



OFFICE OF THE INSPECTOR GENERAL

U.S. NUCLEAR REGULATORY COMMISSION

DEFENSE NUCLEAR FACILITIES SAFETY BOARD

Audit of NRC's Implementation of Federal Managers' Financial Integrity Act for Fiscal Year 2015

OIG-16-A-20

September 19, 2016



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

**OFFICE OF THE
INSPECTOR GENERAL**

September 19, 2016

MEMORANDUM TO: Victor M. McCree
Executive Director for Operations

Maureen E. Wylie
Chief Financial Officer

FROM: Steven E. Zane \RA\
Acting Assistant Inspector General for Audits

SUBJECT: AUDIT OF NRC'S IMPLEMENTATION OF FEDERAL
MANAGERS' FINANCIAL INTEGRITY ACT FOR FISCAL
YEAR 2015 (OIG-16-A-20)

Attached is the Office of the Inspector General's (OIG) audit report titled *Audit of NRC's Implementation of Federal Managers' Financial Integrity Act for Fiscal Year 2015*.

The report presents the results of the subject audit. Following the August 16, 2016, exit conference, agency staff indicated that they had no formal comments for inclusion in this report.

Please provide information on actions taken or planned on each of the recommendations within 30 days of the date of this memorandum. Actions taken or planned are subject to OIG followup as stated in Management Directive 6.1.

We appreciate the cooperation extended to us by members of your staff during the audit. If you have any questions or comments about our report, please contact me at (301) 415-5915 or Eric Rivera, Team Leader, at (301) 415-7032.

Attachment: As stated



Office of the Inspector General

U.S. Nuclear Regulatory Commission
Defense Nuclear Facilities Safety Board

OIG-16-A-20

September 19, 2016

Results in Brief

Why We Did This Review

The Federal Managers' Financial Integrity Act (FMFIA) requires federal agencies, including NRC, to establish and maintain effective internal control over its operations to help accomplish its mission. FMFIA requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency. Further, FMFIA requires that the head of each executive agency report annually to the President and Congress on their agency's compliance with FMFIA requirements.

NRC updated Management Directive (MD) 4.4, *Internal Control*, in 2012 to comply with FMFIA. MD 4.4 established a uniform process to assess internal control that meets FMFIA requirements.

The audit objectives were to (1) assess the NRC fiscal year (FY) 2015 compliance with FMFIA, and (2) evaluate the effectiveness of NRC's process to assess internal control over program operations, as reported in the Chairman's FMFIA Statement published in the agency's Performance and Accountability Report.

Audit of NRC's Implementation of Federal Managers' Financial Integrity Act for Fiscal Year 2015

What We Found

Overall, the agency complies with the requirements of the guidance related to the FMFIA Statement. However, the effectiveness of NRC's process to evaluate internal control over program operations could be improved to provide the NRC Chairman with more reliable information to support the annual internal control assessment process.

NRC has not fully implemented MD 4.4 and further stated that it is out-of-date. Finally, the agency was not able to provide documentation to support the completion of all five steps of the MD 4.4 Five-Step Approach to Evaluate Programmatic Internal Control. The OIG audit identified opportunities to improve the agency's implementation of the assessment of internal controls over program operations.

What We Recommend

The report makes recommendations to improve the effectiveness of NRC's process to assess internal control over program operations. When implemented, these recommendations will strengthen the agency's programmatic internal control process.

Agency management stated their general agreement with the finding and recommendations in this report.

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ABBREVIATIONS AND ACRONYMS

CFO	Chief Financial Officer
ECIC	Executive Committee on Internal Control
EDO	Executive Director for Operations
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal Year
ICP	Internal Control Plan
MD	Management Directive
MOU	Memoranda of Understanding
NRC	U.S. Nuclear Regulatory Commission
OIG	Office of the Inspector General
OMB	Office of Management and Budget
QPR	Quarterly Performance Review

I. BACKGROUND

The U.S. Nuclear Regulatory Commission's (NRC) mission is to license and regulate the Nation's civilian use of radioactive materials to protect public health and safety, promote the common defense and security, and protect the environment. NRC strives to be a trusted, independent, transparent, and effective nuclear regulator. In addition, NRC aspires to maintain its regulatory competence, convey that competence to stakeholders, and promote trust in the agency.

NRC is mandated by the Federal Managers' Financial Integrity Act (FMFIA) to establish and maintain effective internal control over its operations to help accomplish its mission. FMFIA, enacted on September 8, 1982, requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency. Further, FMFIA requires the head of each executive agency to report annually to the President and Congress on their agency's compliance with FMFIA requirements.

The annual FMFIA assessment process culminates in a meeting of the NRC Executive Committee on Internal Control (ECIC) in October of each year. The committee is comprised of the Executive Director for Operations (EDO), Chief Financial Officer (CFO), Deputy CFO, Deputy EDOs and the EDO's Assistant for Operations. The General Counsel serves as an advisor, and the Inspector General observes the process and issues an annual report. Senior agency officials noted that the EDO and the CFO review business line reasonable assurance documentation, results of internal control activities and other sources of information, and prepare briefing material for the ECIC. The voting members of the ECIC provide the Chairman with the committee's recommendation for the agency's annual statement. On November 9, 2015, the NRC Chairman signed the Fiscal Year (FY) 2015 FMFIA Statement which was published in the agency's Performance and Accountability Report.

Management Directive and Handbook (MD) 4.4, *Internal Control*, is NRC's guidance to comply with the annual FMFIA requirements.¹ MD 4.4 Handbook has guidance on assessing internal control over program operations and financial reporting, as well as instructions for completing the annual Reasonable Assurance

¹ MD 4.4 was last revised on October 2, 2012.

Certifications. An additional goal of the overall internal control process is to integrate internal control activities with quarterly performance reporting.

MD 4.4 identifies specific organizational responsibilities for the EDO and the CFO related to FMFIA. The EDO's role is to provide oversight and leadership for internal control over programmatic operations, while the CFO establishes and maintains an internal control program for NRC's programmatic and administrative activities, including revisions to MD 4.4.

MD 4.4 also identifies responsibilities for the Inspector General. These include serving as an observer to the ECIC on internal control matters while maintaining independence from the ECIC's decisionmaking process and overseeing independent audits. In the past, the Office of the Inspector General (OIG) has reviewed NRC's implementation of the FMFIA focusing on the statements of reasonable assurance. In June 2015, OIG published *Audit of NRC's Reactor Business Lines' Compliance With Agency Non-Financial Internal Control Guidance*. That audit concluded that NRC's two reactor safety business lines did not comply with the majority of the agency's nonfinancial internal control process requirements detailed in the MD 4.4 Handbook and made recommendations to enhance internal controls. Since the report was published, NRC has made progress in implementing those recommendations.

II. OBJECTIVE

The objectives of this audit were to

1. Assess NRC's FY 2015 compliance with FMFIA.
2. Evaluate the effectiveness of NRC's process to assess internal control over program operations, as reported in the Chairman's FMFIA Statement, as published in the agency's Performance and Accountability Report.

III. FINDING

The agency is compliant with the requirements of FMFIA. However, the effectiveness of NRC's process to assess internal control over program operations could be improved to provide the NRC Chairman with more reliable information to support the annual FMFIA Statement.

The Office of Management and Budget (OMB) has been revising circular A-123, *Management's Responsibility for Internal Control*, for the past 2 years and issued its update, OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, on July 15, 2016. Agency management stated they held off updating MD 4.4 until OMB updated Circular A-123.

A. Internal Control Assessment Over Program Operations Needs Improvement

Federal laws and guidance require managers to establish policies and procedures to ensure program objectives are achieved and assets are safeguarded. However, NRC's official guidance for programmatic internal control is out-of-date. Management has not made updating and aligning published authoritative programmatic internal control policy a priority and does not retain adequate documentation to support internal control policies and decisions. As a result, the agency may not have the most reliable data to support the Chairman's annual FMFIA Statement.

What Is Required

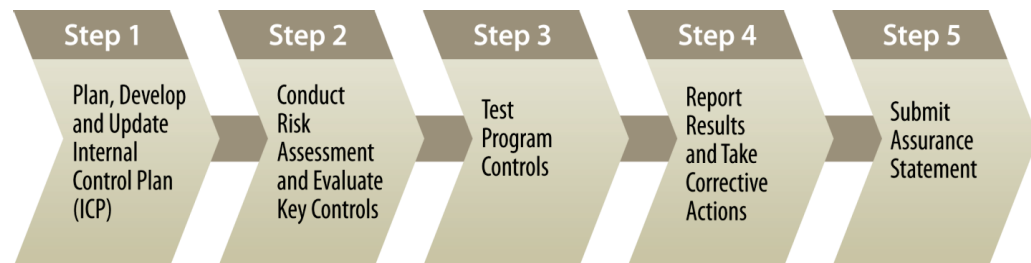
Internal control – organization, policies, and procedures – are tools to help program and financial managers achieve results and safeguard the integrity of their programs. Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

On October 2, 2012, NRC developed MD 4.4 to comply with FMFIA requirements and to incorporate OMB Circular A-123, dated December 31, 2004. MD 4.4 included an overall framework for establishing and maintaining internal control and a centralized repository for all documents relevant to the internal control process across the agency in the Agencywide Documents Access and Management System. Further, NRC was to integrate internal control activities comprising responsibilities such as performance plans, quarterly performance reporting, Internal Control Plans (ICP), and recommendations to support the Chairman's FMFIA Statement.

The figure below shows the five steps in the programmatic internal control process outlined in MD 4.4, Chapter III.

Figure 1. Five-Step Approach to Evaluate Programmatic Internal Control



Source: MD 4.4

Under the current process NRC is supposed to create an ICP for each business line². The ICPs provide fields to record risk assessments, tests of program control information, results, and corrective action plans.

MD 4.4 outlines a similar process for the internal control review over financial reporting in Chapter IV. The five steps are (1) Planning, (2) Evaluating Internal Control at the Entity Level, (3) Evaluating Internal Control at the Process Level, (4) Testing at the Transaction Level, and (5) Concluding, Reporting, and Correcting Deficiencies and Weaknesses.

Finally, MD 4.4, Chapter V, describes the process for business line managers to submit Reasonable Assurance Certifications. These documents support the Chairman's FMFIA Statement.

The purpose of the MD system is to effectively communicate agency policies and guidance to NRC employees and to reflect decisions of the EDO and the CFO. According to agency guidance available during FY 2015, Yellow Announcements (Policy) are on a par with MDs and serve as interim guidance until the entire MD is revised.

What We Found

MD 4.4 Not Fully Implemented

Overall, the agency complies with the requirements of the internal control processes related to FMFIA assurance certifications. However, NRC has not fully implemented MD 4.4, specifically, the five-step approach outlined in Chapter III. OIG requested and received documentation showing implementation of MD 4.4, Chapters IV and V, Assessment of Internal Control over Financial Reporting and Assurance Certifications. The documentation to support the assessment and reporting requirements of these two chapters is complete.

However, the documentation supporting the assessment of internal control over program operations was not complete. The agency provided ICP documents for 11 of 15 business lines for 2015 which included information

² A business line is a subdivision or component part of an agency program or administrative function that can be assessed for risks and allow for a meaningful evaluation of internal control.

from 20 of 26 offices. This is the first step mentioned in Figure 1. OIG asked for support for Steps 2 through 4 as shown in Figure 1. The information received was incomplete and did not fully support the items mentioned in the ICPs. The agency provided complete documentation for Step 5 of the process, "Submit Assurance Statement."

To support the internal control assessment process the agency has a system of Reasonable Assurance Justification Templates signed by offices in their role as lead, independent, or partner office for business and product lines to support Business Line Reasonable Assurance Certifications. Twenty-five offices had signed Reasonable Assurance Justifications on file for FY 2015.

Finally, the agency has Memoranda of Understanding (MOU) which are meant to clarify expectations between business or product line lead offices and their partners and support the Reasonable Assurance Justification Templates. MOUs require that internal control risks, weaknesses, deficiencies, and reportable conditions be documented and communicated in the ICP to ensure that these issues receive senior management attention. At the end of FY 2015, of the 26 NRC offices, 6 had not signed an MOU. An agency senior manager represented that MOUs were not needed for the Policy Support and Training business lines which includes two of these offices. Additionally, three independent offices do not sign MOUs.

Quarterly Performance Review Process

NRC staff and management noted there is an additional internal control process within the agency, the Quarterly Performance Review (QPR) process. The agency provided both the guidance and results of the FY 2015 QPR. This guidance does not contain any reference to internal control. The QPR process reported 240 performance items in the fourth quarter 2015 meeting. The MD 4.4 process included 62 internal control items in the ICPs as of the end of FY 2015. Twenty-one (21) internal control items were addressed in both processes.

Authoritative Guidance Not Clearly Communicated to Staff

The CFO, who is in charge of revising MD 4.4, did not publish a Yellow Announcement announcing that MD 4.4 had been updated to reflect any of the policy updates communicated in previously issued memoranda. Furthermore, the FY 2015 guidance memorandum issued by the EDO and the CFO directed staff to the outdated MD 4.4 for general guidance on the internal control assessment process.

Documentation Requirements

MD 4.4 clearly describes supporting documentation requirements. For FY 2015 one of 62 items presented a complete risk assessment in the documentation provided. Similarly, for ICPs, only some tests of program controls, corrective action plans, and results of the corrective action plans were provided.³

Why This Occurred

Criteria Are Unclear and Not Authoritative

NRC has not made revising and aligning programmatic internal control guidance a priority. An agency manager stated that MD 4.4 is out-of-date and the programmatic internal control chapter has been out of date since the day it was published. NRC staff and management stated that the guidance “veered” away from MD 4.4 and was replaced with annual memoranda from the CFO and EDO. However, these annual memoranda are not on the same hierarchical tier as MDs and thus not as authoritative.

In addition, NRC management mentioned the QPR as a process to monitor internal control issues. While MD 4.4 states that internal control

³ OCFO management stated they have an Internal Control SharePoint Site, which the Agency uses as a “one stop shop” for internal control statutory requirements, policy guidance, and documentation for communications organized by business line. This site also contains links to management directives and other references the business lines use to implement internal controls in their daily operations. Agency management stated FMFIA supporting documentation is centrally maintained and made available in the Agencywide Document Access and Management System. The ICPs, tests of program controls, and corrective action plans are, however, decentralized among its safety, security, and other programs, which does not conform to the guidance in MD 4.4, Section III.

includes quarterly performance reviews as part of the internal control process, the QPR guidance does not mention internal control.

Finally, when asked to produce documentation to support completion of all steps identified in MD 4.4, agency officials could not produce ICPs for all business and product lines.

Why This Is Important

The reliability of the information supporting the Chairman's FMFIA Statement can be improved. Unclear and contradictory guidance for strategic planning, internal control, and QPR makes it more difficult to align these related oversight processes to enhance agency operations. Gaps in the information provided in the ICPs make it difficult for the agency to track its progress in resolving internal control issues. NRC's official guidance for programmatic internal controls should be updated to be consistent with OMB Circular A-123 published in July 2016. This update to MD 4.4 will strengthen the process the agency uses to develop the Chairman's annual FMFIA Statement.

Further, NRC's Strategic Plan for Fiscal Years 2014-2018 states that NRC seeks to remain a model for regulatory effectiveness. Clear, effectively communicated and consistently applied internal control guidance and processes are integral to implementing the agency's cross-cutting strategy of regulatory effectiveness in support of its safety and security goals.

Recommendations

OIG recommends that the Executive Director for Operations and the Chief Financial Officer

1. Provide interim guidance via the Yellow Announcement process to update Management Directive 4.4, especially Chapter III.
2. Update and align agency guidance and processes related to internal control over program operations, quarterly performance review, and strategic planning.
3. Develop and implement enhanced record retention requirements for documentation related to internal control and corrective action plans to conform to the guidance in MD 4.4, Section III.

IV. AGENCY COMMENTS

An exit conference was held with the agency on August 16, 2016. Prior and subsequent to this meeting, agency management reviewed a discussion draft and provided comments that have been incorporated into this report as appropriate. As a result, agency management opted not to provide formal comments for inclusion in this report.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objectives of this audit were to

1. Assess NRC's FY 2015 compliance with FMFIA.
2. Evaluate the effectiveness of NRC's process to assess internal control over program operations, as reported in the Chairman's FMFIA Statement, as published in the agency's Performance and Accountability Report.

Scope

We audited the internal controls related to NRC's implementation of FMFIA for FY 2015. During this audit, OIG reviewed documents provided by the agency in support of Business Line Reasonable Assurance Certifications as of September 31, 2015.

We conducted this performance audit at NRC headquarters in Rockville, Maryland, from February 2016 to June 2016. OIG also reviewed and analyzed internal controls related to the audit objectives. Throughout the audit, auditors were aware of the possibility of fraud, waste, and abuse in the program.

Methodology

OIG staff reviewed the following Federal guidance related to internal control:

- Federal Managers' Financial Integrity Act of 1982.
- Office of Management and Budget Circular A-123.
- Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 and GAO-14-704G.

Additionally, OIG staff reviewed the following agency guidance related to internal control, hierarchy of guidance, document retention:

- Management Directive 4.4, *Internal Control*.
- Management Directive 3.53, *Records and Document Management Program*.
- General Categories for NRC Hierarchy of NRC Internal Policy and Guidance Documents.
- Annual guidance documents for Programmatic Internal Control and Reasonable Assurance Guidance for 2010-2016.
- Annual guidance for Quarterly Performance Review for 2015.

OIG staff reviewed all supporting documentation for the FY 2015 programmatic internal control and statement of reasonable assurance as provided by the agency during the audit. OIG staff also reviewed the supporting documentation for internal control over financial reporting for FY 2015 and reasonable assurance that financial systems comply with Federal accounting standards.

Lastly, OIG interviewed NRC managers and staff to gain an understanding of roles and responsibilities as they relate to NRC oversight of programmatic internal controls.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit was conducted by Eric Rivera, Team Leader; Mary Meier, Audit Manager; Gail F. P. Butler, Senior Auditor; Stephen Morgan, Auditor; and Ellen Goff, Student Management Analyst.

TO REPORT FRAUD, WASTE, OR ABUSE

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COMMENTS AND SUGGESTIONS

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