

September 1996

# FINANCIAL AUDIT

## Review of the Audit of SEMATECH's Financial Statements for 1995



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

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Accounting and Information  
Management Division

B-274419

September 30, 1996

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, our eighth in response to the legislative requirement,<sup>1</sup> 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, 1995.

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## Results in Brief

Price Waterhouse's opinion, dated January 26, 1996, stated that SEMATECH's 1995 financial statements are fairly presented in all material respects in conformance 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 did not issue a management letter, as it had no issues to report.

We found no indication during our review that Price Waterhouse's opinion on SEMATECH's 1995 financial statements, its report on internal control structure, or its report on compliance with laws and regulations cannot be relied upon.

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<sup>1</sup>See list of related GAO products at the end of this report.

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We noted that SEMATECH enhanced its disclosure of government agency funding and investments in notes to its 1995 financial statements, which we provided for their consideration in last year's review.<sup>2</sup> The notes indicate that \$39 million was appropriated by the Congress to SEMATECH for 1996. However, funds are appropriated to the Department of Defense in a lump sum that is available for grants to SEMATECH. Subsequent to the preparation of SEMATECH's financial statements, Defense made \$84.6<sup>3</sup> million available to SEMATECH from its appropriated funds for the fiscal year ended September 30, 1996.

Our suggestion for enhanced disclosure concerning the effect that advance notices of resignation by several consortium members may have on funding was mitigated during 1995 by (1) a member rescinding its 2-year notice of intent to resign and (2) a member reaffirming its intent to remain a consortium member.

Price Waterhouse also evaluated our suggestion from last year's review that it discuss as a matter of emphasis the potential effects on SEMATECH's operations and financial condition of a loss of funding resulting from (1) SEMATECH's intent not to seek government funding after December 31, 1996, and (2) several members' notices of intent to resign. During 1995, SEMATECH finalized its 5-year plan to continue operations without government funding through higher levels of member funding and lower levels of expenditures. The plan, which was approved by its membership board of directors, included personnel reductions from 750 to 600 by March 31, 1996. These events, coupled with the changes in member advance notices of intent to resign as discussed above, mitigated the need for a matter of emphasis paragraph in the report on SEMATECH's 1995 financial statements.

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## Background

SEMATECH was incorporated in Delaware in August 1987 as a nonprofit membership 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. In April 1988, the Secretary of Defense delegated responsibility for overseeing SEMATECH to the Advanced Research Project

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<sup>2</sup>Financial Audit: Review of the Audit of SEMATECH's Financial Statements for 1994 (GAO/AIMD-95-168, Aug. 8, 1995).

<sup>3</sup>An additional \$4.4 million was withheld for administrative costs by the Advanced Research Project Agency.

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Agency, which granted SEMATECH about \$90 million annually for fiscal years 1994 through 1996, and about \$100 million annually from fiscal years 1988 through 1993.

The act also required the Secretary of Defense to enter into a memorandum of understanding with SEMATECH. 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.

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## Scope and Methodology

To determine the extent of funding match, we examined SEMATECH's 1995 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 auditor used, (3) whether a review was conducted of SEMATECH's internal control structure, (4) whether the auditor tested for compliance with applicable laws and regulations, and (5) whether evidence in the working papers supported the auditor's opinion on the financial statements and internal control structure and compliance reports.

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We conducted our review of the Price Waterhouse audit of SEMATECH's 1995 financial statements in May 1996 in accordance with generally accepted government auditing standards. We discussed the results of our review with cognizant Price Waterhouse, SEMATECH, and Defense officials. This report does not include a copy of SEMATECH's 1995 financial statements because they contain proprietary information.

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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.



Lisa G. Jacobson  
Director, Defense Financial Audits

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# Related GAO Products

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Financial Audit: Review of the Audit of SEMATECH's Financial Statements for 1994 (GAO/AIMD-95-168, Aug. 8, 1995).

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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