

December 1992

FEDERAL RESEARCH

Assessment of the Financial Audit for SEMATECH's Activities in 1991



148113

**Resources, Community, and
Economic Development Division**

B-236668

December 11, 1992

The Honorable Sam Nunn
Chairman, Committee on
Armed Services
United States Senate

The Honorable Les Aspin
Chairman, Committee on
Armed Services
House of Representatives

The National Defense Authorization Act for Fiscal Years 1988 and 1989 (P.L. 100-180) requires that we review the annual audits of the financial statements of SEMATECH, Inc., a consortium of U.S. semiconductor manufacturers and the Department of Defense (DOD), and provide comments to you on their accuracy and completeness. This report, our fourth in response to the legislative requirement,¹ reviews the audit conducted by Price Waterhouse, an independent public accountant, of SEMATECH's financial statements for the year ending December 31, 1991. During the course of this review, we also followed up on (1) a recommendation made in our report on SEMATECH's 1990 financial statements² and (2) a prior issue concerning the inclusion of SEMATECH contributions as overhead costs on government contracts.

Price Waterhouse's opinion, dated February 5, 1992, stated that SEMATECH's 1991 financial statements are fairly presented in all material respects in conformance with generally accepted accounting principles. Also, in conformance with generally accepted government auditing standards, Price Waterhouse issued reports on SEMATECH's internal control structure and compliance with laws and regulations. These reports disclosed no material internal control weaknesses or noncompliance with laws and regulations. In addition, Price Waterhouse issued a management letter that made several recommendations that, although not material to the financial statements, were intended to improve SEMATECH's management efficiency and enhance its internal control structure.

¹See the list of related GAO products at the end of this report.

²Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1990 (GAO/RCED-92-97, Apr. 9, 1992).

Results in Brief

We found no indication during our review that the opinion of Price Waterhouse on SEMATECH's 1991 financial statements, its report on internal control structure, or its report on compliance with laws and regulations cannot be relied upon.

In our report on SEMATECH's 1990 financial statements, we recommended that the Secretary of Defense require that funds be disbursed through a letter of credit instead of making funds available in advance through quarterly payments to SEMATECH. DOD has agreed to modify its procedure for disbursing funds to SEMATECH in January 1993, when it revises the grant agreement, by providing advance payments to SEMATECH on a monthly basis.

In addition, for our July 1992 report on SEMATECH's technological progress,³ five member companies stated that they had included a portion of their SEMATECH contributions as overhead costs on government contracts that they held, while eight members said they had not charged the government for such expenses. While allowable under government cost accounting principles, reimbursing members' contributions through overhead serves indirectly to increase the government's overall support for SEMATECH. We note, however, that even if the amounts included as overhead were added to federal and state government contributions, member companies would still have paid their required 50 percent of SEMATECH's costs.

Background

SEMATECH was incorporated in Delaware in August 1987 as a nonprofit research and development corporation with the objective of advancing semiconductor manufacturing technology. The National Defense Authorization Act for Fiscal Years 1988 and 1989, enacted in December 1987, authorized the Secretary of Defense to make grants to SEMATECH to defray research and development expenses. The act required the Secretary of Defense to enter into a memorandum of understanding that provided, in part, that (1) the total amount of funds made available to SEMATECH by federal, state, and local government agencies for any fiscal year for the support of research and development activities may not exceed 50 percent of the total cost of such activities and (2) an independent, commercial auditor must submit annual reports to the Secretary of Defense, SEMATECH, and the Comptroller General on the extent to which SEMATECH's use of funds made available by the United States is consistent with the purposes of the act and SEMATECH's charter and annual operating plan.

³Federal Research: SEMATECH's Technological Progress and Proposed R&D Program (GAO/RCED-92-223BR, July 16, 1992).

In April 1988 the Secretary of Defense delegated responsibility for overseeing SEMATECH to the Defense Advanced Research Projects Agency (DARPA). In May 1988 DARPA entered into a memorandum of understanding with SEMATECH and signed a grant agreement. The Congress has made available about \$100 million annually for SEMATECH's use since fiscal year 1988 to match the contributions of SEMATECH's member companies. As of the end of 1991, member companies had contributed about \$4.6 million more than was needed to fulfill the legislative requirement that they contribute at least 50 percent of SEMATECH's annual expenditures. (See app. I for a list of SEMATECH's member companies in 1991.)

Prior Issues

In accordance with a recommendation in our report on the fiscal year 1990 financial statements, DARPA plans to revise its procedures in January 1993 to provide advance payments to SEMATECH on a monthly basis using SEMATECH's quarterly expenditure projections. Beginning in July 1988, SEMATECH obtained quarterly advances from DARPA to match allowable member company contributions and, on occasion, accumulated large balances of unexpended federal funds. For large grants such as SEMATECH's, the Office of Management and Budget's Circular A-110, Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations, generally requires letter-of-credit funding.

In addition, on the basis of unaudited company information obtained through DOD's Defense Contract Audit Agency, our report on SEMATECH's 1989 financial statements noted that at least two member companies had included a portion of their SEMATECH contributions as overhead costs on government contracts they held.⁴ Reimbursing these costs through overhead is allowable under government cost accounting principles. However, such reimbursement serves indirectly to increase the government's overall support for SEMATECH.

In response to our report, the Subcommittee on Defense, Senate Committee on Appropriations, asked us to survey SEMATECH's 14 member companies to determine whether their SEMATECH contributions and/or assignee pay and benefits had been included as an indirect expense or in an overhead pool charged to federal government contracts. Of the 13 members that responded,⁵ 5 stated that from 1987 through 1991 they had

⁴Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1989 (GAO/RCED-91-74, Apr. 30, 1991).

⁵Each of SEMATECH's original 14 member companies responded, except Micron Technology, Inc., which withdrew from the consortium during 1992.

included a total of at least \$3.7 million in SEMATECH contributions in their overhead pools; the other 8 members said they have not charged the government for such expenses. The \$3.7 million included for reimbursement is small in comparison with the total amount that member companies contributed to SEMATECH. We note that even if this amount were added to federal and state government contributions, the total would still be less than member companies' total contributions. However, such reimbursements might become significant for determining an appropriate level of direct federal funding in future years if other member companies begin including SEMATECH contributions in their overhead pools for government contracts.

Agency Comments

A draft of this report was sent to the Department of Defense and SEMATECH for comment. In its written comments, DOD concurred with the presentation of the report. (See app. II.) In written comments, SEMATECH's Chief Executive Officer said he was pleased to learn that we did not identify any issues requiring change or adjustment in SEMATECH's financial statements. (See app. III.)

Scope and Methodology

To determine the accuracy and completeness of the Price Waterhouse audit, we

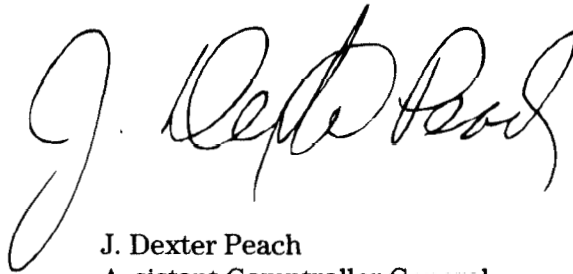
- reviewed the auditors' approach and planning of the audit;
- evaluated the qualifications and independence of the audit staff;
- reviewed the financial statements and auditors' reports to evaluate their compliance with generally accepted accounting principles and generally accepted government auditing standards; and
- reviewed the auditors' working papers to determine (1) the nature, timing, and extent of audit work performed; (2) the extent of audit quality control methods that the auditors used; (3) whether a review was conducted of SEMATECH's internal control structure; (4) whether the auditors tested transactions for compliance with applicable laws and regulations; and (5) whether evidence in the working papers supported the auditors' opinion on the financial statements and internal control structure and compliance reports.

We conducted our review of the Price Waterhouse audit of SEMATECH's 1991 financial statements from August to October 1992 in accordance with generally accepted government auditing standards. This report does not

include a copy of the 1991 financial statements because they contain proprietary information.

As agreed with your offices, we are sending copies of this report to the Secretary of Defense, the Chairman of the Board of Directors for SEMATECH, representatives of Price Waterhouse, and other interested parties. Copies will be made available to others upon request.

This report was prepared under the direction of Victor S. Rezendes, Director, Energy and Science Issues, who can be reached on (202) 275-1441 if you or your staffs have any questions. Major contributors to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read "J. Dexter Peach". The signature is written in a cursive style with a large initial "J".

J. Dexter Peach
Assistant Comptroller General

Contents

Letter	1
Appendix I SEMATECH's Member Companies in 1991	8
Appendix II Comments From the Department of Defense	9
Appendix III Comments From SEMATECH	10
Appendix IV Major Contributors to This Report	11
Related GAO Products	12

Abbreviations

DARPA	Defense Advanced Research Projects Agency
DOD	Department of Defense
GAO	General Accounting Office
SEMATECH	SEmiconductor MANufacturing TEChnology

SEMATECH's Member Companies in 1991

Advanced Micro Devices, Inc.

American Telephone and Telegraph Company (AT&T)

Digital Equipment Corporation

Harris Corporation

Hewlett-Packard Company

Intel Corporation

International Business Machines Corporation (IBM)

LSI Logic Corporation^a

Micron Technology, Inc.^a

Motorola, Inc.

National Semiconductor Corporation

NCR Corporation^b

Rockwell International Corporation

Texas Instruments, Inc.

^aWithdrew from SEMATECH in 1992.

^bNCR Corporation has been acquired by AT&T.

Comments From the Department of Defense



DIRECTOR OF DEFENSE RESEARCH AND ENGINEERING

WASHINGTON, DC 20301-3010

19 NOV 1992

Mr. Victor S. Rezendes, Jr.
Director, Energy and Science Issues
Resources, Community, and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Rezendes:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled--"FEDERAL RESEARCH: Assessment of the Financial Audit for SEMATECH's Activities in 1991," dated October 16, 1992 (GAO Code 307704/OSD Case 9241). The DoD fully concurs with the GAO findings.

The DoD is pleased that the GAO supports the independent audit by Price Waterhouse. Your findings are a credit to the sound management and competence of both SEMATECH and its independent certified public accounting firm.

The Department appreciates the opportunity to review and comment on the draft report.

Sincerely,


Victor H. Reis

Comments From SEMATECH



2706 MONTOPOLIS DRIVE
AUSTIN, TEXAS 78741-6499
(512) 356-3500

November 2, 1992

Mr. Victor S. Rezendes
Director, Energy and Science Issues
United States General Accounting Office
441 G Street NW, Room 1842
Washington, DC 20548

Dear Mr. Rezendes: *Vic*

We appreciate the opportunity to comment on the draft GAO report, dated October 16, 1992, which reviews the accuracy and completeness of the audit of SEMATECH's 1991 financial statements performed by Price Waterhouse.

I am pleased to learn that there are no issues requiring change or adjustment by SEMATECH. I am further pleased that the report affirms the excellent work of Price Waterhouse in conducting this audit to meet all necessary commercial and governmental standards.

We at SEMATECH are committed to the highest standards of financial reporting and compliance with generally accepted accounting principles as well as applicable laws and regulations, commensurate with our responsibility as a public-private partnership pursuing an important national mission.

We appreciate the courtesy and cooperation of the GAO officials in conducting their reviews over the past five years, as well as the open and forthright manner in which they have presented and examined the issues with us.

Sincerely,

William J. Spencer
President and Chief Executive Officer

WJS/ahe

Major Contributors to This Report

Resources,
Community, and
Economic
Development
Division, Washington,
D.C.

Lowell Mininger, Assistant Director
Richard P. Cheston, Assignment Manager

Accounting and
Financial
Management Division,
Washington, D.C.

Roger R. Stoltz, Assistant Director, Civil Audits

Dallas Regional Office

Joe D. Quicksall, Issue Area Manager
James D. Berry, Evaluator-in-Charge

Related GAO Products

Federal Research: Lessons Learned From SEMATECH (GAO/RCED-92-283, Sept. 28, 1992).

Federal Research: SEMATECH's Technological Progress and Proposed R&D Program (GAO/RCED-92-223BR, July 16, 1992).

Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1990 (GAO/RCED-92-97, Apr. 9, 1992).

Federal Research: SEMATECH's Efforts to Develop and Transfer Manufacturing Technology (GAO/RCED-91-139FS, May 10, 1991).

Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1989 (GAO/RCED-91-74, Apr. 30, 1991).

Federal Research: SEMATECH's Efforts to Strengthen the U.S. Semiconductor Industry (GAO/RCED-90-236, Sept. 13, 1990).

Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1988 (GAO/RCED-90-35, Feb. 16, 1990).

Federal Research: The SEMATECH Consortium's Start-up Activities (GAO/RCED-90-37, Nov. 3, 1989).

Ordering Information

The first copy of each GAO report is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

**U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877**

Orders may also be placed by calling (202) 275-6241.

**United States
General Accounting Office
Washington, D.C. 20548**

**Official Business
Penalty for Private Use \$300**

**First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100**
