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United States Government Accountability Office
Washington, D.C. 20548

October 27, 2005

Mr. Jesse Funches
Chief Financial Officer
Nuclear Regulatory Commission

The Honorable Hubert T. Bell
Inspector General
Nuclear Regulatory Commission

Subject: *Financial Audit: Restatements to the Nuclear Regulatory Commission's Fiscal Year 2003 Financial Statements*

As you know, the Secretary of Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required to annually prepare and submit audited financial statements of the U.S. government to the President and Congress. We are required to audit these consolidated financial statements (CFS) and report on the results of our work.[1] An issue meriting concern and close scrutiny that emerged during our fiscal year 2004 CFS audit was the growing number of Chief Financial Officers (CFO) Act agencies that restated[2] certain of their financial statements for fiscal year 2003 to correct errors.[3] Errors in financial statements can result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. Further, when restatements do occur, it is important that financial statements clearly communicate, and readers of the restated financial statements understand, that the financial statements originally issued by management in the previous year and the opinion thereon should

[1]The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. § 331 (e). The federal government has elected to include certain financial information on the legislative and judicial branches in the CFS as well.

[2]A financial statement restatement occurs when an entity either voluntarily or prompted by its auditors or regulators revises public financial information that has previously been reported.

[3]According to Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, prior period financial statements presented should be restated only to correct errors that caused such statements to be materially misstated.

no longer be relied on and instead the restated financial statements and related auditor's opinion should be used.

Eleven of the 23 CFO Act agencies[4] restated certain of their financial statements for fiscal year 2003. Five CFO Act agencies had restatements in fiscal year 2003 covering their fiscal year 2002 financial statements. Three CFO Act agencies had restatements covering both years. We noted that the extent of the restatements to CFO Act agencies' fiscal year 2003 financial statements varied from agency to agency, ranging from correcting two line items on one agency's balance sheet to correcting numerous line items on several of another agency's financial statements. In some cases, the net operating results of an agency were affected by the restatement. The amounts of the agencies' restatements ranged from several million dollars to more than $91 billion.

Nine of the 11 agencies that had restatements for fiscal year 2003 received unqualified opinions on their originally issued fiscal year 2003 financial statements. The auditors for 6 of these 9 agencies issued unqualified opinions on the restated financial statements, replacing the previous unqualified opinions on the respective agencies' original fiscal year 2003 financial statements. The auditors for 2 of these 9 withdrew their unqualified opinions on the fiscal year 2003 financial statements and issued other than unqualified opinions on the respective agencies' restated fiscal year 2003 financial statements because they could not determine whether there were any additional misstatements and the effect of any such misstatements on the restated fiscal year 2003 financial statements. For the remaining agency, the principal auditor of the agency's fiscal year 2004 financial statements was not the principal auditor of the agency's fiscal year 2003 financial statements, and an audit opinion on the agency's restated fiscal year 2003 financial statements was not issued.

Our review focused on the 9 agencies with restatements for fiscal year 2003 that received unqualified opinions on their originally issued fiscal year 2003

[4]The Federal Emergency Management Agency (FEMA) was transferred to the Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA was no longer required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies for the remainder of fiscal year 2003 and for fiscal year 2004. The DHS Financial Accountability Act, Pub. L. No. 108-330, 118 Stat. 1275 (Oct. 16, 2004), added DHS to the list of CFO Act agencies, increasing the number of CFO Act agencies again to 24 beginning in fiscal year 2005.

financial statements.[5] These were the Department of Agriculture, Department of State, Department of Justice, Department of Transportation, Department of Health and Human Services, General Services Administration, National Science Foundation, Nuclear Regulatory Commission (NRC), and Office of Personnel Management.

Because of the varying nature and circumstances surrounding the restatements, we are issuing a number of separate reports on the matter. This report communicates our observations regarding NRC's fiscal year 2003 restatements. Going forward, we hope that the lessons learned from the fiscal year 2003 restatements, together with our recommendations, will help (1) NRC avoid the need for restatements to its future financial statements and (2) ensure that NRC's auditor applies appropriate audit procedures in future audits to test for unrecorded and unbilled licensee fees and related internal controls.

We reviewed four key areas with respect to the restatements of NRC's fiscal year 2003 financial statements: (1) the nature and cause of the errors that necessitated the restatements, including planned corrective actions by the agency and its auditors; (2) the timing of communicating the material misstatement to users of the financial statements; (3) the extent of transparency[6] exhibited in disclosing the nature and impact of the material misstatement in the financial statements and the reissued auditor's report; and (4) audit issues that contributed to the failure to detect the errors that necessitated the restatements during the audit of the agency's fiscal year 2003 financial statements.

Results in Brief

NRC's lack of effective internal controls over unrecorded and unbilled licensee fees[7] led to the material misstatement that necessitated the restatement of NRC's originally issued fiscal year 2003 financial statements. NRC's management representation letter, dated November 20, 2003, included representations that NRC's fiscal year 2003 financial statements were fairly stated and that the agency had effective internal controls. As of

[5]The 2 agencies that had restatements for fiscal year 2003 but did not receive unqualified opinions on their originally issued fiscal year 2003 financial statements were the Department of Defense and the Small Business Administration.

[6]Transparency is the full, accurate, and timely disclosure of information.

[7]Licensee fees include fees related to reactor and materials inspections.

the same date, the contracted independent public accountant (IPA) dated its audit report, which contained an unqualified, or clean, audit opinion on NRC's fiscal year 2003 financial statements. On December 17, 2003, certain NRC officials became aware that (1) there was an underbilling error of at least $500,000 for fiscal year 2003,[8] (2) the underbilling error may have resulted from an internal control deficiency within NRC's licensee fee billing system that could affect the reliability of NRC's fiscal year 2003 financial statements, and (3) further research was needed to determine the cause of the error and whether the error was an isolated incident or a systemic billing system weakness. Nevertheless, on December 19, 2003,[9] over 1 month prior to OMB's required January 30, 2004 due date for federal agencies to issue their fiscal year 2003 financial statements, NRC submitted its management representation letter and financial statements to OMB.

Consistent with OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*,[10] NRC should have timely notified the IPA of the error and related internal control deficiency, but never did. According to the IPA, it was not aware of the material error until May 2004 when it independently discovered that NRC had recorded and billed licensee fees during fiscal year 2004 that instead should have been recorded and billed during fiscal year 2003. The IPA determined that the underbilling error resulted from certain internal control deficiencies related to NRC's fee billing system.

Based on its interpretation of the American Institute of Certified Public Accountants (AICPA) Codification of Auditing Standards, AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, the IPA stated that upon discovery of the error in May 2004, it discussed the material error with NRC but did not advise NRC to make appropriate disclosures of the newly discovered facts and their effects on the fiscal year 2003 financial statements to persons who may have been relying on such financial statements and related auditor's report. The IPA told us that it came to this decision because (1) it considered issuance of

[8]Underbilling error was discovered by NRC as a result of an inquiry from an NRC licensee.

[9]Although OMB encouraged CFO Act agencies to accelerate issuance of their fiscal year 2003 audited financial statements to November 15, 2003 (or as close to that date as possible) in preparation for the accelerated reporting date for fiscal year 2004, OMB's required due date for agencies' fiscal year 2003 audited financial statements was January 30, 2004.

[10]Office of Management and Budget, Bulletin 01-02, *Audit Requirements for Federal Financial Statements* (Washington, D.C.: Oct. 16, 2000).

the fiscal years 2004 and 2003 comparative financial statements to be imminent and (2) in May 2004, it did not think that any users would still be relying on the fiscal year 2003 financial statements and related auditor's report. However, in our view, the issuance of NRC's fiscal years 2004 and 2003 comparative financial statements, which occurred in November 2004, was not imminent when the IPA discovered the material error in May 2004, more than 5 months prior to OMB's November 15, 2004 deadline for federal agencies to issue their fiscal year 2004 financial statements. In addition, the IPA did not provide us with documentation of the basis for its conclusion that users were not likely to still be relying on the fiscal year 2003 financial statements and would not attach importance to the correction of the material error. In our view, such documentation should include the identification of potential users, such as Congress, OMB, GAO, and the Department of the Treasury (Treasury), and an analysis of whether the users would likely be relying on the fiscal year 2003 financial statements. We have some concerns that, without notification, anyone who may have been relying on the fiscal year 2003 financial statements would not have known from May to mid-November 2004, or for more than 5 months, that NRC's originally issued financial statements, which received an unqualified opinion, were materially misstated and should not be relied on.

In addition to NRC's lack of effective internal controls over licensee fees, we noted two areas where additional audit procedures could have identified the problem at the time of the fiscal year 2003 audit. During its audit of the fiscal year 2003 financial statements, the IPA did not design or perform sufficient audit procedures to (1) determine whether all eligible licensee fees[11] were billed and properly presented in the financial statements and (2) detect the internal control deficiencies related to NRC's recording of licensee fees.

We are making a recommendation to NRC's CFO to determine whether the new procedures, which NRC represents as having been established, effectively ensure that all eligible licensee fees are properly recorded and billed. We are also making a recommendation to NRC's Inspector General to work with the IPA so that audit procedures to test for unrecorded and unbilled licensee fees and related internal controls are fully and effectively implemented.

[11]Certain fees are exempt from fee collection by regulation.

In commenting on a draft of this report, NRC's CFO and Inspector General both concurred with the recommendation that we made to each of them. We also received a technical comment from NRC's CFO, which we have incorporated.

Background

In conducting the fiscal year 2004 audit of the CFS, we reviewed the 23 CFO Act agencies' performance and accountability reports for possible restatements and identified 11 agencies that had restated certain of their audited fiscal year 2003 financial statements.

The primary intended users of federal agencies' financial reports are citizens, Congress, federal executives, and federal program managers.[12] Each of these groups may use federal agencies' financial statements to satisfy their specific needs. Citizens are interested in many aspects of the federal government, particularly federal programs that affect their financial well-being. Congress is interested in monitoring and assessing the efficiency and effectiveness of federal programs. Federal executives, such as central agency officials at OMB and Treasury, are interested in federal financial statements to assist the President of the United States. OMB assists the President in overseeing the preparation of the federal budget by formulating the President's spending plans, evaluating the effectiveness of agency programs, assessing competing funding demands among agencies, and setting funding priorities. Treasury assists the President in managing the finances of the federal government and prepares the CFS, which is based on audited financial statements prepared by federal agencies. GAO audits the CFS and reports on the results of its audit. Finally, federal program managers use agency financial statements as tools for managing their operations within the limits of the spending authority granted by Congress.

The primary accounting and auditing standards that apply to restatement disclosures by federal entities are the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards

[12]Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting.*

(SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and AU section 561.[13]

Objective, Scope, and Methodology

The objective of our review of restatements of NRC's fiscal year 2003 financial statements was to determine the nature and cause of the errors, the transparency and timing of communicating the material misstatements, any audit issues relating to such misstatements, and any actions being taken to help preclude similar errors from occurring in the future.

We reviewed the nature and causes of the restatements, and we also examined corrective actions taken by NRC to help preclude similar errors from occurring in the future. We interviewed the preparers and auditors of NRC's fiscal year 2003 financial statements, including staff from the agency's Office of Inspector General (OIG), and we obtained and reviewed relevant audit documentation. Our work was not designed to and we did not test the accuracy or appropriateness of the restatements.

In our review, we considered certain accounting and auditing standards, including SFFAS No. 21; OMB Bulletin 01-02; the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 16, *Prior Period Adjustments*; and the AICPA Codification of Auditing Standards, AU section 420, *Consistency of Application of Generally Accepted Accounting Principles*, AU section 508, *Reports on Audited Financial Statements*, and AU section 561.

We performed our review of the restatements of NRC's fiscal year 2003 financial statements from December 2004 to July 2005 in accordance with U.S. generally accepted government auditing standards.

We requested comments on a draft of this report from NRC's CFO and Inspector General or their designees. Written comments from NRC's CFO and Inspector General are reprinted in enclosures I and II, respectively, and are also discussed in the Agency Comments section.

[13]Generally accepted government auditing standards incorporate AICPA reporting and auditing standards unless the Comptroller General of the United States excludes them by formal announcement.

Issues Related to Restatements of NRC's Fiscal Year 2003 Financial Statements

With respect to restatement of certain of NRC's fiscal year 2003 financial statements, we identified the following three areas that need improvement: (1) certain internal controls related to NRC's recording of licensee fees; (2) communication by NRC with the IPA, OIG, and users of the financial statements concerning the identified material error; and (3) audit procedures for unrecorded and unbilled licensee fees and related internal controls. These issues are discussed in detail below.

Material Error Resulted from Deficiencies in Certain Internal Controls Related to Recording Licensee Fees

In fiscal year 2004, NRC restated certain of its fiscal year 2003 financial statements to reflect approximately $3 million in unrecorded and unbilled licensee fees,[14] which resulted from certain internal control deficiencies related to NRC's fee billing system. NRC inspects its licensees' facilities and users of nuclear materials to ensure compliance with regulatory requirements and recovers most of its appropriations from inspection fees paid by NRC licensees. If NRC does not bill its licensees or does not bill them for the full amount they owe, NRC's Accounts Receivable and related revenue will be understated and the federal government may not receive the full amount of fees to which it is entitled.

According to NRC's IPA, during fiscal year 2003, the fee billing system failed to include all billable hours in the invoices issued to NRC's licensees. The IPA stated that this condition resulted from the following deficiencies:

- inadequate testing by NRC of the fee billing system to ensure that modifications to system software performed as intended,
- use of intensive manual processes, and

[14]According to NRC officials, since NRC was already restating the fiscal year 2003 financial statements for this $3 million material error, it also decided to correct for less significant errors that had been identified. Specifically, the fiscal year 2003 Balance Sheet was restated for $777 thousand relating to capital leases, and the fiscal year 2003 Statement of Budgetary Resources was restated for $4.7 million for unfilled customer orders. These errors were not deemed material by NRC's IPA.

- lack of comprehensive quality assurance procedures over the billing process.[15]

As a result, NRC had to restate its originally issued fiscal year 2003 Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Financing to accurately reflect approximately $3 million in licensee fees that had not been recorded and billed.

The $3 million unrecorded and unbilled licensee fees error represented about 5 percent of the Other Intragovernmental Liabilities[16] and about 6 percent of the Accounts Receivable balances on the originally issued fiscal year 2003 Balance Sheet, approximately 5 percent of Net Cost of Operations[17] on NRC's originally issued fiscal year 2003 Statement of Net Cost,[18] about 5 percent of the Total Financing Sources component of Cumulative Results of Operations on NRC's originally issued fiscal year 2003 Statement of Changes in Net Position, and approximately 4 percent of the Total Resources Used to Finance Activities on NRC's originally issued fiscal year 2003

Statement of Financing. Because at the time of the issuance of NRC's fiscal years 2004 and 2003 comparative financial statements there was insufficient evidence to support the completeness of the Accounts

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[15]Procedures to detect potential underbillings were not effective because they did not provide for reconciliations of data generated by different sources. Such reconciliations are used to identify unrecorded and unbilled fees and erroneous licensee invoices. In addition, some reports produced by the fee system did not contain totals to enable comparisons of invoices to data sources, thus complicating the process to detect potential underbillings.

[16]The Other Intragovernmental Liabilities account increased by approximately $3 million from approximately $57 million, as originally reported in fiscal year 2003, to approximately $60 million when restated in the fiscal year 2004 and 2003 comparative financial statements. The underbilling error affected Other Intragovernmental Liabilities because NRC incurs a liability to offset the net accounts receivable for fees assessed. This liability represents amounts which, when collected, will be transferred to Treasury to offset NRC's appropriations in the year collected. Therefore, the Total Financing Sources component of Cumulative Results of Operations on the Statement of Changes in Net Position and the Total Resources Used to Finance Activities on the Statement of Financing were restated to capture the effect of NRC's obligation to transfer funds to Treasury for fees assessed.

[17]The $3 million licensee fees error represented almost 1 percent of the Earned Revenues from the Public reported on NRC's originally issued fiscal year 2003 Statement of Net Cost.

[18]In addition, Net Cost of Operations reported on NRC's originally issued fiscal year 2003 Statement of Changes in Net Position and Statement of Financing were also understated by approximately 5 percent.

Receivable and related revenue balances reported in NRC's restated fiscal year 2003 financial statements, the IPA updated the originally issued unqualified opinion to a qualified opinion.

According to NRC officials, the fee billing system has since been modified to improve the functionality of the system's interface, and the acceptance testing of fee billing system software modifications has been expanded and is now independently validated and verified. The officials also stated that they implemented a manual internal control procedure that compares the number of inspection hours billed by NRC on licensee invoices against the number of hours eligible to be charged to inspections by NRC staff as indicated in the NRC inspection database. These procedures are to be performed throughout the year and thus are intended to determine, on a timely basis, that all eligible hours have been billed.

Identified Material Error Was Not Communicated Timely

NRC's management representation letter, dated November 20, 2003, included representations that NRC's fiscal year 2003 financial statements were fairly stated and that the agency had effective internal controls. As of the same date, the IPA dated its audit report, which contained an unqualified, or clean, audit opinion on NRC's fiscal year 2003 financial statements. On December 17, 2003, certain NRC officials became aware that (1) there was an underbilling error of at least $500,000 for fiscal year 2003, (2) the underbilling error may have resulted from an internal control deficiency within NRC's licensee fee billing system that could affect the reliability of NRC's fiscal year 2003 financial statements, and (3) further research was needed to determine the cause of the error and whether the error was an isolated incident or a systemic billing system weakness. Nevertheless, on December 19, 2003, over 1 month prior to OMB's required January 30, 2004 due date for federal agencies to issue their fiscal year 2003 financial statements, NRC submitted its management representation letter and financial statements to OMB.

Subsequently, NRC researched the problem and by February 2004 had completed a preliminary review of NRC's fiscal year 2003 licensee fees. This review identified a total of about $2.4 million of unrecorded and unbilled licensee fees for fiscal year 2003. NRC continued to research the issue and by November 2004 found additional unrecorded and unbilled licensee fees. In total, approximately $3 million in unrecorded and unbilled licensee fees was identified for fiscal year 2003.

According to the OIG, despite the fact that NRC officials met with the agency's IPA and OIG on several occasions between the time that NRC's staff discovered the billing error and the IPA subsequently discovered the error, NRC did not report the billing error to the IPA or OIG. Specifically, the IPA and OIG stated that they were totally unaware of the error until the IPA discovered in May 2004 that NRC, as a result of the error, had recorded licensee fees and issued bills during fiscal year 2004 for licensee fees that instead should have been recorded and billed in fiscal year 2003. In accordance with OMB Bulletin 01-02, there shall be open and timely communication throughout the audit process between agency officials, including the CFO and the OIG, as well as the IPA if one is used, which would include potential audit findings, materially misstated or unsupported amounts in the financial statements, and material weaknesses in internal control. Accordingly, NRC officials had a responsibility to report the billing error and, if known, the cause of the error to the IPA when NRC became aware of it on December 17, 2003, because of the effect that the error could have on the fiscal year 2003 financial statements. Failure to timely provide this information is a serious matter that violates the tenets of the relationship between the audited entity and the auditor. As a result, NRC's OIG initiated an investigation of the matter and issued an internal report dated February 14, 2005, which we reviewed as part of our work, that discusses the details of the material error noted above.

After NRC's IPA independently discovered the error in May 2004, the IPA discussed the error with NRC but did not advise NRC to notify the users of the financial statements, such as Congress, OMB, GAO, and Treasury, about the material error. According to AU section 561, once the auditor becomes aware of subsequently discovered information that is found to be both reliable and to have existed at the date of the auditor's report, the auditor should take certain actions if the nature and effect of the matter are such that (1) the auditor's report would have been affected if the information had been known to the auditor at the date of the report and had not been reflected in the financial statements and (2) the auditor believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the information. If these conditions are met, the auditor should advise the reporting entity to make appropriate disclosures of the newly discovered facts and their effects on the financial statements to persons who are known to be relying or who are likely to rely on the financial statements and the related auditor's report. AU 561 states that when issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements. AU section 561 also states that if a material error in the prior year financial statements has been discovered but the effect of the subsequently discovered information cannot be quantified without a prolonged investigation, appropriate disclosure would consist of the reporting entity notifying users known or likely to be relying on the financial statements and the related auditor's report that the statements and auditor's report should not be relied on and that revised financial statements and a revised auditor's report will be issued upon completion of an investigation. AU section 561 further states that the auditor should take whatever steps are necessary to be satisfied that the reporting entity has made the appropriate disclosures.

However, until the issuance of NRC's fiscal years 2004 and 2003 comparative financial statements on November 15, 2004, users of NRC's financial statements were not aware that certain of the fiscal year 2003 financial statements originally issued were materially misstated. Based on its interpretation of AU 561, the IPA stated that it discussed the error with NRC but did not advise NRC to make appropriate disclosures of the newly discovered facts and their effects on the fiscal year 2003 financial statements to persons known to rely or likely to rely on such financial statements and related auditor's report. The IPA told us that it came to this decision because (1) it considered issuance of the fiscal years 2004 and 2003 comparative financial statements to be imminent and (2) in May 2004, it did not think that any users would still be relying on the fiscal year 2003 financial statements and related auditor's report. However, in our view, the issuance of NRC's fiscal years 2004 and 2003 comparative financial statements, which occurred in November 2004, was not imminent when the IPA discovered the material error in May 2004, more than 5 months prior to OMB's November 15, 2004 deadline for federal agencies to issue their fiscal year 2004 financial statements. In addition, the IPA did not provide us with documentation of the basis for its conclusion that users were not likely to still be relying on the fiscal year 2003 financial statements and would not attach importance to the correction of the material error. In our view, such documentation should include identification of potential users, such as Congress, OMB, GAO, and Treasury, and an analysis of whether the users would likely be relying on the fiscal year 2003 financial statements. We have concerns that, without notification, anyone who may have been relying on the fiscal year 2003 financial statements would not have known from May to mid-November 2004, or for more than 5 months, that NRC's originally issued financial statements, which received an unqualified opinion, were materially misstated and should not be relied on.

Audit Procedures Did Not Detect Unrecorded and Unbilled Licensee Fees and Related Internal Control Deficiencies

The above-noted material error was not discovered during the audit of NRC's fiscal year 2003 financial statements because the IPA did not design or perform sufficient audit procedures to (1) determine whether all eligible licensee fees were billed and properly presented in the financial statements and (2) detect the previously noted internal control deficiencies related to NRC's recording of licensee fees.

According to the *Financial Audit Manual* (FAM),[19] the auditor should perform audit procedures to test for all significant assertions[20] in significant financial statement line items and accounts. The FAM states that an assertion is significant if misstatements in the assertion could exceed test materiality for the related line item, account, or disclosure. Based on the materiality of NRC's Accounts Receivable and related revenue and the potential for material understatement, the auditor should have identified the completeness assertion as significant and performed audit procedures to determine whether all applicable fees were billed and presented in the financial statements. To test for completeness, the auditor should (1) select from an independent population of items that should be recorded in the account, (2) select items that should be recorded from a source that is likely to contain all the items that should be recorded, and (3) determine whether the selected items are included in the recorded balance. However, although the IPA did perform certain audit procedures during fiscal year 2003 to test Accounts Receivable and related revenue, the IPA did not design or perform audit procedures to test for the completeness assertion. For example, we found no documentation of audit procedures to compare the total number of inspection hours billed by NRC on licensee invoices against the total number of hours charged to inspections by NRC staff in the NRC inspection database in order to determine if all eligible hours had been billed.

Also, during the fiscal year 2003 audit, the IPA did not identify and report the internal control deficiencies, described earlier in this report, that led to NRC's failure to bill for all applicable licensee fees. According to OMB

[19]GAO/President's Council on Integrity and Efficiency, *Financial Audit Manual*, GAO-01-765G (Washington, D.C.: July 2001), updated by GAO-04-1015G and GAO-04-942G (July 2004).

[20]Financial statement assertions are management representations that are embodied in financial statement components. The assertions can be either explicit or implicit and can be classified into the following categories: (1) existence or occurrence, (2) completeness, (3) rights and obligations, (4) valuation or allocation, and (5) presentation and disclosure.

Bulletin 01-02, auditors are responsible for performing sufficient tests of internal controls that have been properly designed and placed in operation to support a low level of assessed control risk.[21] However, the IPA's fiscal year 2003 audit procedures were not sufficient to detect NRC's internal control deficiencies. The IPA stated that it took corrective action in fiscal year 2004 and designed audit procedures to detect unrecorded and unbilled licensee fees and to test related internal controls.

Conclusions

NRC did not disclose the material error it detected in its fiscal year 2003 financial statements to its IPA or OIG. In addition, in our view, NRC did not timely disclose the material error to users of its financial statements. NRC corrected the error and issued restated financial statements as part of its fiscal years 2004 and 2003 comparative financial statements on November 15, 2004, more than 8 months after NRC determined that the error totaled at least $2.4 million and about 11 months after it first became aware of an underbilling error. Going forward, it will be important for NRC to ensure that its new procedures, which it represents as having been implemented, effectively address the cause of the error. In addition, it will be important that the agency promptly notify its IPA and OIG of any errors it discovers in future financial statements. It will also be important that NRC's auditor fully and effectively implement audit procedures to detect any similar errors or internal control deficiencies in the future.

Recommendations for Executive Action

We recommend that NRC's Chief Financial Officer determine whether the new procedures, which NRC represents as having been established, effectively ensure that all eligible licensee fees are recorded and billed.

We recommend that NRC's Inspector General work with NRC's IPA so that audit procedures to test for unrecorded and unbilled licensee fees and related internal controls are fully and effectively implemented.

Agency Comments

In written comments on a draft of this report, which are reprinted in enclosures I and II, NRC's CFO and Inspector General, in separate letters, concurred with the recommendations that we made to each of them. We

[21]Control risk is the risk that a material misstatement that could occur in an assertion will not be prevented or detected and corrected on a timely basis by the entity's internal control.

also received a technical comment from NRC's CFO, which we have incorporated.

Within 60 days of the date of this report, we would appreciate receiving a written statement on actions taken to address these recommendations.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Homeland Security and Governmental Affairs; the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Government Reform; and the Subcommittee on Government Management, Finance and Accountability, House Committee on Government Reform. In addition, we are sending copies to the Fiscal Assistant Secretary of the Treasury and the Controller of OMB. This report is also available at no charge on GAO's Web site at www.gao.gov.

We appreciate the courtesy and cooperation extended to us by your staff throughout our work. We look forward to continuing to work with your offices to help improve financial management in the federal government. If you have any questions about the contents of this report, please contact me at (202) 512-3406 or engelg@gao.gov.

Gary T. Engel

Gary T. Engel
Director
Financial Management and Assurance

Enclosure I: Comments from the Chief Financial Officer, Nuclear Regulatory Commission

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

CHIEF FINANCIAL OFFICER

October 19, 2005

Mr. Gary T. Engel, Director
Financial Management Assurance
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Engel:

Thank you for the opportunity to review the United States Government Accountability Office's draft report, *Financial Audit: Restatement to the Nuclear Regulatory Commissions Fiscal Year 2003 Financial Statements.*

I agree with the report's recommendation that the Nuclear Regulatory Commission's Chief Financial Officer determine whether the new fee billing procedures effectively ensure that all eligible licensee fees are recorded and billed. However, to more accurately reflect the actions the Nuclear Regulatory Commission has taken with respect to its fee billing system, I recommend the following change to the first sentence of the last paragraph on page 13 of the draft report:

> According to NRC officials, the fee billing system has since been modified ~~so that it now records all billable hours~~ to improve the functionality of the system's interface, and the acceptance testing of fee billing system software modifications has been expanded and is now independently validated and verified.

If you have any questions concerning our response, please contact Mary S. Givvines, Director, Division of Financial Management on (301) 415-7379.

Sincerely,

Jesse Funches

cc: Chairman Diaz
Commissioner McGaffigan
Commissioner Merrifield
Commissioner Jaczko
Commissioner Lyons
L. A. Reyes, EDO
M. Malloy, OEDO

Enclosure II: Comments from the Inspector General, Nuclear Regulatory Commission

Note: A GAO comment supplementing those in the report text appear at the end of this enclosure.

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

OFFICE OF THE
INSPECTOR GENERAL

October 14, 2005

Mr. Gary T. Engel, Director
Financial Management and Assurance
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Engel:

The U. S. Nuclear Regulatory Commission (NRC), Office of the Inspector General appreciates the opportunity to respond to the Government Accountability Office (GAO) report entitled *Financial Audit: Restatements to the Nuclear Regulatory Commission's Fiscal Year 2003 Financial Statements.*

One point in the report requires clarification.

This relates to the comment on the tests of completeness. On page 19 of the draft report, the statement is made that GAO found "no documentation of audit procedures to compare the total number of inspection hours billed by NRC on licensee invoices against the total number of hours charged to inspections by NRC staff in the NRC inspection database in order to determine if all eligible hours had been billed."

See comment 1.

OIG response: There is no "inspection database" that includes all the hours billed during a particular year. Data in the fee billing system comes from several sources. As a result, the testing of completeness is accomplished through a variety of alternative techniques.

We have reviewed the report and concur with the recommendation that NRC's Inspector General work with its IPA so that audit procedures to test for unrecorded and unbilled licensee fees and related internal controls are fully and effectively implemented.

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Thank you for the opportunity to review the draft copy of this report. If you have any questions regarding this response, please contact Stephen Dingbaum, Assistant Inspector General for Audits, at (301) 415-5915.

Sincerely,

Hubert T. Bell
Inspector General

cc: Chairman Diaz
Commissioner Merrifield
Commissioner Jaczko
Commissioner Lyons
Commissioner McGaffigan
Luis Reyes, EDO
Melinda Malloy, OEDO

The following is a comment on the Nuclear Regulatory Commission's (NRC) Inspector General letter dated October 14, 2005.

GAO Comment

1. NRC's Inspector General noted that there is no "inspection database" that includes all the hours billed during a particular year. We agree. Our report does not state that the inspection database includes all the hours billed during a particular year. Instead, this report states that the NRC inspection database includes the hours eligible to be charged to inspections by NRC staff. NRC's Inspector General also stated that data in the fee billing system comes from several sources and, as a result, the testing of completeness is accomplished through a variety of alternative techniques. While we agree that data in the fee billing system comes from several sources and that the testing of completeness can be accomplished through several means, the IPA's fiscal year 2003 audit procedures were not designed or performed to test for the completeness assertion.