

January 10, 2007

MEMORANDUM TO: Luis A. Reyes
Executive Director for Operations

Jesse L. Funches
Chief Financial Officer

FROM: Stephen D. Dingbaum */RA/*
Assistant Inspector General for Audits

SUBJECT: MEMORANDUM REPORT – REVIEW OF NRC'S
IMPLEMENTATION OF THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT FOR FISCAL YEAR 2006
(OIG-07-A-07)

This report reflects the Office of the Inspector General's (OIG) assessment of the Nuclear Regulatory Commission's (NRC) FY 2006 compliance with the *Federal Managers' Financial Integrity Act (FMFIA) of 1982*. We found that NRC complied with the FMFIA, except for the following material weaknesses associated with:

- ◆ The Federal Information Security Management Act
 - Lack of current certification and accreditation for the agency's information system security program,
 - Lack of contingency plan testing for the agency's information system security program, and
- ◆ NRC's Fee Billing System.

This report contains no recommendations because the material weaknesses and the associated audit recommendations are included in the OIG report, *Results of the Audit of the United States Nuclear Regulatory Commission's Financial Statements for Fiscal Years 2006 and 2005*, report number OIG-07-A-02, dated November 9, 2006.

BACKGROUND

The FMFIA was enacted on September 8, 1982, in response to continuing disclosures of waste, loss, unauthorized use, and misappropriation of funds or assets associated with weak internal controls and accounting systems. Congress felt such abuses hampered the effectiveness and accountability of the Federal Government and eroded the public's confidence. The FMFIA requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal controls and accounting systems for which they are responsible.

The FMFIA requires that, each year, the head of each executive agency (subject to the FMFIA) shall submit a report to the President and the Congress on the status of control and financial systems that protect the integrity of agency programs and administrative activities. NRC incorporates its FMFIA assessment and report in its annual *Performance and Accountability Report*.

Effective for FY 2006, Office of Management and Budget Circular A-123, *Management's Responsibility for Internal Control*, (OMB Circular A-123), revised in December 2004, requires that management provide a separate assurance statement relating to internal control over financial reporting. In addition, OMB Circular A-123 requires that significant deficiencies identified under the Federal Information Security Management Act be reported as material weaknesses in the annual FMFIA report.

RESULTS

The Chairman and the Inspector General reported different results on the agency's FY 2006 compliance with the FMFIA as explained below.

Federal Information Security Management Act

Both the Chairman and the Inspector General identified material weaknesses related to the lack of current certification and accreditation for the agency's information system security program, and the lack of contingency plan testing for the agency's information system security program.

Fee Billing System

The Chairman categorized the Fee Billing System as follows:

- ◆ A non-conformance in NRC's internal control over the efficiency and effectiveness of operations and compliance with applicable laws and regulations, and
- ◆ Not as a material weakness in internal control over financial reporting.

The Inspector General identified the issues related to the agency's Fee Billing System as a continuing material weakness.

Chairman's Criteria and Results

OMB Circular A-123 is the agency's implementing guidance for FMFIA. It states that material weaknesses are "Reportable conditions which the agency head determines to be significant enough to be reported outside the agency." Material weaknesses shall be included in the annual FMFIA assurance statement and reported in the agency's annual *Performance and Accountability Report*. The term "internal controls," as envisioned by the FMFIA encompasses accounting and administrative controls, which include program, operational and administrative areas as well as accounting and financial management. Further, OMB Circular A-123, Appendix A, *Internal Control Over Financial Reporting*, states that, with respect to internal control over financial reporting, a material weakness is a "reportable condition, or combination of reportable conditions, that results in more than a remote likelihood that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected."

Using this criteria, the Chairman, in the *FY 2006 Performance and Accountability Report*, provided a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA, with the exception of two material weaknesses related to NRC's information system security program and one non-conformance concerning the Fee Billing System.

With respect to OMB Circular A-123, Appendix A, the Chairman provided reasonable assurance that the agency's internal control over financial reporting as of June 30, 2006, was operating effectively and no material weaknesses were found in the design or operation of internal control over financial reporting.

Inspector General's Criteria and Results

OMB Bulletin No. 06-03¹, *Audit Requirements for Federal Financial Statements*, dated August 23, 2006, provides the criteria used by the Inspector General. Section 2.11 of the Attachment to the Bulletin states:

"Material weaknesses in internal control" are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud or noncompliance in amounts that would be material in relation to the Basic Statements or Required Supplementary Stewardship Information being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The auditor shall use this definition of material weaknesses to report on an entity's internal

¹ OMB Bulletin 06-03 supersedes OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

control in accordance with the requirements of U.S. Government Auditing Standards and this bulletin, rather than the definition of material weaknesses used by management to prepare an agency's FMFIA report.

The Inspector General applied the aforementioned criteria and found that, for FY 2006, the NRC complied with the provisions of the FMFIA, except for the following material weaknesses associated with:

- ◆ The Federal Information Security Management Act:
 - Lack of current certification and accreditation for the agency's information system security program,
 - Lack of contingency plan testing for the agency's information system security program, and
- ◆ NRC's Fee Billing System.

AGENCY COMMENTS

A draft of the report was shared with NRC management. The Office of the Executive Director for Operations and the Office of the Chief Financial Officer had a minor editorial comment which was incorporated into this report.

SCOPE/CONTRIBUTORS

We evaluated the internal control related to the NRC's implementation of the FMFIA for FY 2006, and conducted our work in December 2006, in accordance with Generally Accepted Government Auditing Standards. This audit was conducted by Kathleen Stetson, Audit Manager.

If you have any questions, please contact me at 415-5915 or Steven Zane at 415-5912.

cc: Chairman Klein
Commissioner McGaffigan
Commissioner Merrifield
Commissioner Jaczko
Commissioner Lyons
M. Johnson, OEDO
M. Malloy, OEDO
P. Tressler, OEDO