
**OFFICE OF
THE INSPECTOR GENERAL**

**U.S. NUCLEAR
REGULATORY COMMISSION**

Audit of the Nuclear Regulatory Commission's
FY 2003 Financial Statements

OIG-04-A-03 December 17, 2003

AUDIT REPORT



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December 17, 2003

MEMORANDUM TO: Chairman Diaz

FROM: Hubert T. Bell/**RA**/
Inspector General

SUBJECT: RESULTS OF THE AUDIT OF THE U.S. NUCLEAR
REGULATORY COMMISSION'S FISCAL YEAR 2003 FINANCIAL
STATEMENTS (OIG-04-A-03)

Attached is the independent auditors' report, issued by R. Navarro & Associates, Inc., on the U.S. Nuclear Regulatory Commission's (NRC) financial statements for the years ended September 30, 2003 and 2002. The Chief Financial Officers Act of 1990 requires the Inspector General (IG) or an independent external auditor, as determined by the IG, to annually audit NRC's Principal Financial Statements. The report contains: (1) the principal statements and the auditors' opinion on those statements; (2) the opinion on management's assertion about the effectiveness of internal controls; and (3) a report on NRC's compliance with laws and regulations. Written comments were obtained from the Chief Financial Officer (CFO) and are included as an appendix to the report.

Audit Results

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

In the report on management's assertion about the effectiveness of internal controls, the auditors concluded that management's assertion is fairly stated. The auditors identified three new reportable conditions and one prior-year reportable condition which remains resolved. Additionally, one prior-year reportable condition was closed. The new conditions concern information systems security access, monitoring of accounting for internal use software, and managerial cost accounting.

The report on NRC's compliance with laws and regulations disclosed one prior-year noncompliance. NRC's 10 CFR Part 170 hourly rates are not based on full cost.

Performance Reporting

As required by Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, 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. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

Comments of the Chief Financial Officer

The CFO generally agreed with the auditors' recommendations and stated that corrective action has been taken or is underway. We will follow-up on the CFO's corrective action during FY 2004.

The independent auditors' management letter providing observations on ways to strengthen internal controls and operating efficiency will be sent separately.

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

Attachment: As stated

cc: Commissioner McGaffigan
Commissioner Merrifield

R. McOsker, OCM/RAM
B. Torres, ACMUI
B.J. Garrick, ACNW
M. Bonaca, ACRS
J. Larkins, ACRS/ACNW
P. Bollwerk III, ASLBP
K. Cyr, OGC
J. Cordes, OCAA
W. Travers, EDO
E. Merschoff, CIO
J. Funches, CFO
P. Rabideau, Deputy CFO
J. Dunn Lee, OIP
D. Rathbun, OCA
W. Beecher, OPA
A. Vietti-Cook, SECY
W. Kane, DEDH/OEDO
C. Paperiello, DEDMRS/OEDO
P. Norry, DEDM/OEDO
M. Springer, ADM
J. Dyer, NRR
G. Caputo, OI
P. Bird, HR
C. Kelley, SBCR
M. Virgilio, NMSS
S. Collins, DEDR
A. Thadani, RES
P. Lohaus, STP
F. Congel, OE
M. Federline, NMSS
R. Zimmerman, NSIR
R. Wessman, IRO
H. Miller, RI
L. Reyes, RII
J. Caldwell, RIII
B. Mallett RIV
OPA-RI
OPA-RII
OPA-RIII
OPA-RIV

U.S. NUCLEAR REGULATORY COMMISSION

**INDEPENDENT AUDITORS' REPORT AND PRINCIPAL STATEMENTS
FOR THE YEARS SEPTEMBER 30, 2003 AND 2002**

R. NAVARRO & ASSOCIATES, INC.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

This Performance and Accountability Report represents the culmination of the U.S. Nuclear Regulatory Commission's (NRC) program and financial management processes, which began with mission and program planning, continued through the formulation and justification of NRC's budget to the President and the Congress, through budget execution, and ended with this report on our program performance and use of the resources entrusted to us. This report was prepared pursuant to the requirements of the Chief Financial Officers Act, as amended by the Reports Consolidation Act, and covers activities from October 1, 2002, to September 30, 2003.

Chapter 1, Management's Discussion and Analysis, provides a high-level overview of the NRC. It consists of six sections: *About the NRC* describes the agency's mission, organizational structure, and regulatory responsibility; *Future Challenges* includes forward-looking information; *Program Performance Overview* discusses the agency's success in achieving its strategic goals; *President's Management Agenda* describes the agency progress in "Getting to Green" for the five management initiatives; *Financial Performance Overview* provides highlights of the NRC's financial position and audit results; and *Systems, Controls, and Legal Compliance* describes the agency's compliance with key legal and regulatory requirements.

ABOUT THE NRC

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

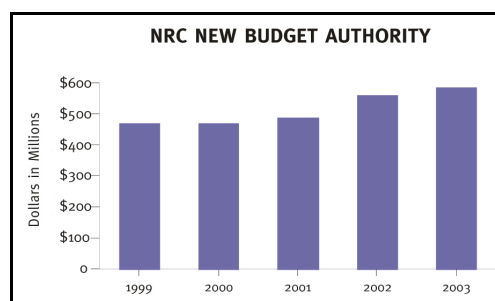
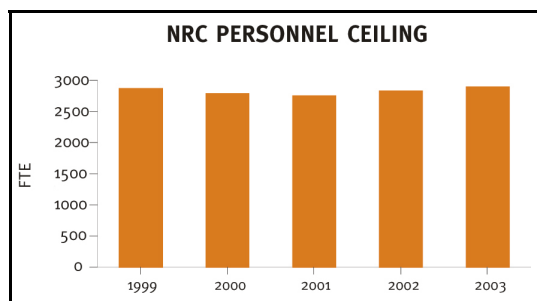
Organization

The NRC is headed by a Commission composed of five members, with one member designated by the President to serve as Chairman. Each member is appointed by the President, with the advice and consent of the Senate, and serves a term of 5 years. The Chairman serves as the principal executive officer and official spokesman for the Commission. The chief operating officer is the Executive Director for Operations who carries out the program policies and decisions made by the Commission.

The NRC's headquarters offices are located in Rockville, Maryland. Four regional offices are located in King of Prussia, Pennsylvania; Atlanta, Georgia; Lisle, Illinois; and Arlington, Texas; and a technical training center is located in Chattanooga, Tennessee. The NRC's Operations Center is the focal point for NRC communications with its licensees, State agencies, and other Federal agencies concerning operating events in the commercial nuclear sector. The Operations Center is staffed 24 hours a day by NRC operations officers. The NRC also has resident inspector offices at each commercial nuclear power plant.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The NRC's budget for fiscal year (FY) 2003 was \$584.6 million and 2,906 full-time equivalent staff. The FY 2002 budget was \$558.6 million and 2,842 full-time equivalent staff. The NRC is a fee-based agency that recovers most of its funding from fees paid by NRC licensees. Approximately 47 percent of the budget and 54 percent of the staff are for reactor safety.



Regulatory Responsibility

To fulfill its responsibility to protect the public health and safety, the NRC performs three principal regulatory functions: (1) establish standards and regulations, (2) issue licenses for nuclear facilities and users of nuclear materials, and (3) inspect facilities and users of nuclear materials to ensure compliance with regulatory requirements. These regulatory functions relate to both nuclear power plants and other civilian uses of nuclear materials, such as nuclear medicine programs at hospitals; academic activities at educational institutions; research work; industrial applications, such as gauges and testing equipment; and the transport, storage, and disposal of nuclear materials and wastes. The NRC has aligned its regulatory programs into the following four strategic arenas.

Nuclear Reactor Safety encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities, as well as test and research reactors, are operated in a manner that adequately protects public health and safety and the environment, and that safeguards special nuclear materials used in reactors.

Nuclear Materials Safety encompasses NRC efforts to ensure that nuclear fuel cycle facilities; and academic, industrial, and medical uses of nuclear materials are handled in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

Nuclear Waste Safety encompasses NRC efforts to ensure that the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive wastes are handled in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

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

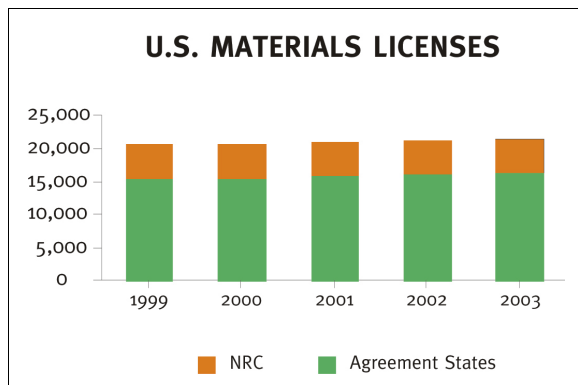
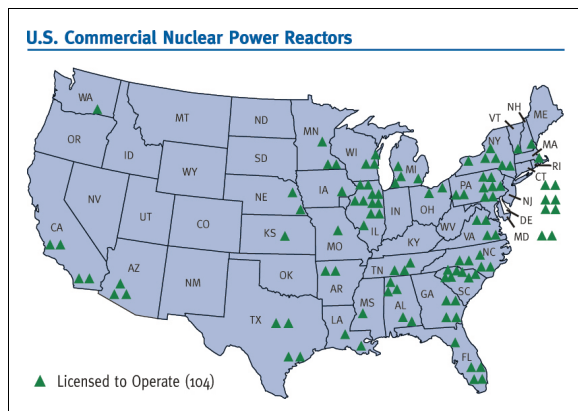
MANAGEMENT'S DISCUSSION AND ANALYSIS

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

Approximately 20 percent of the Nation's electricity is generated by 104 commercial nuclear reactors which are licensed by the NRC to operate in 31 States. Since 1991, nuclear electric generation has increased by 21 percent. The NRC expends over 330,000 hours of inspection effort at 104 operating reactors and licenses approximately 4,500 reactor operators.

The NRC oversees approximately 4,800 licenses for medical, academic, industrial, and general uses of nuclear materials. The NRC conducts approximately 1,100 health and safety inspections of its nuclear materials licensees annually. Additionally, approximately 16,600 licenses are administered by the 33 States that participate in the Agreement States Program, which authorizes the State to regulate the use of radioactive materials within that State. The NRC, Agreement States, and their licensees share a common responsibility to protect public health and safety.

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



FUTURE CHALLENGES

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

Homeland Security

Few areas of nuclear regulation have undergone as much change as the area of security since the terrorist attacks on September 11, 2001. To deal with initial concerns about the increased threat in the wake of those attacks, the NRC issued advisories and orders to its licensees and participated in many Federal ad hoc and standing committees and task groups to enhance National response and international decisions. The agency continues to work to strengthen relationships among the

MANAGEMENT'S DISCUSSION AND ANALYSIS

various Federal, State, and local agencies, including the new Department of Homeland Security (DHS), that have assumed responsibility for protecting nuclear facilities and activities and responding to incidents when they occur.

The primary challenge facing the NRC in the coming years is to emerge from this period of temporary measures, determine what long-term security provisions are necessary, and revise its regulations, security enhancements, orders and internal procedures to ensure public health and safety and the common defense and security in the elevated threat environment. In particular, the NRC will focus its efforts on the following activities:

- # Complete the identification of vulnerabilities at licensed facilities.
- # Revise requirements to provide additional protection where needed.
- # Explore improved methods of communicating sensitive information to licensees.
- # Enhance controls on high-risk radiation sources.
- # Develop more formal, long-term relationships with Federal, State, and local organizations with shared responsibilities for protecting nuclear facilities and activities.

The NRC may also be called upon to expand its role in international activities related to the security of nuclear materials and facilities. Today, the agency participates in the formulation of foreign policy guidance and shares with the U.S. Department of Energy (DOE) the responsibility for providing international assistance in nuclear safety and safeguards. The agency also reviews applications and issues import and export licenses for nuclear materials and equipment. The heightened level of attention to these types of activities may affect the NRC's security strategies over the next several years. The NRC's involvement with the International Atomic Energy Agency (IAEA) on nuclear safeguards, non-proliferation, and international regulatory standards is also likely to be affected.

The agency has contributed significantly to integrated efforts to protect against terrorist attacks on American interests. The NRC is maintaining state-of-the-art expertise in matters of both domestic and international security.

Nuclear Power and National Energy Needs

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

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

Compared to the operating record at the beginning of the 1990s, nuclear power plants today are more efficiently run, with fewer outages and greater reliability. In less than a decade, average capacity utilization in the industry has increased from 70 percent to 92 percent in 2002. (FY 2003 data will be available in mid-FY 2004.) At the same time, objective measures of safety performance have also shown considerable improvement. The growth in demand for electric power, improved economic fundamentals for nuclear power generation, and concerns about the supply of energy

MANAGEMENT'S DISCUSSION AND ANALYSIS

from other sources and their environmental impact have increased electric utilities' interest in building and operating new nuclear power plants. The NRC is currently reviewing three design certification applications and expects to receive one additional application in the next year. Two early site permit applications have been received with one more expected in early FY 2004. The NRC has been putting in place the necessary regulatory processes to review an application for a new plant and to monitor its construction. The NRC must meet the challenge of keeping pace with industry plans and schedules for new reactor licensing activities, including early site permit reviews, design reviews, and enhancement to the regulatory infrastructure.

Nuclear Waste

Radioactive waste is a byproduct of generating nuclear power. In April 2002, the President accepted the Secretary of Energy's recommendation that the Yucca Mountain, Nevada, site be developed as a potential repository for the disposal of high-level nuclear wastes and spent nuclear fuel. In July 2002, Congress approved a resolution of siting approval, which authorizes DOE to apply to the NRC for a license to operate Yucca Mountain as a nuclear waste repository. The NRC will play a critical role in ensuring that any repository built at Yucca Mountain provides for the long-term safety of the surrounding environment and public health. The agency's activities, in anticipation of DOE's operating license application, began to scale up in FY 2003. The NRC also issued the final Yucca Mountain Review Plan (YMRP), describing the information that the NRC is to review in the license application, as well as the criteria for determining whether issues have been satisfactorily addressed. The NRC expects DOE to file its license application in late 2004. In FY 2003, the NRC published a final rule which addresses unlikely events for the proposed Yucca Mountain repository that can be excluded from certain required assessments due to their low probability of occurrence.

PROGRAM PERFORMANCE OVERVIEW

Federal agencies provide an annual performance plan to Congress, setting goals with measurable target levels of performance based on the Government Performance and Results Act (GPRA). The NRC evaluates its program performance within a structured planning, budgeting, and performance management (PBPM) process. As such, NRC has organized its strategic goals, performance goals, and strategies for achieving its mission into four strategic arenas. Our highest priority is safety, and our strategic goals focus on the achievement of this priority. NRC's FY 2000-2005 Strategic Plan is available on its Web site at www.nrc.gov. The complete FY 2003 Performance Report, with strategic goal measures, is contained in Chapter 2: Program Performance.

Nuclear Reactor Safety

Strategic Goal: Prevent radiation-related deaths and illnesses, promote the common defense and security, and protect the environment in the use of civilian nuclear reactors.

The NRC regulates 104 civilian nuclear power reactors licensed to operate and 36 non-power reactors. During FY 2002 and 2003, the NRC met all five of the strategic goal measures for this arena.

For the past year, the NRC met or exceeded all established schedules for license renewal activities. This is significant given the interest by our licensees whose licenses need to be renewed to continue operations. In addition, during FY 2003 NRC approved 17 requests from licensees for power uprates, which increase the electrical generating capacity of the licensees' nuclear reactor power plants. To date, the NRC has approved 99 requests from licensees for power uprates. Approval of power uprates has resulted in an electrical generating capacity gain equivalent to approximately three large nuclear power plants. New reactor licensing activities during FY 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

included the receipt of two reactor design review applications and two early site permit applications. To promote common defense and security, NRC took significant actions requiring licensees to enhance the already robust security at nuclear power plants and other sensitive facilities.

Nuclear Materials Safety

Strategic Goal: Prevent radiation-related deaths and illnesses, promote the common defense and security, and protect the environment in the use of source, byproduct, and special nuclear material.

The NRC has regulatory oversight for 42 fuel cycle facilities, including eight major fuel cycle facilities and two gaseous diffusion plants. This strategic arena also includes oversight of approximately 20,000 specific and 150,000 general licenses regulated by the NRC and the 33 Agreement States. During FY 2002 and 2003, the NRC met all five of its strategic goal measures for this arena.

In addition to achieving our strategic goal measures, it is noteworthy to describe the NRC's progress in reviewing application submissions from the Duke, Cogema, Stone & Webster (DCS) to construct a mixed-oxide (MOX) fuel fabrication facility on the DOE's Savannah River site near Aiken, South Carolina. The proposed use of MOX fuel is part of a national non-proliferation effort to dispose of surplus weapons-grade plutonium by irradiating it in existing commercial light-water reactors. The NRC completed and issued a draft environmental impact statement (EIS) in February 2003. Then, in March 2003, the NRC held public meetings throughout the area surrounding the site to facilitate public comments on the draft EIS. In April 2003, the NRC issued a revised draft safety evaluation report that documents the NRC's review of the revised construction authorization request submitted by DCS on October 31, 2002.

Nuclear Waste Safety

Strategic Goal: Prevent significant adverse impacts from radioactive waste to the current and future public health and safety and the environment, and promote the common defense and security.

Nuclear Waste Safety encompasses regulatory activities associated with the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive waste. For FY 2002 and 2003, the NRC met all four of its strategic goal measures for this arena.

Over the past few years, the NRC has continued to build and refine the regulatory framework for evaluating the license application for the proposed Yucca Mountain repository. In FY 2003, the NRC published a final rule which addresses unlikely events for the proposed Yucca Mountain repository that can be excluded from certain required assessments due to their low probability of occurrence.

Also in FY 2003, the NRC issued the YMRP, an important companion to the rules in 10 Code of Federal Regulations (CFR) Part 63. The YMRP describes the information that the NRC is to review in the license application, as well as the criteria for determining whether issues have been satisfactorily addressed. The NRC expects DOE to file its license application in late 2004.

International Nuclear Safety Support

Strategic Goal: Support U.S. interests in the safe and secure use of nuclear materials and in nuclear nonproliferation.

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This arena encompasses international nuclear policy formulation, export-import licensing for nuclear materials and equipment, treaty implementation, nuclear proliferation deterrence, international safety assistance, and safeguards support and assistance. All three measures established for this arena were met in FY 2002 and in FY 2003.

During FY 2003, the NRC continued to provide extensive support to international developments in response to the possible terrorist use of radiological dispersal devices (RDD) and radiological exposure devices. This support included extensive participation by the NRC Chairman and senior management in the IAEA International Conference on the Security of International Sources in Vienna, Austria, in March 2003. In addition, during technical meetings held in Vienna in March and July 2003, NRC staff supported the IAEA in developing its revised Code of Conduct for the control and security of radioactive sources. NRC staff contributions toward the IAEA's revised Code of Conduct were particularly notable in categorizing the sources of greatest concern.

PRESIDENT'S MANAGEMENT AGENDA

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

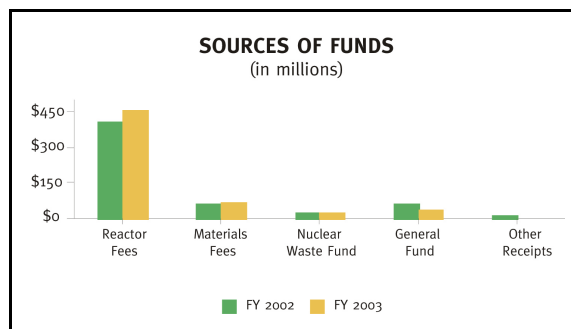
FINANCIAL PERFORMANCE OVERVIEW

As of September 30, 2003, and 2002, the financial condition of the NRC was sound with respect to having sufficient funds to meet program needs and adequate control of these funds in place to ensure obligations did not exceed budget authority. The NRC prepared its financial statements in accordance with the accounting standards codified in the Statements of Federal Financial Accounting Standards (SFFAS) and Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Sources of Funds

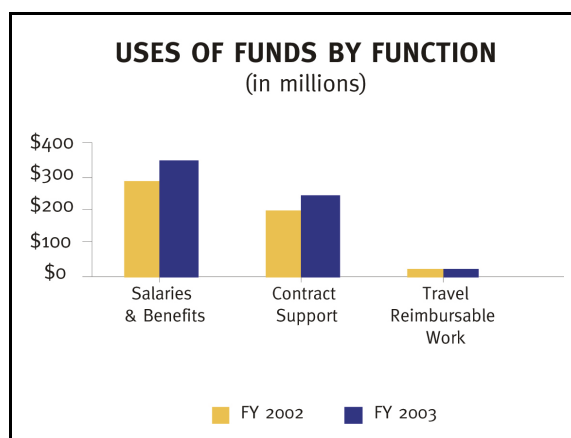
The NRC has two appropriations, Salaries and Expenses and Office of the Inspector General (OIG), and funds for both appropriations are available until expended. The NRC's total new FY 2003 budget authority was \$584.6 million, of this amount, \$577.8 million is for the Salaries and Expenses appropriation, and \$6.8 million is for the Office of the Inspector General appropriation. This represents an overall increase in new budget authority of \$26.0 million over FY 2002 (\$25.4 million for the Salaries and Expenses Appropriation and \$0.6 million for the Office of the Inspector General Appropriation). In addition, \$41.1 million from prior-year appropriations, \$3.4 million from prior-year reimbursable work, and \$8.3 million for new reimbursable work to be performed for others was available to obligate in FY 2003. The sum of all funds available to obligate for FY 2003 was \$637.4 million, which is a \$41.4 million increase over the FY 2002 amount of \$596.0 million.



The Omnibus Budget Reconciliation Act of 1990 (OBRA-90), as amended, required the NRC to collect fees to offset approximately 94 percent of its new budget authority, less the amount appropriated to the NRC from the Nuclear Waste Fund for FY 2003. The NRC collected \$526.3 million in FY 2003. This is 100 percent of the recovery requirement. For FY 2002, OBRA-90 required NRC to collect approximately 96 percent of its new budget authority, excluding appropriations from the Nuclear Waste Fund.

Uses of Funds by Function

The NRC incurred obligations of \$597.0 million, which was an increase of \$38.3 million over FY 2002. Approximately 57 percent of obligations were used for salaries and benefits. The remaining 43 percent was used to obtain technical assistance for the NRC's principal regulatory programs, to conduct confirmatory safety research, to cover operating expenses, (e.g., building rentals, transportation, printing, security services, supplies, office automation, training), staff travel, and reimbursable work. The unobligated budget authority available at the end of FY 2003 was \$40.4 million, which is an increase over the FY 2002 amount of \$37.3 million. Of this \$40.4 million, \$5.7 million is for reimbursable work and \$34.7 million is available to fund critical needs in FY 2004.



Audit Results

The NRC received an unqualified audit opinion on its FY 2003 financial statements, with no material internal control weaknesses and no substantial noncompliances with the Federal Financial Management Improvement Act (Improvement Act). This was the 10th consecutive year the NRC received an unqualified opinion. In addition, during FY 2003, the auditors evaluated the NRC's

MANAGEMENT'S DISCUSSION AND ANALYSIS

corrective actions on the agency's only material internal control weakness regarding the implementation of SFFAS Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. The auditors concluded that the actions taken adequately addressed the material weakness and the associated substantial noncompliance with FFMA; therefore, the cost accounting reportable condition in the current year is not a material weakness nor a substantial noncompliance with the Improvement Act.

For FY 2003, the auditors identified one new reportable condition concerning system security access. In addition to cost accounting, four reportable conditions were carried over from FY 2002. Three of these reportable conditions remained open at the end of FY 2003 concerning the development of the hourly rate for license fees, accounting for internal use software, and contracts in close-out. The agency expects to fully implement corrective action during FY 2004 for the open reportable conditions.

Financial Statement Highlights

The NRC's financial statements summarize the financial activity and financial position of the agency. The financial statements, footnotes, and the balance of the required supplementary information, appear in Chapter 3: Auditor's Report and Financial Statement. Analysis of the principal statements follows.

Analysis of the Balance Sheet

The NRC's assets were approximately \$276.2 million as of September 30, 2003. This is an increase of \$11.8 million from the end of FY 2002 and is mainly due to an increase in Fund Balance with Treasury. The assets reported in NRC's Balance Sheet are summarized in the accompanying table.

The Fund Balance with Treasury represents the NRC's largest asset of \$193.4 million as of September 30, 2003, an increase of \$12.0 million from the FY 2002 year-end balance. This balance accounts for approximately 70 percent of total assets and represents appropriated funds, collected license fees, and other funds maintained at the U.S. Treasury to pay current liabilities.

ASSET SUMMARY (in millions)		
	FY 2003	FY 2002
Fund Balance with Treasury	\$193.4	\$181.4
Accounts Receivable, Net	50.2	44.8
Property, Plant, & Equipment, Net	29.6	36.9
Other	3.0	1.2
Total Assets	\$276.2	\$264.3

Accounts Receivable, Net, as of September 30, 2003, was \$50.2 million and includes an offsetting allowance for doubtful accounts of \$2.8 million. This is a 12 percent increase over the FY 2002 year-end Accounts Receivable, Net, balance of \$44.8 million. Accounts Receivable Due from the Public was \$47.6 million, representing 17 percent of total assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The value of Property, Plant, and Equipment, Net, was \$29.6 million, representing 11 percent of total assets. The majority of the balance is comprised of nuclear reactor simulators, leasehold improvements, and computer hardware and software. The Property, Plant, and Equipment line item reflects the adoption of capitalizing the full costs of developing internal use software, as required by SSFAS Number 10, *Accounting for Internal Use Software*, implemented on October 1, 2000.

The NRC's liabilities were \$134.6 million as of September 30, 2003. The accompanying table shows a decrease in Total Liabilities of \$1.9 million from the FY 2002 year-end balance of \$136.5 million. Other Liabilities include \$49.5 million for recoveries from unbilled accounts receivable, \$8.1 million for accrued salaries to employees, and \$30.0 million for accrued annual leave. Of the agency's liabilities, \$40.8 million were not covered by budgetary resources, which is a slight increase over the balance as of September 30, 2002.

Liabilities not covered by budgetary resources are unfunded pension expenses, accrued annual leave, and future workers' compensation. The Federal budget process does not recognize the cost of future benefits for today's employees. Instead, the Federal budget process recognizes those costs in future years when they are actually paid.

LIABILITIES SUMMARY (in millions)		
	FY 2003	FY 2002
Accounts Payable	\$27.3	\$28.4
Federal Employee Benefits	9.1	9.1
Other Liabilities	98.2	99.0
Total Liabilities	\$134.6	\$136.5

The difference between total assets and total liabilities, net position, was \$141.6 million as of September 30, 2003. This is an increase of \$13.7 million from the FY 2002 year-end balance. Unexpended Appropriations is the amount of authority granted by Congress that has not been expended. Cumulative Results of Operations represent net results of operations since the NRC's inception. The decrease is primarily the result of a \$7.3 million decrease in Property, Plant, and Equipment, Net.

NET POSITION SUMMARY (in millions)		
	FY 2003	FY 2002
Unexpended Appropriations	\$150.3	\$128.3
Cumulative Results of Operations	(8.7)	(0.4)
Total Net Position	\$141.6	\$127.9

MANAGEMENT'S DISCUSSION AND ANALYSIS

Analysis of the Statement of Net Cost

The Statement of Net Cost presents the net cost of NRC's four strategic arenas as identified in the NRC Annual Performance Plan. The purpose of this statement is to link program performance under GPRA reporting to the cost of programs. The NRC's net cost of operations for the year ended September 30, 2003, was \$63.6 million, which is a decrease of \$15.6 million over the FY 2002 net cost of \$79.2 million. Net costs by strategic arena are shown in the accompanying table.

NET COST OF OPERATIONS (in millions)		
	FY 2003	FY 2002
Nuclear Reactor Safety	\$(61.9)	\$(43.5)
Nuclear Materials Safety	34.0	38.7
Nuclear Waste Safety	77.6	72.1
International Nuclear Safety Support	13.9	11.9
Net Cost of Operations	\$63.6	\$79.2

Total exchange revenue for the year ended September 30, 2003, was \$537.5 million, which is an increase of \$64.4 million over the exchange revenue of \$473.1 million for the year ended September 30, 2002. Exchange revenue is derived from fees for licensing inspections, other services, and annual fees assessed in accordance with 10 CFR Parts 170 and 171.

Analysis of Statement of Changes in Net Position

The Statement of Changes in Net Position reports the change in net position during the reporting period. Net position is affected by changes in its two components—Cumulative Results of Operations and Unexpended Appropriations. The increase in Net Position of \$13.7 million from FY 2002 to FY 2003 is due primarily from the net change in Cumulative Results of Operations of \$(8.3) million and an increase in Unexpended Appropriations of \$22.0 million.

Analysis of the Statement of Budgetary Resources

The Statement of Budgetary Resources shows the sources of budgetary resources available and the status at the end of the period. It presents the relationship between budget authority and budget outlays, and reconciles obligations to total outlays. For FY 2003, NRC had Budgetary Resources available of \$637.4 million, the majority of which was derived from new budget authority. This represents a 7 percent increase over FY 2002 budgetary resources available of \$596.0 million.

For FY 2003, the Status of Budgetary Resources showed obligations of \$597.0 million, or 94 percent of funds available. This is comparable to FY 2002 obligations of \$558.7 million, also 94 percent of funds available. Total Outlays for FY 2003 were \$574.3 million, which represents a \$58 million increase from FY 2002 total Outlays of \$516.1 million.

Analysis of the Statement of Financing

The Statement of Financing is designed to provide the bridge between accrual-based (financial accounting) information in the Statement of Net Cost and obligation-based (budgetary accounting) information in the Statement of Budgetary Resources by reporting the differences and reconciling the two statements. This reconciliation ensures that the proprietary and budgetary accounts in the financial management system are in balance. The Statement of Financing takes Budgetary Obligations of \$597.0 million and reconciles to the Net Cost of Operations of \$63.6 million by deducting non-budgetary resources, costs not requiring resources, and financing sources yet to be provided.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

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

- # Federal Managers' Financial Integrity Act
- # Federal Financial Management Improvement Act
- # Prompt Payment Act
- # Debt Collection Improvement Act
- # Biennial Review of User Fees
- # Inspector General Act
- # Other key legal and regulatory requirements

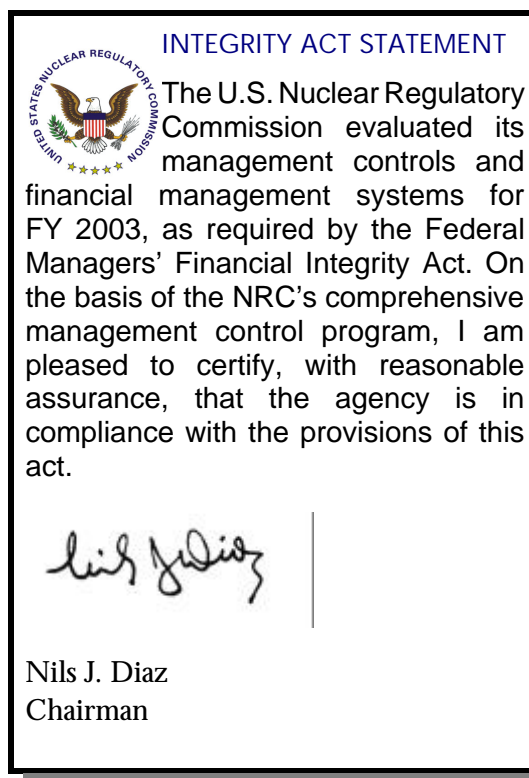
Federal Managers' Financial Integrity Act

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

Management Control Review Program

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

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



MANAGEMENT'S DISCUSSION AND ANALYSIS

The NRC's Executive Committee on Management Controls is comprised of senior executives from offices of the Chief Financial Officer and the Executive Director of Operations, with the General Counsel and the Inspector General participating as advisors. The committee met and reviewed these individual assurance statements. The committee then advised the Chairman whether the NRC had any management control deficiencies serious enough to be reported as a material weakness or material non-compliance.

The NRC's ongoing management control program requires, among other things, that management control deficiencies are integrated into offices' and regions' annual operating plans. The operating plan process has provisions for periodic updates and for attention from senior managers. The management control information in these plans, combined with the individual assurance statements discussed previously, provides the framework for monitoring and improving the agency's management controls on an ongoing basis.

FY 2003 Integrity Act Results

The NRC evaluated its management control systems for the fiscal year ending September 30, 2003. This evaluation provided reasonable assurance that the agency's management controls achieved their intended objectives. As a result, management concluded that the NRC did not have any material weaknesses in its programmatic or administrative activities. During FY 2003, a prior-year auditor-identified material weakness concerning implementation of managerial cost accounting was remediated. The next section under "FY 2003 Improvement Act Results" contains a complete description of the corrective actions taken to resolve the issues associated with managerial cost accounting.

Federal Financial Management Improvement Act

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

FY 2003 Improvement Act Results

As of September 30, 2003, the NRC evaluated its financial systems to determine if they complied with applicable Federal requirements and accounting standards required by the Improvement Act. The following seven systems were evaluated: the Federal Financial System, Human Resources Management System, Cost Accounting System, Advice of Allotments/Financial Plan, Capitalized Property System, Fee Billing Systems, and Controller Resource Database System.

The Chairman of the NRC determined that as of September 30, 2003, NRC financial management systems were in substantial compliance with the Improvement Act. In making his determination, the Chairman considered all the information available to him, including the NRC Executive Committee on Management Control's report on the effectiveness of internal controls and OIG audit reports. He also considered the results of the financial management systems reviews conducted by the agency.

At the end of FY 2002, the NRC had one finding of substantial noncompliance with the Improvement Act, for failure of the Cost Accounting System to meet Governmentwide financial management systems requirements and applicable Federal accounting standards. During FY 2003, NRC completed a comprehensive assessment of its Cost Accounting System to identify noncompliance issues associated with system requirements, security requirements, and SFFAS Number 4.

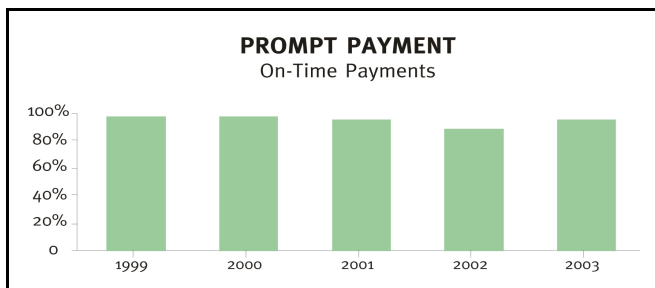
MANAGEMENT'S DISCUSSION AND ANALYSIS

During FY 2003, the NRC developed a remediation plan to aggressively implement corrective actions to resolve all Improvement Act, system security, and SFFAS Number 4 noncompliance issues. All of the remediation plan corrective actions were completed by the end of FY 2003. Corrective actions included the following tasks to improve the Cost Accounting System:

- # Provide agency managers with timely quarterly reports for decisionmaking.
- # Employ a process to assign and distribute the full cost of outputs.
- # Improve cost allocation methodology.
- # Employ a process to link responsibility segments to measurable costs of output.
- # Improve system security and efficiency issues.

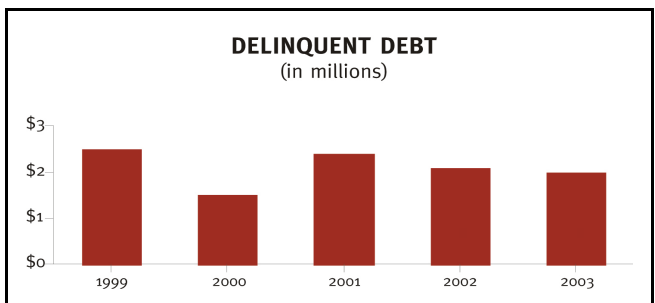
Prompt Payment

The Prompt Payment Act requires Federal agencies to make timely payments to vendors for supplies and services, to pay interest penalties when payments are made after the due date, and to take cash discounts when they are economically justified. From FY 2002 to FY 2003, the NRC had an increase of 1,584 invoices (from 6,544 to 8,128) that were paid and subject to the Prompt Payment Act. For FY 2003, the NRC increased its on-time payments subject to the Prompt Payment Act from 87 percent in FY 2002 to 94 percent in FY 2003. The amount of interest penalties incurred during FY 2003 was \$2,927, which is a significant decrease over the FY 2002 amount of \$7,647. The agency continued to make over 99 percent of its vendor payments electronically.



Debt Collection

The Debt Collection Improvement Act is intended to enhance the ability of the Federal Government to service and collect debts. The agency's goal is to maintain the delinquent debt owed to the NRC, at year-end to less than one percent of its annual billings. The NRC continues to meet this goal and has kept delinquent debt to less than one percent for the past 8 years. Delinquent debt at the end of FY 2003 was \$2.0 million. This is a decrease of \$0.1 million over FY 2002 and a decrease in the number of outstanding receivables from 280 to 233. The NRC continues to aggressively pursue the collection of delinquent debt and continues to timely refer all eligible delinquent debt over 180 days to the U.S. Treasury for collection.



Biennial Review of User Fees

The Chief Financial Officers (CFO) Act requires agencies to conduct a biennial review of fees, royalties, rents, and other charges imposed by agencies, and make revisions to cover program and administrative costs incurred. During FY 2002 and FY 2003, the NRC reviewed its fees subject to the biennial review requirement. Each year, the NRC revises the

MANAGEMENT'S DISCUSSION AND ANALYSIS

hourly rates for license and inspection fees and adjusts the annual fees to meet the fee collection requirements of the Omnibus Budget Reconciliation Act of 1990, as amended.

The most recent changes to the license, inspection, and annual fees are described in the *Federal Register* (68 FR 36714, June 18, 2003). The following fees and charges were also revised to more appropriately recognize actual costs: fees for public use of the auditorium, administrative charges imposed on delinquent debt, fees for search and review time to respond to Freedom of Information Act and Privacy Act requests, and license fees based on average number of hours. Reviews of other types of fees concluded that fee revisions were not warranted at this time.

Treasury Performance Measure Summary

Treasury has five key elements for measuring how agencies complied with reporting requirements for the Federal Agencies Centralized Trial Balance Statement (FACTS I) trial and intragovernmental activity. Overall for FY 2002, the NRC complied with the five reporting elements for timely reporting, reconciliation of beginning and ending net position differences, reliability of FACTS I reporting, consistency of audited financial statements to FACTS I reporting, and intragovernmental activity for elimination of differences. Treasury has not issued its FY 2003 Performance Measure Summary; however, based on our self-evaluation, NRC also met the requirements for this fiscal year.

Inspector General Act

The agency has established and continues to maintain an excellent record in resolving and implementing open audit recommendations presented in Office of the Inspector General (OIG) reports. Section 5(b) of the Inspector General Act requires agencies to report on final actions taken on OIG audit recommendations. This information as well as data concerning disallowed costs determined through contract audits conducted by the Defense Contract Audit Agency can be found in Appendix B.

Improper Payments

Improper payments continue to be at low risk for the agency. The NRC continues to evaluate its internal controls to guard against improper payments and monitors and reports on all improper payments within its programs. At the present time, NRC's inventory of functional payment areas consists of commercial vendor, travel, and payroll payments and refunds issued to NRC licensees.

OMB met with all CFO Act agencies regarding the implementation of the Improper Payments Information Act. OMB supported NRC's position that there were no significant risks of improper payments at the NRC based on the review of its programs in FY 2002. In addition, the General Accounting Office reviewed the FY 2002 improper payment data submitted by NRC and agreed that the controls in place were working and that the programs were an area of low risk. NRC does not administer any grant, loan, or entitlement programs. For FY 2003, NRC made 171,930 payments and identified 84 as improper payments, or less than one-half of one percent. The dollar value of improper payments was \$88.6 thousand out of total payments of \$618.4 million.

Chairman Nils J. Diaz
U.S. Nuclear Regulatory Commission
Washington, DC

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

- The balance sheets of NRC as of September 30, 2003 and 2002, and the related statements of net cost, statements of changes in net position, statements of budgetary resources, and statements of financing for the fiscal years then ended are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- Management's assertion was fairly stated that NRC's systems of accounting and internal control in place as of September 30, 2003, are in compliance with the internal control objectives in the Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. The Bulletin requires that transactions be 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; and
- No new current year reportable instances of noncompliance with the laws and regulations were noted.

The following sections outline each of these conclusions in more detail.

INDEPENDENT AUDITORS' REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheets of NRC as of September 30, 2003 and 2002, and the related statements of net cost, statements of changes in net position, statements of budgetary resources, and statements of financing 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. 01-02. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Matters of Emphasis

Classification of Costs

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, provides guidance to federal agencies for presenting program costs classified by intragovernmental and public components. The basis for classification relies on the concept of who received the benefits of the costs incurred (e.g. private sector licensees versus federal licensees) rather than who was paid. However, following the advice of OMB, NRC classified the costs on the Statement of Net Cost using an underlying concept of who was paid. Furthermore, OMB Bulletin 01-09 requires that the Statement of Net Cost be presented using full program costs by output. The agency presents its costs aggregated by mission-related strategic arenas, which are comprised of NRC's programs.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. NRC's Statements of Net Cost include approximately \$73.1 and \$54.5 million, respectively for the years ended September 30, 2003 and 2002, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations within NRC. The work placed with DOE is under the auspices of a Memorandum of Understanding between NRC and DOE. The examination of DOE National Laboratories for compliance with laws and regulations is DOE's responsibility. This responsibility was further clarified by a memorandum of the General Accounting Office's (GAO) Assistant General Counsel, dated March 6, 1995, where he opined that "...DOE's inability to assure that its contractors' costs [National Laboratories] are legal and proper...does not compel a conclusion that NRC has failed to comply with laws and regulations." DOE also has the cognizant responsibility to assure audit resolution and should provide the results of its audits to NRC.

In our opinion, the financial statements referred to above and included in the NRC's performance and accountability report, present fairly, in all material respects, the financial position of NRC at September 30, 2003 and 2002, and its net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

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

We have examined management's assertion, as of September 30, 2003, that NRC's systems of accounting and internal control are in compliance with the internal control objectives listed in OMB Bulletin No. 01-02. The Bulletin requires management 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 management's assertion 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 audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02. 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.

In our opinion, management's assertion that NRC maintained effective internal control over financial reporting as of September 30, 2003, is fairly stated, in all material respects based on the internal control objectives listed in OMB Bulletin No. 01-02.

However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the AICPA and OMB Bulletin No. 01-02. A reportable condition is a matter coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to meet the internal control objectives described above. We identified three reportable conditions; NRC needs to (1) strengthen controls to protect its information systems' security access; (2) improve monitoring over accounting for internal use software; and (3) sustain cost accounting reporting system improvements.

A material weakness, as defined by the AICPA and OMB Bulletin No. 01-02, is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the principal financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that the reportable conditions that follow are not material weaknesses as defined by the AICPA and OMB Bulletin No. 01-02.

Information Systems Security Access

GAO's *Standards for Internal Control in the Federal Government* provide for agencies to design management controls to promote the reliability of the financial and performance information. Inherent to the design of such controls is the reduction of potential risks to the agency.

During our review of the agency's information security environment, we noted exceptions in two of the agency's seven financial management core systems. The issues identified indicate weaknesses in the agency's management controls. The conditions, which are not discussed in

this report with specificity because of their sensitivity, relate to the improper design of management controls affecting:

- Lack of proper maintenance and oversight of system user profiles, which resulted in assignment of incompatible duties; and
- Lack of compliance with agency policy (Management Directive No. 12.5, *NRC Automated Information Security Program*) for software password security authentication.

These issues were discussed at length with agency information system managers. The agency initiated corrective actions and is presently undergoing a thorough operational and security review of the exceptions in order to build a more robust security system.

Recommendation

1. The CFO should develop policies and procedures to ensure that changes impacting user profiles are analyzed fully by system administrators for compatibility of duties. Additionally, the CFO should periodically review software enabled system controls to ensure compliance with agency policy.

Monitoring of Accounting for Internal Use Software

As reported in FY 2002, the Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, effective October 1, 2000. SFFAS No. 10 defines three software life-cycle phases: planning, development and operations. Paragraph 16 requires, "For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the development phase." The Statement defines full cost to include salaries of programmers, project managers, administrative personnel, and associated employee benefits and outside consultants' fees.

Our assessment during FY 2002, noted that the OCFO did not have proactive monitoring procedures to identify projects that had begun or completed the development phase. The GAO's *Standards for Internal Control in the Federal Government* state, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations."

In the current fiscal year, the management control structure continued to rely heavily on project managers to inform the OCFO of time and costs expended in the software development phase. However, the OCFO has not fully addressed execution of existing monitoring procedures to ensure the completeness or reasonableness of the information provided.

Our review of the agency's practices for accounting for internal use software projects, identified the following inconsistencies:

1. Contractor costs incurred on projects were not being routinely captured and capitalized;
2. Contractor costs were not being recorded correctly;
3. Project managers were not coding their time appropriately during the development phase of their projects;
4. Indirect charges to the project were not being tracked, thus understating the cost of development; and

5. Labor certifications were not being completed, signed and/or were being completed late.

These exceptions continue to indicate that the agency does not have a routine, timely and disciplined process in place to monitor the adequacy of accounting information necessary to capitalize internal use software projects.

Recommendation

2. The CFO should reassess the accounting activities being undertaken by agency personnel to ensure the completeness and propriety of accounting transactions. Additionally, the CFO should be more proactive in monitoring and training project managers to instill discipline which provides reliability of financial information.

Managerial Cost Accounting

In FY 1998, we identified the lack of compliance with the implementation of SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*. The NRC's CFO responded to the condition by developing a remediation plan to implement cost accounting. During FY 2002, the agency made progress by issuing preliminary reports to managers, and by initiating a dialogue with agency managers on the adequacy and usefulness of the reports provided. In May 2002, the CFO asserted completion of the remediation actions and implemented a cost accounting system.

Although the agency made progress in FY 2002, the cost accounting reporting system did not meet the requirements of SFFAS No. 4. Furthermore, the system did not contain fundamental management controls as required by the Joint Financial Management Improvement Program (JFMIP) guidelines. During FY 2002, we reported the condition as both a material weakness and an FFMIA substantial noncompliance, prompting the CFO to develop and implement remediation actions to address continuing challenges.

In the current year, the agency successfully achieved a redesign of the cost accounting system and enhanced the documentation of controls and operating procedures. As a result, the material weakness and FFMIA substantial noncompliance were adequately addressed. The corrective actions, however, occurred late in the fiscal year. Consequently, the improved system controls and related processes were in place an insufficient amount of time, thereby precluding our assessment of the effectiveness of design and operation of related controls for the entire fiscal year. We were, however, able to apply sufficient procedures to the output from the system to assess the reliability and completeness of the information used for the statement of net cost.

Examples of the cost accounting implementation actions include: (1) development of user and operations guides enhancing the processing protocols of the system; (2) completion of an electronic audit trail tool to both document the audit trail from the general ledger to the statement of net cost, and to eliminate manual processes; and (3) redefining outputs, in compliance with SFFAS No. 4, as programs rather than program accomplishments (i.e. activities).

Recommendation

3. The CFO should sustain the management controls over cost accounting with the same focus demonstrated at year-end. As the cost accounting processes become more routine, refinements may be needed. For example, effective in FY 2004, quarterly reports will be required 21 days after the quarter's end, thus necessitating the current process to produce cost accounting information for financial reporting sooner. We believe that continued senior management attention will yield additional benefits in future periods.

Status of Prior Year Comments

In the prior year, we included conditions related to external reporting and the agency's close-out processing procedures. Corrective actions implemented have closed the comment on external reporting. In the current fiscal year, however, the agency's actions on contract close-out procedures were not adequate. Continued analysis of the process in place and development and implementation of improved policy will be necessary prior to closing the comment.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We conducted our audit for the year ended September 30, 2003, 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. 01-02.

NRC management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of 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. 01-02, including the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to NRC. The results of our tests of compliance disclosed no noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. NRC's Statements of Net Cost include approximately \$73.1 and \$54.5 million, respectively for the years ended September 30, 2003 and 2002, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations within NRC. The work placed with DOE is under the auspices of a Memorandum of Understanding between NRC and DOE. The examination of DOE National Laboratories for compliance with laws and regulations is DOE's responsibility. This responsibility was further clarified by a memorandum of the 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 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.

A noncompliance issue reported in prior years reports continues to be unresolved. Specifically, this issue addresses the following condition:

Part 170 Hourly Rates

As previously reported from FY 1998 through 2002, the Omnibus Budget Reconciliation Act (OBRA) of 1990 requires the NRC to recover approximately 100 percent of its budget authority by assessing fees. (The recovery percentage has been reduced in recent years by 2 percent each year. During FY 2003, the recovery percentage was 94 percent.) Accordingly, NRC assesses two types of fees to its licensees and applicants. One type, specified in 10 CFR Part 171, consists of annual fees assessed to power reactors, materials and other licensees. The other type, specified in 10 CFR Part 170 and authorized by the Independent Offices Appropriation Act of 1952, is assessed for specific licensing actions, inspections and other services provided to NRC's licensees and applicants.

Each year, the OCFO computes the hourly rates used to charge for Part 170 services. Consistent with OBRA of 1990, the rates are based on budgetary data and are used to price individually identifiable Part 170 services. The FY 1998 and subsequent years' rates were developed using the budgetary basis without validating the fee amounts to the full cost of providing Part 170 services.

The CFO has been awaiting the implementation of cost accounting to fully address this condition. During the final quarter of FY 2003, the agency achieved compliance with SFFAS No.4 regarding cost accounting. Therefore, we anticipate that during FY 2004 the agency will address this noncompliance.

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

INTERNAL CONTROL RELATED TO PERFORMANCE MEASURES

With respect to internal controls related to performance measures, 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, Schedule of Assets and Liabilities, and the management discussion and analysis is not a required part of the financial statements but is supplementary information required by OMB Bulletin No. 01-09. 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.

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, is not a required part of the financial statements but is supplementary information required by OMB Bulletin No. 01-09. This information is also presented for purposes of additional analysis of the financial statements rather than to present the budgetary resources of the NRC programs. 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.

VIEWS OF RESPONSIBLE OFFICIALS

Our draft report was provided to the Chief Financial Officer on November 18, 2003, to facilitate discussion at our November 20, 2003, exit conference. At the exit conference the CFO, OIG and OCFO representatives discussed all issues in the report and potential opportunities for corrective actions. The Chief Financial Officer responded to our report on November 26, 2003, and generally agreed with the conditions identified. The corrective actions provided in the CFO's response appear appropriate and will be reviewed for implementation in subsequent audits.

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

November 20, 2003

**FINANCIAL STATEMENTS, ACCOMPANYING NOTES AND
REQUIRED SUPPLEMENTARY INFORMATION**

LIMITATIONS OF THE FINANCIAL STATEMENTS

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

The NRC's FY 2003 financial statements were audited by R. Navarro and Associates, under contract to the NRC's Office of the Inspector General.

BALANCE SHEET*(Dollars in Thousands)*

As of September 30,	2003	2002
Assets		
Intragovernmental		
Fund balances with Treasury (Note 2)	\$ 193,420	\$ 181,449
Accounts receivable (Note 3)	2,667	2,031
Other	2,933	1,141
<i>Total intragovernmental</i>	199,020	184,621
Cash and other monetary assets	20	20
Accounts receivable, net (Note 3)	47,563	42,774
Property and equipment, net (Note 4)	29,622	36,922
Other	19	20
Total Assets	\$ 276,244	\$ 264,357
Liabilities		
Intragovernmental		
Accounts payable	\$ 7,399	\$ 8,411
Other (Notes 5 and 6)	57,084	49,157
<i>Total intragovernmental</i>	64,483	57,568
Accounts payable	19,937	19,996
Federal employees benefits (Note 6)	9,073	9,062
Other liabilities (Note 5)	41,106	49,869
Total Liabilities	134,599	136,495
Net Position		
Unexpended appropriations	150,317	128,336
Cumulative results of operations (Note 8)	(8,672)	(474)
Total Net Position	141,645	127,862
Total Liabilities and Net Position	\$ 276,244	\$ 264,357

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

STATEMENT OF NET COST*(Dollars in Thousands)*

For the year ended September 30,	2003	2002
<i>Nuclear Reactor Safety</i>		
Intragovernmental gross costs	\$ 121,024	\$ 102,729
Less: Intragovernmental earned revenue	(25,984)	(22,914)
<i>Intragovernmental net costs</i>	95,040	79,815
Gross costs with the public	280,195	259,855
Less: Earned revenues from the public	(437,155)	(383,157)
<i>Net costs with the public</i>	(156,960)	(123,302)
<i>Total Net Cost of Nuclear Reactor Safety</i>	(61,920)	(43,487)
<i>Nuclear Materials Safety</i>		
Intragovernmental gross costs	22,270	21,956
Less: Intragovernmental earned revenue	(4,510)	(4,748)
<i>Intragovernmental net costs</i>	17,760	17,208
Gross costs with the public	67,947	64,852
Less: Earned revenues from the public	(51,688)	(43,375)
<i>Net costs with the public</i>	16,259	21,477
<i>Total Net Cost of Nuclear Materials Safety</i>	34,019	38,685
<i>Nuclear Waste Safety</i>		
Intragovernmental gross costs	24,780	22,107
Less: Intragovernmental earned revenue	(1,726)	(1,762)
<i>Intragovernmental net costs</i>	23,054	20,345
Gross costs with the public	68,858	66,609
Less: Earned revenues from the public	(14,305)	(14,793)
<i>Net costs with the public</i>	54,553	51,816
<i>Total Net Cost of Nuclear Waste Safety</i>	77,607	72,161
<i>International Nuclear Safety Support</i>		
Intragovernmental gross costs	4,951	4,782
Less: Intragovernmental earned revenue	(510)	(329)
<i>Intragovernmental net costs</i>	4,441	4,453
Gross costs with the public	11,103	9,470
Less: Earned revenues from the public	(1,604)	(2,034)
<i>Net costs with the public</i>	9,499	7,436
<i>Total Net Cost of International Nuclear Safety Support</i>	13,940	11,889
<i>Net Cost of Operations</i>	\$ 63,646	\$ 79,248

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

STATEMENT OF CHANGES IN NET POSITION

(Dollars in Thousands)

For the year ended September 30,	2003		2002	
	Cumulative Results	Unexpended Appropriations	Cumulative Results	Unexpended Appropriations
Beginning Balances	\$ (474)	\$ 128,336	\$ 6,693	\$ 86,980
<i>Budgetary Financing Sources</i>				
Appropriations received	-	560,084	-	535,430
Appropriations transferred-in/out	-	(499,120)	-	(448,676)
Other adjustments	-	(219)	-	(430)
Appropriations used	38,764	(38,764)	44,968	(44,968)
Non-exchange revenue	624	-	1,354	-
Transfers-in/out without reimbursement	(624)	-	(1,354)	-
<i>Other Financing Sources</i>				
Imputed financing from costs absorbed by others	21,978	-	18,780	-
Other	(5,294)	-	8,333	-
Total Financing Sources	55,448	21,981	72,081	41,356
Net Cost of Operations	(63,646)	-	(79,248)	-
Ending Balances	\$ (8,672)	\$ 150,317	\$ (474)	\$ 128,336

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

STATEMENT OF BUDGETARY RESOURCES*(Dollars in Thousands)*

For the year ended September 30,	2003	2002
<i>Budgetary Resources</i>		
Budget authority		
Appropriations received	\$ 560,084	\$ 535,430
Net transfers	24,738	23,650
Unobligated balances		
Beginning of period	37,346	26,747
Spending authority from offsetting collections		
Reimbursements earned	5,337	5,845
Change in unfilled customer orders	2,928	201
<i>Total Spending Authority from Offsetting Collections</i>	8,265	6,046
Recoveries of prior year obligations	7,386	4,634
Permanently not available	(219)	(430)
<i>Total Budgetary Resources</i>	\$ 637,600	\$ 596,077
<i>Status of Budgetary Resources</i>		
Obligations incurred (Note 12)		
Direct	\$ 590,978	\$ 553,083
Reimbursable	6,050	5,648
Unobligated balance		
Apportioned	39,812	36,179
Exempt from apportionment	760	1,167
<i>Total Status of Budgetary Resources</i>	\$ 637,600	\$ 596,077
<i>Relationship of Obligations to Outlays</i>		
Obligated balance, net, beginning of period	\$ 136,899	\$ 104,988
Obligated balance, net, end of period		
Accounts receivable	(598)	(539)
Unfilled customer orders from Federal sources	(8,028)	(1,788)
Undelivered orders	110,082	88,346
Accounts payable	37,767	50,880
<i>Obligated balance, net, end of period</i>	\$ 139,223	\$ 136,899
Outlays		
Disbursements	\$ 581,020	\$ 522,314
Collections	(6,677)	(6,175)
<i>Subtotal</i>	574,343	516,139
Less: Offsetting Receipts	(526,273)	(475,965)
<i>Net Outlays</i>	\$ 48,070	\$ 40,174

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

STATEMENT OF FINANCING*(Dollars in Thousands)*

For the year ended September 30,	2003	2002
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations incurred (Note 12)	\$ 597,028	\$ 558,731
Less: Spending authority from offsetting collections and recoveries	(15,651)	(10,680)
<i>Obligations Net of Offsetting Collections and Recoveries</i>	581,377	548,051
Less: Offsetting receipts	(526,273)	(475,965)
<i>Net Obligations</i>	55,104	72,086
Other Resources		
Imputed financing from costs absorbed by others	21,978	18,780
Allocation transfer	1,576	3,375
Other	(5,294)	8,333
<i>Net Other Resources Used to Finance Activities</i>	18,260	30,488
Total Resources Used to Finance Activities	73,364	102,574
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(17,916)	(30,493)
Resources that finance the acquisition of assets	(4,106)	(2,476)
Other	592	364
<i>Total Resources Used to Finance Items not Part of the Net Cost of Operations</i>	(21,430)	(32,605)
Total Resources Used to Finance the Net Cost of Operations	51,934	69,969
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in the Future Periods		
Increase in annual leave liability	1,692	1,870
Increase (Decrease) Actuarial Workers' Compensation	11	(1,787)
Increase (Decrease) in Unfunded Workers Compensation	(163)	28
Increase in Unfunded Unemployment	7	22
<i>Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods</i>	1,547	133
Components not Requiring or Generating Resources:		
Depreciation and amortization	10,165	9,146
<i>Total Components not Requiring or Generating Resources</i>	10,165	9,146
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	11,712	9,279
Net Cost of Operations	\$ 63,646	\$ 79,248

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

NOTES TO PRINCIPAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**A. Reporting Entity**

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

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

B. Basis of Presentation

These principal statements were prepared to report the financial position and results of operations of the NRC as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These financial statements were prepared from the books and records of the NRC in conformity with accounting principles generally accepted in the United States of America, the requirements of Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and NRC accounting policies. These statements are, therefore, different from the financial reports, also prepared by the NRC pursuant to OMB directives, which are used to monitor and control NRC's use of budgetary resources.

In accordance with OMB Bulletin 01-09, NRC made several changes to its principal financial statements and notes. Certain amounts were reclassified from FY 2002 to conform with the FY 2003 financial statement presentation. NRC has not prepared a Statement of Custodial Activity because the amounts involved are immaterial and are incidental to its operations and mission.

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

Nuclear Reactor Safety which encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities, as well as test and research reactors, are operated in a manner that adequately protects public health and safety and the environment, and that safeguards special nuclear materials used in reactors.

Nuclear Materials Safety which encompasses NRC efforts to ensure that nuclear fuel cycle facilities; and academic, industrial, and medical uses of nuclear materials are handled in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

NOTES TO PRINCIPAL STATEMENTS

Nuclear Waste Safety which encompasses NRC efforts to ensure that the decommissioning of nuclear reactors and other facilities, storage of spent nuclear fuel, transportation of radioactive materials, and disposal of radioactive wastes are handled in a manner that adequately protects public health and safety and the environment, and protects against radiological sabotage and theft or diversion of special nuclear materials.

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

C. *Budgets and Budgetary Accounting*

Budgetary accounting measures appropriation and consumption of budget/spending authority or other budgetary resources and facilitates compliance with legal constraints and controls over the use of Federal funds. Under budgetary reporting principles, budgetary resources are consumed at the time of purchase. Assets and liabilities, which do not consume current budgetary resources, are not reported, and only those liabilities for which valid obligations have been established are considered to consume budgetary resources.

For the past 29 years, Congress has enacted no-year appropriations, which are available for obligation by NRC until expended. The Energy and Water Development Appropriations Act, 2003, requires the NRC to recover approximately 94 percent of its new budget authority of \$584.6 million by assessing fees less amounts derived from the Nuclear Waste Fund of \$24.7 million. The \$584.6 million does not include any amounts transferred from the U.S. Agency for International Development. For FY 2002, NRC recovered approximately 96 percent of its new budget authority of \$558.6 million less amounts derived from the Nuclear Waste Fund of \$23.7 million and \$36 million received from Homeland Security.

D. *Basis of Accounting*

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

E. *Revenues and Other Financing Sources*

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

NOTES TO PRINCIPAL STATEMENTS

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

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

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

G. Accounts Receivable

Accounts receivable consist of amounts owed to the NRC by other Federal agencies and the public. Amounts due from the public are presented net of an allowance for uncollectible accounts. The allowance is based on an analysis of the outstanding balances. Receivables from Federal agencies are expected to be collected; therefore, there is no allowance for uncollectible accounts.

H. Non-Entity Assets

Accounts receivable include non-entity assets of \$44,000 and \$27,000 at September 30, 2003, and 2002, respectively, and consist of miscellaneous penalties and interest due from the public, which, when collected, must be transferred to the U.S. Treasury.

I. Property and Equipment

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

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

The costs of internal use software, including the full cost of salaries and benefits from agency personnel involved in software development, are capitalized in accordance with the above criteria.

NOTES TO PRINCIPAL STATEMENTS

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

Intragovernmental

The U.S. Department of Labor (DOL) paid Federal Employees Compensation Act (FECA) benefits on behalf of NRC which had not been billed or paid by NRC as of September 30, 2003, and 2002, 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 3.84 percent for FY 2003 and 5.20 percent for FY 2002.

Other

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

L. Contingencies

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

NOTES TO PRINCIPAL STATEMENTS

M. Annual, Sick, and Other Leave

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

N. Retirement Plans

NRC employees belong to either the Federal Employees Retirement System (FERS) or the Civil Service Retirement System (CSRS). For FY 2003 and FY 2002, employees belonging to FERS, the NRC withheld 0.8 percent of base pay earnings, in addition to Federal Insurance Contribution Act (FICA) withholdings, and matched the withholdings with a 10.7 percent contribution. 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 7.0 percent in FY 2003 and an 8.51 percent contribution in FY 2002.

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 13 percent in calendar year (CY) 2003, and 12 percent in CY 2002. Employees belonging to CSRS may contribute up to 8 percent of their salary in CY 2003, and 7 percent in CY 2002, but there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan is \$12,000 in the CY 2003 portion of FY 2002 and \$11,000 in the CY 2002 portion of FY 2003. The sum of the employees' and NRC's contributions are transferred to the Federal Retirement Thrift Investment Board.

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

O. Leases

The total capital lease liability is funded on an annual basis and included in NRC's annual budget. The NRC's capital leases are for personal property consisting of reproduction equipment which is installed in various NRC facilities. For FY 2003 and 2002 the leases were for 3 and 5 years and the interest rates paid were 6.59 percent and 4.75 percent, respectively. During FY 2004, the remaining capital lease (3 years at 6.59 percent) will be completed. The reproduction equipment is depreciated over 5 years using the straight-line method with no salvage value.

NOTES TO PRINCIPAL STATEMENTS

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

P. U.S. Department of Energy Charges

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

Q. Pricing Policy

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

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

R. Net Position

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

S. Use of Management Estimates

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

NOTES TO PRINCIPAL STATEMENTS

NOTE 2. FUND BALANCES WITH TREASURY

(In thousands)	<u>2003</u>	<u>2002</u>
Fund Balances		
Appropriated funds	\$ 184,487	\$ 174,226
Allocation transfers	5,183	6,941
Other fund types	3,750	282
Total	<u>\$ 193,420</u>	<u>\$ 181,449</u>
Status of Fund Balance with Treasury		
Unobligated Balance		
Available		
Appropriated funds	\$ 40,572	\$ 37,346
Allocation transfers	2,948	1,809
Unavailable	4,063	612
Obligated balance not yet disbursed	145,837	141,682
Total	<u>\$ 193,420</u>	<u>\$ 181,449</u>

NOTE 3. ACCOUNTS RECEIVABLE

(In thousands)	<u>2003</u>	<u>2002</u>
Intragovernmental		
Receivables and reimbursements	<u>\$ 2,667</u>	<u>\$ 2,031</u>
Receivables with the Public		
Materials and facilities fees - billed	\$ 4,657	\$ 4,166
Materials and facilities fees - unbilled	45,607	41,185
Other (Penalties and Interest)	110	94
Total Accounts Receivable	50,374	45,445
Less: Allowance for uncollectible accounts	(2,811)	(2,671)
Accounts Receivable, Net	<u>\$ 47,563</u>	<u>\$ 42,774</u>

NOTE 4. PROPERTY AND EQUIPMENT, NET

(In thousands)			Accumulated Depreciation and Amortization	2003 Net Book Value	2002 Net Book Value
<u>Fixed Assets Class</u>	<u>Service Years</u>	<u>Acquisition Value</u>			
Equipment	5-8	\$ 15,891	\$ (14,129)	\$ 1,762	\$ 1,996
ADP software	5	40,961	(25,651)	15,310	23,718
ADP software under development	-	2,318	-	2,318	390
Leasehold improvements	20	20,294	(10,141)	10,153	10,703
Leasehold improvements in progress		79	-	79	115
		<u>\$ 79,543</u>	<u>\$ (49,921)</u>	<u>\$ 29,622</u>	<u>\$ 36,922</u>

NOTES TO PRINCIPAL STATEMENTS

NOTE 5. OTHER LIABILITIES

(In thousands)	<u>2003</u>	<u>2002</u>
Intragovernmental		
Liability to offset net accounts receivable for fees assessed	\$ 49,492	\$ 44,177
Liability from fees collected which will offset subsequent year's appropriations	3,590	-
Liability to offset miscellaneous accounts receivable	42	27
Liability for advances from other agencies	1,222	845
Accrued workers' compensation	1,646	1,809
Accrued unemployment compensation	29	22
Employee benefit contributions	1,063	2,277
Total Intragovernmental Other Liabilities	<u>\$ 57,084</u>	<u>\$ 49,157</u>

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

(In thousands)	<u>2003</u>	<u>2002</u>
Accrued annual leave	\$ 30,035	\$ 28,343
Accrued salaries	8,138	18,092
Contract holdbacks, advances, and other	2,933	3,434
Total Other Liabilities	<u>\$ 41,106</u>	<u>\$ 49,869</u>

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

NOTE 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

(In thousands)	<u>2003</u>	<u>2002</u>
Intragovernmental		
FECA paid by DOL	\$ 1,646	\$ 1,809
Accrued unemployment compensation	29	22
Federal Employee Benefits		
Future FECA	9,073	9,062
Other		
Accrued annual leave	30,035	28,343
Total Liabilities not Covered by Budgetary Resources	<u>\$ 40,783</u>	<u>\$ 39,236</u>

NOTES TO PRINCIPAL STATEMENTS

NOTE 7. LEASES

(In thousands)

Future Lease Payments Due:

			<u>2003</u>	<u>2002</u>
Fiscal Year	Capital	Operating		
2003	\$ -	\$ -	\$ -	\$ 20,493
2004	2	20,505	20,507	20,507
2005	-	20,372	20,372	20,372
2006	-	19,560	19,560	19,560
2007	-	19,603	19,603	19,603
2008 and thereafter	-	111,600	111,600	112,891
Total	<u>2</u>	<u>191,640</u>	<u>191,642</u>	<u>213,426</u>
Less: imputed interest		-	-	(2)
Total Future Lease Payments	<u>\$ 2</u>	<u>\$ 191,640</u>	<u>\$ 191,642</u>	<u>\$ 213,424</u>

NOTE 8. CUMULATIVE RESULTS OF OPERATIONS

(In thousands)

	<u>2003</u>	<u>2002</u>
Future funding requirements	\$ (40,783)	\$ (39,236)
Investment in property and equipment, net	29,622	36,922
Contributions from foreign cooperative research agreements	2,481	1,819
Other	8	21
Cumulative Results of Operations	<u>\$ (8,672)</u>	<u>\$ (474)</u>

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 2003, and 2002. 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. EXCHANGE REVENUES

(In thousands)

	<u>2003</u>	<u>2002</u>
Fees for licensing, inspection, and other services	\$531,567	\$467,632
Revenue from reimbursable work	5,915	5,480
Total Exchange Revenues	<u>\$537,482</u>	<u>\$473,112</u>

NOTES TO PRINCIPAL STATEMENTS

NOTE 10. BUDGET FUNCTIONAL CLASSIFICATION

(In thousands)

			<u>2003</u>	<u>2002</u>
Functional Classification	Gross Cost	Earned Revenue	Net Cost	Net Cost
276 - Energy Information, Policy, & Regulation	\$ 596,788	\$ 537,411	\$ 59,377	\$ 76,707
150 - AID International Affairs	4,340	71	4,269	2,541
Total	<u>\$ 601,128</u>	<u>\$ 537,482</u>	<u>\$ 63,646</u>	<u>\$ 79,248</u>

Intragovernmental

			<u>2003</u>	<u>2002</u>
Functional Classification	Gross Cost	Earned Revenue	Net Cost	Net Cost
276 - Energy Information, Policy, & Regulation	\$ 168,685	\$ 32,659	\$ 136,026	\$ 119,280
150 - AID International Affairs	4,340	71	4,269	2,541
Total	<u>\$ 173,025</u>	<u>\$ 32,730</u>	<u>\$ 140,295</u>	<u>\$ 121,821</u>

NOTE 11. FINANCING SOURCES OTHER THAN EXCHANGE REVENUE

(In thousands)

Appropriated Funds Used

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

	<u>2003</u>	<u>2002</u>
Funds consumed	<u>\$565,037</u>	\$520,933
Less: collection from fees assessed	<u>(526,273)</u>	(475,965)
Appropriated funds used	<u>\$ 38,764</u>	<u>\$ 44,968</u>

Funds consumed includes \$39,767 thousand and \$26,747 thousand through September 30, 2003, and 2002, respectively, of available funds from prior years.

Non-Exchange Revenue

	<u>2003</u>	<u>2002</u>
Civil penalties	\$ 353	\$ 453
Miscellaneous receipts	271	901
Total Non-Exchange Revenue	<u>\$ 624</u>	<u>\$ 1,354</u>

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

NOTES TO PRINCIPAL STATEMENTS

Imputed Financing

	<u>2003</u>	<u>2002</u>
Civil Service Retirement System	\$ 11,588	\$ 9,934
Federal Employee Health Benefit	9,832	8,788
Federal Employee Group Life Insurance	53	49
U.S. Treasury Judgment Fund	505	9
Total Imputed Financing	<u>\$ 21,978</u>	<u>\$ 18,780</u>

Transfers In/Out

	<u>2003</u>	<u>2002</u>
Transfers out to Treasury		
License Fees	\$526,273	\$ 475,965
Non-exchange revenue	624	1,354
Total Transfers-Out to Treasury	<u>\$526,897</u>	<u>\$ 477,319</u>

NOTE 12. TOTAL OBLIGATIONS INCURRED

(In thousands)

	<u>2003</u>	<u>2002</u>
Direct Obligations		
Category A	\$565,784	\$ 529,517
Exempt from Apportionment	25,194	23,566
Total Direct Obligations	<u>590,978</u>	<u>553,083</u>
Reimbursable Obligations	6,050	5,648
Total Obligations Incurred	<u>\$597,028</u>	<u>\$ 558,731</u>

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

REQUIRED SUPPLEMENTARY INFORMATION

U.S. Nuclear Regulatory Commission Required Supplementary Information

SCHEDULE OF INTRAGOVERNMENTAL ASSETS AND LIABILITIES

(Dollars in Thousands)		
As of September 30,	2003	2002
Intragovernmental Assets		
Fund Balance with Treasury		
Department of the Treasury	\$ 193,420	\$ 181,449
Accounts Receivable		
Tennessee Valley Authority	1,844	1,197
Department of Energy	600	412
Other Agencies	223	422
<i>Total Accounts Receivable</i>	2,667	2,031
Other Assets		
General Services Administration	487	520
Department of Commerce	227	360
Department of Interior	664	1
Department of the Navy	1,495	19
Department of Labor	42	204
Other Agencies	18	37
<i>Total Other Agencies</i>	2,933	1,141
Total Intragovernmental Assets		
	\$ 199,020	\$ 184,621
As of September 30,	2003	2002
Intragovernmental Liabilities		
Accounts Payable		
General Services Administration	\$ 953	\$ 3,157
Department of Energy	5,851	4,500
Other Agencies	595	754
<i>Total Accounts Payable</i>	7,399	8,411
Other Liabilities		
Department of the Treasury - General Fund	53,082	44,177
Department of Labor	1,675	1,831
Office of Personnel Management	1,063	2,277
Other Agencies	1,264	872
<i>Total Other Liabilities</i>	57,084	49,157
Total Intragovernmental Liabilities		
	\$ 64,483	\$ 57,568

U.S. Nuclear Regulatory Commission Required Supplementary Information

SCHEDULE OF BUDGETARY RESOURCES

(Dollars in Thousands)

For the year ended September 30, 2003

	X0200	X0300	Total
Budgetary Resources			
Budget authority			
Appropriations received	\$ 553,284	\$ 6,800	\$ 560,084
Net transfers	24,738	-	24,738
Unobligated balances			
Beginning of period	36,411	935	37,346
Spending authority from offsetting collections			
Reimbursements earned	5,336	1	5,337
Change in unfilled customer orders	2,928	-	2,928
<i>Total Spending Authority from Offsetting Collections</i>	8,264	1	8,265
Recoveries of prior year obligations	7,382	4	7,386
Permanently not available	(216)	(3)	(219)
Total Budgetary Resources	\$ 629,863	\$ 7,737	\$ 637,600

Status of Budgetary Resources:

Obligations incurred			
Direct	\$ 584,462	\$ 6,516	\$ 590,978
Reimbursable	6,050	-	6,050
Unobligated balance			
Apportioned	38,591	1,221	39,812
Exempt from apportionment	760		760
Total Status of Budgetary Resources	\$ 629,863	\$ 7,737	\$ 637,600

Relationship of Obligations to Outlays:

Obligated balance, net, beginning of period	\$ 135,968	\$ 931	\$ 136,899
Obligated balance, net, end of period:			
Accounts receivable	(597)	(1)	(598)
Unfilled customer orders from Federal sources	(8,028)	-	(8,028)
Undelivered orders	109,304	778	110,082
Accounts payable	37,472	295	37,767
<i>Obligated balance, net, end of period</i>	<i>\$ 138,151</i>	<i>\$ 1,072</i>	<i>\$ 139,223</i>

Outlays:

Disbursements	\$ 574,637	\$ 6,383	\$ 581,020
Collections	(6,665)	(12)	(6,677)
<i>Subtotal</i>	<i>567,972</i>	<i>6,371</i>	<i>574,343</i>
Less: Offsetting receipts	(526,273)	-	(526,273)
Net Outlays	\$ 41,699	\$ 6,371	\$ 48,070



CHIEF FINANCIAL
OFFICER

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

November 26, 2003

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

FROM: Jesse L. Funches
Chief Financial Officer *J. Funches for*

SUBJECT: DRAFT AUDIT REPORT - AUDIT OF THE FY 2003 FINANCIAL
STATEMENTS

I have reviewed the draft audit report of the agency's FY 2003 Financial Statements, dated November 18, 2003. Our responses to the three recommendations follow.

Recommendation 1

The CFO should develop policies and procedures to ensure that changes impacting user profiles are analyzed fully by system administrators for compatibility of duties. Additionally, the CFO should periodically review software enabled system controls to ensure compliance with agency policy.

Response

Agree. The CFO will issue guidance for system administrators to ensure that changes impacting user profiles are analyzed by system administrators for compatibility of duties. Guidance will be issued by June 1, 2004. We will also complete reviews of software-enabled system controls annually, as required by the Federal Information Security Management Act. However, based on discussions with the NRC's Senior IT Security Officer, we do not agree with the statement on page 3 of the draft report that: "The conditions . . . relate to the improper design of management controls affecting: . . . lack of compliance with agency policy (Management Directive No. 12.5, *NRC Automated Information Security Program*) for software password security authentication." NRC management has elected to accept the low residual risk associated with certain minor departures from MD 12.5. The low residual risk associated with these minor departures is, according to the Office of the Chief Information Officer, compliant with MD 12.5.

Recommendation 2

The CFO should reassess the accounting activities being undertaken by agency personnel to ensure the completeness and propriety of accounting transactions. Additionally, the CFO should be more proactive in monitoring and training project managers to install discipline which provides reliability of financial information.

CONTACT: Barbara K. Gusack, OCFO/DFM/FSRT
415-6054

Response

Agree. The CFO will modify its current procedures for monitoring approved software development projects to ensure more proactive monitoring and training of project managers and monitoring of accounting activities. Revised procedures will be issued by January 15, 2004.

Recommendation 3

The CFO should sustain the management controls over cost accounting with the same focus demonstrated at year-end. As the cost accounting processes become more routine, refinements may be needed. For example, effective in FY 2004, quarterly reports will be required 21 days after the quarter's end, thus necessitating the current process to produce cost accounting information for financial reporting sooner. We believe that continued senior management attention will yield additional benefits in future periods.

Response

Agree.

cc: D. Galik, OCIO
W. Dean, AO/OEDO
M. Malloy, OEDO
P. Tressler, OEDO