



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

Accounting and Information
Management Division

B-261989

July 20, 1995

Mr. Daniel A. Damon
Chief Financial Officer
SEMATECH
2706 Montopolis Drive
Austin, TX 78741

Dear Mr. Damon:

We have completed our review of the Price Waterhouse audit of SEMATECH's financial statements for 1994 and are now preparing a report (GAO/AIMD-95-168) on our review for the Chairmen, Senate Committee on Armed Services and House Committee on National Security. We performed this review pursuant to the National Defense Authorization Act for Fiscal Years 1988 and 1989 (Public Law 100-180).

Our review found no indication 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 disclosures in the financial statements with respect to (1) government agency funding, (2) member company funding, and (3) investments.

In this regard, we are making specific suggestions to provide enhanced disclosures in the notes to SEMATECH's future financial statements. We are providing examples of wording to illustrate how our suggestions might be implemented. We used the symbol "X" in lieu of some names and numbers for purposes of these illustrations.

GOVERNMENT AGENCY FUNDING

We believe that SEMATECH should disclose in its financial statements its July 15, 1994, public announcement of its intent not to seek government funding after December 31, 1996, and the effects the significant reduction in revenues would have on its operations and financial statements. Through discussions with you, we understand that this

GAO/AIMD-95-164R SEMATECH Enhanced Disclosure

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announcement pertains to the existing annual grant from the Advanced Research Projects Agency and does not preclude SEMATECH from applying for other public grants or funding. We suggest that a new paragraph such as the following be added at the end of "Government Agency Funding" in note 2:

"On July 15, 1994, SEMATECH's Board of Directors announced the consortium's intent not to seek its existing annual grant from the Advanced Research Projects Agency after December 31, 1996. The effect this reduction of half of its funding will have on its organization and future operations is . . ."

MEMBER COMPANY FUNDING

We believe that more details should be provided on the number of consortium members and the effect advance notices of resignation may have on member company funding. We suggest that wording such as the following be added at the end of the first paragraph of "Member Company Funding" in note 2:

"Of 14 original consortium members, 3 resigned prior to December 31, 1994, and X have given notice. The X members that have given notice provided X percent of 199X member funding, the loss of which could require higher dues to the remaining X members, dues from the recruitment of new members, and/or corresponding reductions in expenditures."

INVESTMENTS

We believe that further details should be provided on the amounts and composition of funding provided and planned for investments. We suggest that the underlined wording be added to the second paragraph of note 3 "Investments" as shown below:

"In September 1994, SEMATECH provided XXX with \$XXX to increase its manufacturing capacity. Of this amount, SEMATECH expensed \$XXX as direct program costs and recognized an investment of \$XXX for a warrant to purchase XXX shares of XXX common stock. The warrant may be exercised at any time at a fixed price of \$XXX per share. The warrant also . . . expires in XXX. Depending upon the outcome of negotiations with XXX, the remaining \$XXX of planned funding will be recognized as direct program costs or as an investment."

In our judgment, the enhanced disclosures we are suggesting would have been appropriate for SEMATECH's 1994 financial statements. However, we believe that the enhanced disclosure

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will certainly be needed in the 1995 financial statements, particularly with respect to SEMATECH's intent not to seek government funding after 1996 and the possible loss of funding from several consortium members.

We are including copies of this letter with our report to the Chairmen, Senate Committee on Armed Services and House Committee on National Security. We are also providing a copy to Price Waterhouse. We appreciate the courtesies extended by you and the SEMATECH Controller during our review.

Sincerely yours,



David M. Connor
Director, Defense Financial Audits

Enclosure

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