

August 1995

FINANCIAL AUDIT

Review of the Audit of SEMATECH's Financial Statements for 1994





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

Accounting and Information
Management Division

B-261197

August 8, 1995

The Honorable Strom Thurmond
Chairman
The Honorable Sam Nunn
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Floyd Spence
Chairman
The Honorable Ronald V. Dellums
Ranking Minority Member
Committee on National Security
House of Representatives

The National Defense Authorization Act for Fiscal Years 1988 and 1989 (Public Law 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, and provide comments to you on the statements' accuracy and completeness. This report, the seventh in response to the legislative requirement,¹ presents the results of our review of the audit conducted by Price Waterhouse, an independent public accountant, of SEMATECH's financial statements for the year ending December 31, 1994.

Results in Brief

Price Waterhouse's opinion, dated January 26, 1995, stated that SEMATECH's 1994 financial statements are fairly presented in all material respects in conformity with generally accepted accounting principles. Also, as required by generally accepted government auditing standards, Price Waterhouse issued reports on SEMATECH's internal control structure and its compliance with laws and regulations. These reports disclosed no material internal control weaknesses or noncompliance with laws and regulations. Price Waterhouse also issued a management letter to SEMATECH making a recommendation to improve documentation over off-site assets. This issue, although not material with respect to the 1994 financial statements, was intended to improve SEMATECH's management efficiency and enhance its internal control structure.

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

We found no indication during our review that Price Waterhouse's opinion on SEMATECH's 1994 financial statements, its report on internal control structure, or its report on compliance with laws and regulations cannot be relied upon. However, based on our review we noted the need for enhanced disclosure in the financial statements with respect to matters pertaining to (1) government agency funding, (2) member company funding, and (3) investments.

Specifically, we believe that SEMATECH should have disclosed its July 15, 1994, public announcement of its intent not to seek government funding after December 31, 1996, and the effect that this significant funding reduction would have on its operations and financial condition. We also believe that more details should have been provided on the effect that advance notices of resignation by several consortium members may have on member company funding. Finally, we believe that further details should have been provided on the amounts and composition of funding provided and planned for investments.

We suggest that Price Waterhouse discuss as a matter of emphasis in its opinion on SEMATECH's 1995 financial statements the potential effects that the loss of funding resulting from (1) the intent not to seek government funding after December 31, 1996, and (2) several consortium members' notice of intent to resign will have on SEMATECH's operations and financial condition.

We have provided SEMATECH's Chief Financial Officer and Price Waterhouse with letters containing more detailed discussion of the above matters for enhanced disclosure in notes to SEMATECH's future financial statements (See GAO/AIMD-95-164R).

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. For these purposes, the Congress, through appropriations made to the Advanced Research Projects Agency, has granted SEMATECH about \$90 million annually for fiscal years 1994 and 1995, and about \$100 million annually for fiscal years 1988 through 1993.

The act also required the Secretary of Defense to enter into a memorandum of understanding with SEMATECH. As required by the act, the memorandum provided that 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. Additionally, an independent, commercial auditor must submit annual reports to the Secretary of Defense, SEMATECH, and the Comptroller General.

Our review considered (1) the extent to which SEMATECH has ensured that member company funding was not less than 50 percent of the cost of research and development activities and (2) the accuracy and completeness of the financial audit conducted by the independent, commercial auditor.

Scope and Methodology

To determine the extent of the funding match, we examined SEMATECH's 1994 financial statements and related notes and compared the amounts funded by the consortium members, plus interest earned and less any unallowable costs, to amounts funded by federal and state governments.

To determine the accuracy and completeness of the independent, commercial audit conducted by Price Waterhouse, we

- reviewed the auditor's approach and planning of the audit;
- evaluated the qualifications and independence of the audit staff;
- reviewed the financial statements and auditor's reports to evaluate compliance with generally accepted accounting principles and generally accepted government auditing standards; and
- reviewed the auditor's working papers to determine (1) the nature, timing, and extent of audit work performed, (2) the extent of audit quality control methods 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 1994 financial statements in April 1995 in accordance with generally accepted government auditing standards. This report does not include a

copy of the 1994 financial statements because they contain proprietary information.

Entity Comments and Our Evaluation

A draft of this report was discussed with SEMATECH's Chief Financial Officer and the Price Waterhouse Engagement Partner on the 1994 SEMATECH audit. They agreed to consider the applicability of our suggestions for enhanced disclosure when preparing SEMATECH's 1995 financial statements and during the subsequent audit of those statements. We believe that this agreement is responsive to our comments.

We are sending copies of this report to the Secretary of Defense, the Chairman of the Board of Directors of SEMATECH, representatives of Price Waterhouse, and other interested parties. Copies will be made available to others upon request. Please call me or Roger Stoltz, Assistant Director, at (202)512-9095 if you or your staffs have any questions.



David M. Connor
Director, Defense Financial Audits

Related GAO Products

Financial Audit: Review of the Audit of SEMATECH's Financial Statements for 1993 (GAO/AIMD-94-163, Aug. 29, 1994).

Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1992 (GAO/RCED-94-17, Oct. 13, 1993).

Federal Research: Assessment of the Financial Audit for SEMATECH's Activities in 1991 (GAO/RCED-93-50, Dec. 11, 1992).

Federal Research: Lessons Learned From SEMATECH (GAO/RCED-92-283, Sept. 29, 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).

The SEMATECH Consortium's Start-up Activities (GAO/T-RCED-90-11, Nov. 8, 1989).

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

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