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

OFFICE OF THE
INSPECTOR GENERAL

November 10, 2008

MEMORANDUM TO: Chairman Klein

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

SUBJECT: RESULTS OF THE AUDIT OF THE UNITED STATES NUCLEAR REGULATORY COMMISSION'S FINANCIAL STATEMENTS FOR FISCAL YEAR 2008 (OIG-09-A-01)

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, Urbach Kahn & Werlin, LLP (UKW) was retained by the Office of the Inspector General (OIG) to conduct this annual audit. Transmitted with this memorandum are the following UKW reports:

- Opinion on the Principal Statements.
- Opinion on Internal Control.
- Compliance with Laws and Regulations.

NRC's Performance and Accountability Report includes comparative financial statements for FY 2008 and FY 2007. Therefore, it is important to note that R. Navarro & Associates, Inc. performed the audit of NRC's FY 2007 financial statements.

Objective of a Financial Statement Audit

The objective of a financial statement audit is to determine whether the audited entity's 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.

UKW's audit and examination were made in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. 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.

FY 2008 Audit Results

The results are as follows:

Financial Statements

- Unqualified opinion

Internal Controls

- Unqualified opinion
- Significant deficiency
  - Estimation of accounts payable year-end balance

Compliance with Laws and Regulations

- Substantial noncompliance
  - License Fee Billing System lack of certification and accreditation

Office of the Inspector General Oversight of UKW Performance

To fulfill our responsibilities under the CFO Act and related legislation for ensuring the quality of the audit work performed, we monitored UKW's audit of NRC's FY 2008 financial statements by:

- Reviewing UKW's audit approach and planning.
- Evaluating the qualifications and independence of UKW's auditors.
- Monitoring audit progress at key points.

- Examining the working papers related to planning and performing the audit and assessing NRC's internal controls.

- Reviewing UKW's audit reports to ensure compliance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended.

- Coordinating the issuance of the audit reports.

- Performing other procedures deemed necessary.

UKW is responsible for the attached auditors' reports, dated November 7, 2008, and the conclusions expressed therein. 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.

- NRC's compliance with laws and regulations.

However, our monitoring review, as described above, disclosed no instances where UKW did not comply, in all material respects, with applicable auditing standards.

It is noted that OIG performed similar oversight of R. Navarro & Associates, Inc.'s audit of NRC's FY 2007 financial statements.

Meeting with the Chief Financial Officer

At the exit conference on November 7, 2008, representatives of the Office of the Chief Financial Officer, OIG, and UKW discussed the issues in the report related to the results of the audit.

Comments of the Chief Financial Officer

In his response, the Chief Financial Officer (CFO) generally agreed with the auditors' recommendations. We will follow up on the CFO's implementation of planned corrective actions during FY 2009. 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.

Attachment: As stated

cc: Commissioner Jaczko
Commissioner Lyons
Commissioner Svinicki
V. Ordaz, OEDO

INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Nuclear Regulatory Commission

Chairman
United States Nuclear Regulatory Commission

We have audited the accompanying balance sheet of the United States Nuclear Regulatory Commission (NRC), as of September 30, 2008, and the related statements of net cost, changes in net position, and budgetary resources (Principal Statements) for the year then ended. The Principal Statements of NRC as of and for the year ended September 30, 2007 were audited by other auditors. We also examined the NRC's internal control over financial reporting as of September 30, 2008.

Summary

We concluded that the NRC's 2008 Principal Statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. We also concluded that, although improvements are needed as noted below, the NRC had effective internal control over financial reporting (including the safeguarding of assets):

- The NRC should continue to enhance its procedures for determining accounts payable

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We found one reportable instance of noncompliance with laws and regulations.

This report (including Appendices A through D) discusses: (1) these conclusions and our conclusions relating to other information presented in the Performance and Accountability Report, (2) management's responsibilities, (3) our objectives, scope and methodology, (4) management's response and our evaluation of their response, and (5) the current status of prior year findings and recommendations.

Opinion on the Principal Statements

In our opinion, the Principal Statements referred to above present fairly, in all material respects, the financial position of the NRC as of September 30, 2008, and its net cost, changes in net position, and budgetary resources for the year then ended, in conformity with accounting principles generally accepted in the United States of America. The Principal Statements of NRC as of and for the year ended September 30, 2007 were audited by other auditors, whose report, dated November 7, 2007, expressed an unqualified opinion on those statements.

As described in footnote 1 of the Principal Statements, the NRC revised its methodology for accounting for accounts payable as of September 30, 2008. We have not determined what impact, if any, this revised methodology may have had on the Principal Statements if applied in the prior year.

Opinion on Internal Control

In our opinion, the NRC maintained, in all material respects, effective control over financial reporting (including safeguarding of assets) as of September 30, 2008 that provided reasonable assurance that misstatements, losses or noncompliance material in relation to the financial statements would be prevented on a timely basis. Our opinion is based on criteria established under 31 U.S.C. 3512 (c), (d), the Federal Managers' Financial Integrity Act, and the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*.

However, we noted the matter summarized below and more fully described in Appendix A, involving the internal control and its operation that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects the NRC's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the NRC's Principal Statements that is more than inconsequential will not be prevented or detected by the NRC's internal control.

The NRC should continue to enhance its procedures for determining accrued accounts payable

The NRC currently does not have a business process to record accounts payable and related accrued expenses in the general ledger at the transaction level. For the last several years, the NRC used an estimation methodology based on historical expenses to estimate these balances. Because of material variances in their prior estimates, and because the NRC transferred its bill paying function to the Department of Interior's National Business Center during fiscal year 2008, the NRC did not have adequate historical data to fully support its estimate recorded as of September 30, 2008. For September 30, 2008, the NRC requested its program managers to calculate, confirm or estimate the amounts of goods and services received but not yet paid for its 200 largest open obligations. An estimated amount for unbilled and/or unpaid goods and services was applied to the remaining balances based on the results of a sample of smaller obligations. We were able to perform adequate compensating procedures to determine the potential effect of this deficiency.

Specific details and the related recommendations for this finding are provided in Appendix A of this report.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the Principal Statements will not be prevented or detected by the NRC's internal control. We do not consider this matter to be a material weakness.

Compliance with Laws and Regulations

The results of our tests of compliance with laws and regulations, exclusive of those referred to under the Federal Financial Management Improvement Act (FFMIA), disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under FFMIA, we are required to report whether the NRC's financial management systems substantially comply with the federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard general ledger at the transaction level. To meet this requirement, we performed tests of compliance with the provisions of FFMIA section 803(a). The results of our tests disclosed one substantial noncompliance with federal financial management systems requirements.

> The NRC did not complete its certification and accreditation (C&A) for the License Fee Billing System (FEES). The NRC is currently reevaluating its process for the modernization of its financial management systems as part of the core financial system replacement and has delayed the timeline for the replacement of FEES. Management intends to complete the C&A for the system by the end of the second quarter of FY 2009.

The current status of prior year findings and recommendations is included in Appendix B.

Other Information

The information in the Management's Discussion and Analysis section of the NRC's Performance and Accountability Report is not a required part of the Principal Statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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 Program Performance and Appendices listed in the table of contents are presented for additional analysis and are 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 them.

Management Responsibilities

Management is responsible for (1) preparing the Principal Statements in conformity with accounting principles generally accepted in the United States of America, (2) establishing, maintaining and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers Financial Integrity Act of 1982 are met; (3) ensuring that the NRC's financial management systems substantially comply with FFMIA; and (4) complying with applicable laws and regulations.

Objectives, Scope and Methodology

We are responsible for planning and performing our audit 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 are responsible for planning and performing our examination to obtain reasonable assurance about whether management maintained effective internal control over financial reporting (including safeguarding of assets) and compliance with applicable laws and regulations based on criteria established under 31 U.S.C. 3512 (c), (d), the Federal Managers' Financial Integrity Act, and OMB Circular A-123, *Management's Responsibility for Internal Control*. Our examination included obtaining an understanding of internal control related to financial reporting (including safeguarding assets) and compliance with laws and regulations (including execution of transactions in accordance with budget authority); testing relevant internal controls over financial reporting (including safeguarding assets) and compliance, evaluating the design and operating effectiveness of internal control; and performing such other procedures as we considered necessary in the circumstances. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act.

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 the internal control 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 the policies or procedures may deteriorate.

We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements. We did not test compliance with all laws and regulations applicable to the NRC. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2008. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

INDEPENDENT AUDITOR'S REPORT, CONTINUED

We conducted our audit and examinations in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards,* issued by the Comptroller General of the United States; attestation standards established by the American Institute of Certified Public Accountants; and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. We believe that our audit and examinations provide a reasonable basis for our opinions.

We also noted other less significant matters involving the NRC's internal control and its operation, which we have reported to the management of the NRC in a separate letter, dated November 7, 2008.

Distribution

This report is intended solely for the information and use of the NRC OIG, the management of NRC, OMB, the Government Accountability Office and the Congress of the United States, and is not intended to be and should not be used by anyone other than these specified parties.

Urbach Kahn & Werlin LLP

Arlington, Virginia
November 7, 2008

In our report dated November 7, 2008, we described the results of our audit of the consolidated balance sheet of the Nuclear Regulatory Commission (NRC), as of September 30, 2008, and the related consolidated statements of net cost, changes in net position, and the combined statement of budgetary resources (Principal Statements) for the year then ended. The objective of our audit was to express an opinion on these financial statements. In connection with our audit, we also considered the NRC's internal control over financial reporting and tested the NRC's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements. The following presents additional detail on the internal control deficiency discussed in that report.

1. The NRC should continue to enhance its procedures for determining accrued accounts payable.

The NRC currently does not have a business process to record accounts payable and related accrued expenses in the general ledger at the transaction level. For the last few years, the NRC has used an estimation methodology based on historical average percentage of actual accounts payable to expenses. The actual amount of accounts payable for a prior period was calculated through a review of subsequent disbursements. During fiscal year 2008, the NRC's management identified errors in its subsequent review procedures and found that their methodology was not reliable in estimating the September 30, 2007 non-federal accounts payable balance.

During fiscal year 2008, the NRC also transferred its bill paying function to the Department of Interior's National Business Center. Although management does not believe this transition has materially impacted its bill paying patterns for the fiscal year end, they did not have sufficient time to analyze this data to support their historical estimation methodology for the current fiscal year end.

For September 30, 2008, the NRC requested its program managers to calculate, confirm or estimate the amounts of goods and services received but not yet paid for its 200 largest open obligations. An estimated amount for unbilled and/or unpaid goods and services was applied to the remaining balances based on the results of a sample of smaller obligations.

While this new methodology should reduce the risk of misstatements in the recorded balance for non-federal accounts payable, the NRC has not fully documented its business processes and policies related to this methodology. In addition, the NRC has not established historical relationships between the accrued accounts payable balances and unliquidated obligations in order to corroborate the results of this process. We were able to perform adequate compensating procedures to determine the potential effect of this deficiency.

Without effective documented procedures and historical analysis, management cannot adequately ensure that the potential misstatement related to using this methodology rather than recording accounts payable and the related accrued expenses at the transaction level is appropriately immaterial.

We recommend that the NRC's Chief Financial Officer:

1. Ensure the NRC's long term plans for replacing the core financial management system evaluate the system requirements for recording accounts payable and related accrued expenses at the transaction level. (New)

2. Document the NRC's policies and procedures for calculating, estimating and recording accounts payable for the largest obligations quarterly. (New)

3. Consider the accounts payable process a high risk area in connection with the agency's management control program and conduct reviews and testing of the interim quarters for FY 2009 accordingly. (New)

4. Establish historical relationships between accrued expenses and unliquidated obligation levels that may support near term calculations of accounts payable and related accrued expenses. (New)

Appendix B
Status of Prior Year Findings and Recommendations

Our assessment of the current status of reportable conditions and material weaknesses identified in prior year audits is presented below:

Prior Recommendation	***Type***	***Fiscal Year 2008 Status***
1. The NRC CFO should coordinate with the Office of Information Services and the Executive Director for Operations to ensure that any vulnerabilities of the general support systems and the financial management systems are addressed and resolved timely.	2007 Material Weakness/Substantial Noncompliance with Laws and Regulations	Closed.
2. The NRC CFO should continue to define, design and implement compensating controls over the fee billing system.	2007 Significant Deficiency	Closed.