarked fund. Generally, an earmarked fund is established by law to use specifically identified financing sources only for designated activities, and the statute provides explicit authority to retain current, unused revenues for future use. Also, the law includes a requirement to account for and report on the receipt and use of the financing sources as distinguished from general revenues.

In 1982, Congress passed the Nuclear Waste Policy Act of 1982 (PL 97-425) establishing the Nuclear Waste Fund (NWF) to be administered by the Department of Energy (DOE) (42 U.S.C. 10222). Given the terms of the statute, the NWF clearly meets the definition of an earmarked fund from DOE's perspective, and DOE does indeed report the NWF as an earmarked fund in its Performance and Accountability Report (PAR).

However, to NRC the NWF transfer is a source of financing; its receipt of NWF funds is a use of NWF resources. NRC collects no revenue on behalf of the NWF and has no administrative control over it. Furthermore, the U.S. Treasury has no separate fund symbol for the NWF under NRC's agency location code (ALC). The receipt and expenditure of NWF money is reported to the U.S. Treasury under the NRC's primary Salaries and Expenses Fund (X0200).

Based on these facts, the NWF is not an earmarked fund from NRC's perspective. However, in order to provide additional information to the users of these financial statements, enhanced disclosure of the fund is presented below.

The funding is provided to NRC in FY 2007 and 2006 for the purpose of performing activities associated with DOE's application for a high level waste repository at Yucca Mountain, Nevada. These activities included assistance to DOE with the application, review of the application, the conduct of thorough safety and security evaluations, preparation of the safety evaluation report, initiation of the inspection program, ensuring that the regulation process was made available to stakeholders and the general public, and to provide legal advice and representation for staff reviews and Commission actions.

Note 13. Nuclear Waste Fund (NWF) (continued)

The NWF amounts received, expended, obligated, and unobligated balances as of September 30, 2007, and 2006 are shown in the following:

	2007	2006
Appropriations Received	**$ 45,826**	$ 45,657
Expended Appropriations	**$ 45,640**	$ 47,554
Obligations Incurred	**$ 45,247**	$ 43,701
Unobligated Balances	**$ 26,717**	$ 25,697

Note 14. Change in Accounting Principle

As discussed in note 1T, the NRC receives allocation transfers from USAID. In prior years, the NRC appropriately reported the proprietary activity related to the allocation transfers on its financial statements. The accompanying FY 2006 financial statements include assets of $3,025 thousand; liabilities of $188 thousand, appropriation transfers of $1,587 thousand and costs of $1,448 thousand related to allocation transfers received from USAID in FY 2006 and prior years.

Effective in FY 2007, OMB Circular A-136, *Financial Reporting Requirements* mandates that a parent entity must report all budgetary and proprietary activity in its financial statements, whether material to a child entity, or not. The effect of this reporting change on prior periods should be reported as a change in accounting principle consistent with SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*.

The cumulative effect of the change on beginning unexpended appropriations is reported in the accompanying FY 2007 Statement of Changes in Net Position as follows:

Unexpended Appropriations:	
Beginning Balances, October 1, 2006	**$ 193,694**
Less: USAID Allocation transfers	**(2,838)**
Restated beginning balance, October 1, 2006	**$ 190,856**

Note 15. Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government

Statement of Federal Financial Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*, requires the NRC to reconcile the budgetary resources reported on the Statement of Budgetary Resources to the prior fiscal year actual budgetary resources presented in the Budget of the U.S. Government and explain any material differences. NRC does not have any material differences between the Statement of Budgetary Resources and the Budget of the U.S. Government. The President's Budget with actual results for NRC has not been published for FY 2007. It is expected to be published on February 5, 2008. The estimates will be available on the NRC web page, and the actuals can be found on the OMB web page.

Note 16. Reconciliation of Net Cost of Operations to Budgetary Resources

OMB Circular No. A-136, Financial Reporting Requirements, dated June 29, 2007, requires agencies to reclassify the Statement of Financing to display in the Notes to the Principal Statements. The disclosure requirements are outlined in SFFAS No. 7.

For the years ended September 30,	**2007**	2006
Budgetary Resources Obligated		
Obligations incurred (Note 12)	**$ 838,771**	$ 734,750
Less: Spending authority from offsetting collections and recoveries	**(11,783)**	(10,150)
Less: Distributed offsetting receipts	**(669,245)**	(624,042)
Net Obligations	**157,743**	100,558
Other Resources		
Imputed financing from costs absorbed by others	**27,627**	28,022
Allocation transfer	**-**	1,444
Other - Revenue from excess collections	**(18,386)**	(11,415)
Net Other Resources Used to Finance Activities	**9,241**	18,051
Total Resources Used to Finance Activities	**166,984**	118,609
Resources Used to Finance Items not Part of the Net Cost of Operations	**(79,278)**	(46,809)
Total Resources Used to Finance the Net Cost of Operations	**87,706**	71,800
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	**5,742**	8,754
Net Cost Of Operations	**$ 93,448**	$ 80,554

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF BUDGETARY RESOURCES

(IN THOUSANDS)

For the year ended September 30, 2007	Salaries & Expenses X0200	Office of Inspector General X0300	Nuclear Facility Fees X5280	**Total**
Budgetary Resources				
Unobligated balances, brought forward, October 1	$ 73,319	$ 936	$ -	**$ 74,255**
Recoveries of prior year obligations				
Actual	5,243	448	-	**5,691**
Budget authority				
Appropriation	154,808	836	669,249	**824,893**
Spending authority from offsetting collections				
Reimbursements earned - Collected	4,381	-	-	**4,381**
Reimbursements earned - Change in receivables	371	-	-	**371**
Change in unfilled customer orders - Advance received	1,433	-	-	**1,433**
Change in unfilled customer orders - Without advance	(93)	-	-	**(93)**
Subtotal - Spending authority from offsetting collections	6,092	-	-	**6,092**
Net Transfers	661,721	7,524	(669,245)	**-**
Total Budgetary Resources	$ 901,183	$ 9,744	$ 4	**$ 910,931**
Status of Budgetary Resources				
Obligations incurred (Note 12)				
Direct	$ 824,928	$ 9,198	$ -	**$ 834,126**
Reimbursable	4,645	-	-	**4,645**
Subtotal	829,573	9,198	-	**838,771**
Unobligated balance				
Apportioned	44,892	546	-	**43,738**
Exempt from apportionment	26,718	-	4	**26,722**
Subtotal	71,610	546	4	**72,160**
Total Status of Budgetary Resources	$ 901,183	$ 9,744	$ 4	**$ 910,931**
Change in Obligated Balance				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 200,962	$ 1,484	$ -	**$ 202,446**
Obligations incurred, net	829,573	9,198	-	**838,771**
Gross outlays	(755,376)	(8,978)	-	**(764,354)**
Recoveries of prior year obligations, actual	(5,243)	(448)	-	**(5,691)**
Change in uncollected customer payments, from Federal Sources	(278)	-	-	**(278)**
Obligated balance, net, end of period				
Unpaid obligations	273,489	1,256	-	**274,745**
Uncollected customer payments, from Federal sources	(3,851)	-	-	**(3,851)**
Total unpaid obligated balance, net , end of period	$ 269,638	$ 1,256	$ -	**$ 270,894**
Net outlays				
Gross outlays	$ 755,376	$ 8,978	$ -	**$ 764,354**
Offsetting collections	(5,814)	-	-	**(5,814)**
Distributed offsetting receipts	-	-	(669,245)	**(669,245)**
Net Outlays	$ 749,562	$ 8,978	$(669,245)	**$ 89,295**

AUDITORS' REPORT

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

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM TO: Chairman Klein

FROM: Hubert T. Bell
Inspector General

SUBJECT: RESULTS OF THE AUDIT OF THE UNITED STATES NUCLEAR REGULATORY COMMISSION'S FINANCIAL STATEMENTS FOR FISCAL YEARS 2007 AND 2006 (OIG-08-A-01)

The Chief Financial Officers Act of 1990, as amended, (CFO Act) requires the Inspector General (IG) or an independent external auditor, as determined by the IG, to annually audit the United States Nuclear Regulatory Commission's (NRC) financial statements in accordance with applicable standards. In compliance with this requirement, this memorandum transmits the following R. Navarro & Associates, Inc. Auditors' Reports:

- Independent Auditors' Report on the Financial Statements,
- Independent Auditors' Report on the Effectiveness of Internal Control over Financial Reporting, and
- Report on Compliance with Laws and Regulations.

Objective of a Financial Statement Audit

The objective of a financial statement audit is to determine 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.

R. Navarro & Associates' examination was made in accordance with generally accepted auditing standards, Government Auditing Standards issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, Audit Requirements for Federal Financial Statements. The audit included obtaining an understanding of the internal controls over financial reporting and testing and evaluating the design and operating effectiveness of the internal controls. Because of inherent limitations in any internal control, there is a risk that errors or fraud may occur and not be detected. Also, projections of an evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Results of Audit

The results are as follows:

Financial Statements

- FYs 2007 and 2006 - Unqualified opinion

FY 2007 Internal Controls

- Qualified opinion
- Significant Deficiencies:
  - Information Systems Security Controls (Continuing Material Weakness)
  - Fee Billing System (Significant Deficiency)

FY 2007 Compliance with Laws and Regulations

- Substantial Noncompliance:
  - Information Systems Security Controls

OIG Oversight of R. Navarro & Associates, Inc. Performance

To fulfill our responsibilities under the CFO Act and related legislation for ensuring the quality of the audit work performed, we monitored R. Navarro & Associates' audit of NRC's FYs 2007 and 2006 financial statements by:

- Reviewing their approach and planning of the audit,
- Evaluating the qualifications and independence of its auditors,
- Monitoring the progress of the audit at key points,
- Examining the working papers related to planning and performing the audit and assessing NRC's internal control,
- Reviewing R. Navarro & Associates' audit reports to ensure compliance with Government Auditing Standards and OMB Bulletin No. 07-04,
- Coordinating the issuance of the audit reports, and
- Performing other procedures that we deemed necessary.

R. Navarro & Associates, Inc. is responsible for the attached auditors' reports, dated November 7, 2007, and the conclusions expressed therein. The Office of the Inspector General (OIG) is responsible for technical and administrative oversight regarding the firm's performance under the terms of the contract. Our review, as differentiated from an audit in conformance with Government Auditing Standards, was not intended to enable us to express, and accordingly we do not express, an opinion on:

- NRC's financial statements,
- The effectiveness of NRC's internal control over financial reporting, or
- NRC's compliance with laws and regulations.

However, our monitoring review, as described above, disclosed no instances where R. Navarro & Associates, Inc.

did not comply with applicable auditing standards.

Performance Reporting

As required by OMB Bulletin No. 07-04, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we:

- Obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, and
- Determined whether they have been placed in operation.

Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

Meeting with the Chief Financial Officer

At the exit conference on November 7, 2007, representatives of the Office of the Chief Financial Officer, OIG, and R. Navarro & Associates, Inc. discussed the issues in the report related to the results of the audit.

Comments of the Chief Financial Officer

In his response, the CFO agreed with the auditors' recommendations. We will follow-up on the CFO's implementation of planned corrective actions during FY 2008. The full text of the CFO's response follows this report.

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

INDEPENDENT AUDITORS' REPORT ON THE FINANCIAL STATEMENTS

R. NAVARRO
& ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

2831 Camino Del Rio South, Suite 306
San Diego, California 92108
(619) 298-8193

Chairman Dale E. Klein
U.S. Nuclear Regulatory Commission
Washington, DC

In our audits of the U.S. Nuclear Regulatory Commission (NRC), we found:

- the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- NRC had effective internal control over financial reporting except for the effects of a material weakness related to information systems security controls;
- no instances of noncompliance with laws and regulations, exclusive of the Federal Financial Management Improvement Act (FFMIA), that are required to be reported under applicable audit standards; and
- one instance of substantial noncompliance with the requirements of FFMIA related to information systems security controls.

The following sections provide additional detail about our conclusions and the scope of our audits.

We have audited the accompanying balance sheets of NRC as of September 30, 2007, and 2006, and the related statements of net cost, statements of changes in net position, and statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of NRC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04, Audit Requirements for Federal Financial Statements. Those standards and the Bulletin 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 that our audits provide a reasonable basis for our opinion.

Matters of Emphasis

Classification of Costs

OMB Circular A-136, Financial Reporting Requirements, 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 (i.e., private sector licensees versus Federal licensees) rather than who was paid. However, following the advice of OMB, NRC classified the costs on the Statements of Net Cost using an underlying concept of who was paid. Furthermore, OMB Circular A-136 requires that the Statement of Net Cost be presented using full program costs by output. NRC presents its costs aggregated by strategic plan programs.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. For the fiscal years ended September 30, 2007, and 2006, NRC's Statements of Net Cost include approximately $64.4 and $67.8 million, respectively, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations applicable to 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 Government Accountability 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 provide the results of its audits to NRC.

Opinion

In our opinion, the financial statements referred to above and included in NRC's Performance and Accountability Report present fairly, in all material respects, the financial position of NRC as of September 30, 2007, and 2006, and its net costs, changes in net position, and budgetary resources for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 14 to the financial statements, NRC changed its presentation of allocation transfers as required by OMB Circular A-136.

Independent Auditors' Report on the Effectiveness of Internal Control Over Financial Reporting

We have examined the effectiveness of NRC's internal control over financial reporting, as of September 30, 2007, based on the criteria in OMB Bulletin No. 07-04. The Bulletin states management is required to establish internal accounting and administrative controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America and that assets be safeguarded against loss from unauthorized acquisition, use or disposal. NRC's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control over financial reporting based on our examination.

Our examination was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants (AICPA); the standards applicable to financial statement audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Accordingly, we obtained an understanding of the internal control over financial reporting, tested and evaluated the design and operating effectiveness of internal control, and performed such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

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

We noted certain matters involving the internal control and its operation that we consider to be significant deficiencies under standards established by the AICPA and OMB Bulletin No. 07-04.

A significant deficiency is a deficiency in internal control, or combination of deficiencies, that adversely affects an entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected. As discussed further in this report, the significant deficiencies are related to: (1) weaknesses in NRC's information systems security controls, and (2) weaknesses in NRC's fee billing system.

As defined by OMB Bulletin No. 07-04, a material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. The significant deficiency related to information systems security controls is considered to be a material weakness.

In our opinion, except for the effect of the material weakness described below, NRC has maintained, in all material respects, effective internal control over financial reporting as of September 30, 2007, based on the internal control objectives listed in OMB Bulletin No. 07-04.

Information Systems Security Controls

The Federal Information Security Management Act (FISMA) independent evaluations for fiscal years 2005 and 2006 identified several weaknesses in NRC's information systems security program. The fiscal year 2007 evaluation (Report OIG-07-A-19) identified similar results, including 14 weaknesses of which the following two were considered to be significant deficiencies:

- "Only 2 of the 30 operational NRC information systems have a current certification and accreditation, and only 4 of 11 systems used or operated by a contractor or other organization on behalf of NRC have a current certification and accreditation.… [and]
- Annual contingency testing is still not being performed for all systems."

Based on a self-evaluation of management controls over information systems, NRC concluded that the two significant deficiencies identified in the FISMA report should be reported as a material weakness in its annual statement of assurance required by the Federal Managers' Financial Integrity Act (FMFIA).

Certification and Accreditation

The primary financial management systems consist of three NRC operated systems and two systems operated by the Department of Interior's National Business Center. Of these five systems, three had current certifications and accreditations as of September 30, 2007. The other two operated under interim authorities to operate (IATO) during the entire year. An IATO is a limited authorization to operate an information system under specific terms and conditions and acknowledges greater agency-level risk for a limited period of time. An information system is not considered accredited during the period of limited authority to operate.

Furthermore, although some of the financial management systems have current certifications and accreditations, all financial management systems were and are at risk because they either reside on or rely on a general support system (GSS) which does not have a current certification and accreditation. Therefore, management does not know whether the security controls for the general support systems are adequate, thereby creating potential risk. All NRC information systems that depend on the security controls provided by the general support systems inherit that potential risk.

OMB Circular A-130, Management of Federal Resources, Appendix III, characterizes the absence of authorization to process (certification and accreditation) as an example of a significant deficiency.

Annual Contingency Testing

During fiscal year 2007, annual contingency plan testing was performed for all of the primary financial management systems, however, testing was not performed for 25 of the remaining NRC information systems, including a GSS, and 9 of the remaining contractor operated systems. Contingency plan testing is considered to be a key element of information system security programs, and is essential in determining whether or not plans will function as intended in an emergency situation.

Recommendation

1. The CFO should coordinate with the Office of Information Services and the Executive Director for Operations to ensure that any vulnerabilities of the general support systems and the financial management systems are addressed and resolved timely.

OMB Bulletin 07-04 requires significant deficiencies identified in the FISMA evaluation that are related to financial management systems be reported as a substantial noncompliance with FFMIA. Accordingly, our report on compliance with laws and regulations identifies the FISMA significant deficiencies previously described as a substantial noncompliance with FFMIA, because three systems did not have a current certification and accreditation, and contingency plan testing was not performed for a GSS.

Fee Billing System

NRC is required by law to recover a percentage of its budget authority in each year through fees billed to reactor and materials licensees and applicants. Annual license fees are assessed under 10 CFR Part 171 for nuclear facilities and materials licensees. Other fee types include licensing actions, inspections and other services, established in 10 CFR Part 170. Since fiscal year 2004, we have reported a material weakness related to NRC's fee billing system. The deficiencies reported included: (1) intensive manual processes, (2) the lack of comprehensive quality assurance procedures over the billing process, and (3) the fee billing feeder processes.

The following paragraphs describe the conditions and the agency's progress in addressing them.

- Intensive Manual Processes. Due to the age and design of the Fee Billing System, NRC has evolved an operating style characterized by over-reliance on a small team to prepare, review, and issue billings on a monthly and quarterly basis. The system does not easily provide a drill down capacity to review billing questions.
- Comprehensive Quality Assurance Procedures. NRC's existing quality assurance procedures do not fully address the completeness of billable hours.
- Fee Billing Feeder Processes. In prior years, NRC has identified significant underbillings due to various deficiencies of feeder processes, and a lack of independent checks to validate the completeness of feeder data.

The above conditions continue to affect the fee billing process. However, as discussed below, during fiscal year 2007, NRC took various steps to improve its internal control over the billing cycle.

In February 2007, NRC revised its standard procedures for the Part 170 quarterly certification process used by Headquarters and regional offices. The procedures were revised based on consultations with fee coordinators and an analysis of prior underbilling cases, and were designed to improve the accuracy of the quarterly billings. These procedures were applied to the third and fourth quarter of FY 2007.

NRC also developed a validation application to compare hours recorded in HRMS, the time and labor system, to the hours billed under Part 170. The application was used as a compensating control to validate billings issued for inspections, licensing actions and other billable tasks for the entire fiscal year. This effort resulted in identifying underbillings of approximately $2.6 million that had not been detected by employees in the normal course of performing their assigned billing duties. These results illustrate the need for the continued and expanded application of detection controls to compensate for deficiencies inherent in the current billing process. Further, although the application was used to validate most billings for the entire fiscal year, it was not performed on an ongoing routine basis throughout the entire fiscal year. Finally, we noted that the validation application has not been applied to casework fees.

In fiscal year 2007, we noted that the Part 170 fees receivable of $26 million related to inspections in process at year end were initially understated by $4.7 million because existing controls did not detect that the quarterly "future billables" reports only reflect unbilled hours incurred during a given quarter. At our request, management adjusted the accounts receivable reported in the accompanying financial statements to appropriately reflect all unbilled hours at year end.

While many improvements were made to the fee billing processes in FY 2007, we conclude that the remaining weaknesses constitute a significant deficiency as defined by OMB. However, this finding is no longer considered to be a material weakness.

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. It is performed continually and is ingrained in agency's supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

Recommendation

2. The CFO should continue to define, design, and implement compensating controls over the fee billing system.

Report on Compliance With Laws and Regulations

We conducted our audit for the year ended September 30, 2007, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04.

NRC management is responsible for complying with laws and regulations applicable to NRC. As part of obtaining reasonable assurance about whether NRC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of applicable 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. 07-04, including FFMIA requirements. We limited our tests of compliance to those provisions and we did not test compliance with all laws and regulations applicable to NRC.

The objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions of 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. For the fiscal years ended September 30, 2007, and 2006, NRC's Statements of Net Cost include approximately $64.4 and $67.8 million, respectively, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations applicable to 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 GAO's 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 laws and regulations, exclusive of those referred to for FFMIA, disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards or OMB Bulletin No. 07-04.

Under FFMIA, we are required to report whether NRC's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with the provisions of FFMIA section 803(a). The results of our tests disclosed one instance, noted below, where NRC's financial management systems did not substantially comply with Federal financial management systems requirements.

In our Report on the Effectiveness of Internal Control Over Financial Reporting, we identified a material weakness in NRC's information systems security controls. We believe that this matter represents substantial noncompliance with the Federal financial management system requirements under FFMIA.

Status of Prior Year Comments

In our prior year report on internal control, we discussed the presence of material weaknesses related to the fee billing system and information systems security controls. During fiscal year 2007, NRC improved its internal control over fee billings by implementing additional detection controls. Consequently, we conclude that the remaining weaknesses in the fee billing system constitute a significant deficiency, as defined by OMB, but the significant deficiency is not considered to be a material weakness. The material weakness related to the information systems security controls continued to exist during fiscal year 2007.

In our prior year report on compliance with laws and regulations we reported a noncompliance related to the development of Part 170 fees and a substantial noncompliance with FFMIA related to the Fee Billing System. Corrective actions have been implemented by NRC to remediate the Part 170 fees noncompliance and that prior finding is now closed. Furthermore, due to certain compensating controls implemented by management in FY 2007, we determined that the remaining weaknesses in the Fee Billing System do not represent substantial noncompliance with FFMIA.

Internal Control Related to Performance Measures

With respect to internal controls related to performance measures described in Chapter 2 of the performance and accountability report, the OIG performed those procedures and will address 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.

Consistency of Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements of NRC taken as a whole. The required supplementary information referred to as the Management Discussion and Analysis, Chapter 1 of this Performance and Accountability Report, is not a required part of the financial statements but is supplementary information required by OMB Circular A-136. 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 the information and express no opinion on it.

The other accompanying information included in Chapter 2 and the appendices to the Performance and Accountability Report, is required by OMB Circular A-136 and is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of NRC taken as a whole. The required supplementary information, Schedule of Budgetary Resources, included in the Performance and Accountability Report, is not a required part of the financial statements but is supplementary information required by OMB Circular A-136. This information is also presented for purposes of additional analysis. This information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

We noted certain additional matters that we will report to NRC management in a separate letter.

This report is intended solely for the information and use of NRC management, the Inspector General, OMB, GAO, and the Congress and is not intended to be and should not be used by anyone other than these specified parties.

R. Navarro & Associates, Inc.

November 7, 2007

MANAGEMENT'S RESPONSE TO THE INDEPENDENT AUDITORS' REPORT ON THE FINANCIAL STATEMENTS

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

November 9, 2007

OFFICE OF THE
CHIEF FINANCIAL OFFICER

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

FROM: William M. McCabe
Chief Financial Officer

SUBJECT: AUDIT OF THE FISCAL YEARS 2007 AND 2006 FINANCIAL STATEMENT AUDITS

We appreciate the collaborative relationship between the Office of the Inspector General, the auditors and the Office of the Chief Financial Officer in supporting our continuing effort to improve financial reporting. We have reviewed the independent auditors' report of the Agency's Fiscal Year 2007 and 2006 financial statements and are in general agreement with the report and overall findings.

Our responses to the recommendations follow:

Recommendation 1

The Chief Financial Officer (CFO) should coordinate with the Office of Information Services and the Executive Director for Operations to ensure that any vulnerabilities of the general support systems and the financial management systems are addressed and resolved timely.

Response

Agree. The CFO will continue to coordinate with the Office of Information Services and the Executive Director for Operations to ensure that vulnerabilities of the general support systems and the financial management systems are addressed timely.

Recommendation 2

The CFO should continue to define, design, and implement compensating controls over the fee billing system.

Response

Agree. The CFO will continue to assess and implement opportunities to improve the internal controls over the fee billing system.