OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Audit of EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements

Report No. 08-1-0032

November 15, 2007

Abbreviations

ASSERT	Automated Self Evaluation and Reporting Tool
BRAINS	Billing & Reimbursable Accounting Information Network System
CNC	Currently Not Collectible
DOJ	Department of Justice
EPA	U.S. Environmental Protection Agency
FFMIA	Federal Financial Management Improvement Act
FMFIA	Federal Managers' Financial Integrity Act
GAO	Government Accountability Office
IFMS	Integrated Financial Management System
IT	Information Technology
mLINQS	Relocation Expense Management System
OARM	Office of Administration and Resources Management
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
READ	Registry of EPA Applications and Databases
RMDS	Resources Management Directive System
RSSI	Required Supplementary Stewardship Information
SSFAS	Statement of Federal Financial Accounting Standards
SUSF	Suspense Table

At a Glance

Catalyst for Improving the Environment

Why We Did This Audit

We performed this audit in accordance with the Government Management Reform Act, which requires the U.S. Environmental Protection Agency (EPA) to prepare, and the Office of Inspector General to audit, the Agency's financial statements each year. Our primary objectives were to determine whether:

- EPA's consolidated financial statements were fairly stated in all material respects.
- EPA's internal controls over financial reporting were in place.
- EPA management complied with applicable laws and regulations.

Background

The requirement for audited financial statements was enacted to help bring about improvements in agencies' financial management practices, systems, and controls so that timely, reliable information is available for managing federal programs.

For further information, contact our Office of Congressional and Public Liaison at (202) 566-2391.

To view the full report, click on the following link:
www.epa.gov/oig/reports/2008/20071115-08-1-0032.pdf

Audit of EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements

EPA Receives Unqualified Opinion

We rendered an unqualified, or clean, opinion on EPA's Consolidated Financial Statements for fiscal 2007 and 2006 (restated), meaning that they were fairly presented and free of material misstatement.

Internal Control Material Weakness, Significant Deficiencies Noted

We noted one material weakness with EPA's Implementation of the "Currently Not Collectible" policy for accounts receivable that caused a Material Understatement of Asset Value and led to the restatement of the fiscal 2006 financial statements. Further, we noted the following six significant deficiencies:

- EPA did not properly compute an allowance for doubtful accounts.
- EPA needs to improve internal controls in recording and accounting for accounts receivable.
- Key applications do not meet federal and EPA information security requirements.
- Access and security practices over critical information technology assets need improvement.
- EPA needs to improve controls over the Integrated Financial Management System Suspense Table.
- EPA did not maintain adequate documentation for obligating accounting adjustments.

Noncompliance With Laws and Regulations Noted

EPA is in noncompliance with regulations relating to reconciling intragovernmental transactions.

Federal Financial Management Improvement Act Noncompliance

We identified two instances of substantial noncompliance under the Federal Financial Management Improvement Act. These noncompliances are also significant deficiencies. Two critical applications did not meet federal and EPA information technology security requirements. Also, key controls associated with certain servers did not comply with federal guidelines.

Agency Comments and Office of Inspector General Evaluation

In a memorandum received on November 9, 2007, from the Chief Financial Officer, the Agency recognized the issues raised and indicated it will take corrective actions.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
INSPECTOR GENERAL

November 15, 2007

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements
Report No. 08-1-0032

FROM: Paul C. Curtis
Director, Financial Statement Audits

TO: Lyons Gray
Chief Financial Officer

Attached is our audit report on the U.S. Environmental Protection Agency's (EPA's) Fiscal 2007 and 2006 (restated) consolidated financial statements. We are reporting a material weakness related to EPA's accounting for delinquent receivables, as well as six reportable conditions. Two of the reportable conditions are financial report systems-related significant deficiencies under the Federal Information Security Management Act of 2002. By definition they are also instances of substantial noncompliance under the Federal Financial Management Improvement Act. We also identified a noncompliance with laws and regulations related to reporting intragovernmental transactions. Attachment 3 contains the status of recommendations from prior years.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is $2,367,128.

This audit report represents the opinion of the Office of Inspector General, and the findings in this report do not necessarily represent the final EPA position. EPA managers in accordance with established EPA audit resolution procedures will make final determinations on matters in this audit report. Accordingly, the findings described in this audit report are not binding upon EPA in any enforcement proceeding brought by EPA or the Department of Justice. We have no objections to the further release of this report to the public. This report will be available at http://epa.gov/oig/.

In accordance with EPA Manual 2750, *Audit Management Process*, you are required to provide us with a written response to the final audit report within 90 days of the final report date. The response should address all issues and recommendations contained in Attachments 1 and 2. For corrective actions planned but not completed by the response date, reference to specific milestone dates will assist us in deciding whether or not to close this report in our audit tracking system.

Should you or your staff have any questions about the report, please contact me at (202) 566-2523; or Melissa Heist, Assistant Inspector General for Audit, at (202) 566-0899.

Attachments

cc: See Appendix III, Distribution

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Inspector General's Report on EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements

The Administrator
U.S. Environmental Protection Agency

We have audited the consolidated balance sheet of the U.S. Environmental Protection Agency (EPA, or the Agency) as of September 30, 2007 and 2006 (Restated), and the related consolidated statements of net cost, net cost by goal, changes in net position, and custodial activity; and the combined statement of budgetary resources for the years then ended. These financial statements are the responsibility of EPA's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards; the standards applicable to financial statements contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 40, the Agency has restated its financial statements for fiscal 2006 due to material errors in accounting for delinquent debts. In fiscal 2006, EPA adopted OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, for accounting for what it considered to be delinquent debts. This policy, as adopted by EPA, required that all receivables outstanding longer than 2 years be removed from the books and put in a memo account. In fiscal 2007, EPA received material collections on those receivables. Further review of correspondence from attorneys indicated that material receivables removed from the books in 2006 were collectible. The evidence was available to the Agency but not considered at the time. As a result, EPA has re-evaluated its decision to adopt OMB Circular A-129, did an in-depth review of the receivables removed from the books, and determined that it needed to restate the fiscal 2006 financial statements in order to properly reflect the value of Agency assets. The Agency restated the fiscal 2006 financial statements to reflect an increase in the net book value of receivables of $247,413, an increase in liabilities of $12,910, a reversal of write-offs to expense of $160,185, and a prior period adjustment of $74,318.

Due to the material errors found in accounting for delinquent debts, our report on EPA's fiscal 2006 financial statements, issued on November 15, 2006, is not to be relied upon. That report is replaced by this report on the restated fiscal 2006 financial statements. We reported the internal control deficiencies that resulted in the material errors as a material weakness in the Internal Control section of our report.

The financial statements include expenses of grantees, contractors, and other federal agencies. Our audit work pertaining to these expenses included testing only within EPA. Audits of grants, contracts, and interagency agreements performed at a later date may disclose questioned costs of an amount undeterminable at this time. The U.S. Treasury collects and accounts for excise taxes that are deposited into the Superfund and Leaking Underground Storage Tank Trust Funds. The U.S. Treasury is also responsible for investing amounts not needed for current disbursements and transferring funds to EPA as authorized in legislation. Since the U.S. Treasury, and not EPA, is responsible for these activities, our audit work did not cover these activities.

The Office of Inspector General (OIG) is not independent with respect to amounts pertaining to OIG operations that are presented in the financial statements. The amounts included for the OIG are not material to EPA's financial statements. The OIG is organizationally independent with respect to all other aspects of the Agency's activities.

In our opinion, the consolidated financial statements present fairly, including the accompanying notes, in all material respects, the consolidated assets, liabilities, net position, net cost, net cost by goal, changes in net position, custodial activity, and combined budgetary resources of EPA as of and for the years ended September 30, 2007 and 2006 (restated), in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information for earmarked and all other funds presented in the statement of changes in net position is for purposes of additional analysis of the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Review of EPA's Required Supplementary Stewardship Information, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis

We inquired of EPA's management as to its methods for preparing Required Supplementary Stewardship Information (RSSI), Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis, and reviewed this information for consistency with the financial statements. The Supplemental Information includes the unaudited Superfund Trust Fund financial statements for fiscal 2007 and 2006 (restated), which are being presented for additional analysis and are not a required part of the basic financial statements. However, our audit was not designed to express an opinion and, accordingly, we do not express an opinion on EPA's RSSI, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis.

We did not identify any material inconsistencies between the information presented in EPA's consolidated financial statements and the information presented in EPA's RSSI, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis.

Evaluation of Internal Controls

As defined by OMB, internal control, as it relates to the financial statements, is a process, affected by the Agency’s management and other personnel, designed to provide reasonable assurance that the following objectives are met:

> **Reliability of financial reporting** - Transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and RSSI in accordance with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
>
> **Compliance with applicable laws, regulations, and government-wide policies** - Transactions are executed in accordance with laws governing the use of budget authority, government-wide policies, laws identified by OMB, and other laws and regulations that could have a direct and material effect on the financial statements.
>
> **Reliability of performance reporting** - Transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

In planning and performing our audit, we considered EPA’s internal controls over financial reporting by obtaining an understanding of the Agency’s internal controls, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls. We did this as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting nor on management’s assertion on internal controls included in Management’s Discussion and Analysis. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers’ Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal controls and, accordingly, we do not express an opinion on internal controls.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Agency's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed below involving the internal control and its operation that we consider to be significant deficiencies, of which one is considered a material weakness.

In addition, we considered EPA's internal control over the RSSI by obtaining an understanding of the Agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on these internal controls and, accordingly, we do not express an opinion on such controls.

Finally, with respect to internal controls related to performance measures presented in *EPA's Fiscal Year 2007 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not express an opinion on such controls.

Material Weakness

EPA's Implementation of the "Currently Not Collectible" Policy for Accounts Receivable Materially Understated Asset Value

During fiscal 2006, EPA materially understated the fiscal 2006 asset value by writing off $150 million for 31 accounts receivable that were collectible. EPA recorded the write-offs based on implementation of its new "Currently Not Collectible" (CNC) policy. This policy mandated automatic write-off from accounts receivable to a CNC memo account set up for those receivables that had no collection activity for 2 years. After write-off, the Servicing Finance Offices were supposed to review the receivables recorded in the CNC memo account in the Integrated Financial Management System (IFMS) and determine whether they were properly classified as CNC. EPA did not review accounts receivable that were automatically written off. During fiscal 2007, EPA collected $150 million of receivables written off, including one large receivable of $127 million. As a result, EPA did not disclose receivables in the 2006 Financial Statements that had a material net realizable value. Federal accounting standards require EPA to record receivables at net realizable value. We consider the control weakness that resulted in EPA undervaluing its fiscal 2006 receivables by $150 million to be a material weakness.

Significant Deficiencies

Allowance for Doubtful Accounts Calculation Needs Improvement

EPA did not properly compute an allowance for doubtful accounts for fiscal 2006 and 2007. Federal accounting standards and OMB Circular A-136 require agencies to reduce accounts receivable to net realizable value by computing an allowance for doubtful accounts. EPA did not obtain sufficient objective evidence to support the calculation of its allowance estimate on the 2006 re-established receivables and the 2007 receivables.

By not using objective evidence to support their allowance estimates, EPA's financial statements could be misstated.

EPA Needs to Improve Internal Controls in Recording and Accounting for Accounts Receivable

We found 150 errors during testing of internal controls for EPA's accounting for accounts receivable. These errors occurred because EPA had not established or implemented procedures to ensure timely and accurate recording of accounts receivable. Federal accounting standards and EPA policies require accurate and timely recording of transactions. These errors and internal control deficiencies affect the reliability and integrity of accounts receivable on the financial statements and the information used to manage these receivables.

Key Applications Do Not Meet Federal and EPA Information Security Requirements

EPA had not complied with federal and Agency information security standards. In particular, key systems (BRAINS and mLINQS)[1] did not have required contingency plans and signed authorizations to operate. The systems also lacked independent reviews of security controls and security plans. EPA did not review these systems for compliance with Federal Financial Management System Requirements. At the time of our review, EPA also had not recognized these systems in either of the Agency's databases used to track the inventory of EPA applications (ASSERT or READ).[2] The conditions noted existed because EPA management did not consider these systems "major applications," and thus did not believe it was necessary to comply with published requirements. This is also a substantial noncompliance issue under the Federal Financial Management Improvement Act (FFMIA) of 1996.

Access and Security Practices Over Critical Information Technology Assets Need Improvement

EPA needs to take more steps to support its security practices and access controls over critical information technology (IT) assets. In particular, our field work disclosed concerns in the following management control areas:

- **Disaster Recovery Practices –** EPA had not separated duties for backing up, transporting, and securing critical business data, thereby creating a situation where key business data is susceptible to loss, theft, or misuse without detection. EPA lacks accountability over the use and custody of media drives containing key financial and sensitive personally identifiable information.

[1] BRAINS (Billing & Reimbursable Accounting Information Network System) is used to process accounts receivable; mLINQS (Relocation Expense Management System) is used to process Permanent Change of Station payments.
[2] ASSERT (Automated Self Evaluation and Reporting Tool) and READ (Registry of EPA Applications and Databases) track the inventory of EPA applications.

- **System Monitoring Practices –** EPA does not monitor critical servers for known vulnerabilities or review system log files for violations of Agency policy. Personnel with significant security responsibility did not receive training on their responsibilities. EPA does not use all available system configuration and security monitoring tools to enforce Agency policies.

- **Server Room Access Controls –** EPA lacks practices to control the access to critical IT assets by non-EPA personnel and other visitors. EPA lacks control over keys to the server room, and the server room activity is not captured or recorded. Critical IT assets are not secured in a manner that would prevent an unauthorized user from tampering with them. For example, unauthorized personnel could physically access the server components and use this access to bypass security implemented to protect the server's data.

Environmental Controls – The server room did not have a correctly installed water shield to protect EPA servers and Uninterrupted Power Supply. The server room did not have sensors that can monitor and alert appropriate personnel of environmental conditions that are hazardous to critical IT assets (excessive humidity, high temperature, and water).

This is also a substantial noncompliance under FFMIA.

EPA Needs to Improve Controls Over the IFMS Suspense Table

EPA needs to improve practices for removing financial transactions that do not process completely in IFMS. IFMS is EPA's core financial accounting system. We found that, monthly, EPA personnel automatically purged all financial transactions over 45 days old from the IFMS Suspense Table (SUSF) without obtaining evidence that the transactions should be deleted, as required by EPA Office of Financial Management Policy Announcement 04-02. This occurred because EPA had not implemented a management oversight process to enforce the Agency's policy requiring EPA offices to explain entries in the SUSF file between 30-45 days old. Although EPA sent notices to the originator regarding the status of its SUSF entries, the originator did not provide responses. In addition, EPA had not put in place a delinquency notice to inform senior EPA officials that uncleared entries remain in the SUSF. In an attempt to reduce the number of excessive out-of-date entries in the SUSF table never reviewed, subsequently deleted, or cleared, EPA personnel said they deleted the financial transactions instead of having the user that originated it do so.

EPA Did Not Maintain Adequate Documentation for Obligation Accounting Adjustments

EPA made adjustments to obligation transactions in IFMS without documenting why the transactions were made and who approved them. This occurred because finance personnel did not understand the policy requirements for documenting adjustments. We have reported similar instances of unsupported transactions since fiscal 2000. EPA policy requires that all financial transactions recorded in the accounting system be supported by adequate source documentation. Inputting adjusting entries into the Agency's accounting system without adequate documentation increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered.

Attachment 3 contains the status of recommendations related to significant deficiencies reported in prior years' reports. We reported less significant matters regarding internal controls in the form of position papers during the course of the audit. We will not issue a separate management letter.

Comparison of EPA's FMFIA Report with Our Evaluation of Internal Controls

OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, requires us to compare material weaknesses disclosed during the audit with those material weaknesses reported in the Agency's FMFIA report that relate to the financial statements and identify material weaknesses disclosed by the audit that were not reported in the Agency's FMFIA report.

For reporting under FMFIA, material weaknesses are defined differently than they are for financial statement audit purposes. OMB Circular A-123, *Management Accountability and Control*, defines a material weakness as a deficiency that the Agency head determines to be significant enough to be reported outside the Agency.

For financial statement audit purposes, OMB defines material weaknesses in internal control as a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

The Agency reported that three material weaknesses had been identified for fiscal 2007, one of which has been corrected. All these material weaknesses were identified by the OIG in the course of this audit, and are described in this report.

Tests of Compliance with Laws and Regulations

EPA management is responsible for complying with laws and regulations applicable to the Agency. As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. The OMB guidance requires that we evaluate compliance with federal financial management system requirements, including the requirements referred to in the FFMIA of 1996. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to EPA.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. A number of ongoing investigations involving EPA's grantees and contractors could disclose violations of laws and regulations, but a determination about these cases has not been made.

Our tests of laws and regulations disclosed the following noncompliance issue.

EPA Needs to Reconcile Differences With Trading Partners

As of September 30, 2007, EPA had over $375 million in net unreconciled differences with 46 of its trading partners for intragovernmental transactions. Treasury policy requires agencies to confirm and reconcile intragovernmental transactions with their trading partners. EPA had difficulty reconciling these differences primarily because of differing accounting treatments and accrual methodologies between federal agencies. EPA's inability to reconcile its intragovernmental transactions contributes to a long-standing government-wide problem that hinders the ability of the Government Accountability Office (GAO) to render an opinion on the Consolidated Financial Statements of the Federal Government. Attachment 2 provides additional details and our recommendations on actions that should be taken on this matter.

Federal Financial Management Improvement Act Noncompliance

Under FFMIA, we are required to report whether the Agency's financial management systems substantially comply with the federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level. An OMB memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*, lists the specific requirements of FFMIA, as well as factors to consider in reviewing systems and for determining substantial compliance with FFMIA. It also provides guidance to Agency heads for developing corrective action plans to bring an Agency into compliance with FFMIA. To meet the FFMIA requirement, we performed tests of compliance with FFMIA section 803(a) requirements and used the OMB guidance, revised on January 4, 2001, for determining substantial noncompliance with FFMIA.

The results of our work disclosed instances where the Agency's financial management systems did not substantially comply with the applicable federal accounting standard. We identified two financial report systems-related significant deficiencies under the Federal Information Security Management Act of 2002. By definition they are also instances of substantial noncompliances under FFMIA. The noncompliances are: (1) two critical applications did not meet federal and EPA IT security requirements; and (2) key managerial, operational, and technical controls associated with monitoring for system vulnerabilities on, controlling physical access to, and monitoring environmental controls associated with certain servers did not comply with federal guidelines. The noncompliances occurred because management did not consider the two critical applications to be "major applications," did not document performance expectations in written procedures, and did not correct previously identified deficiencies. These issues are also considered to be significant deficiencies. The details of these noncompliances can be found above and in attachment 1.

We reported other less significant matters involving compliance with laws and regulations in position papers during the course of our audit. We will not be issuing a separate management letter.

Our audit work was also performed to meet the requirement in 42 U.S. Code 9611(k) with respect to the Hazardous Substance Superfund to conduct an annual audit of payments, obligations, reimbursements, or other uses of the Fund. We reported a material weakness on accounting for delinquent receivables, which relates primarily to Superfund receivables and other significant deficiencies above.

Prior Audit Coverage

During previous financial or financial-related audits, we reported weaknesses that impacted our audit objectives in the following areas:

- Payroll internal controls.
- General ledger adjustments for receivables transferred to the Cincinnati Finance Center.
- Contingency plans for financial applications.
- Reconciling and reporting intragovernmental transactions, assets, and liabilities by federal trading partner.
- Recording marketable securities.
- Correcting rejected transactions.
- Assessing automated application processing controls for IFMS.
- Security screenings for non-federal personnel.
- Change control procedures for IFMS.

Attachment 3, Status of Prior Audit Report Recommendations, summarizes the current status of corrective actions taken on prior audit report recommendations.

Agency Comments and OIG Evaluation

In a memorandum dated November 9, 2007, the Office of the Chief Financial Officer (OCFO) responded to our draft report.

The rationale for our conclusions and a summary of the Agency comments are included in the appropriate sections of this report, and the Agency's complete response is included as Appendix II to this report.

This report is intended solely for the information and use of the management of EPA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Paul C. Curtis

Paul C. Curtis
Director, Financial Statement Audits
Office of Inspector General
U.S. Environmental Protection Agency
November 14, 2007

Material Weakness and Significant Deficiencies

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Material Weakness

Significant Deficiencies

1 – EPA's Implementation of the "Currently Not Collectible" Policy for Accounts Receivable Materially Understated Asset Value

During fiscal 2006, EPA materially understated the fiscal 2006 asset value by writing off $150 million for 31 accounts receivable that were collectible. EPA recorded the write-offs based on implementation of its new "Currently Not Collectible" (CNC) policy. This policy mandated automatic write-off from accounts receivable to a CNC memo account set up for those receivables that had no collection activity for 2 years. After write-off, the Servicing Finance Offices were supposed to review the receivables recorded in the CNC memo account in IFMS and determine whether they were properly classified as CNC. EPA did not review accounts receivable that were automatically written off. During fiscal 2007, EPA collected $150 million of receivables written off, including one large receivable of $127 million. As a result, EPA did not disclose receivables in the 2006 Financial Statements that had a material net realizable value. Federal accounting standards require EPA to record receivables at net realizable value. We consider the control weakness that resulted in EPA undervaluing its fiscal 2006 receivables by $150 million to be a material weakness.

OCFO based the CNC policy on OMB Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*. Circular A-129 made write-off of accounts receivable generally mandatory for delinquent debt older than 2 years. EPA's implementation of OMB's policy in fiscal 2006 made write-off of accounts receivable mandatory if delinquent for more than 2 years. EPA's write-offs included receivables that were considered to be collectible.

As of September 30, 2006, EPA wrote off $725 million under the policy. In fiscal 2007, we identified collections of $150 million on previously written-off receivables. The collections included $127 million for one receivable written off in fiscal 2006. EPA wrote off the receivable even though the case attorney considered the receivable to be fully collectible. The material collections on write-offs indicate that EPA did not value the receivables at the proper net realizable value.

Statement of Federal Financial Accounting Standards (SFFAS) Number 1 prescribes asset valuation. SFFAS states that a receivable should be recognized when a federal entity establishes a claim. An allowance for an estimated uncollectible amount should reduce the gross amount of receivables to its net realizable value.

EPA's Resources Management Directive System (RMDS) 2540-09,[3] Chapter 9, *Receivables and Billings*, stated that the Servicing Finance Offices should use a combination of the percentage analysis method and the specific identification method. The percentage analysis method is used for smaller dollar debts, whereas the specific identification method is used for large debts. Both methods require an objective analysis of the outstanding debt using an aging of receivables (debt) report at the end of each quarter.

[3] RMDS 2540-09 Chapter 9 was updated on September 18, 2007, and states that EPA should recognize an allowance for estimated uncollectible amounts to reduce the gross amount of debt to its net realizable value. EPA should individually analyze accounts that represent significant amounts to determine the loss allowance. EPA should assess potential losses for other accounts on a group basis.

The CNC policy required automatic write-off of receivables that were delinquent for 2 or more years even though they might be collected in the future. The policy was not appropriate for valuing the majority of EPA's receivables, such as Superfund cost recovery and grant refund receivables, because they commonly require several years to collect.

EPA's implementation of the CNC policy, as described by RMDS 2540-09 Chapter 9, is in direct conflict with generally accepted accounting standard SFFAS Number 1. RMDS 2540-09 Chapter 9 requires receivables to be removed from the general ledger and classified as CNC if "the debt has been delinquent for two or more years; the debt might be collected in the future and EPA will continue …collection activity...." SFFAS Number 1 requires assets to be reflected at their net realizable value. By writing off receivables that were considered collectible, EPA was in noncompliance with standards and materially understated receivables.

EPA did not properly implement the CNC policy as required by RMDS 2540-09. In addition to the process that automatically wrote off receivables that had no collections for 2 years, the policy required the Servicing Finance Offices to follow up to determine if the receivable was properly classified. If the debt was not properly classified as CNC, the Servicing Finance Offices were to "reclassify the debt as either open or close-out." In a July 5, 2005, email, EPA's case attorney for the $127 million settlement stated the receivable was fully collectible. EPA did not act upon the attorney's information to prevent the write-off. The policy also required Receivables and Billings staff in the Reports and Analysis Staff to (1) monitor and evaluate each Servicing Finance Office's quarterly review for quality control and compliance, and (2) ensure that all quarterly reviews collectively support the CNC 9050 general ledger account. EPA did not perform a quarterly review of CNC receivables, nor did Reports and Analysis Staff evaluate items reclassified as CNC. As a result, EPA wrote off some non-delinquent receivables, including receivables that had recent collections. In reports to OMB, EPA also misstated the amount of its delinquent receivables.

Because of the materiality of the collectible accounts receivable that were written off, the continued collection on written-off receivables, and the likelihood such errors will repeat under the current system of controls, we consider the Agency's valuation of accounts receivable to be a material weakness. OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, dated September 4, 2007, defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. EPA will need to correct this material error by restating the fiscal 2006 financial statements.

Recommendations

We recommend that the OCFO:

1. Change its accounting policy to reflect receivables at their net realizable value. The policy should provide that accounts receivable considered fully or partially collectible should not be written off, but should remain in accounts receivable with an appropriate allowance for doubtful accounts.

2. Restore all CNC receivables to open accounts receivable with an appropriate allowance for doubtful accounts.

Agency Comments and OIG Evaluation

The Agency agreed with our findings and recommendations. The Agency restated its fiscal 2006 financial statements and discontinued the practice of writing off delinquent receivables over 2 years old.

2 – EPA's Allowance for Doubtful Accounts Calculation Needs Improvement

EPA did not properly compute an allowance for doubtful accounts for fiscal 2006 and 2007. Federal accounting standards and OMB Circular A-136 require agencies to reduce accounts receivable to net realizable value by computing an allowance for doubtful accounts. EPA did not obtain sufficient objective evidence to support the calculation of its allowance estimate on the 2006 re-established receivables and the 2007 receivables. By not using objective evidence to support allowance estimates, EPA's financial statements could be misstated.

EPA re-established $704,818,433 of fiscal 2006 accounts receivable that were previously written off as currently not collectible. We tested the allowance estimate on a majority of the re-established high dollar receivables and some smaller receivables. Overall we tested $661,702,225, or 94 percent, of the amount of the re-established accounts receivable. The table below summarizes the test results.

	No. of Transactions	Receivable Amount	Allowance Amount
Re-established Accounts Receivable at EPA	665	$704,818,433	$507,018,368
Amounts Tested	55	$661,702,225	$471,982,994
Unsupported Allowance	25	$201,531,819	$179,729,256

Source: OIG analysis

For $201,531,819, or 29 percent of the dollars tested, accounts receivable files did not contain sufficient objective information to support EPA's allowance estimates.

Objective evidence for allowance estimates should be documented, relevant to the conclusion, and from an authoritative third party. Sufficient evidence may be obtained from external sources such as the case attorney, Program Official, or Department of Justice (DOJ). Examples of objective evidence would be the case attorney's assessment of the collectibility of an accounts receivable, an assessment by someone in the program office with knowledge of the accounts receivable, or historical documentation on the status of the receivable.

The Agency did not properly update or apply aging percentages in computing the fiscal 2007 allowance for doubtful accounts. We found that EPA did not properly calculate the second and third quarter 2007 allowance for doubtful accounts. EPA did not:

- Reconcile the receivables used in the allowance calculation to the general ledger balances and ensure the calculation included all receivables.
- Use the fiscal 2007 percentages for the second and third quarter allowance calculations. Rather than use the 2007 percentages, EPA substituted substantially higher percentages in several categories.
- Update the percentages based on current data. EPA has not updated its methodology since it consolidated the receivable function at one of its finance centers.

SFFAS Number 1 states that an allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of accounts receivable to its net realizable value. Accounts receivable representing significant amounts should be individually analyzed to determine loss amounts using a systematic methodology. Loss estimates should be based on (a) the debtor's ability to pay, (b) the debtor's payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources.

Under Generally Accepted Accounting Principles, the Objectivity Principle states that accounting will be recorded on the basis of objective evidence. The Objectivity Principle describes objective evidence as "…different people looking at the same evidence will arrive at the same values for the transaction. Accounting entries will be based on fact and not on personal opinion or feelings."

EPA's RMDS 2540, Chapter 9, Section 10(a), requires Servicing Finance Offices to "derive by age category an estimated percentage of the amount that will not be collected based on the experience of collecting past due accounts."

Appropriate allowance estimates are necessary to recognize accounts receivable at net realizable value. Without appropriate estimates of accounts receivable collectibility, EPA's financial statements and results of operations would not be fairly stated.

Recommendations

We recommend that the OCFO:

3. Prepare the specific identification allowance for doubtful accounts estimates based upon the objective evidence. Such evidence may be obtained from the case attorney, Program Official, DOJ assessment of the receivable's collectibility, or other sources, depending upon the type of receivable.

4. Reconcile the receivables to the general ledger and ensure the allowance for doubtful accounts calculation includes all receivables.

5. Use the percentages applicable to the current year for the year-end allowance for doubtful account percentage analysis calculations.

6. Update the allowance for doubtful account percentages based on current data.

Agency Comments and OIG Evaluation

The Agency agreed with our findings and recommendations.

3 - EPA Needs to Improve Internal Controls in Recording and Accounting for Accounts Receivable

We found 150 errors during testing of EPA's internal controls for accounting for accounts receivable. These errors occurred because EPA had not established or implemented procedures to ensure timely and accurate recording of accounts receivable. Federal accounting standards and EPA policies require accurate and timely recording of transactions. These errors and internal control deficiencies affect the reliability and integrity of accounts receivable on the financial statements and the information used to manage these receivables.

GAO's *Standards for Internal Control in the Federal Government* require accurate and timely recording of transactions and events. OMB Circular A-123, *Management's Responsibility for Internal Control,* states: "control activities include policies, procedures and mechanisms in place to help ensure that agency objectives are met. Several examples include: proper segregation of duties (separate personnel with authority to authorize a transaction, process the transaction, and review the transaction); proper authorization; and appropriate documentation and access to that documentation."

During our testing of accounts receivable, we found the following weaknesses in EPA's internal controls and ability to account for accounts receivable:

- EPA did not timely receive 39 legal documents totaling $35,344,222 that supported accounts receivable. Further, EPA did not timely record 11 receivables totaling $20,612,176 after receipt of legal documents. Regional counsel and DOJ did not forward legal documents and supporting documentation to the Finance Office within a reasonable time. Some receivable documents were not received until up to 141 days after the effective date. EPA's RMDS 2550 D, Chapter 14, requires regional enforcement and counsel offices to forward copies of all entered consent decrees and judgments to the finance offices within 3 work days of receipt from DOJ or the court. Finance offices are to record the Superfund accounts receivable in IFMS within 3 work days of receipt of the legal document.

- EPA did not record 10 receivables totaling $4,068,971 included on regional office and DOJ reports. EPA finance offices did not follow up with regional offices and DOJ to obtain legal documents when collections were received prior to accounts receivable documentation being received and recorded in IFMS. Further, EPA finance offices did not routinely communicate with regional counsel offices, program offices, or DOJ when there were discrepancies between accounts receivable recorded in IFMS and external reports. EPA's *Office of the Comptroller Transmittal No. 00-05: Reporting and Tracking Superfund Accounts Receivable*, dated January 11, 2000, states finance offices must maintain routine communications with the Office of Regional Counsel and program offices to ensure Superfund accounts receivable are recorded timely. Subsequent to our review, EPA researched the receivables, concurred with the auditors, and recorded the receivables in the accounting system. These receivables represent potential monetary benefits to EPA.

- EPA did not record 18 bankruptcy accounts receivable totaling $9,331,597 at the court-approved claim amount. EPA does not have a uniform process to record bankruptcies. Some bankruptcy receivables were recorded at the assessed claim amount while others were recorded at the collection amount. EPA's *Office of the Comptroller Policy Announcement No. 02-05: Superfund Accounts Receivable: Collection Actions for Delinquent Accounts*, dated August 20, 2002, requires EPA to record bankruptcy accounts receivable at the assessed claim amount. EPA bankruptcy receivables may be based on a pre-existing consent decree, judgment, administrative agreement, Administrative Order on Consent, or a proof of claim. Subsequent to our review, EPA researched the receivables, concurred with the auditors, and recorded the bankruptcy receivables in the accounting system. These also represent potential monetary benefits to EPA.

- EPA recorded 6 federal accounts receivable totaling $3,162,722 as non federal accounts receivable. EPA staff has not received training on the different types of accounts receivable. SFFAS Number 1 states: "Receivables from federal entities are intra-governmental receivables, and should be reported separately from receivables from non federal entities." In addition, EPA recorded $226,137 of interest for six receivables in general ledger accounts used for principal instead of general ledger accounts used for interest.

- EPA did not maintain evidence of supervisory review and approval for 5 transactions totaling $24 million. EPA's management has not established internal control procedures for supervisory review of transactions. EPA's current practice permits accountants and financial specialists to record accounts receivable activity (including corrections and cancellations) directly into IFMS without supervisory review and approval. One such transaction was a $14 million entry that resulted in an overstatement in accounts receivable at September 30, 2007.

  OMB *Circular A-123* cites supervision and the separation of duties as examples of management control standards. It states managers should exercise appropriate oversight to ensure individuals do not exceed or abuse their assigned authorities. GAO's *Standards for Internal Controls* states: "key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them and reviewing the transactions." The standards also state that all transactions and other significant events are to be clearly documented, documentation is to be readily available for examination, and qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved.

- EPA wrote off 70 accounts receivable totaling $149,900 without supporting documentation, and also exceeded its authority when it improperly wrote off 1 accounts receivable. We statistically sampled 55 transactions and found that EPA wrote off all 55 accounts receivable tested, totaling $45,246, because EPA could not locate the files. We found that EPA wrote off all 70 transactions in the same manner. Office of Comptroller Policy Announcement No. 93-02, *Policies for Documenting Agency Financial*

Transactions, requires that "all financial transactions recorded in the accounting system be supported by adequate source documentation, and that this documentation be easily accessible." By not exercising proper collection efforts and maintaining adequate documentation to support the validity of receivables, EPA may have incorrectly written off receivables with net realizable values.

Without adequate supporting documentation, questions arise about the validity and integrity of the financial information in IFMS. Failure to require adequate documentation before adjusting entries are input in the Agency's accounting system increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered. The high error rate encountered on the above transactions indicates that controls are not functioning as prescribed. The weaknesses in internal control procedures increase the risk that accounts receivable may not be accurately stated and their status and collectibility may not be accurately reflected.

Recommendations

We recommend that the OCFO:

7. Establish procedures to monitor all tracking reports and follow up with the regional offices and DOJ to obtain receivable documents identified through reconciliations or by receiving collections in advance of the legal documents.

8. Develop uniform procedures to record bankruptcy receivables and establish procedures to properly record federal receivables and their related allowance.

9. Provide staff with training to ensure accounts receivable are accurately recorded in the accounting system.

10. Require standardized recording techniques for accounts receivable items, including proper supporting documentation for transactions, evidence of supervisory review and approval, and segregating duties of entry origination (accountants) and data entry.

11. Determine how the accounts receivable files were lost, and develop procedures to ensure the situation does not repeat. Re-establish the improperly written-off accounts receivable and establish an appropriate allowance for doubtful accounts until determination has been made by management as to whether the debts should be written off.

Agency Comments and OIG Evaluation

The Agency agreed with our findings and recommendations.

4 – Key Applications Do Not Meet Federal and EPA Information Security Requirements

EPA had not complied with federal and Agency information security standards. In particular, key systems (BRAINS and mLINQS)[4] did not have required contingency plans and signed authorizations to operate. The systems also lacked independent reviews of security controls and security plans. EPA did not review these systems for compliance with Federal Financial Management System Requirements. At the time of our review, EPA also had not recognized these systems in either of the Agency's databases used to track the inventory of EPA applications (ASSERT or READ).[5] The conditions noted existed because EPA management did not consider these systems "major applications," and thus did not believe it was necessary to comply with published requirements.

Our research and interviews disclosed these key systems play a vital role in EPA's mission. For example, the EPA accounts receivable system processed over $479 million of financial transactions in fiscal 2007. EPA enters this system's output into IFMS, the Agency's core financial management application, and these entries make up a material amount in the accounts receivable general ledger balance within IFMS. In addition, the system EPA uses to process Permanent Change of Station payments contains sensitive personally identifiable information that is susceptible to identity fraud, if compromised. Management stated EPA would also use this system to process Permanent Change of Station payments for other federal agencies. For these reasons, and the fact that these key systems are critical to EPA's financial mission, management should have taken steps to comply with all mandatory information security requirements. This includes implementing controls to protect the integrity, confidentiality, and availability of the data processed by these applications.

While management made some progress to address weaknesses noted, much still needs to be accomplished. An effective security program needs time to mature. Due to the significance of these weaknesses, EPA cannot be assured that its systems and data are adequately secured. Until these controls are in place, operating, and effectively established, information security management remains a significant deficiency for EPA. OMB emphasizes the importance of these required security controls and prescribes management's reporting requirements for significant deficiencies in OMB Circular A-130, *Management of Federal Information Resources*. With respect to Federal Financial Management System Requirements, the noted weaknesses represent substantial noncompliance with requirements in OMB Circular A-127, *Financial Management Systems.* If these weaknesses are compromised, the potential exists that EPA cannot reasonably ensure it can: (1) provide reliable and timely financial information for managing current operations; and (2) reliably account for its assets so that they can be properly protected from loss, misappropriation, or destruction.

[4] BRAINS (Billing & Reimbursable Accounting Information Network System) is used to process accounts receivable; mLINQS (Relocation Expense Management System) is used to process Permanent Change of Station payments.
[5] ASSERT (Automated Self Evaluation and Reporting Tool) and READ (Registry of EPA Applications and Databases) track the inventory of EPA applications.

Recommendations

We recommend that the OCFO:

12. Develop a contingency plan for BRAINS and mLINQS. The plans should be approved by management and have documented annual reviews and testing.

13. Develop a security plan for BRAINS and mLINQS. This should include having both applications comply with all the federal security requirements specified by the National Institute for Standards and Technology, including the completion of the security certification and accreditation process and the resulting formal authorization to operate.

14. Record BRAINS and mLINQS in the Agency's system inventory databases (ASSERT and READ).

15. Enter Plans of Action and Milestones for all the above noted deficiencies in the Agency's security weakness tracking database (ASSERT).

Agency Comments and OIG Evaluation

The Agency agreed with our findings and recommendations and has committed to comply with all systems and security requirements in time for the OIG to verify compliance by December 31, 2007.

5 – Access and Security Practices Over Critical IT Assets Need Improvement

EPA needs to take more steps to support its security practices and access controls over critical IT assets. In particular, our field work disclosed concerns in the following management control areas:

- **Disaster Recovery Practices –** EPA had not separated duties for backing up, transporting, and securing critical business data, thereby creating a situation where key business data is susceptible to loss, theft, or misuse without detection. EPA lacks accountability over the use and custody of media drives containing key financial and sensitive personally identifiable information.

- **System Monitoring Practices –** EPA does not monitor critical servers for known vulnerabilities or review system log files for violations of Agency policy. Personnel with significant security responsibility did not receive training on their responsibilities. EPA does not use all available system configuration and security monitoring tools to enforce Agency policies.

- **Server Room Access Controls –** EPA lacks practices to control the access to critical IT assets by non-EPA personnel and other visitors. EPA lacks control over keys to the server room and the server room activity is not captured or recorded. Critical IT assets are not secured in a manner that would prevent an unauthorized user from tampering with them. For example, unauthorized personnel could physically access the server components and use this access to bypass security implemented to protect the server's data.

- **Environmental Controls –** The server room did not have a correctly installed water shield to protect EPA servers and Uninterrupted Power Supply. The server room did not have sensors that can monitor and alert appropriate personnel of environmental conditions that are hazardous to critical IT assets (excessive humidity, high temperature, and water).

These controls are vital because EPA processes all of EPA's accounts receivable, except those related to grants, contracts, and payroll. EPA uses BRAINS to process over $479 million in accounts receivable transactions. BRAINS' output is the main data entry source for the Agency's financial management system. EPA also uses another system, mLINQS, that contains personally identifiable information and requires additional controls to detect a security breach and protect the data. EPA plans to use mLINQS to process Permanent Change of Station payments for other federal agencies. Therefore, EPA assumed greater responsibility for (1) providing increased security, and (2) reporting security breaches for mLINQS.

The key cause for many of the noted conditions stems from EPA not stating performance expectations in written procedures. EPA referenced many of the needed controls in its Local Area Network security plan. However, the plan did not assign responsibility or provide detailed steps on how to accomplish the tasks. EPA also had not reassessed its risks, although EPA underwent consolidation of financial services and increased the use of automation to process financial transactions. EPA's risks also increased because EPA needed to provide increased security to protect personally identifiable information in mLINQS. As a result, these weaknesses placed sensitive information, including financial information and EPA employee information, at risk of inadvertent or deliberate misuse, fraudulent use, improper disclosure, theft, or destruction, possibly occurring without detection.

Federal requirements outline the design for controls reviewed during this audit. Properly designed controls should provide the Agency the ability to reasonably ensure that they can provide reliable and timely financial information for managing current operations. The controls should provide the Agency the ability to account for assets reliably, so that they can be properly protected from loss, misappropriation, or destruction. Our site visit to EPA determined that it is highly likely that if a security incident, breach, or hazardous incident occurred, the event would adversely affect EPA's ability to report financial information as required by federal laws.

Subsequent to audit field work, EPA transferred to the Office of Administration and Resources Management (OARM) the responsibility for managing the service support of its business servers. This includes performing data backups and system maintenance, as well as securing the server room. EPA and OARM use a Memorandum of Understanding to outline the support requirements between the two offices. However, our review of the Memorandum of Understanding noted that it lacked the specific requirements as to how OARM should provide the service support. Since EPA does not have written procedures, EPA does not have benchmarks to measure the service provided by OARM.

Recommendations

We recommend that the OCFO:

16. Update the Memorandum of Understanding with OARM to incorporate requirements for the following key security responsibilities:

    - **Critical server data backup and handling of storage media –** The procedures should delineate separation of duties between the backup tasks and the media handling tasks.
    - **Server scanning and monitoring –** The procedures should outline the frequency for testing servers and require a copy of the test results to be provided to the Cincinnati Finance Center for review.
    - **System logs practices –** The procedures should include guidance on areas such as configuring log sources, performing log analysis, and initiating responses to identified events.
    - **Server room access practices –** The procedures should include steps for logging and escorting visitors and controls over the use of the server room key.

17. Request that OARM implement the use of all available Agency-provided system monitoring reports for operating systems in use on EPA servers and provide the results to EPA management monthly for review.

18. Conduct and document an annual verification and validation of implemented procedures to ensure controls are implemented as intended and are effective**.**

19. Correctly install the existing water shield over the Cincinnati Finance Center's servers and expand its coverage to include the Uninterruptible Power Supply system.

20. Add controls to protect the Cincinnati Finance Center's servers from the risk associated with unmonitored visitors having access to servers operating critical business applications. This could include relocating the Cincinnati Finance Center's servers to a location controlled by the Finance Center, partitioning the server room in a manner where servers have improved physical access controls, or installing a lockable container within the current server room that is controlled by the Finance Center.

21. Install an environmental monitoring system to protect the Cincinnati Finance Center-owned servers from possible heat and water damage. The system should include sensors that monitor for humidity, temperature, and water.

Agency Comments and OIG Evaluation

The Agency agreed with our findings and recommendations and has committed to comply with all systems and security requirements in time for the OIG to verify compliance by December 31, 2007.

6 – EPA Needs to Improve Controls Over the IFMS Suspense Table

EPA needs to improve practices for removing financial transactions that do not process completely in IFMS. IFMS is EPA's core financial accounting system. We found that, monthly, EPA personnel automatically purged all financial transactions over 45 days old from the IFMS Suspense Table (SUSF) without obtaining evidence that the transactions should be deleted, as required by Office of Financial Management Policy Announcement 04-02. This occurred because EPA had not implemented a management oversight process to enforce the Agency's policy requiring EPA offices to explain entries in the SUSF file between 30-45 days old. Although EPA sent notices to the originator regarding the status of its SUSF entries, the originator did not provide responses. In addition, EPA had not put in place a delinquency notice to inform senior EPA officials that un-cleared entries remained in the SUSF. In an attempt to reduce the number of excessive out-of-date entries in the SUSF table never reviewed, subsequently deleted, or cleared, EPA personnel said they deleted the financial transactions instead of having the user that originated it do so.

The monthly purging of SUSF entries greater than 45 days old could result in relevant financial data being deleted, causing a misstatement in IFMS. Failure to provide explanations of entries in the SUSF table between 30-45 days is a violation of EPA's policy. It also creates a control weakness in that the originator of a transaction has no accountability for the entry after it is created.

Subsequent to the end of the accounting period, EPA personnel completed a review of financial transactions automatically purged from SUSF and provided results of their analysis to the OIG. We conducted a limited review of these results, and did not find instances where EPA personnel inappropriately deleted material financial transactions.

Recommendations

We recommend that the OCFO:

22. Terminate the automatic monthly purging of all SUSF entries that are greater than 45 days old and require the originator of the SUSF entry to delete or clear the entry.

23. Continue sending out monthly SUSF entry reports to all entry originators and their supervisors.

24. Require originators of SUSF entries to provide EPA staff with explanations for why entries greater than 30 days old remain in the SUSF, and provide the estimated date these entries will be cleared. EPA staff should review these explanations and share the information with the originator's supervisor.

25. Develop a delinquency report for all SUSF transactions that are greater than 60 days old and distribute the report monthly to EPA Assistant and Regional Administrators.

Agency Comments and OIG Evaluation

The Agency generally agreed with our findings and recommendations.

7 – EPA Did Not Maintain Adequate Documentation for Obligation Accounting Adjustments

EPA made adjustments to obligation transactions in IFMS without documenting why the transactions were made and who approved them. This occurred because finance personnel did not understand the policy requirements for documenting adjustments. We have reported similar instances of unsupported transactions since fiscal 2000. EPA policy requires that all financial transactions recorded in the accounting system be supported by adequate source documentation. Inputting adjusting entries into the Agency's accounting system without adequate documentation increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered.

EPA Comptroller Policy Announcement 93-02, *Policies for Documenting Agency Financial Transactions* (November 1992), requires that all financial transactions recorded in the accounting system be supported by adequate source documentation, and that this documentation be easily accessible. These requirements apply to transactions initially entered into IFMS and to adjustments made to the entries. According to Policy Announcement 93-02:

> *"Adequately documented" means an independent individual competent in accounting and possessing reasonable knowledge of EPA's operations should be able to examine the documentation and reach substantially the same conclusions as the persons who made and/or approved the entry.*
>
> *Lack of adequate supporting documentation raises questions about the validity and integrity of the Agency's financial information contained in IFMS. Failure to require adequate source documentation before recording transactions in the Agency's accounting system, the IFMS, increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered into the accounting system.*

GAO's *Standards for Internal Controls in the Federal Government* state that "... all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination." The standards also state "qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved."

During our analysis of obligation transactions, we found two adjustments to entries in IFMS, totaling $50,055,643, that were not supported by sufficient documentation. There was no explanation as to why the entries were made and no evidence of supervisory approval.

Transaction Date	Transaction Code	Transaction Number	Object Class Code	Transaction Amount Debit (Credit)
01/08/07	CG01	CS39000106	4111	$(49,305,643)
02/05/07	GO01	BG99732505	4108	$(750,000)
Total				**$(50,055,643)**

Source: OIG analysis

One obligation transaction, totaling $49,305,643, had no supporting documentation, explanation of the entry, or evidence of supervisory approval. The second obligation transaction, totaling $750,000, did not have a journal or standard voucher to document the reason for the entry and evidence of supervisory approval.

Lack of adequate supporting documentation affects the validity and integrity of the Agency's financial information. Inputting adjusting entries into the Agency's accounting system without adequate documentation increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information will be entered in IFMS. We recognize that the Agency has a policy in place that requires adequate documentation of adjustments to IFMS entries; however, noncompliance with the policy indicates the need for management attention.

Recommendations

We recommend that the OCFO:

26. Reiterate to the Finance Center personnel the importance of adequately documenting adjusting and correcting entries entered in IFMS in accordance with the EPA Comptroller Policy Announcement No. 93-02, *Policies for Documenting Agency Financial Transactions,* and the GAO *Standards for Internal Controls in the Federal Government*.

27. Instruct the Finance Center Directors to ensure that supervisory approval is documented for any adjustments to IFMS entries.

28. During quality assurance reviews, verify that EPA policies on approving and documenting accounting adjustments are being followed.

Agency Comments and OIG Evaluation

The Agency indicated it understood the concerns raised and will emphasize the importance of adequately documenting accounting adjustments to the financial management community and determine the appropriate level of approval for these entries.

Attachment 2

Compliance with Laws and Regulations

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8 - EPA Needs to Reconcile Differences with Trading Partners

As of September 30, 2007, EPA had over $375 million in net unreconciled differences with 46 of its trading partners for intragovernmental transactions. Treasury policy requires agencies to confirm and reconcile intragovernmental transactions with their trading partners. EPA had difficulty reconciling these differences primarily because of differing accounting treatments and accrual methodologies between federal agencies. EPA's inability to reconcile its intragovernmental transactions contributes to a long-standing government-wide problem that hinders the ability of GAO to render an opinion on the Consolidated Financial Statements of the Federal Government.

In addition to the $375 million, EPA also had $371 million in differences with Treasury's General Fund. Most of these differences related to custodial liabilities, tax revenues, and accrued collections, as well as adjustments to benefit expenses related to EPA's contributions to the Federal Insurance Contributions Act.

Treasury's fiscal 2007 4th quarter Intragovernmental Activity Detail Report and Material Differences Report showed the following material differences for EPA:

Federal Agency	Difference	Category of Difference
General Services Administration	$21 million	Accounts Receivable/Payable
Department of Homeland Security	$46 million	Accounts Receivable/Payable
Department of Homeland Security	$18 million	Advances to/From Other Agencies
Department of Homeland Security	$22 million	Buy/Sell Costs/Revenue
Department of Health and Human Services	$36 million	Advances to/From Other Agencies
Department of Health and Human Services	$21 million	Buy/Sell Costs/Revenue
Various Federal Agencies	$211 million	Various Categories

While the Agency has actively worked with its trading partners to reduce differences, material differences continue to exist. Many of the differences result from different accounting treatments and accrual methodologies used by EPA's trading partners. Other situations that contribute to the differences include incorrect trading partner coding, working capital fund revenue recognition, and advance payments in suspense. The differences could be resolved by EPA using the dispute resolution process described in Treasury's Financial Manual, Bulletin No. 2007-03, *Intragovernmental Business Rules*, and making adjustments to address the other situations described above.

EPA reported in the 4th quarter Intragovernmental Activity Detail Report $19.9 million in differences with seven trading partners in the Transfers Receivable/Payable category. EPA created these differences with allocation transfer entries made in prior fiscal years and has not provided documentation to identify reasons for the transactions. The seven trading partners did not report any reciprocal activity in this category. Treasury's Financial Manual states that the transferor and the transferee shall establish procedures to ensure that transfers are acknowledged and recorded by the transferee in a timely manner. We believe EPA should review and discuss these transfers with its trading partners to comply with Treasury guidance.

During fiscal 2007, EPA increased its efforts to reconcile its intragovernmental activity on a quarterly basis with its partners. Numerous differences persist, and EPA's inability to resolve these differences negatively affects GAO's ability to opine on the Consolidated Financial Statements. EPA should use the dispute resolution process described in the *Intragovernmental Business Rules* and increase its efforts to record proper adjustments with its partners.

Recommendations

We recommend the OCFO:

29. Continue to reconcile the Agency's intragovernmental transactions and make appropriate adjustments to comply with federal financial reporting requirements.

30. Use the resolution dispute process to work with its trading partners on the treatment of accounting and accrual methodology differences.

31. Research prior year Transfers Receivable/Payable entries, and provide information to the Cincinnati Finance Center for discussion with the trading partners to resolve the $19.9 million differences.

Agency Comments and OIG Evaluation

The Agency agreed with our findings. The also agreed to make appropriate adjustments to comply with federal financial reporting requirements, and use the dispute resolution process to resolve outstanding issues when appropriate.

Status of Prior Audit Report Recommendations

EPA's position is that "audit follow-up is an integral part of good management," and "corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations." The Chief Financial Officer is the Agency Follow-up Official and is responsible for ensuring that corrective actions are implemented. Starting in fiscal 2006, OCFO included in its Organizational Assessment Measures a metric for audit follow-up. OCFO management regularly reviews these measures during OCFO's monthly Budget and Performance Review meetings. In fiscal 2007, the Agency took steps to improve its audit follow-up process by certifying completion of corrective actions and improving documentation of corrective actions.

The Agency has continued to make substantial progress in completing corrective actions from prior years. The status of issues from prior financial statement audits and other audits whose findings and recommendations could have a material effect on financial statements and have corrective actions in process are listed in the following table.

Audit Issue Areas with Corrective Actions in Process
• **Automated Application Processing Controls for IFMS:** EPA has made progress towards replacing IFMS, and expects to begin implementation in fiscal 2008. However, until EPA implements the planned replacement automated accounting system that addresses past issues, we will continue to disclose a significant deficiency concerning documentation of the current accounting system and its automated application processing controls.
• **EPA Needs to Improve Contingency Plans for Financial Applications:** Although EPA has made some progress in correcting this deficiency, EPA still needs to update the PeoplePlus personnel contact list within the National Computer Center Critical Application Disaster Recovery Plan. EPA is currently updating this Plan. We plan to follow up to verify that the Plan has been appropriately updated during the fiscal 2008 financial statements audit.
• **EPA Needs to Improve Reconciliation of Differences with Trading Partners:** EPA has decreased its material differences in reconciling intragovernmental transactions with other agencies. However, as described in Attachment 2, *Compliance with Laws and Regulations*, there remain significant amounts not reconciled with trading partners.
• **EPA Needs to Strengthen Financial Database Security Oversight and Monitor Compliance:** EPA did not complete all the corrective actions in response to Audit Report No. 2007-P-00017 (March 29, 2007), *EPA Needs to Strengthen Financial Database Security Oversight and Monitor Compliance*, by the end of fiscal 2007. While those actions we reviewed appeared to have addressed our recommendations, we will need to review all corrective actions in response to this audit during the fiscal 2008 financial statements audit to determine if they are effective in correcting the underlying conditions.

Attachment 4

Status of Current Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	12	Change its accounting policy to reflect receivables at their net realizable value. The policy should provide that accounts receivable considered fully or partially collectible should not be written off, but should remain in accounts receivable with an appropriate allowance for doubtful accounts.		Office of the Chief Financial Officer			
2	13	Restore all CNC receivables to open accounts receivable with an appropriate allowance for doubtful accounts.		Office of the Chief Financial Officer			
3	15	Prepare the specific identification allowance for doubtful accounts estimates based upon the objective evidence. Such evidence may be obtained from the case attorney, Program Official, DOJ assessment of the receivable's collectibility, or other sources, depending upon the type of receivable.		Office of the Chief Financial Officer			
4	15	Reconcile the receivables to the general ledger and ensure the allowance for doubtful accounts calculation includes all receivables.		Office of the Chief Financial Officer			
5	15	Use the percentages applicable to the current year for the year-end allowance for doubtful account percentage analysis calculations.		Office of the Chief Financial Officer			
6	15	Update the allowance for doubtful account percentages based on current data.		Office of the Chief Financial Officer			
7	18	Establish procedures to monitor all tracking reports and follow up with the regional offices and DOJ to obtain receivable documents identified through reconciliations or by receiving collections in advance of the legal documents.		Office of the Chief Financial Officer		$4,069.0	$4,069.0
8	18	Develop uniform procedures to record bankruptcy receivables and establish procedures to properly record federal receivables and their related allowance.		Office of the Chief Financial Officer		$9,331.6	$9,331.6
9	18	Provide staff with training to ensure accounts receivable are accurately recorded in the accounting system.		Office of the Chief Financial Officer			
10	18	Require standardized recording techniques for accounts receivable items, including proper supporting documentation for transactions, evidence of supervisory review and approval, and segregating duties of entry origination (accountants) and data entry.		Office of the Chief Financial Officer			

		RECOMMENDATIONS				POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
11	18	Determine how the accounts receivable files were lost, and develop procedures to ensure the situation does not repeat. Re-establish the improperly written-off accounts receivable and establish an appropriate allowance for doubtful accounts until determination has been made by management as to whether the debts should be written off.		Office of the Chief Financial Officer		$149.9	$149.9
12	20	Develop a contingency plan for BRAINS and mLINQS. The plans should be approved by management and have documented annual reviews and testing.		Office of the Chief Financial Officer			
13	20	Develop a security plan for BRAINS and mLINQS. This should include having both applications comply with all the federal security requirements specified by the National Institute for Standards and Technology, including the completion of the security certification and accreditation process and the resulting formal authorization to operate.		Office of the Chief Financial Officer			
14	20	Record BRAINS and mLINQS in the Agency's system inventory databases (ASSERT and READ).		Office of the Chief Financial Officer			
15	20	Enter Plans of Action and Milestones for all the above noted deficiencies in the Agency's security weakness tracking database (ASSERT).		Office of the Chief Financial Officer			
16	22	Update the Memorandum of Understanding with OARM to incorporate requirements for the following key security responsibilities: • Critical server data backup and handling of storage media – The procedures should delineate separation of duties between the backup tasks and the media handling tasks. • Server scanning and monitoring – The procedures should outline the frequency for testing servers and require a copy of the test results to be provided to the Cincinnati Finance Center for review. • System logs practices – The procedures should include guidance on areas such as configuring log sources, performing log analysis, and initiating responses to identified events. • Server room access practices – The procedures should include steps for logging and escorting visitors and controls over the use of the server room key.		Office of the Chief Financial Officer			
17	22	Request that OARM implement the use of all available Agency-provided system monitoring reports for operating systems in use on EPA servers and provide the results to EPA management monthly for review.		Office of the Chief Financial Officer			
18	23	Conduct and document an annual verification and validation of implemented procedures to ensure controls are implemented as intended and are effective.		Office of the Chief Financial Officer			

Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
		RECOMMENDATIONS				POTENTIAL MONETARY BENEFITS (in $000s)	
19	23	Correctly install the existing water shield over the Cincinnati Finance Center's servers and expand its coverage to include the Uninterruptible Power Supply system.		Office of the Chief Financial Officer			
20	23	Add controls to protect the Cincinnati Finance Center's servers from the risk associated with unmonitored visitors having access to servers operating critical business applications. This could include relocating the Cincinnati Finance Center's servers to a location controlled by the Finance Center, partitioning the server room in a manner where servers have improved physical access controls, or installing a lockable container within the current server room that is controlled by the Finance Center.		Office of the Chief Financial Officer			
21	23	Install an environmental monitoring system to protect the Cincinnati Finance Center-owned servers from possible heat and water damage. The system should include sensors that monitor for humidity, temperature, and water.		Office of the Chief Financial Officer			
22	24	Terminate the automatic monthly purging of all SUSF entries that are greater than 45 days old and require the originator of the SUSF entry to delete or clear the entry.		Office of the Chief Financial Officer			
23	24	Continue sending out monthly SUSF entry reports to all entry originators and their supervisors.		Office of the Chief Financial Officer			
24	24	Require originators of SUSF entries to provide EPA staff with explanations for why entries greater than 30 days old remain in the SUSF, and provide the estimated date these entries will be cleared. EPA staff should review these explanations and share the information with the originator's supervisor.		Office of the Chief Financial Officer			
25	24	Develop a delinquency report for all SUSF transactions that are greater than 60 days old and distribute the report monthly to EPA Assistant and Regional Administrators.		Office of the Chief Financial Officer			
26	26	Reiterate to the Finance Center personnel the importance of adequately documenting adjusting and correcting entries entered in IFMS in accordance with the EPA Comptroller Policy Announcement No. 93-02, *Policies for Documenting Agency Financial Transactions,* and the GAO *Standards for Internal Controls in the Federal Government.*		Office of the Chief Financial Officer			
27	26	Instruct the Finance Center Directors to ensure that supervisory approval is documented for any adjustments to IFMS entries.		Office of the Chief Financial Officer			
28	26	During quality assurance reviews, verify that EPA policies on approving and documenting accounting adjustments are being followed.		Office of the Chief Financial Officer			

		RECOMMENDATIONS				POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
29	29	Continue to reconcile the Agency's intragovernmental transactions and make appropriate adjustments to comply with federal financial reporting requirements.		Office of the Chief Financial Officer			
30	29	Use the resolution dispute process to work with its trading partners on the treatment of accounting and accrual methodology differences.		Office of the Chief Financial Officer			
31	29	Research prior year Transfers Receivable/Payable entries, and provide information to the Cincinnati Finance Center for discussion with the trading partners to resolve the $19.9 million differences.		Office of the Chief Financial Officer			

1 O = recommendation is open with agreed-to corrective actions pending;
C = recommendation is closed with all agreed-to actions completed;
U = recommendation is undecided with resolution efforts in progress

EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements

Principal Financial Statements

Financial Statements

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2. Consolidated Statement of Net Cost
3. Consolidated Statement of Net Cost by Goal
4. Consolidating Statement of Changes in Net Position
5. Combined Statement of Budgetary Resources
6. Statement of Custodial Activity

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Environmental Protection Agency
Consolidated Balance Sheet
As of September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

	FY 2007	Restated FY 2006
ASSETS		
Intragovernmental:		
Fund Balance With Treasury (Note 2)	$ 10,466,600	$ 11,173,443
Investments (Notes 4 and 18)	5,753,061	5,366,264
Accounts Receivable, Net (Notes 5 and 40)	57,039	135,263
Other (Note 6)	81,069	59,143
Total Intragovernmental	$ 16,357,769	$ 16,734,113
Cash and Other Monetary Assets (Note 3)	10	10
Accounts Receivable, Net (Notes 5 and 40)	359,302	483,701
Loans Receivable, Net - Non-Federal (Note 7)	23,161	30,836
Property, Plant & Equipment, Net (Note 9)	809,873	756,794
Other (Note 6)	4,574	4,278
Total Assets	$ **17,554,689**	**$ 18,009,732**
Stewardship PP& E (Note 11)		
LIABILITIES		
Intragovernmental:		
Accounts Payable and Accrued Liabilities (Note 8)	122,207	107,525
Debt Due to Treasury (Note 10)	16,156	18,896
Custodial Liability (Notes 12 and 40)	39,369	41,800
Other (Note 13)	98,360	102,934
Total Intragovernmental	$ 276,092	$ 271,155
Accounts Payable & Accrued Liabilities (Note 8)	$ 912,000	$ 725,667
Pensions & Other Actuarial Liabilities (Note 15)	39,786	39,408
Environmental Cleanup Costs (Note 24)	18,214	10,083
Cashout Advances, Superfund (Notes 16 and 40)	190,269	224,407
Commitments & Contingencies (Notes 19 and 24)	-	8
Payroll & Benefits Payable (Note 35)	205,198	195,746
Other (Notes 13 and 40)	113,739	134,747
Total Liabilities	$ 1,755,298	$ 1,601,221
NET POSITION		
Unexpended Appropriations - Other Funds (Note 17)	9,350,591	10,299,640
Cumulative Results of Operations - Earmarked Funds (Notes 20 and 40)	5,886,227	5,533,025
Cumulative Results of Operation - Other Funds (Note 40)	562,573	575,846
Total Net Position	15,799,391	16,408,511
Total Liabilities and Net Position	**$ 17,554,689**	**$ 18,009,732**

The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Consolidated Statement of Net Cost
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

		FY 2007		Restated FY 2006
COSTS				
Gross Costs (Notes 22 and 40)	$	9,263,304	$	9,061,660
Less:				
Earned Revenue (Notes 21, 22 and 40)		550,098		876,105
NET COST OF OPERATIONS (Notes 22 and 40)	**$**	**8,713,206**	**$**	**8,185,555**

The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2007
(Dollars in Thousands)

	Clean Air	Clean & Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
Costs:					
Intragovernmental	$ 185,389	$ 180,571	$ 396,786	$ 275,068	$ 182,101
With the Public	818,753	3,868,428	1,607,952	1,144,793	603,463
Total Costs (Note 22)	1,004,142	4,048,999	2,004,738	1,419,861	785,564
Less:					
Earned Revenue, Federal	15,594	11,016	101,036	18,450	5,613
Earned Revenue, non-Federal	2,997	2,262	352,963	38,902	1,265
Total Earned Revenue (Notes 21 and 22)	18,591	13,278	453,999	57,352	6,878
NET COST OF OPERATIONS (Note 22)	**$ 985,551**	**$ 4,035,721**	**$ 1,550,739**	**$ 1,362,509**	**$ 778,686**

	Consolidated Totals
Costs:	
Intragovernmental	$ 1,219,915
With the Public	$ 8,043,389
Total Costs (Note 22)	$ 9,263,304
Less:	
Earned Revenue, Federal	$ 151,709
Earned Revenue, non-Federal	$ 398,389
Total Earned Revenue (Notes 21 and 22)	$ 550,098
NET COST OF OPERATIONS (Note 22)	**$ 8,713,206**

The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2006 (Restated)
(Dollars in Thousands)

	Clean Air	Clean & Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
Costs:					
Intragovernmental	$ 192,774	$ 137,874	$ 448,101	$ 271,667	$ 183,628
With the Public	763,805	3,717,427	1,722,469	1,029,787	594,128
Total Costs (Notes 22 and 40)	956,579	3,855,301	2,170,570	1,301,454	777,756
Less:					
Earned Revenue, Federal	37,264	9,088	440,068	37,670	9,998
Earned Revenue, non-Fed	2,258	2,822	303,497	31,090	2,350
Total Earned Revenue (Notes 21, 22 and 40)	39,522	11,910	743,565	68,760	12,348
NET COST OF OPERATIONS (Notes 22 and 40)	**$ 917,057**	**$ 3,843,391**	**$ 1,427,005**	**$ 1,232,694**	**$ 765,408**

	Restated Consolidated Totals
Costs:	
Intragovernmental	$ 1,234,044
With the Public	$ 7,827,616
Total Costs (Notes 22 and 40)	$ 9,061,660
Less:	
Earned Revenue, Federal	$ 534,088
Earned Revenue, non-Fed	$ 342,017
Total Earned Revenue (Notes 21, 22 and 40)	$ 876,105
NET COST OF OPERATIONS (Notes 22 and 40)	**$ 8,185,555**

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The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

		FY 2007 Earmarked Funds		FY 2007 All Other Funds		FY 2007 Consolidated Total
Cumulative Results of Operations:						
Net Position - Beginning of Period		5,533,025		575,846		6,108,871
Adjustment:						
Change in Accounting Principle (Note 38)		20,900		-		20,900
Beginning Balances, as Adjusted	$	5,553,925	$	575,846	$	6,129,771
Budgetary Financing Sources:						
Appropriations Used		-		8,367,123		8,367,123
Nonexchange Revenue - Securities Investment (Note 37)		258,986		-		258,986
Nonexchange Revenue - Other (Note 37)		252,148		-		252,148
Transfers In/Out (Note 33)		(25,686)		43,491		17,805
Trust Fund Appropriations		1,040,371		(1,040,371)		-
Total Budgetary Financing Sources	$	1,525,819	$	7,370,243	$	8,896,062
Other Financing Sources (Non-Exchange)						
Transfers In/Out (Note 33)		39		525		564
Imputed Financing Sources (Note 34)		21,868		113,741		135,609
Total Other Financing Sources	$	21,907	$	114,266	$	136,173
Net Cost of Operations		(1,215,424)		(7,497,782)		(8,713,206)
Net Change		332,302		(13,273)		319,029
Cumulative Results of Operations	$	**5,886,227**	$	**562,573**	$	**6,448,800**
Unexpended Appropriations:						
Net Position - Beginning of Period		-		10,299,640		10,299,640
Beginning Balances, as Adjusted		-		10,299,640		10,299,640
Budgetary Financing Sources:						
Appropriations Received		-		7,422,635		7,422,635
Other Adjustments (Note 36)		-		(4,561)		(4,561)
Appropriations Used		-		(8,367,123)		(8,367,123)
Total Budgetary Financing Sources		-		(949,049)		(949,049)
Total Unexpended Appropriations		-		9,350,591		9,350,591
TOTAL NET POSITION	**$**	**5,886,227**	**$**	**9,913,164**	**$**	**15,799,391**

The accompanying notes are an integral part of these financial statements

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

	Restated FY 2006 Earmarked Funds	Restated FY 2006 All Other Funds	Restated FY 2006 Consolidated Total
Cumulative Results of Operations:			
Net Position - Beginning of Period	4,882,528	525,757	5,408,285
Prior Period Adjustment (Note 40)	62,150	12,168	74,318
Beginning Balances, as Adjusted	$ 4,944,678	$ 537,925	$ 5,482,603
Budgetary Financing Sources:			
Appropriations Used	-	8,204,577	8,204,577
Nonexchange Revenue - Securities Invest (Note 37)	206,473	-	206,473
Nonexchange Revenue - Other (Note 37)	249,553	-	249,553
Transfers In/Out (Note 33)	(32,672)	43,366	10,694
Trust Fund Appropriations	1,204,826	(1,204,826)	-
Total Budgetary Financing Sources	$ 1,628,180	$ 7,043,117	$ 8,671,297
Other Financing Sources (Nonexchange)			
Transfers In/Out (Note 33)	-	(28)	(28)
Imputed Financing Sources (Note 34)	19,106	121,448	140,554
Total Other Financing Sources	$ 19,106	$ 121,420	$ 140,526
Net Cost of Operations	(1,058,939)	(7,126,616)	(8,185,555)
Net Change	588,347	37,921	626,268
Cumulative Results of Operations	$ **5,533,025**	$ **575,846**	$ **6,108,871**
Unexpended Appropriations:			
Net Position - Beginning of Period	-	11,007,589	11,007,589
Budgetary Financing Sources:			
Appropriations Received	-	7,691,493	7,691,493
Appropriations Transferred In/Out (Note 33)	-	753	753
Other Adjustments (Note 36)	-	(195,618)	(195,618)
Appropriations Used	-	(8,204,577)	(8,204,577)
Total Budgetary Financing Sources	-	(707,949)	(707,949)
Total Unexpended Appropriations	-	10,299,640	10,299,640
TOTAL NET POSITION	**$ 5,533,025**	**$ 10,875,486**	**$ 16,408,511**

The accompanying notes are an integral part of these financial statements

Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Periods Ending September 30, 2007 and 2006
(Dollars in Thousands)

	FY 2007	FY 2006
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:		
Brought Forward October 1	$ 3,247,087	$ 3,106,756
Adjustment to Unobligated Balance (Alloc Transfer Agencies) (Note 38)	15,527	-
Adjusted Subtotal	3,262,614	3,106,756
Recoveries of Prior Year Unpaid Obligations (Note 29)	387,621	264,710
Budgetary Authority:		
Appropriation	7,495,028	7,828,401
Borrowing Authority	29	-
Spending Authority from Offsetting Collections		
Earned:		
Collected	640,354	930,417
Change in Receivables from Federal Sources	(72,546)	87,322
Change in Unfilled Customer Orders:		
Advance Received	(34,934)	(8,617)
Without Advance from Federal Sources	(625)	149,607
Expenditure Transfers from Trusts Funds	43,491	43,366
Total Spending Authority from Offsetting Collections	575,740	1,202,095
Nonexpenditure Transfers, Net, Anticipated and Actual (Note 33)	1,344,610	1,258,208
Temporarily Not Available Pursuant to Public Law (Note 29)	-	(9,466)
Permanently Not Available (Note 29)	(7,333)	(198,484)
Total Budgetary Resources (Note 28)	$ 13,058,309	$ 13,452,220
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$ 9,027,170	$ 9,292,415
Reimbursable	489,752	912,718
Total Obligations Incurred (Note 28)	9,516,922	10,205,133
Unobligated Balances:		
Apportioned (Note 30)	3,274,344	3,156,100
Exempt from Apportionment	-	
Total Unobligated Balances	3,274,344	3,156,100
Unobligated Balances Not Available (Note 30)	267,043	90,987
Total Status of Budgetary Resources	$ 13,058,309	$ 13,452,220

The accompanying notes are an integral part of these financial statements

Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Periods Ending September 30, 2007 and 2006
(Dollars in Thousands)

	FY 2007	FY 2006
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	$ 10,956,328	$ 11,623,098
Adjustment to Unpaid Obligations (Alloc Transfer Agencies) (Note 38)	7,215	-
Adjusted Total	10,963,543	11,623,098
Less: Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(712,239)	(486,985)
Total Unpaid Obligated Balance, Net	10,251,304	11,136,113
Obligations Incurred, Net (Note 28)	9,516,922	10,205,133
Less: Gross Outlays (Note 28)	(10,219,637)	(10,607,195)
Less: Recoveries of Prior Year Unpaid Obligations, Actual (Note 29)	(387,621)	(264,710)
Change in Uncollected Customer Payments from Federal Sources	79,449	(225,252)
Total, Change in Obligated Balance	9,240,417	10,244,089
Obligated Balance, Net, End of Period:		
Unpaid Obligations	9,873,207	10,956,328
Less: Uncollected Customer Payments from Federal Sources	(632,790)	(712,239)
Total, Unpaid Obligated Balance, Net, End of Period	$ 9,240,417	$ 10,244,089
NET OUTLAYS		
Net Outlays:		
Gross Outlays (Note 28)	$ 10,219,637	$ 10,607,195
Less: Offsetting Collections (Note 28)	(655,188)	(976,843)
Less: Distributed Offsetting Receipts (Notes 28 and 32)	(1,307,458)	(1,314,780)
Total, Net Outlays	$ 8,256,991	$ 8,315,572

The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Statement of Custodial Activity
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

	FY 2007	Restated FY 2006
Revenue Activity:		
Sources of Cash Collections:		
Fines and Penalties	$ 86,409	$ 35,842
Other	(4,171)	66,348
Total Cash Collections	$ 82,238	$ 102,190
Accrual Adjustment	7,092	(80,806)
Total Custodial Revenue (Note 27)	$ 89,330	$ 21,384
Disposition of Collections:		
Transferred to Others (General Fund)	$ 90,774	$ 102,298
Increases/Decreases in Amounts to be Transferred	(1,444)	(80,914)
Total Disposition of Collections	$ 89,330	$ 21,384
Net Custodial Revenue Activity (Note 27)	**$ -**	**$ -**

The accompanying notes are an integral part of these financial statements.

Environmental Protection Agency
Notes to Financial Statements
(Dollars in Thousands)

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

These consolidated financial statements have been prepared to report the financial position and results of operations of the U. S. Environmental Protection Agency (EPA or Agency) as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The reports have been prepared from the financial system and records of the Agency in accordance with OMB Circular A-136, *Financial Reporting Requirements*, and the EPA's accounting policies which are summarized in this note. In addition to the reports required by OMB Circular A-136, the Statement of Net Cost has been prepared in accordance with the Agency's strategic goals.

B. Reporting Entities

The EPA was created in 1970 by executive reorganization from various components of other Federal agencies in order to better marshal and coordinate Federal pollution control efforts. The Agency is generally organized around the media and substances it regulates - air, water, land, hazardous waste, pesticides and toxic substances.

For FY 2007, the accompanying financial statements are grouped and presented in a consolidated manner. These financial statements include the accounts of all funds described in this note by their respective Treasury fund group.

General Fund Appropriations (Treasury Fund Groups 0000 – 3999)

a. State and Tribal Assistance Grants (STAG) Appropriation: The STAG appropriation, Treasury fund group 0103, provides funds for environmental programs and infrastructure assistance including capitalization grants for State revolving funds and performance partnership grants. Environmental programs and infrastructure supported are: Clean and Safe Water; capitalization grants for the Drinking Water State Revolving Funds; Clean Air; direct grants for Water and Wastewater Infrastructure needs, partnership grants to meet Health Standards, Protect Watersheds, Decrease Wetland Loss, and Address Agricultural and Urban Runoff and Storm Water; Better Waste Management; Preventing Pollution and Reducing Risk in Communities, Homes, Workplaces and Ecosystems; and Reduction of Global and Cross Border Environmental Risks.

b. Science and Technology (S&T) Appropriation: The S&T appropriation, Treasury fund group 0107, finances salaries, travel, science, technology, research and development activities including laboratory supplies, certain operating expenses, grants, contracts, intergovernmental agreements, and purchases of scientific equipment. These activities provide the scientific basis for the Agency's regulatory actions.

In FY 2007, Superfund research costs were appropriated in Superfund and transferred to S&T to allow for proper accounting of the costs. Environmental scientific and technological activities and programs include Clean Air; Clean and Safe Water; Americans Right to Know about Their Environment; Better Waste Management; Preventing Pollution and Reducing Risk in Communities, Homes, Workplaces, and Ecosystems; and Safe Food.

c. Environmental Programs and Management (EPM) Appropriation: The EPM appropriation, Treasury fund group 0108, includes funds for salaries, travel, contracts, grants, and cooperative agreements for pollution abatement, control, and compliance activities and administrative activities of the Agency's operating programs. Areas supported from this appropriation include: Clean Air, Clean and Safe Water, Land Preservation and Restoration, Healthy Communities and Ecosystems, and Compliance and Environmental Stewardship.

d. Buildings and Facilities Appropriation (B&F): The B&F appropriation, Treasury fund group 0110, provides for the construction, repair, improvement, extension, alteration, and purchase of fixed equipment or facilities that are owned or used by the EPA.

e. Office of Inspector General (OIG) Appropriation: The OIG appropriation, Treasury fund group 0112, provides funds for audit and investigative functions to identify and recommend corrective actions on management and administrative deficiencies that create the conditions for existing or potential instances of fraud, waste and mismanagement. Additional funds for audit and investigative activities associated with the Superfund and the LUST Trust Funds are appropriated under those Trust Fund accounts and transferred to the Office of Inspector General account. The audit function provides contract, internal controls and performance, and financial and grant audit services. The appropriation includes expenses incurred and reimbursed from the appropriated trust funds accounted for under Treasury fund group 8145 and 8153.

f. Payments to the Hazardous Substance Superfund Appropriation: The Payment to the Hazardous Substance Superfund appropriation, Treasury fund group 0250, authorizes appropriations from the General Fund of the Treasury to finance activities conducted through the Hazardous Substance Superfund Program.

g. ***Payments to Leaking Underground Storage Tank Appropriation:*** The Payment to the Leaking Underground Storage Tank appropriation, Treasury fund group 0251, authorizes appropriations from the General Fund of the Treasury to finance activities conducted through the Leaking Underground Storage Tank program.

h Asbestos Loan Program: The Asbestos Loan Program is accounted for under Treasury fund group 0118, Program Account, for interest subsidy and administrative support; under Treasury fund group 4322, Financing Account, for loan disbursements, loans receivable and loan collections on post-FY 1991 loans; and under Treasury fund group 2917 for pre-FY 1992 loans receivable and loan collections. The Asbestos Loan Program was authorized by the Asbestos School Hazard Abatement Act of 1986 to finance control of asbestos building materials in schools. Funds have not been appropriated for this Program since FY 1993. For FY 1993 and FY1992, the program was funded by a subsidy appropriated from the General Fund for the actual cost of financing the loans, and by borrowing from Treasury for the unsubsidized portion of the loan. The Program Account 0118 disburses the subsidy to the Financing Fund for increases in the subsidy. The Financing Account 4322 receives the subsidy payment, borrows from Treasury and collects the asbestos loans.

i.   Allocations and Appropriations Transferred to the Agency: The EPA does not receive allocations or appropriations transferred from other Federal agencies.

j.   Treasury Clearing Accounts: The EPA Department of the Treasury Clearing Accounts include: (1) the Budgetary Suspense Account, (2) the Unavailable Check Cancellations and Overpayments Account, and (3) the Undistributed Intra-agency Payments and Collections (IPAC) Account. These are accounted for under Treasury fund groups 3875, 3880 and 3885, respectively.

k.   General Fund Receipt Accounts: General Fund Receipt Accounts include: Hazardous Waste Permits; Miscellaneous Fines, Penalties and Forfeitures; General Fund Interest; Interest from Credit Reform Financing Accounts; Downward Re-estimates of Subsidies; Fees and Other Charges for Administrative and Professional Services; and Miscellaneous Recoveries and Refunds. These accounts are accounted for under Treasury fund groups 0895, 1099, 1435, 1499, 2753.3, 3200 and 3220, respectively.

l.   Allocation of Budget Authority: EPA is an allocation budget transfer parent to five Federal agencies: Department of the Interior (DOI), Department of Labor (DOL), Centers for Disease Control and Prevention (CDC), Department of Commerce (DOC), and Federal Emergency Management Agency (FEMA). EPA has a Memorandum of Understanding (MOU) with each child agency to provide an annual work plan and quarterly progress report containing an accounting of funds obligated in each budget category within 15 days after the end of each quarter. This allows EPA to properly report the financial activity. The allocation transfers are reported in the net cost of operations, changes in net position, balance sheet and budgetary resources where activity is being performed by the receiving Federal entity.

Revolving Funds (Treasury Fund Group 4000 – 4999)

a.   Federal Insecticide, Fungicide and Rodenticide Act (FIFRA): The FIFRA Revolving Fund, Treasury fund group 4310, was authorized by the FIFRA Act of 1972, as amended in 1988 and as amended by the Food Quality Protection Act of 1996. Pesticide Maintenance fees are paid by industry to offset the costs of pesticide reregistration and reassessment of tolerances for pesticides used in or on food and animal feed, as required by law.

b.   Tolerance Revolving Fund: The Tolerance Revolving Fund, Treasury fund group 4311, was authorized in 1963 for the deposit of tolerance fees. Fees are paid by industry for Federal services to set pesticide chemical residue limits in or on food and animal feed. The fees collected prior to January 2, 1997, were accounted for under this fund. Presently these fees are being deposited in the FIFRA fund (see above).

c.   Asbestos Loan Program: The Asbestos Loan Program is accounted for under Treasury fund group 4322, Financing Account for loan disbursements, loans receivable and loan collections on post-FY 1991 loans. Refer to General Fund Appropriations paragraph h. for details.

d. Working Capital Fund (WCF): The WCF, Treasury fund group 4565, includes three activities: computer support services, financial system services, and postage. The WCF derives revenue from these activities based upon a fee for services. WCF's customers currently consist primarily of Agency program offices and a small portion from other Federal agencies. Accordingly, those revenues generated by the WCF from services provided to Agency program offices and expenses recorded by the program offices for use of such services, along with the related advances/liabilities, are eliminated on consolidation of the financial statements.

Special Funds (Treasury Fund Group 5000 - 5999)

a. Environmental Services Receipt Account: The Environmental Services Receipt Account authorized by a 1990 act, "To amend the Clean Air Act (P.L. 101-549)," Treasury fund group 5295, was established for the deposit of fee receipts associated with environmental programs, including radon measurement proficiency ratings and training, motor vehicle engine certifications, and water pollution permits. Receipts in this special fund will be appropriated to the S&T and the EPM appropriations to meet the expenses of the programs that generate the receipts.

b. Exxon Valdez Settlement Fund: The Exxon Valdez Settlement Fund authorized by a 1992 act, "Making appropriations for the Department of Veterans Affairs and Housing and Urban Development, and for sundry independent agencies, boards, commissions corporations, and offices for the fiscal year ending September 30, 1993 (P.L. 102-389)," Treasury fund group 5297, has funds available to carry out authorized environmental restoration activities. Funding is derived from the collection of reimbursements under the Exxon Valdez settlement as a result of an oil spill.

c. Pesticide Registration Fund: The Pesticide Registration Fund authorized by a 2004 act, "Consolidated Appropriations Act (P.L. 108-199)," Treasury fund group 5374, was authorized in 2004 for the expedited processing of certain registration petitions and associated establishment of tolerances for pesticides to be used in or on food and animal feed. Fees covering these activities, as authorized under the FIFRA Act of 1988, are to be paid by industry and deposited into this fund group.

Deposit Funds (Treasury Fund Group 6000 – 6999)

Deposits include: Fees for Ocean Dumping; Nonconformance Penalties; Clean Air Allowance Auction and Sale; Advances without Orders; Suspense and Payroll Deposits for Savings Bonds; and State and City Income Taxes Withheld. These funds are accounted for under Treasury fund groups 6264, 6265, 6266, 6500, 6050 and 6275, respectively.

Trust Funds (Treasury Fund Group 8000 – 8999)

a. Superfund Trust Fund: In 1980, the Superfund Trust Fund, Treasury fund group 8145, was established by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) to provide resources needed to respond to and clean up hazardous substance emergencies and abandoned, uncontrolled hazardous waste sites. The Superfund Trust Fund financing is shared by federal and state governments as well as industry. The EPA allocates funds from its appropriation to other Federal agencies to carry out CERCLA. Risks to public health and the environment at uncontrolled hazardous waste sites qualifying for the Agency's National Priorities List (NPL) are reduced and addressed through a process involving site assessment and analysis and the design and implementation of cleanup remedies. NPL cleanups and removals are conducted and financed by the EPA, private parties, or other Federal agencies. The Superfund Trust Fund includes Treasury's collections and investment activity.

b. Leaking Underground Storage Tank (LUST) Trust Fund: The LUST Trust Fund, Treasury fund group 8153, was authorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA) as amended by the Omnibus Budget Reconciliation Act of 1990. The LUST appropriation provides funding to respond to releases from leaking underground petroleum tanks. The Agency oversees cleanup and enforcement programs which are implemented by the states. Funds are allocated to the states through cooperative agreements to clean up those sites posing the greatest threat to human health and the environment. Funds are used for grants to non-state entities including Indian tribes under Section 8001 of the Resource Conservation and Recovery Act. The program is financed by a one cent a gallon tax on motor fuels which will expire in 2011.

c. ***Oil Spill Response Trust Fund:*** The Oil Spill Response Trust Fund, Treasury fund group 8221, was authorized by the Oil Pollution Act of 1990 (OPA). Monies were appropriated to the Oil Spill Response Trust Fund in 1993. The Agency is responsible for directing, monitoring and providing technical assistance for major inland oil spill response activities. This involves setting oil prevention and response standards, initiating enforcement actions for compliance with OPA and Spill Prevention Control and Countermeasure requirements, and directing response actions when appropriate. The Agency carries out research to improve response actions to oil spills including research on the use of remediation techniques such as dispersants and bioremediation. Funding for oil spill cleanup actions is provided through the Department of Transportation under the Oil Spill Liability Trust Fund and reimbursable funding from other Federal agencies.

d. Miscellaneous Contributed Funds Trust Fund: The Miscellaneous Contributed Funds Trust Fund authorized in the Federal Water Pollution Control Act (Clean Water Act) as amended by P.L. 92-500, The Federal Water Pollution Control Act Amendments of 1972, Treasury fund group 8741, includes gifts for pollution control programs that are usually designated for a specific use by donors and/or deposits from pesticide registrants to cover the costs of petition hearings when such hearings result in unfavorable decisions to the petitioner.

C. Budgets and Budgetary Accounting

General Funds

Congress passes an annual appropriation for STAG, B&F, and for Payments to the Hazardous Substance Superfund to be available until expended, as well as annual appropriations for S&T, EPM and for the OIG to be available for 2 fiscal years. When the appropriations for the General Funds are enacted, Treasury issues a warrant to the respective appropriations. As the Agency disburses obligated amounts, the balance of funds available to the appropriation is reduced at Treasury.

The Asbestos Loan Program is a commercial activity financed from a combination of two sources, one for the long term costs of the loans and another for the remaining non-subsidized portion of the loans. Congress adopted a 1 year appropriation, available for obligation in the fiscal year for which it was appropriated, to cover the estimated long term cost of the Asbestos loans. The long term costs are defined as the net present value of the estimated cash flows associated with the loans. The portion of each loan disbursement that did not represent long term cost is financed under permanent indefinite borrowing authority established with the Treasury. A permanent indefinite appropriation is available to finance the costs of subsidy re-estimates that occur in subsequent years after the loans were disbursed.

Funds transferred from other Federal agencies are funded by a nonexpenditure transfer of funds from the other Federal agencies. As the Agency disburses the obligated amounts, the balance of funding available to the appropriation is reduced at Treasury.

Clearing accounts and receipt accounts receive no appropriated funds. Amounts are recorded to the clearing accounts pending further disposition. Amounts recorded to the receipt accounts capture amounts collected for or payable to the Treasury General Fund.

Revolving Funds

Funding of the FIFRA and Pesticide Registration Funds is provided by fees collected from industry to offset costs incurred by the Agency in carrying out these programs. Each year the Agency submits an apportionment request to OMB based on the anticipated collections of industry fees.

Funding of the WCF is provided by fees collected from other Agency appropriations and other Federal agencies to offset costs incurred for providing Agency administrative support for computer and telecommunication services, financial system services, and postage.

Special Funds

The Environmental Services Receipt Account obtains fees associated with environmental programs that will be appropriated to the S&T and EPM appropriations.

Exxon Valdez uses funding from the collection of reimbursements under the Exxon Valdez settlement.

Deposit Funds

Deposit accounts receive no appropriated funds. Amounts are recorded to the deposit accounts pending further disposition.

Trust Funds

Congress adopts an annual appropriation amount for the Superfund, LUST and the Oil Spill Response Trust Funds to remain available until expended. A transfer account for the Superfund and LUST Trust Fund has been established for purposes of carrying out the program activities. As the Agency disburses obligated amounts from the transfer account, the Agency draws down monies from the Superfund and LUST Trust Fund at Treasury to cover the amounts being disbursed. The Agency draws down all the appropriated monies from the Principal Fund of the Oil Spill Liability Trust Fund when Congress adopts the appropriation amount.

D. Basis of Accounting

Transactions are recorded on an accrual accounting basis and on a budgetary basis (where budgets are issued). Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

E. Revenues and Other Financing Sources.

The following EPA policies and procedures to account for inflow of revenue and other financing sources are in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 7, "Accounting for Revenues and Other Financing Sources."

The Superfund program receives most of its funding through appropriations that may be used, within specific statutory limits, for operating and capital expenditures (primarily equipment). Additional financing for the Superfund program is obtained through: reimbursements from other Federal agencies, state cost share payments under Superfund State Contracts (SSCs), and settlement proceeds from Potentially Responsible Parties (PRPs) under CERCLA Section 122(b)(3) may be placed in site-specific special accounts. Special accounts were previously limited to settlement amounts for future costs. However, beginning in FY 2001, cost recovery amounts received under CERCLA Section 122 (b)(3) settlements could be placed in special accounts. Cost recovery settlements that are not placed in reimbursable special accounts continue to be deposited in the Trust Fund and made available for future appropriation.

The majority of all other funds receive funding needed to support programs through appropriations, which may be used, within statutory limits, for operating and capital expenditures. However, under Credit Reform provisions, the Asbestos Loan Program received funding to support the subsidy cost of loans through appropriations which may be used within statutory limits. The Asbestos Direct Loan Financing fund 4322, an off-budget fund, receives additional funding to support the outstanding loans through collections from the Program fund 0118 for the subsidized portion of the loan. The last year Congress provided appropriations to make new loans was 1993.

The FIFRA and Pesticide Registration funds receive funding through fees collected for services provided and interest on invested funds. The WCF receives revenue through fees collected for services provided to Agency program offices. Such revenue is eliminated with related Agency program expenses upon consolidation of the Agency's financial statements. The Exxon Valdez Settlement Fund receives funding through reimbursements.

Appropriated funds are recognized as Other Financing Sources expended when goods and services have been rendered without regard to payment of cash. Other revenues are recognized when earned (i.e., when services have been rendered).

F. Funds with the Treasury

The Agency does not maintain cash in commercial bank accounts. Cash receipts and disbursements are handled by Treasury. The major funds maintained with Treasury are Appropriated Funds, Revolving Funds, Trust Funds, Special Funds, Deposit Funds, and Clearing Accounts. These funds have balances available to pay current liabilities and finance authorized obligations, as applicable.

G. Investments in U.S. Government Securities

Investments in U.S. Government securities are maintained by Treasury and are reported at amortized cost net of unamortized discounts. Discounts are amortized over the term of the investments and reported as interest income. No provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity (see Note 4).

H. Notes Receivable

The Agency records notes receivable at their face value and any accrued interest as of the date of receipt.

I. Marketable Securities

The Agency records marketable securities at cost as of the date of receipt. Marketable securities are held by Treasury and reported at their cost value in the financial statements until sold (see Note 4).

J. Accounts Receivable and Interest Receivable

The majority of receivables for non-Superfund funds represent penalties and interest receivable for general fund receipt accounts, unbilled intragovernmental reimbursements receivable, allocations receivable from Superfund (eliminated in consolidated totals), and refunds receivable for the STAG appropriation.

Superfund accounts receivable represent recovery of costs from PRPs as provided under CERCLA as amended by SARA. However, cost recovery expenditures are expensed when incurred since there is no assurance that these funds will be recovered (see Note 5).

The Agency records accounts receivable from PRPs for Superfund site response costs when a consent decree, judgment, administrative order, or settlement is entered. These agreements are generally negotiated after site response costs have been incurred. It is the Agency's position that until a consent decree or other form of settlement is obtained, the amount recoverable should not be recorded.

The Agency also records accounts receivable from states for a percentage of Superfund site remedial action costs incurred by the Agency within those states. As agreed to under SSCs, cost sharing arrangements may vary according to whether a site was privately or publicly operated at the time of hazardous substance disposal and whether the Agency response action was removal or remedial. SSC agreements are usually for 10 percent or 50 percent of site remedial action costs, depending on who has the lead for the site (i.e., publicly or privately owned). States may pay the full amount of their share in advance or incrementally throughout the remedial action process.

During fiscal year 2007, EPA collected debt previously written-off and considered not collectible. Consequently, EPA reevaluated its implementation of the policy on delinquent debt classified as Currently Not Collectible (CNC). The Agency determined that it cannot forecast collections with absolute certainty due to the nature and unpredictability of external factors that impact a debtor’s ability to pay. Therefore, EPA has discontinued writing off delinquent receivables over 2-years old as CNC.

K. Advances and Prepayments

Advances and prepayments represent funds advanced or prepaid to other entities both internal and external to the Agency for which a budgetary expenditure has not yet occurred.

L. Loans Receivable

Loans are accounted for as receivables after funds have been disbursed. Loans receivable resulting from obligations on or before September 30, 1991, are reduced by the allowance for uncollectible loans. Loans receivable resulting from loans obligated on or after October 1, 1991, are reduced by an allowance equal to the present value of the subsidy costs associated with these loans. The subsidy cost is calculated based on the interest rate differential between the loans and Treasury borrowing, the estimated delinquencies and defaults net of recoveries offset by fees collected and other estimated cash flows associated with these loans.

M. Appropriated Amounts Held by Treasury

For the Superfund and LUST Trust Funds and for amounts appropriated from the Superfund Trust Fund to the S&T and OIG funds, cash available to the Agency that is not needed immediately for current disbursements remains in the respective Trust Funds managed by Treasury.

N. Property, Plant, and Equipment

EPA accounts for its personal and real property accounting records in accordance with SFFAS No. 6, “Accounting for Property, Plant and Equipment.” For EPA-held property, the Fixed Assets Subsystem (FAS) automatically generates depreciation entries monthly based on acquisition dates.

A purchase of EPA-held or contractor-held personal property is capitalized if it is valued at $25 thousand or more and has an estimated useful life of at least 2 years. Prior to implementing FAS, depreciation was taken on a modified straight-line basis over a period of 6 years depreciating 10 percent the first and sixth year, and 20 percent in years 2 through 5. This modified straight-line method is still used for contractor-held property; detailed records are maintained and accounted for in contractor systems, not in FAS. All EPA-held personal property purchased before the implementation of FAS was assumed to have an estimated useful life of 5 years. New acquisitions of EPA-held personal property are depreciated using the straight-line method over the specific asset's useful life, ranging from 2 to 15 years.

Personal property also consists of capital leases. In order to be defined as a capital lease, it must, at its inception, have a lease term of two or more years and the lower of the fair value or present value of the minimum lease payments must be $75 thousand or more. In addition, the lease must meet one of the following criteria: transfers ownership to EPA, contains a bargain purchase option, the lease term is equal to 75 percent or more of the estimated service life, or the present value of the lease and other minimum lease payments equal or exceed 90 percent of the fair value.

Superfund contractor-held property used as part of the remedy for site-specific response actions is capitalized in accordance with the Agency's capitalization threshold. This property is part of the remedy at the site and eventually becomes part of the site itself. Once the response action has been completed and the remedy implemented, EPA retains control of the property (i.e., pump and treat facility) for 10 years or less, and transfers its interest in the facility to the respective state for mandatory operation and maintenance – usually 20 years or more. Consistent with EPA's 10 year retention period, depreciation for this property is based on a 10 year life. However, if any property is transferred to a state in a year or less, this property is charged to expense. If any property is sold prior to EPA relinquishing interest, the proceeds from the sale of that property shall be applied against contract payments or refunded as required by the Federal Acquisition Regulations.

An exception to the accounting of contractor-held property includes equipment purchased by the Working Capital Fund (WCF). This property is retained in FAS and depreciated utilizing the straight-line method based upon the asset's acquisition date and useful life.

Real property consists of land, buildings, and capital and leasehold improvements. Real property, other than land, is capitalized when the value is $85 thousand or more. Land is capitalized regardless of cost. Buildings were valued at an estimated original cost basis, and land was valued at fair market value if purchased prior to FY 1997. Real property purchased during and after FY 1997 is valued at actual cost. Depreciation for real property is calculated using the straight-line method over the specific asset's useful life, ranging from 10 to 102 years. Leasehold improvements are amortized over the lesser of their useful life or the unexpired lease term. Additions to property and improvements not meeting the capitalization criteria, expenditures for minor alterations, and repairs and maintenance are expensed as incurred.

Software for the WCF, a revenue generating activity, is capitalized if the purchase price was $100 thousand or more with an estimated useful life of 2 years or more. All other funds capitalize software if those investments are considered either Capital Planning and Investment Control (CPIC) or CPIC Lite systems with the provisions of SFFAS No. 10, "Accounting for Internal Use Software." Once software enters the maintenance life cycle phase, it is depreciated using the straight-line method over the specific asset's useful life ranging from 2 to 10 years.

O. Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the Agency as the result of a transaction or event that has already occurred. However, no liability can be paid by the Agency without an appropriation or other collections. Liabilities for which an appropriation has not been enacted are classified as unfunded liabilities and there is no certainty that the appropriations will be enacted. Liabilities of the Agency arising from other than contracts can be abrogated by the Government acting in its sovereign capacity.

P. Borrowing Payable to the Treasury

Borrowing payable to Treasury results from loans from Treasury to fund the Asbestos direct loans described in part B. and C. of this note. Periodic principal payments are made to Treasury based on the collections of loans receivable.

Q. Interest Payable to Treasury

The Asbestos Loan Program makes periodic interest payments to Treasury based on its debt. At the end of FY 2006 and FY 2007, there was no outstanding interest payable to Treasury since payment was made through September 30.

R. Accrued Unfunded Annual Leave

Annual, sick and other leave is expensed as taken during the fiscal year. Sick leave earned but not taken is not accrued as a liability. Annual leave earned but not taken as of the end of the fiscal year is accrued as an unfunded liability. Accrued unfunded annual leave is included in Note 39, Statement of Financial Position, as a component of "Payroll and Benefits Payable."

S. Retirement Plan

There are two primary retirement systems for Federal employees. Employees hired prior to January 1, 1987, may participate in the Civil Service Retirement System (CSRS). On January 1, 1984, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, elected to either join FERS and Social Security or remain in CSRS.

A primary feature of FERS is that it offers a savings plan to which the Agency automatically contributes one percent of pay and matches any employee contributions up to an additional four percent of pay. The Agency also contributes the employer's matching share for Social Security.

With the issuance of SFFAS No. 5, "Accounting for Liabilities of the Federal Government," accounting and reporting standards were established for liabilities relating to the Federal employee benefit programs (Retirement, Health Benefits, and Life Insurance). SFFAS No. 5 requires that the employing agencies recognize the cost of pensions and other retirement benefits during their employees' active years of service. SFFAS No. 5 requires that the Office of Personnel Management (OPM), as administrator of the CSRS and FERS, the Federal Employees Health Benefits Program, and the Federal Employees Group Life Insurance Program, provide Federal agencies with the actuarial cost factors to compute the liability for each program.

T. Prior Period Adjustments

Prior period adjustments will be made in accordance with SFFAS No. 21, "Reporting Corrections of Errors and Changes in Accounting Principles." Specifically, prior period adjustments will only be made for material prior period errors to: (1) the current period financial statements, and (2) the prior period financial statements presented for comparison. Adjustments related to changes in accounting principles will only be made to the current period financial statements, but not to prior period financial statements presented for comparison.

Note 2. Fund Balance with Treasury (FBWT)

Fund Balances with Treasury as of September 30, 2007 and 2006, consist of the following:

	FY 2007 Entity Assets	FY 2007 Non-Entity Assets	FY 2007 Total	FY 2006 Entity Assets	FY 2006 Non-Entity Assets	FY 2006 Total
Trust Funds:						
Superfund	$ 51,081	$ -	$ 51,081	$ 35,086	$ -	$ 35,086
LUST	32,406	-	32,406	25,497	-	25,497
Oil Spill & Misc.	4,576	-	4,576	6,789	-	6,789
Revolving Funds:						
FIFRA/Tolerance	9,313	-	9,313	8,074	-	8,074
Working Capital	70,460	-	70,460	77,635	-	77,635
Cr. Reform Finan.	429	-	429	400	-	400
Appropriated	10,084,002	-	10,084,002	10,820,079	-	10,820,079
Other Fund Types	205,693	8,640	214,333	182,303	17,580	199,883
Total	**$ 10,457,960**	**$ 8,640**	**$ 10,466,600**	**$ 11,155,863**	**$ 17,580**	**$ 11,173,443**

Entity fund balances, except for special fund receipt accounts, are available to pay current liabilities and to finance authorized purchase commitments (see Status of Fund Balances below). Entity Assets for Other Fund Types consist of special purpose funds and special fund receipt accounts, such as the Pesticide Registration funds and the Environmental Services receipt account. The Non-Entity Assets for Other Fund Types consist of clearing accounts and deposit funds, which are either awaiting documentation for the determination of proper disposition or being held by EPA for other entities.

Status of Fund Balances:	FY 2007	FY 2006
Unobligated Amounts in Fund Balances		
Available for Obligation	$3,274,338	$3,156,100
Unavailable for Obligation	267,042	90,987
Net Receivables from Invested Balances	(2,527,186)	(2,515,007)
Balances in Treasury Trust Fund (Note 18)	14,394	12,505
Obligated Balance not yet Disbursed	9,240,417	10,244,089
Non-Budgetary FBWT	197,595	184,769
Totals	**$10,466,600**	**$11,173,443**

The funds available for obligation may be apportioned by the OMB for new obligations at the beginning of the following fiscal year. Funds unavailable for obligation are mostly balances in expired funds, which are available only for adjustments of existing obligations. For FY 2007 and FY 2006 no differences existed between Treasury's accounts and EPA's statements for fund balances with Treasury.

Note 3. Cash and Other Monetary Assets

For September 30, 2007 and September 30, 2006, cash consists of an imprest fund of $10 thousand.

Note 4. Investments

For September 30, 2007 and September 30, 2006 investments related to Superfund and LUST consist of the following:

			Cost	Unamortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value
Intragovernmental Securities:							
Non-Marketable	FY 2007	$	5,680,321 $	(29,481) $	43,259 $	5,753,061 $	5,753,061
Non-Marketable	FY 2006	$	5,305,992 $	(21,752) $	38,520 $	5,366,264 $	5,366,264

CERCLA, as amended by SARA, authorizes EPA to recover monies to clean up Superfund sites from responsible parties (RP). Some RPs file for bankruptcy under Title 11 of the U.S. Code. In bankruptcy settlements, EPA is an unsecured creditor and is entitled to receive a percentage of the assets remaining after secured creditors have been satisfied. Some RPs satisfy their debts by issuing securities of the reorganized company. The Agency does not intend to exercise ownership rights to these securities, and instead will convert them to cash as soon as practicable. (See Note 6.) All investments in Treasury securities are earmarked funds (See Note 20).

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to EPA as evidence of its receipts. Treasury securities are an asset to EPA and a liability to the U.S. Treasury. Because EPA and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or liability in the U.S. Government-wide financial statements.

Treasury securities provide EPA with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When EPA requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

The Accounts Receivable for September 30, 2007 and September 30, 2006 Restated, consist of the following:

		FY 2007		Restated FY 2006
Intragovernmental Assets:				
Accounts & Interest Receivable	**$**	57,039	**$**	148,796
Less: Allowance for Uncollectibles		-		(13,533)
Total	$	**57,039**	$	**135,263**
Non-Federal Assets:				
Unbilled Accounts Receivable	$	136,779	$	116,060
Accounts & Interest Receivable		992,575		1,076,891
Less: Allowance for Uncollectibles		(770,052)		(709,250)
Total	**$**	**359,302**	**$**	**483,701**

The Allowance for Uncollectible Accounts is determined both on a specific identification basis, as a result of a case-by-case review of receivables, and on a percentage basis for receivables not specifically identified.

Note 6. Other Assets

Other Assets for September 30, 2007 and 2006, consist of the following:

		FY 2007		FY 2006
Intragovernmental Assets:				
Advances to Federal Agencies	$	80,940	$	58,847
Advances for Postage		129		296
Total Intragovernmental Assets	**$**	**81,069**	**$**	**59,143**
Non-Federal Assets:				
Travel Advances	$	106	$	154
Letter of Credit Advances		9		9
Grant Advances		116		118
Other Advances		3,699		3,249
Operating Materials and Supplies		160		183
Inventory for Sale		246		565
Securities Received in Settlement of Debt		238		-
Total Non-Federal Assets	**$**	**4,574**	**$**	**4,278**

Note 7. Loans Receivable, Net - Non-Federal

Asbestos Loan Program loans disbursed from obligations made prior to FY 1992 are net of allowances for estimated uncollectible loans, if an allowance was considered necessary. Loans disbursed from obligations made after FY 1991 are governed by the Federal Credit Reform Act, which mandates that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, anticipated delinquencies, and defaults) associated with direct loans be recognized as an expense in the year the loan is made. The net loan present value is the gross loan receivable less the subsidy present value. The amounts as of September 30, 2007and 2006, are as follows:

		FY 2007			FY 2006	
	Loans Receivable, Gross	Allowance*	Value of Assets Related to Direct Loans	Loans Receivable, Gross	Allowance*	Value of Assets Related to Direct Loans
Direct Loans Obligated Prior to FY 1992	$ 7,435	$ -	$ 7,435	$ 12,327	$ -	$ 12,327
Direct Loans Obligated After FY 1991	18,440	(2,714)	15,726	22,391	(3,882)	18,509
Total	**$ 25,875**	**$ (2,714)**	**$ 23,161**	**$ 34,718**	**$ (3,882)**	**$ 30,836**

* Allowance for Pre-Credit Reform loans (prior to FY 1992) is the Allowance for Estimated Uncollectible Loans, and the Allowance for Post Credit Reform Loans (after FY 1991) is the Allowance for Subsidy Cost (present value).

Subsidy Expenses for Credit Reform Loans (reported on a cash basis):

	Interest Rate Re-estimate	Technical Re-estimate	Total
Downward Subsidy Reestimate - FY 2007	$ (17)	$ (12)	$ (29)
FY 2007 Totals	**$ (17)**	**$ (12)**	**$ (29)**
Upward Subsidy Reestimate – FY 2006	$ 32	$ 26	$ 58
FY 2006 Totals	**$ 32**	**$ 26**	**$ 58**

Note 8. Accounts Payable and Accrued Liabilities

The Accounts Payable and Accrued Liabilities are current liabilities and consist of the following amounts as of September 30, 2007 and 2006.

		FY 2007		FY 2006
Intragovernmental:				
Accounts Payable to other Federal Agencies	$	2,611	$	923
Liability for Allocation Transfers		19,878		20,580
Accrued Liabilities, Federal		99,718		86,022
Total Intragovernmental	$	**122,207**	$	**107,525**

Non-Federal:		**FY 2007**		**FY 2006**
Accounts Payable, Non-Federal	$	114,082	$	106,156
Advances Payable, Non-Federal		16		16
Interest Payable		7		7
Grant Liabilities		601,034		414,112
Other Accrued Liabilities, Non-Federal		196,861		205,376
Total Non-Federal	$	**912,000**	$	**725,667**

Note 9. General Property, Plant and Equipment (PP&E)

Plant, property and equipment consist of software; real, EPA-Held and Contractor-Held personal, and capital lease property.

As of September 30, 2007 and 2006, Plant, Property and Equipment consist of the following:

		FY 2007				FY 2006	
		Acquisition Value	Accumulated Depreciation	Net Book Value	Acquisition Value	Accumulated Depreciation	Net Book Value
EPA-Held Equipment	$	222,848 $	(119,605) $	103,243 $	207,328 $	(116,228) $	91,100
Software		258,637	(49,407)	209,230	198,961	(37,871)	161,090
Contractor Held Equip.		64,641	(23,486)	41,155	64,757	(25,001)	39,756
Land and Buildings		579,880	(143,594)	436,286	573,887	(132,168)	441,719
Capital Leases		47,505	(27,546)	19,959	49,844	(26,715)	23,129
Total	**$**	**1,173,511 $**	**(363,638) $**	**809,873 $**	**1,094,777 $**	**(337,983) $**	**756,794**

Note 10. Debt Due to Treasury

The debt due to Treasury consists of the following as of September 30, 2007 and 2006:

All Other Funds	FY 2007			FY 2006		
	Beginning Balance	Net Borrowing	Ending Balance	Beginning Balance	Net Borrowing	Ending Balance
Intragovernmental:						
Debt to Treasury	$ 18,896	$ (2,740)	$ 16,156	$ 21,744	$ (2,848)	$ 18,896

Note 11. Stewardship Land

The Agency acquires title to certain land and land rights under the authorities provided in Section 104 (J) CERCLA related to remedial clean-up sites. The land rights are in the form of easements to allow access to clean-up sites or to restrict usage of remediated sites. In some instances, the Agency takes title to the land during remediation and returns it to private ownership upon the completion of clean-up. A site with "land acquired" may have more than one acquisition property. Sites are not counted as a withdrawal until all acquired properties have been transferred.

As of September 30, 2007 and 2006, the Agency possesses the following land and land rights:

	FY 2007	FY 2006
Superfund Sites with Easements		
Beginning Balance	32	33
Additions	2	-
Withdrawals	1	1
Ending Balance	**33**	**32**
Superfund Sites with Land Acquired		
Beginning Balance	31	29
Additions	1	2
Withdrawals	0	-
Ending Balance	**32**	**31**

Note 12. Custodial Liability

Custodial Liability represents the amount of net accounts receivable that, when collected, will be deposited to the Treasury General Fund. Included in the custodial liability are amounts for fines and penalties, interest assessments, repayments of loans, and miscellaneous other accounts receivable. As of September 30, 2007 and 2006, custodial liability is $39 and $42 million (restated), respectively.

Note 13. Other Liabilities

Other Liabilities consist of the following as of September 30, 2007:

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Other Liabilities – Intragovernmental			
Current			
Employer Contributions & Payroll Taxes	$ 13,632	$ -	$ 13,632
WCF Advances	1,779	-	1,779
Other Advances	11,040	-	11,040
Advances, HRSTF Cashout	40,063	-	40,063
Deferred HRSTF Cashout	609	-	609
Liability for Deposit Funds	(37)	-	(37)
Resources Payable to Treasury	138	-	138
Subsidy Payable to Treasury	34	-	34
Non-Current			
Unfunded FECA Liability	-	9,102	9,102
Payable to Treasury Judgment Fund	-	22,000	22,000
Total Intragovernmental	$ **67,258**	**$ 31,102**	**$ 98,360**
Other Liabilities - Non-Federal			
Current			
Unearned Advances, Non-Federal	$ 72,671	$ -	$ 72,671
Liability for Deposit Funds, Non-Federal	8,453	-	8,453
Non-Current			-
Other Liabilities	-	230	230
Capital Lease Liability	-	32,385	32,385
Total Non-Federal	$ **81,124**	**$ 32,615**	$ **113,739**

Other Liabilities consist of the following as of September 30, 2006 (Restated):

Other Liabilities – Intragovernmental		Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
Current						
Employer Contributions & Payroll Taxes	$	13,203	$	-	$	13,203
WCF Advances		11,730		-		11,730
Other Advances		8,786		-		8,786
Advances, HRSTF Cashout		38,684		-		38,684
Deferred HRSTF Cashout		53		-		53
Liability for Deposit Funds		(44)		-		(44)
Resources Payable to Treasury		29		-		29
Non-Current						
Unfunded FECA Liability		-		8,493		8,493
Payable to Treasury Judgment Fund		-		22,000		22,000
Total Intragovernmental	$	**72,441**	**$**	**30,493**	**$**	**102,934**
Other Liabilities - Non-Federal						
Current						
Unearned Advances, Non-Federal	$	81,548	$	-	$	81,548
Liability for Deposit Funds, Non-Federal		17,477		-		17,477
Non-Current						
Other Liabilities		-		280		280
Capital Lease Liability		-		35,442		35,442
Total Non-Federal	$	**99,025**	**$**	**35,722**	**$**	**134,747**

Note 14. Leases

Capital Leases:

The Capital Leases:

EPA has three capital leases for land and buildings housing scientific laboratories and/or computer facilities. All of these leases include a base rental charge and escalator clauses based upon either rising operating costs and/or real estate taxes. The base operating costs are adjusted annually according to escalators in the Consumer Price Indices published by the Bureau of Labor Statistics, U.S. Department of Labor. The real property leases terminate in FYs 2010, 2013, and 2025.

		FY 2007		FY 2006
Summary of Assets Under Capital Lease:				
Real Property	$	40,913	$	40,913
Personal Property		155		2,494
Software License		6,437		6,437
Total	**$**	**47,505**	**$**	**49,844**
Accumulated Amortization	$	27,546	$	26,715

EPA also had capital leases terminating in FY 2007 for seven shuttle buses. However, during FY 2006, three of the seven shuttle buses were no longer needed and disposed of in the Fixed Asset System and General Ledger. These leases are expended out of the EPM appropriation.

EPA has two capital leases expended out of the Working Capital Fund -- the capital leases are for an IBM Supercomputer and Microsoft Office software. The IBM Supercomputer was disposed of in FY 2007, and the Microsoft Office software's lease will terminate in FY 2009.

During FY 2005, EPA entered into a capital lease for a Storage Area Network. The lease terminates in FY 2008 and payments are expended from the EPM appropriation.
The total future minimum capital lease payments are listed below.

Future Payments Due:		
Fiscal Year		**Capital Leases**
2008	$	7,866
2009		6,295
2010		6,101
2011		5,714
After 5 Years		59,201
Total Future Minimum Lease Payments	**$**	85,177
Less: Imputed Interest		(52,792)
Net Capital Lease Liability	**$**	**32,385**
Liabilities not Covered by Budgetary Resources (See Note 13)	**$**	**32,385**

Operating Leases:

The GSA provides leased real property (land and buildings) as office space for EPA employees. GSA charges a Standard Level User Charge that approximates the commercial rental rates for similar properties.

EPA has two current direct operating leases and one which expired in FY 2007, for land and buildings housing scientific laboratories and/or computer facilities. Both leases include a base rental charge and escalator clauses based upon either rising operating costs and/or real estate taxes. The base operating costs are adjusted annually according to escalators in the Consumer Price Indices published by the Bureau of Labor Statistics. One lease expires in FYs 2017 and the other in 2020. These charges are expended from the EPM appropriation.

The total minimum future operating lease costs are listed below.

Fiscal Year		Operating Leases, Land and Buildings
2008	$	74
2009		74
2010		74
2011		74
Beyond 2011		550
Payments	**$**	**846**

Note 15. Pensions and Other Actuarial Liabilities

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Annually, EPA is allocated the portion of the long term FECA actuarial liability attributable to the entity. The liability is calculated to estimate the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability amounts and the calculation methodologies are provided by the Department of Labor.

The FECA Actuarial Liability at September 30, 2007 and 2006, consists of the following:

		FY 2007		FY 2006
FECA Actuarial Liability	$	39,786	$	39,408

The FY 2007 present value of these estimated outflows are calculated using a discount rate of 4.93 percent in the first year, and 5.078 percent in the years thereafter. The estimated future costs are recorded as an unfunded liability.

Note 16. Cashout Advances, Superfund

Cashouts are funds received by EPA, a state, or another PRP under the terms of a settlement agreement (e.g., consent decree) to finance response action costs at a specified Superfund site. Under CERCLA, Section 122(b)(3), cashout funds received by EPA are placed in site-specific, interest bearing accounts known as special accounts and are used for potential future work at such sites in accordance with the terms of the settlement agreement. Funds placed in special accounts may be disbursed to potentially responsible parties, to states that take responsibility for the site, or to other Federal agencies to conduct or finance response actions in lieu of EPA without further appropriation by Congress.

Note 17. Unexpended Appropriations – Other Funds

As of September 30, 2007 and 2006, the Unexpended Appropriations consist of the following:

Unexpended Appropriations:	**FY 2007**	**FY 2006**
Unobligated		
Available	$ 1,791,873	$ 1,724,552
Unavailable	81,753	51,852
Undelivered Orders	7,476,965	8,523,236
Total	**$ 9,350,591**	**$ 10,299,640**

Note 18. Amounts Held by Treasury

Amounts Held by Treasury for Future Appropriations consist of amounts held in trusteeship by Treasury in the Superfund and LUST Trust Funds.

Superfund (Unaudited)

Superfund is supported primarily by general revenues, cost recoveries of funds spent to clean up hazardous waste sites, interest income, and fines and penalties.

The following reflects the Superfund Trust Fund maintained by Treasury as of September 30, 2007 and 2006. The amounts contained in these notes have been provided by Treasury. As indicated, a portion of the outlays represents amounts received by EPA's Superfund Trust Fund; such funds are eliminated on consolidation with the Superfund Trust Fund maintained by Treasury.

SUPERFUND FY 2007		EPA		Treasury		Combined
Undistributed Balances						
Uninvested Fund Balance	$	-	$	1,538	$	1,538
Total Undisbursed Balance		-		1,538		1,538
Interest Receivable		-		12,795		12,795
Investments, Net		2,466,812		272,244		2,739,056
Total Assets	$	2,466,812	$	286,577	$	2,753,389
Liabilities & Equity						
Receipts and Outlays		-		-		-
Equity	$	2,466,812	$	286,577	$	2,753,389
Total Liabilities and Equity	$	2,466,812	$	286,577	$	2,753,389
Receipts						
Corporate Environmental	$	-	$	2,602	$	2,602
Cost Recoveries		-		234,050		234,050
Fines & Penalties		-		1,063		1,063
Total Revenue		-		237,715		237,715
Appropriations Received		-		1,040,371		1,040,371
Interest Income		-		141,407		141,407
Total Receipts	$	-	$	1,419,493	$	1,419,493
Outlays						
Transfers to/from EPA, Net	$	1,316,114	$	(1,316,114)	$	-
Transfers from CDC (recovery)	$	-	$	1,370	$	1,370
Total Outlays		1,316,114		(1,314,744)		1,370
Net Income	$	**1,316,114**	$	**104,749**	$	**1,420,863**

In FY 2007, the EPA received an appropriation for Superfund of $1,040.3 million. Treasury's Bureau of Public Debt (BPD), the manager of the Superfund Trust Fund assets, records a liability to EPA for the amount of the appropriation. BPD does this to indicate those trust fund assets that have been assigned for use and, therefore, are not available for appropriation. As of September 30, 2007 and 2006, the Treasury Trust Fund has a liability to EPA for previously appropriated funds of $2,466.8 million and $2,446.5 million, respectively.

SUPERFUND FY 2006	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 775	$ 775
Total Undisbursed Balance	-	775	775
Interest Receivable	-	7,985	7,985
Investments, Net	2,446,467	173,069	2,619,536
Total Assets	$ 2,446,467	$ 181,829	$ 2,628,296
Liabilities & Equity			
Receipts and Outlays	$	$ 82,274	$ 82,274
Equity	$ 2,446,467	$ 99,555	$ 2,546,022
Total Liabilities and Equity	$ 2,446,467	$ 181,829	$ 2,628,296
Receipts			
Corporate Environmental	$ -	$ 1,144	$ 1,144
Cost Recoveries	-	59,661	59,661
Fines & Penalties	-	2,467	2,467
Total Revenue	-	63,272	63,272
Appropriations Received	-	1,189,826	1,189,826
Interest Income	-	108,807	108,807
Total Receipts	$ -	$ 1,361,905	$ 1,361,905
Outlays			
Transfers to/from EPA, Net	$ 1,280,333	$ (1,280,333)	$ -
Transfers from CDC (recovery)	$	$ 702	$ 702
Total Outlays	1,280,333	(1,279,631)	702
Net Income	$ **1,280,333**	$ **82,274**	$ **1,362,607**

LUST (Unaudited)

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FYs 2007 and 2006 there were no fund receipts from cost recoveries. The following represents the LUST Trust Fund as maintained by Treasury. The amounts contained in these notes have been provided by Treasury. Outlays represent appropriations received by EPA's LUST Trust Fund; such funds are eliminated on consolidation with the LUST Trust Fund maintained by Treasury.

LUST FY 2007	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 12,856	$ 12,856
Total Undisbursed Balance	-	12,856	12,856
Interest Receivable	-	30,465	30,465
Investments, Net	80,252	2,890,497	2,970,749
Total Assets	$ 80,252	$ 2,933,818	$ 3,014,070
Liabilities & Equity			
Equity	$ 80,252	$ 2,933,818	$ 3,014,070
Equity	$ 80,252	$ 2,933,818	$ 3,014,070
Receipts			
Highway TF Tax	$ -	$ 204,272	$ 204,272
Airport TF Tax	-	23,528	23,528
Inland TF Tax	-	457	457
Refund Gasoline Tax	-	(914)	(914)
Refund Diesel Tax	-	(934)	(934)
Refund Aviation Fuel	-	(197)	(197)
Refund Aviation Tax	-	(18)	(18)
Total Revenue	-	226,194	226,194
Interest Income	-	117,579	117,579
Total Receipts	$ -	$ 343,773	$ 343,773
Outlays			
Transfers to/from EPA, Net	$ 72,035	$ (72,035)	$ -
Total Outlays	72,035	(72,035)	-
Net Income	$ **72,035**	$ **271,738**	$ **343,773**

LUST FY 2006	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 11,750	$ 11,750
Total Undisbursed Balance	-	11,750	11,750
Interest Receivable	-	30,535	30,535
Investments, Net	88,417	2,619,793	2,708,210
Total Assets	$ 88,417	$ 2,662,078	$ 2,750,495
Liabilities & Equity			
Equity	$ 88,417	$ 2,662,078	$ 2,750,495
Equity	$ 88,417	$ 2,662,078	$ 2,750,495
Receipts			
Highway TF Tax	$ -	$ 196,371	$ 196,371
Airport TF Tax	-	2,772	2,772
Inland TF Tax	-	404	404
Transfers from EPA	-	15,000	15,000
Refund Gasoline Tax	-	(1,453)	(1,453)
Refund Diesel Tax	-	(1,434)	(1,434)
Refund Aviation Fuel	-	(409)	(409)
Refund Aviation Tax	-	(24)	(24)
Total Revenue	-	211,227	211,227
Interest Income	-	97,666	97,666
Total Receipts	$ -	$ 308,893	$ 308,893
Outlays			
Transfers to/from EPA, Net	$ 86,861	$ (86,861)	$ -
Total Outlays	86,861	(86,861)	-
Net Income	$ **86,861**	$ **222,032**	$ **308,893**

Note 19. Commitments and Contingencies

EPA may be a party in various administrative proceedings, legal actions and claims brought by or against it. These include:

- Various personnel actions, suits, or claims brought against the Agency by employees and others.
- Various contract and assistance program claims brought against the Agency by vendors, grantees and others.
- The legal recovery of Superfund costs incurred for pollution cleanup of specific sites, to include the collection of fines and penalties from responsible parties.
- Claims against recipients for improperly spent assistance funds which may be settled by a reduction of future EPA funding to the grantee or the provision of additional grantee matching funds.

Superfund:

Under CERCLA Section 106(a), EPA issues administrative orders that require parties to clean up contaminated sites. CERCLA Section 106(b) allows a party that has complied with such an order to petition EPA for reimbursement from the fund of its reasonable costs of responding to the order, plus interest. To be eligible for reimbursement, the party must demonstrate either that it was not a liable party under CERCLA Section 107(a) for the response action ordered, or that the Agency's selection of the response action was arbitrary and capricious or otherwise not in accordance with law.

As of September 30, 2007, there are currently two CERCLA Section 106(b) administrative claims. If the claimants are successful, the total losses on the claims could amount to approximately $5.7 million. The Environmental Appeals Board has not yet issued final decisions on any of the administrative claims; therefore, a definite estimate of the amount of the contingent loss cannot be made. The claimants' chance of success overall is characterized as reasonably possible.

All Other Funds:

As of September 30, 2007, there is one claim amounting to $5.6 million which may be considered threatened litigation involving all other appropriated funds of the Agency.

Judgment Fund:

In cases that are paid by the U.S. Treasury Judgment Fund, the Agency must recognize the full cost of a claim regardless of who is actually paying the claim. Until these claims are settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for the payment, claims that are probable and estimable must be recognized as an expense and liability of the Agency. For these cases, at the time of settlement or judgment, the liability will be reduced and an imputed financing source recognized. See Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions."

As of September 30, 2007, there are no material claims pending in the Treasury Judgment Fund. However, EPA has a $22 million liability to the Treasury Judgment Fund for a payment made by the Fund to settle a contract dispute claim.

Note 20. Earmarked Funds

	Environmental Services	LUST	Superfund	Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2007					
ASSETS					
Fund Balance with Treasury	$ 188,370	$ 32,405	$ 51,081	$ 31,213	$ 303,069
Investments	-	3,001,214	2,751,850	(3)	5,753,061
Accounts Receivable, Net	-	-	329,829	3,724	333,553
Other Assets	-	180	86,558	757	87,495
Total Assets	$ 188,370	$ 3,033,799	$ 3,219,318	$ 35,691	$ 6,477,178
					-
Other Liabilities	$ -	$ 10,030	$ 548,893	$ 32,028	$ 590,951
Total Liabilities	$ -	$ 10,030	$ 548,893	$ 32,028	$ 590,951
					-
Cumulative Results of Operations	$ 188,370	$ 3,023,769	$ 2,670,425	$ 3,663	$ 5,886,227
Total Liabilities and Net Position	$ 188,370	$ 3,033,799	$ 3,219,318	$ 35,691	$ 6,477,178
Statement of Changes in Net Cost For the Period Ended September 30, 2007					-
Gross Programs Costs	$ -	$ 76,242	$ 1,497,010	$ 72,308	$ 1,645,560
Less: Earned Revenues	-	(1,414)	377,904	53,646	430,136
					-
Net Cost of Operations	$ -	$ 77,656	$ 1,119,106	$ 18,662	$ 1,215,424
Statement of Changes in Net Position for the Period Ended September 30, 2007					-
Net Position, Beginning of Period	$ 165,723	$ 2,757,325	$ 2,606,400	$ 3,577	$ 5,533,025
Changes in Accounting Principle (Alloc Trans Agency) (Note 38)			20,900	-	20,900
Beginning Balance as Adjusted	165,723	2,757,325	2,627,300	3,577	5,553,925
Nonexchange Revenue - Securities Investment	-	117,579	141,407	-	258,986
Nonexchange Revenue - Other	22,648	226,194	2,721	585	252,148
Other Budgetary Financing Sources	-	-	998,952	15,733	1,014,685
Other Financing Sources	-	327	19,151	2,429	21,907
Net Cost of Operations	-	(77,656)	(1,119,106)	(18,662)	(1,215,424)
Change in Net Postion	$ 22,648	$ 266,444	$ 43,125	$ 85	$ 332,302
					-
Net Position End of Period	$ 188,371	$ 3,023,769	$ 2,670,425	$ 3,662	$ 5,886,227

	Environmental Services	LUST	Superfund	Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2006 (Restated)					
ASSETS					
Fund Balance with Treasury	$ 165,723	$ 25,497	$ 35,086	$ 31,445	$ 257,751
Investments	-	2,738,746	2,627,521	(3)	5,366,264
Accounts Receivable, Net	-	-	447,747	2,821	450,568
Other Assets	-	176	63,874	1,067	65,117
Total Assets	$ 165,723	$ 2,764,419	$ 3,174,228	$ 35,330	$ 6,139,700
					-
Other Liabilities	$ -	$ 7,094	$ 567,828	$ 31,753	$ 606,675
Total Liabilities	$ -	$ 7,094	$ 567,828	$ 31,753	$ 606,675
					-
Cumulative Results of Operations	$ 165,723	$ 2,757,325	$ 2,606,400	$ 3,577	$ 5,533,025
Total Liabilities and Net Position	$ 165,723	$ 2,764,419	$ 3,174,228	$ 35,330	$ 6,139,700
Statement of Changes in Net Cost For the Period Ended September 30, 2006 (Restated)					-
Gross Programs Costs	$ -	$ 75,073	$ 1,284,267	$ 62,435	$ 1,421,775
Less: Earned Revenues	-	-	327,606	35,230	362,836
					-
Net Cost of Operations	$ -	$ 75,073	$ 956,661	$ 27,205	$ 1,058,939
					-
					-
Statement of Changes in Net Position for the Period Ended September 30, 2006 (Restated)					-
Net Position, Beginning of Period	$ 145,088	$ 2,523,158	$ 2,200,115	$ 14,167	$ 4,882,528
Prior Period Adjustment (Note 40)			62,150		62,150
Beginning Balance as Adjusted	145,088	2,523,158	2,262,265	14,167	4,944,678
Nonexchange Revenue-Securities Investment		97,666	108,807		206,473
Nonexchange Revenue-Other	$ 20,635	$ 196,227	$ 32,691	$ -	$ 249,553
Other Budgetary Financing Sources	-	15,000	1,141,824	15,330	1,172,154
Other Financing Sources	-	347	17,474	1,285	19,106
Net Cost of Operations	-	(75,073)	(956,661)	(27,205)	(1,058,939)
					-
Change in Net Postion	$ 20,635	$ 234,167	$ 344,135	$ (10,590)	$ 588,347
					-
Net Position End of Period	$ 165,723	$ 2,757,325	$ 2,606,400	$ 3,577	$ 5,533,025

Earmarked funds are as follows:

Environmental Services Receipt Account: The Environmental Services Receipt Account authorized by a 1990 Act, “To amend the Clean Air Act (P.L. 101-549),” Treasury fund group 5295, was established for the deposit of fee receipts associated with environmental programs, including radon measurement proficiency ratings and training, motor vehicle engine certifications, and water pollution permits. Receipts in this special fund will be appropriated to the S&T and the EPM appropriations to meet the expenses of the programs that generate the receipts.

Leaking Underground Storage Tank (LUST) Trust Fund: The LUST Trust Fund, Treasury fund group 8153, was authorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA) as amended by the Omnibus Budget Reconciliation Act of 1990. The LUST appropriation provides funding to respond to releases from leaking underground petroleum tanks.

The Agency oversees cleanup and enforcement programs which are implemented by the states. Funds are allocated to the states through cooperative agreements to clean up those sites posing the greatest threat to human health and the environment. Funds are used for grants to non-state entities including Indian tribes under Section 8001 of the Resource Conservation and Recovery Act. The program is financed by a one cent a gallon tax on motor fuels which will expire in 2011.

Superfund Trust Fund: In 1980, the Superfund Trust Fund, Treasury fund group 8145, was established by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) to provide resources needed to respond to and clean up hazardous substance emergencies and abandoned, uncontrolled hazardous waste sites. The Superfund Trust Fund financing is shared by federal and state governments as well as industry. The EPA allocates funds from its appropriation to other Federal agencies to carry out CERCLA. Risks to public health and the environment at uncontrolled hazardous waste sites qualifying for the Agency's National Priorities List (NPL) are reduced and addressed through a process involving site assessment and analysis and the design and implementation of cleanup remedies. NPL cleanups and removals are conducted and financed by the EPA, private parties, or other Federal agencies. The Superfund Trust Fund includes Treasury's collections, special account receipts from settlement agreements, and investment activity.

Other Earmarked Funds:

Oil Spill Response Trust Fund: The Oil Spill Response Trust Fund, Treasury fund group 8221, was authorized by the Oil Pollution Act of 1990 (OPA). Monies were appropriated to the Oil Spill Response Trust Fund in 1993. The Agency is responsible for directing, monitoring and providing technical assistance for major inland oil spill response activities. This involves setting oil prevention and response standards, initiating enforcement actions for compliance with OPA and Spill Prevention Control and Countermeasure requirements, and directing response actions when appropriate. The Agency carries out research to improve response actions to oil spills including research on the use of remediation techniques such as dispersants and bioremediation. Funding for oil spill cleanup actions is provided through the Department of Transportation under the Oil Spill Liability Trust Fund and reimbursable funding from other Federal agencies.

Miscellaneous Contributed Funds Trust Fund: The Miscellaneous Contributed Funds Trust Fund authorized in the Federal Water Pollution Control Act (Clean Water Act) as amended P.L. 92-500 (The Federal Water Pollution Control Act Amendments of 1972), Treasury fund group 8741, includes gifts for pollution control programs that are usually designated for a specific use by donors and/or deposits from pesticide registrants to cover the costs of petition hearings when such hearings result in unfavorable decisions to the petitioner.

Pesticide Registration Fund: The Pesticide Registration Fund authorized by a 2004 Act, "Consolidated Appropriations Act (P.L. 108-199)," Treasury fund group 5374, was authorized in 2004 for the expedited processing of certain registration petitions and associated establishment of tolerances for pesticides to be used in or on food and animal feed. Fees covering these activities, as authorized under the FIFRA Act of 1988, are to be paid by industry and deposited into this fund group.

Federal Insecticide, Fungicide and Rodenticide Act (FIFRA): The FIFRA Revolving Fund, Treasury fund group 4310, was authorized by the FIFRA Act of 1972, as amended in 1988 and as amended by the Food Quality Protection Act of 1996. Pesticide Maintenance fees are paid by industry to offset the costs of pesticide reregistration and reassessment of tolerances for pesticides used in or on food and animal feed, as required by law.

Tolerance Revolving Fund: The Tolerance Revolving Fund, Treasury fund group 4311, was authorized in 1963 for the deposit of tolerance fees. Fees are paid by industry for Federal services to set pesticide chemical residue limits in or on food and animal feed. The fees collected prior to January 2, 1997 were accounted for under this fund. Presently these fees are being deposited in the FIFRA fund.

Exxon Valdez Settlement Fund: The Exxon Valdez Settlement Fund authorized by a 1992 Act, "Making appropriations for the Department of Veterans Affairs and Housing and Urban Development, and for sundry independent agencies, boards, commissions, corporations, and offices for the fiscal year ending September 30, 1993 (P.L. 102-389)," Treasury fund group 5297, has funds available to carry out authorized environmental restoration activities. Funding is derived from the collection of reimbursements under the Exxon Valdez settlement as a result of an oil spill.

Note 21. Exchange Revenues, Statement of Net Cost

Exchange revenues on the Statement of Net Cost include income from services provided, interest revenue (with the exception of interest earned on trust fund investments), and miscellaneous earned revenue. As of September 30, 2007 and 2006 (restated), exchange revenues are $550 million and $876 million (restated), respectively.

Note 22. Intragovernmental Costs and Exchange Revenue

	FY 2007			FY 2006 (Restated)		
	Intragovern-mental	With the Public	TOTAL	Intragovern-mental	With the Public	TOTAL
Clean Air						
Program Costs	$ 185,389	$ 818,753	$ 1,004,142	$ 192,774	$ 763,805	$ 956,579
Earned Revenue	15,594	2,997	18,591	37,264	2,258	39,522
NET COST	$ 169,795	$ 815,756	$ 985,551	$ 155,510	$ 761,547	$ 917,057
Clean & Safe Water						
Program Costs	$ 180,571	$ 3,868,428	$ 4,048,999	$ 137,874	$ 3,717,427	$ 3,855,301
Earned Revenue	11,016	2,262	13,278	9,088	2,822	11,910
NET COST	$ 169,555	$ 3,866,166	$ 4,035,721	$ 128,786	$ 3,714,605	$ 3,843,391
Land Preservation & Restoration						
Program Costs	$ 396,786	$ 1,607,952	$ 2,004,738	$ 448,101	$ 1,722,469	$ 2,170,570
Earned Revenue	101,036	352,963	453,999	440,068	303,497	743,565
NET COST	$ 295,750	$ 1,254,989	$ 1,550,739	$ 8,033	$ 1,418,972	$ 1,427,005
Healthy Communities & Ecosystems						
Program Costs	$ 275,068	$ 1,144,793	$ 1,419,861	$ 271,667	$ 1,029,787	$ 1,301,454
Earned Revenue	18,450	38,902	57,352	37,670	31,090	68,760
NET COST	$ 256,618	$ 1,105,891	$ 1,362,509	$ 233,997	$ 998,697	$ 1,232,694
Compliance & Environmental Stewardship						
Program Costs	$ 182,101	$ 603,463	$ 785,564	$ 183,628	$ 594,128	$ 777,756
Earned Revenue	5,613	1,265	6,878	9,998	2,350	12,348
NET COST	$ 176,488	$ 602,198	$ 778,686	$ 173,630	$ 591,778	$ 765,408
Total						
Program Costs	$ 1,219,915	$ 8,043,389	$ 9,263,304	$ 1,234,044	$ 7,827,616	$ 9,061,660
Earned Revenue	151,709	398,389	550,098	534,088	342,017	876,105
NET COST	$ 1,068,206	$ 7,645,000	$ 8,713,206	$ 699,956	$ 7,485,599	$ 8,185,555

Intragovernmental costs relate to the source of the goods or services not the classification of the related revenue.

Note 23. Cost of Stewardship Land

The costs related to the acquisition of stewardship were less than $150 thousand in FY 2007 and approximately $1 million in FY 2006. These costs are included in the Statement of Net Cost.

Note 24. Environmental Cleanup Costs

As of September 30, 2007 EPA has three sites that require clean up stemming from its activities. Costs amounting to $205 thousand may be paid out of the Treasury Judgment Fund. Two claimants' chance of success is characterized as reasonably possible. Additionally EPA has one site ($80 thousand) characterized as remote chance of success. EPA also holds title to a site in Edison, New Jersey which was formerly an Army Depot.

While EPA did not cause the contamination, the Agency could potentially be liable for a portion of the cleanup costs. However, it is expected that the Department of Defense and General Services Administration will bear all or most of the cost of remediation. In addition, EPA has two sites that have an unfunded environmental liability of $230 thousand.

Accrued Cleanup Cost:

The EPA has 15 sites that will require future clean up associated with permanent closure. The estimated costs will be approximately $18 million. Since the cleanup costs associated with permanent closure are not primarily recovered through user fees, EPA has elected to recognize the estimated total cleanup cost as a liability and record changes to the estimate in subsequent years.

The FY 2007 estimate for unfunded cleanup costs increased by $8 million from the FY 2006 estimate. This increase is due primarily to a change in methodology used by a site to calculate unfunded cleanup costs.

Note 25. State Credits

Authorizing statutory language for Superfund and related Federal regulations require states to enter into SSCs when EPA assumes the lead for a remedial action in their state. The SSC defines the state's role in the remedial action and obtains the state's assurance that they will share in the cost of the remedial action. Under Superfund's authorizing statutory language, states will provide EPA with a 10 percent cost share for remedial action costs incurred at privately owned or operated sites, and at least 50 percent of all response activities (i.e., removal, remedial planning, remedial action, and enforcement) at publicly operated sites. In some cases, states may use EPA approved credits to reduce all or part of their cost share requirement that would otherwise be borne by the states. Credit is limited to state site-specific expenses EPA has determined to be reasonable, documented, direct out-of-pocket expenditures of non-Federal funds for remedial action.

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2007, the total remaining state credits have been estimated at $14.5 million. The estimated ending credit balance on September 30, 2006 was $17.1 million.

Note 26. Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2007, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling $25 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment.

Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

Note 27. Custodial Revenues and Accounts Receivable

		FY 2007		Restated FY 2006
Fines, Penalties and Other Miscellaneous Receipts	$	**89,330**	$	**21,384**
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts:				
Accounts Receivable	$	196,590	$	192,739
Less: Allowance for Uncollectible Accounts		(156,401)		(150,943)
Total	$	**40,189**	$	**41,796**

EPA uses the accrual basis of accounting for the collection of fines, penalties and miscellaneous receipts. Collectibility by EPA of the fines and penalties is based on the RPs' willingness and ability to pay.

Note 28. Statement of Budgetary Resources

Budgetary resources, obligations incurred and outlays, as presented in the audited FY 2007 Statement of Budgetary Resources, will be reconciled to the amounts included in the FY 2009 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2007 has not yet been published. We expect it will be published by March 2008, and it will be available on the OMB website at http://www.whitehouse.gov/omb/budget/fy2009. The actual amounts published for the year ended September 30, 2006 are included in EPA's FY 2007 financial statement disclosures.

FY 2006		Budgetary Resources		Obligations		Offsetting Receipts		Net Outlays
Statement of Budgetary Resources	$	13,452,220		10,205,133	$	1,314,780	$	9,630,352
Funds Reported by Other Federal Entities		19,090		3,563		-		3,661
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other		5,763		1,825		-		-
Expired and Immaterial Funds*		(94,312)		(1,535)		-		-
Rounding Differences**		1,239		1,014		220		(1,013)
Reported in Budget of the U. S. Government	$	**13,384,000**	$	**10,210,000**	$	**1,315,000**	$	**9,633,000**

* Expired funds are not included in Budgetary Resources Available for Obligation and Total New Obligations in the Budget Appendix (lines 23.90 and 10.00). Also, minor funds are not included in the Budget Appendix.
** Balances are rounded to millions in the Budget Appendix.

Note 29. Recoveries and Resources Not Available, Statement of Budgetary Resources

Recoveries of Prior Year Obligations, Temporarily Not Available, and Permanently Not Available on the Statement of Budgetary Resources consist of the following amounts:

	FY 2007	FY 2006
Recoveries of Prior Year Obligations-downward adjustments of prior years' obligations	$ **387,621**	$ **264,710**
Temporarily Not Available-rescinded authority	**-**	**(9,466)**
Permanently Not Available:		
Payments to Treasury	(2,769)	(2,848)
Rescinded authority	-	(185,472)
Canceled authority	(4,564)	(10,164)
Total Permanently Not Available	**$ (7,333)**	**$ (198,484)**

Note 30. Unobligated Balances Available

The unobligated balances available consist of the following as of September 30, 2007 and 2006. Unobligated balances are a combination of two lines on the Statement of Budgetary Resources: Apportioned, Unobligated Balances and Unobligated Balances Not Available. Unexpired unobligated balances are available to be apportioned by the OMB for new obligations at the beginning of the following fiscal year. The expired unobligated balances are only available for upward adjustments of existing obligations.

	FY 2007	FY 2006
Unexpired Unobligated Balance	$ 3,279,240	$ 3,156,100
Expired Unobligated Balance	262,147	90,987
Total	**$ 3,541,387**	**$ 3,247,087**

Note 31. Undelivered Orders at the End of the Period

Budgetary resources obligated for undelivered orders at the end of the September 30, 2007 and 2006 are as follows:

		FY 2007		FY 2006
Undelivered Orders	$	8,714,675	$	10,000,509

Note 32. Offsetting Receipts

Distributed offsetting receipts credited to the general fund, special fund, or trust fund receipt accounts offset gross outlays. For FYs 2007 and 2006, the following receipts were generated from these activities:

		FY 2007		FY 2006
Trust Fund Recoveries	$	234,171	$	59,748
Special Fund Environmental Service		22,648		20,634
Downward Re-estimates of Subsidies		29		-
Trust Fund Appropriation		1,040,372		1,204,825
Special Fund Receipt Account and Treasury Miscellaneous Receipts and Clearing Accounts		10,238		29,573
Total	**$**	**1,307,458**	**$**	**1,314,780**

Note 33. Transfers-In and Out, Statement of Changes in Net Position

Appropriation Transfers, In/Out:

For FYs 2007 and 2006, the Appropriation Transfers under Budgetary Financing Sources on the Statement of Changes in Net Position are comprised of nonexpenditure transfers that affect Unexpended Appropriations for non-invested appropriations. These amounts are included in the Budget Authority, Net Transfers and Prior Year Unobligated Balance, Net Transfers lines on the Statement of Budgetary Resources. Detail of the Appropriation Transfers on the Statement of Changes in Net Position and reconciliation with the Statement of Budgetary Resources follow:

Transfers In/Out Without Reimbursement, Budgetary:

Fund/Type of Account	FY 2007	FY 2006
Department of State	$ -	$ 1,500
Appalachian Regional Commission	-	(747)
Total Appropriation Transfers (Other Funds)	$ -	$ 753
Net Transfers from Invested Funds	1,344,610	1,248,523
Allocations Rescinded	-	8,932
Total of Net Transfers on Statement of Budgetary Resources	**$ 1,344,610**	**$ 1,258,208**

For FYs 2007 and 2006 Transfers In/Out under Budgetary Financing Sources on the Statement of Changes in Net Position consists of transfers to or from other Federal agencies and between EPA funds. These transfers affect Cumulative Results of Operations. Detail of the transfers-in and transfers-out, expenditure and nonexpenditure, follows:

Type of Transfer/Funds	FY 2007		FY 2006	
	Earmark	Other Funds	Earmark	Other Funds
Transfers-in (out), nonexpenditure to other federal agencies	$ -	$ -	$ (4,509)	$ (127)
Transfers-in (out) nonexpenditure, Earmark to S&T and OIG funds	(43,491)	43,491	(43,493)	43,493
Transfer-in nonexpenditure recovery from CDC	1,370	-	-	-
Transfers-in, nonexpenditure, Oil Spill	15,734	-	15,330	-
Adjustment from Prior Year	701	-	-	-
without Reimbursement, Budgetary	$ **(25,686)**	$ **43,491**	**$** **(32,672)**	$ **43,366**

Transfers In/Out without Reimbursement, Other Financing Sources:

For FYs 2007 and 2006 Transfers In/Out without Reimbursement under Other Financing Sources on the Statement of Changes in Net Position are comprised of negative subsidy to a special receipt fund for the credit reform funds. The amounts reported on the Statement of Changes in Net Position are as follows:

Type of Transfer/Funds	FY 2007		FY 2006	
	Earmark	Other Funds	Earmark	Other Funds
Transfers-in by allocation tranfer agency	$ 39	$ -	$ -	$ -
Transfers-in property	-	530	-	-
Transfers (out) of prior year negative subsidy to be paid following year	-	(5)	-	(28)
Total Transfers in (out) without Reimbursement, Budgetary	**$ 39**	**$ 525**	**$ -**	**$ (28)**

34. Imputed Financing Sources

In accordance with SFFAS No. 5, "Accounting for Liabilities of the Federal Government," Federal agencies must recognize the portion of employees' pensions and other retirement benefits to be paid by the OPM trust funds. These amounts are recorded as imputed costs and imputed financing for each agency. Each year the OPM provides Federal agencies with cost factors to calculate these imputed costs and financing that apply to the current year. These cost factors are multiplied by the current year's salaries or number of employees, as applicable, to provide an estimate of the imputed financing that the OPM trust funds will provide for each agency. The estimates for FY 2007 were $133.3 million ($21.9 million from Earmark funds, and $111.4 million from Other Funds). For FY 2006, the estimates were $131.1 million ($19.1 million from Earmark Funds, and $112 million from Other Funds).

In addition to the pension and retirement benefits described above, EPA also records imputed costs and financing for Treasury Judgment Fund payments made on behalf of the Agency. Entries are made in accordance with the Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions." For FY 2007 entries for Judgment Fund payments totaled $2.3 million (Other Funds). For FY 2006, entries for Judgment Fund payments totaled $9.5 million (Other Funds).

The combined total of imputed financing costs for FY 2007 is $135.6 million and in FY 2006 was $140.6 million.

Note 35. Payroll and Benefits Payable

Payroll and benefits payable to EPA employees for the years ending September 30, 2007 and 2006, consist of the following:

FY 2007 Payroll & Benefits Payable		Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
Accrued Funded Payroll & Benefits	$	30,957	$	-	$	30,957
Withholdings Payable		29,297		-		29,297
Employer Contributions Payable-TSP		2,101		-		2,101
Accrued Unfunded Annual Leave		-		142,843		142,843
Total - Current	$	**62,355**	$	**142,843**	$	**205,198**
FY 2006 Payroll & Benefits Payable						
Accrued Funded Payroll & Benefits	$	31,023	$	-	$	31,023
Withholdings Payable		27,653		-		27,653
Employer Contributions Payable-TSP		2,010		-		2,010
Accrued Unfunded Annual Leave		-		135,060		135,060
Total - Current	$	**60,686**	$	**135,060**	$	**195,746**

Note 36. Other Adjustments, Statement of Changes in Net Position

The Other Adjustments under Budgetary Financing Sources on the Statement of Changes in Net Position consist of rescissions to appropriated funds and cancellation of funds that expired 5 years earlier. These amounts affect Unexpended Appropriations.

		Other Funds FY 2007		Other Funds FY 2006
Rescissions to General Appropriations	$	-	$	185,472
Canceled General Authority		4,561		10,146
Total Other Adjustments	**$**	**4,561**	**$**	**195,618**

Note 37. Nonexchange Revenue, Statement of Changes in Net Position

The Nonexchange Revenue, Budgetary Financing Sources, on the Statement of Changes in Net Position for FYs 2007 and 2006 consist of the following items:

		Earmark Funds FY 2007		Earmark Funds Restated FY 2006
Interest on Trust Fund	$	258,986	$	206,473
Tax Revenue, Net of Refunds		228,796		197,372
Fines and Penalties Revenue		704		31,422
Special Receipt Fund Revenue		22,648		20,759
Revenue	**$**	**511,134**	**$**	**456,026**

Note 38. Adjustment for Allocation Transfers

Beginning in FY 2007, the agency that transfers budget authority to another Federal entity must report all budgetary and proprietary activity related to these transfers in its financial statements. The cumulative effect of this activity is reported as a "Change in Accounting Principle" on the Statement of Net Position ($20.9 million - Earmark Funds) and as an "Adjustment to Unobligated Balance, Brought Forward" and an "Adjustment to Unpaid Obligations, Brought Forward" on the Statement of Budgetary Resources.

Statement of Budgetary Resources

		FY 2007
Beginning Balance:		
Unobligated Balance, Brought Forward October 1	$	3,247,087
Adjustment of Unobligated Balance (Allocation Transfer Agencies)		15,527
Adjusted Total Beginning Balance	$	**3,262,614**

Note 39. Reconciliation of Net Cost of Operations to Budget (formerly the Statement of Financing)

	FY 2007	Restated FY 2006
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated		
Obligations Incurred	$ 9,516,922	$ 10,205,133
Less: Spending Authority from Offsetting Collections and Recoveries	(963,361)	(1,466,805)
Obligations, Net of Offsetting Collections	$ 8,553,561	$ 8,738,328
Less: Offsetting Receipts (Note 32)	(1,307,458)	(1,314,780)
Net Obligations	$ 7,246,103	$ 7,423,548
Other Resources		
Transfers In/Out Without Reimbursement, Property	$ 530	$ -
Imputed Financing Sources (Note 34)	135,609	140,554
Net Other Resources Used to Finance Activities	$ 136,139	$ 140,554
Total Resources Used To Finance Activities	$ 7,382,242	$ 7,564,102
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS:		
Change in Budgetary Resources Obligated	$ 1,229,438	$ 722,153
Resources that Fund Prior Periods Expenses	-	(2,020)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations:		
Credit Program Collections Increasing Loan Liabilities for Guarantees or Subsidy Allowances	3,979	4,114
Offsetting Receipts Not Affecting Net Cost	267,087	109,955
Resources that Finance Asset Acquistion	(113,393)	(115,641)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	$ 1,387,111	$ 718,561
Total Resources Used to Finance the Net Cost of Operations	$ 8,769,353	$ 8,282,663

		FY 2007		Restated FY 2006
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:				
Components Requiring or Generating Resources in Future Periods:				
Increase in Annual Leave Liability	$	7,771	$	4,776
Increase in Environmental and Disposal Liability		8,073		3,352
Upward/Downward Reestimates of Credit Subsidy Expense		33		-
Increase in Public Exchange Revenue Receivables		(168,330)		(42,011)
Increase in Workers Compensation Costs		986		37
Other		420		1,823
Total Components of Net Cost of Operations that Require or Generate Resources in Future Periods	$	(151,047)	$	(32,023)
Components Not Requiring/Generating Resources:				
Depreciation and Amortization	$	52,248	$	56,959
Revaluation of Assets and Liabilities		-		-
Expenses Not Requiring Budgetary Resources		42,652		(122,044)
Total Components of Net Cost that Will Not Require or Generate Resources	$	94,900	$	(65,085)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	$	(56,147)	$	(97,108)
Net Cost of Operations	**$**	**8,713,206**	**$**	**8,185,555**

Note 40. Restatement of FY 2006 Financial Statements

In FY 2006, EPA implemented a policy following the Office of Management and Budget (OMB), Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, for delinquent receivables that were currently not collectible (CNC). EPA's policy required receivables over 2-years delinquent with no past collections to be written-off and reclassified as CNC or closed-out when there was uncertainty about collection. Consistent with its policy, the Agency wrote-off and reclassified to $704 million of non-Federal and $21 million of Federal receivables. Of this amount, approximately $653.6 million were Superfund-related receivables. Prior to the reclassification of the receivables in FY 2006, EPA had no material collections for these receivables.

OMB Circular A-129 also required that in those cases where material collections could be documented to occur after 2 years, debt could not be written-off until the estimated collections become immaterial. In such cases, the receivable must remain on the Agency's books with an adequate reserve for the uncollectible portion.

Late in FY 2007, EPA had material collections of receivables that had been written-off and classified as CNC. One of the receivables was a 1989 judgment granted in favor of EPA for cleanup costs incurred at a Superfund site. A bond for the amount due to EPA was posted in 1999. The judgment was appealed by the polluter through the U.S. Courts and was upheld in favor of EPA on each appeal.

In FY 2005, an EPA attorney considered the receivable 100% collectible. In FY 2007, the Agency collected the full value of the receivable established in 1989 plus interest.

Based on these material collections, EPA reevaluated its policy and implementation of reclassifying receivables to CNC. The Agency determined that it cannot forecast collections with absolute certainty due to the nature and unpredictability of external factors that impact a debtor's ability to pay EPA. Therefore, EPA has updated its policy to discontinue reclassification of its receivables over 2-years delinquent to CNC. This change is consistent with the documented material collections language in OMB Circular A-129.

In addition, the facts related to the material collection indicated that the receivable should not have been reclassified as CNC during FY 2006, as it was likely that EPA would collect the receivable at some point in the future. As a result, EPA has restated its FY 2006 financial statements to reflect the impact of recognizing the net realizable value for the receivables previously classified as CNC. A prior period adjustment was recorded to reflect amounts that were charged to bad debt expense in prior fiscal years related to the CNC reclassification.

The FY 2006 Consolidated Balance Sheet was restated to reflect a net increase of $7.5 million in intragovernmental receivables and $239.9 million in non-Federal receivables, which resulted in an increase of $247.4 million in total assets. Liabilities, which include custodial liabilities ($8.8 million), cashout advances, Superfund ($0.7 million) and other non-Federal liabilities ($3.4 million), increased by $12.9 million.

The cumulative results of operations (CRO) beginning balance on the Consolidating Statement of Changes in Net Position for FY 2006 increased by $74.3 million. The increase is the result of the reduction in prior fiscal years bad debt expense. In addition, on the FY 2006 Consolidating Statement of Changes in Net Position, the Net Cost of Operations decreased by $160.2 million as a result of the additional revenue earned and reduction in bad debt expense on the re-established receivables. The decrease in expenses and increase in revenues increased the ending CRO balance by $234.5 million.

On the Statement of Custodial Activity, custodial revenue increased by $1.8 million.

The following table depicts the changes by financial statements and line item for FY 2006:

Financial Statement & Line Item Affected by Restatement	Restated FY 2006	Original FY 2006	Change
Consolidated Balance Sheet			
Intragovernmental Accounts Receivable, Net	135,263	127,727	7,536
Non-Federal Assets			
Accounts & Interest Receivable	1,076,890	364,517	712,373
Less: Allowance for Uncollectibles	(709,250)	(236,753)	(472,497)
Accounts Receivable, Net-Non Federal	483,700	243,824	239,876
Restatement Effect on Total Assets	18,009,732	17,762,319	247,413
Custodial Liability	41,801	32,963	8,838
Cashout Advances, Superfund	224,407	223,760	647
Other-Non Federal	134,747	131,322	3,425
Restatement Effect on Total Liabilities	1,601,222	1,588,312	12,910
Cumulative Results of Operations - Earmarked Funds	5,533,025	4,177,329	1,355,696
Cumulative Results of Operation - Other Funds	575,846	1,697,038	(1,121,192)
Total Net Position	16,408,511	16,174,007	234,504
Total Liabilities and Net Position	18,009,732	17,762,319	247,413
Consolidated Statement of Net Cost			
Gross Costs	9,061,660	9,215,502	(153,842)
Earned Revenue	876,105	869,762	6,343
Net Cost of Operations	8,185,555	8,345,740	(160,185)
Consolidating Statement of Changes in Net Position			
Net Position - Beginning of Period, Prior Period Adjustment (Earmark Funds)	62,150	-	62,150
Net Position - Beginning of Period, Prior Period Adjustment (Other Funds)	12,168	-	12,168
Net Cost of Operations	8,185,555	8,345,740	(160,185)
Net Change	626,268	466,082	160,186
Cummulative Results of Operations	6,108,871	5,874,367	234,504
Statement of Custodial Activity			
Accrual Adjustment	(80,806)	(82,620)	1,814
Total Custodial Revenue	21,384	19,570	1,814
Increase/Decreases in Amounts to be transferred	(80,914)	(82,728)	1,814
Total Disposition of Collections	21,384	19,570	1,814

1.
Environmental Protection Agency
Required Supplementary Information
As of September 30, 2007
(Dollars in Thousands)
(Unaudited)

Deferred Maintenance

The EPA classifies tangible property, plant, and equipment as follows: (1) EPA-Held Equipment, (2) Contractor-Held Equipment, (3) Land and Buildings, and, (4) Capital Leases. The condition assessment survey method of measuring deferred maintenance is utilized. The Agency adopts requirements or standards for acceptable operating condition in conformance with industry practices. No deferred maintenance was reported for any of the four categories.

Stewardship Land

Stewardship land is acquired as contaminated sites in need of remediation and clean-up; thus the quality of the land is far-below the standard for usable and manageable land. Easements on stewardship lands are in good and usable condition but acquired in order to gain access to contaminated sites.

2.
Environmental Protection Agency
Required Supplementary Information
Supplemental Statement of Budgetary Resources (Unaudited)
As of September 30, 2007
(Dollars in Thousands)

	EPM	FIFRA	LUST	S&T	STAG	OTHER	TOTAL
BUDGETARY RESOURCE							
Unobligated Balance Brought Forward, October 1							
Brought Forward October 1	$ 566,216	$ 5,645	$ 15,266	$ 205,792	$ 1,310,813	$ 1,143,355	$ 3,247,087
Adjustment to Unobligation Balance (Alloc Transfer Agencies) (Note 38)						15,527	15,527
Adjusted Subtotal	566,216	5,645	15,266	205,792	1,310,813	1,158,882	3,262,614
Recoveries of prior year unpaid obligations	100,745	828	2,659	11,988	136,882	134,519	387,621
Budgetary Authority:							
Appropriation	2,358,370	-	-	733,387	3,213,708	1,189,563	7,495,028
Borrowing Authority	-	-	-	-	-	29	29
Spending Authority from Offsetting Collections:							
Collected	153,929	21,390	44	9,299	6,960	448,732	640,354
Change in receivables from Federal sources	(69,820)	-	-	(1,648)	(27)	(1,051)	(72,546)
Advance received	4,647	631	-	(1,907)	-	(38,305)	(34,934)
Without advance from Federal source	(28,978)	-	-	(547)	27	28,873	(625)
Expenditure Transfers from trust funds	-	-	-	30,156	-	13,335	43,491
Nonexpenditure transers, net anticipated and actual	-	-	72,034	-	-	1,272,576	1,344,610
Temporarily not available pursuant to Public Law	-	-	-	-	-	-	-
Permanently not available	(2,855)	-	-	(1,668)	-	(2,810)	(7,333)
Total Budgetary Resources	**$ 3,082,254**	**$ 28,494**	**$ 90,003**	**$ 984,852**	**$ 4,668,363**	**$ 4,204,343**	**$ 13,058,309**
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	$ 2,323,967	$ -	$ 83,691	$ 757,078	$ 3,337,633	$ 2,524,801	$ 9,027,170
Reimbursable	86,200	21,479	40	5,837	-	376,196	489,752
Total Obligations Incurred	2,410,167	21,479	83,731	762,915	3,337,633	2,900,997	9,516,922
Unbligated Balances:							
Unobligated funds apportioned	444,096	7,015	6,272	192,010	1,330,730	**1,294,221**	3,274,344
Unobligated balance not available	227,991	-	-	29,927	-	9,125	267,043
Total Status of Budgetary Resources	**$ 3,082,254**	**$ 28,494**	**$ 90,003**	**$ 984,852**	**$ 4,668,363**	**$ 4,204,343**	**$ 13,058,309**
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid obligations brought forward, October 1	$ 989,404	$ 2,426	$ 85,443	$ 586,759	$ 7,674,782	$ 1,617,514	$ 10,956,328
Adjustment to Unpaid Obligations (Alloc Transfer Agencies) (Note 38)	-	-	-	-	-	7,215	7,215
Adjusted Total	989,404	2,426	85,443	586,759	7,674,782	1,624,729	10,963,543
Less: Uncollected customer payments from Federal sources brought forward, October 1	(546,184)	-	-	(42,296)		(123,759)	(712,239)
Total unpaid obligation balance, net	443,220	2,426	85,443	544,463	7,674,782	1,500,970	10,251,304
Obligations incurred, net	2,410,167	21,478	83,733	762,916	3,337,632	2,900,996	9,516,922
Less: Gross outlays	(2,468,491)	(20,781)	(72,986)	(831,325)	(3,945,094)	(2,880,960)	(10,219,637)
Less: Recoveries of prior year unpaid obligations, actual	(100,745)	(828)	(2,659)	(11,988)	(136,882)	(134,519)	(387,621)
Change in uncollected customer payments from Federal sources	98,799	-	-	8,336	-	(27,686)	79,449
Total	382,950	2,295	93,531	472,402	6,930,438	1,358,801	9,240,417
Obligated balance, net, end of period:							
Unpaid obligations	830,336	2,295	93,531	506,362	6,930,438	1,510,245	9,873,207
Less: Uncollected customer payments from Federal sources	(447,386)	-	-	(33,960)	-	(151,444)	(632,790)
Total, unpaid obligated balance, net, end of period	$ 382,950	$ 2,295	$ 93,531	$ 472,402	$ 6,930,438	$ 1,358,801	$ 9,240,417
NET OUTLAYS							
Gross outlays	$ 2,468,491	$ 20,781	$ 72,986	$ 831,324	$ 3,945,095	$ 2,880,960	$ 10,219,637
Less: Offsetting collections	(158,576)	(22,020)	(45)	(43,689)	(6,959)	(423,899)	(655,188)
Less: Distributed Offsetting Receipts	-	-	-	-	-	(1,307,458)	(1,307,458)
Total, Net Outlays	$ 2,309,915	$ (1,239)	$ 72,941	$ 787,635	$ 3,938,136	$ 1,149,603	$ 8,256,991

Environmental Protection Agency
Required Supplementary Stewardship Information (Unaudited)
For the Year Ended September 30, 2007
(Dollars in Thousands)

INVESTMENT IN THE NATION'S RESEARCH AND DEVELOPMENT: (Non-Federal Physical Property):

Public and private sector institutions have long been significant contributors to our nation's environment and human health research agenda. EPA's Office of Research and Development, however, is unique among scientific institutions in this country in combining research, analysis, and the integration of scientific information across the full spectrum of health and ecological issues and across the risk assessment and risk management paradigm. Research enables us to identify the most important sources of risk to human health and the environment, and by so doing, informs our priority-setting, ensures credibility for our policies, and guides our deployment of resources. It gives us the understanding, the framework, and technologies we need to detect, abate, and avoid environmental problems. Research also provides the crucial underpinning(s) for EPA decision-making and challenges us to apply the best available science and technical analysis to our environmental problems and to practice more integrated, efficient and effective approaches to reducing environmental risks.

Among the Agency's highest priorities are research programs that address the environmental effects on children's health; the development of alternative techniques for prioritizing chemicals for further testing through computational toxicology; the provision of near-term, appropriate, affordable, reliable, tested, and effective technologies and guidance for potential threats to homeland security; the potential risks of unregulated contaminants in drinking water; the health effects of air pollutants such as particulate matter; and the protection of the nation's ecosystems. For FY 2007, the full cost of the Agency's Research and Development activities totaled over $724.6 million. Below is a breakout of the expenses (dollars in thousands):

	FY 2003	FY 2004	FY 2005	FY 2006	FY2007
Programmatic Expenses	593,295	581,323	628,467	630,438	624,088
Allocated Expenses	106,971	91,675	112,558	104,167	100,553

See Section II of the PAR for more detailed information on the results of the Agency's investment in research and development. Each of EPA's strategic goals has a Science and Research Objective.

INVESTMENT IN THE NATION'S INFRASTRUCTURE:

The Agency makes significant investments in the nation's drinking water and clean water infrastructure. The investments are the result of three programs: the Construction Grants Program which is being phased out and two State Revolving Fund (SRF) programs.

Construction Grants Program: During the 1970s and 1980s, the Construction Grants Program was a source of Federal funds, providing more than $60 billion of direct grants for the construction of public wastewater treatment projects. These projects, which constituted a significant contribution to the nation's water infrastructure, included sewage treatment plants, pumping stations, and collection and intercept sewers, rehabilitation of sewer systems, and the control of combined sewer overflows. The construction grants led to the improvement of water quality in thousands of municipalities nationwide.

Congress set 1990 as the last year that funds would be appropriated for Construction Grants. Projects funded in 1990 and prior will continue until completion. After 1990, EPA shifted the focus of municipal financial assistance from grants to loans that are provided by State Revolving Funds.

State Revolving Funds: EPA provides capital, in the form of capitalization grants, to state revolving funds which state governments use to make loans to individuals, businesses, and governmental entities for the construction of wastewater and drinking water treatment infrastructure. When the loans are repaid to the state revolving fund, the collections are used to finance new loans for new construction projects. The capital is reused by the states and is not returned to the Federal Government.

The Agency also is appropriated funds to finance the construction of infrastructure outside the Revolving Funds. These are reported below as Other Infrastructure Grants.

The Agency's expenses related to investments in the nation's Water Infrastructure are outlined below (dollars in thousands):

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Construction Grants	15,845	48,948	21,148	39,193	9,975
Clean Water SRF	1,295,394	1,407,345	1,127,883	1,339,702	1,399,616
Safe Drinking Water SRF	842,936	802,629	715,060	910,032	962,903
Other Infrastructure Grants	582,091	341,767	385,226	411,023	381,481
Allocated Expenses	493,349	410,129	402,853	446,113	443,716

See the Goal 2 – Clean and Safe Water portion in Section II of the PAR for more detailed information on the results of the Agency's investment in infrastructure.

HUMAN CAPITAL

Agencies are required to report expenses incurred to train the public with the intent of increasing or maintaining the nation's economic productive capacity. Training, public awareness, and research fellowships are components of many of the Agency's programs and are effective in achieving the Agency's mission of protecting public health and the environment, but the focus is on enhancing the nation's environmental, not economic, capacity.

The Agency's expenses related to investments in the Human Capital are outlined below (dollars in thousands):

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Training and Awareness Grants	47,827	48,416	46,750	43,765	32,845
Fellowships	6,572	7,553	10,195	12,639	12,185
Allocated Expenses	9,808	8,826	10,199	9,320	7,255

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Balance Sheet for Superfund Trust Fund
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

		FY 2007		Restated FY 2006
ASSETS				
Intragovernmental:				
Fund Balance With Treasury (Note S1)	$	51,081	$	35,086
Investments		2,751,850		2,627,521
Accounts Receivable, Net (Note 40)		16,955		15,064
Other		14,927		8,191
Total Intragovernmental	$	2,834,813	$	2,685,862
Accounts Receivable, Net (Note 40)		312,874		432,683
Property, Plant & Equipment, Net		70,601		54,917
Other		1,030		766
Total Assets	$	**3,219,318**	**$**	**3,174,228**
LIABILITIES				
Intragovernmental:				
Accounts Payable and Accrued Liabilities		89,239		84,706
Other		46,182		44,324
Total Intragovernmental	$	135,421	$	129,030
Accounts Payable & Accrued Liabilities	$	139,607	$	122,788
Pensions & Other Actuarial Liabilities		6,889		6,925
Cashout Advances, Superfund (Note S2 and Note 40)		190,269		224,406
Payroll & Benefits Payable		35,914		34,969
Other (Note 40)		40,793		49,710
Total Liabilities	$	548,893	$	567,828
NET POSITION				
Cumulative Results of Operations (Note 40)		2,670,425		2,606,400
Total Net Position		2,670,425		2,606,400
Total Liabilities and Net Position	**$**	**3,219,318**	**$**	**3,174,228**

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Net Cost for Superfund Trust Fund
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

		FY 2007		Restated FY 2006
COSTS				
Gross Costs (Note 40)	$	1,497,010	$	1,284,267
Expenses from Other Appropriations (Note S5)		76,452		61,635
Total Costs		1,573,462		1,345,902
Less:				
Earned Revenue (Note 40)		377,904		327,606
NET COST OF OPERATIONS (Note 40)	**$**	**1,195,558**	**$**	**1,018,296**

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Changes in Net Position for Superfund Trust Fund
For the Periods Ending September 30, 2007 and 2006 (Restated)
(Dollars in Thousands)

	FY2007 Cumulative Results of Operations	Restated FY 2006 Cumulative Results of Operations
Net Position - Beginning of Period	$ 2,606,400	$ 2,200,115
Adjustment:		
(a) Change in Accounting Principles (Alloc Transfer Agencies) (Note 38)	20,900	-
(b) Prior Period Adjustment (Note 40)	-	62,150
Beginning Balances, as Adjusted	$ 2,627,300	$ 2,262,265
Budgetary Financing Sources:		
Nonexchange Revenue -Securities Investment	141,407	108,807
Nonexchange Revenue -Other	2,721	32,691
Transfers In/Out	(41,419)	(48,002)
Trust Fund Appropriations	1,040,371	1,189,826
Income from Other Appropriations (Note S5)	76,452	61,635
Total Budgetary Financing Sources	$ 1,219,532	$ 1,344,957
Other Financing Sources (Non-Exchange)		
Transfers in/Out	39	-
Imputed Financing Sources	19,112	17,474
Total Other Financing Sources	$ 19,151	$ 17,474
Net Cost of Operations	(1,195,558)	(1,018,296)
Net Change	43,125	344,135
Cumulative Results of Operations	$ **2,670,425**	$ **2,606,400**

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2007 and 2006
(Dollars in Thousands)

	FY 2007	FY 2006
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:		
Brought Forward October 1	$ 1,088,388	$ 930,392
Adjustment to Unobligated Balance (Alloc Transfer Agcy) (Note 38)	15,527	-
Adjusted Subtotal	1,103,915	930,392
Recoveries of Prior Year Unpaid Obligations	127,261	121,664
Budgetary Authority:		
Appropriation	43,493	92,269
Spending Authority from Offsetting Collections		
Earned:		
Collected	227,367	289,736
Change in Receivables from Federal Sources	(1,811)	54
Change in Unfilled Customer Orders:		
Advance Received	(33,969)	(18,990)
Without Advance from Federal Sources	29,999	3,693
Total Spending Authority from Offsetting Collections	221,586	274,493
Nonexpenditure Transfers, Net, Anticipated and Actual	1,272,575	1,184,428
Temporarily Not Available Pursuant to Public Law		(7,767)
Permanently Not Available	(2)	(19)
Total Budgetary Resources	$ 2,768,828	$ 2,595,460
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$ 1,367,588	$ 1,337,854
Reimbursable	155,929	169,218
Total Obligations Incurred	1,523,517	1,507,072
Unobligated Balances:		
Apportioned	1,240,416	1,088,388
Total Unobligated Balances	1,240,416	1,088,388
Unobligated Balances Not Available	4,895	-
Total Status of Budgetary Resources (S6)	$ 2,768,828	$ 2,595,460

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2007 and 2006
(Dollars in Thousands)

	FY 2007	FY 2006
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	$ 1,454,495	$ 1,546,186
Adjustment to Unpaid Obligations (Alloc Transfer Agencies) (Note 38)	7,215	-
Adjusted Total	1,461,710	1,546,186
Less: Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(81,983)	(78,234)
Total Unpaid Obligated Balance, Net	1,379,727	1,467,952
Obligations Incurred	1,523,517	1,507,072
Less: Gross Outlays	(1,496,631)	(1,477,100)
Less: Recoveries of Prior Year Unpaid Obligations, Actual	(127,261)	(121,664)
Change in Uncollected Customer Payments from Federal Sources	(28,187)	(3,748)
Total, Change in Obligated Balance	1,251,165	1,372,512
Obligated Balance, Net, End of Period:		
Unpaid Obligations	1,361,335	1,454,495
Less: Uncollected Customer Payments from Federal Sources	(110,170)	(81,983)
Total, Unpaid Obligated Balance, Net, End of Period	$ 1,251,165	$ 1,372,512
NET OUTLAYS		
Net Outlays:		
Gross Outlays (Note S6)	$ 1,496,631	$ 1,477,100
Less: Offsetting Collections (Note S6)	(193,398)	(270,746)
Distributed Offsetting Receipts * (Note S6)	(1,274,542)	(1,249,574)
Total, Net Outlays	28,691	(43,220)

*Offsetting receipts line includes the amount in 68X0250 (payment to trust fund) from Treasury.
The payment cannot be made directly through the trust fund but must go through a "pass-through" fund.

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements (Unaudited)
Related Notes to Superfund Trust Financial Statements

Note S1. Fund Balance with Treasury for Superfund Trust

Fund Balances with Treasury as of September 30, 2007 and 2006 consist of the following:

	FY 2007	FY 2006
Fund Balance	$ 51,081	$ 35,086

Fund balances are available to pay current liabilities and to finance authorized purchase commitments (see Status of Fund Balances below).

Status of Fund Balances:	**FY 2007**	**FY 2006**
Unobligated Amounts in Fund Balances:		
Available for Obligation	$ 1,240,417	$ 1,088,389
Unavailable for Obligations	4,895	-
Net Receivables from Invested Balances	(2,446,934)	(2,426,589)
Balances in Treasury Trust Fund	1,539	775
Obligated Balance not yet Disbursed	1,251,164	1,372,511
Totals	**$ 51,081**	**$ 35,086**

The funds available for obligation may be apportioned by the OMB for new obligations at the beginning of the following fiscal year. Funds unavailable for obligation are mostly balances in expired funds, which are available only for adjustments of existing obligations.

Note S2. Cashout Advances, Superfund

Cashouts are funds received by EPA, a state, or another PRP under the terms of a settlement agreement (e.g., consent decree) to finance response action costs at a specified Superfund site. Under CERCLA Section 122(b)(3), cashout funds received by EPA are placed in site-specific, interest bearing accounts known as special accounts and are used in accordance with the terms of the settlement agreement. Funds placed in special accounts may be used without further appropriation by Congress.

Note S3. Superfund State Credits

Authorizing statutory language for Superfund and related Federal regulations require states to enter into SSCs when EPA assumes the lead for a remedial action in their state. The SSC defines the state's role in the remedial action and obtains the state's assurance that they will share in the cost of the remedial action. Under Superfund's authorizing statutory language, states will provide EPA with a 10 percent cost share for remedial action costs incurred at privately owned or operated sites, and at least 50 percent of all response activities (i.e., removal, remedial planning, remedial action, and enforcement) at publicly operated sites. In some cases, states may use EPA approved credits to reduce all or part of their cost share requirement that would otherwise be borne by the states. Credit is limited to state site-specific expenses EPA has determined to be reasonable, documented, direct out-of-pocket expenditures of non-Federal funds for remedial action.

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2007, the total remaining state credits have been estimated at $14.5 million. The estimated ending credit balance on September 30, 2006 was $17.1 million.

Note S4. Superfund Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2007, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling $25 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

Note S5. Income and Expenses from other Appropriations; General Support Services Charged to Superfund

The Statement of Net Cost reports costs that represent the full costs of the program outputs. These costs consist of the direct costs and all other costs that can be directly traced, assigned on a cause and effect basis, or reasonably allocated to program outputs.

During FYs 2007 and 2006, the EPM appropriation funded a variety of programmatic and non-programmatic activities across the Agency, subject to statutory requirements. This appropriation was created to fund personnel compensation and benefits, travel, procurement, and contract activities. This distribution is calculated using a combination of specific identification of expenses to Reporting Entities, and a weighted average that distributes expenses proportionately to total programmatic expenses.

As illustrated below, this estimate does not impact the consolidated totals of the Statement of Net Cost or the Statement of Changes in Net Position.

	FY 2007			FY 2006		
	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect
Superfund	$ 76,452	$ (76,452)	$ -	$ 61,635	$ (61,635)	$ -
All Others	(76,452)	76,452	-	(61,635)	61,635	-
Total	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

In addition, the related general support services costs allocated to the Superfund Trust Fund from the S&T and EPM funds are $2.3 million for FY 2007 and $3 million for FY 2006.

Note S6. Statement of Budgetary Resources, Superfund

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2007 Statement of Budgetary Resources, will be reconciled to the amounts included in the Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2007 has not yet been published. We expect it will be published by March 2008, and it will be available on the OMB website at *http://www.whitehouse.gov/omb/budget/fy2009*. The actual amounts published for the year ended September 30, 2006 are included in EPA's FY 2007 financial statement disclosures.

FY 2006	Budgetary Resources	Obligations	Offsetting Receipts	Outlays
Statement of Budgetary Resources	$ 2,595,460	1,507,072	$ 1,249,574	$ 1,206,354
Funds Reported by Other Federal Entities	19,090	3,563	-	3,661
Adjustments to Outlays				(5,105)
Rounding Differences*	450	365	426	90
Reported in Budget of the U. S. Government	**$ 2,615,000**	**$ 1,511,000**	**$ 1,250,000**	**$ 1,205,000**

* Balances are rounded to millions in the Budget Appendix.

Note S7. Superfund Eliminations

The Superfund Trust Fund has intra-agency activities with other EPA funds which are eliminated on the consolidated Balance Sheet and the Statement of Net Cost. These are listed below:

	FY 2007	FY 2006
Advances	$ 5,817	$ 7,843
Expenditure Transfers Payable	$30,948	$37,227
Accrued Liabilities	$ 6,001	$ 4,642
Expenses	$21,418	$25,491
Transfers	$43,491	$43,493

Agency's Response to Draft Report

November 8, 2007

MEMORANDUM

SUBJECT: OCFO Response to OIG Draft Audit Report, "Audit of EPA's Fiscal 2007 and 2006 (Restated) Consolidated Financial Statements," dated November 8, 2007

FROM: Lyons Gray
Chief Financial Officer

TO: Bill Roderick
Acting Inspector General

Thank you for another opportunity to work with the Office of the Inspector General on the U. S. Environmental Protection Agency's Consolidated Financial Statements and related audit. OCFO's response to the audit report is attached.

The Agency remains committed to sound internal controls and effective policies and procedures. We are continually evaluating ways to improve operations without compromising fiscal integrity. In this regard, I want to personally thank your staff for their willingness to return to Cincinnati in December to verify that we have implemented appropriate corrective actions for the material weaknesses related to information security and physical access to IT hardware.

I look forward to another productive year working with you and your staff. If you have any questions pertaining to operations, please contact Milton Brown, Director of the Office of Financial Services. Contact Lorna McAllister, Director of the Office of Financial Management for questions on the financial statements.

Attachment

cc: Melissa Heist
Paul Curtis
Maryann Froehlich
Joshua Baylson
Lorna McAllister
Milton Brown

Attachment

OCFO's Response to the Draft OIG Report

"Audit of EPA's Fiscal 2007 and 2006 Consolidated Financial Statements"

Introduction

In FY 2007, EPA completed the consolidation of its major financial services within OCFO's four national finance centers. Transfers included travel payments, vendor and other commercial payments, grant and interagency agreement payments, along with the accounts receivable function. In addition to delivering financial services more efficiently and using automation to gain economies of scale, the goal was to achieve greater compliance with EPA, OMB and other government financial regulations and guidelines. The Agency financial consolidation has reduced Agency costs and has yielded better performance against established financial goalposts.

EPA consolidated all functions to facilitate an employee move into a one-stop-shop center. This new approach will ensure that employees are given consistent information related to their move by experienced staff experts. The centralized web-based relocation program is supported by a COTS software (mLINQs).

In addition, EPA re-evaluated its operating practice of reclassifying certain delinquent receivables after it collected approximately $150 million in debts previously written-off. The Agency revised its existing policy and operating practices, and reestablished $725 million in receivables along with appropriate allowances. As a result of these actions, EPA restated its FY 2006 financial statements to reflect the value of the previously reclassified receivables.

EPA also partnered with other Federal agencies to narrow significantly the gap in the differences reported by the Department of the Treasury with the Agency's major trading partners.

OIG Concerns 1 - 3: The OIG made three recommendations on how the Agency records, documents, and values delinquent debt.
OCFO agrees. During fiscal year 2007, EPA collected debt previously written-off and considered not collectible. Consequently, EPA reevaluated its implementation of the policy on delinquent debt. The Agency determined that it cannot forecast collections with absolute certainty due to the nature and unpredictability of external factors that impact a debtor's ability to pay. Therefore, EPA has discontinued the practice of writing off delinquent receivables over two years old.

EPA restored all of these receivables to their net realizable value, which includes an appropriate allowance for doubtful accounts. The fiscal year 2006 column of the financial statements has been updated to reflect these changes.

EPA recognizes that there are improvement opportunities in accounts receivable operating practices including:

- Timely acquisition and maintenance of documentation and supporting evidence;
- Segregation of duties for effective verification and reconciliation;
- Staff training on standard processes, which will support uniformity and consistency; and
- Approach and method to calculate allowances for doubtful accounts.

EPA is actively working to change its business practices to address all of the above.

OIG Concerns 4 - 5: The OIG made two recommendations on information security for two applications and physical access practices and safeguards over IT hardware.
OCFO agrees. The applications in question support accounts receivable work and e-Relocation services to EPA and other government entities. EPA commits to comply with all systems and security requirements in time for OIG to verify compliance by the end of December 2007.

OIG Concern 6: The OIG identified a minor inconsistency in the process for purging and documenting transactions that failed automated system controls established to ensure the integrity of the financial information.
OCFO understands the OIG's concern. EPA evaluated every questionable transaction and determined each transaction was properly processed within a reasonable time. EPA will establish procedures and metrics to ensure transactions are managed appropriately prior to deletion.

OIG Concern 7: EPA did not maintain adequate documentation for obligation accounting adjustments.
OCFO understands the concerns raised by OIG. We will emphasize the importance of adequately documenting accounting adjustments to the financial management community and determine the appropriate level of approval for these entries.

OIG Concern 8: EPA needs to reconcile differences with trading partners.
OCFO agrees. OCFO will make appropriate adjustments to comply with Federal financial reporting requirements and, when appropriate, use the dispute resolution process to resolve outstanding issues.

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