

OFFICE OF THE INSPECTOR GENERAL

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AUDIT REPORT



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REVIEW OF NRC'S IMPLEMENTATION
OF THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT FOR 1992

OIG/92A-22

December 23, 1992

AUDIT REPORT



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

OFFICE OF THE
INSPECTOR GENERAL

December 23, 1992

MEMORANDUM FOR: The Chairman
Commissioner Rogers
Commissioner Curtiss
Commissioner Remick
Commissioner de Planque

David C. Williams

FROM: David C. Williams
Inspector General

SUBJECT: REVIEW OF NRC'S IMPLEMENTATION OF THE
FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT
FOR FISCAL YEAR 1992

The Federal Managers' Financial Integrity Act (FMFIA) requires Federal managers to establish a continuous process for evaluating, improving and reporting on the internal control and accounting systems for which they are responsible. The FMFIA specifies that by December 31 of each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress stating whether the evaluation of internal controls was conducted in accordance with the Internal Control Guidelines issued by the Office of Management and Budget (OMB) and whether the agency's system of internal accounting and administrative controls complies with the standards established by the Comptroller General.

Both OMB Circular A-123, Revised, "Internal Control Systems," and Circular A-127, "Financial Management Systems," provide that an agency's Inspector General or senior audit official may advise the head of the agency on whether the agency's internal control and accounting systems evaluation process was conducted in accordance with OMB guidelines. Accordingly, the Office of the Inspector General (OIG) has performed a review of the process used by the NRC to evaluate its internal control and accounting systems. This review provides the OIG with a basis for advising the Chairman whether the agency has conducted the internal control evaluation process in a reasonable and prudent manner. The results of our review are contained in the attached report.

Conclusion

NRC should strengthen the process by which the FMFIA is implemented by establishing a quality assurance program that would be administered by the agency's Internal Control Committee (ICC). Audits performed during the past year have disclosed significant internal control deficiencies within the agency's operations. OMB has recently raised concerns regarding the relative lack of material weaknesses reported by NRC. These deficiencies indicate that the agency's FMFIA process should be enhanced so that all internal control weaknesses can be appropriately identified and corrected.

This report identifies internal control deficiencies in the areas of computer security, payments to DOE labs, management of DOE projects, and the NRC's general ledger which we believe are material weaknesses as defined by OMB Circular A-123. In accordance with the FMFIA requirements, these material internal control weaknesses should be included in the 1992 report to the President and Congress.

Our report contains four recommendations. To ensure agency compliance with the provisions of the FMFIA, we recommended that the ICC develop a quality assurance program that will ensure (1) FMFIA activities are planned and conducted continuously throughout the year; 2) Internal Control Review (ICR) reports are consistent in presentation and format; and 3) ICRs are documented with sufficient evidence that link actual work performed during the ICR process with the report. We also recommended that the Office of the Controller include quality assurance program provisions in NRC Manual Directive 4.4, "Internal Controls" (currently Manual Chapter 0801).

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INTRODUCTION

The Federal Managers' Financial Integrity Act (FMFIA) was enacted on September 8, 1982, in response to continuing disclosures of waste, loss, unauthorized use and misappropriation of funds or assets associated with weak internal controls and accounting systems. Congress felt such abuses hampered the effectiveness and accountability of the Federal Government and eroded the public's confidence. The FMFIA requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal controls and accounting systems for which they are responsible.

Office of Management and Budget (OMB) Circular A-123, Revised, "Internal Control Systems," and Circular A-127, "Financial Management Systems," provide that an agency's Inspector General or senior audit official may advise the head of the agency on whether the agency's internal controls and financial management systems evaluation processes were conducted in accordance with OMB guidelines. Accordingly, the Nuclear Regulatory Commission's (NRC) Office of the Inspector General (OIG) annually performs a limited review of the process used by the NRC to evaluate its internal controls and financial management systems. This review provides the OIG with a basis for advising the Chairman whether the agency has conducted the internal controls and financial management systems evaluation processes in a reasonable and prudent manner.

The term "internal controls," as envisioned by the FMFIA, is synonymous with "management controls" and encompasses program and administrative areas, as well as the accounting and financial management areas. OMB defined internal controls in Circular A-123 as the plan of organization and all of the methods and measures adopted within the agency to safeguard its resources; assure the accuracy and reliability of its information; assure adherence to applicable laws, regulations and policies; and promote operational economy and efficiency. Internal controls are inherent in the management function and are integral to all systems used by management to achieve the objectives of programs or functions.

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

BACKGROUND

The FMFIA specifies that by December 31, 1983, and by each succeeding December 31, the head of each executive agency subject to the Act shall submit a report to the President and Congress stating whether the evaluation of internal controls was conducted in accordance with the Internal Control Guidelines issued by OMB and whether the agency's system of internal accounting and administrative controls complies with the standards established by the Comptroller General.

The Executive Director for Operations (EDO), who has also been designated the agency's Chief Financial Officer (CFO), is responsible for establishing and maintaining a system of internal controls within NRC. In addition, the Chief Financial Officers Act requires an independent assessment of the agency's systems of internal controls be performed. The results of this independent assessment, the first of which will be performed for Fiscal Year (FY) 1992, must be coordinated with the results of the FMFIA assessment.

To ensure the agency is implementing the FMFIA as required, NRC established an Internal Control Committee (ICC) in May 1982 in response to OMB Circular A-123. The ICC is chaired by the Deputy Controller and is composed of representatives from various NRC offices. The ICC is responsible for recommending guidelines and procedures to the EDO/CFO for the agency's compliance with the FMFIA and OMB Circular A-123. The Committee is also responsible for preparing the agency's annual report from the Chairman to the President and Congress in response to the FMFIA.

FINDINGS

Past OIG reviews of NRC's FMFIA compliance have not raised substantial concerns regarding the agency's process for FMFIA implementation. Our reviews have shown that the agency has generally complied with the basic requirements of the FMFIA. However, recent OIG audits disclosed significant internal control deficiencies within the agency's operations. This situation, as well as recent concerns raised by OMB regarding the relative lack of material weaknesses reported by NRC, indicates that additional strengthening of the NRC's FMFIA process is necessary. When questioning why a particular agency internal control review (ICR) had not disclosed an

issue that later was raised by an OIG audit report, one ICC member asked "Why didn't we find it?".

As described earlier, the ICC is an integral part of the agency's FMFIA process. We believe that the effectiveness of the ICC can be greatly enhanced, and the agency's FMFIA process strengthened, by implementing a quality assurance program.

A QUALITY ASSURANCE PROGRAM WOULD STRENGTHEN THE FMFIA PROCESS

Presently, the ICC has not developed a quality assurance program to ensure that the agency has complied with all FMFIA requirements. As discussed below, we believe a lack of a quality assurance program has resulted in inadequate planning of FMFIA activities, wide variances in ICR report format, and inadequate supporting documentation for ICRs.

Better Planning of FMFIA Activities Needed

Most of NRC's FMFIA activities are planned for completion during the last few months of the calendar year. For example, ICRs, limited/detailed reviews of financial systems, and reasonable assurance letters are generally completed and submitted to the ICC in October and November. As mentioned earlier, the agency's annual FMFIA report is required to be issued to the President and Congress by December 31. We believe that this scheduling methodology does not provide sufficient time for the ICC to assess these reviews and assurance letters for compliance with FMFIA requirements. We believe that the FMFIA process should be a year-long activity and as such, work and work products should be scheduled, completed, and received by the ICC continuously throughout the year.

ICR Report Format Varies Widely Among NRC Offices

ICR reports for FY 1992 were inconsistent in presentation and format. Of the ten ICR reports submitted to the ICC, four were general in scope, providing only a statement of reasonable assurance, with a discussion of the corresponding risk assessment or a description of the assessable unit's operations. The other six ICR reports were more detailed in scope, providing

information regarding event cycles, general control environment, control objectives, and control techniques. But even these latter reports generally failed to adequately address the testing of internal controls. A consistent ICR format would allow for a more efficient review and identification of problem areas by the ICC. For a glossary of FMFLA terminology, see Appendix II.

According to OMB Guidelines, ICR reports should address the following: In what way is the general control environment inadequate to provide the necessary atmosphere for the appropriate functioning of specific controls?; In what areas are necessary control techniques nonexistent or inadequate?; In what way are necessary control techniques not functioning as intended?; In what areas are control techniques excessive, thereby fostering a lack of economy or creating inefficiencies?; and In what ways are executive, legislative, or other management requirements excessive, thereby creating inefficiencies?

OMB guidelines further state that reports should also contain recommendations for how such situations could be corrected or improved. In evaluating possible alternatives, consideration should be given to the costs and expected benefits of changes in order that control objectives can be achieved in a cost-effective manner.

ICR'S Were Not Adequately Supported

We found that none of the ten ICRs completed for FY 1992 were supported by adequate documentation. The existing documentation (i.e., workpapers), which generally consisted of only supplementary data on risk assessments and overviews of assessable unit operations, did not provide support for the work performed or the results disclosed. We believe that workpapers are the link between the actual work performed during the ICR process and the ICR report. As such, they should contain adequate evidence to support the event cycles, internal control objectives, internal control techniques, testing, judgements, conclusions, recommendations and corrective action plans.

SEVERAL MATERIAL WEAKNESSES SHOULD BE INCLUDED IN NRC'S 1992 FMFIA REPORT

In our opinion, the following internal control deficiencies "significantly weaken agency safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets", as defined in OMB Circular A-123 and, therefore, constitute material weaknesses. Such material weaknesses are required by the FMFIA to be identified in the agency's annual report to the President and Congress. As described below, these deficiencies were identified through a variety of sources, including OIG reports, limited/detailed reviews performed by the Office of the Controller (OC), and ICRs.

1. Computer Security - The NRC's Office of Information Resources Management (IRM) contracted with the Los Alamos National Laboratory to perform a computer security review for the agency. In November 1991, Los Alamos reported its findings and recommendations to IRM. As reported in OIG draft report 92A-10, "Significant Weaknesses Hamper NRC's Computer Security Program", dated October 13, 1992, half (15 of 30) of the Los Alamos recommendations have yet to be implemented. As a result, the agency's computer security program fails to comply with the minimum security requirements of OMB Circular A-130, "Management of Federal Information Resources".

2. Payments to Department of Energy (DOE) Labs - In OIG report 92A-08, "Improvements Needed in NRC's Process For Approving Payments To The Department of Energy", we disclosed that the agency has made payments of approximately \$500 million to DOE Labs since 1986 without reviewing or approving the associated invoices. Such reviews and approvals are required by statute, the General Accounting Office, Department of the Treasury, and agency guidance.

3. Management of DOE Projects - An internal NRC review of DOE agreements identified project management practices that require improvement to adequately protect the agency's business interests. The results of the review disclosed that the agency's project files did not reflect adequate analysis of proposed contractor costs or effective project monitoring. It was also found that the agency needs to institute better control over these projects to ensure that required goods and services are obtained at reasonable prices.

Deficiencies identified during this internal review were attributed to the lack of an agency-wide standard for contract management. The management of DOE projects was identified as a significant result of reviews of management controls in the agency's 1991 FMFIA report.

After consideration of OMB comments relative to the identification of these deficiencies as a material weakness, the NRC's Executive Director for Operations notified OMB via memorandum dated May 29, 1992, that the agency will identify the management of DOE projects as a material weakness in its 1992 FMFIA report.

4. General Ledger - Many OIG audit reports and limited/detailed reviews performed by the agency have disclosed significant internal control deficiencies within the agency's financial systems. These deficiencies include:
- failure to reconcile the general ledger with subsidiary ledgers;
 - failure to obtain approval from the originating branch before making adjustments to the general ledger; and
 - incompatibility of financial systems.

CONCLUSION

To ensure compliance with the provisions of the FMFIA, NRC should strengthen the process by which the FMFIA is implemented by establishing a quality assurance program that would be administered by the ICC. Audits performed during the past year have disclosed significant internal control deficiencies within the agency's operations. OMB has recently raised concerns regarding the relative lack of material weaknesses reported by NRC. These deficiencies indicate that the agency's FMFIA process should be enhanced so that all internal control weaknesses can be appropriately identified and corrected.

This report identifies internal control deficiencies in the areas of computer security, payments to DOE labs, management of DOE projects, and the NRC's general ledger which we believe are material weaknesses as defined by OMB Circular A-123. In accordance with the FMFIA requirements, these material internal control weaknesses should be included in the 1992 report to the President and Congress.

RECOMMENDATIONS

To ensure that the agency has complied with all FMFIA requirements, we recommend that the ICC develop a quality assurance program that will ensure:

1. FMFIA activities are planned and conducted continuously throughout the year.
2. ICR reports are consistent in presentation and format.
3. ICRs are documented with sufficient evidence that link the actual work performed during the ICR process with the report.

We also recommend that OC include quality assurance program provisions in NRC Management Directive 4.4, "Internal Controls" (currently Manual Chapter 0801).

AGENCY COMMENTS

On December 22, 1992, the Deputy Executive Director for Nuclear Materials Safety, Safeguards and Operations Support provided a response to our draft report. The comments are included as Appendix III.

The Deputy Executive Director agreed with the recommendations set forth in the report and provided the actions to be taken to correct the weaknesses.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether the NRC has complied with the requirements of the FMFIA. The Act requires Federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. We conducted our review at NRC Headquarters from October to November 1992 and included an assessment of:

- The documentation supporting the agency's internal control evaluation process including the management control plans and risk assessments.
- The internal control reviews and financial management system reviews conducted by NRC for FY 1992.
- The system used to track the status of corrective actions resulting from the internal control and financial system reviews.
- The training programs conducted for those individuals responsible for performing the internal control and financial management system reviews.

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

GLOSSARY

ASSESSABLE UNIT	A major program, administrative activity, organization, or functional subdivision of an agency.
EVENT CYCLES	Processes used to initiate and perform related activities, create the necessary documentation, and gather and report related data. It is a series of steps taken to get something done and provides the focal points for the conduct of internal control reviews.
GENERAL CONTROL ENVIRONMENT	The environment in which activities are conducted that may have a major impact on the effectiveness of internal controls within an agency. Several factors determine the general control environment including management attitude, organizational structure, personnel, delegation and communication of authority and responsibility, policies and procedures, budgeting and reporting practices, organizational checks and balances and automated data processing considerations.
INTERNAL CONTROL GUIDELINES	Guidelines issued by the Office of Management and Budget (OMB) in December 1982, entitled "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government."
INTERNAL CONTROL OBJECTIVE	A specific end to be achieved by control techniques used in an assessable unit.

APPENDIX II

Review of NRC's Implementation of the Federal Managers' Financial Integrity Act for 1992

INTERNAL CONTROL
REVIEW

A detailed examination of a system of internal controls using the methodology specified in the Internal Control Guidelines.

INTERNAL CONTROL
STANDARDS

The standards developed by the General Accounting Office, and published in "Standards for Internal Controls in the Federal Government," October 31, 1984.

INTERNAL CONTROL
SYSTEM

The organization structure, operating procedures, and administrative practices adopted by all levels of management to provide reasonable assurance that programs and administrative activities are effectively carried out in accordance with the objectives of the Federal Managers' Financial Integrity Act (FMFIA) and OMB Circular A-123.

INTERNAL CONTROL
TECHNIQUES

The management processes and documents necessary to accomplish an internal control objective.

REASONABLE ASSURANCE

A judgement by an agency head based upon all available information that the systems of internal control are operating as intended by the FMFIA.

RISK ASSESSMENT

A documented review by management of a component's susceptibility to waste, loss, unauthorized use, or misappropriation.

TESTING

Procedures to determine whether internal control systems are working in accordance with management internal control objectives.

Review of NRC's Implementation of the Federal Managers' Financial Integrity Act for 1992



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

December 22, 1992

MEMORANDUM FOR: David C. Williams
Inspector General

FROM: Hugh L. Thompson, Jr.
Deputy Executive Director for Nuclear
Materials Safety, Safeguards and
Operations Support

SUBJECT: DRAFT REPORT ON REVIEW OF NRC'S
IMPLEMENTATION OF THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT FOR 1992

This responds to the December 7, 1992, memorandum transmitting the subject audit report. With respect to your specific recommendations, I submit the following:

Recommendation 1

Develop a quality assurance program to ensure that FMFIA activities are planned and conducted continuously throughout the year.

Response

Agree. FMFIA activities are planned and conducted continuously throughout the year and this will be formalized by the Controller in the revision of Manual Chapter 0802 (See Recommendation 4). In the Spring, the Committee identifies 15 to 18 management control reviews to be conducted in that fiscal year and provides training to the persons designated to conduct the reviews. In 1992, training was provided on May 26 and the due date for the completion of the reviews was October 1.

The 1992 semiannual status reports on open management control corrective actions were obtained from the offices in January and August. To the extent possible, special projects are conducted in non-peak periods throughout the year. For example, the process for validation of corrective actions was developed during the summer of 1992. The reasonable assurance determinations are obtained from senior managers after October 1, since their determinations cover the fiscal year ending September 30.

APPENDIX III

Review of NRC's Implementation of the Federal Managers' Financial Integrity Act for 1992

David C. Williams

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In view of the OIG's finding in their FY 1992 annual audit that the offices did not have sufficient documentation of their 1992 reviews, the Committee will escalate the due date for completion of the management control reviews. This will allow time for the offices to perform any additional work needed to satisfy the intent of the management control reviews when the OIG or the Committee determines that insufficient work was performed. The Committee will determine the escalated due date after consultation with the OIG. Completion date: March 31, 1993.

Recommendation 2

Develop a quality assurance program to ensure that ICR reports are consistent in presentation and format.

Response

Agree. The specific guidance for preparation of reports that is currently provided to the offices by the Internal Control Committee (ICC) incorporates the reporting requirements in OMB's "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government." The reports submitted to the ICC in FY 1992 were generally consistent with the guidance provided by OMB, except many offices provided more information to the Committee than was requested. The ICC guidance, along with designated responsibility for assuring compliance with the guidance, will be formalized by the Controller in the revision of Manual Chapter 0801. (See Recommendation 4).

Recommendation 3

Develop a quality assurance program that will ensure that ICRs are documented with sufficient evidence that link the actual work performed during the ICR process with the report.

Response

Agree. Each year training is provided to the employees who are assigned to conduct that year's management control reviews. In addition to this one-day training, the ICC provides supplemental guidance on how to conduct and document the reviews. This supplemental guidance is based on OMB guidance for conducting and documenting management control reviews and includes formats and instructions developed by OMB for documenting the work that was performed during the reviews. The use of these instructions and formats should provide adequate evidence to support the event cycles, internal control objectives, internal control techniques, and testing, and also provide a basis to support the judgments and conclusions reached in the review.

David C. Williams

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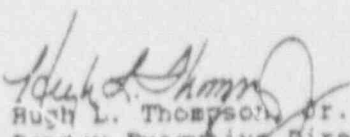
The ICC will review the workpapers supporting the 1992 management control reviews to determine whether the offices are using the instructions and formats provided and determine whether additional guidance needs to be developed for preparation of supporting documentation. The ICC guidance, along with designated responsibility for assuring compliance with the guidance, will be formalized by the Controller in the revision of Manual Chapter 0801 (See Recommendation 4). Completion date: July 1, 1993.

Recommendation 4

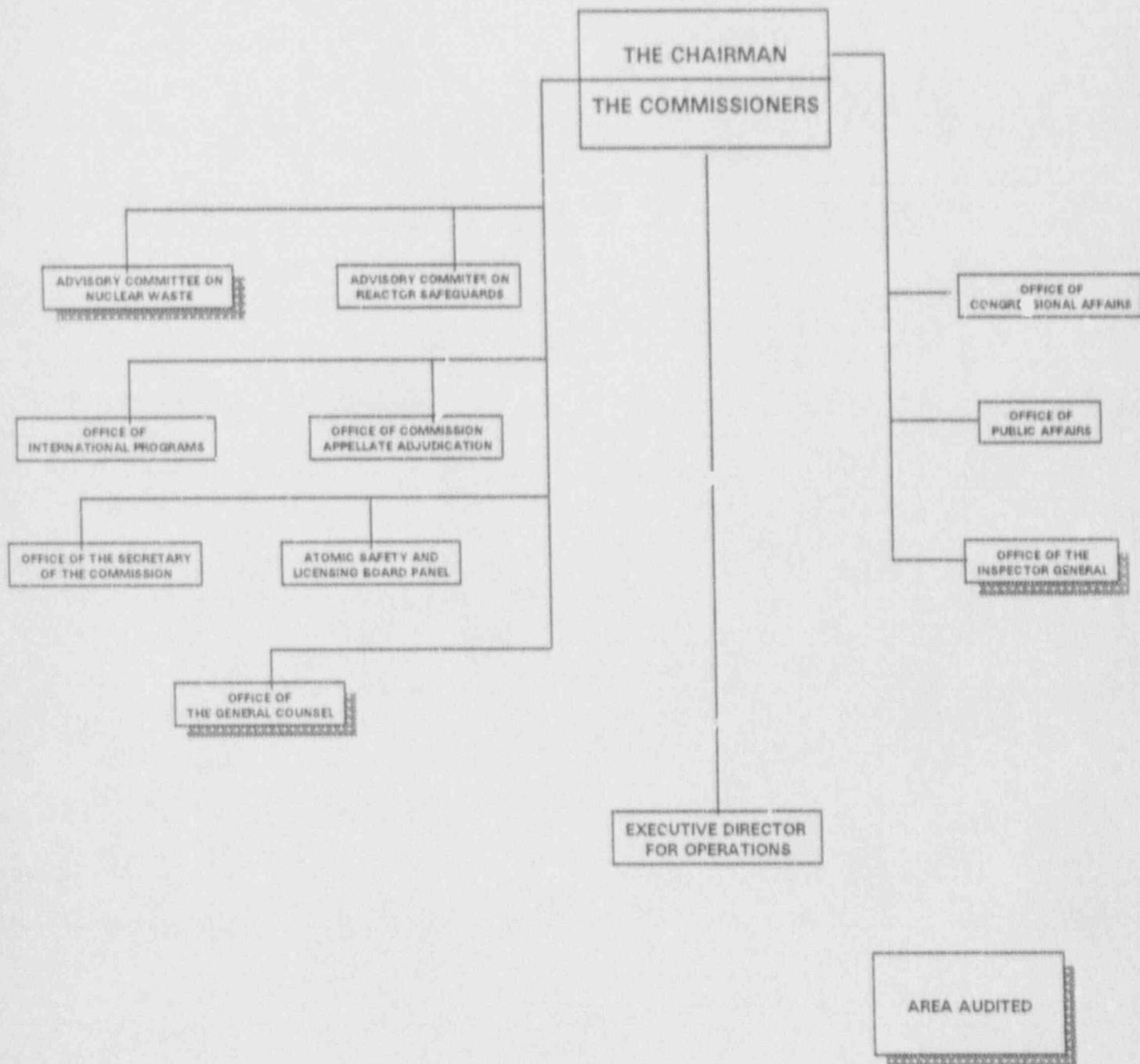
OC should include quality assurance program provisions in NRC Management Directive 4.4, "Internal Controls" (currently Manual Chapter 0801).

Response

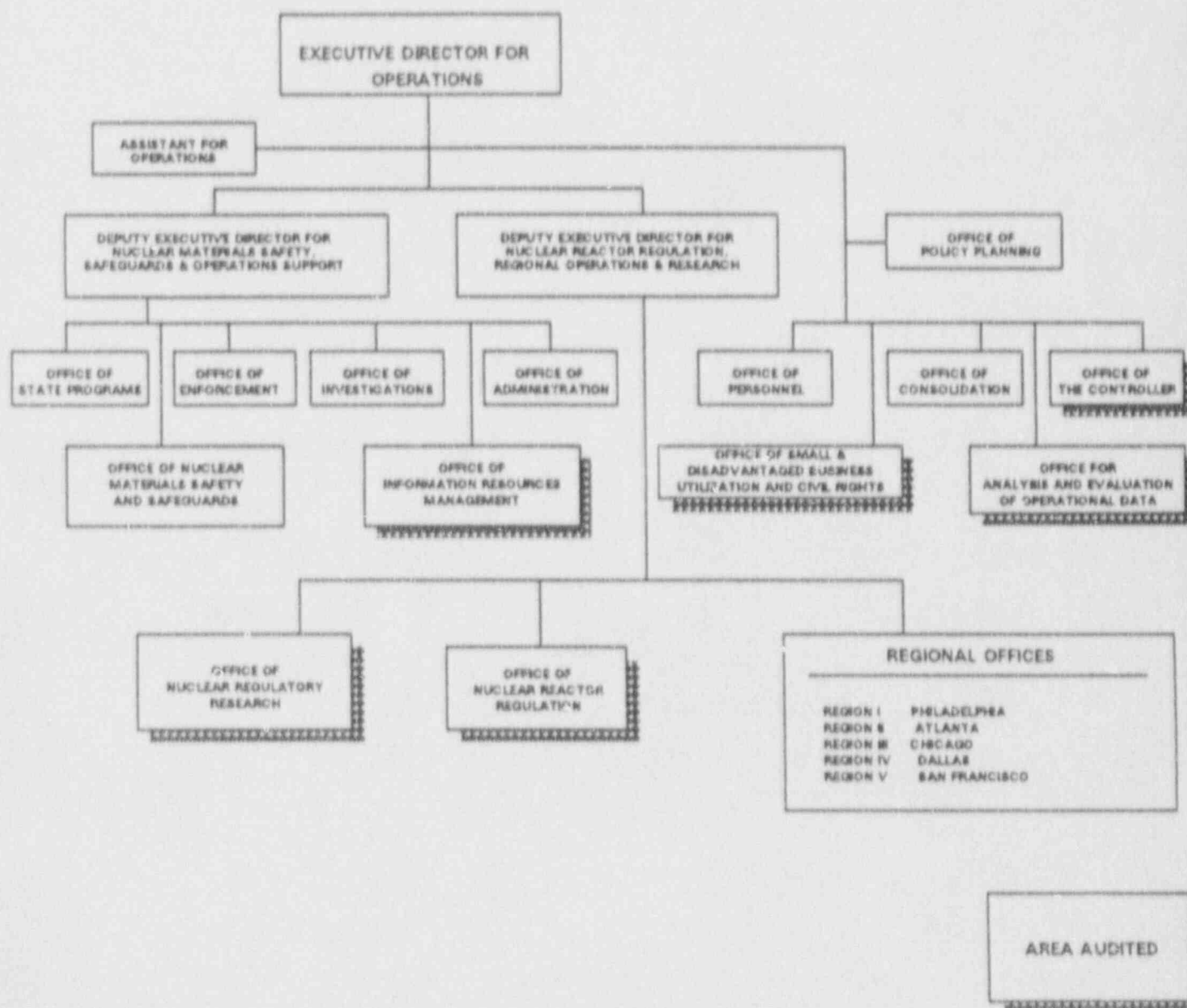
Agree. Quality assurance program provisions will be incorporated in the revision of Manual Chapter 0801 that include the annual FMFIA activities and the guidance for reporting and documenting management control reviews that currently is provided to the offices. Responsibility for assuring compliance with the guidance will be designated in the new management directive. Completion date: August 31, 1993.


Hugh L. Thompson, Jr.
Deputy Executive Director for Nuclear
Materials Safety, Safeguards and
Operations Support

U.S. NRC FUNCTIONAL ORGANIZATION CHART



U.S. NRC FUNCTIONAL ORGANIZATION CHART



MAJOR CONTRIBUTORS TO THIS REPORT

William L. Glenn, Jr.
Team Leader, Financial Management Audit Team

Gary S. Janosko
Senior Auditor

Edward Gillen
Auditor





HOTLINE NUMBER:
1-800-233-3497

THE OFFICE OF THE
INSPECTOR GENERAL

Attention: The Hotline Program
Mail Stop MNBB 6715
Washington, D.C. 20555