REVIEW OF NRC'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT FOR FISCAL YEAR 1998

OIG/99A-11 March 3, 1999

March 3, 1999

MEMORANDUM TO: Chairman Jackson

FROM: Hubert T. Bell
Inspector General

SUBJECT: REVIEW OF NRC'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT FOR FISCAL YEAR 1998

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. The FMFIA requires that each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities. As part of an Office of Management and Budget (OMB) sponsored pilot program to streamline financial reporting, the Nuclear Regulatory Commission (NRC) issues its FMFIA report as part of its annual "Accountability Report."

OMB Circular A-123, Revised, "Management Accountability and Control," is the implementing guidance for FMFIA. The term "internal controls," as envisioned by the FMFIA, is synonymous with "management controls" and encompasses program and administrative areas, as well as the accounting and financial management areas.

NRC redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and OMB's 1995 revision to OMB Circular A-123. The redesigned program required offices designated as highest risk (with respect to programmatic and administrative activities) to submit management control plans and reasonable assurance letters to NRC's Executive Committee for Management Controls. The Executive Director for Operations is the Chairman of the Executive Committee.

We are reporting the NRC's absence of a managerial cost accounting process as a material weakness. Such a process is required by Statement of Federal Financial Accounting Standards Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, issued in July 1995. The original effective date was for reporting periods beginning after September 30, 1996. Because of concerns raised by the Chief Financial Officers Council, the Federal Accounting Standards Advisory Board amended the effective date to October 1, 1997.

Although we found that NRC has complied with the procedural requirements of the FMFIA during Fiscal Year (FY) 1998, we disagree with NRC's determination that the absence of management cost accounting is not a material weakness. Managerial cost accounting is intended to be an integral process for managing Government operations, and it is a vital component for implementing the Government Performance and Results Act.

FY 1998 was the fourth year of NRC's revised management control program. Our review of the first year (FY 1995) not only examined management control plans and reasonable assurance letters, but also evaluated the implementation of NRC's process. Over the next two years, we focused on issues raised by the Office of the Inspector General (OIG) and the offices in their control plans and reasonable assurance letters. During FY 1998, OIG again examined the implementation process and issued a report in December 1998.[1]

Attachment: As stated

cc: Commissioner Dicus
Commissioner Diaz
Commissioner McGaffigan
Commissioner Merrifield

[1] OIG Report 98A-08, *NRC Should Reconsider The Methodology and Implementation of the Management Control Program*, December 9, 1998.

REPORT SYNOPSIS

Continuing disclosures of Federal waste, loss, unauthorized use, and misappropriation of funds or assets associated with weak internal controls and accounting systems resulted in the passage of the Federal Managers' Financial Integrity Act (FMFIA) in September 1982. 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.

In 1995, the Nuclear Regulatory Commission (NRC) redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and the Office of Management and Budget's 1995 revision to Circular A-123. The redesigned program required offices designated as the highest risk to submit management control plans and reasonable assurance letters to an Executive Committee for Management Controls. The Executive Director for Operations is Chairman of the Executive Committee.

To assist NRC in evaluating its management control program, the Office of the Inspector General annually reviews NRC's program. We are reporting the NRC's absence of a managerial cost accounting process as a material weakness. Such a process is required by Statement of Federal Financial Accounting Standards Number 4, *Managerial Cost Accounting Standards*, issued in July 1995. The original effective date was for reporting periods beginning after September 30, 1996. Because of concerns raised by the Chief Financial Officers Council, the Federal Accounting Standards Advisory Board amended the effective date for periods beginning after September 30, 1997 (Fiscal Year 1998).

We found that NRC has complied with the procedural requirements of the FMFIA during Fiscal Year 1998. However, we disagree with the Agency's determination that the absence of managerial cost accounting is not a material weakness, and we are reporting it as a material weakness. Managerial cost accounting is intended to be an integral process for managing Government operations, and it is a vital component for implementing the Government Performance and Results Act.

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INTRODUCTION

The Federal Managers' Financial Integrity Act (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.

Office of Management and Budget (OMB) Circular A-123, Revised, "Management Accountability and Control," is the implementing guidance for FMFIA. The term "internal controls," as envisioned by the FMFIA, is synonymous with "management controls" and encompasses program and administrative areas, as well as the accounting and financial management areas. OMB defined management controls in Circular A-123 as the controls used to ensure that: (1) the organization, policies and procedures are reasonable to ensure that programs achieve their intended results; (2) resources are used consistent with an agency's mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and, (5) reliable and timely information is obtained, maintained, reported and used for decision making.

See Appendix I for the objective, scope, and methodology of our review.

BACKGROUND

The FMFIA requires that each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities.

In Fiscal Year (FY) 1995, the Nuclear Regulatory Commission (NRC) redesigned and streamlined its management control program in accordance with the National Performance Review recommendations and the 1995 revision to OMB Circular A-123. The redesigned program required offices designated as the highest risk (with respect to programmatic and administrative activities) to submit management control plans and reasonable assurance letters to the Chairman, Executive Committee for Management Controls. The Executive Director for Operations is the Chairman of this Committee.

FY 1998 was the fourth year of NRC's revised management control program. Our review of the first year (FY 1995) not only examined management control plans and reasonable assurance letters, but also evaluated the implementation of NRC's process. Over the next two years, we focused on issues raised by the offices in their control plans and reasonable assurance letters. During FY 1998, the Office of the Inspector General (OIG) again examined the implementation process and issued a report in December 1998.[1] That report made three recommendations to strengthen and improve NRC's management control program.

NRC is one of six pilot agencies granted permission to streamline financial reporting pursuant to the Government Management Reform Act (GMRA). GMRA permits the Director of the OMB to consolidate or adjust the frequency and due dates of certain statutory financial management reports after consultation with Congress. For FY 1995, NRC streamlined its reporting requirements by issuing its first "Accountability Report," which included NRC's FMFIA reporting requirements.

To assist NRC in evaluating its management control program, OIG annually reviews NRC's program.

FINDINGS

Although NRC is not reporting any material weaknesses for FY 1998, OIG has identified the absence of a managerial cost accounting process as a material weakness. Without such a process, NRC does not comply with Federal accounting standards, which require that cost accounting be performed on a regular and consistent basis. Further, the Federal Accounting Standards Advisory Board (FASAB) stated that "reliable and relevant cost information is indispensable for implementing the requirements of the Government Performance and Results Act [GPRA]." While NRC is in general compliance with FMFIA, we believe that the managerial cost accounting issue is of such significance that it must be classified as a material weakness and reported to the President.

The Lack Of A Managerial Cost Accounting Process Is A Material Weakness

Statement of Federal Financial Accounting Standards (SFFAS) Number 4 requires that NRC and other Federal agencies have a cost accounting process in place for FY 1998. By the end of that fiscal year, NRC had no such process in place. NRC has delayed implementing a cost accounting methodology and has only recently begun a process to develop one. As a result, NRC cannot provide agency-wide cost data for its responsibility segments and meet the requirements for GPRA. We

[1] OIG Report 98A-08, *NRC Should Reconsider The Methodology and Implementation of the Management Control Program*, December 9, 1998.

believe this weakness is material to the Agency as a whole and meets threshold for a material weakness as defined in NRC Management Directive 4.4.[2]

In July 1993, Congress passed the GPRA, which mandates Federal agencies to measure performance. In September of that year, the Vice President recommended an action that required the FASAB to issue a set of cost accounting standards for all Federal entities. Those standards were intended to provide a method for identifying the unit cost of all Government activities.

On July 31, 1995, FASAB issued SFFAS Number 4, *Managerial Cost Accounting Standards*. This statement establishes the requirement for cost accounting. It states that each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. It adds that costs may be accumulated by using cost accounting systems or by using cost finding techniques. Management should define and establish responsibility segments and use managerial cost accounting to measure and report the cost of each segment's outputs.

SFFAS Number 4 recognizes the need for consistent cost accounting on a regular basis. To perform cost accounting on a regular basis means that "entities should establish procedures to accumulate and report costs continuously, routinely, and consistently for management purposes." The statement also ties together legislative actions designed to demonstrate the need for cost accounting:

> The requirement for managerial cost accounting on a regular and consistent basis supports recent legislative actions. The CFO [Chief Financial Officers] Act of 1990 states that agency CFOs shall provide for the development and reporting of cost information and the periodic measurement of performance. In addition, the GPRA of 1993 requires each agency, for each program, to establish performance indicators and measure or assess relevant outputs, service levels, and outcomes of each program as a basis for comparing actual results with established goals. The nature of these legislative mandates requires reporting entities to develop and report cost information on a consistent and regular basis.

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2 NRC Management Directive 4.4 states, "A deficiency that the Chairman determines to be significant enough to be reported in the annual Integrity Act report [FMFIA] shall be considered a 'material weakness.' This designation requires a judgment as to the relative risk and significance of the deficiency and whether it merits the attention of the Executive Office of the President or the relevant congressional oversight committees." The Directive also states that the Executive Committee for Management Controls (ECMC) will make recommendations to the Executive Director for Operations as to which "significant weaknesses" are deemed material to the agency as a whole and should be considered for inclusion in the annual Integrity Act report to the President and Congress.

In July 1997, the FASAB received a request from the CFO Council for a two year deferral of the effective date for SFFAS Number 4. The Statement's original implementation date was for FY 1997. The Board considered the request and decided to delay implementation for one year, to FY 1998. In denying the CFO Council's request, FASAB stated in part:

> The Board cannot agree with this request. It believes that cost accounting capability must be developed in time to fully support the GPRA reporting. The Board thus urges Federal entities to give implementation of SFFAS No. 4 a high priority and take immediate actions to define and structure responsibility segments and develop costing methodologies.

In late 1998, the Office of the Chief Financial Officer (OCFO) began a project to bring cost accounting to NRC. OCFO hopes to develop a cost accounting strategy during FY 1999. The CFO also advised us that the Agency's proposed financial management system, STARFIRE, will satisfy the reporting requirements for cost accounting. However, the core system is not expected to become operational until late FY 1999.

The CFO advised us that for FY 1998 the Executive Council and the Program Review Committee[3] recognize that the Agency has a significant weakness concerning managerial cost accounting. However, they did not refer it to the Chairman for consideration as a material weakness.

CONCLUSION

Since NRC identified the lack of managerial cost accounting as a significant Agency weakness, we believe that, overall, the Agency has complied with FMFIA requirements. However, OIG disagrees with NRC's assessment that this is not a material weakness. Legislative mandates support the need for cost accounting and SFFAS Number 4 and the FASAB's deferral conclusion stress the high priority and management attention that managerial cost accounting deserves. This activity is intended to be an agency-wide function to better manage NRC's resources.

We do not believe that NRC management gave priority attention to this issue. Because NRC has only recently begun to explore potential cost accounting methodologies, it was not prepared to implement GPRA costing at the beginning of FY 1999, as the FASAB had envisioned. As a result, we believe the lack of a managerial cost accounting process is a material weakness that "merits the attention of the Executive Office of the President, " as stated in MD 4.4.

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[3] A recently reconstituted ECMC consists of the Executive Council and the Program Review Committee.

RECOMMENDATION

A recommendation addressing the NRC's need for managerial cost accounting is contained in OIG's report on NRC's financial statements for FY 1998.[4] Therefore, we are not making recommendations in this report.

4 OIG Report 98A-09, *Independent Auditors' Report and the Principal Statements for the Year Ended September 30, 1998*, dated March 1, 1999.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine whether the U.S. Nuclear Regulatory Commission (NRC) complied with the provisions of the Federal Managers' Financial Integrity Act, which 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.

We conducted our review at NRC headquarters in January 1999. We reviewed applicable laws, implementing guidance, and the management control plans and reasonable assurance letters submitted by NRC offices for fiscal year 1998. Our review included discussions with the Executive Committee staff and other NRC officials.

Our review was conducted in accordance with generally accepted Government auditing standards and included such tests of the data and records and other auditing procedures as we considered necessary.

MAJOR CONTRIBUTORS TO THIS REPORT

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Team Leader

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GLOSSARY: OFFICE OF THE INSPECTOR GENERAL PRODUCTS

INVESTIGATIVE

1. *INVESTIGATIVE REPORT - WHITE COVER*

   An Investigative Report documents pertinent facts of a case and describes available evidence relevant to allegations against individuals, including aspects of an allegation not substantiated. Investigative reports do not recommend disciplinary action against individual employees. Investigative reports are sensitive documents and contain information subject to the Privacy Act restrictions. Reports are given to officials and managers who have a need to know in order to properly determine whether administrative action is warranted. The agency is expected to advise the OIG within 90 days of receiving the investigative report as to what disciplinary or other action has been taken in response to investigative report findings.

2. *EVENT INQUIRY - GREEN COVER*

   The Event Inquiry is an investigative product that documents the examination of events or agency actions that do not focus specifically on individual misconduct. These reports identify institutional weaknesses that led to or allowed a problem to occur. The agency is requested to advise the OIG of managerial initiatives taken in response to issues identified in these reports but tracking its recommendations is not required.

3. *MANAGEMENT IMPLICATIONS REPORT (MIR) - MEMORANDUM*

   MIRs provide a "ROOT CAUSE" analysis sufficient for managers to facilitate correction of problems and to avoid similar issues in the future. Agency tracking of recommendations is not required.

AUDIT

4. *AUDIT REPORT - BLUE COVER*

   An Audit Report is the documentation of the review, recommendations, and findings resulting from an objective assessment of a program, function, or activity. Audits follow a defined procedure that allows for agency review and comment on draft audit reports. The audit results are also reported in the OIG's "Semiannual Report" to the Congress. Tracking of audit report recommendations and agency response is required.

5. *SPECIAL EVALUATION REPORT - BURGUNDY COVER*

   A Special Evaluation Report documents the results of short-term, limited assessments. It provides an initial, quick response to a question or issue, and data to determine whether an in-depth independent audit should be planned. Agency tracking of recommendations is not required.

REGULATORY

6. *REGULATORY COMMENTARY - BROWN COVER*

   Regulatory Commentary is the review of existing and proposed legislation, regulations, and policies so as to assist the agency in preventing and detecting fraud, waste, and abuse in programs and operations. Commentaries cite the IG Act as authority for the review, state the specific law, regulation or policy examined, pertinent background information considered and identifies OIG concerns, observations, and objections. Significant observations regarding action or inaction by the agency are reported in the OIG Semiannual Report to Congress. Each report indicates whether a response is required.