
**OFFICE OF
THE INSPECTOR GENERAL**

**U.S. NUCLEAR
REGULATORY COMMISSION**

**NRC'S LICENSE FEE DEVELOPMENT
PROCESS NEEDS IMPROVEMENT**

OIG/99A-01 December 14, 1999

AUDIT REPORT





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

December 14, 1999

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM TO: Jesse L. Funches
Chief Financial Officer

FROM: *Thomas J. Barchi*
Thomas J. Barchi
Assistant Inspector General for Audits

SUBJECT: AUDIT REPORT -- NRC'S LICENSE FEE DEVELOPMENT
PROCESS NEEDS IMPROVEMENT

Attached is the Office of the Inspector General's audit report titled, "NRC's License Fee Development Process Needs Improvement." This report reflects the results of our review.

On December 1, 1999, you responded to a draft of this report. Our report contained three recommendations, which including subparts, amount to eight specific recommendations for corrective action. Based on the response, we have closed only subpart (b) of recommendation three. The remaining seven specific recommendations will remain open until we determine that corrective actions have been implemented.

Please contact me on 415-5915 if we can assist you further in this matter.

Attachment: As stated

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REPORT SYNOPSIS

The U.S. Nuclear Regulatory Commission (NRC) is required to recover 100 percent of its budget authority, less the Nuclear Waste Fund and General Fund appropriations, by collecting fees from its licensees. To meet this requirement, NRC assesses two types of fees. First, NRC assesses user charges under the authority of the Independent Offices Appropriation Act of 1952 (IOAA). Second, under the authority of the Omnibus Budget Reconciliation Act of 1990 (OBRA-90), as amended, NRC assesses annual fees.

In the fiscal year (FY) 1998 audit of NRC's financial statements, the Office of the Inspector General (OIG) identified an IOAA non-compliance in the license fee development process. As a result, OIG initiated an in-depth review of NRC's license fee development methodology. The objectives of this review were to determine: (1) if the overall process complies with pertinent laws and regulations, and (2) if management controls over the fee development process are adequate.

Our review confirmed our previously reported non-compliance in the fee development process and we also identified a potential non-compliance with the intent of OBRA-90. We identified management control weaknesses in the methodologies used to develop fees. Specifically, these issues concern (1) the effects of using the percent change methodology over an extended period of time to recover annual fees, (2) a lack of criteria for achieving full cost in the hourly rate, and (3) management control weaknesses, including lack of adequate criteria, lack of aggressive quality control, and incomplete public information during the Rulemaking comment period.

NRC established the percent change method for annual fees to provide fee stability from year to year. However, its continued use without examining and adjusting, as needed, the cost relationships due to budget shifts and changes in the numbers of licensees has not, in our opinion, fully met the intent of OBRA-90 and has not eliminated fee instability but only postponed it. By FY 1998, NRC's fee structure deviated further away from associating fees with the cost of services provided. As a result, NRC did not, in OIG's opinion, fully meet OBRA-90's mandate that "charges shall have a reasonable relationship to the cost of providing regulatory services..." However for FY 1999, NRC rebaselined its annual fees, where charges have a reasonable relationship to their costs, and therefore fully met the legislative mandate.

NRC has not developed specific definitions for generic costs and as a result, treats such costs inconsistently in fee calculations. Further, the Agency applies budgeted direct costs as if they were billable direct costs. However, we believe they are not always the same and should not be used interchangeably. These deficiencies have led to inconsistent treatment of costs and non-compliance with IOAA and Office of Management and Budget Circular A-25 provisions with respect to recovering full cost.

Finally, inadequate management oversight has resulted in weak management controls over this vital Agency process. The lack of aggressive and comprehensive

management controls has led to inconsistent processes and procedures, inadequate quality control, and ultimately resulted in fee calculation errors. While no process can be expected to be completely error free, effective management controls would have mitigated many of the issues disclosed.

Left unaddressed, these issues have the potential to undermine the Agency's credibility with the public as it relates to NRC's ability to prepare and calculate fees that fully reflect the intent of appropriate legislation. Strengthening the management of the whole fee setting process by instituting more aggressive and comprehensive controls and oversight would help ensure that the fees developed fully meet the intent of laws and regulations.

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INTRODUCTION

In the fiscal year (FY) 1998 audit of the U.S. Nuclear Regulatory Commission's (NRC) financial statements, the Office of the Inspector General (OIG) identified a regulatory non-compliance in the license fee development process. As a result, OIG initiated an in-depth review of NRC's license fee development methodology. The objectives of this review were to determine: (1) if the overall fee development process complies with pertinent laws and regulations, and (2) if the management controls over this important Agency function are adequate. Appendix I contains a detailed description of our objectives, scope, and methodology.

BACKGROUND

The Omnibus Budget Reconciliation Act of 1990 (OBRA-90), as amended, requires that NRC recover approximately 100 percent of its budget authority, less the Nuclear Waste Fund and General Fund appropriations, by collecting fees from its applicants and licensees. To meet this requirement, NRC assesses two types of fees: user charges and annual fees.

First, under the authority of the Independent Offices Appropriation Act of 1952 (IOAA), NRC assesses user charges to recover the cost of providing individually identifiable services to specific applicants and licensees. NRC implements user charges for inspection services and licensing actions for the reactor and materials programs under the Code of Federal Regulations, Title 10 Part 170 (10 CFR 170⁽¹⁾). Licensing actions include reviews of applications for new licenses and amendments to, or renewal of, existing licenses. NRC develops two professional staff-hour rates to charge licensees for its services, one for reactor licensees and one for materials licensees. (Section A of Appendix II contains a description of the hourly rate calculations.) In FY 1998, the hourly rate for the reactor program was \$124 and the rate for the materials program was \$121. Currently, Part 170 fees recover approximately 20 to 25 percent of the total budgeted amount to be recovered through fees.

The second type of fee is an annual fee, implemented through 10 CFR Part 171.⁽²⁾ NRC assesses this fee to recover generic and other regulatory costs not recovered through Part 170 fees. The Agency has used one of two methods to calculate annual fees: (1) rebaselining, or (2) percent change. (Sections B and C of Appendix II contain a description for each method.)

¹ Part 170 - *Fees for Facilities, Materials, Import and Export Licenses, and Other Regulatory Services Under the Atomic Energy Act of 1954, as Amended.*

² Part 171 - *Annual Fees for Reactor Licenses and Fuel Cycle Licenses and Materials Licenses, Including Holders of Certificates of Compliance, Registrations, and Quality Assurance Program Approvals and Government Agencies Licensed by NRC.*

The License Fee and Accounts Receivable Branch (LFARB), within NRC's Office of the Chief Financial Officer (OCFO), is responsible for administering NRC fee programs. LFARB is also responsible for formulating the policies and procedures for license fee activities.

RESULTS OF AUDIT

Since FY 1991, NRC has annually collected approximately 100 percent of its budget as required by OBRA-90. However, our review identified potential and actual non-compliances with laws and regulations, and management control weaknesses in the methodologies NRC used to develop fees. Specifically, these issues concern (1) the use of the percent change methodology over an extended period of time, (2) a lack of criteria for achieving full cost in the hourly rate, and (3) management control weaknesses, including inconsistencies and poor quality control.

EXTENDED USE OF THE PERCENT CHANGE METHODOLOGY AFFECTS NRC'S ABILITY TO MEET THE INTENT OF OBRA - 90

OBRA-90 requires that NRC establish annual fees by rule, using a schedule of charges distributed "fairly and equitably" among the licensees. The legislation requires that "to the maximum extent practicable, the charges shall have a reasonable relationship to the cost of providing regulatory services and may be based on the allocation of the Commission's resources among licensees or classes of licensees." We found that by using the percent change method over an extended period of time, the resulting relationship between fees and the costs of providing services does not, in OIG's opinion, reflect the changes in the budget and in the number of licensees. As a result by FY 1998, this relationship deteriorated, and the annual fees did not fully reflect the intent of OBRA-90.

From FYs 1991 through 1995, the Agency used the rebaselining method to calculate annual fees. Since FY 1996, the Agency has used either the rebaselining method or the percent change method. The rebaselining method attempts to allocate budgeted resources to classes of licensees (e.g., Power Reactors). This method is consistent with the requirements in OBRA-90, because it maintains a reasonable relationship to the cost of providing services. The Agency rebaselined recently for the FY 1999 annual fees.

In the FY 1995 fee rule, NRC announced its intention to adjust the annual fees for FYs 1996 through 1999 using the percent change method. This alternative process was developed as an effort to stabilize fees. Since Congress enacted OBRA in 1990, the number of NRC licensees has significantly decreased,⁽³⁾ causing those

³ Prior to OBRA-90, only operating power reactors had an annual fee assessed. Because licenses were not being used or for other reasons, many licensees terminated their licenses.

remaining to bear the budgeted costs⁽⁴⁾ for their class of license. This, in combination with budget shifts each year, caused some annual fees to increase substantially and unexpectedly. To bring some predictability to the annual fees, NRC introduced the percent change method. In this way, licensees would be able to plan ahead, because their annual fees would change in synchrony with changes in NRC's total budget. In theory, for example, if NRC's budget decreased by 5 percent, a licensee could expect its annual fee to similarly decrease by approximately 5 percent.

The FY 1995 fee rule stated that the percent change method would be applied to all annual fees for the next four years "unless there is a substantial change in the total NRC budget or the magnitude of the budget allocated to a specific class of licensees, in which case the annual fee base would be reestablished. The decision on whether to establish a new baseline will be made each year during budget formulation." According to Agency officials, this was the criteria to be used to determine whether to rebaseline or continue to use percent change. Subsequently, NRC used the percent change method to calculate annual fees for fiscal years 1996, 1997 and 1998.

Although the Agency provided criteria for deciding which method to use in calculating the annual fees, NRC did not define the terms "substantial change" or "magnitude of the budget allocated." In addition, OCFO staff told us that they did not know if any analyses were performed during FYs 1996 and 1997 to determine whether to use the percent change or rebaselining method. For those years, NRC continued to establish annual fees using the percent change method. In FY 1998, NRC analyzed projected annual fees using both methodologies. However, the Agency postponed rebaselining and continued to use the percent change method.

The FY 1999 fee rule demonstrated the effect of rebaselining after using the percent change method for three years. With rebaselining, the FY 1999 annual fees for each category increased or decreased from FY 1998 at various rates. For example, the Operating Power Reactor annual fee decreased by over 13 percent, while the annual fees for Uranium Recovery Class II facilities increased by more than 200 percent.⁽⁵⁾ During the three-year period of using the percent change method, budgeted costs changed, losing the relationship between the cost of services and the fees assessed. Thus, the anticipated stability and predictability of the percent change method was ultimately negated.

Because the percent change method is not based on the cost relationship of providing services, fees may become inequitable over time. As a result, some licensees actually subsidize the costs of other licensees until the next rebaseline method is applied. This situation is compounded when the number of licensees in a class decreases during the period NRC uses the percent change method.

4 Decreases in the number of licensees does not always result in a corresponding decrease in the budget, because the cost of NRC's programs may not be reduced.

5 See Appendix III for a summary of the percent change in annual fees for each fee category from FY 1998 to FY 1999.

LACK OF FULL COST RECOVERY CRITERIA RESULTS IN NON - COMPLIANCE WITH IOAA

IOAA authorizes agencies to charge fees for services and things of value. One objective of the Act is to efficiently allocate the Nation's resources by establishing charges for special benefits provided that are at least as great as the costs to the Government for providing the benefit. IOAA requires that each charge be fair, based on the costs to the Government, and based on other relevant facts. NRC uses a budget-based approach to compute its hourly rates. We found that the inclusion and exclusion of certain costs is inconsistent and is not in compliance with the requirements of IOAA guidance to recover full cost. In addition, the Agency does not use all of its best available records when developing the hourly rates. Part A of Appendix II contains a detailed description of the Part 170 hourly rate calculation.

NRC Treats Similar Costs Inconsistently

Office of Management and Budget Circular A-25 (OMB Circular A-25), revised, *User Charges*, provides the guidance to implement IOAA. The guidance states that user fees will be sufficient to recover the full cost to the Federal Government of providing the service, resource, or good. Furthermore, OMB Circular A-25 states that " 'Full cost,' includes all direct and indirect costs to any part of the Federal Government of providing a good, resource, or service." (Emphasis added.)

We identified two inconsistent treatments of costs in developing the hourly rates. Specifically, NRC treats generic costs inconsistently, and inconsistently uses budget data to prepare the hourly rates. As a result, the hourly rates are not developed in full compliance with the full cost requirements of OMB Circular A-25.

Inconsistent Treatment of Generic Costs

By excluding some costs assumed to be generic in the hourly rate calculation, while including other costs that are specified as generic, the Agency treats these costs inconsistently. For example, by excluding certain contract support costs from the hourly rate calculation, the Agency excludes assumed generic costs. This is the same finding reported in the FY 1998 financial statement audit.⁽⁶⁾ In preparing the hourly rates, the Agency made a blanket exclusion of all direct contract support dollars from the Program Cost Centers⁽⁷⁾. In FY 1998, this was approximately \$70 million of contract support, less costs directly billable to licensees and

⁶ *Independent Auditors' Report and Principal Statements for the Year Ended September 30, 1998* OIG/98A-09, dated, March 1, 1999. This issue is repeated here to provide additional information and a more complete analysis of the finding.

⁷ The term "Program Cost Centers" has been used in this report to designate the group of cost centers that are not considered Management and Support. In FY 1998, these cost centers were components of NRC's two major Strategic Arenas, "Regulatory Programs" and "Regulatory Effectiveness." Appendix II, page 2 contains a list of the FY 1998 Program Cost Centers and Management and Support Cost Centers.

applicants. OCFO officials stated that they exclude these costs because they are considered generic costs. They explained that the OBRA-90 Conference Agreement, the authoritative guidance for implementing OBRA-90, requires that such costs be excluded. However, the Agency did not analyze these contract support costs to determine if they are truly generic.

IOAA does not address generic costs. The source for the term "generic" is the OBRA-90 Conference Agreement. A section of the Agreement refers to Part 170 user fees, and mentions excluding generic costs from the Part 170 collections. Although, the Conference Agreement does not explicitly define generic⁽⁸⁾ costs, it provides specific examples of such costs.

We found that the Agency includes costs in the hourly rates that were specified as generic. Most of the generic costs identified in the Conference Agreement, such as the Offices of the Commissioners, the General Counsel, and the Inspector General, were included in the hourly rate calculation. Yet, the Conference Agreement states that these generic costs were expected to be recovered through the annual fees. Thus, identified generic costs that were to be excluded from user fee recovery are actually included. As a result, NRC inconsistently includes some "generic" costs and excludes others.

Inconsistent Application of Budget Data

We also found that the Agency's use of budget data to develop hourly rates is applied inconsistently. The Agency's approach to preparing the hourly rates uses definitions and data originally intended for budget preparation. Budgeted costs are not always traceable to billable activities. Instead, they are estimates prepared to obtain Congressional funding. We believe that resources classified as direct costs for budgetary purposes are not equivalent to the direct costs that should be used for billing purposes. In one situation, for example, rent for NRC's Technical Training Center was budgeted as a direct cost and thus was treated as a "billable" direct cost. In contrast, rent for NRC's headquarters, also budgeted as a direct cost, was not treated as a billable direct cost.

Another inconsistency in using budget data is caused by including cost centers that do not have billable activities. For example, in FY 1998 most of the direct FTEs⁽⁹⁾ for the Program Cost Centers were included in the hourly rate, because this was how these costs were classified in NRC's budget. Yet, some cost centers included in the Program Cost Centers, such as *Enforcement*, usually do not provide billable services. Therefore, cost centers with and without billable activities were included in the calculation. We believe that including resources from cost centers without billable activities affects the hourly rate, making it unreliable.

⁸ The Conference Agreement describes the cost of generic activities as those "that benefit licensees generally."

⁹ FTE is the abbreviation for Full-time Equivalency (2,080 labor hours per year).

Over-reliance on budget data without considering the nature of costs also caused a significant error in the FY 1998 hourly rate calculation. In the budget, a new cost center, *Region Management and Support Services*, was classified as a Program Cost Center. Because of this budget classification, 134 direct FTEs from Region Management and Support Services were included in the rate calculation as billable direct FTEs. OCFO officials stated that during the preparation of the hourly rates, staff did not question why a cost center named "Region Management and Support Services" would be considered a Program Cost Center. The Agency did not recognize this error until it prepared the FY 1999 hourly rates. The proposed FY 1999 fee rule explained this error as the major reason for the \$17 and \$19 per hour increases in the professional hourly rates. (See Appendix IV detailing these inconsistencies in the hourly rate calculations.)

NRC Does Not Use All of the Best Available Data to Develop Rates

OMB Circular A-25 states that "Full cost shall be determined or estimated from the best available records of the Agency, and new cost accounting systems need not be established solely for this purpose." Because NRC does not use actual data to validate its hourly rates, the rates developed may be unreliable estimates.

Although the Agency uses budget data to prepare the rates, actual data from previous year's billings is available and can provide feedback on the reliability of the Part 170 full cost estimates. We found that NRC does not assess the reasonableness of the hourly rate calculation by using actual billing data collected in the Regulatory Information Tracking System⁽¹⁰⁾ (RITS). For example, based on estimates of FY 1998 billing data, we estimated that the actual billable FTEs for reactor inspections and licensing actions were significantly fewer than the FTE estimates used in the reactor hourly rate calculation. Although there are many factors that may account for the difference between these two amounts, this difference can also indicate that the data used to prepare the hourly rates may not be providing valid estimates. For example, as stated in the previous section, NRC's hourly rate calculations also include FTEs from cost centers that do not have billable activities.

It should also be noted that Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards*, includes using actual cost information in preparing user fees, such as the Part 170 hourly rates. Although the standard was in effect beginning FY 1998, the Agency has not implemented it.

SFFAS No. 4 supports compliance with OMB Circular A-25 and emphasizes that "cost information is an important basis in setting fees and reimbursements." One purpose of using cost information is to determine reimbursements and to set fees and prices.

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RITS is used to track labor hours in support of inspection and licensing actions. This and other systems are used to provide data for the Part 170 fees which are billed.

MANAGEMENT CONTROLS NEED STRENGTHENING

Management controls, in the broadest sense, include the organization, methods, and procedures adopted by management to ensure that its goals are met. We found that weak management controls resulted in fee calculation errors, inconsistent processes, and an absence of adequate information. We believe these issues can undermine the credibility and integrity of the process.

According to OMB Circular A-123 revised, *Management Accountability and Control*, "management controls are the organization, policies, and procedures used by agencies to reasonably ensure that: (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported, and used for decision making."

We identified several management control weaknesses that not only affect the Agency's ability to comply with OBRA-90 and IOAA, but can also affect licensee perceptions of the Agency's fee development process. These weaknesses include: (1) lack of formal procedures, (2) lack of quality control over the fee calculations, and (3) lack of adequate information provided for the Rulemaking public comment period.

NRC Has No Formal Procedures for Developing License Fees

We found that there are no formally documented procedures for calculating fees and preparing the fee rule. A few informal procedures, accumulated over the years in a piecemeal fashion, do exist. However, most of the methodologies for fee calculation were passed verbally from individual to individual.

In FY 1998, there was a change in staffing for the fee rule development process and all new staff were assigned to develop the fee rule. The staff members told us that it took several months to transfer, orally, the detailed process for calculating the professional hourly rates and the annual fees. A new staffer has attempted to develop some written methodologies, but at the time we completed our work, only the rebaselining method had been completed. This written methodology was used in FY 1998 as a guide to prepare the analysis for whether to rebaseline or use percent change. Although this written procedure is no longer current, it does provide a framework on which NRC could base other procedures. Currently, there are no written procedures for preparing the hourly rates or for preparing the annual fees using the percent change method.

Without formal procedures, the transition from FYs 1997 to 1998 was difficult and challenging for the new staff, and the entire process was an intensive learning experience for all the parties. There are only a few individuals familiar with the process of calculating fees and primarily two individuals prepare the entire fee rule and rate calculations. We found that the FY 1998 rate calculations contained several errors, some of which were not identified until NRC developed the FY 1999 fee rule. Formally documented procedures would not only have made the transition smoother, but also would have provided guidance for quality control reviews which could have identified the errors.

License Fee Calculations Lack Adequate Quality Control

We believe a significant management control weakness exists due to the lack of a quality control process or procedures for the fee calculations. Since the FY 1998 change in staffing, NRC has not performed an objective review of the calculations to detect errors and ensure they were prepared correctly.

We found that inadequate review resulted in errors not being identified and inconsistencies in the two fee calculations (hourly rate and percent change method) prepared for FY 1998. In the hourly rate calculation, the Agency identified an error related to the inclusion of *Region Management and Support Services*. This error, discussed previously on page 6, was not identified until one year later, when the Agency prepared its FY 1999 fee rule. The effect of the error was a substantial increase in the hourly rates, as described in the FY 1999 proposed fee rule.

Other inaccuracies in the hourly rate and percent change calculations also existed. For example, we identified an error in the FY 1998 percent change method, which caused the percent change to be a higher factor than it should have been. The percent change method relies on a fairly simple set of calculations compared to the rebaseline and hourly rate calculations. During our review, we noted that a column of three numbers was added incorrectly. This resulted in a higher percent factor than if that column were added correctly. As a result, for those licensees with relatively high annual fees, the FY 1998 annual fees were greater than they would have been. For example, we recalculated the percent change after correcting the error and found that each Power Reactor annual fee was approximately \$11,000 more per license because of this error. While the amount of the overcharge does not seem significant in relation to the total reactor annual fee (about \$3 million), we believe it reflects negatively on NRC's integrity and process. Furthermore, a basic quality control process would have disclosed this error.

With the exception of the *Region Management and Support Services* misclassification, OCFO management was not aware of these errors until we brought them to their attention. An OCFO official confirmed that there was no quality control process and that there was no detailed review of the fee calculations prepared for the fee rule.

Information Provided During the Public Comment Period Was Inadequate

During the public comment period, NRC makes its workpapers supporting the fee rule available for examination in NRC's Public Document Room. This information is intended to facilitate public understanding when submitting comments to the rule. The Administrative Procedure Act requires that this information be made available. Because a critical document was withheld from the FY 1998 fee rule workpapers, we believe it would have been difficult, if not impossible, for the public to understand NRC's calculations.

We found that NRC omitted a key document linking the budget to the fee calculations from the workpapers which were made available to the public for FY 1998. This document was the spreadsheet used to allocate the budgeted costs to the classes of licensees. This is the first step in the hourly rate calculation, but also provides the basis for rebaselining annual fees. Although it was only one document, it was the only document that would have shown the relationships between the restructured budget and the fee rates. NRC omitted the document because the Agency used it as part of the deliberative process for making the decision on whether to rebase and considered it to be pre-decisional⁽¹¹⁾ information. During our analysis of the hourly rates, we were not able to determine how the fees were developed without this document. We believe the public would have had similar difficulties in reviewing the calculations.

In a 1974 court case concerning the exclusion of certain data from the public record, the District of Columbia Circuit Court stated "[i]t is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or data that, [in] critical degree is known only to the agency." Using a Freedom of Information Act exemption to withhold pre-decisional information is provided under the deliberative process privilege. However, when a withheld document, such as the spreadsheet, is crucial to the public's understanding of NRC's process and determination, we believe the Agency has a duty to note in the workpapers that they did not provide such a document. Public commenters could then contact the Agency to determine other avenues to obtaining a full understanding of NRC's decisions. We believe that omitting key documents or additional information without placing a marker in the workpapers hinders the public's ability to make informed decisions about NRC's fee development policies.

CONCLUSION

The lack of sound criteria to manage and monitor the development and implementation of license fee rules and rates has led to potential non-compliance with the intent of OBRA, non-compliance with IOAA, errors in fee rate calculations, and inadequate information during the public comment period.

¹¹ Pre-decisional information is protected by the Freedom of Information Act, Exemption 5, under the deliberative process privilege, and therefore may be withheld from release to the public.

Using the percent change method over time, without regular analysis, does not resolve the instability of annual fees. It merely delays it. Prolonged use may conceal the shifts in budget classifications, as well as decreases in the number of licensees. Because the relationships between fees and the cost of providing services can deteriorate over a period of time, this method will affect compliance with OBRA-90.

NRC's criteria for recovering full cost under IOAA and OMB Circular A-25 is generally inadequate. NRC considers and treats generic costs inconsistently, treats budget costs as direct billable costs inconsistently, and does not consider actual cost data when setting hourly rates. As a result, NRC does not recover full cost as required by IOAA and OMB Circular A-25.

Finally, inadequate management oversight has led to weak management controls over this vital Agency process. Weak management controls have led to inconsistent processes and procedures, inadequate quality control, and resulted in fee calculation errors. While no process can be expected to be completely error free, strong management controls would have mitigated the matters disclosed.

We believe these issues erode the credibility of the Agency's ability to prepare and calculate fees that fully reflect the intent of appropriate legislation. Strengthening the management of this process by instituting appropriate criteria, controls, and oversight would ensure that the fees are developed in compliance with pertinent laws and regulations and reduce potential litigation risks.

RECOMMENDATIONS

NRC must revisit its policies, procedures, and processes for developing license fees and their associated calculations. To fully meet the intent of OBRA-90, address the IOAA noncompliance issue, and to establish effective management controls over the license fee development process, we recommend that the Chief Financial Officer (CFO) reevaluate each step or phase of the license fee development process to include:

1. Using the percent change method for fee calculation only after conducting an annual pro-forma rebaselining analysis. The CFO should develop specific thresholds to determine substantial changes at the fee classification level and use these thresholds in making a decision on which method to use for calculating annual fees.
2. Reevaluating the hourly rate calculation methodology so that the rates NRC develops include the full cost concept as embodied in OMB Circular A-25 and SFFAS No. 4. The reassessment should (a) define and identify generic costs and explain how to treat such costs, (b) establish a policy that clearly defines direct resources and how such resources should be treated in fee calculations, and (c) use actual billing and cost data to develop and refine future rate calculations.

3. Developing formal criteria and procedures that (a) implement recommendations one and two, (b) describe the fee development process and steps, (c) ensure consistency of fee calculations, and (d) provide quality control procedures for fee calculation.

OIG COMMENTS ON AGENCY RESPONSE

On December 1, 1999, the Chief Financial Officer (CFO) and the General Counsel (GC), responded to our draft report. Their response is included, in its entirety, in Appendix VI. In addition to addressing each of our recommendations, the CFO and GC provided a detailed legal analysis of our findings. With respect to this analysis, we believe that the legal arguments set forth by the CFO and GC tend to obfuscate the basic programmatic and management control issues we are surfacing. Further, we believe that the responses to our recommendations do not fully address the programmatic and control weaknesses we identified. Our recommendations are intended to bring discipline and structure to a process with weak management controls. With the exception of subpart (b) to Recommendation 3, all recommendations and their subparts will remain open. Each of the recommendations, the CFO/GC comments, and our analysis of those comments follows:

Recommendation 1:

Using the percent change method for fee calculation only after conducting an annual pro-forma rebaselining analysis. The CFO should develop specific thresholds to determine substantial changes at the fee classification level and use these thresholds in making a decision on which method to use for calculating annual fees.

CFO/GC response: Agree in part.

Based on the on-going efforts at the time of the proposed FY 1999 fee rule development and comments received from the Commission, the OCFO plans, as part of each year's fee rule development and Commission paper, to conduct an analysis based on percent change and rebaselining. As you are aware, this was done for both the FY 1998 and FY 1999 fee rules to assist the Commission in establishing the fee policy for those years. Those preliminary numbers will be provided with the CFO's recommendation as to which method to use for each fiscal year and will take into consideration all other policy issues which may affect the fee rule. Whether to use the percent change method or whether to rebase is a policy judgement to be made only after evaluation and consideration of the many factors involved. While we could consider establishing numerical thresholds for the various fee classifications, we do not believe numbers alone should be the determining factor as to when to rebase. We believe establishment of mechanical numerical thresholds would eliminate the Commission judgement

needed to develop fair fee schedules that take into account all pertinent considerations. Therefore, the OCFO does not plan to recommend to the Commission that the NRC establish thresholds which would form the bases of when to rebaseline.

OIG Analysis:

Although OCFO agrees "in part," nevertheless, they will not develop rebaselining thresholds. Neither the direct response to the recommendation nor the detailed legal arguments provided any data analysis to demonstrate that NRC fees, in fact, bear a reasonable relationship to the costs. Our analysis of OCFO's data clearly demonstrated that by FY 1998, the relationship between fees and costs had deteriorated. Because our report does not recommend specific numeric thresholds, OCFO could develop a range as a threshold guide for when rebaselining should be required. We do not accept NRC's criteria that "substantial change in the NRC's budget or magnitude of the budget allocated to a specific class of licensee..." is adequate to exert effective management over this vital agency process. Therefore, we continue to believe that developing and using thresholds to determine substantial changes at the fee classification level would support any Commission decisions to rebaseline and ensure the methodology used remains within the requirements of the law.

Recommendation 2:

Reevaluating the hourly rate calculation methodology so that the rates NRC develops include the full cost concept as embodied in OMB Circular A-25 and SFFAS No. 4. The reassessment should (a) define and identify generic costs and explain how to treat such costs, (b) establish a policy that clearly defines direct resources and how such resources should be treated in fee calculations, and (c) use actual billing and cost data to develop and refine future rate calculations.

CFO/GC response: Agree in part.

We agree with the OIG's recommendation that we examine the existing approach for developing fees to determine if the approach can be improved in a cost-effective manner.

As indicated in the CFO's February 25, 1999 response to Recommendation 7 of the Draft Audit Report - Audit of the NRC's Fiscal Year 1998 Financial Statements, OCFO formed a multi-office team to study the generic costs to determine whether the costs currently identified as "generic" continue to meet the definition contained in the Conference Report to the Omnibus Budget Reconciliation Act. The OCFO expects to issue a report on the study in early December 1999. After you have reviewed the report, if you still have concerns that we are not complying with the requirements of IOAA, it is important that we meet and discuss this issue further. Therefore, since we continue to dispute your findings with regard to the calculation

of the hourly rate, OCFO will not be implementing your recommendations with regard to how the hourly rate calculations are determined at this time, nor do we plan to modify the methodology employed.

In the meantime, OCFO has entered into a contract with an outside professional accounting firm for an analysis of the current fee model for development of alternatives for determining whether there are cost-effective methods to improve the allocation of the budget for fee purposes. Until this effort is completed, we do not expect to use actual billings and cost data to develop and refine future rate calculations. Definitions, identification and treatment of generic costs, and establishment of a policy that more clearly defines resources and how they should be treated in the fee calculations, including any changes resulting from the analysis, will be included in the documentation of the fee development process described in our response to Recommendation 3 below.

OIG Analysis:

The response states that OCFO agrees "in part" with our recommendation. However, our recommendation does not address examining "...the existing approach for developing fees to determine if the approach can be improved in a cost-effective manner." Rather, our point is that NRC's fee development process does not embody the full cost recovery principles espoused by IOAA and OMB Circular A-25.

For subpart (a), OCFO expects to issue a report addressing the generic cost issue in early December. Although OCFO indicates that their report will "determine whether the costs currently identified as *generic* continue to meet the definition contained in the Conference Report," there is no such definition in the Conference Report. Therefore, subpart (a) will remain open until we receive OCFO's report and evaluate its effect on our recommendation.

Although the response to subparts (b) and (c) states that "OCFO will not be implementing your recommendation with regard to how the hourly rate calculations are determined at this time, nor do we plan to modify the methodology employed," it also states OCFO has engaged a contractor to evaluate the current fee model. These statements contrast with an earlier statement made on page 9 of the comments. That statement asserts that "...we find nothing in SFFAS 4 that would require the agency to use actual cost accounting data to prepare the hourly rates." It is not clear how the contractor effort will address our specific concerns about full cost recovery under IOAA for NRC Part 170 fees. As a result, subparts (b) and (c) of this recommendation will remain open until we determine that NRC has taken effective corrective actions.

Recommendation 3:

Developing formal criteria and procedures that (a) implement recommendations one and two, (b) describe the fee development process and steps, (c) ensure consistency of fee calculations, and (d) provide quality control procedures for fee calculation.

CFO/GC response: Agree in part.

For subpart (a), OCFO will develop any necessary criteria and procedures for those portions of Recommendations 1 and 2 with which we agree. For subpart (b), OCFO has developed a Request for Proposal to have a contractor document the fee development process. We estimate it will be completed by September 30, 2000. For subpart (c), we believe there is consistency in the current fee calculations and that future fee rules will have consistent fee treatment. As for subpart (d), OCFO already provides quality assurance reviews for fee calculations commensurate with available staff resources and the short time frame for fee rule development. However, as with all our financial activities, we will strive to improve the quality assurance and quality control of the fee rule development process. Our QA process will be included in the documentation of the fee development process previously discussed.

OIG Analysis:

OCFO agrees "in part." For part (a) the response says that "OCFO will develop any necessary criteria and procedures for those portions of Recommendations 1 and 2 with which we agree." While OCFO did agree to annually analyze fees using the percent change and rebaselining methods, OCFO did not agree to establish thresholds and, therefore, will not establish relevant criteria. Further, OCFO action to ensure full cost recovery under IOAA and OMB Circular A-25 remains unclear. As a result, subpart (a) will remain open until such time as we believe that corrective action is taken.

For subpart (b), OCFO plans to have a contractor document the fee development process. This process must include documenting the policy and procedures for providing information to the public. As stated in the report, the public information provided for the FY 1998 fee rule was inadequate; NRC should ensure that the public has adequate information upon which to base informed decisions. Should the NRC decide to exclude such information for legitimate reasons, we believe the Agency has a duty to inform the public that they did not provide the information. This would allow the public to determine other avenues of obtaining an understanding of NRC's decisions. Despite the extensive legal analysis provided, we believe that the commitment "...to assure that there is sufficient information made available to the public" satisfies the intent of our recommendation.

For subpart (c), OCFO disagrees with our recommendation because they believe there is already consistency in fee calculations. As explained in our report, we found several inconsistencies in the calculations for Part 170 fees. OIG and OCFO

staff have discussed this issue several times without resolution. We believe OCFO should seek an outside source to verify the concept of full cost recovery as it relates to IOAA and Part 170 fees. Subpart (c) of this recommendation will remain open until corrective action is taken.

For subpart (d), the response states that "OCFO already provides quality assurance reviews for fee calculations commensurate with available staff resources and the short time frame for fee rule development." As stated in the report, some of the errors were obvious and we found them simply by looking at the data provided. No intricate calculations or computations were required. Additionally, an OCFO official told us that license fee calculations were not reviewed prior to placing them in the public document room with the fee rule package. The quality assurance process for license fee calculations is clearly not adequate. Therefore, subpart (d) of this recommendation will remain open until NRC takes corrective action.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to determine: (1) if the fee development process complies with pertinent laws and regulations, and (2) if there are adequate management controls over the fee development process. We limited the scope of the audit to the fee development process, including the calculations used to prepare the rates and fees under the Code of Federal Regulations, Title 10 Parts 170 and 171 for fiscal years (FYs) 1995 through 1999.

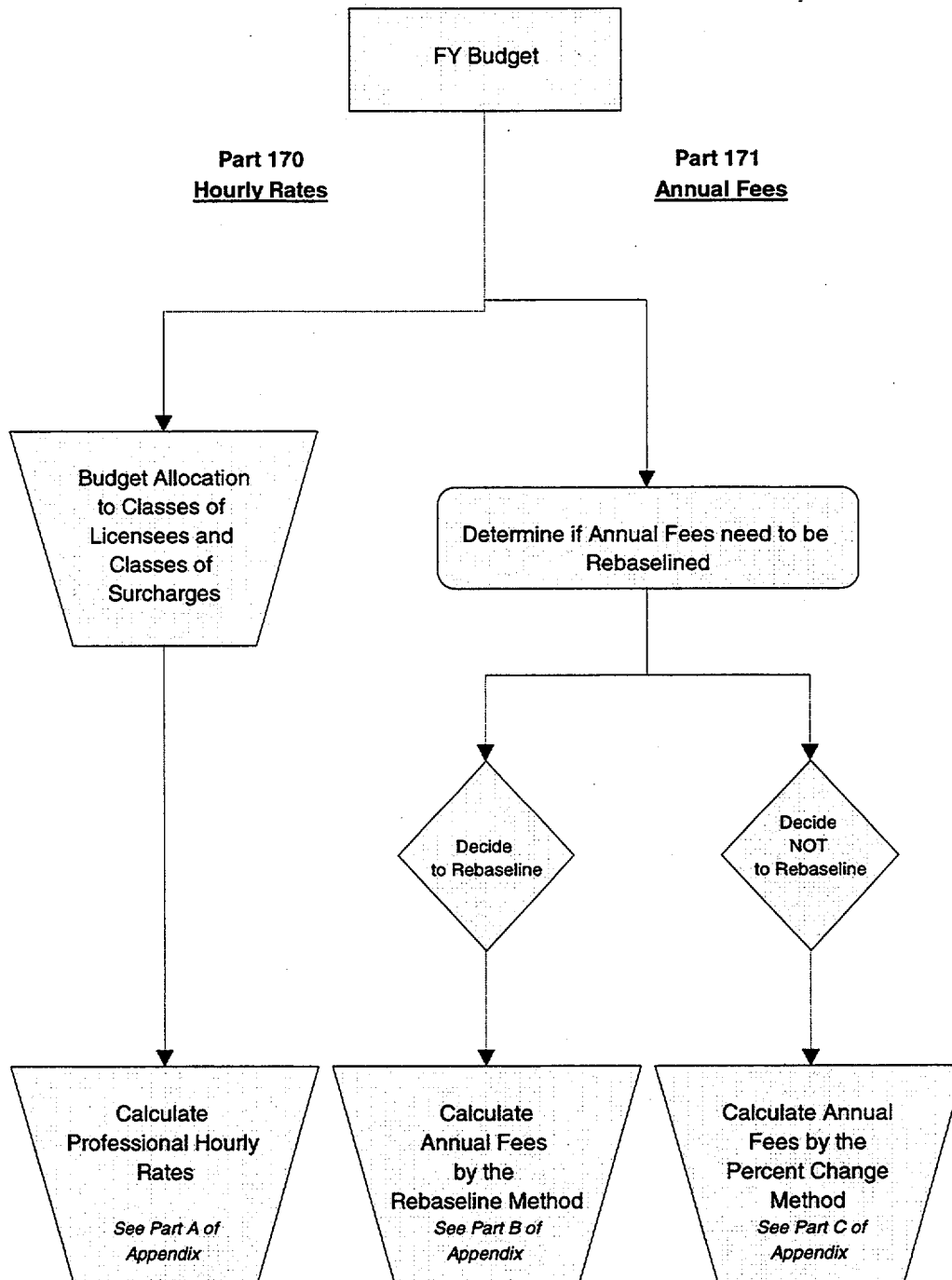
To accomplish these objectives, we reviewed: the Omnibus Budget Reconciliation Act of 1990 (OBRA-90); the OBRA-90 Conference Agreement; the Independent Offices Appropriation Act of 1952 (IOAA); Office of Management and Budget (OMB) Circular A-25; and the legislation and guidance for Rulemaking related to the Administrative Procedure Act. In addition, we interviewed officials from the Office of the Chief Financial Officer (OCFO), OMB, and the Nuclear Energy Institute.

To gain an understanding of how NRC derived the rates and to develop the description of those processes presented in Appendix II, we analyzed each of the calculations from the OCFO workpapers and pre-decisional information as follows: (1) we used the FY 1998 fee rule workpapers and additional supporting documentation for the hourly rate calculations; (2) we used the FY 1996, 1997, and 1998 workpapers for the percent change methodology; and (3) we analyzed the rebaseline methodology using the FY 1995 workpapers, FY 1998 pre-decisional data, and FY 1999 workpapers. Each of the methodologies described in Appendix II was reviewed by OCFO staff for accuracy and verification.

We conducted our work from November 1998 to April 1999 in accordance with generally accepted Government auditing standards and included such tests of the data and records as we considered necessary.

FEE CALCULATION METHODOLOGIES

Fee Calculation Overview



A. PROFESSIONAL HOURLY RATE METHODOLOGY FOR PART 170 FEES

The professional hourly rates are developed using a budget resource approach. They are developed whether annual fees are established by rebaselining or by the percent change method. But when the Agency rebaselines, one of the products of the hourly rate calculation is the framework of allocated costs that form the cost pool for each licensee class.

NRC uses three functions to prepare the budget. These are 1) *Salaries and Benefits* for full-time equivalents (FTE), 2) *Contract Support*, and 3) *Travel*. Each of these functions includes *direct resources* and/or *overhead*. In the hourly rate calculation, all travel costs are treated as overhead.

A resource is included in the hourly rate calculation depending on which cost center⁽¹⁾ it was budgeted to. Using fiscal year (FY) 1998 as an example of how the rates are calculated, the Nuclear Regulatory Commission's (NRC) budget was divided into two subsets of 13 cost centers, as follows:

- I *Program⁽²⁾ Cost Centers*
 - 1. Nuclear Reactor Regulation
 - 2. Nuclear Material Safety and Safeguards
 - 3. State Programs
 - 4. Region Management and Support Services
 - 5. Nuclear Regulatory Research
 - 6. Analysis and Evaluation of Operational Data
 - 7. Enforcement
 - 8. Investigations

- II *Management and Support (M&S) Cost Centers*
 - 1. Management Services
 - 2. Chief Information Officer
 - 3. Chief Financial Officer
 - 4. Policy Support
 - 5. Inspector General

¹ As of FY 2000, the term "cost center" is no longer used. The comparable budget level now used is called "Program/Organization."

² The term "Program cost centers" has been used in this report to designate the group of cost centers that are not considered Management and Support. In FY 1998, these cost centers were components of NRC's two Strategic Arenas, "Regulatory Programs" and "Regulatory Effectiveness." In FY 2000, NRC restructured its budget to include four Strategic Arenas.

Step 1 Budget Allocation of Program Cost Centers

The first step is the allocation of budgeted costs. This allocation also provides the framework for rebaselining. During this step, budgeted direct costs from the Program Cost Centers are allocated to the classes of licensees, or to classes of surcharge activities, or to high level waste (HLW).

- Direct Costs

In FY 1998, each budgeted direct cost (FTE and Program Support⁽³⁾) was allocated to nine classes of licensees, or to eight classes of surcharge activities, or to a HLW class. The bases for each cost allocation vary and depend on input from each Program Cost Center, or other information. The classes used for FY 1998, were as follows:

- I Reactor Hourly Rate Pool*
 - 1. Power Reactor
 - 2. Non-power Reactor

- II Materials Hourly Rate Pool*
 - 3. Fuel Facility
 - 4. Spent Fuel
 - 5. Materials
 - 6. Transportation
 - 7. Rare Earth Facilities
 - 8. Uranium Recovery
 - 9. Reviews of Other Applicants

- III Surcharge Activities*
 - 1. Federal Exemption
 - 2. Nonprofit Exemption
 - 3. International Activities
 - 4. Agreement State Oversight
 - 5. Agreement State Regulatory Support
 - 6. Site Decommissioning Management Plan (SDMP)
 - 7. Generic Decommissioning/Reclamation
 - 8. Generic Low Level Waste

- IV High Level Waste Budget*

Step 2 Hourly Rate Pools

Three hourly rate pools are formed. The classes of licensees are combined to form two pools, Reactor and Materials. The third pool, Surcharge, is used to collect budgeted costs for surcharge activities. Budgeted HLW costs are not used in the hourly rate calculation, because the Omnibus Budget Reconciliation Act of 1990

³ "Program Support" is synonymous with "Contract Support."

(OBRA-90) excludes Nuclear Waste Fund resources from cost recovery. The costs accumulated in both the Surcharge pool and the HLW class are eliminated from the hourly rates.

Step 3 **Overhead Allocation**

After the pools are established, budgeted overhead is allocated from each cost center.

- Overhead

Budgeted overhead costs are allocated to the Surcharge pool based on the percentage of direct costs in each cost center and the Surcharge pool. The remaining budgeted overhead costs for each Program Cost Center are allocated to the Reactor and Materials pools based on the ratio of direct FTE costs within each pool.

Step 4 **Exclusion of Direct Costs from M&S Allocation Amount**

With few exceptions, the costs from M&S cost centers are allocated to each of the hourly rate pools. But those M&S costs that are directly related to the Reactor and Materials or Surcharge programs are excluded from the M&S allocation and included as direct costs of each hourly rate pool.

- Direct Costs and Overhead

All costs from the M&S cost centers are combined to arrive at a single M&S amount. There are a few offices within the M&S cost centers that were identified as providing, or supporting, Part 170 billable activities. In FY 1998, these offices provided direct resource estimates to be included with the direct resources. The M&S total is adjusted (by reducing it) for the direct resources, while the direct resources for each pool are increased in total by the same amount.

Step 5 **M&S Allocation**

Using the total direct FTE and overhead costs from the Program Cost Centers (including the direct M&S costs), the remaining M&S is allocated to each hourly rate pool based on the ratio of the direct and overhead costs for each rate pool.

Step 6 **Annual Professional Rate Calculation**

Total costs (excluding Program contract support) for each of the Reactor and Materials pool are calculated. These costs include direct salary and benefits, allocated overhead, and allocated M&S. Each total is then divided by the number of direct FTE for the Reactor or Materials pool to obtain two average professional FTE annual rates, one for Materials and one for Reactors. (Total costs ÷ direct FTE = average annual professional rate.) In FY 1998, the average annual professional FTE rate for Reactors was \$219,901 and for Materials was \$214,185. Below is a summary of each component used in the FY 1998 calculation.

- Total costs for Reactor (excluding all direct contract support)

The total cost used to calculate the Reactor annual professional rate was \$260,883,351. This total included direct salary and benefits (from the direct FTE), allocated overhead, and allocated M&S. It did not include any direct contract support other than those costs included in the allocated M&S. The direct contract support costs are recovered through either directly to individual licensees through Part 170 billings, or through annual fees assessed under Part 171.

- Direct FTEs for Reactor

The number of direct FTE for Reactors was approximately 1,186. These include FTEs from seven Program Cost Centers and one Management and Support Cost Center as follows: Nuclear Reactor Regulation, Nuclear Material Safety and Safeguards, Region Management and Support Services, Nuclear Regulatory Research, Analysis and Evaluation of Operational Data, Enforcement, Investigations, and Policy Support.

- Total costs for Materials (excluding all direct contract support)

The total cost used to calculate the Materials annual professional rate was \$57,254,676. This total included direct salary and benefits (from the direct FTE), allocated overhead, and allocated M&S. It did not include any direct contract support other than those costs included in the allocated M&S. The direct contract support costs for Materials are recovered similarly to those for Reactors.

- Direct FTE for Materials

The number of direct FTE for Materials was approximately 267. These include FTEs from six Program Cost Centers and one Management and Support Cost Center as follows: Nuclear Material Safety and Safeguards, Region Management and Support Services, Nuclear Regulatory Research, Analysis and Evaluation of Operational Data, Enforcement, Investigations, and Policy Support.

- Surcharge

Although not included in the professional hourly rates published in Part 170, a separate Surcharge hourly rate, is developed and used to calculate Surcharge when rebaselining.

Step 7 Professional Hourly Rate Calculation

The Professional hourly rate is calculated by dividing the Professional annual rate by 1,776 hours (from OMB Circular A-76⁽⁴⁾). In FY 1998, the Professional hourly rate for Reactors was \$124 and for Materials was \$121.

⁴ OMB Circular A-76, "Performance of Commercial Activities."

B. REBASELINING METHODOLOGY FOR PART 171 ANNUAL FEES

The rebaselining method allocates costs to the various classes of licensees, establishing a relationship between budgeted costs and the classes of licensees. The fees developed from the rebaselining method become the base fees on which percent change is calculated in subsequent years.

Step 1 Budget Allocation of Program Cost Centers

The first step is the allocation of budgeted costs. This is also the first step in the hourly rate calculation. During this step, budgeted direct costs from the Program Cost Centers are allocated to the classes of licensees, or to classes of surcharge activities, or to HLW.

Step 2 Classification Totals

For each class of licensee, the direct contract support costs are combined to form a total for that class. And similarly, the direct FTEs are combined to form a total for each class.

Step 3 FTE Conversion to Dollars

The total direct FTEs are converted to dollar amounts by multiplying by the annual professional FTE rate. For example, in FY 1998, the annual reactor FTE rate of \$219,901 would have been used for the Power reactor classes and the annual FTE rate of \$214,185 would have been used for the Materials classes.⁽⁵⁾ An annual FTE rate calculated for surcharge activities would also be used to convert Surcharge FTEs to dollar amounts. Using the annual professional FTE rates to convert FTEs also serves to allocate overhead and M&S costs to each class of licensee.

Step 4 Annual Fee Amounts

The converted FTE and Direct Program support dollars are combined for each class of licensee to arrive at a total, or base fee amount, for each class.

Step 5 Part 170 Billing, Allocation of Surcharge, and Other Adjustments

From the base fee amount, estimated Part 170 collections for each class are deducted to arrive at the amount to be collected for each class from Part 171. Surcharge costs are allocated to each class of licensee based on the percent of base fee amount for each class. Additional adjustments, such as billing adjustments, are made to arrive at the total amount to be collected for each class under Part 171.

⁵ In FY 1998, the Agency did not rebaseline, but used the percent change methodology to calculate the annual fees.

Step 6 **Fee Categories**

Most classes of Materials licensees are subdivided into license fee categories. The method used to allocate costs to the fee categories varies for each class. For example, in FY 1995, costs for the Fuel Cycle Facilities class were allocated to the fee categories based on a matrix depicting license authorization and the relative programmatic effort associated with each category.

C. PERCENT CHANGE METHODOLOGY FOR PART 171 ANNUAL FEES

The percent change method was established to allow for some predictability for licensees, because their annual fees would change in synchrony with changes in NRC's total budget. Unlike rebaselining where each class of licensee may have a different percentage change from the previous year, the percent change method results in all licensees annual fees changing by the same percentage. In theory, for example, if the budget decreased by 5 percent, a licensee could expect their annual fee to similarly decrease by approximately 5 percent.

The percent change method requires a base year where annual fees are established using the rebaselining method. Base annual fees were established in FY 1995. In FYs 1996 through 1998, annual fees were adjusted based on the total changes in each fiscal year's budget and other adjustments.

In general, the percent change calculation is fairly simple. Using the *Budget amount to be recovered through fees* (NRC Budget Authority less amounts appropriated for the Nuclear Waste Fund and the General Fund), the change from the previous fiscal year to the current year is calculated. This amount is reduced by the change in the amount of *Estimated Part 170 collections and other receipts*. That result is further adjusted by the differences in Part 171 *Billing Adjustments* (such as the Small Entity Allowance, Unpaid Part 171 Bills, and Payments from Prior Year Part 171 Bills) between the two fiscal years. After the billing adjustments are made, there is an adjustment for the number of licenses. This adjustment is subtracted from (or added to) the subtotal to arrive at the *Total Percent Change*, the factor used to adjust all Part 171 annual fees.

The *Total Percent Change* factor is applied to each annual fee category by multiplying the previous fiscal year fee by the percent change to arrive at the current year's annual fee. The resulting number is rounded for the final fee to be published. The following steps (on page 8) are used to calculate the percent change:

Step 1 **Calculation of the Percent Change factor**
(Percent Adjustment Calculation)

NRC Budget Authority
Less: Appropriations from the Nuclear Waste Fund
Less: Appropriations from the General Fund
Equals: *Budget amount to be recovered through fees**

Less: Estimated amount to be recovered through Part 170 and other receipts*
Add: Net Billing Adjustments*
Total amount to be recovered through Part 171*

*For each of the lines starting with the *Budget amount to be recovered through fees* and those below it, the difference is calculated between the previous fiscal year amounts and the current fiscal year amounts. These differences are summed up and:

Divided by: Previous Fiscal Year ***Total amount to be recovered through Part 171***
Equals: *Percent Change prior to the adjustment for the number of licenses*

Adjustment: Factor for the change in the number of licenses
Equals: **Total Percent Change Factor** to be applied to all annual fees

Step 2 **Applying the Percent Change Factor to the fee categories**
(Determination of Annual Fees calculation which *includes rounding*)

Previous FY annual fee (exact \$ amount)
x Percent Change Factor
Current FY annual fee (*exact \$ amount*)

Step 3 **Rounding the annual fees**

The *exact \$ amount* for the Current FY annual fee is rounded before it is issued as the final fee amount. Depending on its size, the amount will be rounded differently (e.g. fees under \$1,000 should be rounded to the nearest \$10, fees that are greater than \$1,000 should be rounded to the nearest \$100).

SUMMARY OF PERCENT CHANGES FOR ANNUAL FEES FROM FY 1998 TO FY 1999

Using the proposed FY 1999 fee rule, we extracted a portion of a table prepared by OCFO demonstrating the change by percentage in the annual fees from FY 1998 to FY 1999 after rebaselining.

<u>License Fee Category</u>	<u>FY 1998 Annual Fee (Rounded)</u>	<u>FY 1999 Annual Fee (Rounded)</u>	<u>Percent Increase or Decrease</u>
REACTORS:			
Power	2,976,000	2,570,391	-13.63%
Non-power	57,300	85,855	49.83%
FUEL FACILITIES & SNM:			
HEU	2,604,000	3,281,000	26.00%
LEU	1,278,000	1,100,000	-13.93%
Limited Fuel Fab	508,000	432,000	-14.96%
All Other Fuel Fab	345,000	314,000	-8.99%
Independent Spent Fuel Storage	283,000	N/A	
Industrial Gauges	1,300	1,200	-7.69%
All Other SNM	3,100	3,300	6.45%
Uranium Enrichment	2,604,000	2,043,000	-21.54%
URANIUM RECOVERY & SOURCE MATERIAL:			
UF6 Conversion	648,000	472,000	-27.16%
Class I (Conventional Mills)	61,700	131,000	112.32%
Class II (In-situ Mills)	34,900	109,000	212.32%
Other (Rare Earth Mills)	22,300	30,415	36.39%
Disposal of 11e(2) Materials	45,300	81,000	78.81%
11e(2) Disposal Incidental to Operations	8,000	13,000	62.50%
Shielding	490	600	22.45%
Other Source Materials	8,700	11,700	34.48%
BYPRODUCT MATERIAL:			
Manufacturing - Broad	16,600	26,000	56.63%
Manufacturing - Other	5,600	6,300	12.50%
Radiopharmaceuticals - Manuf/Process	11,200	15,300	36.61%
Radiopharmaceuticals - No Manuf/Process	4,400	3,800	-13.64%

PERCENT INCREASE OR DECREASE IN ANNUAL FEES FOR FY 1999

<u>License Fee Category</u>	<u>FY 1998 Annual Fee (Rounded)</u>	<u>FY 1999 Annual Fee (Rounded)</u>	<u>Percent Increase or Decrease</u>
Irradiators - Self Shield	3,200	3,400	6.25%
Irradiators - <10,000 Ci	3,800	5,700	50.00%
Irradiators - >10,000 Ci	19,700	14,800	-24.87%
Exempt Distribution - Device Review	5,000	3,200	-36.00%
Exempt Distribution - No Device Review	8,900	4,600	-48.31%
Gen License - Device Review	3,800	2,100	-44.74%
Gen License - No Device Review	3,200	1,700	-46.88%
R&D - Broad	12,300	11,200	-8.94%
R&D - Other	5,500	5,000	-9.09%
Service License	6,100	5,200	-14.75%
Radiography	14,000	14,700	5.00%
All Other Byproduct Materials	1,700	2,600	52.94%
WASTE DISPOSAL & PROCESSING:			
Waste Disposal		N/A	
Waste Receipt/Packaging	14,500	11,300	-22.07%
Waste Receipt - Prepackaged	7,700	8,400	9.09%
WELL LOGGING:			
Well Logging	8,200	9,900	20.73%
Field Flooding Tracers Studies		N/A	
NUCLEAR LAUNDRY:			
Nuclear Laundry	14,700	18,900	28.57%
HUMAN USE OF BYPRODUCT, SOURCE, OR SNM:			
Teletherapy	10,300	15,300	48.54%
Medical - Broad	23,500	27,800	18.30%
Medical - Other	4,700	5,800	23.40%
CIVIL DEFENSE:			
Civil Defense	1,800	1,200	-33.33%
DEVICE, PRODUCT, OR SEALED SOURCE SAFETY EVALUATION:			
Device/Product Safety Evaluation - Broad	7,200	6,000	-16.67%
Device/Product Safety Evaluation - Other	3,700	4,300	16.22%
Sealed Sources Safety Evaluation - Broad	1,600	1,800	12.50%
Sealed Sources Safety Evaluation - Other	780	600	-23.08%

PERCENT INCREASE OR DECREASE IN ANNUAL FEES FOR FY 1999

<u>License Fee Category</u>	<u>FY 1998 Annual Fee (Rounded)</u>	<u>FY 1999 Annual Fee (Rounded)</u>	<u>Percent Increase or Decrease</u>
TRANSPORTATION:			
Certificate of Compliance	0	N/A	
Approvals (Users & Fabricators)	78,800	66,700	-15.36%
Approvals (Users Only)	1,000	2,200	120.00%
OTHER LICENSES:			
Standardized Spent Fuel Facilities		N/A	
Special Projects		N/A	
Spent Fuel Storage Certificate of Compl		N/A	
Spent Fuel General License	283,000	N/A	
Decommissioning/Possession - Only		N/A	
Export/Import		N/A	
Reciprocity		N/A	
Master Material License	421,000	358,000	-14.96%
DOE Transportation Activities	1,168,000	872,000	-25.34%
DOE UMTRCA Activities	1,964,000	868,623	-55.77%

SUMMARY

In the table, there are 50 license categories listed with annual fees. All of the fees changed from FY 1998 to 1999 and at different rates. For example, a Power Reactor License decreased by 13.63 percent, while the Non-Power Reactor License increased by 49.83 percent. Of the 50 fee categories, 42, or 84 percent, had a greater than 10 percent change (increase or decrease) from FY 1998 to FY 1999. Twenty-three, or 46 percent, had a greater than 25 percent change in annual fees.

EXAMPLES OF INCONSISTENCIES IN THE HOURLY RATE CALCULATIONS

The following are two examples of inconsistencies in the use of budget data to prepare the hourly rates. First is the use of budget data without considering of the nature of the costs. In fiscal year (FY) 1998, Headquarters rent of \$13,216,000 was a budgeted direct cost to a Management and Support Cost Center. All Management and Support Cost Centers are included in the hourly rate calculations through allocation. In contrast, we found that Technical Training Center (TTC) rent of \$888,000 was a budgeted direct cost for the *Analysis and Evaluation of Operational Data* cost center. Because this cost center was treated as a Program Cost Center rather than a Management and Support Cost Center, TTC rent was excluded from the full cost calculation on the assumption that contract support dollars are generic. Therefore, Headquarters rent was included in the hourly rate calculation while TTC rent was excluded from the calculation without regard to the nature of the cost. Interestingly, TTC rent was excluded from the hourly rate calculation because the Agency considers all direct contract support costs (not recovered directly from licensees through Part 170) to be "generic." Therefore, TTC rent costs were excluded from the calculation.

The following illustrates the inconsistent treatment of budgetary data based on cost center classifications. In FY 1998, all of the Program Cost Centers were included in the hourly rate as direct costs, because that was how the budget classified these cost centers, regardless of whether these cost centers provided billable services. Some of the Program Cost Centers do not provide billable services. For example, the activities from three budgeted Program Cost Centers, *Nuclear Regulatory Research, Enforcement, and Investigations* are not usually billable Part 170 services. Yet, most of the budgeted resources, approximately 150 FTE (or \$14.7 million), from these cost centers were included as direct resources when calculating the hourly rates. Including these extra resources because they are budget-classified in the Program Cost Centers affects the hourly rate.

In contrast, several activities budget-classified in Management and Support Cost Centers were identified as billable direct resources based on the nature of the activities. Although this is appropriate to recover full cost for an activity, including these costs is inconsistent with using the budget structure for calculation the hourly rates. In FY 1998, the costs of approximately \$5.4 million (or 53 FTE) were included in the hourly rate pools from the offices of the *General Counsel, ACRS/ACNW* and *ASLBP* activities of the *Policy and Support* cost center. By moving these costs from Management and Support, the contract support dollars of approximately \$531,000 were excluded from the hourly rate, while the 53 FTEs were included. Although there could be some billable activities identified in these cost centers, it is inconsistent to add these costs, while not evaluating and eliminating cost centers that have no billing activities.

ABBREVIATIONS AND ACRONYMS

ACNW	Advisory Committee on Nuclear Waste
ACRS	Advisory Committee on Reactor Safeguards
ASLBP	Atomic Safety and Licensing Board Panel
CFR	Code of Federal Regulations
DOE	Department of Energy
FTE	Full-time Equivalents (2,080 labor hours per year)
FY	Fiscal Year (October 1 through September 30)
HEU	High Enriched Uranium
HLW	High Level Waste
IOAA	Independent Offices Appropriation Act of 1952
LEU	Low Enriched Uranium
LFARB	License Fee and Accounts Receivable Branch, OCFO
M&S	Management and Support
NRC	Nuclear Regulatory Commission
OBRA-90	Omnibus Budget Reconciliation Act of 1990, as amended
OCFO	Office of the Chief Financial Officer
OIG	Office of the Inspector General
OMB	Office of Management and Budget
R&D	Research and Development
RITS	Regulatory Information Tracking System
SFFAS	Statement of Federal Financial Accounting Standards
SNM	Special Nuclear Material

TTC	Technical Training Center
UMTRCA	Uranium Mill Tailings Radiation Control Act of 1978

December 1, 1999

MEMORANDUM TO: Thomas J. Barchi
Assistant Inspector General for Audits

FROM: Jesse Funches /s/
Chief Financial Officer

Karen Cyr /s/
General Counsel

SUBJECT: RESPONSE TO DRAFT AUDIT REPORT ENTITLED
"NRC'S LICENSE FEE DEVELOPMENT PROCESS
NEEDS IMPROVEMENT"

Thank you for the opportunity to comment on the revised draft report. We appreciate the work that went into its preparation, the effort made to take into account our reply to the original draft report, and your willingness to consider our views in response to some of the issues raised. We, in turn, have made a conscientious attempt to address each of these issues but we still are not in complete agreement with many of the key aspects of your report. We remain convinced that we operate in compliance with both the letter and the spirit of the Omnibus Budget Reconciliation Act of 1990 (OBRA-90) and the Independent Offices Appropriation Act of 1952 (IOAA). We are prepared to meet with you to resolve any differences we may have prior to issuance of the report in final. Nonetheless, we have given your recommendations our thoughtful consideration and have made a good faith effort to employ them to make cost effective improvements in our program. This response includes our comments on the recommendations, which we did not specifically address in our previous response.

OBRA-90 COMPLIANCE

OIG FINDING: "Extended use" over a period of three years of the percent change methodology did not fully reflect the intent of OBRA-90. There were no specific thresholds for baselining. During this time, budgeted costs changed, and the relationship between costs and fees deteriorated. This resulted in some licensees subsidizing the costs of other licensees. The desired result of maintaining predictability and stability was negated.

RESPONSE TO OIG FINDINGS:

Extended use of percent change

The OIG is critical of the percent change methodology being used over an "extended" period of time, which it contends resulted in promulgation of an annual fee schedule in FY 1998 that, in its opinion, did not fully comply with the intent of OBRA-90. This assessment is based on the OIG judgment that utilization of the percent change methodology over the three years from fiscal year (FY) 1996 through FY 1998 did not produce the desired results—maintaining a close relationship between fees and the costs of providing services while preserving fee stability and predictability. In addition, the OIG challenges the Commission's decision to use percent change because it results in the potential for certain licensees to subsidize the costs of other licensees.

The CFO has the delegated authority to develop and promulgate proposed and final revisions to the agency's fee regulations, except those that involve significant questions of policy. When significant policy questions are involved, the staff provides the Commission with a paper outlining the policy and legal issues for the Commission's consideration. After carefully analyzing the complex legal and policy considerations set forth by the staff in the Commission paper for the FY 1998 fee rulemaking (SECY 98-034), and mindful of the competing interests involved in maintaining the requisite relationship between costs and fees while maintaining fee stability, the Commission made a conscious decision not to rebase fees in FY 1998 (March 23, 1998, Staff Requirements Memorandum for SECY 98-034). That Commission decision also was preceded by a lengthy meeting of Commission Office Assistants with the representatives of OCFO and OGC, during which the pertinent legal and policy considerations were fully discussed. The Office of the General Counsel had advised that election of that method was legally defensible and that it had no legal objection to the use of the percent change method in calculating FY 1998 annual fees.

The Office of the General Counsel's conclusion that the FY 1998 fee rule satisfied legal requirements is based on its reading of OBRA-90⁽¹⁾ and the caselaw interpreting that statute.⁽²⁾ Under OBRA-90, NRC has express authority to assess fees for costs in providing services or things of value, pursuant to the Independent Offices Appropriations Act (IOAA). OBRA-90 also establishes NRC authority to collect annual charges from licensees in an amount that approximates 100 percent of the budget authority of the Commission in the fiscal year in which the charge is collected, less amounts appropriated from the Nuclear Waste Fund and IOAA fees collected.

¹42 U.S.C. §2214.

²Allied-Signal, Inc. v. NRC, 988 F. 2d 146 (D.C. Cir. 1993).

The statutory criteria for annual charges are fairly simple: the fees must be established by rule; they must be fairly and equitably allocated among licensees; and they must have a reasonable relationship to the cost of providing regulatory services, to the maximum extent practicable. From the limited OBRA-90 caselaw available, we learn that the NRC is not required to apportion generic costs within a class of licensees, because OBRA-90 annual fees are not service-specific, i.e., they do not relate to identifiable services, even if the regulatory effort involved was precipitated by the circumstances of a single licensee. There is a legal presumption that results of the generic regulatory effort, such as the conduct of research or the promulgation of regulations, will yield benefits across the class of roughly equal importance for all members, assuming the costs in question were correctly classified.⁽³⁾

Fee stability and predictability

The OIG draft report expresses concern that the NRC's reliance on the percent change methodology resulted in the loss of the required "reasonable relationship" between fees and the costs of providing services. The Commission found to the contrary, in approving promulgation of the FY 1998 fee rule. The Commission determined that there would continue to be a reasonable relationship between costs and fees if the percent change method was used, although the distribution of the agency's budget had changed somewhat from the FY 1995 baseline. After evaluating the data provided to it by the CFO, the Commission decided that the relationship between costs and fees was not sufficiently attenuated to justify rebaselining under the criteria it had established previously during the rulemaking process. It therefore chose to continue fee stabilization by using the percent change method. This was consistent with the Commission's announcement in 1995, in response to industry complaints about fee instability, that for a five year period, it only would rebaseline fees if certain stated criteria were met.

As the OIG draft report acknowledges, adoption of the percent change methodology stemmed from an effort to bring stability and predictability to fees, so licensees would have some means of estimating the fee burden from year to year and plan for it in their budgeting process. The objective was to soften some of the more dramatic annual swings produced if an annual rebaselining methodology is used. The record amply demonstrates that by using the percent change method for FYs 1996 through 1998, the desired fee stability was achieved. This does not mean that fees would remain at a constant level any more than that it could suggest that no licensee would ever experience a spike in fee rates. An eventual readjustment of the fee schedule was not only anticipated but was, in fact, to be the ultimate goal of applying the stated criteria, based on evaluating the overall circumstances that would dictate the need for a significant shift. Thus, it is the extent and timing of the readjustment over which we disagree. To be sure, rebaselining could have been employed sooner, had the Commission determined that the criteria had been met. However, it assessed the situation carefully and concluded that rebaselining was not

³Id.

warranted at that time. Indications from licensees are consistent with this, as many favorable comments on fee stability were received from licensees during this period. Ultimately, even though the Commission desired to accommodate licensee pleas for prolonged fee stability, the Commission concluded that circumstances warranted rebaselining fees in FY 1999, in accordance with the stated criteria.

We believe the Commission has appropriately considered and balanced the complex competing interests in establishing fee policies, and that each year's fee rules have comported with applicable legal requirements. Additionally, each year the Commission promulgates a proposed fee rule which describes intended changes and solicits comments from our licensees. Those comments are considered and responded to in our final fee rule.

Specific thresholds for rebaselining

The draft report suggests that the OIG concerns could be resolved by developing more specific thresholds that could be mechanically applied to determine whether fees should be rebaselined each year. This would involve developing a definition for "substantial change" and "magnitude of the budget allocated," criteria used by the Commission for determining whether fees should be rebaselined. While there may be some benefits to such an approach, the difficulty it presents is that establishing specific thresholds for rebaselining would eliminate the Commission's ability to weigh all the pertinent factors during the decision-making process.

Whether to use the percent change method or to rebaseline annual fees is a policy judgment to be made only after evaluation of many considerations. For example, the Commission decision to rebaseline FY 1999 annual fees was based in large part on fee policy changes, such as establishment of a new fee class and the inclusion of amendment costs in nuclear material users' annual fees. However, not every Commission decision can be made on the basis of quantifiable thresholds. Moreover, public comments on the FY 1995 through FY 1999 fee rules do not indicate the need to develop more precise rebaselining criteria. In addition, substantial changes in individual licensees' annual fee amounts may result from many things other than changes in the budget or in the amount of the budget allocated to a class of licensees, such as reduced IOAA fee collections from a class of licensees or a decreasing number of licensees in the class.

Licensees subsidizing costs of others

The draft report is also critical of the percent change methodology because it could result in some licensees subsidizing the costs of others. This is not legally objectionable. Indeed, in the Conference Report accompanying OBRA-90, Congress expressly recognized that

there are expenses that cannot be attributed either to an individual licensee or a class of licensees.... The conferees intend the NRC to

fairly and equitably recover these expenses from its licensees through the annual charge even though these expenses cannot be attributed to individual licensees or classes of licensees. These expenses may be recovered from such licensees as the Commission, in its discretion, determines can fairly, equitably, and practicably contribute to their payment.⁽⁴⁾

Thus, Congress expected a certain amount of cost subsidization and there certainly would be no legal bar to licensees subsidizing costs of others, either under the percent change method or under rebaselining. OBRA-90 states that "To the maximum extent practicable, the [annual] charges shall have a reasonable relationship to the cost of providing regulatory services...."⁽⁵⁾ The statute goes on to say that the annual charges "may be based on the allocation of the Commission's resources among licensees or classes of licensees." Congress recognized that the allocation of fees would necessarily diverge from the allocation of resources in the budget, since it understands that some agency activities are not easily traceable to particular licenses or classes of licenses. Indeed, in the face of the 100 percent recovery mandate, there are few alternatives available to achieve a reasonable and equitable fee schedule, particularly since the NRC, for legal or policy reasons, exempts or reduces the fee burden for certain groups. For example, the Commission lacks the legal authority to charge other Federal agencies (other than TVA) for licensing reviews and inspections. Similarly, annual fees cannot be imposed on Agreement States, although the Commission's development and oversight of the materials licensing program includes activities that provide regulatory support to the Agreement States. Also, consistent with the policies of the Regulatory Flexibility Act, small entities pay reduced annual fees. Therefore, the costs of activities benefitting beneficiaries who are exempted from fees either by statute or Commission policy must be borne by other licensees.

IOAA COMPLIANCE

OIG FINDING: Lack of full cost recovery criteria results in non-compliance with IOAA.

Similar costs were treated inconsistently and as a result hourly rates are not in compliance with the full cost requirement of OMB Circular A-25. NRC inconsistently includes some generic costs and excludes others in the hourly rates. Contract support costs excluded from the hourly rate were not analyzed to determine if they are truly generic. Some costs included in the hourly rate were specified in the OBRA-90 Conference Committee Report as

⁴H.R. Rep. No. 962-3, 101st Cong. 2d Sess at 962-963 (1990).

⁵42 U.S.C. §2214 (c)(3).

generic (i.e., Offices of the Commissioners, the General Counsel, and the Inspector General).

Budget data is applied inconsistently in developing the hourly rates. Using budget data without considering the nature of the costs resulted in errors. Reasonableness of the hourly rate calculation was not assessed from actual billing data in RITS. The NRC did not implement the requirement of the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Standards, to use actual costs from cost accounting data to prepare hourly rates.

RESPONSE TO OIG FINDINGS:

We strongly disagree with the draft report's conclusion that the agency is not recovering the full cost of those activities whose costs are recovered through fees imposed pursuant to the IOAA. That statute authorizes agencies to establish charges for services or "things of value" and requires only that the charges be fair and based on costs to the government, as well as value to the recipient. This law permits agencies to recoup costs from identifiable beneficiaries but not from whole industries. Caselaw instructs that IOAA charges may only be assessed against specific entities for specific services,⁽⁶⁾ and only to the extent that a specific benefit is conferred upon an identifiable beneficiary.⁽⁷⁾ Under the law, broad conferral of a general benefit, even upon the affected industry, does not justify the imposition of IOAA fees.⁽⁸⁾ The courts have further taught that agencies are entitled to recover all reasonable costs incurred and that these costs must bear a reasonable, but not necessarily exact, relationship to the fees assessed.⁽⁹⁾ Scientific precision is not required. The D.C. Circuit has opined, "[c]alculations must necessarily be based on numerous approximations and can only be expected to be accurate within reasonable limits."⁽¹⁰⁾

Based on the numerous meetings between our staffs and our review of the draft report, it appears that the major disagreement between our offices centers on whether certain generic contract support costs should be included in the hourly rates for purposes of Part 170 fees. The draft OIG report contends that the

⁶Federal Power Commission v. New England Power Co., 415 U.S. 345 (1974).

⁷Engine Mfrs. Ass'n v. EPA, 20 F. 3d 1177 (D.C. Cir. 1994).

⁸Id.

⁹Yosemite Park and Curry Co. v. U.S., 686 F. 2d 925 (Ct. Cl. 1982).

¹⁰Central & Southern Tariff Association, Inc. v. U.S., 777 F.2d 722, 736 (D.C. Cir. 1985).

agency's failure to include some of these costs in that hourly rate violates the full cost recovery provisions of OMB Circular A-25.⁽¹¹⁾ Moreover, it results in the OIG's view that similar costs have been treated inconsistently. We remain convinced that our current Part 170 fee schedule is fully consistent with the provisions of the IOAA as well as OMB Circular A-25. We agree that the agency's user fees must recover its full costs; we disagree that the full costs must all be recovered solely through the hourly rate. In fact, the NRC's methodology used in calculating its Part 170 fee schedules has been affirmed by the courts.⁽¹²⁾

There is no dispute that the NRC can recover pursuant to the IOAA the full costs of providing licensing and inspection services to identifiable beneficiaries of those agency services. This would include not only direct salaries, benefits, and direct program contract support costs, but a prorated share of overhead and general and administrative costs (G&A) such as light, heat, rent, financial accounting and personnel services. Specific research costs that are incurred by the NRC staff as necessary or useful in its review of a particular application can also be charged to the applicant. It is equally clear that the costs of generic activities such as rulemaking and research that cannot be attributed to a single identifiable beneficiary (such as research that benefits all pressurized water reactors) cannot be recovered pursuant to the IOAA.⁽¹³⁾ These are the principles that the NRC uses in developing its Part 170 fee schedules.

While recognizing these principles, the OIG concludes in the draft report that the NRC includes some generic costs in its Part 170 hourly rate calculation and therefore, has not consistently interpreted the statutory requirement. The OIG believes that generic contract costs in support of NRC mission programs could similarly be included in the Part 170 hourly rate calculation. The draft report notes that the Congressional Conferees that developed OBRA-90 in explaining the statutory provisions indicated that some agency costs that could not be recovered under the IOAA would need to be recovered through imposition of annual fees. Specifically, the conferees stated that:

¹¹OMB Circular A-25 is a statement of policy that does not have the force and effect of law and is not binding on the courts. Bechtel v. FCC, 10 F.3d 975 (D.C. Cir. 1993). It has the legal status of neither statute nor regulation and it is susceptible to judicial construction of any underlying statute. Indeed, the Supreme Court has held that it is within an agency's discretion whether it will comply at all with requirements of an OMB Circular, unless compliance is mandated by an "applicable law." IRS v. FLRA, 494 U.S. 922 (1990) (concerning IRS implementation of OMB Circular A-76 on "contracting out" non-governmental activities).

¹²Mississippi Power & Light Company V. NRC, 601 F.2d 223 (5th Cir. 1979), cert. den., 444 U.S. 1102 (1980).

¹³Id.

Examples of these expenses may include costs associated with certain generic research and rulemaking proceedings and the operating expenses of various NRC offices, including those of the Commissioners, the General Counsel, the Inspector General, and Governmental and Public Affairs.⁽¹⁴⁾

Consistent with the Conferees' guidance above, the Commission has viewed these as examples, not as a legally binding determination of which costs cannot be recovered under the IOAA. The Commission has decided that most of the functions performed by the listed offices are general and administrative, akin to light, heat, and rent—fundamental services performed within any Federal agency. Thus, most of the costs of these offices are treated similarly to overhead in calculating the hourly rate. The agency has chosen to use the same hourly rate for determining fees under Part 170 and Part 171. The costs of these offices are distributed to Part 170 and Part 171 fees in the same ratio as the agency's direct program FTE cost recovery under the two parts. Thus, if the agency recovers 30 percent of its direct program FTE costs through Part 170 fees in a given year, 30 percent of the heat, light, rent, and costs of the offices listed above would be recovered through Part 170 fees.

It might be argued that if data were maintained showing what percentage of each employee's time is allocated between activities under the two Parts, perhaps, for example, only 25 percent of a Commissioner's time would be recovered under Part 170. However, as noted above, IOAA fees do not need to be calculated with mathematical precision and any effort to otherwise allocate the costs of the listed offices to Parts 170 and 171 would only complicate the fee schedule. Complicating the fee schedule would be contrary to the OIG's 1993 Report which suggested that calculation of the Part 171 fees be simplified.

This contrasts with the Commission's treatment of the generic contract costs that are of concern to the OIG. The Commission does not view those costs as akin to light, heat, and rent. These are costs for activities that are being performed solely to support NRC's generic programmatic efforts, such as rulemaking and generic confirmatory research. It is clear under IOAA caselaw, particularly Mississippi Power and Light, supra, that the costs of generic rulemaking and research cannot be recovered under Part 170. It follows that contract support work associated with those generic activities cannot similarly be recovered under Part 170. Thus, the Office of the General Counsel has concluded that the treatment of generic contract support costs advocated by the OIG is not consistent with legal requirements.

Including direct FTE from program offices that do not usually perform Part 170 work in the hourly rate calculations does not result in unreliable rates or in costs for generic activities being recovered under Part 170 as the report suggests. These

¹⁴H.R. Rep. No. 964, 101st Cong. 2d Sess at 962-963 (1990).

direct employees are included in the hourly rate calculations to arrive at an average fee amount per direct program employee, whether the employee is performing Part 170 work or work that is not subject to Part 170 cost recovery. If a direct program employee performs Part 170 work, that work is billed under Part 170 at the hourly rate. If a direct program employee performs generic or other work that is not subject to Part 170 fees, the costs are recovered in annual fees under Part 171 at the same hourly rate.

The draft report findings continue to indicate the OIG's belief that the hourly rates are developed and used solely for Part 170 fee purposes. This is not the case. On several occasions, we have explained to the audit staff the concepts behind NRC's hourly rate development and their purpose. Additionally, the approach is provided in each fee rule for public comment. In brief, the hourly rates are developed based on the total number of direct program FTE; those direct program FTE who perform work that is billable under Part 170 and those direct program FTE who perform work that is recovered under Part 171. For each direct program FTE, the hourly rates reflect an appropriate share of direct costs (salaries and benefits) and indirect costs (office overhead and agency G&A costs, such as rent, and the Offices of the Commissioners, General Counsel, and Public Affairs), consistent with OMB Circular A-25. Thus, the hourly rate prorates overhead and general and administrative costs to both Part 170 and Part 171 fees. The hourly rate represents the "full cost" (direct salaries and benefits plus a prorated share of overhead and G&A expenses) for a direct program FTE.

In calculating rebaselined annual fees, the total budgeted direct program FTEs allocated to each of the eight licensee classes are converted to dollar amounts using the established hourly rates. The total budgeted direct program contract support costs is added to the direct program FTE costs to arrive at the total budgeted costs for each class. The annual fee amount for each class is then determined by subtracting the estimated amount of Part 170 fees from the total budgeted costs for that class. This results in a fair and accurate allocation of costs using the simplest methodology we have been able to devise.

We do not believe it is appropriate or useful, as the draft report suggests, to base hourly rate calculations on historical RITS billable data because the hourly rate does not, and is not designed to, include only FTE whose work is billable under Part 170. Thus, comparing the total FTEs included in the hourly rates only to the FTEs billed under Part 170 results in an inappropriate comparison.

Finally, we find nothing in SFFAS 4 that would require the agency to use actual cost accounting data to prepare the hourly rates. We are aware that SFFAS 4 lists fee or price setting as one of several purposes for which managerial cost accounting can be used, and the OIG's draft report correctly quotes from SFFAS 4 that "[c]ost information is an important basis in setting fees and reimbursements." However, immediately following the sentence quoted by the OIG, SFFAS 4 goes on to say, "[p]ricing and costing, however, are two different concepts. Setting prices is a policy

matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies. Thus, the price of a good or service does not necessarily equal the cost of the good or the service determined under a particular set of principles. Nevertheless, cost is an important consideration in setting government prices." In addition, Section 204 of Appendix A to SFFAS 4 states, in part, "[o]nly with reliable full cost information can management ensure that user charges fully recover the costs." This statement is footnoted, though: "[t]he standard of determining full cost discussed in this document, however, should not be construed as a standard for setting fees, prices, and reimbursements." Nonetheless, in light of these concerns that you raised early in the audit process, OCFO has reviewed all generic contract costs to make sure they were properly allocated between Parts 170 and 171. This is further discussed in our response to Recommendation 2.

STRENGTHENING OF MANAGEMENT CONTROLS

OIG FINDING: There are no formal procedures for developing license fees. Formal procedures and increased quality control could have detected errors. Two errors were identified.

RESPONSE TO OIG FINDINGS:

The report points out that there are no formal procedures for developing license fees. The report concludes that formal procedures would have made the transition for new staff smoother and would have provided for quality control reviews which could have identified errors that occurred. The report also contends that fee calculations lack adequate quality control; there was no objective review of the calculations to detect errors and ensure calculations were correctly prepared. Two errors were identified: the inclusion of Regional Management and Support as direct costs in the FY 1998 hourly rate and an error in the percent change calculation.

We generally agree that formal procedures may be helpful. However, each year there is the potential for changes in fee policy, budget structure, and/or agency processes that could affect the manner in which the fees are determined. As a result, it must be recognized that formal procedures may have to be relatively general in nature. Moreover, while formal procedures and additional reviews of the calculations may help to maintain accuracy, this recommendation should not cloud the fact that great effort is made by everyone involved in the process to avoid errors in the fee calculations. Our goal is 100 percent accuracy; however, despite the detailed process followed to assure the fees are fair and satisfy legal requirements, as the report concedes, errors cannot be totally prevented. Errors in the fee development process, however, have been few and infrequent. OCFO takes pride in the fact that the checks and balances inherent in its system produce a careful examination of its own process, which generally would lead to discovery of any errors and permit corrective action in a timely manner. This position is supported

by the fact that one of the errors referred to in the report was recognized by the OCFO and corrective steps were taken prior to initiation of this very audit.

Each year, given limited resources, OCFO must analyze the budget, consider issues to be addressed, develop the fees, prepare a Commission paper if appropriate, prepare a proposed rule, analyze public comments, and prepare the final rule. All of this must be accomplished by mid-June of each year in order for the final rule to become effective and to bill and collect the required amounts before the end of the fiscal year, as required by OBRA-90. It is impossible, given available resources, to conduct detailed quality assurance reviews of each of the hundreds of calculations and meet this stringent schedule. Further, the cost effectiveness of additional detailed quality assurance reviews is not evident.

INFORMATION PROVIDED DURING PUBLIC COMMENT PERIOD

OIG FINDING: Inadequate information was provided during the public comment period. A key document linking the budget to the fee calculations was omitted from the fee work papers in violation of the requirements of the Administrative Procedure Act. OIG believes the public would have had difficulties in reviewing the hourly rate calculations.

RESPONSE TO OIG FINDINGS:

The report states that inadequate information was provided during the public comment period, and in particular, that a key document linking the budget to the fee calculations was omitted from the supporting work papers, which purportedly are required to be made available under the Administrative Procedure Act (APA). Without this document, the report says, it was not possible to determine how the fees were developed and the report presumes that the public would have had similar difficulties in reviewing the hourly rate calculations.

APA statutory requirements are broadly stated;⁽¹⁵⁾ the matter of supporting papers is not addressed at all. Courts have interpreted the APA notice requirement as

¹⁵The APA requires that a general notice of proposed rule be published in the *Federal Register* and that it include:

- (1) a statement of the time, place, and nature of the public rule making proceedings;
- (2) reference to the legal authority under which the rule is proposed; and
- (3) **either the terms or substance** of the proposed rule or a description of the subjects and issues involved. [emphasis added] 5 U.S.C. §553(b).

affording meaningful public participation in the adoption of an agency rule.⁽¹⁶⁾ This requires that the agency provide sufficient factual detail and rationale to permit interested parties to comment meaningfully⁽¹⁷⁾ but the agency need not provide precise notice of each aspect of the regulations eventually adopted.⁽¹⁸⁾ Under the APA, the purpose of the notice is to disclose the agency's thinking and the data on which it relied.⁽¹⁹⁾ The agency is obligated to make its views known to the public in concrete and focused form so as to make criticism or formulation of alternatives possible.⁽²⁰⁾ The notice will be considered legally sufficient if the notice is adequately descriptive of the subjects and issues involved so interested parties may offer informed criticism and comments.⁽²¹⁾ In sum, the notice must simply "fairly apprise interested persons" of the issues in the rulemaking.⁽²²⁾ There is no legal requirement for the agency to publish every bit of background information it used in preparing the rule.⁽²³⁾

Agencies are to justify IOAA fees by a clear statement of the service or benefit expected to be reimbursed.⁽²⁴⁾ The cost basis for each fee is to be calculated by allocating specific expenses to the smallest practical unit, excluding any that serve an independent public interest, and providing an explanation of the specific expenses to be included in the cost basis for the individual fee, with the criteria used to include or exclude particular items.⁽²⁵⁾ NRC has complied with each of these requirements. In addition to the complete and detailed explanation contained in its published rulemaking notices, the NRC places its work papers supporting both its

¹⁶Nevada Land Action Ass'n v. Forest Service, 8 F. 3d 713 (9th Cir. 1993).

¹⁷Florida Power & Light Co. v. U.S., 846 F. 2d 765 (D.C. Cir. 1988), cert. den. 490 U.S. 1045 (1989).

¹⁸Forester v. Consumer Product Safety Commission, 559 F. 2d 774 (D.C. Cir. 1977).

¹⁹Lloyd Noland Hosp. and Clinic v. Heckler, 762 F. 2d 1561 (11th Cir. 1985).

²⁰Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir. 1977), cert. den. 434 U.S. 829 (1977).

²¹National Mining Association v. MSHA, 116 F. 3d 520 (D.C. Cir. 1997); Association of Am. Railroads v. DOT, 39 F. 3d 582 (D. C. Cir. 1994); Ethyl Corp. v. EPA, 541 F. 2d 1 (D.C. Cir. 1976), cert. den. 426 U.S. 941 (1976).

²²United Steelworkers v. Marshall, 647 F. 2d 1189, 1221 (D. C. Cir. 1980).

²³B. F. Goodrich Co. v. DOT, 541 F. 2d 1178 (D.C. Cir. 1976), cert. den. 430 U.S. 930 (1977). See also federal guidelines on adequacy of notice. Lubbers, *A Guide to Federal Agency Rulemaking*, 1998 ABA Sec. Pub. 186.

²⁴Public Service Co. of Colorado v. Andrus, 433 F. Supp. 144 (D.C. Colo. 1977).

²⁵Id.

proposed rule and its final rule in the Public Document Room (PDR) so they can be examined by the public. Moreover, the NRC has done more than is required by law in making its supporting work papers publicly available through the PDR.

In this case, we received no complaints from commenters about a lack of adequate information concerning the FY 1998 hourly rate calculations, which tends to support our view that the public believed we provided adequate means to examine the fee rule. In addition, the name, phone number, and address of the NRC employee to be contacted were provided in the proposed rule in case there was a need for additional information. Thus, we believe that we provided complete and sufficient information to permit the public full opportunity to understand and comment upon the FY 1998 fee rule. The OIG's assertion that NRC violated the APA in the fee rulemaking is simply wrong. However, in response to the OIG's concern, in the future, if circumstances occur where some of the background material for the fee rule is withheld from public disclosure as predecisional information, we will conduct a specific review of the material used to develop the rule to assure that there is sufficient information made available to the public.

RESPONSE TO RECOMMENDATIONS:

Recommendation 1:

Using the percent change method for fee calculation only after conducting an annual pro-forma rebaselining analysis. The CFO should develop specific thresholds to determine substantial changes at the fee classification level and use these thresholds in making a decision on which method to use for calculating annual fees.

Response: Agree in part.

Based on the on-going efforts at the time of the proposed FY 1999 fee rule development and comments received from the Commission, the OCFO plans, as part of each year's fee rule development and Commission paper, to conduct an analysis based on percent change and rebaselining. As you are aware, this was done for both the FY 1998 and FY 1999 fee rules to assist the Commission in establishing the fee policy for those years. Those preliminary numbers will be provided with the CFO's recommendation as to which method to use for each fiscal year and will take into consideration all other policy issues which may affect the fee rule. Whether to use the percent change method or whether to rebaseline is a policy judgment to be made only after evaluation and consideration of the many factors involved. While we could consider establishing numerical thresholds for the various fee classifications, we do not believe numbers alone should be the determining factor as to when to rebaseline. We believe establishment of mechanical numerical thresholds would eliminate the Commission judgment needed to develop fair fee schedules that take into account all pertinent considerations.

Therefore, the OCFO does not plan to recommend to the Commission that the NRC establish thresholds which would form the bases of when to rebaseline.

Recommendation 2:

Reevaluating the hourly rate calculation methodology so that the rates NRC develops include the full cost as embodied in OMB Circular A-25 and SFFAS No. 4. The reassessment should (a) define and identify generic costs and explain how to treat such costs, (b) establish a policy that clearly defines resources and how such resources should be treated in fee calculations, and (c) use actual billing and cost data to develop and refine future rate calculations.

Response: Agree in part.

We agree with the OIG's recommendation that we examine the existing approach for developing fees to determine if the approach can be improved in a cost-effective manner.

As indicated in the CFO's February 25, 1999, response to Recommendation 7 of the Draft Audit Report-Audit of the NRC's Fiscal Year 1998 Financial Statements, OCFO formed a multi-office team to study the generic costs to determine whether the costs currently identified as "generic" continue to meet the definition contained in the Conference Report to the Omnibus Budget Reconciliation Act. The OCFO expects to issue a report on the study in early December 1999. After you have reviewed the report, if you still have concerns that we are not complying with the requirements of IOAA, it is important that we meet to discuss this issue further. Therefore, since we continue to dispute your findings with regard to the calculation of the hourly rate, OCFO will not be implementing your recommendations with regard to how the hourly rate calculations are determined at this time, nor do we plan to modify the methodology employed.

In the meantime, OCFO has entered into a contract with an outside professional accounting firm for an analysis of the current fee model and for development of alternatives for determining whether there are cost-effective methods to improve the allocation of the budget for fee purposes. Until this effort is completed, we do not expect to use actual billings and cost data to develop and refine future rate calculations. Definitions, identification and treatment of generic costs, and establishment of a policy that more clearly defines resources and how they should be treated in the fee calculations, including any changes resulting from this analysis, will be included in the documentation of the fee development process described in our response to Recommendation 3 below.

Recommendation 3:

Developing formal criteria and procedures that (a) implement Recommendations 1 and 2, (b) describe the fee development process and steps, (c) ensure consistency of fee calculations, and (d) provide quality control procedures for fee calculation.

Response: Agree in part.

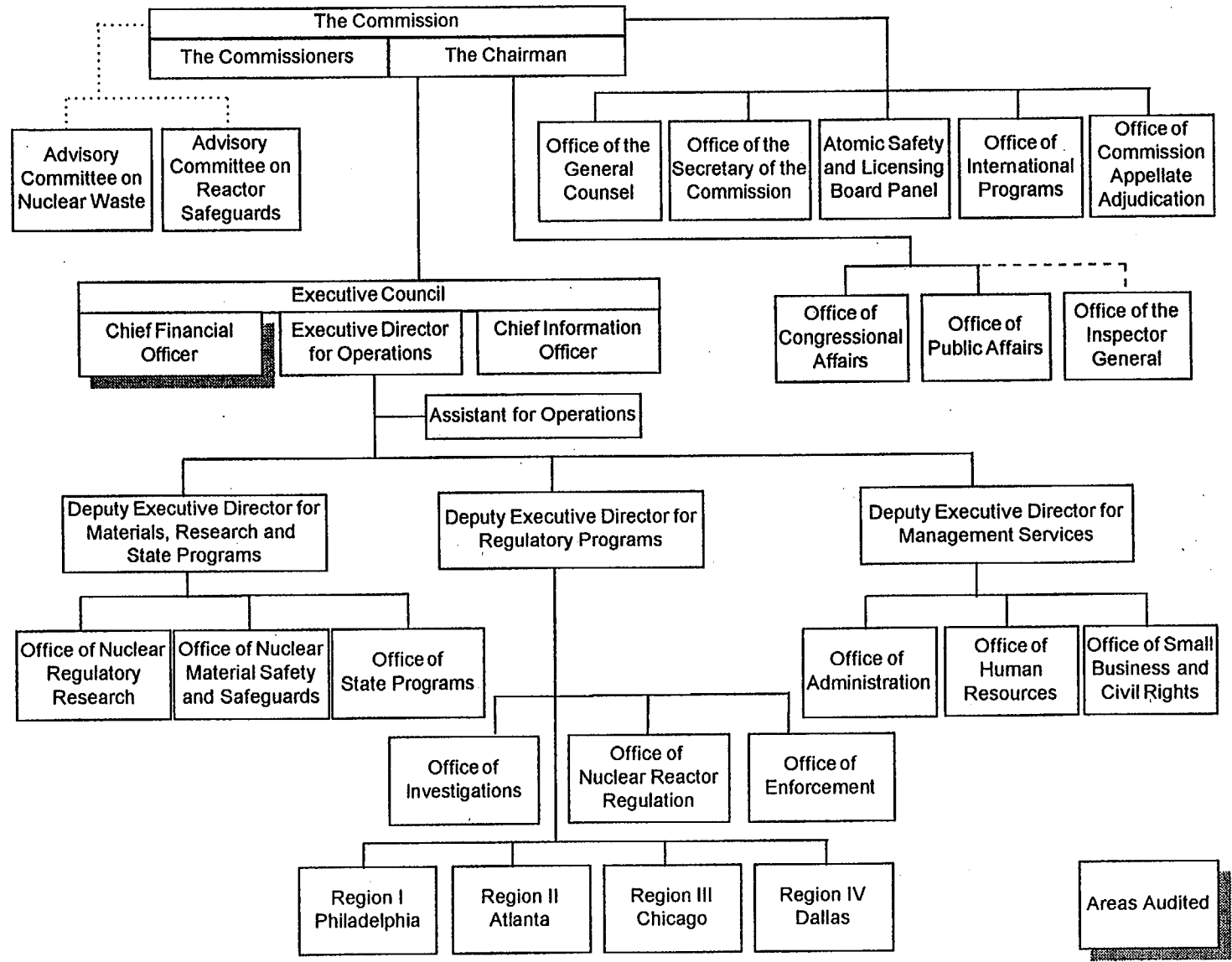
For subpart (a), OCFO will develop any necessary criteria and procedures for those portions of Recommendations 1 and 2 with which we agree. For subpart (b), OCFO has developed a Request for Proposal to have a contractor document the fee development process. We estimate it will be completed by September 30, 2000. For subpart (c), we believe there is consistency in the current fee calculations and that future fee rules will have consistent fee treatment. As for subpart (d), OCFO already provides quality assurance reviews for fee calculations commensurate with available staff resources and the short time frame for fee rule development. However, as with all our financial activities, we will strive to improve the quality assurance and quality control of the fee rule development process. Our QA process will be included in the documentation of the fee development process previously discussed.

CONCLUSION:

Based on the legal and policy reasons presented, we continue to disagree with a substantial number of the findings and conclusions in the audit report. We do not believe the report accurately portrays the program conducted by the agency to prepare and calculate fees. We believe that the fees developed and assessed were fairly and accurately distributed among licensees, were in compliance with pertinent laws and regulations and fully reflected the intent of applicable legislation.

NRC ORGANIZATION CHART

NRC's License Fee Development Process Needs Improvement
Appendix VII



OIG/99A-01

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MAJOR CONTRIBUTORS TO THIS REPORT

Anthony Lipuma
Team Leader

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Auditor

OFFICE OF THE INSPECTOR GENERAL PRODUCTS**INVESTIGATIVE****1. INVESTIGATIVE REPORT - WHITE COVER**

An Investigative Report documents pertinent facts of a case and describes available evidence relevant to allegations against individuals, including aspects of an allegation not substantiated. Investigative reports do not recommend disciplinary action against individual employees. Investigative reports are sensitive documents and contain information subject to the Privacy Act restrictions. Reports are given to officials and managers who have a need to know in order to properly determine whether administrative action is warranted. The agency is expected to advise the OIG within 90 days of receiving the investigative report as to what disciplinary or other action has been taken in response to investigative report findings.

2. EVENT INQUIRY - GREEN COVER

The Event Inquiry is an investigative product that documents the examination of events or agency actions that do not focus specifically on individual misconduct. These reports identify institutional weaknesses that led to or allowed a problem to occur. The agency is requested to advise the OIG of managerial initiatives taken in response to issues identified in these reports but tracking its recommendations is not required.

3. MANAGEMENT IMPLICATIONS REPORT (MIR) - MEMORANDUM

MIRs provide a "ROOT CAUSE" analysis sufficient for managers to facilitate correction of problems and to avoid similar issues in the future. Agency tracking of recommendations is not required.

AUDIT**4. AUDIT REPORT - BLUE COVER**

An Audit Report is the documentation of the review, recommendations, and findings resulting from an objective assessment of a program, function, or activity. Audits follow a defined procedure that allows for agency review and comment on draft audit reports. The audit results are also reported in the OIG's "Semiannual Report" to the Congress. Tracking of audit report recommendations and agency response is required.

5. SPECIAL EVALUATION REPORT - BURGUNDY COVER

A Special Evaluation Report documents the results of short-term, limited assessments. It provides an initial, quick response to a question or issue, and data to determine whether an in-depth independent audit should be planned. Agency tracking of recommendations is not required.

REGULATORY**6. REGULATORY COMMENTARY - BROWN COVER**

Regulatory Commentary is the review of existing and proposed legislation, regulations, and policies so as to assist the agency in preventing and detecting fraud, waste, and abuse in programs and operations. Commentaries cite the IG Act as authority for the review, state the specific law, regulation or policy examined, pertinent background information considered and identifies OIG concerns, observations, and objections. Significant observations regarding action or inaction by the agency are reported in the OIG Semiannual Report to Congress. Each report indicates whether a response is required.



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