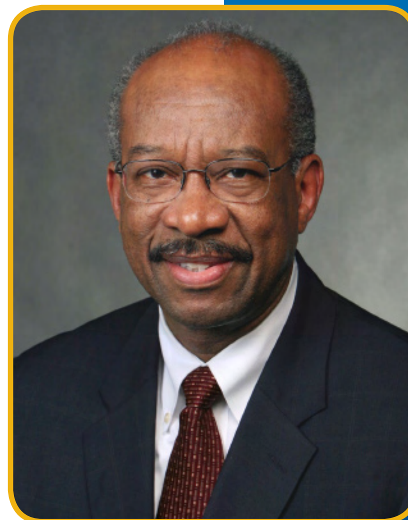
Chapter 3

AUDITORS' REPORT AND FINANCIAL STATEMENTS

A MESSAGE FROM THE CHIEF FINANCIAL OFFICER



I am pleased to present the U.S. Nuclear Regulatory Commission's (NRC) financial statements for FY 2006 as an integral part of the Agency's FY 2006 Performance and Accountability Report. Our independent auditors have rendered an unqualified opinion on our financial statements, attesting to the fact that NRC's financial statements are fairly presented and demonstrate discipline and accountability in the execution of our responsibilities as stewards of the American taxpayers' dollars.

As of September 30, 2006, the financial condition of the NRC is sound with respect to having sufficient funds to meet its mission and having adequate control of these funds to ensure our budget authority is not exceeded. We successfully completed the assessment of the Agency's key financial controls as required by Circular A-123, Appendix A: Internal Control Over Financial Reporting, identifying no material internal control weaknesses. Additionally, we successfully collected 100 percent of the Agency's budget that is subject to fee recovery from NRC licensees and maintained delinquent debt to less than one-half of one percent of collections. Ninety-five percent of payments subject to the Prompt Payment Act were made on-time, with less than one-half of one percent made erroneously. We have also received excellent ratings for our timely and accurate reporting to Treasury and the Office of Management and Budget.

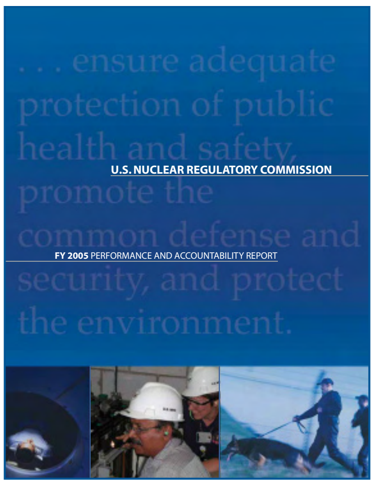
In FY 2006, we continued our efforts to eliminate the auditor-identified material weakness related to the Fee Billing System. We made significant improvements to the quality assurance procedures to address this weakness and plan to further strengthen our internal controls. Further, the auditors identified a material weakness related to the Agency's information system-wide security controls, which have not undergone contingency tests and do not have certifications and accreditations to operate. The Agency plans to complete contingency plan testing in FY 2007 and have all major information systems certified and accredited by FY 2008.

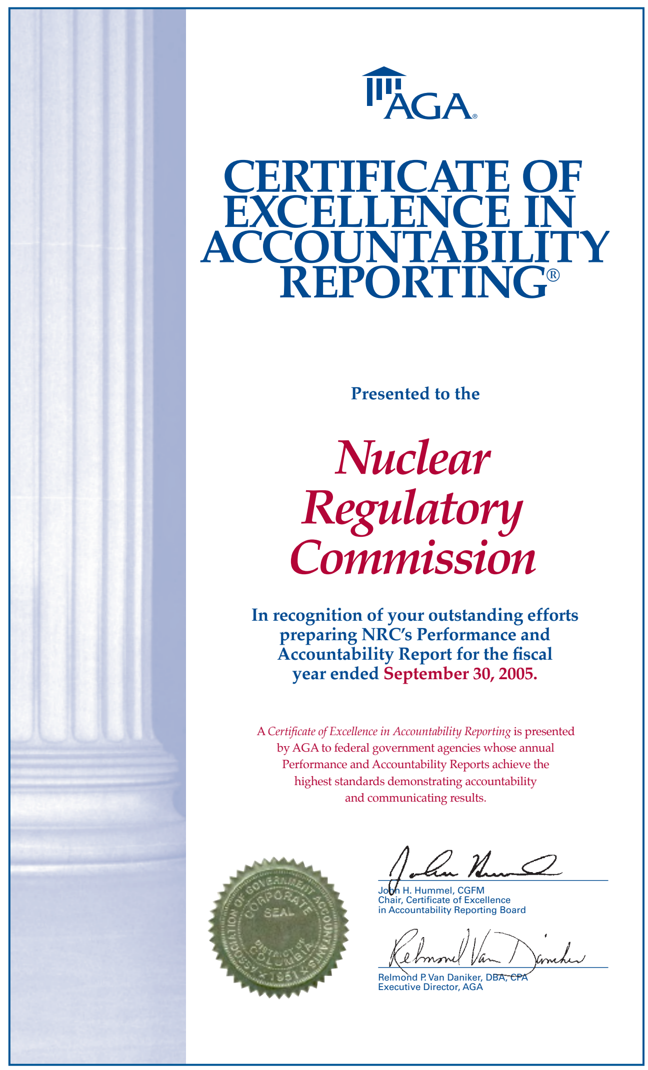
We have resolved two reportable conditions and are working to address the remaining one. We have also worked with our shared service provider to resolve two substantial noncompliances with Federal financial management system requirements. The Agency's Fee Billing System remains in substantial noncompliance with Federal financial management system requirements. Our remediation plan involves replacement of the Fee Billing System by FY 2009.

We are in the process of replacing the Agency core accounting system. We plan to incorporate the functional requirements for core accounting, cost accounting, capitalized property, and fee billing to achieve a more integrated financial management system. This will improve the efficiency and effectiveness of the NRC's business processes.

The NRC is committed to effective and efficient management of its resources. Our goals and strategies for improving financial management are centered on maintaining unqualified audit opinions, eliminating internal control weaknesses, upgrading financial systems to conform to Federal requirements, and meeting financial reporting requirements. I work collaboratively and continuously interact with my program counterparts to ensure the Agency's financial data is accurate and provided timely. I look forward to and anticipate another productive year in FY 2007 to continue the same high level of financial services that resulted in our past successes.

Jesse L. Funches
November 15, 2006




AGA

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In recognition of your outstanding efforts preparing NRC's Performance and Accountability Report for the fiscal year ended September 30, 2005.

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AUDITORS' REPORT

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

OFFICE OF THE
INSPECTOR GENERAL

November 9, 2006

MEMORANDUM TO: Chairman Klein

FROM: Hubert T. Bell
Inspector General

SUBJECT: RESULTS OF THE AUDIT OF THE UNITED STATES NUCLEAR REGULATORY COMMISSION'S FINANCIAL STATEMENTS FOR FISCAL YEARS 2006 AND 2005 (OIG-07-A-02)

The Chief Financial Officers Act of 1990, as amended, (CFO Act) requires the Inspector General (IG) or an independent external auditor, as determined by the IG, to annually audit the United States Nuclear Regulatory Commission's (NRC) financial statements in accordance with applicable standards. In compliance with this requirement, this memorandum transmits the following R. Navarro & Associates, Inc. Auditors' Reports:

- Independent Auditors' Report on the FYs 2006 and 2005 Financial Statements,
- Report on the Effectiveness of Internal Control over Financial Reporting, and
- Report on Compliance with Laws and Regulations.

Objective of a Financial Statement Audit

The objective of a financial statement audit is to determine 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.

R. Navarro & Associates' examination was made in accordance with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. The audit included obtaining an understanding of the internal controls over financial reporting and testing and evaluating the design and operating effectiveness of the internal controls. Because of inherent limitations in any internal control, there is a risk that errors or fraud may occur and not be detected. Also, projections of an 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.

Results of Audit

The results are as follows:

Financial Statements

- FYs 2006 and 2005 - Unqualified opinion

FY 2006 Internal Controls

- Qualified opinion
- Reportable Conditions:
  - Fee Billing System (Continuing Material Weakness)
  - Information System-wide Security Controls (New Material Weakness)

FY 2006 Compliance with Laws and Regulations

- Noncompliances:
  - Part 170 Hourly Rates (Continuing Noncompliance)
  - Fee Billing System (Continuing Substantial Noncompliance)

OIG Oversight of R. Navarro & Associates, Inc. Performance

To fulfill our responsibilities under the CFO Act and related legislation for ensuring the quality of the audit work performed, we monitored R. Navarro & Associates' audit of NRC's FYs 2006 and 2005 financial statements by:

- Reviewing their approach and planning of the audit,
- Evaluating the qualifications and independence of its auditors,
- Monitoring the progress of the audit at key points,
- Examining the working papers related to planning and performing the audit and assessing NRC's internal control,
- Reviewing R. Navarro & Associates' audit reports to ensure compliance with Government Auditing Standards and OMB Bulletin No. 06-03,
- Coordinating the issuance of the audit reports, and
- Performing other procedures that we deemed necessary.

R. Navarro & Associates, Inc. is responsible for the attached auditors' reports, dated November 7, 2006, and the conclusions expressed therein. The Office of the Inspector General (OIG) is responsible for technical and administrative oversight regarding the firm's performance under the terms of the contract. Our review, as differentiated from an audit in conformance with *Government Auditing Standards*, was not intended to enable us to express, and accordingly we do not express, an opinion on:

- NRC's financial statements,
- The effectiveness of NRC's internal control over financial reporting, or
- NRC's compliance with laws and regulations.

However, our monitoring review, as described above, disclosed no instances where R. Navarro & Associates, Inc. did not comply with applicable auditing standards.

Performance Reporting

As required by OMB Bulletin No. 06-03, 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, and
- Determined whether they have been placed in operation.

Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

Meeting with the Chief Financial Officer

At the exit conference on November 7, 2006, representatives of the Office of the Chief Financial Officer, OIG, and R. Navarro & Associates, Inc. discussed the issues in the report related to the results of the audit.

Comments of the Chief Financial Officer

In his response, the CFO agreed with the auditors' recommendations. We will follow-up on the CFO's implementation of planned corrective actions during FY 2007. The full text of the CFO's response follows this report.

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

R. NAVARRO
& ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

2831 Camino Del Rio South, Suite 306
San Diego, California 92108
(619) 298-8193

Chairman Dale E. Klein
U.S. Nuclear Regulatory Commission
Washington, DC

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

- The balance sheets of NRC as of September 30, 2006, and 2005, 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;
- Except for the effect of the material weaknesses related to the Fee Billing System and Information System-wide Security Controls, the effectiveness of internal control over financial reporting was fairly stated as of September 30, 2006, in compliance with the internal control objectives in the Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*; and
- NRC continues to be non-compliant with the provisions of OMB Circular A-25, *User Charges*, for Part 170 fees. Additionally, NRC continues to have a substantial non-compliance related to the Fee Billing System.

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, 2006, and 2005, 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. 06-03. 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 Circular A-136, *Financial Reporting Requirements*, 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 (i.e., private sector licensees versus Federal licensees) rather than who was paid. However, following the advice of OMB, NRC classified the costs on the Statements of Net Cost using an underlying concept of who was paid. Furthermore, OMB Circular A-136 requires that the Statement of Net Cost be presented using full program costs by output. The agency presents its costs aggregated by strategic plan programs.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. For the years ended September 30, 2006, and 2005, NRC's Statements of Net Cost include approximately $67.8 and $68.7 million, respectively, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations applicable to 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 Government Accountability 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 NRC's Performance and Accountability Report present fairly, in all material respects, the financial position as of September 30, 2006, and 2005, and its net cost, changes in net position, budgetary resources, and reconciliations 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.

As discussed in Notes 15 and 16 to the financial statements, in FY 2006 the NRC changed its method for recording transactions of the Nuclear Waste Fund and the process for recording transfers of license fee collections.

Report on the Effectiveness of Internal Control Over Financial Reporting

We have examined the effectiveness of NRC's internal control over financial reporting, as of September 30, 2006, based on the criteria in OMB Bulletin No. 06-03. 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 the effectiveness of internal control 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 statement audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03. 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.

We identified continuing significant deficiencies in the Fee Billing System and in the Information System-wide Security Controls. The fee billing system in place does not meet the requirements of sound internal control over financial reporting as provided in OMB Bulletin No. 06-03, nor is the system's design compliant with the requirements of the Joint Financial Management Improvement Program (effective December 2004, the JFMIP principals created the Financial Systems Integration Office within the General Services Administration). Additionally, the information system-wide security controls have not undergone contingency tests nor do the Agency's systems have certifications and accreditations to operate. We believe these conditions represent material weaknesses. The Agency did not identify the condition related to the Fee Billing System as a material weakness over financial reporting in their assessment under OMB Circular A-123, Appendix A nor in their report on the Federal Managers' Financial Integrity Act (FMFIA).

In our opinion, except for the effect of the material weaknesses described in the preceding paragraph, NRC has maintained, in all material respects, effective internal control over financial reporting as of September 30, 2006, based on the internal control objectives listed in OMB Bulletin No. 06-03.

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. 06-03. 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 two reportable conditions: NRC needs to (1) improve the Fee Billing System, and (2) strengthen information system-wide security controls. Both conditions are considered material weaknesses.

A material weakness, as defined by OMB Bulletin No. 06-03, is a reportable condition 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 principal statements being audited, or material to the 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. We believe that the reportable conditions that follow are material weaknesses as defined by the AICPA and OMB Bulletin No. 06-03.

Fee Billing System

We reported in FYs 2004 and 2005 a significant deficiency in the NRC's Fee Billing System; this condition continues to exist as described below. The Agency has put forth a significant effort to address the issues reported in the previous years; however, continued emphasis and demonstrated sustainable business process improvements must be designed and implemented to fully remediate the material weakness.

In the current year, the agency has been diligent in gaining a better understanding of the Fee Billing System's data interfaces, processes and needed management controls. In a small category of license fee revenue (less than 10 percent of total revenue) the Agency performed a detailed review of annual materials license fees and identified and quantified underbillings for inclusion in the current year financial statements. This category was chosen because it was a known risk area where underbillings had been identified in a prior year conversion effort. The Agency recorded $1.3 million of underbillings as a result of this project. The underbillings date back to FY 2000. Efforts of this nature are commendable and will build a foundation to gain greater assurance over the fee billing process in future years.

The Omnibus Budget Reconciliation Act (OBRA-1990), Public Law 101-508, as amended, requires that NRC recover, through fee billing, a percentage of its budget authority in each fiscal year, less amounts appropriated from the Nuclear Waste Fund. In FYs 2006 and 2005, the recovery percentage was 90 percent. In order to meet this requirement, the NRC assesses two types of fees to recover its budget authority. Annual license fees are assessed under 10 CFR Part 171 for nuclear facilities and materials licensees, commonly known as Part 171 fees. Other fee types include licensing actions, inspections and other services, established in 10 CFR Part 170 under the authority of the Independent Offices Appropriation Act of 1952 (IOAA). The Part 170 fees are assessed to recover NRC's costs of providing individually identifiable services to specific applicants and licensees.

The conditions reported in the prior year, which continue to impact the reliability of the fee billing process include: (1) intensive manual processes, (2) the lack of comprehensive quality assurance procedures over the billing process, and (3) the fee billing feeder processes. In the current year, the Agency's assessment efforts identified new underbilling problems, indicating a continued vulnerability and the need to continue to identify, design, implement and assess internal controls for each operating aspect of the system.

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. It is performed continually and is ingrained in the Agency's supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

The following examples provide insight into the Agency's progress and current condition in addressing (1) intensive manual processes, (2) comprehensive quality assurance procedures, and (3) fee billing feeder processes.

Intensive Manual Processes

As reported previously, due to the age and design of the Fee Billing System, NRC has evolved over the years into an operating style characterized by over-reliance on a small team to prepare, review, and issue billings on a monthly and quarterly basis. The License Fee Team (LFT) employs various manual processes to compensate for the lack of flexibility in the legacy fee billing system. The system does not have the ability to give the agency drill down capacity to review billing questions. In particular, the system does not provide automated audit trails from the initial source of the transaction (i.e., billable hours) to the development of an invoice. In the current year the Agency implemented a variety of quality assurance processes that are directionally sound and can be used as a foundation for the development of compensating controls.

As reported in the prior year, the Agency performed an assessment of the Fee Billing System and concluded, "...that the existing nine systems that collectively comprise the Fee Systems will not fully support fee billing and will not promote consistency across the Agency. Streamlining, automating, and improving its fee systems and processes with modern and integrated technology and processes will be critical to the Agency, its staff, and its customers going forward." The Agency continues to stay focused on the remediation plan's actions designed to replace the existing system. Deployment of the replacement solution is planned for FY 2009.

The lack of system functionality coupled with the age of the system and its reliance on manual intervention continues to result in a Federal Financial Management Improvement Act (FFMIA) substantial non-compliance.

Comprehensive Quality Assurance Procedures

During the current year, the Agency continued to enhance quality assurance procedures to reconcile the completeness of Part 170 (hourly) invoices to the license fee reports produced by the Fee Billing System. The reports provide the amounts available for billing. However, the Agency did not address several other reconciliation points that are essential to the internal control over fee billings.

For example, the quality assurance procedures do not address the completeness of Technical Assignment Controls (TAC) as compared with TACs available to be billed or simply those that were billable in the previous billing cycle. The procedures also do not provide for a review of the reliability and completeness of data inputs from sources outside the Office of the Chief Financial Officer's (OCFO) business domain, which are integral to the reliability of invoices. Regional and technical offices such as Nuclear Reactor Regulation (NRR) are the feeder source for license fee activities. This data is fundamental to gaining control of the total available billable time. We commend the Agency for its continued emphasis in developing quality assurance procedures; however, more needs to be done to mitigate known design and system risks of the legacy system and to assert to the completeness and reliability of the fee billing process.

Fee Billing Feeder Processes

In the current year, the Agency identified instances of underbilling, which impacted the Part 170 (hourly) billings. The Agency established a project that was operated out of the Office of the Executive Director for Operations for the short-term purpose of performing security assessments of reactor facilities. The project was referred to as the Nuclear Security Special Project. As the project grew in size and complexity it was moved to NRR. During the third quarter billing cycle, the hours incurred on this project were inadvertently overlooked for billing purposes. It is our understanding that an application used by NRR, erroneously changed the billing classification of over 200 TACs representing approximately 4,000 billable hours. These hours represent approximately $750 thousand in underbilling. As a result, those hours were not billed during the third quarter. Although the Agency executed its quality assurance procedures, this underbilling error was not detected during the normal third quarter billing review process. Subsequent to the issuance of the invoices, an Agency billing gatekeeper identified the exception. This example demonstrates the need for the Agency to continue to identify feeder processes, enhance quality assurance during preparation of billings, and develop independent checks in order to validate the completeness of feeder data from offices. The hours are presently being billed by the agency.

The unbilled amounts illustrate the need to mitigate risks and to seek to improve quality assurance procedures over the billing preparation process.

Recommendations

1. The Chief Financial Officer (CFO) should continue the assessment of all aspects of the Fee Billing System to ensure that the remediation plan is updated as necessary and implemented in a timely manner to enhance the controls over fee billing processes.
2. The CFO should continue to define, design, and implement compensating controls over the Fee Billing System, while the system is being considered for redesign.
3. As the CFO identifies needed improvement of internal controls that are outside OCFO's business domain, there should be further coordination and collaboration with the Executive Director for Operations as to how the internal controls should be strengthened in operational program feeder systems relied upon by OCFO for billing preparation purposes.

Information System-wide Security Controls

An FY 2005 report issued by the Office of Inspector General (OIG) (Report No. OIG-05-A-21) identified risks in the Agency's information security environment. The report identified various conditions placing the Agency in an "at risk" position. The following is a partial list of the issues reported:

- A majority of the information systems (19 of 27) are under an interim authorization to operate and therefore are not considered certified;
- Agency information system security self-assessments were not performed timely;
- Annual contingency planning is not being performed; and
- Oversight of other contractor systems is lacking.

In the current year, the OIG issued a report (OIG-06-A-26), which describes two significant deficiencies regarding the status of the Agency's information systems. The OIG's report states:

- "Only 1 of 30 operational NRC information systems has a current certification and accreditation, and only 4 of 12 systems used or operated by a contractor or other organization on behalf of the Agency have a current certification and accreditation. The certification and accreditation for the one Agency system that was current during the evaluation expires in October 2006.
- Annual contingency planning is not being performed."

Based on the Agency's self-evaluation of management controls over systems, the Agency concluded that the two significant deficiencies identified in the OIG report would be reported as material weaknesses in the FMFIA report.

Again, we reiterate that NRC's general support systems have not had a complete certification and accreditation performed in the past 4 years. Therefore, the Agency does not know whether the security controls for these general support systems are adequate, thereby creating unknown potential risk. As a result, all NRC information systems that depend on the security controls provided by these general support systems inherit that unknown potential risk.

The primary Agency financial reporting systems include cost accounting, Human Resources Management System, fees and two systems outsourced with Department of Interior's National Business Center (DOI-NBC). The two outsourced systems are Federal Financial System - FFS (the general ledger application) and Federal Personnel and Payroll System - FPPS (the payroll application). These systems operate or have access protocols on the NRC's general support system, which has been identified as vulnerable, since the general support system had a lapsed authorization to operate. However, DOI-NBC has properly reported that the certification and accreditations and contingency testing for these two systems have been performed. Notwithstanding this condition, the applications would be at risk since they rely on the top tier controls of the NRC general support system.

Recommendation

4. The CFO should continue to coordinate with the Office of Information Services and the Executive Director for Operations to ensure that vulnerabilities to the general support systems are addressed and resolved timely.

Status of Prior Year Comments

In the prior year we included conditions related to Monitoring of Accounting for Internal Use Software and Financial Controls Over Disbursements. Corrective actions were implemented during the year to close these two conditions. However, conditions related to the Fee Billing System and Information System-wide Security Controls continued in the current fiscal year.

Report on Compliance with Laws and Regulations

We conducted our audit for the year ended September 30, 2006, 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. 06-03.

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. 06-03, including the requirements in the FFMIA. 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 noncompliances with laws and regulations that are required to be reported under *Government Auditing Standards*, OMB Bulletin No. 06-03 or under FFMIA.

U.S. Department of Energy Expenses

NRC's principal statements include reimbursable expenses of the U.S. Department of Energy (DOE) National Laboratories. For the years ended September 30, 2006, and

2005, NRC's Statements of Net Cost include approximately $67.8 and $68.7 million, respectively, of reimbursed expenses. Our audits included testing these expenses for compliance with laws and regulations applicable to 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.

In the current year we identified two continuing noncompliances. The first, which was initially reported in 1998, relates to the Part 170 Hourly Rates. The other is related to the Fee Billing System, which is considered a substantial noncompliance with FFMIA. The following discussion addresses the noncompliances:

Part 170 Hourly Rates

As previously reported from FYs 1998 through 2005, OBRA-1990 requires the NRC to recover approximately 100 percent of its budget authority by assessing fees. (In recent years, the recovery percentage has been reduced by two percent each year. During FY 2006, the recovery percentage was 90 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 IOAA, 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-1990, the rates are based on budgetary data and are used to price individually identifiable Part 170 services. NRC developed the FY 1998 and subsequent years' rates using the budgetary basis without validating the fee amounts to the full cost of providing Part 170 services. OMB Circular A-25, *User Charges*, states that user charges must be sufficient to recover the full costs of providing benefits.

During FYs 2004 through 2006, the Agency formulated a strategy to address this noncompliance. The Agency developed a methodology that uses the prior year's financial information from the general ledger and the cost accounting system to identify full program costs. Those costs are then compared with budget based rates calculated for the fee rule in order to identify variances. The variances undergo analysis in order to identify the adjustment or impact on the upcoming year's fee rule. Based on progress made to date, adjustments if any, will be reflected in the FY 2007 fee rule, which has a projected release date of June 2007. Upon completion of the OCFO's work on the validation model, we will undertake an assessment of the Agency's compliance with OMB Circular A-25. The review will include the assessment of the model and the underlying documented assumptions and data sources used in order to verify the reliability and completeness of the results. The audit assessment will also evaluate the adequacy of fee rule changes, if any. We commend the OCFO for their continuing commitment to close this comment.

Recommendation

5. The CFO should implement the results of their assessment strategy. After the changes have been reflected in the FY 2007 fee rule, we will assess, in coordination with the Office of Inspector General, actions implemented to address this condition.

Fee Billing System

In our *Report on the Effectiveness of Internal Control Over Financial Reporting*, we continue to identify the Fee Billing System as both a material weakness and an FFMIA substantial noncompliance. Refer to that report for a detailed discussion of the condition.

Status of Prior Year Comments

In the prior year, the condition related to Information System-wide Security Controls included an FFMIA substantial non-compliance with the DOI-NBC service bureau environment impacting both FFS and FPPS. Corrective actions have been implemented by NRC and DOI-NBC to remediate that condition. The conditions related to Part 170 fees and the FFMIA substantial noncompliance of the Fee Billing System continued in the current fiscal year.

Internal Control Related to Performance Measures

With respect to internal controls related to performance measures described in Chapter 2 of the performance and accountability report, 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 referred to as the Management Discussion and Analysis, Chapter 1 of this Performance and Accountability Report, is not a required part of the financial statements but is supplementary information required by OMB Circular A-136. 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.

The other accompanying information included in Chapter 2 and the appendices to the performance and accountability report, is required by OMB Circular A-136 and is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we 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, included on page 105 of this Performance and Accountability Report, is not a required part of the financial statements but is supplementary information required by OMB Circular A-136. This information is also presented for purposes of additional analysis. 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.

We noted certain matters that we reported to NRC management in a separate letter dated November 7, 2006.

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

R. Navarro & Associates, Inc.

November 7, 2006

MANAGEMENT'S RESPONSE TO THE INDEPENDENT AUDITORS' REPORT ON THE FINANCIAL STATEMENTS

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

November 9, 2006

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

FROM: Jesse L. Funches
Chief Financial Officer

SUBJECT: AUDIT OF THE FY 2006 FINANCIAL STATEMENTS

I have reviewed the independent auditors' report of the Agency's FY 2006 financial statements. Our responses to the recommendations follow:

Recommendation 1

The Chief Financial Officer (CFO) should continue the assessment of all aspects of the Fee Billing system to ensure that the remediation plan is updated as necessary and implemented in a timely manner to enhance the controls over fee billing processes.

Response

Agree. During FY 2007, the Office of the Chief Financial Officer (OCFO) will continue to assess the operating aspects of the Fee Billing System that are essential to the internal control over fee billings, including the processes related to data obtained from feeder systems, to identify cost-effective controls that will further strengthen the completeness and reliability of the fee billing processes. The remediation plan will be updated as necessary based upon the results of the continuing assessment.

Recommendation 2

The CFO should continue to define, design, and implement compensating controls over the Fee Billing System, while the system is being considered for redesign.

Response

Agree. During FY 2007, the OCFO will use the results of the continuing assessment performed in response to Recommendation 1, and the experience gained implementing improved controls and quality assurance procedures, to establish additional cost-effective compensating controls in the existing fee billing processes, as appropriate.

Recommendation 3

As the OCFO identifies needed improvement of internal controls that are outside OCFO's business domain, there should be further coordination and collaboration with the Executive Director for Operations as to how the internal controls should be strengthened in operational program feeder systems relied upon by OCFO for billing preparation purposes.

Response

Agree.

Recommendation 4

The CFO should continue to coordinate with the Office of Information Services and the Executive Director for Operations to ensure that vulnerabilities to the general support systems are addressed and resolved timely.

Response

Agree.

Recommendation 5

The CFO should implement the results of their assessment strategy. After the changes have been reflected in the FY 2007 fee rule, we will assess, in coordination with the Office of the Inspector General (OIG), actions implemented to address this condition.

Response

Agree. The OCFO will provide the OIG with a copy of the FY 2007 proposed and final fee rules, once they are issued. The hourly rate in the FY 2007 rule will be based on FY 2007 budget data, which has been informed by cost data, as demonstrated in the documentation provided to the OIG in July 2006.

PRINCIPAL STATEMENTS

BALANCE SHEET
(In Thousands)

As of September 30,		2006		2005
Assets				
Intragovernmental				
Fund balances with Treasury (Note 2)	$	**281,715**	$	220,695
Accounts receivable (Note 3)		**3,904**		3,227
Other - Advances and prepayments		**2,247**		1,961
Total intragovernmental		**287,866**		225,883
Accounts receivable, net (Note 3)		**71,287**		60,757
Property and equipment, net (Note 4)		**26,915**		26,983
Other		**19**		66
Total Assets	**$**	**386,087**	$	313,689
Liabilities				
Intragovernmental				
Accounts payable	**$**	**8,225**	$	7,730
Other (Note 5)		**81,023**		69,495
Total intragovernmental		**89,248**		77,225
Accounts payable		**22,940**		21,296
Federal employee benefits (Note 6)		**7,434**		8,417
Other liabilities (Note 5)		**53,872**		49,268
Total Liabilities		**173,494**		156,206
Net Position				
Unexpended appropriations		**193,694**		170,836
Cumulative results of operations (Note 8)		**18,899**		(13,353)
Total Net Position		**212,593**		157,483
Total Liabilities and Net Position	**$**	**386,087**	$	313,689

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

STATEMENT OF NET COST

(In Thousands)

For the years ended September 30,	**2006**	2005
Nuclear Reactor Safety		
Gross costs	**$ 515,374**	$ 476,481
Less: Earned revenue	**(565,782)**	(476,020)
***Total Net Cost of Nuclear Reactor Safety* (Note 9)**	**(50,408)**	461
Nuclear Materials and Waste Safety		
Gross costs	**205,221**	206,518
Less: Earned revenue	**(74,259)**	(73,972)
***Total Net Cost of Nuclear Materials and Waste Safety* (Note 9)**	**130,962**	132,546
Net Cost of Operations	**$ 80,554**	$ 133,007

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

STATEMENT OF CHANGES IN NET POSITION

(In Thousands)

For the years ended September 30,		2006		2005
Cumulative Results of Operations				
Beginning Balance	$	**(13,353)**	$	(12,425)
Budgetary Financing Sources				
Appropriations used		**50,542**		116,100
Non-exchange revenue		**590**		7,344
Transfers-in/out without reimbursement		**45,067**		(7,344)
Other Financing Sources				
Imputed financing from costs absorbed by others		**28,022**		25,904
Other		**(11,415)**		(9,925)
Total Financing Sources		**112,806**		132,079
Net Cost of Operations		**(80,554)**		(133,007)
Net Change		**32,252**		(928)
Cumulative Results of Operations	$	**18,899**	$	(13,353)
Unexpended Appropriations				
Beginning Balance	$	**170,836**	$	149,901
Budgetary Financing Sources				
Appropriations received		**72,532**		601,245
Appropriations transferred-in/out		**1,587**		(463,729)
Other adjustments		**(719)**		(481)
Appropriations used		**(50,542)**		(116,100)
Total Budgetary Financing Sources		**22,858**		20,935
Total Unexpended Appropriations		**193,694**		170,836
Net Position	$	**212,593**	$	157,483

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

STATEMENT OF BUDGETARY RESOURCES

(In Thousands)

For the years ended September 30,	**2006**	2005
Budgetary Resources		
Unobligated balance, beginning of period (Note 16)	**$ 57,349**	$ 36,328
Recoveries of prior year unpaid obligations	**6,642**	11,019
Budget authority		
Appropriation	**742,687**	601,245
Spending authority from offsetting collections		
Reimbursements earned - Collected	**6,757**	5,789
Reimbursements earned - Change in receivables	**(277)**	47
Change in unfilled customer orders - Advance received	**(2,615)**	427
Change in unfilled customer orders - Without advance	**(358)**	4
Subtotal-spending authority from offsetting collections	**3,507**	6,267
Nonexpenditure transfers, net, actual	**-**	68,498
Temporarily not available pursuant to Public Law	**(461)**	-
Permanently not available	**(719)**	(481)
Total Budgetary Resources	**$ 809,005**	$ 722,876
Status of Budgetary Resources		
Obligations incurred (Note 12)		
Direct	**$ 730,902**	$ 659,530
Reimbursable	**3,848**	6,002
Subtotal	**734,750**	665,532
Unobligated balance		
Apportioned	**48,558**	33,620
Exempt from apportionment	**25,697**	23,724
Subtotal	**74,255**	57,344
Total Status of Budgetary Resources	**$ 809,005**	$ 722,876
Change in Obligated Balance		
Obligated balance, net		
Unpaid obligations beginning of period	**$ 160,291**	$ 157,218
Obligations Incurred, net	**734,750**	665,532
Less: Gross outlays	**(686,588)**	(651,389)
Less: Recoveries of prior year unpaid obligations, actual	**(6,642)**	(11,019)
Change in uncollected customer payments, from Federal sources	**635**	(51)
Obligated balance, net, end of period		
Unpaid obligations	**206,019**	164,498
Less: Uncollected customer payments, from Federal sources	**(3,573)**	(4,207)
Total unpaid obligated balance, net, end of period	**$ 202,446**	$ 160,291
Net outlays		
Gross outlays	**$ 686,588**	$ 651,389
Less: Offsetting collections	**(4,143)**	(6,216)
Less: Distributed offsetting receipts	**(624,042)**	(534,119)
Net Outlays	**$ 58,403**	$ 111,054

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

STATEMENT OF FINANCING

(In Thousands)

For the years ended September 30,	2006	2005
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations incurred (Note 12)	**$ 734,750**	$ 665,532
Less: Spending authority from offsetting collections and recoveries	**(10,149)**	(17,286)
Obligations net of offsetting collections and recoveries	**724,601**	648,246
Less: Distributed offsetting receipts	**(624,042)**	(534,119)
Net Obligations	**100,559**	114,127
Other Resources		
Imputed financing from costs absorbed by others	**28,022**	25,904
Allocation transfer	**1,444**	2,124
Other	**(11,415)**	(9,925)
Net Other Resources Used to Finance Activities	**18,051**	18,103
Total Resources Used to Finance Activities	**$ 118,610**	$ 132,230
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	**$ (40,910)**	$ (151)
Resources that finance the acquisition of assets	**(6,685)**	(7,393)
Other resources to net obligated resources that do not affect net cost of operations	**786**	(46)
Total Resources Used to Finance Items not Part of the Net Cost of Operations	**(46,809)**	(7,590)
Total Resources Used to Finance the Net Cost of Operations	**$ 71,801**	$ 124,640
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	**$ 3,028**	$ 755
Increase (Decrease) Actuarial Workers' Compensation	**(983)**	303
Increase (Decrease) in Unfunded Workers' Compensation	**(47)**	228
Increase in Unfunded Unemployment	**4**	(12)
Total Components of Net Cost of Operations that will require or generate resources in future periods	**2,002**	1,274
Components not Requiring or Generating Resources:		
Depreciation and amortization	**6,751**	7,093
Total Components not requiring or generating resources	**6,751**	7,093
Total Components of Net Cost of Operations that will not require or generate resources in the current period	**8,753**	8,367
Net Costs Of Operations	**$ 80,554**	$ 133,007

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

NOTES TO THE PRINCIPAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (All Tables are Presented in Thousands)

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) Circular A-136, *Financial Reporting Requirements*, 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.

NRC has not presented a Statement of Custodial Activity because the amounts involved are immaterial and incidental to its operations and mission.

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 32 years, Congress has enacted no-year appropriations, which are available for obligation by NRC until expended. For FY 2006 the Energy and Water Development Appropriations Act, 2005, requires the NRC to recover approximately 90 percent of its new budget authority of $742.7 million less a recision of funding in the amount of $1.18 million, which is permanently unavailable, by assessing fees less amounts derived from the Nuclear Waste Fund of $46.1 million and for costs related to waste incidental to reprocessing of $2.5 million from P.L. 109-103. The $742.7 million does not include any amounts transferred from the U.S. Agency for International Development.

For FY 2005, NRC recovered approximately 90 percent of its new budget authority of $669.3 million less amounts derived from the Nuclear Waste Fund of $68.5 million.

D. *Basis of Accounting*

These financial statements reflect both accrual and budgetary accounting transactions. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting is also used to record the obligation of funds prior to the accrual-based transaction. 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 from the assessment of 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.*

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*

The NRC's cash receipts and disbursements are processed by the U.S. Treasury. The fund balances with the U.S. Treasury 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.

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 nonentity assets of $5 thousand at September 30, 2006 and 2005, 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 costs of internal use software include the full cost of salaries and benefits from agency personnel involved in software development. 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 thousand 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.

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 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, 2006, and 2005, 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 5.17 percent for FY 2006 and 4.53 percent for FY 2005.

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. In FY

2005, the NRC was a party to one case where an adverse outcome was reasonably possible. In FY 2006, there are no contingent liabilities.

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 2006 and FY 2005, 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 11.2 percent contribution in FY 2006 and a 10.7 percent contribution in FY 2005. The sum is transferred to the Federal Employees Retirement Fund. For employees covered by CSRS, NRC withholds seven percent of base pay earnings. The NRC matched this withholding with a seven percent contribution in FY 2006 and FY 2005.

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 unlimited in calendar year 2006, and 15 percent in 2005. Employees belonging to CSRS may contribute an unlimited percent of their salary in calendar year 2006, and 10 percent in 2005, but there is no NRC matching of the contribution. The maximum amount that either FERS or CSRS employees may contribute to the plan is $15 thousand in 2006 and $14 thousand in 2005. 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 at NRC headquarters. For FY 2006, there are seven capital leases with terms of 5 years, consisting of: five capital leases that were added in FY 2006 with interest rates of 4.25 percent and 4.15 percent, and two capital leases for FY 2005 with an interest rate of 4.38 percent for both leases. The reproduction equipment is depreciated over 5 years using the straight-line method with no salvage value.

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 U.S. Department of Energy (DOE) and NRC are fully automated through the U.S. Treasury's Intragovernmental 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 the U.S. 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.

Note 2. Fund Balances with Treasury

	2006	2005
Fund Balances		
Appropriated funds	**$ 237,956**	$ 217,637
Allocation transfers	**3,025**	3,047
Nuclear waste fund	**38,747**	-
Other fund types	**1,987**	11
Total	**$ 281,715**	$ 220,695
Status of Fund Balance with Treasury		
Unobligated Balance		
Available		
Appropriated funds	**$ 74,256**	$ 57,344
Allocation transfers	**1,766**	1,638
Unavailable	**2,146**	155
Obligated balance not yet disbursed	**203,547**	161,558
Total	**$ 281,715**	$ 220,695

The Fund Balance with Treasury consists of Unobligated and Obligated Balances budgetary accounts. It includes Nuclear Waste Fund activity. The Nuclear Waste Fund Unobligated Balance is $25.7 million and $23.7 million as of September 30, 2006, and 2005, respectively.

Note 3. Accounts Receivable

	2006	2005
Intragovernmental		
Receivables and reimbursements	**$ 3,904**	$ 3,227
Receivables with the Public		
Materials and facilities fees - billed	**$ 2,094**	$ 2,124
Materials and facilities fees - unbilled	**72,131**	61,482
Other	**109**	38
Total Accounts Receivable	**74,334**	63,644
Less: Allowance for uncollectible accounts	**(3,047)**	(2,887)
Accounts Receivable, Net	**$ 71,287**	$ 60,757

Note 4. Property and Equipment, Net

Fixed Assets Class	Service Years	Acquisition Value	Accumulated Depreciation and Amortization	2006 Net Book Value	2005 Net Book Value
Equipment	5-8	$ 12,085	$ (11,260)	**$ 825**	$ 1,094
Leased equipment	5-8	1,224	(755)	**469**	272
IT software	5	47,766	(40,078)	**7,688**	5,818
IT software under development	-	5,953	-	**5,953**	8,303
Leasehold improvements	20	25,019	(13,861)	**11,158**	9,418
Leasehold improvements in progress	-	822	-	**822**	2,078
Total		$ 92,869	$ (65,954)	**$ 26,915**	$ 26,983

Note 5. Other Liabilities

	2006	2005
Intragovernmental		
Liability to offset net accounts receivable for fees assessed	**$ 75,047**	$ 63,627
Liability from fees collected which will offset current year's appropriations	**495**	6
Liability to offset miscellaneous accounts receivable	**5**	3
Liability for advances from other agencies	**74**	2,090
Accrued workers' compensation	**1,836**	1,883
Accrued unemployment compensation	**15**	12
Employee benefit contributions	**2,060**	1,874
Liability for clearing account	**1,491**	-
Total Intragovernmental Other Liabilities	**$ 81,023**	$ 69,495

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.

	2006	2005
Accrued annual leave	**$ 35,989**	$ 32,960
Accrued salaries	**13,815**	12,986
Contract holdbacks, advances, and other	**4,068**	3,322
Total Other Liabilities	**$ 53,872**	$ 49,268

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

Note 6. Liabilities Not Covered by Budgetary Resources

	2006	2005
Intragovernmental		
FECA paid by DOL	**$ 1,836**	$ 1,883
Accrued unemployment compensation	**15**	12
Federal Employee Benefits		
Future FECA	**7,434**	8,417
Other		
Accrued annual leave	**35,989**	32,960
Total Liabilities not Covered by Budgetary Resources	**$ 45,274**	$ 43,272

Balance Sheet amounts represent ending balances of worker's compensation and annual leave. The Statement of Financing amount represents the change in activity in the worker's compensation and annual leave balances.

Note 7. Leases

Future Lease Payments Due:

Fiscal Year	Capital	Operating	2006	2005
2006	-	-	**-**	25,066
2007	214	23,462	**23,676**	23,653
2008	90	16,575	**16,665**	16,575
2009	94	14,279	**14,373**	14,279
2010	79	14,342	**14,421**	14,342
2011 and thereafter	2	38,624	**38,626**	38,624
Total	479	107,282	**107,761**	132,539
Add: Imputed Interest	32	-	**32**	12
Total Future Lease Payments	$ 511	$ 107,282	**$ 107,793**	$ 132,551

Note 8. Cumulative Results of Operations

	2006	2005
Future funding requirements	**$ (45,274)**	$ (43,272)
Investment in property and equipment, net	**26,915**	26,983
Contributions from foreign cooperative research agreements	**2,110**	2,867
Change in Nuclear Waste Fund	**35,107**	-
Other	**41**	69
Cumulative Results of Operations	**$ 18,899**	$ (13,353)

Future funding requirements represent the amount of future funding needed to pay the accrued unfunded expenses as of September 30, 2006, and 2005. 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. Statement of Net Cost

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

Nuclear Reactor Safety encompasses all NRC efforts to ensure that civilian nuclear power reactor facilities and research and test reactors are licensed and operated in a manner that adequately protects the public health and safety, the environment and protects against radiological sabotage and theft or diversion of special nuclear materials. The Nuclear Reactor Safety program contains two activities – Nuclear Reactor Licensing and Nuclear Reactor Inspection

Nuclear Materials and Waste Safety encompasses all NRC efforts to protect the public health and safety and the environment and ensures the secure use and management of radioactive materials. The Nuclear Materials and Waste Safety program contains five activities – Fuel Facilities Licensing and Inspection, Nuclear Materials Users Licensing and Inspection, High-Level Waste Repository, Decommissioning and Low-Level Waste, and Spent Fuel Storage and Transportation Licensing and Inspection.

For the years ended September 30,	**2006**	2005
Nuclear Reactor Safety		
Intragovernmental gross costs	**$ 147,028**	$ 143,035
Less: Intragovernmental earned revenue	**(33,121)**	(29,299)
Intragovernmental net costs	**113,907**	113,736
Gross costs with the public	**368,346**	333,446
Less: Earned revenues from the public	**(532,661)**	(446,721)
Net costs with the public	**(164,315)**	(113,275)
Total Net Cost of Nuclear Reactor Safety	**$ (50,408)**	$ 461
Nuclear Materials and Waste Safety		
Intragovernmental gross costs	**$ 48,414**	$ 48,551
Less: Intragovernmental earned revenue	**(6,569)**	(5,113)
Intragovernmental net costs	**41,845**	43,438
Gross costs with the public	**156,807**	157,967
Less: Earned revenues from the public	**(67,690)**	(68,859)
Net costs with the public	**89,117**	89,108
Total Net Cost of Nuclear Materials and Waste Safety	**$ 130,962**	$ 132,546

For "Intragovernmental gross costs," the buyers and sellers are both Federal entities. For "Earned revenues from the public," the buyers of the goods or services are non-Federal entities.

Note 10. Exchange Revenues

	2006	2005
Fees for licensing, inspection, and other services	**$ 635,457**	$ 544,044
Revenue from reimbursable work	**4,584**	5,948
Total Exchange Revenues	**$ 640,041**	$ 549,992

Note 11. Financing Sources Other Than Exchange Revenue

Appropriated Funds Used

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

	2006	2005
Funds consumed	**$ 685,134**	$ 650,219
Less: collection from fees assessed	**(624,042)**	(534,119)
Less: Nuclear Waste Funding Used	**(10,550)**	-
Appropriated funds used	**$ 50,542**	$ 116,100

Funds consumed includes $59.6 million and $38.3 million through September 30, 2006, and 2005, respectively, of available funds from prior years.

Non-Exchange Revenue

	2006	2005
Civil penalties	**$ 461**	$ 5,807
Miscellaneous receipts	**129**	1,537
Total Non-Exchange Revenue	**$ 590**	$ 7,344

Imputed Financing

	2006	2005
Civil Service Retirement System	**$ 11,256**	$ 11,993
Federal Employee Health Benefit	**14,912**	13,735
Federal Employee Group Life Insurance	**66**	62
Judgements Awards	**1,788**	114
Total Imputed Financing	**$ 28,022**	$ 25,904

Transfers In/Out

	2006	2005
Transfers out to Treasury		
License Fees	**$ 624,042**	$ 534,119
Non-exchange revenue	**590**	7,344
Total Transfers-Out to Treasury	**$ 624,632**	$ 541,463

Note 12. Total Obligations Incurred

	2006	2005
Direct Obligations		
Category A	**$ 687,201**	$ 613,502
Exempt from Apportionment	**43,701**	46,028
Total Direct Obligations	**730,902**	659,530
Reimbursable Obligations	**3,848**	6,002
Total Obligations Incurred	**$ 734,750**	$ 665,532

Obligations exempt from apportionment are the result of funds derived from the Nuclear Waste Fund. Category A Obligations consist of NRC appropriations only. Undelivered orders for the Nuclear Waste Fund are $9.4 million and $5.7 million, Salaries and Expenses $148.1 million and $119.4 million, and the Office of the Inspector General $979 thousand and $1.2 million through September 30, 2006, and 2005, respectively.

Note 13. Nuclear Waste Fund

Included in NRC's budget for FY 2006 and 2005 are $46.118 million and $68.498 million, respectively, provided from the Nuclear Waste Fund. In accordance with Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds*, NRC has determined that funding from the Nuclear Waste Fund does not fully meet the definition as an earmarked fund. However, in order to provide additional information to the users of these financial statements, enhanced disclosure of the fund is presented below.

The Nuclear Waste Fund was authorized by the Nuclear Waste Policy Act of 1982 (PL 97-425). The funding provided to NRC in FY 2006 and 2005 for the purpose of performing activities associated with the U.S. Department of Energy's (DOE) application for a high level waste repository at Yucca Mountain, Nevada. These activities included assistance to DOE with the application, review of the application, the conduct of thorough safety and security evaluations, preparation of the safety evaluation report, initiation of the inspection program, ensuring that the regulation process was made available to stakeholders and the general public, and to provide legal advice and representation for staff reviews and Commission actions.

The Nuclear Waste Fund amounts received, expended, obligated, and unobligated balances as of September 30, 2006, and 2005 are shown in the following:

	2006	2005
Appropriations Received	**$ 46,118**	$ 68,498
Expended Appropriations	**$ 47,554**	$ 41,976
Obligations Incurred	**$ 43,701**	$ 46,028
Unobligated Balances	**$ 25,697**	$ 23,724

Note 14. Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government

Statement of Federal Financial Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*, requires the NRC to reconcile the budgetary resources reported on the Statement of Budgetary Resources to the prior fiscal year actual budgetary resources presented in the Budget of the U.S. Government and explain any material differences. NRC does not have any material differences between the Statement of Budgetary Resources and the Budget of the U.S. Government. The President's Budget with actual results for NRC has not been published for FY 2006. It is expected to be published on February 5, 2007. The estimates will be available on the NRC webpage, and the actuals can be found on the OMB webpage.

Note 15. Comparability of Financial Statements

In FY 2006, NRC made a change in the accounting methodology used to record the transfer to NRC from DOE's Nuclear Waste Trust Fund. The change was made pursuant to guidance from OMB to be more compatible with DOE's accounting treatment of the transfer and to eliminate a significant intra-governmental difference in trading partner activity between NRC and DOE.

The change in accounting treatment, as reflected in the Statement of Changes in Net Position, impacts the comparability of the current and prior year amounts as illustrated in the following table (dollars in thousands):

Cumulative Results of Operations	**2006**	**2005**
Transfers in/out without reimbursement (Gross)	$ 46,118	$ -
Unexpended Appropriations		
Appropriations transferred in/out	$ -	$ 68,498

The change is also reflected in the Statement of Budgetary Resources, as shown below (in thousands of dollars).

Budgetary Resources	**2006**	**2005**
Nonexpenditure transfers, net actual	$ -	$ 68,498

Note 16. Statement of Changes in Net Position and Statement of Budgetary Resources Reclassifications

In the current year the Statement of Changes in Net Position (CNP) reflects a change in the treatment of the fees collected as an offset to appropriations received. In prior years, it was recorded as an appropriations transfer.

In accordance with OMB Circular A-136, the Statement of Budgetary Resources (SBR) has been revised to better align with the SF 133, *Report on Budget Execution and Budgetary Resources*. This revision was necessitated by revisions to the SF-133 format, as described in OMB Circular A-11. As a result, the amounts in FY 2005 have been reclassified to conform with FY 2006 guidelines.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF BUDGETARY RESOURCES
(*In Thousands*)

For the year ended September 30, 2006

	X0200	X0300	X5280	Total
Budgetary Resources				
Unobligated balances, beginning of period (Note 16)	$ 56,263	$ 1,081	$ 5	$ 57,349
Recoveries of prior year obligations	6,540	102	-	6,642
Budget authority				
Appropriations	117,811	839	624,037	742,687
Spending authority from offsetting collections				
Reimbursements earned - Collected	6,757	-	-	6,757
Reimbursements earned - Change in receivables	(277)	-	-	(277)
Change in unfilled customer orders - Advance received	(2,615)	-	-	(2,615)
Change in unfilled customer orders - Without advance	(358)	-	-	(358)
Subtotal spending authority from offsetting collections	3,507	-	-	3,507
Nonexpenditure transfers, net, actual	616,565	7,477	(624,042)	-
Temporarily not available pursuant to Public Law	(461)	-	-	(461)
Permanently not available	(711)	(8)	-	(719)
Total Budgetary Resources	$ 799,514	$ 9,491	$ -	$ 809,005
Status of Budgetary Resources				
Obligations incurred (Note 13)				
Direct	$ 722,347	$ 8,555	$ -	$ 730,902
Reimbursable	3,848	-	-	3,848
Subtotal	726,195	8,555	-	734,750
Unobligated balance				
Apportioned	47,622	936	-	48,558
Exempt from apportionment	25,697	-	-	25,697
Subtotal	73,319	936	-	74,255
Total Status of Budgetary Resources	$ 799,514	$ 9,491	$ -	$ 809,005
Change in Obligated Balance				
Obligated balance, net				
Unpaid obligations beginning of period	$ 158,816	$ 1,475	$ -	$ 160,291
Obligations Incurred, net	726,195	8,555	-	734,750
Less: Gross outlays	(678,144)	(8,444)	-	(686,588)
Less: Recoveries of prior year obligations, actual	(6,540)	(102)	-	(6,642)
Change in uncollected customer payments, from Federal sources	635	-	-	635
Obligated balance, net, end of period				
Unpaid obligations	204,535	1,484	-	206,019
Less: Uncollected customer payments, from Federal sources	(3,573)	-	-	(3,573)
Total unpaid obligated balance, net , end of period	$ 200,962	$ 1,484	$ -	$ 202,446
Net outlays				
Gross outlays	$ 678,144	$ 8,444	-	$ 686,588
Less: Offsetting collections	(4,143)	-	-	(4,143)
Less: Distributed offsetting receipts	-	-	(624,042)	(624,042)
Net Outlays	$ 674,001	$ 8,444	$ (624,042)	$ 58,403