INDEPENDENT AUDITORS' REPORT AND
PRINCIPAL STATEMENTS FOR THE
YEARS ENDED SEPTEMBER 30, 1997 AND 1996

OIG/97A-17 February 13, 1998

February 13, 1998

MEMORANDUM TO: Chairman Jackson

FROM: Hubert T. Bell
Inspector General

SUBJECT: RESULTS OF THE AUDIT OF U.S. NUCLEAR REGULATORY COMMISSION'S FISCAL YEAR 1997 FINANCIAL STATEMENTS

Attached is the independent auditors' report on the U.S. Nuclear Regulatory Commission's (NRC) Fiscal Year 1997 financial statements. The Chief Financial Officers (CFO) 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 auditors' opinion on management's assertion about the effectiveness of internal controls, and (3) a report on NRC's compliance with laws and regulations. Written comments were obtained from the CFO and are included as an appendix to the independent auditors' report.

Audit Results

The independent auditor issued an unqualified opinion on the Statement of Financial Position, the Statements of Operations and Changes in Net Position, Cash Flows, and Budgetary Resources and Actual Expenses.

In the opinion on management's assertion about the effectiveness of internal controls, the auditor identified two new reportable conditions and closed two prior-year reportable conditions. The new conditions concern (1) business continuity (recovery) plans for financial systems, and (2) segregation of duties for certain accounting functions. The two reportable conditions closed concern (1) software capitalization procedures, and (2) payroll system integration and labor cost distribution.

The report on NRC's compliance with laws and regulations disclosed that the reportable condition relating to business continuity plans is considered a substantial noncompliance with the Federal Financial Improvement Act of 1996. Tests of compliance with selected provisions of other laws and regulations disclosed no other instances of noncompliance.

The CFO’s response to the issue relating to business continuity plans stated, “The three systems mentioned in the audit report are all scheduled for replacement within the next one to two years....The OCFO [Office of the Chief Financial Officer] and the OCIO [Office of the Chief Information Officer] will determine the cost effectiveness of developing continuity/contingency plans for the systems that are to be retired or replaced.” Because this is a significant issue, we wish to reiterate and clarify our position.

The Office of Management and Budget Circular A-130 clearly requires agencies to plan for reasonable continuity of support should normal operations be disrupted. Although NRC plans to replace or retire several financial information systems, the agency should not allow its business operations to continue to be at risk. We fully understand that a strategy for cost containment is essential to any agency decision. However, unless a system replacement or retirement is imminent (e.g. , the current payroll system), all systems must have some type of continuity/contingency recovery mechanism.

We did not review NRC performance data this year because NRC is in a transition period for reporting this data. Further, over the five previous fiscal years, OIG has reviewed the systems and verified data from which performance information was derived. With one exception, OIG found the prior performance data to be accurate. NRC took corrective action on that one exception. In the future, we plan to review performance data reported in NRC’s annual performance plan.

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

Attachment: As stated

U. S. NUCLEAR REGULATORY COMMISSION

INDEPENDENT AUDITORS' REPORT AND PRINCIPAL STATEMENTS FOR THE YEARS ENDED SEPTEMBER 30, 1997 AND 1996

CONTENTS

R. Navarro & Associates, Inc.

Chairman Shirley A. Jackson
U.S. NUCLEAR REGULATORY COMMISSION
Washington, DC

INDEPENDENT AUDITORS' REPORT

We audited the U.S. Nuclear Regulatory Commission's (NRC) principal statements at September 30, 1997 and for the year then ended, as required by the *Chief Financial Officers (CFO) Act of 1990.* We found that the principal statements present fairly in all material respects. We believe that our audit provides a reasonable basis for our opinion. The principal statements of the NRC at September 30, 1996 and for the year then ended, were audited by other auditors whose report dated March 6, 1997, expressed an unqualified opinion on those statements. Management stated that the internal control structure in place at September 30, 1997, was effective in (1) safeguarding assets from material loss, (2) assuring material compliance with laws and regulations governing the use of budgetary authority and with other relevant laws and regulations, and (3) assuring that there were no material misstatements in the Principal Statements. We noted two reportable conditions in the current year. One reportable condition relating to business continuity plans is classified as a substantial noncompliance with the *Federal Financial Management Improvement Act* (FFMIA), as well.

The following section outlines our conclusions and discusses the Overview of the Reporting Entity and the scope of the audit.

REPORT ON PRINCIPAL STATEMENTS

The Principal Statements, including the accompanying notes, present fairly in all material respects, in conformity with a comprehensive basis of accounting other than generally accepted accounting principles, as described in Note 1 to the principal statements, NRC's:

assets, liabilities, and net position;
revenue, financing sources and expenses;
cash flows; and
budgetary resources and actual expenses.

REPORT ON MANAGEMENT ASSERTION ABOUT THE EFFECTIVENESS OF THE INTERNAL CONTROL STRUCTURE

We evaluated management's assertion that the NRC maintained an effective internal control structure designed to:
safeguard assets against loss from unauthorized acquisition, use or disposition;

- # assure the execution of transactions in accordance with laws governing the use of budget authority and with laws and regulations that have a direct and material effect on the Principal Statements or that are listed in the *Office of Management and Budget (OMB) Bulletin 93-06,* as amended, that could have a material effect on the Principal Statements; and

- # properly record, process, and summarize transactions to permit the preparation of reliable financial statements and to maintain accountability for assets.

NRC management fairly stated that internal controls in place on September 30, 1997, provided reasonable assurance that losses, noncompliance, or misstatements, material in relation to the Principal Statements, would be prevented and detected on a timely basis. Management made this assertion based upon criteria established by the *Federal Managers' Financial Integrity Act of 1982 (FMFIA)* and *OMB Circular A-123, Management Accountability and Control*.

REPORTABLE CONDITIONS AND AUDIT FOLLOW-UP

We noted two matters involving the internal control structure and its operation that are considered reportable conditions under the standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06, as amended. Although not material in relation to the Principal Statements, these reportable conditions involve deficiencies in the internal control structure that, in our judgment, could adversely affect the NRC's ability to ensure that it meets the objectives of internal controls. Management considered these conditions in making their assertion on the effectiveness of the internal controls.

CURRENT YEAR

The matters listed below involve the design or operation of the internal control structure and warrant disclosure as reportable conditions. None are classifiable as material weaknesses.

A. Business Continuity Plans

Our assessment of the NRC's management control program included a review of the agency's business continuity practices for major financial management systems. The agency's major business systems include (1) the core general ledger - Federal Financial System (FFS) serviced by the U.S. Treasury Financial Management Service (FMS); (2) accounts receivable - billing for license fees; and (3) the payroll system. These systems are critical to recording, summarizing and preparing financial information. We noted that these agency systems either did not have established test plans, did not have a documented recovery plan, or did not have a plan that reflected the actual operations of the system.

OMB Circular A-130, Management of Federal Information Resources, requires agencies to plan for reasonable continuity of support should normal operations be disrupted in an emergency and assigns responsibility to the Department of Commerce for developing guidance and standards for information processing systems.

Guidance provided by the Department of Commerce states [that agencies] "...ensure IT [Information Technology] systems shall develop and maintain, in an up-to-date state, contingency and disaster recovery plans which will provide reasonable assurance that critical data processing can be continued, or resumed quickly, if normal operations are interrupted. The plan for large systems supporting essential...agency functions shall be fully documented and operationally tested at least annually...."

The individual circumstances for the lack of recovery plans are described.

General Ledger - Federal Financial System

Prior to fiscal year (FY) 1997, FFS did not have back-up recovery capabilities, as reported by Treasury-FMS in the annual FMFIA reports. During FY 1997, the FMS reported that additional disk storage capacity was installed at the designated FFS back-up site in Austin, Texas. However, due to a lack of available budget resources, the recovery plan will not be tested and validated until sometime in FY 1998. Consequently, the condition was reported in the FMS FY 1997 FMFIA report as: "Unable to demonstrate the ability to perform data recovery and back-up capabilities of the FFS application in the event of a disaster."

Recovery Plans for Fee Systems

In September and December 1996, the Office of Information Resources Management certified the major fee systems based on reviews performed by a contractor. The work included: (1) creating security plans; (2) developing and executing test plans; and (3) preparing certification documents.

The results of the reviews indicated that adequate security provisions were in place. However, the contractor indicated that NRC had not developed a contingency or business resumption plan for any of the major fee systems. As of the end of our field work no plans have been developed in response to the conditions reported.

Recovery Plans for Payroll System

There is no current recovery plan for the payroll system. A previously existing recovery plan was not updated when the payroll Automatic Data Processing (ADP) operations were transferred from the agency's prior location about four years ago. Currently, the payroll functions are planned to move to a new payroll/personnel system in April 1998, therefore, actions planned for developing a recovery plan will focus on the new system.

Recommendation

The CFO should establish, for systems within the agency's control, initiatives for designing recovery plans for all financial management systems. In providing such guidance, the CFO should assess the priority of each system. Furthermore, the CFO should assure that policies are issued ensuring that the design or development of any new financial management systems, and the related security and maintenance programs of such systems include the development of a plan which is documented and tested. We recognize that NRC, as a user of the FFS, does not have the leverage to compel FMS to comply with a sound disaster recovery program. Therefore, no recommendation is offered other than continued monitoring of this condition through the user group.

CFO's Comments

"Agency financial systems are currently undergoing major changes. The three systems mentioned in the audit report are all scheduled for replacement within the next one to two years. The Federal Financial System (FFS) and the accounts receivable/license fee billing system will be replaced by the new agency-wide resource management system STARFIRE. The Payroll System will be replaced by the Payroll/Personnel (PAY/PERS) System. The OCFO [Office of Chief Financial Officer] and the OCIO [Office of Chief Information Officer] will determine the cost effectiveness of developing continuity/contingency plans for the systems that are to be retired or replaced. The OCFO and OCIO will then jointly prepare a plan by June 1, 1998 to develop the required continuity/contingency plans for continuing financial systems. These plans will be developed in accordance with OMB Circular A-130, Management of Federal Information Resources, and NRC System Development and Life Cycle Management (SDLCM) Methodology."

Auditors' Position

OMB Circular A-130 clearly requires agencies to plan for reasonable continuity of support should normal operations be disrupted. Although NRC plans to replace or retire several financial information systems, the agency should not allow its business operations to continue to be at risk. We fully understand that NRC has a variety of initiatives in place and that a strategy for cost containment is essential to any agency decision. The remediation plan that the CFO and the Chief Information Officer (CIO) will develop and deliver to the Office of the Inspector General (OIG) by June 1, 1998, must focus on managing the NRC's existing business continuity risks and provide detailed steps and timetables that will be used as a framework to minimize such risks. Unless a system replacement or retirement is imminent (e.g. the current payroll system) all systems must have continuity/contingency plans. We further believe that the framework developed under the remediation plan should provide a basis for developing continuity/contingency plans for any planned financial systems.

B. Segregation of Duties - FFS

NRC uses the FFS as its primary accounting system. The Division of Accounting and Finance (DAF), OCFO is responsible for maintaining FFS, including controlling access. FFS access is controlled by hierarchical access profiles that range from inquiry only access to the "system administrator" profile that permits unrestricted system access and updating security tables.

At September 30, 1997, there were 92 active FFS users with varying access levels depending on their functions. At that time, eight DAF employees held a "lead accountant" access profile which ranks just below the "system administrator" profile. The "lead accountant" profile allows holders to enter transactions and change any existing transaction or table except for the security tables. At least three of these employees are also responsible for reconciling FFS output to source documents or to output from other systems including the payroll system.

Thus, the employees holding "lead accountant" profiles and preparing reconciliations are performing incompatible functions from an internal control perspective because they are in a position to both commit errors and irregularities and to conceal them in the course of discharging their normal duties.

The General Accounting Office's (GAO) *Standards for Internal Controls in the Federal Government* state "...key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals."

Recommendation

The CFO should reduce the number of persons holding the 'lead accountant' access profile and/or implement additional compensating controls. The compensating controls could include requiring supervisory review and certification of reconciliations and their resulting journal vouchers.

CFO's Comments

"The OCFO will examine those persons holding the "lead accountant" access profile and determine whether it is appropriate to make any changes to access profiles. In addition, the OCFO will institute compensating controls consisting of review and certification of reconciliations and their resulting journal vouchers by the Financial Team Leader."

Auditors' Position

The actions described by the CFO should strengthen the design of controls over segregation of duties. The CFO should advise the OIG when the controls have been redesigned, in order that during a subsequent audit, controls can be tested to verify implementation of the corrective action.

PRIOR YEAR

CAPITALIZATION PROCEDURES FOR ADP SOFTWARE NEED IMPROVEMENT

The FY 1996 audit disclosed a need for improvements to software capitalization procedures. This finding represented a continuing OIG concern about NRC's financial reporting of property. While OIG raised and the NRC has resolved similar issues over the past few years, it was believed that the issue indicated a continuing concern and must be identified as a reportable condition.

In the current year, NRC addressed the practice used for properly identifying and classifying software acquisitions in a memorandum dated August 19, 1997. The procedures outlined in the memorandum provide adequate resolution, therefore, this issue is closed.

PAYROLL SYSTEM MUST BE INTEGRATED WITH THE GENERAL LEDGER AND POSSESS LABOR DISTRIBUTION CAPABILITIES.

In the FY 1995 audit, OIG reported that NRC's accounting system did not include all of the necessary general accounting controls to produce timely and accurate financial information needed to prepare complete financial reports as required by OMB Bulletin 94-01, *Form and Content of Agency Financial Statements.* The principal weaknesses and issues that remained were:

the compatibility and integration of the NRC general ledger and subsystems used by NRC for payroll did not provide labor cost distribution capabilities.

heavy reliance on manual inputs due to the use of incompatible subsystems.

During the current year, NRC developed a year-end methodology using cost center data to present program costs by budgetary program. Furthermore, the guidance provided by FFMIA no longer requires integration of financial systems. Both these actions, presentation of costs by program and the FFMIA, enable us to close this condition.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our tests of compliance with selected provisions of laws and regulations disclosed no instances of noncompliance, except the reportable condition relating to business continuity plans which is considered a substantial noncompliance with FFMIA, that would be reportable under *Government Auditing* Standards or OMB Bulletin 93-06, *Audit Requirements for Federal Financial Statements,* as amended. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

MATTER OF EMPHASIS

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. For FY 1997 and 1996, NRC's Statement of Operations included approximately $79 and $89 million, respectively, of reimbursed expenses, which represent approximately 14% and 17%, respectively, of total expenses. Our audit included testing these expenses and financing sources 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 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.

CONSISTENCY OF OTHER INFORMATION

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

OBJECTIVES, SCOPE AND METHODOLOGY

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

We are responsible for expressing an opinion on whether (1) the Principal Statements are free of material misstatement and presented fairly, in all material respects, in conformity with the basis of accounting described in Note 1 to the principal statements, and (2) for obtaining reasonable assurance whether management's assertion about the effectiveness of the internal control structure 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 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 this annual financial statement. 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 the internal control structure 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 Budgetary 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), CFO's Act (PL 101-576), Budget and Accounting Act, Federal Financial Management Improvement Act (PL 104-208); and,

reviewed compliance and reported in accordance with FFMIA whether the agency's financial management systems substantially comply with the Federal financial management system requirements, applicable accounting standards and the U.S. Standard General Ledger at the transaction level.

We did not evaluate all internal controls relevant to operating objectives as broadly as defined in FMFIA, such as those controls for preparing statistical reports and those for ensuring efficient and effective operations. We limited our internal control tests to those necessary to achieve the objectives described in our opinion on management's assertion about the effectiveness of internal controls. Because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control structure over financial reporting to future periods is subject to the risk that the internal control structure may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We performed our work in accordance with generally accepted auditing standards, *Government Auditing Standards* and OMB Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended.

AGENCY COMMENTS

On February 6, 1998, the CFO responded to the Inspector General on our draft report and addressed the two recommendations noted in the report. The CFO did not provide specific remedial actions for the substantial non-compliance relating to business continuity. However, the CFO has indicated that a [remediation] plan will be prepared by June 1, 1998, in conjunction with the CIO. Based on our review of the CFO's comments, we are satisfied that the actions described meet the intent of our recommendations and FFMIA guidelines. The CFO's comments are appended to this report in their entirety.

Under separate cover, comments will be provided to NRC management outlining opportunities for strengthening internal control and operating efficiency. We appreciate NRC staff's cooperation and continued interest in improving financial management within the agency.

This report is intended solely for the use of management of the U.S. Nuclear Regulatory Commission and the Office of Inspector General. This restriction is not intended to limit the distribution of this report, which upon acceptance by the Office of Inspector General is a matter of public record.

January 23, 1998

STATEMENT OF FINANCIAL POSITION
September 30, 1997 and 1996

ASSETS	1997	1996
Entity Assets:		
Intragovernmental assets:		
Fund balances with Treasury (Note 2)	$176,556,311	$210,748,055
Accounts receivable (Note 3)	3,019,507	5,822,652
Advances and prepayments (Note 4)	2,948,348	4,948,524
Governmental assets:		
Accounts receivable, net (Note 3)	28,854,870	24,079,551
Advances and prepayments (Note 4)	512,767	472,592
Property and equipment, net (Note 5)	35,798,569	38,189,091
Total entity assets	$247,690,372	$284,260,465
Non-Entity Assets:		
Governmental assets:		
Accounts receivable, net (Note 3)	55,061	312,470
Total non-entity assets	55,061	312,470
Total assets	$247,745,433	$284,572,935

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

STATEMENT OF FINANCIAL POSITION (Continued)
September 30, 1997 and 1996

LIABILITIES	1997	1996
Liabilities Covered By Budgetary Resources:		
Intragovernmental liabilities:		
Accounts payable and advances (Note 6)	$ 12,775,896	$ 11,805,497
Other intragovernmental liabilities (Note 8)	30,754,696	26,519,644
Governmental liabilities:		
Accounts payable (Note 6)	21,155,283	21,229,287
Other governmental liabilities (Note 8)	5,525,519	7,143,659
Accrued payroll and benefits (Note 7)	12,450,388	11,527,847
Total liabilities covered by budgetary resources	$ 82,661,782	$ 78,225,934
Liabilities Not Covered By Budgetary Resources:		
Governmental liabilities:		
Other governmental liabilities (Note 9)	36,635,843	32,710,987
Total liabilities not covered by budgetary resources	36,635,843	32,710,987
Total liabilities	$119,297,625	$110,936,921
NET POSITION		
Balances (Note 11):		
Unexpended appropriations	129,285,082	168,157,910
Invested capital	35,798,569	38,189,091
Future funding requirements	(36,635,843)	(32,710,987)
Total net position	$128,447,808	$173,636,014
Total liabilities and net position	**$247,745,433**	**$284,572,935**

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

STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
for the years ended September 30, 1997 and 1996

REVENUES AND FINANCING SOURCES	**1997**	**Restated 1996**
Appropriated capital used (Note 12)	$ 62,086,597	$ 52,837,295
Other revenues and financing sources (Note 14)	477,704,094	452,184,128
Excess (shortage) of current year receipts of fees over billings	(4,707,194)	14,633,020
Imputed financing (Note 13)	19,976,493	20,478,243
Less: Receipts transferred to the Treasury or other agencies	(6,055,409)	(2,925,845)
Total revenues and financing sources	$549,004,581	$537,206,841
EXPENSES		
Operating Expenses		
Personnel services and benefits	$291,993,719	$283,521,310
Travel and transportation	15,451,061	16,174,764
Rent, communication, and utilities	26,276,698	25,240,443
Printing and reproduction	1,605,504	1,579,151
Contractual services	194,959,500	189,329,595
Supplies and materials	13,829,863	12,868,778
Grants, subsidies, and contributions	1,653,680	1,486,946
Insurance claims and indemnities and other	40,903	101,991
Total operating expenses	545,810,928	530,302,978
Depreciation and amortization (Note 5)	6,462,011	8,540,608
Interest	3,370	4,683
Other expenses (Note 17)	653,130	17,101
Total expenses	$552,929,439	$538,865,370
Excess or (shortage) of revenues and financing sources over total expenses (Note 18)	**$ (3,924,858)**	**$ (1,658,529)**
Net position, beginning balance	**$173,636,014**	$**209,483,290**
Excess (shortage) of revenues and financing sources over expenses	(3,924,858)	(1,658,529)
Plus non-operating changes (Note 19)	(41,263,348)	(34,188,747)
Net position, ending balance	**$128,447,808**	**$173,636,014**

STATEMENT OF CASH FLOWS

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

for the years ended September 30, 1997 and 1996

CASH PROVIDED (USED) BY OPERATING ACTIVITIES	**1997**	**1996**
Cash Provided:		
Fees for licensing, inspection, and other services (Note 12)	$ 458,626,753	$ 454,049,125
Other operating cash provided	8,968,118	8,450,745
Total cash provided	$ 467,594,871	$ 462,499,870
Cash Used:		
Personnel services and benefits	(267,638,742)	(259,816,269)
Travel and transportation	(15,766,363)	(16,275,698)
Rent, communications, and utilities	(25,184,924)	(26,342,185)
Printing and reproduction	(1,670,930)	(1,554,538)
Other contractual services	(188,142,460)	(193,678,520)
Supplies and materials	(14,406,394)	(11,162,708)
Insurance claims and indemnities	(44,125)	(98,271)
Grants, subsidies, and contributions	(1,489,740)	(1,527,452)
Other operating cash used	(1,900,841)	(6,867,038)
Total cash used	$(516,244,519)	$(517,322,679)
Net cash used by operating activities	$ (48,649,648)	$ (54,822,809)
CASH USED BY INVESTING ACTIVITIES		
Purchase of property and equipment	(6,365,343)	(11,680,069)
Net cash used by investing activities	$ (6,365,343)	$ (11,680,069)
CASH PROVIDED BY FINANCING ACTIVITIES		
Appropriations	18,173,247	18,536,875
Add: Transfers of cash from others	2,650,000	111,672
Net appropriations	$ 20,823,247	$ 18,648,547
Net cash provided by financing activities	$ 20,823,247	$ 18,648,547

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

STATEMENT OF CASH FLOWS (Continued)
for the years ended September 30, 1997 and 1996

	1997	1996
Net cash provided (used) by operating, investing, and financing activities	$ (34,191,744)	$ (47,854,331)
Fund balances with Treasury, beginning	210,748,055	258,602,386
Fund balances with Treasury, ending	$176,556,311	$210,748,055
Reconciliation of Shortage of Revenues and Financing Sources Over Total Expenses:		
Excess (shortage) of revenue and financing sources over total expenses	$ (3,924,858)	$ (1,658,529)
Adjustments to Reconcile Shortage Of Revenues and Financing Sources Over Total Expenses to Net Cash Provided by Operating Activities:		
Appropriated capital used	(62,086,597)	(52,837,295)
Decrease (increase) in accounts receivable	2,740,306	(2,823,343)
Decrease (increase) in other assets	1,960,001	(2,258,975)
Increase (decrease) in accounts payable	896,395	(887,331)
Increase (decrease) in other liabilities	(911,952)	(6,682,254)
Depreciation and amortization	6,462,011	8,540,608
Other unfunded expenses	3,924,858	1,658,529
Other adjustments	2,290,188	2,125,781
Total adjustments	(44,724,790)	(53,164,280)
Net Cash Used by Operating Activities	$ (48,649,648)	$ (54,822,809)

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

STATEMENT OF BUDGETARY RESOURCES AND ACTUAL EXPENSES
for the years ended September 30, 1997 and 1996

Programs (Note 15)	Budget Resources	Budget Obligations Direct	Budget Obligations Reimbursements	Actual 1997 Expenses	Restated Actual 1996 Expenses
Regulatory Program	$227,669,016	$223,768,332	$ 894,825	$238,846,031	
Regulatory Effectiveness Program	119,111,948	111,459,273	3,835,296	132,520,693	
Management and Support Program	164,003,050	156,423,699	1,941,596	167,707,506	
Regulation of DOE Program	3,500,000	2,584,705	163,175	1,661,955	
Inspector General Program	6,877,839	5,245,692	-	5,263,367	
Depreciation and amortization expenses not allocated to programs				6,462,011	
Other expenses not allocated to programs				467,876	$538,865,370
Unissued allowances-funds not assigned to programs	14,525,133	-	-	-	
Totals	$535,686,986	$499,481,701	$6,834,892	$552,929,439	$538,865,370

***Budget Reconciliation*:**

	1997	1996
Total expenses	$552,929,439	$538,865,370
Add: Capital acquisitions	6,365,343	11,680,069
Other expended budget authority	(1,698,068)	(2,105,885)
Less: Expenses not covered by available budgetary resources:		
Depreciation and amortization	(6,462,011)	(8,540,608)
Unfunded annual leave expense	(546,501)	(795,701)
Unfunded workers' compensation expense	(3,378,357)	(862,828)
Employer's pension benefit paid by others	(19,976,493)	(20,478,243)
Accrued expenditures	527,233,352	517,762,174
Less reimbursements	(8,311,063)	(9,842,179)
Accrued expenditures, direct	$518,922,289	$507,919,995

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

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These principal statements were prepared to report the financial position and results of operations of the U.S. Nuclear Regulatory Commission (NRC) as required by the Chief Financial Officers Act of 1990. The principal statements were prepared from the books and records of NRC in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletins 94-01 and 97-01 and NRC accounting policies summarized in this note. 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.

B. Reporting Entity/Program Name

The 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 uses of nuclear materials.

NRC has two appropriations:

- 31X0200 - Salaries and Expenses
- 31X0300 - Office of Inspector General

The 31X0200 appropriation includes approximately $11 million for FY 1997 and for FY 1996 of funds derived from the Nuclear Waste Fund in accordance with the provisions of Public Law 104-206. Public Law 104-134 rescinded $0.7 million from the FY 1996 NRC Salaries and Expenses Appropriation.

In addition, $2.65 million and $0.5 million of the appropriation received by the U.S. Agency for International Development for FY 1997 and 1996, respectively, was transferred for the Nuclear Safety Assistance Program in Russia, Armenia, Kazakhstan and the Ukraine which is under the control of NRC. The accompanying financial statements of NRC include the accounts of all funds under NRC control.

C. Budgets and Budgetary Accounting

For the past 23 years, Congress has enacted no-year appropriations which are available for obligation by NRC until expended. The Omnibus Budget Reconciliation Act (OBRA) of 1990 requires NRC to recover approximately 100 percent of its new budget authority, less the amount derived from the Nuclear Waste Fund, by assessing fees. For FY 1997, Congress appropriated funds for the commercial vitrification of high-level radioactive waste at the Hanford, Washington,

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

site. These funds are exempt from the requirement in OBRA for fee recovery. At the end of the fiscal year, NRC's appropriations are reduced by the amount of revenues collected during the fiscal year.

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. Budgetary accounting facilitates compliance with legal constraints and control over the use of Federal funds.

E. Revenues and Other Financing Sources

Licensing fees and fees for inspections and other services, assessed in accordance with OBRA, are recognized as other financing sources when earned.

For reporting purposes, appropriations are recognized as revenues (Appropriated Capital 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). Appropriated Capital Used does not include (a) appropriations used to purchase capital items; (b) expenses incurred but not yet funded by Congress, such as workers' compensation benefits and annual leave expenses; and (c) expenses which are paid by other Federal agencies, such as retirement benefits. The differences between the accrual basis recognition of appropriations expensed and the budgetary basis recognition of outlays are presented in the Statement of Budgetary Resources and Actual Expenses.

Miscellaneous receipts collected by NRC are not available to NRC for obligation or expenditure. These receipts must be transferred to the U.S. Treasury when collected.

F. Funds with the U.S. Treasury and Cash

NRC cash receipts and disbursements are processed by the U.S. Treasury. The fund balances with the Treasury and cash are primarily appropriated funds that are available to pay current liabilities and to finance authorized purchase commitments. Cash balances held outside the U.S. Treasury are not material.

G. Accounts Receivable, Net of Allowance

The amounts due for receivables, except those due from Federal agencies, are stated net of an allowance for uncollectible accounts. Since receivables from Federal agencies are expected to be collected, there is no allowance for uncollectible accounts. The estimate of the allowance is based on an analysis of the outstanding balances and the application of estimated uncollectible percentages to categories of aged receivable balances.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

H. Advances

NRC makes cash payments to other Federal agencies, employees, grantees, and contractors to provide for future NRC program expenditures. These advance payments are recorded as assets which are reduced when NRC receives reports of expenditures or when accruals of cost estimates are made.

I. Property and Equipment

The NRC's property and equipment consists primarily of typical office furnishings, nuclear reactor simulators, and computer hardware and software. The agency has no real property and loan or loan guarantee programs.

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 are capitalized at cost and depreciated. Other property items are expensed when purchased. Normal repairs and maintenance are charged to expense as incurred.

Property is depreciated using the straight-line method over useful lives which range from 5 to 20 years.

J. Prepaid and Deferred Charges

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and are recognized as expenditures/expenses when the related goods and services are received.

K. Liabilities

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. However, no liability can be paid by NRC absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is no certainty that an appropriation will be enacted are classified as Liabilities not Covered by Budgetary Resources. Also, NRC liabilities arising from sources other than contracts can be abrogated by the Government acting in its sovereign capacity.

L. Contingencies

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 position or results of operations.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

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.

Sick leave and other types of nonvested leave are expensed as taken.

N. Retirement Plans

NRC employees hired after December 31, 1983, are automatically covered by the Federal Employees' Retirement System (FERS), which was implemented on January 1, 1987. Employees hired prior to that date could elect to join FERS or to remain in the Civil Service Retirement System (CSRS). Approximately 60 percent of NRC employees belong to CSRS and 40 percent belong to FERS. In FY 1997 and 1996, for employees in FERS, NRC withheld 0.8 percent of base pay earnings in addition to Federal Insurance Contribution Act (FICA) withholdings and matched the withholding with an 11.4 percent contribution. The sum was transferred to the Federal Employees Retirement Fund. The FY 1997 contribution resulted in approximately $622,000 being paid in excess of NRC’s pension expense for the year. For employees covered by CSRS, NRC withholds 7 percent of their base pay earnings. This withholding is matched by NRC and the sum of the withholding and the match is transferred to the CSRS.

On April 1, 1987, the Federal government initiated the Thrift Savings Plan (TSP) which is a retirement savings and investment plan for employees covered by either FERS or CSRS. For employees covered by FERS, NRC automatically contributes one percent of base pay to their account and matches contributions up to an additional four percent. The maximum percentage that an employee participating in FERS may contribute is 10 percent of base pay. Employees covered by CSRS may contribute up to five percent of their base pay, but there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan in a calendar year is $9,500. The sum of the employees’ and NRC’s contributions is 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 Office of Personnel Management. The portion of the current and estimated future outlays for CSRS not paid by NRC is included in NRC’s financial statements as an imputed financing source (Note 13).

O. Net Position

The NRC's net position consists of the following components:

1. **Unexpended appropriations** which include the undelivered orders and unobligated balances of NRC's funds. All NRC appropriations remain available for obligation until expended.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

2. **Invested capital** which represents U.S. Government resources invested in NRC's property and equipment. Increases to invested capital are recorded when assets are acquired with direct appropriations, and decreases are recorded as a result of the depreciation, amortization, and disposition of capital assets.

3. **Future funding requirements** which represent (a) accumulated annual leave earned but not taken as of the financial statement date and (b) actual and estimated future payments to be made for worker's compensation pursuant to the Federal Employees Compensation Act (FECA). The expense for these accruals is not funded from current appropriations, but rather will be funded from future appropriations and assessments.

P. Department of Energy Charges

Financial transactions between the Department of Energy (DOE) and NRC are fully automated through the U.S. Treasury's On-Line Payment and Collection (OPAC) System. The OPAC System allows DOE to collect amounts due from NRC directly from NRC's account at the U.S. Treasury for goods and/or services rendered. Project manager verification of goods and/or services received is subsequently accomplished through a system-generated voucher approval system. The vouchers are returned to the Division of Accounting and Finance documenting that the charges have been accepted. For FY 1997, NRC made approximately $79.5 million in payments to DOE in this manner for research conducted by the DOE National Laboratories.

Q. Restatement

Certain amounts for FY 1996 have been restated to conform with the FY 1997 presentation.

NOTE 2. FUND BALANCES WITH THE U.S. TREASURY

Fund balances with the U.S. Treasury consist of the following amounts as of September 30, 1997 and 1996:

	1997	1996
Appropriated funds:		
Obligated	$153,920,505	$180,045,631
Unobligated	21,257,563	28,682,412
	175,178,068	208,728,043
Other fund types	1,378,243	2,020,012
	$176,556,311	$210,748,055

U.S. Government cash is handled on an overall consolidated basis by the U.S. Treasury. "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. The obligated and unobligated balances exclude amounts related to unfilled customer orders.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

NOTE 3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, is composed of the following amounts as of September 30, 1997 and 1996:

Entity Assets

Intragovernmental accounts receivable consists primarily of receivables and reimbursements due from other Federal agencies which were $3,019,507 and $5,822,652 at September 30, 1997 and 1996, respectively.

Governmental accounts receivable is comprised of the following amounts as of September 30, 1997 and 1996:

	1997	**1996**
Materials and facilities fees - billed	$ 4,270,361	$ 3,532,779
Materials and facilities fees - unbilled	25,475,254	22,667,134
Other	121,624	103,295
Total accounts receivable	$29,867,239	26,303,208
Less: Allowance for uncollectible accounts	(1,012,369)	(2,223,657)
Accounts receivable, net	$28,854,870	$24,079,551

Governmental accounts receivable represents primarily amounts due for fees assessed for licensing and inspections of nuclear facilities and radioactive materials and other services. In the year collected, the amounts will be used to offset NRC's appropriations.

Non-Entity Assets

Governmental accounts receivable, net, represents miscellaneous amounts due from the public ($55,061 and $312,470 at September 30, 1997 and 1996, respectively), which, when collected, must be transferred to the U.S. Treasury.

The NRC's methodology to estimate the allowance for uncollectible accounts is based on an analysis of the outstanding balances and the application of estimated uncollectible percentages to categories of aged receivable balances.

NOTE 4. ADVANCES AND PREPAYMENTS

Advances and prepayments as of September 30, 1997 and 1996, consist primarily of the following:

Entity Assets	**1997**	**1996**
Intragovernmental:		
Advances - other Federal agencies	$2,325,666	$4,948,524
Prepayment - pension expenses	622,682	-
	$2,948,348	$4,948,524

	1997	**1996**

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

Governmental:		
Advances	$ 512,767	$ 472,592

Advances and prepayments are recorded as assets until receipt of the goods or services involved or until contract terms are met. When goods or services are received or contract terms are met, the advance or prepayment is reduced and the expense or acquired asset is recognized.

NOTE 5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net, consists of the following as of September 30, 1997 and 1996:

Fixed Assets Class	Service Years	Acquisition Value	Accumulated Depreciation	1997 Net Book Value	1996 Net Book Value
Equipment	5-8	$ 26,587,156	$(20,400,890)	$ 6,186,266	$ 8,081,496
ADP software	5	45,249,731	(42,526,961)	2,722,770	4,915,553
ADP software under development		11,340,853	-	11,340,853	9,002,437
Leasehold improvements	5-20	19,181,964	(3,633,284)	15,548,680	14,625,594
Leasehold improvements in progress		-	-	-	1,564,011
Total		$102,359,704	$(66,561,135)	$35,798,569	$38,189,091

The straight-line depreciation method is used for all classes of fixed assets. Depreciation expense for FY 1997 and 1996 was $6,462,011 and $8,540,608, respectively.

The land and buildings occupied by NRC are provided by GSA. For FY 1997 and 1996, GSA charged NRC $19,499,176 and $24,100,381, respectively, for the use of these facilities based on a rental fee which is to approximate the commercial rates for similar properties.

NOTE 6. ACCOUNTS PAYABLE AND ADVANCES

Accounts payable and advances consist of the following as of September 30, 1997 and 1996:

		1997	1996
Intragovernmental:			
Accounts payable			
Department of Energy	$ 7,079,111	$ 9,368,752	
Other Federal agencies		5,331,554	2,282,932
		12,410,665	11,651,684
Advances		365,231	153,813
		$12,775,896	$11,805,497

	1997	1996

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

Governmental:		
Accounts payable		
Vendors payable	$19,474,528	$19,743,864
Contract holdbacks	1,680,755	1,485,423
	$21,155,283	$21,229,287

The vendors payable are all current. Current payables represent amounts which are expected to be paid within the fiscal year following the reporting date.

NOTE 7. ACCRUED PAYROLL AND BENEFITS

Accrued payroll and benefits as of September 30, 1997 and 1996, consists of:

	1997	**1996**
Accrued personnel services	$10,629,617	$ 9,824,164
Accrued benefits	1,820,771	1,703,683
	$12,450,388	$11,527,847

Accrued payroll and benefits represent wages and benefits which have been earned but not paid as of the financial statement date.

NOTE 8. OTHER LIABILITIES COVERED BY BUDGETARY RESOURCES

Other liabilities as of September 30, 1997 and 1996, include:

	1997	**1996**
Governmental:		
Liability for deposit funds	$1,126,887	$1,554,395
Advances from others	4,398,632	5,589,264
	$5,525,519	$7,143,659

The liability for deposit funds consists primarily of liabilities arising from payroll deductions and tax withholdings. Advances from others consists of funds primarily from foreign governments for the participation in cooperative research programs.

	1997	**1996**
Intragovernmental:		
Liability to offset net accounts receivable for fees assessed	$30,699,637	$26,206,946
Liability to offset net miscellaneous accounts receivable	55,059	312,698
	$30,754,696	$26,519,644

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.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

The liability to offset net miscellaneous accounts receivable represents amounts which will be reverted to the U.S. Treasury when collected.

All other liabilities except advances from others are current. Current liabilities represent amounts which are expected to be paid within the fiscal year following the reporting date. Advances from others may not be liquidated in the fiscal year following the reporting date.

NOTE 9. OTHER LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Unfunded liabilities as of September 30, 1997 and 1996, include:

	1997	1996
Governmental:		
Accrued annual leave	$25,905,986	$25,359,485
Accrued workers' compensation:		
Benefits paid	1,700,857	1,476,502
Estimated future benefits	9,029,000	5,875,000
	$36,635,843	$32,710,987

Accrued annual leave represents the amount of annual leave earned by NRC employees but not yet taken. Accrued workers' compensation includes: (a) FECA benefits paid by the Department of Labor (DOL) on NRC's behalf which had not been billed to or paid by NRC as of September 30, 1997 and 1996, and (b) an actuarial estimate for future disability benefits. The FY 1997 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, and 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.

Accrued annual leave and accrued workers' compensation are not funded by current or prior years' appropriations and assessments. Funding will be provided from future years' appropriations and assessments (see Note 11).

NOTE 10. INTRAGOVERNMENTAL ACTIVITIES

The NRC's financial activities interact with and are dependent upon those of the Federal Government as a whole. Other Federal agencies make financial decisions and report certain financial matters on behalf of all Federal agencies. The practice of having Federal agencies record or report only those government wide financial matters for which they are directly responsible is consistent with generally accepted accounting principles for Federal agencies which seek to identify financial matters to the department or agency that has been granted budget authority and resources to manage them. Activities which are performed or reported by other Federal agencies in which NRC is indirectly involved are as follows:

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

- The NRC funds a portion of its employee pension benefits under the CSRS and the FERS (Note 16). The portion not funded by NRC is included in NRC's financial statements as an imputed financing source (Note 13). The NRC does not disclose actuarial data with respect to accumulated plan benefits, plan assets, or the unfunded pension liability relative to its employees. Reporting of these amounts is the responsibility of the Office of Personnel Management.

  In addition, the NRC makes contributions to the TSP on behalf of its employees. The NRC does not have control over the plan's assets. The TSP is administered by the National Finance Center of the Department of Agriculture.

- Certain legal matters to which NRC may be a named party are administered, and in some cases litigated, by other Federal agencies. Amounts paid under any decision, settlement, or award pertaining thereto are generally funded through the U.S. Treasury.

  In most cases, claims (including personal injury claims) are administered and resolved by the Department of Justice, and any amounts necessary for resolution are obtained from a special fund maintained by the U.S. Treasury. Any legal actions for workers' compensation claims brought by NRC employees fall under FECA, which is administered by DOL's Employment Standards Administration. The cost of administering, litigating, and settling these legal matters has not been allocated to individual Federal agencies.

- 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.

NOTE 11. NET POSITION

The net position consists of the following as of September 30, 1997 and 1996:

	1997	1996
Unexpended appropriations:		
Unobligated	$ 25,683,385	$ 34,765,076
Undelivered orders	103,601,697	133,392,834
	129,285,082	168,157,910
Invested capital	35,798,569	38,189,091
Future funding requirements (Note 9)	(36,635,843)	(32,710,987)
	$128,447,808	$173,636,014

Unexpended appropriations include (a) unobligated appropriation balances and (b) undelivered orders, which are amounts which have been obligated but not yet expended. The unobligated appropriations balance does not include $4,306,364 and $6,262,153 in unfilled customer orders - unobligated as of September 30, 1997 and 1996, respectively. The undelivered orders balance does not include $4,425,821 and $6,082,665 in unfilled customer orders - obligated as of September 30, 1997 and 1996, respectively.

Invested capital represents the net investment of the U.S. Government appropriations expended for NRC's capitalized property and equipment.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 1997 and 1996. These accruals are not funded from current or prior appropriations and assessments, but rather should be funded from future appropriations and assessments. Accordingly, future funding requirements have been recognized for these expenses that will be paid from future appropriations (See Note 9).

NOTE 12. APPROPRIATED CAPITAL USED

Appropriated capital used, a financing source, is recognized to the extent that appropriated funds have been consumed less the amount collected from fees assessed for licensing, inspections, and other services. During FY 1997 and 1996, $458.6 million and $454.0 million, respectively, were collected from fees assessed for licensing, inspections, and other services. OBRA requires NRC to recover approximately 100 percent of its new budget authority, less the amount appropriated from the Nuclear Waste Fund and appropriated for work at the Hanford, Washington, site, by assessing fees. 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.

For FY 1997 and 1996, $458.6 million and $454.0 million, respectively, of collections were used to reduce the fiscal year's appropriations recognized:

	1997	**1996**
Appropriated funds consumed	$520,713,350	$ 506,886,420
Less: Collection from fees assessed	(458,626,753)	(454,049,125)
	$ 62,086,597	$ 52,837,295

The appropriated capital used for FY 1997 and 1996 includes $41,263,348 and $34,188,747, respectively, of available funds from prior years (Note 19).

NOTE 13. IMPUTED FINANCING

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) Number 5, *Accounting for Liabilities of the Federal Government*, the Statement of Operations and Changes in Net Position includes an imputed financing source of $19,976,493 and $20,478,243 for FY 1997 and 1996, respectively. The imputed financing source represents the service costs related to NRC employees' post-employment benefits which are paid by the Office of Personnel Management, as follows:

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

	1997	1996
Civil Service Retirement System	$13,156,011	$14,525,205
Federal Employee Health Benefit	6,788,439	5,921,303
Federal Employee Group Life Insurance	32,043	31,735
	$19,976,493	$20,478,243

NOTE 14. OTHER REVENUES AND FINANCING SOURCES

Other revenues and financing sources for September 30, 1997 and 1996, were:

	1997	1996
Fees for licensing, inspection, and other services	$463,333,946	$439,416,104
Appropriation reimbursements	8,311,063	9,842,179
Other miscellaneous receipts	6,055,409	2,925,845
Gain on disposition of assets	3,676	-
	$477,704,094	$452,184,128

NOTE 15. PROGRAMS

The Statement of Budgetary Resources and Actual Expenses contains operating expenses by program for FY 1997. Comparative data for FY 1996 is not available. The description of NRC's five programs is as follows:

1. **Regulatory Program** encompasses all NRC efforts to ensure that the operation of commercial and nonpower nuclear reactor facilities and all NRC-regulated aspects of nuclear fuel cycle facilities; nuclear materials licensing; nuclear waste transport, storage, and disposal; and decommissioning activities are conducted in a manner that provides reasonable assurance of adequate protection of public health and safety, as required by the Atomic Energy Act of 1954 and other relevant laws.

2. **Regulatory Effectiveness Program** helps ensure adequate protection of the public health and safety, as required by the Atomic Energy Act of 1954, by providing the Commission with the technical bases for regulatory decisions for all regulatory programs.

3. **Management and Support Program** encompasses NRC central policy direction, legal advice for the Commission, analysis of long-term policy issues, administrative proceedings review and advice, liaison with outside constituents and other government agencies, financial management, all administrative and logistical support, information resources management, executive management services for the Commission, personnel and training, international programs, and matters involving small and disadvantaged businesses and civil rights.

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

4. **Regulation of DOE Program** involves the continued commitment of DOE and NRC to resolve issues of concern to either agency that relate to the regulation of nuclear facilities, projects, and activities in the protection of public health and safety and the environment.

5. **Inspector General Program** independently evaluates the agency's programs and operations to ensure their efficiency and effectiveness and investigates allegations of fraud, waste, and abuse.

NOTE 16. EMPLOYEE RETIREMENT PLANS

The NRC's contributions for employee retirement plans for FY 1997 and 1996 were as follows:

	1997	Restated 1996
Civil Service Retirement System	$ 8,963,175	$ 9,066,506
Federal Employees' Retirement System	10,174,861	9,476,956
Federal Insurance Contribution Act	9,850,629	6,078,868
Thrift Savings Plan	4,648,337	3,754,354
	$33,637,002	$28,376,684

Data on the actuarial present value of accumulated benefits, assets available for benefits, and unfunded pension liability are maintained by other Federal agencies and are not allocated to individual departments and agencies. The portion of the current and estimated future outlays for CSRS not paid by NRC is included in NRC's financial statements as an imputed financing source (Note 13).

NOTE 17. OTHER EXPENSES

Other expenses as of September 30, 1997 and 1996, consist of:

	1997	1996
Loss on disposal of property	$613,338	$ 41,403
Bad debt expense	39,792	(24,302)
	$653,130	$ 17,101

NOTE 18. EXCESS OR (SHORTAGE) OF REVENUES AND FINANCING SOURCES OVER TOTAL EXPENSES

The excess or (shortage) of revenues and financing sources over total expenses represents expenses not covered by budgetary resources for the years ended September 30, 1997 and 1996, and consists of:

NOTES TO PRINCIPAL STATEMENTS
September 30, 1997 and 1996

	1997	1996
Accrued annual leave	$ (546,501)	$ (795,701)
Accrued workers' compensation	(3,378,357)	(862,828)
	$(3,924,858)	$(1,658,529)

Expenses not covered by budgetary resources are not funded from current appropriations but are to be funded from future appropriations and assessments.

NOTE 19. NON-OPERATING CHANGES

Non-operating changes for the fiscal years ended September 30, 1997 and 1996, consist of the following:

	1997	1996
Change in unexpended appropriations	$(38,872,829)	$(35,202,426)
Change in invested capital	(2,390,519)	1,013,679
	$(41,263,348)	$(34,188,747)

February 6, 1998

MEMORANDUM TO: Hubert T. Bell
Inspector General

FROM: Jesse L. Funches
Chief Financial Officer

SUBJECT: DRAFT AUDIT REPORT - AUDIT OF THE NUCLEAR REGULATORY COMMISSION'S FISCAL YEAR 1997 FINANCIAL STATEMENTS

We have reviewed the draft audit report of the Nuclear Regulatory Commission's FY 1997 financial statements. There are two reportable conditions and recommendations. Our comments are:

Recommendation 1: The CFO should establish, for systems within the agency's control, initiatives for designing recovery plans for all financial managements systems. In providing such guidance, the CFO should assess the priority of each system. Furthermore, the CFO should assure that policies are issued ensuring that the design or development of any new financial management systems, and the related security and maintenance programs of such systems include the development of a plan which is documented and tested. We recognize that NRC, as a user of the FFS, does not have the leverage to compel FMS to comply with a sound disaster recovery program. Therefore, no recommendation is offered other than continued monitoring of this condition through the user group.

Response: Agency financial systems are currently undergoing major changes. The three systems mentioned in the audit report are all scheduled for replacement within the next one to two years. The Federal Financial System (FFS) and the accounts receivable/license fee billing system will be replaced by the new agency-wide resource management system STARFIRE. The Payroll System will be replaced by the Payroll/Personnel (PAY/PERS) System. The OCFO and OCIO will determine the cost effectiveness of developing continuity/contingency plans for the systems that are to be retired or replaced. The OCFO and OCIO will then jointly prepare a plan by June 1, 1998, to develop the required continuity/contingency plans for continuing financial systems. These plans will be developed in accordance with OMB Circular A-130, Management of Federal information Resources, and the NRC System Development and Life Cycle Management (SDLCM) Methodology.

Recommendation 2: The CFO should reduce the number of persons holding the "lead accountant" access profile and/or implement additional compensating controls. The compensating controls could include requiring supervisory review and certification of reconciliations and their resulting journal vouchers.

CONTACT: Barbara K. Gusack, OCFO/DAF/GAB
415-6054

***Response**:* The OCFO will examine those persons holding the “lead accountant” access profile and determine whether it is appropriate to make any changes to access profiles. In addition, the OCFO will institute compensating controls consisting of review and certification of reconciliations and their resulting journal vouchers by the Financial Team leader.

We appreciate the opportunity to respond to the draft audit report.

cc: A. Galante, CIO
T. Barchi, OIG/AIGA