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

November 9, 2006

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM TO: Chairman Klein

FROM: /Hubert T. Bell/
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.

Attachments: As stated

cc: Commissioner McGaffigan
Commissioner Merrifield
Commissioner Jaczko
Commissioner Lyons

R. NAVARRO
& ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

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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 2 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 **xxx** 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

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

CHIEF FINANCIAL
OFFICER

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 audit 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.

CONTACT: Michele D. Kaplan, OCFO/DFM/FSRT
415-5256

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 OIG in July 2006.

cc: W. Dean, OEDO
M. Malloy, OEDO
P. Tressler, OEDO