Office of Inspector General

Audit Report

FINANCIAL MANAGEMENT

Audit of EPA's Fiscal 2001 and 2000 Financial Statements

Audit Report 2002-1-00082

February 26, 2002

Inspector General Divisions Conducting the Audit

Lead Division:	**Financial Audit Division** Washington, DC
Assist Divisions:	**Mid-Atlantic Audit Division** Philadelphia, PA
	Southern Audit Division Atlanta, GA, and Research Triangle Park, NC
	Northern Audit Division Chicago, IL, and Cincinnati, OH
	Eastern Audit Division New York, NY, and Boston, MA
	Western Audit Division San Francisco, CA
	Information Technology Audits Staff Washington, DC

Abbreviations

APG	Annual Performance Goal
CFMC	Cincinnati Financial Management Center
EPA	Environmental Protection Agency
FFMIA	Federal Financial Management Improvement Act
FinRS	Financial Replacement System
FMFIA	Federal Managers' Financial Integrity Act
GAD	Grants Administration Division
IAG	Interagency Agreement
IFMS	Integrated Financial Management System
OCFO	Office of the Chief Financial Officer
OEI	Office of Environmental Information
OIG	Office of Inspector General
OMB	Office of Management and Budget
RSI	Required Supplementary Information
RSSI	Required Supplemental Stewardship Information
SFFAS	Statement of Federal Financial Accounting Standard

Cover photo of Yosemite by Katherine Thompson, Western Audit Division (Sacramento)

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
Washington, DC 20460

OFFICE OF
THE INSPECTOR GENERAL

February 26, 2002

MEMORANDUM

SUBJECT: Audit Report on EPA's Fiscal 2001 and 2000 Financial Statements

FROM: Paul C. Curtis
Project Manager
Financial Audit Division (2422)

TO: Michael W.S. Ryan
Deputy Chief Financial Officer (2710A)

Dave O'Connor
Acting Assistant Administrator for
Administration and Resources Management (3101A)

Attached is our audit report on the Agency's fiscal 2001 and 2000 financial statements. The report recognizes that the Agency significantly improved the preparation process for the fiscal 2001 financial statements compared to prior year efforts.

Our report reflects our view that the Agency is not in substantial compliance with the managerial cost accounting standard. The audit report also contains other findings that describe issues the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends.

This audit report represents the opinion of the OIG, and the findings contained in this report do not necessarily represent the final Environmental Protection Agency (EPA) position. Final determinations on matters in this audit report will be made by EPA managers in accordance with established EPA audit resolution procedures. 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.

In this particular audit, the OIG did not measure the audited offices' performance against the standards established by the National Contingency Plan. The findings contained in this audit report are not binding in any enforcement proceeding brought by EPA or the Department of Justice under Section 107 of the Comprehensive Environmental Response, Compensation, and Liability Act to recover costs incurred not inconsistent with the National Contingency Plan.

In accordance with EPA Order 2750, *Audit Management Process,* the primary action official is required to provide us with a written response to the final audit report within 90 days of the final audit report date. Since this report deals primarily with financial management issues, we are requesting the Deputy Chief Financial Officer, as the primary action official, to take the lead in coordinating and providing us a written response to this report. 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) 260-8442 or Edward Gekosky at (202) 260-1072.

Attachment

cc: See Appendix III, Report Distribution List

Executive Summary

Introduction

We performed this audit in accordance with the Government Management Reform Act, which requires the Environmental Protection Agency (EPA, or the Agency) to prepare, and the Office of Inspector General (OIG) to audit, the Agency’s financial statements each year. 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.

Objectives

Our primary objectives were to determine whether:

- EPA’s financial statements were fairly presented in all material respects in conformity with generally accepted accounting principles;

- EPA’s internal control over financial reporting related to the financial statements were in place; and

- EPA management complied with applicable laws and regulations which, if not followed, could have a direct and material effect on the financial statements.

Results in Brief

Opinions on EPA’s Fiscal 2001 and 2000 Financial Statements

In our opinion, the consolidating financial statements present fairly the consolidated and individual assets, liabilities, net position, net cost, net cost by goal, changes in net position, reconciliation of net cost to budgetary obligations, and custodial activity of the U.S. Environmental Protection Agency and its subsidiary funds, the Superfund Trust Fund and All Other Appropriated Funds, as of and for the years ended September 30, 2001 and 2000, and budgetary resources as of and for the year ended September 30, 2001, in accordance with generally accepted accounting principles.

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

We inquired of EPA’s management as to their methods of preparing its Required Supplemental Stewardship Information (RSSI), Required Supplemental Information, and Management Discussion and Analysis, and reviewed this information for consistency with the principal financial statements. However, our audit was not designed to express, and we are not expressing, an opinion on this information.

We did not identify any material inconsistencies between the information presented in EPA's financial statements and the information presented in EPA's RSSI, Required Supplementary Information, and Management Discussion and Analysis. Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report, as Required Supplemental Information, their intra-governmental assets and liabilities by Federal trading partner. We did find that, through no fault of EPA, other Federal agencies were unable to reconcile EPA's reported transactions with their records. We note that this is a government-wide issue that needs to be resolved.

Evaluation of Internal Controls

The objective of our audit was not to provide assurance on internal controls and, accordingly, we do not express an opinion on internal controls. Material weaknesses are situations where internal controls do not reduce, to a relatively low level, the risk that errors, fraud, or noncompliance in amounts material to the financial statements may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions. In evaluating the Agency's internal controls, we noted certain matters discussed below involving the internal control and its operation that we consider to be reportable conditions. However, none of the reportable conditions is believed to be a material weakness.

In evaluating the Agency's internal control structure, we identified three reportable conditions in the following areas, which are detailed further in Attachment 1:

- Accounting for Internal Use Software
- EPA's Interagency Agreement Invoice Approval Process
- Automated Application Processing Controls for the Integrated Financial Management System

Tests of Compliance with Laws and Regulations

As part of obtaining reasonable assurance about whether the Agency's financial statements were free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance which could have a direct and material effect on the determination of financial statement amounts. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit. Accordingly, we do not express such an opinion.

We did not identify any instances of noncompliance with laws and regulations that would result in material misstatements to the audited financial statements. However, we did note the following noncompliance issues.

Compliance with the Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act (FFMIA) requires that, as a part of our annual financial statement audit, we determine whether EPA's financial management systems substantially comply with Federal financial management system requirements, applicable accounting standards, and the Standard General Ledger at the transaction level.

We identified the following instance of substantial (as defined by OMB) noncompliance with FFMIA requirements, and one other noncompliance with FFMIA, which are discussed further in Attachment 2:

- The Agency was not in substantial compliance with Statement of Federal Financial Accounting Standards (SFFAS) No. 4 that requires EPA to: (1) determine the full costs of its activities, (2) accumulate and report cost of activities on a regular basis for management information purposes, and (3) use appropriate costing methodologies to accumulate and assign costs to outputs.

- Reconciliation of intra-governmental transactions is reported as a noncompliance, but it does not meet the OMB criteria for substantial noncompliance.

Agency Comments and OIG Evaluation

In memorandums dated February 12 and 25, 2002, the Comptroller responded to our draft report. The OCFO generally concurred with our findings and is in process of implementing corrective actions. However, the OCFO took exception to two issues, Managerial Cost Accounting and Internal Use Software.

The OCFO believes they are complying with the Managerial Cost Accounting Standard and is currently preparing a response to the points raised in the Inspector General's December 12, 2001 memorandum to the Administrator regarding the impasse over FFMIA compliance.

The OCFO acknowledged that SFFAS No. 10, *Accounting for Internal Use Software*, was not implemented until the end of the fiscal year. However, the OCFO believes that by doing so, EPA was able to use the most recent guidance and develop more accurate and complete costs. We do not agree with the OCFO, we found that some of the data and costs for systems that were not capitalized were either incomplete or ambiguous.

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Table of Contents

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Inspector General's Report on EPA's Fiscal 2001 and 2000 Financial Statements

The Administrator
U.S. Environmental Protection Agency

We have audited the consolidating balance sheets of the U.S. Environmental Protection Agency (EPA, or the Agency) and its subsidiary funds, the Superfund Trust Fund (Superfund) and All Other Appropriated Funds (All Other), as of September 30, 2001 and 2000, and the related consolidating statements of net cost and changes in net position, consolidated statements of net cost by goal, combined statements of financing, and consolidated statements of custodial activity for the years then ended, and the related combined statement of budgetary resources for the year ended September 30, 2001. 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 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 01-02, *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.

The financial statements include expense 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. In addition, the United States Treasury collects and accounts for excise taxes that are deposited into the Superfund and Leaking Underground Storage Tank Trust Funds.[1] The United States Treasury is also responsible for investing amounts not needed for current disbursements and transferring funds to EPA as authorized in legislation. Since the United States 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 its operations that are presented in the financial statements. The amounts included for the

1 The Leaking Underground Storage Tank Trust Fund is included in the All Other Appropriated Funds column of the financial statements.

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 consolidating financial statements present fairly the consolidated and individual assets, liabilities, net position, net cost, net cost by goal, changes in net position, reconciliation of net cost to budgetary obligations, and custodial activity of the U.S. Environmental Protection Agency and its subsidiary funds, the Superfund Trust Fund and All Other Appropriated Funds, as of and for the years ended September 30, 2001 and 2000, and budgetary resources as of and for the year ended September 30, 2001, in accordance with generally accepted accounting principles.

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

We inquired of EPA's management as to their methods of preparing its Required Supplemental Stewardship Information (RSSI), Required Supplementary Information (RSI), and Management Discussion and Analysis, and reviewed this information for consistency with the financial statements. However, our audit was not designed to express an opinion and, accordingly, we do not express an opinion.

We did not identify any material inconsistencies between the information presented in EPA's financial statements and the information presented in EPA's RSSI, Required Supplementary Information, and Management Discussion and Analysis. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report, as Required Supplemental Information, their intra-governmental assets and liabilities by Federal trading partner. We did find that, through no fault of EPA, other Federal agencies were unable to reconcile EPA's reported transactions with their records (see Attachment 2 for additional details on this issue).

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 timely and reliable 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.
>
> **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.

Compliance with applicable laws and regulations - Transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements or RSSI; and any other laws, regulations, and government-wide policies identified by OMB.

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, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as supplemented by an OMB memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, 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 reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted certain matters discussed below involving the internal control and its operation that we consider to be reportable conditions, although none of the reportable conditions is believed to be 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. 01-02. 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 control related to performance measures presented in *EPA's Fiscal Year 2001 Annual Report*, Section 1, Overview and Analysis (which addresses requirements for a Management's Discussion and Analysis), we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. 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.

Reportable Conditions

Reportable conditions are internal control weakness matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the organization's ability to meet the OMB objectives for financial reporting discussed above.

In evaluating the Agency's internal control structure, we identified three reportable conditions, as follows:

Implementation of Internal Use Software Standard

EPA did not implement Statement of Federal Financial Accounting Standard (SFFAS) No. 10, *Accounting for Internal Use Software*, until the end of fiscal 2001, even though the standard was applicable for the entire fiscal year. In addition, some of the supporting documentation used to identify capitalized software costs was insufficient to determine whether such costs exceeded the capitalization threshold. Since EPA issued guidance for capitalizing internally-developed software at the end of fiscal 2001, we do not have recommendations.

EPA's Interagency Agreement Invoice Approval Process

Some EPA project officers did not fulfill oversight duties related to reviewing and approving Interagency Agreement (IAG) invoices. We noted deficiencies in this area in prior reports, and we continue to find instances where project offices at EPA's Headquarters and the Cincinnati Financial Management Center (CFMC) did not timely approve IAG invoices because they did not receive the supporting cost information from other Federal agencies to substantiate invoice amounts. Additionally, CFMC continued to use the "first-in first-out" accounting basis (charging the first line of accounting) to allocate costs charged on IAGs with multiple goals/subobjectives, which provides limited assurance that costs were charged to the appropriate goals/subobjectives.

Automated Application Processing Controls

We continue to be unable to assess the adequacy of the automated internal control structure as it relates to automated input, processing, and output controls for the Integrated Financial Management System (IFMS). IFMS applications have a direct and material impact on the Agency’s financial statements. Therefore, an assessment of each application’s automated input, processing, and output controls, as well as compensating manual controls, is necessary to determine the reliance we can place on the financial statements.

Attachment 1 describes each of the above reportable conditions in more detail, our recommendations, and Agency comments on actions that should be taken to correct these conditions.

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

OMB Bulletin No. 01-02, *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 Federal Managers’ Financial Integrity Act (FMFIA or Integrity Act) report that relate to the financial statements and identify material weaknesses disclosed by audit that were not reported in the Agency’s FMFIA report. EPA reports on Integrity Act decisions in EPA’s *Fiscal Year 2001 Annual Report*. For a discussion on Agency reported Integrity Act material weaknesses and corrective action strategy, please refer to EPA’s *Fiscal Year 2001 Annual Report*, Section III, FY 2001 Management Accomplishments and Challenges.

For reporting under FMFIA, material weaknesses are defined differently than they are defined 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 reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements or RSSI being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our audit did not disclose any material weakness that was not reported by the Agency as part of the Integrity Act process.

As a part of the fiscal 2001 Integrity Act process, the Agency reported the following material weaknesses that relate to the Agency’s financial statements:

Information System Security - The Office of Environmental Information recognizes that past improvements to its information security program have not resulted in a complete, comprehensive information security program. Therefore, this office is expanding its existing material and Agency weaknesses, Information Systems Security Plans, and Cyber Security to address all security-related deficiencies. In fiscal 2001, Office of Environmental Information reported that it had developed an approach to correct the information systems security weakness and plans to evaluate the effectiveness of its guidance and security measures through continued testings and audits. Corrective actions are expected to be completed in fiscal 2002.

Construction Grants Close Out - In 1992, EPA designated this area as an Agency weakness, and in 1996 reclassified it as a material weakness due to a concern that lack of Agency-wide attention might result in the loss of resources to properly complete the program. Corrective actions are expected to be completed in fiscal 2002.

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. 01-02, *Audit Requirements for Federal Financial Statements*, as supplemented by an OMB Memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*. The OMB guidance requires that we evaluate compliance with Federal financial management system requirements, including the requirements referred to in the Federal Financial Management Improvement Act (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. There are a number of ongoing investigations involving EPA's grantees and contractors that could disclose violations of laws and regulations, but a determination about these cases has not been made.

None of the noncompliances discussed below would result in material misstatements to the audited financial statements.

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. OMB Bulletin No. 01-02, as supplemented by an OMB memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*, substantially changed the guidance for determining whether or not an Agency substantially complied with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. The document is intended to focus Agency and auditor activities on the essential requirements of FFMIA. The document 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 tests disclosed one instance where the Agency's financial management systems did not substantially comply with the applicable Federal accounting standard. We identified a substantial noncompliance with the SFFAS No. 4 accounting standard for managerial cost accounting, which is described more fully in Attachment 2.

In addition to the above instance of substantial noncompliance, we identified one other noncompliance, related to reconciliation of intra-governmental transactions. However, this noncompliance does not meet the definition of a substantial noncompliance as described in OMB guidance.

Attachment 2 provides additional details, as well as our recommendations and Agency comments on actions that should be taken on these matters.

Appropriation Law Noncompliance

Since fiscal 1994, we have reported that EPA was not complying with appropriation law when making disbursements for grants funded with more than one appropriation. Specifically, disbursements for these grants were made using the oldest available funding (appropriation) first, which may or may not have been the appropriation that benefitted from the work performed. Therefore, EPA was not in compliance with Title 31, U.S. Code, Section 1301, which requires EPA to match disbursements to the benefitting appropriation. A January 13, 2000, Office of General Counsel decision concluded that making disbursements for multiple appropriation grants using the oldest available funding violates Title 31, U.S. Code, Section 1301 and is an inappropriate method of charging, except in limited situations. In fiscal 2001, EPA adopted new procedures for allocating costs on such grants for new awards, although existing grants are still being disbursed using the oldest available funding first. Since EPA has issued guidance for new awards, and since the remaining obligated balances will dissipate and the problem will be corrected, we are not making any recommendations. See Attachment 3 for a description of the Agency's corrective action plans and milestones.

Prior Audit Coverage

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

- The Agency's process for preparing financial statements, including the Statements of Budgetary Resources, Financing, and Net Cost.
- Complying with FFMIA requirements.
- Reviewing unliquidated obligations.
- Reporting intra-governmental assets and liabilities by Federal trading partner.
- Complying with SFFAS No. 4, including accounting for the cost to achieve goals and identifying and allocating indirect costs.
- Accounting for capitalized property.
- Recording accrued liabilities for grants.
- IAG invoice approval process.
- Documenting EPA's IFMS.
- Complying with Federal financial management system security requirements.
- Accounting for payments for grants funded from multiple appropriations.
- Reviewing Agency user fees.
- Documentation and approval of journal vouchers.
- Timely repayment of Asbestos Loan Debt to Treasury.
- Automated application processing controls for the IFMS could not be assessed.
- Reconciliation of intra-governmental transactions.
- Financial system security plans continue to be noncompliant.

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

The Chief Financial Officer, as the Agency's Audit Follow-up Official, oversees EPA's follow-up on audit findings and recommendations, including resolution and implementation of corrective actions. For these prior audits, final action occurs when the Agency completes implementation of the corrective actions to remedy weaknesses identified in the audit.

We acknowledge that many actions and initiatives have been taken to resolve prior financial statement audit issues. We also recognize that the issues we have reported are complex, and require extensive, long-term corrective actions and coordination by the Chief Financial Officer with various Assistant Administrators, Regional Administrators, and Office Directors before they can be completely resolved. A number of issues have been unresolved for many years.

In response to our inquiries on actions taken by the Office of the Chief Financial Officer (OCFO) to resolve long outstanding audit recommendations, a representative informed us of a number of efforts that were conducted in fiscal 2000. The OCFO continued efforts to stress the importance of timely and effective audit management practices. The OIG and OCFO held a joint meeting with the Audit Follow-up Coordinators to: (1) reinforce their roles and responsibilities; (2) review expectations for audit follow-up, as laid out in EPA Order 2750, *Audit Management Process*; and (3) reemphasize the importance to Audit Follow-up Coordinators in keeping their managers and the OIG informed of progress.

The OIG will continue to work with the OCFO in helping to resolve all audit issues resulting from our financial statement audits.

Agency Comments and OIG Evaluation

In memorandums dated February 12 and 25, 2002, the Comptroller responded to our draft report. The OCFO generally concurred with our findings and is in process of implementing corrective actions. However, the OCFO took exception to two issues, Managerial Cost Accounting and Internal Use Software.

The OCFO believes they are complying with the Managerial Cost Accounting Standard and is currently preparing a response to the points raised in the Inspector General's December 12, 2001 memorandum to the Administrator regarding the impasse over FFMIA compliance.

The OCFO acknowledged that SSFAS No. 10 was not implemented until the end of the fiscal year. However, the OCFO believes by doing so, EPA was able to use the most recent guidance and develop more accurate and complete costs. We do not agree with the OCFO, we found that some of the data and costs for systems that were not capitalized were either incomplete or ambiguous.

The rationale for our conclusions and a summary of the Agency comments is 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
Financial Audit Division
Office of Inspector General
U.S. Environmental Protection Agency
February 26, 2002

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Reportable Conditions

Table of Contents

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EPA Did Not Implement Accounting for Internal Use Software Standard Timely

EPA did not implement SFFAS No. 10, *Accounting for Internal Use Software*, until the end of fiscal 2001. This required EPA to adopt an alternative method for capitalizing software. Also, we found that some of the supporting documentation used in this alternative method to identify capitalized software costs was insufficient. As a result, the capitalized software balance (net of accumulated depreciation) of $11 million, may not represent all capitalized software costs.

SFFAS No. 10, issued in June 1998, provides the Federal accounting standard for capitalizing internal use software. Use of the standard was required starting with fiscal 2001. However, EPA did not issue its own implementing guidance on the standard (Comptroller Policy Announcement No. 01-10) until September 28, 2001, only 2 days before the end of fiscal 2001. The EPA guidance informed program managers on how to determine whether internally-developed software should be capitalized and how to identify and record it in the Agency's accounting system. The policy also established an EPA threshold of $500,000 for capitalizing internally-developed software. Because of the lateness of the guidance, the SFFAS criteria was not used for capitalizing internally-developed software during fiscal 2001. Instead, the Agency used a year-end cost accumulation process to implement SSFAS No. 10.

As a result of not having adequate guidance in place during most of fiscal 2001, EPA personnel had to review each of its systems to determine whether costs should be capitalized. EPA reviewed costs listed in Exhibit 53 of its Budget Submission to OMB, which lists all of EPA's large software systems and hardware costs for the current year, to identify systems that met the $500,000 threshold in current year developmental costs. Current year costs for software systems are divided into "steady state" (maintenance) costs and development, modification, and enhancement costs. However, we found that:

- Not all costs listed as development, modification, and enhancement costs on the Exhibit 53 should be capitalized. To determine which costs should be capitalized, Agency personnel had to seek additional documentation (the Capital Planning and Investment Control Proposal) on each system's cost. This documentation provides information on how funds are being spent for the system and milestones for the project.

- Investment information for several systems that were not capitalized were either incomplete or ambiguous. For these systems, we could not determine whether the total systems development costs would reach the $500,000 in capitalized costs threshold.

Since EPA has issued its guidance for capitalizing internally-developed software, we do not believe a recommendation is needed at this time.

Agency Comments and OIG Evaluation

The OCFO acknowledged that SFFAS No. 10 was not implemented until the end of the fiscal year. However, the OCFO believes that by doing so, EPA was able to use the most recent guidance and develop more accurate and complete costs. The OCFO went on to say that the amount capitalized reflected verifiable and compliant software balances, that systems not capitalized either did not meet the $500,000 dollar threshold or capitalization criteria, and that their review provided for a consistent application of the requirements of SFFAS No. 10.

The OIG recognizes the efforts the Agency went through to identify software systems and capitalize costs, and we agree that the costs capitalized reflect verifiable costs. However, such costs may not represent all capitalized software costs. The Agency's efforts were based upon an alternative method to determine costs after the end of the fiscal year from sources that were not designed to capture costs for a software system.. As a result, we found that some of the data and costs for systems that were not capitalized were either incomplete or ambiguous.

Additional Improvements Needed in EPA's Interagency Agreement Invoice Approval Process

Some EPA project officers did not fulfill oversight duties related to reviewing and approving IAG invoices. We noted deficiencies in this area in prior reports, and we continue to find instances where program offices at EPA Headquarters and Regions did not timely approve IAG invoices or identify the proper line of accounting on the Project Officer Approval Form. We also noted additional instances where project officers do not receive supporting cost documentation from other Federal agencies to substantiate invoice amounts. We found five instances in various program offices where the project officer approved the invoice without the detailed documentation. And one instance where the project officer did not sign the approval document. Without project officer approval or proper identification of accounting information, transactions may be recorded in the accounting system with limited assurance that invoices are valid, appropriate, and allowable under the terms of the IAG, and that costs are charged to the appropriate goal, objective, or subobjective.

Project Officer Responsibilities Outlined

The Resources Management Directive System, Section 2550C, Chapter 4, *Interagency Agreements*, paragraph 5(g), states that the project officer is responsible for:

- Providing technical and managerial oversight.
- Receiving and reviewing detailed cost information submitted by other agencies, which should be provided on a project-by-project basis.
- Approving vouchers and OPAC (On-Line Payment and Collection System) billings received from other agencies after determining that performance is in accordance with the agreement.
- Forwarding approved vouchers to CFMC for payment within 5 days after receipt.

Also, paragraph 10(d) states it is the responsibility of the project officer to monitor Funds-Out disbursement agreements. This responsibility includes monitoring EPA's receipt of goods or services to ensure their delivery in accordance with the terms of the agreement, reviewing detailed cost information required of the agency providing the goods or services, and resolving any discrepancies which may arise.

EPA's training manual for project officers, *Managing Your Financial Assistance Agreement*, 3rd Edition, October 1996, Module VIII, provides guidance on OPAC billing. CFMC charges a bill to the appropriate IAG and submits the invoice to the project officer for approval. If there is a problem with the bill, EPA has 90 days to "charge back" the funds to the appropriate account.

Progress Being Made But Further Improvements Needed

We recognize that the Agency has taken corrective actions in response to our previous recommendations and plans to take additional corrective actions. In response to our previous recommendations, the Grants Administration Division issued Fact Sheet No. 12 dated February 7, 2000, "Project Officer's Responsibility for Payments Under Interagency Agreements." The fact sheet directs program leaders to assure project officers disapprove IAG invoices unless adequate information on progress and costs incurred are reasonable. In addition, the fact sheet advises project officers to request the necessary information from the receiving agency (with Grants Administration Division or Financial Services Branch assistance, if necessary) and to request Financial Management Division to suspend or charge back payment if information is not provided promptly. In addition, the Agency stated they plan to implement an automated process during FY 2002.

Since our finding on IAG invoices is similar to what we previously found, and since EPA appears to be taking steps to implement its corrective actions, we are not repeating our previous recommendations. We will continue to evaluate the effectiveness of the Agency's corrective action plans during subsequent financial statement audits. Attachment 3, "*Status of Prior Audit Report Recommendations*," notes our previous recommendations on this issue and the status of corrective actions.

Agency Comments and OIG Evaluation

The agency agreed with our findings.

Automated Application Processing Controls for Integrated Financial Management System Could Not Be Assessed

As we first reported in our fiscal 1995 financial statement audit report, we continue to be unable to assess the adequacy of the automated internal control structure as it relates to automated input, processing, and output controls for IFMS. IFMS applications have a direct and material impact on the Agency's financial statements. Therefore, an assessment of each application's automated input, processing, and output controls, as well as compensating manual controls, is necessary to determine the reliance we can place on the financial statements.

Prior Reports Noted Issues

During past financial statement audits, we attempted to evaluate controls without documentation, but these alternatives proved to be inefficient and impractical. Program level transaction flowcharts or similarly descriptive narrative system documentation were not available. Furthermore, we previously concluded that the IFMS user manuals and other EPA contractor baseline Federal financial systems manuals did not contain the level of detail necessary to construct tests of automated internal controls that would satisfy our field work standards.

Since 1995, Agency officials have maintained that the current level of documentation is sufficient. Nevertheless, Agency officials have taken actions on a number of our recommendations, including completing a system documentation analysis, developing updated accounts receivable documentation, and completing an analysis for creating a comprehensive IFMS data dictionary.

Our fiscal 2000 financial statement audit work indicated EPA upgraded its user documentation in 1999, and that it was adequate for users' needs for entering data. However, we determined that the combined upgraded users' and technical systems documentation still did not address critical system operational controls, such as access to tables or data, electronic approvals, and use of supervisory overrides. Furthermore, neither the users nor technical systems documentation addressed transaction "processing" edits and data flows. Lastly, the Agency has not developed a data dictionary.

Fiscal 2001 Review Results

As part of our fiscal 2001 financial statement audit, we evaluated the Agency's IFMS replacement activities and found that EPA has taken tangible steps to replace IFMS with the Financial Replacement System (FinRS) project. In fiscal 2001, the Agency performed the following activities:

- Included a budget for FinRS in its annual submission to OMB, Exhibit 300B. The milestones and costs associated with FinRS were estimated using a reasonable method.

- Formed the Systems Planning and Integration Staff, which reports directly to the Controller and is responsible for the development of the overall financial system plan. The Systems Planning and Integration Staff's mission and responsibilities are appropriate for replacing IFMS.

- Initiated a contract to develop a high level strategic financial systems assessment that includes alternatives for the replacement of financial systems, along with a cost/benefit analysis of the solutions.

In conclusion, we believe that the steps described above indicate EPA is moving in a credible fashion towards replacing IFMS. However, until the new system is in place and we have had a chance to audit it, we cannot assess the adequacy of the automated internal control structure.

Agency Comments and OIG Evaluation

The agency agreed with our findings.

Compliance with Laws and Regulations

Table of Contents

Substantial Noncompliance with Federal Financial Management Improvement Act

Other Noncompliance Issue with Federal Financial Management Improvement Act [2]

[2] We are reporting this noncompliance issue under FFMIA as it directly relates to FFMIA reporting requirements; however, we note that the issue does not meet the OMB criteria for substantial noncompliance under FFMIA.

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EPA Did Not Comply with Managerial Cost Accounting Standard

EPA did not comply during fiscal 2001 with SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. Specifically, EPA did not comply with the requirements to provide cost per output to management in a timely fashion. In addition, under EPA's current cost accounting structure, when costs by output are produced, such costs are not in sufficient detail to be useful to managers. To comply with the Standard, EPA needs to:

- Educate managers on the importance of, possibilities for, and effective use of a cost accounting system.
- Canvass managers on the level of detail and types of reports needed to effectively manage their programs.
- Develop a cost accounting system that is flexible enough to handle the Agency's diverse missions.
- Ensure that the system is being utilized on a regular basis.

When making decisions, EPA managers often focus their financial consideration on the availability of funds. Much less concern is given to the cost of operations. While some cost information is available, it is generally not in sufficient detail to be used in a meaningful way by Agency decision makers. In our view, EPA needs to elevate the actual cost of operations as a factor in EPA decisions so that the cost of key activities is just as important a consideration as whether funds are available in a budget.

Agency Disagreed with OIG Position in the Past

In our audits of fiscal 1999 and 2000 financial statements, we concluded that EPA did not comply with SFFAS No. 4. OCFO did not agree; and despite numerous discussions between our offices, we have not reached agreement on this issue. In many areas, the Standard allows for broad interpretation of what constitutes compliance. We believe this flexibility, along with varying interpretations by other government agencies, are the causes of our disagreement. However**,** we do believe that there are several litmus tests of compliance with the standard. For example, the standard requires cost per output to be provided to management in a timely fashion. However, EPA did not do this. Therefore, while there is room to debate some areas of the standard, this basic requirement was not satisfied. Accordingly, for reasons discussed below, we continue to believe that EPA does not comply with the Standard. We do believe that OCFO supports creating systems that can provide managers the detailed information necessary to support results-based decisions. However, we believe this process needs to be intensified and visibility heightened.

Objectives and Purpose of Standard

Compliance with the standard, to us, means that a meaningful, useful system is in place and is being effectively utilized by the Agency. The specific objectives of SFFAS No. 4 are listed at paragraph 22 of the standard. They include:

- Provide program managers with relevant and reliable information relating costs to outputs and activities. Based on this information, program managers can respond to inquiries about the costs of the activities they manage. The cost information will assist them in improving operational economy and efficiency.

- Provide relevant and reliable cost information to assist the Congress and executives in making decisions about allocating Federal resources, authorizing and modifying programs, and evaluating program performance.

- Ensure consistency in costs reported in general purpose financial reports and to program managers. This includes standardizing terminology for managerial cost accounting to improve communication among Federal organizations and users of cost information.

The focus of the statement is on cost information needed to improve Federal financial management and management decisions. The standard identifies five essential cost information areas: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees and prices, (4) program evaluations, and (5) making economic choice decisions.

In recent years, cost accounting has become increasingly important, and Congress has placed a greater emphasis on improving information to manage Federal programs. The FFMIA of 1996 was intended to ensure agencies develop and use systems that generate reliable, timely, and consistent information necessary for managing current operations. Also, the managerial cost accounting concepts and requirements contained in the Standard require each Federal agency to produce reliable and timely information on the full costs of Federal programs, their activities, and outputs.

The development of cost information is also important because *The President's Management Agenda for Fiscal Year 2002* emphasizes the need to achieve effective and efficient competition between public and private sources. To facilitate this competition, agencies will need to develop cost information for activities that may be subject to competition with the private sector or other Federal entities in the future. Additionally, the Administration plans to integrate information about costs and program performance into a single oversight process.

More Meaningful Cost Information Needed

In our opinion, EPA's cost accounting system does not completely satisfy the aforementioned objectives of the standard.

To comply with the cost accounting standard, EPA systems should provide program managers with enough basic cost information to accomplish objectives associated with planning, decision making, control, and reporting, as well as accommodating managers' particular cost information needs that may arise due to special situations or circumstances. This cost information should be detailed enough to allow managers to compare alternative courses of action and make decisions by assessing costs and benefits. Agency cost information should also be specific enough to account for activities that cross program lines.

At a minimum, EPA managers should know the cost of Agency efforts to meet Annual Performance Goals (APGs). In fiscal 2000, EPA committed to 73 APGs. However, EPA's cost accounting system was not designed to capture the costs associated with these APGs, or compare the costs against a budget for the APGs. Instead, EPA is working to capture costs by sub-objectives. While the sub-objectives are an integral part of EPA's budget structure, they present costs at too high a level to be useful to managers for activity-based assessments and decision-making purposes. Also, in most cases, the costs associated with the sub-objectives cannot be tied to the costs of an APG. Sometimes the sub-objectives are too broad or vague to tie to a particular APG, and other times the costs associated with an APG are spread over multiple sub-objectives.

To be truly meaningful, EPA's cost accounting system should provide managers with cost information about their basic outputs. For example:

- Managers in the Office of Pesticides should know how much it costs to perform a tolerance reassessment.

- Managers in the Office of Enforcement and Compliance Assurance should know the costs of the various enforcement actions.

- Managers in the Office of Water should know how much it costs to develop the new standard for arsenic in drinking water.

However, EPA's current cost accounting system cannot provide managers with this level of cost information, and the information that is provided relevant to cost of sub-objectives is not timely.

Once managers have basic cost information, they should use it to improve their operations and make them more efficient. This fact has been proven through the operations of EPA's Working Capital Fund. When Agency managers were not aware of the costs of running mainframe computer reports, they ran their reports during peak hours. Once they became aware of the cost differential between peak and off-peak usage rates, many opted to have their reports run during off-peak hours. The same is true with postage costs. Once managers realized how much they were paying for postage services, they began to use electronic mail more and postage services less.

Recommendations

We recommend that the OCFO:

1. Lead an effort to create a more cost conscious culture within the Agency.

2. Canvass Agency managers, executives, and other key stakeholders for the type of cost information they believe they need to effectively manage programs and activities (beyond the currently required costs per sub-objective).

3. Begin an education effort to explain why managerial cost accounting is important, the types of information that can be provided, and how it can benefit decisions.

4. Develop a method for providing cost information to managers in a timely manner.

5. Provide on-going technical assistance to managers on how to effectively utilize cost information, to help ensure proper use of cost information when managers make decisions.

Agency Comments and OIG Evaluation

The OCFO believes they are complying with the Managerial Cost Accounting Standard and is currently preparing a response to the points raised in the Inspector General's December 12, 2001 memorandum to the Administrator regarding the impasse over FFMIA compliance. We are awaiting the Administrator's response.

EPA Continues to Experience Difficulties in Reconciling Intra-Governmental Transactions

EPA continues to experience difficulties in reconciling some of its intra-governmental assets and liabilities due to some Federal entities not performing reconciliations. Without the proper confirmations from its trading partners, EPA has limited assurance that intra-governmental balances are accurate. EPA experienced similar occurrences last year that prohibited the Agency from complying with the applicable requirements. Consequently, EPA prepared the RSI using data from the Agency's financial accounting system.

OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements,* requires Federal agencies to report intra-governmental assets, liabilities, and earned revenue (exchange and non-exchange) by Federal trading partner. This information is to be presented in the financial statements as Required Supplementary Information and should reconcile with the applicable line items in the financial statements. The Treasury Financial Manual also requires Federal agencies to disclose intra-governmental assets, liabilities, and earned revenue by trading partner in the Federal Agencies Centralized Trial-Balance System transmission. On September 28, 2001, Treasury updated the *Federal Intra-governmental Transactions Accounting Policies and Procedures Guide* to provide additional guidance to Federal entities (agencies) to reconcile intra-governmental transactions.

EPA's intra-governmental earned revenue did not exceed the $500 million criterion; therefore, EPA is excluded from reconciling and disclosing this activity.

The OCFO issued a supplemental procedural policy in May 2001 to assist finance offices in confirming and reconciling intra-governmental transactions. The OCFO continues to undertake proactive efforts to reconcile intra-governmental transactions in order to comply with Federal financial reporting requirements. The OIG acknowledges and commends EPA's efforts to reconcile intra-governmental transactions as required by Federal financial reporting requirements.

Intra-governmental reconciliations has been a major issue within the Federal government. A study directed by Joint Financial Management Improvement Program task force identified multiple deficiencies that prohibit Federal agencies from reconciling intra-governmental transactions. Short-term major priorities being addressed are developing identification codes at business level, revising the standard general ledger, determining standard data structure, and creating a web-based clearinghouse portal for intra-governmental activity.

OIG suggests that EPA continue its proactive efforts in reconciling the Agency's intra-governmental transactions to comply with Federal financial reporting requirements.

Agency Comments and OIG Evaluation

The agency agreed with our findings.

Status of Prior Audit Report Recommendations

The Chief Financial Officer, as the Agency's Audit Follow-up Official, oversees EPA's follow-up on audit findings and recommendations, including resolution and implementation of corrective actions. For these prior audits, final action occurs when the Agency completes implementation of the corrective actions to remedy weaknesses identified in the audit.

In response to our inquiry on actions taken by OCFO to resolve long outstanding audit recommendations, a representative informed us that the Deputy Chief Financial Officer formed an Audit Follow-up Council in July 2000. The purpose of the Council is to: (1) review the progress on audit findings, (2) discuss approaches to resolving audit issues, and (3) provide coordination and support across OCFO on audit-related matters. Council membership consists of the Deputy Chief Financial Officer; the OCFO Audit Follow-up Coordinator; the Comptroller and Comptroller Division Directors, and the Director of the Office of Planning, Analysis, and Accountability. The Council meets approximately every six weeks, as the need arises. Through its efforts, the Council has resolved several long-standing audit issues.

The OIG will continue to work with the OCFO in helping to resolve all audit issues resulting from our financial statement audits. We acknowledge that many actions and initiatives have been taken to resolve prior financial statement audit issues. We also recognize that the issues we have reported are complex and require extensive, long-term corrective actions, as well as coordination by the Chief Financial Officer with various Assistant Administrators, Regional Administrators, and Office Directors, before they can be completely resolved.

During the audit of the fiscal 2001 financial statements, we noted substantial progress in completing a number of corrective actions from prior year audits. The major audit issue areas where corrective actions were completed are shown in Table 1.

Table 1	
Fiscal Year Audited	
2000	• Process for Preparing Financial Statements Needs Improvement. (Although all planned corrective actions were reported as completed, we note that the Agency will continue to improve its preparation process and is, or will be, automating major portions of the process for preparing financial statements.) • Accounting for Capitalized Property. (Although all planned corrective actions were reported as completed, we again identified a reportable condition for this issue area. Please see Attachment 1 for additional comments and recommendations.) • Process for Reviewing Unliquidated Obligations Needs Improvement. • Documentation and Approval of Journal Vouchers Needs Improvement. • EPA Needs to Timely Repay the Asbestos Loan Debt to the Treasury. • EPA Was Unable to Reconcile Intra-Governmental Transactions. (Although all actions were reported as completed, EPA continues to experience difficulties in reconciling some of its intra-governmental assets and liabilities due to some Federal entities not performing their respective reconciliations. Without the proper confirmations from its trading partners, EPA has limited assurance that intra-governmental balances are accurate. Please see Attachment 2 for additional comments.)
1998	• Further Improvements Needed in Managing EPA's Accounts Receivable.
1997	• EPA Is Not Compliant With Appropriations Law When Disbursing Grants Funded With Multiple Appropriations. (Please see page 7 for additional comments.)
1995	• Automated Application Processing Controls for IFMS Could Not be Assessed. (Although all planned corrective actions are shown as completed, additional actions are underway to replace IFMS. Until such time as management implements a replacement automated accounting system that addresses past issues, we will continue to disclose a reportable condition concerning the current accounting system and its automated application processing controls. Please see Attachment 1 for additional comments.)
1994	• Grantee Payment Requests Did Not Provide Necessary Information.
1993	• Higher Priority Needs to be Placed on Completing Required Reviews of User Fees.

Since the completion of the audit of EPA's fiscal 2000 financial statements (February 28, 2001), Agency managers have been working on completing a few corrective actions which are repeat findings from prior audits. The major audit issue areas and the latest anticipated dates for completion are shown in Table 2.

Table 2	
Audit Issue Area for Corrective Actions In Process	**Anticipated Completion Date**
EPA's Interagency Agreement Invoice Approval Process *[Repeat finding since the fiscal 1994 audit]* • Implement manual process as a corrective action and plan to automate process.	04/30/02
Despite Improvements, Financial System Security Plans Continue to be Noncompliant *[Repeat finding since the fiscal 1997 audit]* The EPA Deputy Chief Financial Officer continues to address planned corrective actions included in its fiscal 1999 remediation plan submitted to OMB on November 13, 2000, under the FFMIA. On January 18, 2002, a revised remediation plan was updated and submitted as part of EPA's fiscal 2003 budget submission to OMB. EPA reported that corrective actions remain in progress for one of four areas included in the plan. Actions in progress are as follows: • **Financial System Security Corrective Action Plan.** While progress has been noted, the planned completion date of June 2002 for Financial System Security Plan Improvements will not be met in some instances. Some slippages have occurred due to contractor delays beyond OCFO's control.	07/31/02

Compliance with Managerial Cost Accounting Standard

In the audits of the fiscal 1999 and 2000 financial statements, we reported that EPA did not comply with the managerial cost accounting standard, and the OCFO and OIG remain at an impasse on actions to be taken. The Deputy Chief Financial Officer, while acknowledging the desirability for continuing improvements as envisioned by the standard, continues to disagree with our conclusion that EPA did not comply with the standard. Because of this impasse, on December 12, 2001, we elevated this issue to the Administrator for resolution, as required by FFMIA. Please refer to Attachment 2 for this audit issue.

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EPA's Fiscal 2001 and 2000 Financial Statements

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February 2002

EPA's FY2001 CFO AUDITED FINANCIAL STATEMENTS

Produced by the U.S. Environmental Protection Agency
Office of the Chief Financial Officer
Office of the Comptroller
Financial Management Division

Audit Report 2002-1-00082

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TABLE OF CONTENTS

Note: All components of EPA's FY2001 CFO Audited Financial Statements are included in **EPA's FY2001 Annual Report**.

OVERVIEW
AND
ANALYSIS

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OVERVIEW AND ANALYSIS

INTRODUCTION

The mission of the U.S. Environmental Protection Agency (EPA) is to protect human health and to safeguard the natural environment—air, water, and land—upon which life depends. The Agency is committed to making America's air cleaner, water purer, and land better protected and to working closely with its federal, state, tribal, and local government partners; with citizens; and with the regulated community to accomplish these goals. To carry out its mission, EPA has established 10 long-term strategic goals that identify the environmental results the Agency is working to achieve and reflect the sound financial and management practices it intends to employ. Each year, as required under the Government Performance and Results Act (GPRA), the Agency develops an annual plan that translates these long-term goals and objectives into specific actions to be taken and resources to be used during the fiscal year. EPA is accountable to the American people for making progress toward its long-term goals by achieving these annual performance goals (APGs) and using taxpayer dollars efficiently and effectively to do so.

To manage its work and resources most effectively to achieve measurable environmental results, for the past 3 years EPA has linked its long-term and annual planning, budgeting, financial accounting, and performance reporting. For example, EPA has structured its strategic plan to encompass the full scope of its workforce and resources and has restructured its budget and finance processes to mirror strategic goals and objectives. To this end, the Agency's strategic goals include both environmentally oriented goals, such as Clean Air and Safe Water, and functional goals, such as Sound Science and Effective Management, which are critical to achieving environmental and human health outcomes. Linking planning, budgeting, and finance helps EPA to focus resource management on the environmental and human health results to be achieved, provides longer term perspective and continuity for budgeting, and reinforces the importance of financial stewardship and fiscal integrity in achieving the Agency's mission. As a result, EPA can demonstrate to Congress and the public how taxpayer dollars are applied across the Agency's strategic goals to support the achievement of environmental results.

EPA's *Fiscal Year 2001 Annual Report* demonstrates the Agency's accountability to Congress and the American people. First, the *Report* describes the progress that EPA—working with its federal, state, tribal, and local government partners—made toward the annual performance goals established in its Fiscal Year (FY) 2001 Annual Plan and toward its longer range strategic goals. Next, it discusses major management challenges EPA faced during the year and presents the Agency's approaches, solutions, and accomplishments. Finally, after summarizing EPA's financial activities and achievements, it presents the annual financial statements, a portrayal of the Agency's financial position independently audited by EPA's Inspector General.

This Overview and Analysis, which addresses requirements for a "Management's Discussion and Analysis" of the annual financial statements component of the *Fiscal Year 2001*

Annual Report,[3] is intended to provide a broad view of EPA's performance and fiscal accountability over the year. In discussing performance results, it focuses on accomplishments that contributed to environmental achievements, particularly under EPA's Goals 1 through 6. The goal chapters that follow in Section II provide a more extensive discussion of progress and achievements under all goals. The Overview and Analysis also presents approaches and tools the Agency is using to improve results, reviews EPA's financial accomplishments, and discusses significant factors that might affect future Agency operations.

PERFORMANCE RESULTS

During FY 2001 EPA, working with its federal, state, tribal, and local government partners, continued to make significant progress toward a healthier environment—cleaner air, purer water, and better protected land. The discussion that follows briefly describes results achieved over the past fiscal year: it highlights environmental achievements, notes Agency accomplishments in improved management and other functions, aggregates performance results in terms of annual performance goals met and missed, and discusses performance issues and concerns.

Environmental Accomplishments

Under EPA's Clean Air goal, the Agency and its partners continued to improve air quality and to protect the health of all the public, including sensitive populations such as asthmatics, children, and seniors, from the hazards of air pollution. Since the Clean Air Act Amendments of 1990 EPA and its partners have dramatically reduced air pollution from mobile and stationary sources to meet the National Ambient Air Quality Standards (NAAQS) and have reduced acid rain and toxic air pollution to safeguard public health and the environment. Sulfur dioxide (SO_2) and nitrogen oxide (NO_X) gases, for example, form fine particles that, when inhaled, contribute to premature mortality, chronic bronchitis, and other respiratory problems and, in the environment, form haze resulting in decreased visibility.

During FY 2001 people who lived in all counties in which concentrations of nitrogen dioxide (NO_2) or SO_2 were measured breathed air that met NAAQS for these pollutants. Today all areas of the country are in attainment for NO_2; compared to 1990, fewer than half as many people live in counties where monitored air quality exceeds the NAAQS for carbon monoxide; and only 1.5 million people live in counties where lead levels exceed the NAAQS. In terms of

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[3]Because the *Fiscal Year 2001 Annual Report* consolidates a number of specific reports, some required components of the "Management's Discussion and Analysis" are presented in greater detail elsewhere in this report. In particular, EPA's mission statement and long-range goals appear at the front of the report and an EPA organization chart is included as Appendix C. For a discussion of the Agency's performance goals, objectives, and results, refer to Section II. Management accomplishments and challenges are discussed in Section III. Financial statements, along with a discussion of systems, controls, and legal compliance, are presented in Section IV.

ozone, air quality continues to improve: nearly half the areas out of attainment with the 1-hour NAAQS for ozone in 1991 have been brought into attainment and have approved maintenance plans.

In FY 2001 EPA issued far-reaching rules that will dramatically reduce pollution from heavy-duty trucks and buses and cut sulfur levels in diesel fuel, thereby providing the cleanest running heavy-duty trucks in history. These vehicles will be 90 percent cleaner than today's trucks and buses, resulting in an annual reduction of 2.6 million tons of NO_X emissions by calendar year 2030. In addition, during calendar year 2000, EPA's Acid Rain Program controlled annual SO_2 emissions from utility sources to 11.2 million tons. Compared to the 17.5 million tons released in 1980, this reduction represents a decrease of 6.3 million tons in annual emissions and puts the Agency well on the way to achieving its 2010 goal of reducing SO_2 emissions to 8.5 million tons per year. Further, the Acid Rain Program reduced annual NO_X emissions from coal-fired utility sources by more than 2 million tons below those that would have occurred in the absence of the Clean Air Act Amendments of 1990. In the area of air toxics, as of FY 2001 emissions from area, mobile, and stationary sources had decreased by 35 percent from the 1993 baseline of 4.3 million tons.

During FY 2001 EPA continued its work to ensure that all people have drinking water that is clean and safe to drink; that the Nation's rivers, lakes, wetlands, aquifers, and coastal and ocean waters are healthy; and that watersheds and aquatic ecosystems will be restored and protected. Although population growth, as well as urban and rural nonpoint source pollution, continues to challenge the capability of community water systems to provide safe drinking water, in FY 2001, 91 percent of people served by community water systems received water that complied with all health-based standards. In addition, during FY 2001, drinking water facilities completed 469 infrastructure improvement projects to help maintain this high level of public health protection.

Ensuring protection of America's land unites a variety of efforts under a number of the Agency's strategic goals. Throughout FY 2001, EPA worked closely with its federal, state, tribal, and local government partners to ensure that the public has food that is safe to eat and are protected from health threats posed by pesticide residues. The Agency expanded the availability of reduced-risk pesticides and alternatives to organophosphates to reduce health and environmental risks from pesticide use while maintaining the vigor of the country's agricultural production. In addition to preventing pollution from pesticides and other chemicals, the Agency continued its work to reduce risk in communities, homes, workplaces, and ecosystems. Culminating more than 5 years of work, in FY 2001 the Agency promulgated the Lead Hazard Rule, which defines specific levels of lead in dust and soil to be considered "lead-based paint hazards." EPA estimates that, as response actions are taken in homes that exceed these standards, approximately 46 million children will benefit from reduced exposure to lead in paint, dust, and soil over the next 50 years.

Critical to protecting the Nation's land are better waste management, restoration of contaminated sites, and rapid and effective response to waste-related or industrial accidents and emergencies. In FY 2001 EPA's Emergency Response Program responded rapidly and effectively to the terrorist incidents of September 11 and to subsequent acts of bioterrorism. EPA employees were on the ground within hours of the attacks at the World Trade Center and the Pentagon, monitoring for contamination, assisting with waste management, advising on cleanup and decontamination, and providing information to the public. At the World Trade Center, EPA assumed the lead role for coordination of the federal hazardous materials response. When outbreaks of anthrax bioterrorism occurred in early October 2001, EPA response personnel were among the first on the scene. They led the effort to clean up and decontaminate six post offices in Florida and four Congressional office buildings in Washington, DC—the Ford, Longworth, Dirksen, and Hart buildings. Because of their expertise in environmental matters, EPA criminal investigators assisted the Federal Bureau of Investigation in the investigation of the attack.

Apart from these emergency situations, the Agency, working cooperatively with states, tribes, and the regulated community, continued to improve environmental conditions and protect human health by cleaning up hazardous waste sites and seeking to return abandoned or underutilized industrial and commercial properties to productive use. In FY 2001 the Superfund Program achieved 47 construction completions. ("Construction completion" refers to the point at which a site remedy is in place, safeguards prevent the spread of further contamination, and no further cleanup construction is needed.) The Superfund Program also cleaned up 2 million cubic yards of solid hazardous waste and 68,000 gallons of liquid-based waste as a result of removal response actions. The Agency and its partners provided alternative drinking water supplies to 1,000 people at 6 sites. Additionally, EPA cleaned up 302 Superfund removal sites and 19,074 leaking underground storage tanks. From the program's inception through the third quarter of FY 2001, EPA's Brownfields Program, one of the Agency's most successful public partnerships, leveraged more than $3.73 billion in public and private investments and helped create more than 17,000 jobs in cleanup, construction, and redevelopment.

EPA continued to work with other nations and to lead multilateral efforts to reduce global and cross-border environmental risks. For example, the Agency and its partners made significant progress in protecting and improving environmental conditions in the Great Lakes region, removing or containing more than 400,000 cubic yards of contaminated sediments in FY 2000;[4] releasing the State of the Great Lakes 2001 report, for which more than 50 governmental and nongovernmental entities used 33 indicators to assess the health of the Great Lakes; and demonstrating glass furnace technology on 70 tons of Fox River sediment near Green Bay, Wisconsin. (Glass furnace technology destroys organic contaminants and immobilizes inorganic metals in a glass matrix that can then be used as construction fill or for other beneficial uses.)

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[4]During FY 2001 new FY 2000 performance data became available for several EPA programs for which there were delayed reporting cycles or targets set beyond FY 2000. These FY 2000 data represent the Agency's latest results information; FY 2001 data will become available in spring 2002.

Results reported in FY 2001 demonstrate that EPA's voluntary ENERGY STAR program, methane outreach programs, and High Global Warming Potential (HGWP) environmental stewardship program have increased the penetration of energy-efficient products into the marketplace through effective program planning, implementation, and outreach to manufacturers and consumers. The ENERGY STAR label, for example, has become a national symbol for energy efficiency recognized by more than 40 percent of the people. These voluntary programs yield an immediate impact on environmental improvement. In results reported in FY 2000, actions taken through EPA's voluntary climate programs such as ENERGY STAR have saved consumers and businesses more than $8 billion on their energy bills and saved 74 billion kilowatt-hours and more than 10,000 megawatts of peak power. In addition, emissions of almost 160,000 tons of smog-forming NO_X were prevented in 2000, equivalent to the annual emissions from more than 100 power plants.

Finally, EPA's ongoing efforts to promote and monitor compliance and to enforce environmental statutes and regulations continued to advance results in environmental and human health protection. For example, in FY 2001 EPA reached settlements with four major petroleum refiners to resolve significant areas of noncompliance with the Clean Air Act. The settlements, adding pollution controls and operation changes at 27 separate refineries representing approximately 28.8 percent of the Nation's domestic refining capacity, will result in an estimated annual reduction of 87,000 tons of SO_X, 49,500 tons of NO_X, 8,220 tons of volatile organic compounds, and 2,100 tons of particulate matter (PM). In addition, the companies will spend $12 million in a variety of Supplemental Environmental Projects (SEPs) to improve the environment. The SEPs will provide a variety of environmental benefits, including dissemination of information to the public about local environmental issues, additional ambient monitoring, and increased facility controls. One creative SEP will support an effort to reduce emissions from school buses, while another will provide for enhanced public access to permit and compliance information.

Other Agency Accomplishments

To carry out its mission and achieve environmental and human health results, EPA must function effectively as an organization, serve the public responsively and efficiently, work well with its partners and stakeholders, and make the most of its resources—such as quality environmental information and sound science—to inform decision making and advance its efforts. During FY 2001 EPA expanded its multi-year planning to address all major research programs and to allow better assessment of progress toward its strategic research objectives. The Agency continued to improve the collection, quality, and availability of environmental information and to develop and apply the best available science, an improved understanding of environmental risk, and greater innovation to detect emerging risks and to address environmental problems. For example, for EPA's on-line Integrated Risk Information System, the Agency completed or updated seven consensus human health assessments that describe the potential impacts of various chemicals found in the environment. This information will be used for hazard and dose-response evaluations in risk assessments across EPA, at the state level, and by the public and will provide information critical to developing EPA's regulatory standards and making site cleanup decisions.

Similarly, in FY 2001 EPA completed a 5-year pilot of the Environmental Technology Verification program, through which the Agency can provide verified, commercial-ready technologies that eliminate, minimize, or control high-risk pollutants from multiple sectors.

In the area of improved management, EPA's most significant accomplishments reflect strides in strategic management of resources, as the Agency prepared to address the President's Management Agenda. Specifically EPA developed a human capital strategic plan, "Investing in Our People: EPA's Strategy for Human Capital, 2001 through 2003." In preparing the plan, Agency executives and human resources professionals worked in partnership to fine-tune goals, key strategies, and actions to address human resources. In FY 2001 EPA capitalized on the power of the Internet by implementing electronic processes that allow citizens, grantees, and vendors to transact business with the Agency on-line 24 hours a day, 7 days a week.

Summary of Performance Data

In FY 2001 EPA met 65 percent of the APGs for which data are provided in this report. (EPA committed to a total of 70 APGs in its FY 2001 Annual Plan; however, because data for 9 of these APGs will not be available until FY 2002 or later, they are not included in these tallies.) EPA also made significant progress toward the 20 APGs that were not achieved in FY 2001, and the Agency remains on track to meet the long-term goals and objectives associated with these annual targets.

During FY 2001 new performance data also became available for FY 2000 and FY 1999 APGs for which there were delayed reporting cycles or targets set beyond those fiscal years. EPA now has performance data for five of the nine FY 2000 APGs for which there were delayed reporting cycles or targets set beyond FY 2000. For example, the Agency met its goals for reducing greenhouse gas emissions and restricting consumption of ozone depleting substances. In summary, EPA can now report achievement of 81 percent (56) of the 69 APGs for which it has FY 2000 performance data. In addition, new performance data became available during FY 2001 for three of the seven FY 1999 APGs for which there were delayed reporting cycles or targets set beyond FY 1999. For FY 1999, EPA can now report achievement of 52 of the 65 APGs for which it has performance data. Delays in reporting cycles and targets set beyond the fiscal year continue to affect four FY 2000 APGs and four FY 1999 APGs.

Charts presenting EPA's FY 2001 performance results are provided with each goal chapter in Section II. These charts present performance data for each of the Agency's FY 2001 APGs.

Performance Issues and Concerns

Despite the best efforts of EPA and its partners, the Agency was not able to meet all planned targets for FY 2001. However, the Agency does not expect the shortfall in meeting these APGs to compromise progress toward achieving its long-range goals and objectives. For more than half of the missed APGs, EPA fell only slightly short of the targets and met the cumulative goals.

External factors contributed to over 75 percent of the missed APGs. For example, under its Clean Air goal, EPA sets targets for both the number of areas that will move from nonattainment to attainment for the six principal air pollutants and the number of people who will breathe cleaner air as a result. In FY 2001 EPA anticipated that five areas would request redesignation from nonattainment to attainment for the 1-hour ozone standard; however, only three areas were redesignated. States have been reluctant to request redesignation to the current 1-hour ozone standard as long as legal issues remain to be resolved by the courts concerning the more protective 8-hour standard that will replace the 1-hour standard. Despite this uncertainty, however, EPA and states continue to work together to ensure that areas are striving to meet or are maintaining the current 1-hour ozone standard.

For some missed APGs, shortfalls cannot be attributed to a single reason. For example, under the Agency's Clean Water goal, EPA missed its target for issuing National Pollutant Discharge Elimination System (NPDES) permits for major and minor point sources. NPDES permits reduce or eliminate discharges into the Nation's waters of inadequately treated wastewater from municipal and industrial facilities and of pollutants from urban storm water, combined sewer overflows, and concentrated animal feeding operations. In FY 2001 the Agency and its partners exceeded the target for permitting minor point sources, achieving 75 percent of a planned 66 percent; however, permits issued covered only 75 percent of the targeted 89 percent of major point sources. Many factors contributed to the permit backlog and missed target, including permit appeals and challenges, states' lack of or redirection of resources, newly adopted water quality standards that are increasingly comprehensive and more stringent, and the need to integrate individual permits with watershed and other planning processes.

In many cases, missed APGs represent "near misses." One such example falls under the Agency's leaking underground storage tank (LUST) program, which is responsible for cleaning up releases from underground storage tank systems containing gasoline, other petroleum products, or hazardous substances. In FY 2001 EPA and its state partners completed 19,074 cleanups, for a total of nearly 270,000 cleanups since FY 1987. The FY 2001 target of 21,000 LUST cleanups was not met, however, because of the increasing complexity of sites where contaminated groundwater has migrated off-site or which require groundwater cleanup. In addition, many cleanups were complicated by the presence of the contaminant methyl tertiary butyl ether (MTBE), a gasoline additive. These factors have resulted in longer-than-expected cleanup times and higher-than-expected cleanup costs at LUST sites.

In all, EPA and its partners did not meet 20 of the 61 APGs for which performance data are currently available. These APGs are associated with 7 of EPA's 10 strategic goals. The Agency is considering the varied causes of these shortfalls—legal issues; implementation of new, more stringent regulations or requirements; redirection or shortages of staff and resources; unforeseen technical complexities in cleanup or remediation processes; and other factors—as it adjusts its work and APGs for FY 2002 and proceeds to plan and set priorities for FY 2003 and beyond. The performance data charts included in Section II provide more complete information on these missed targets and discuss the progress the Agency has made toward its goals.

IMPROVING RESULTS

During FY 2001 EPA continued to sharpen its focus on achieving results and improving performance. In August 2001 the Agency launched an effort to examine a number of its current management practices—including priority-setting; planning and budgeting; and performance tracking, measuring, and reporting—with an eye toward strengthening these processes and improving the way the Agency works with its partners to focus resources on areas of greatest concern and achieve better results. In addition, the Agency continues to advance its work by strengthening its partnerships, further developing its capability to conduct and apply the results of program evaluation activities, improving performance tracking and measurement, addressing data quality issues, and looking ahead to anticipate future trends and issues.

Strengthening Partnerships

The advances in protection of human health and the environment made over the past year and discussed in the goal chapters that follow would not have been possible without the participation and collaboration of the Agency's federal, state, and tribal partners. During FY 2001 EPA worked in particular to strengthen its partnership with states and tribes to focus on environmental results and make more effective use of collective resources. In spring 2001, for example, states and tribes participated in the Agency's FY 2003 planning and priority-setting process and in a May "lessons learned" forum on improving the Agency's annual performance report.

In August 2001 Administrator Christine Todd Whitman initiated an effort to advance EPA-state performance partnerships under the National Environmental Performance Partnership System (NEPPS). Within the limits of its statutory and regulatory authorities, EPA is working to provide the states with as much flexibility as possible to address state priorities and achieve the greatest environmental results. During FY 2001 EPA Regional Administrators began to meet individually with state leaders to maximize the opportunities available through negotiation of performance partnership agreements and grants. Discussions focused on the flexibility available under performance partnerships, creating additional incentives for participation, and the testing of better measures of program performance. In FY 2001 EPA also began to consult closely with states on two new initiatives to promote achievement of environmental results: designing a strategy for developing and applying innovative approaches ("Innovating for Better

Environmental Results") and developing an "Information Agenda" that will establish a strategic vision and goals for the role of information in environmental programs in the coming years.

EPA also continues to work closely with tribal governments to identify priorities for Indian Country, to improve management of environmental issues, and to develop tribal capability to implement environmental programs. EPA's Indian Program involves significant cross-Agency and multimedia activities designed to ensure that the Agency's trust responsibility to federally recognized tribes is carried out.

In July 2001 Administrator Whitman met with the Tribal Operations Committee to reaffirm the Agency's Indian Policy and the Tribal Operations Committee Charter. The Indian Policy outlines the Agency's firm commitment to principles that promote partnerships with tribes as an integral part of EPA's system to carry out its mission of environmental protection. The re-signing of the Tribal Operations Committee Charter further demonstrates the Administration's support for EPA-tribal government partnerships. EPA is committed to ensuring protection of the environment and human health in Indian Country in a manner that is consistent with the government-to-government relationship and conserves cultural use of natural resources.

EPA also continued to collaborate closely with other federal agencies on a variety of efforts, from research and development projects to the design and implementation of cooperative programs to advance protection of the environment and human health. For example, under the Agency's National Coastal Assessment Program, EPA, the U.S. National Oceanic and Atmospheric Administration, and U.S. Geological Survey laboratories in the Southern Atlantic and Gulf of Mexico regions worked with the Delaware River Basin Committee and 24 of 26 coastal-marine states and tribes to assess the condition of the Nation's coastal resources. In another joint effort to develop information and analytical methods that will improve EPA's economic analyses of its policies and regulations, the Agency worked with the National Science Foundation on solicitations designed to support economic research in a number of key areas.

Apart from such research initiatives, EPA continued to develop and implement environmental programs in partnership with its sister agencies. An important area of collaboration, for example, involves the cleanup of federal sites. During FY 2001 EPA worked with the U.S. Department of Defense, the U.S. Department of Energy, and other federal agencies to complete construction at 3 Superfund sites, to complete cleanups at 28 removal sites, and to sign 4 interagency agreements to obtain enforceable cleanup commitments. In the area of protecting human health, EPA and the U.S. Food and Drug Administration (FDA) developed a national advisory for children and women of childbearing age on mercury in commercial and noncommercial fish. EPA and FDA, in cooperation with the Centers for Disease Control, distributed the advisory throughout the U.S. medical community.

Examples of significant partnership efforts with federal agencies, states, tribes, and local governments are highlighted in the individual goal chapters in Section II.

Using Program Evaluation

During FY 2001 EPA made significant strides in building Agency-wide capability to conduct program evaluation and fostering the use of program evaluation as a management tool for continuous improvement. These efforts will help EPA keep pace with the rapidly expanding evaluation activities conducted at the state level and with the emergence of Environmental Program Evaluation as a nationally recognized sub-discipline of program evaluation. For example, in FY 2001 EPA's Office of the Inspector General (OIG) and Office of Research and Development (ORD) participated in a joint pilot program evaluation focused on the Agency's pollution prevention and new technologies research program. The pilot used a "logic model," which allows evaluators to identify relationships among resources, activities, outputs, customers, and outcomes, to assess environmental research within the context of the Agency's strategic goals and objectives. The pilot demonstrated the potential benefits of a partnership approach to program evaluation and pointed out the need to focus on outcomes to identify the impacts of research on long-term environmental results.

To continue to foster such program evaluation efforts, EPA has developed a Program Evaluation Network of over 50 members who actively promote program evaluation within the Agency. In addition, EPA has accelerated the application of evaluation practice within the Agency by centrally funding internal evaluations on a competitive basis. From the FY 2001 competition, the Agency selected 6 out of 23 proposals for funding, allowing evaluation of a variety of environmental programs. These evaluations are underway and will be reported in the FY 2002 Annual Report.

Improving Environmental Indicators and Performance Measurement

EPA recognizes the need to make greater use of outcome-oriented performance goals and measures. Therefore, the Agency has continued to invest in the development of environmental indicator, monitoring, and management systems that will improve its capability to measure results, plan accordingly, and manage its work to achieve environmental and health outcomes. During FY 2001 EPA initiated a variety of projects to improve performance measurement: conducting training and workshops; preparing analyses to support development of more outcome-oriented goals and measures; benchmarking performance measures used by other agencies with similar functions; and working with its federal, state, tribal, and local government partners and with other stakeholders to improve environmental indicators and measures.

For example, to increase national and state capabilities for strategic monitoring of ecological health, EPA worked with 24 states to complete the first national survey of coastal waters, completed an integrated assessment of the Mid-Atlantic Highlands, and initiated the Western Pilot Study to demonstrate the use of ecological indicators for streams in the 12 western states. Approximately 30 states are evaluating new monitoring designs and a core set of ecological indicators that provide consistent data on quality of the environment and identify changes taking place. Regional vulnerability analyses that use socioeconomic factors to forecast environmental conditions more reliably are being tested in forests in the eastern United States.

In addition, through its Science to Achieve Results competitive research grants, EPA established five Estuarine and Great Lakes Programs at major academic research institutions with coastal expertise. These institutions will work to develop the next generation of environmental indicators for use by the states in assessing the biological health of estuaries and the Great Lakes.

In FY 2001 a cooperative agreement between EPA and Florida State University (FSU) supported the "Chemical and Pesticides Results Measures" project and its first published report. The purpose of the project is to develop a set of environmental outcome indicators and measures for toxic substances, pesticides, and pollution prevention. By working in cooperation with FSU, stakeholders, and the Pollution Prevention Roundtable, EPA will identify indicators and measures that federal, state, and local agencies; tribal entities; and others will find useful in describing, measuring, and understanding environmental trends and conditions in response to environmental programs. Data generated from this project, targeted to a broad audience of potential users, will be used in improving FY 2002 and FY 2003 annual performance goals and measures. The second phase of the project will provide a foundation for additional work on environmental indicators.

The Agency completed several other indicators projects during FY 2001, including the report *Development, Selection, and Pilot Demonstration of Preliminary Environmental Indicators for the Clean Water State Revolving Fund*. The product of a joint EPA/state work group, the report demonstrated the feasibility of applying a set of 7 environmental indicators to 62 State Revolving Fund projects in 6 states.

Addressing Data Quality Problems

While data quality continues to present a significant management challenge for EPA, the Agency's FY 2001 performance data generally can be considered acceptably reliable and complete, according to criteria established by the Office of Management and Budget (OMB) and discussed in OMB Circular A-11. (See Appendix B for a more complete discussion of data quality issues.) Most of the Agency's performance data are collected in major EPA data systems that are subject to Agency-wide data quality standards and periodic audits for accuracy and completeness. As indicated in Appendix B, some common limitations in the performance data are inconsistencies in data collection methods among multiple data sources; inaccuracies due to imprecise measurement or unrepresentative statistical sampling; and uncertainties associated with survey, voluntarily reported, or modeled data. The Agency is committed to full disclosure of these limitations and is working to make significant improvements in its quality systems. For many measures, EPA relies on states and other external sources for performance data and the quality assurance/quality control protocols already in place. The Agency is making significant efforts to engage its partners in improving detection and correction of data error, standardizing measures, and improving the exchange of electronic data and data quality information.

EPA's performance data used to determine whether APGs have been attained are complete for most performance measures. (See performance data charts provided with each goal chapter in Section II.) Where performance data are not yet available, Appendix B indicates when complete data are expected.

During FY 2001 EPA undertook several initiatives to improve the quality of environmental data used to support performance measurement. For example,

- In response to the EPA OIG's declaration of laboratory quality systems as one of the Agency's top 10 "management challenges," independent technical assessments of EPA laboratories were conducted to determine whether laboratory operating systems are producing environmental data of known and documented quality. The assessments identified a number of "best practices" that are being shared across the laboratory community.

- EPA worked with the American Council of Independent Laboratories to develop environmental laboratory ethical standards and train public and private sector laboratory staff and managers on ethical conduct.

- EPA developed the Data and Information Quality Strategic Plan which, when implemented, will improve the measurement and quality of the Agency's data and information over the next 5 to 10 years. The plan provides six overarching recommendations: (1) create an Agency-wide information quality network to clarify the roles, responsibilities, and relationships of Agency staff having data quality functions; (2) develop and require the use of standard data quality indicator metadata; (3) improve implementation of quality assurance requirements for grantees; (4) regularly assess and report on standard quality measures throughout the information life-cycle; (5) expand quality training for EPA and grantees; and (6) provide guidelines to improve information use and product development. The plan represents one Agency response to a major management challenge identified by the General Accounting Office and EPA's OIG. (See Section III, "Management Accomplishments and Challenges," for further discussion.) Further Agency responses to this challenge include implementation of the Central Data Exchange (CDX), which allows the seamless, secure exchange of quality data between EPA and its industrial and governmental partners. Three EPA programs (Toxics Release Inventory, Air, and Drinking Water) now use the CDX.

- EPA adopted a government-wide standard for quality system requirements for contractors and grantees and issued interim guidelines for its use. The Agency is now revising its official policy.

- EPA reviewed 14 organizational Quality Management Plans (QMPs) and approved 9. QMPs, which describe data quality management responsibilities, are required for every EPA organization that collects or uses environmental data. The Agency scheduled follow-up assessments of QMP implementation. EPA also reviewed eight quality systems.

- EPA undertook a formal assessment of Agency-wide, quality-related training needs. The Agency also made progress in improving data quality under specific programs.

While undertaking long-term improvements in data quality, it is important for EPA to disclose the limitations of its data supporting specific goals and measures, as reflected in Appendix B. EPA's long-term strategies—including the *Data and Information Quality Strategic Plan*—will address recognized Agency vulnerabilities in data quality management within and across programs.

Considering Future Trends

Apart from long-standing environmental protection issues, new areas of focus will challenge EPA's ability to look to the future and plan strategically. The future will likely be characterized by increased rates of change and greater uncertainty about the responses of complex biological, ecological, social, and political systems to this rapid change. EPA is exploring ways to keep pace with these developments by looking ahead to gain a better understanding of potential threats to ecological and human health. Issues such as global warming, biotechnology, or threats to biodiversity will require the forging of new cooperative relationships with EPA's federal, state, tribal, and local government partners and with the Agency's stakeholders.

The collective perspective about what actually constitutes "the environment" also is changing. As we begin to appreciate the extent to which humans depend on the ecological systems of the planet, it is becoming clear that numerous issues, previously thought of as independent of the environment, are in fact connected to it. Human health, the economy, social justice, and national security—particularly in terms of the potential for ecoterrorism—all have important environmental aspects because each is dependent to some degree on the structure, functioning, and resiliency of ecological systems.

In today's world, population growth and the resources consumed to sustain this growth are altering the earth in unprecedented ways. Over the next 25 years, for example, the world's population will grow by nearly 2 billion people, largely in developing areas. By 2025 an estimated 2.7 billion people will live in areas experiencing severe water scarcity, creating a potential for major regional conflicts over water rights. Domestically, growth in the southern and southwestern regions will pose major water management issues: water and wastewater infrastructure maintenance, aquifer depletion, and prevention of surface water contamination.

Further, as the population continues to grow, the Agency's general environmental concerns, such as air quality, are likely to continue. Urbanization of previously underdeveloped areas will potentially generate a greater demand for transportation infrastructure, leading to increases in vehicle miles traveled and emissions of conventional pollutants and greenhouse gases like carbon dioxide.

As EPA looks to the future, it will need to employ innovative approaches and sound science to investigate complex, interdisciplinary problems in environmental protection. The Agency will need to expand its efforts for interagency and international cooperation to address environmental issues on an increasingly global scale. Considering energy efficiency and the impacts of energy use—from global climate change to acid rain and multi-pollutant air emissions—promoting closed-loop manufacturing technologies to prevent or reduce pollution, and encouraging design for the environment are among the strategies the Agency is now exploring.

LOOKING AHEAD

As noted earlier, in August 2001 EPA launched a new effort to examine and strengthen its current management practices to achieve better results. As part of this "Managing for Improved Results" initiative, during FY 2002 a Steering Group of senior Agency leaders will consider options for improving EPA's strategic planning, annual planning and budgeting processes, performance measurement, and capability to implement results-based management. As a result of this work, the Agency expects both to make incremental changes to its processes and systems and to effect far-reaching reforms that improve the way it works with its partners to achieve environmental results.

The Agency continues to strive toward making more effective use of performance and results information to inform internal planning and decision-making and to inform the public. In FY 2001 EPA initiated an Agency-wide "Environmental Indicators Initiative" to gather the information it needs to evaluate its progress and make sound, strategic decisions. Environmental indicators are used to track and measure the environment's capacity to support human and ecological health. EPA and others will use indicators such as ozone concentrations, nutrient levels exported from watersheds, and blood lead concentrations to describe and assess conditions, stressors, exposure, and response and to show progress toward meeting management or performance goals. In FY 2002 EPA plans to compile the indicators information it collects to develop the Agency's first State of the Environment Report.

Applying Lessons Learned

EPA is using its FY 2001 results to adjust approaches and develop new strategies for FY 2002 and beyond. In some cases FY 2001 performance information has indicated a need to revise existing annual targets. For example, EPA did not achieve its target for Superfund construction completions in FY 2001. Several factors account for the FY 2001 decline in completions including the large size and considerable complexity of remaining sites. Based on this experience EPA is reducing its FY 2002 construction completion target and reevaluating the constraints and complexity of remaining Superfund sites.

On the other hand, based on FY 2001 performance, the Agency expects that in FY 2002 states will be able to complete more drinking water source assessments than anticipated. In this case national targets were originally established when states were in the early stages of implementing the assessment program and were focused on the preliminary steps necessary to establish source water protection programs (hiring staff, collecting data, setting up databases, presenting plans to the public). Because states have completed these preliminary steps, they will likely undertake source water assessment and prevention activities at a faster pace in the future.

Similarly, EPA has adjusted several of its criteria pollutant targets for FY 2002 based on FY 2001 results. In particular EPA is working with states to ensure that they continue to make progress toward attaining the ozone standard as the Agency continues to develop a policy to make the transition from the 1-hour standard to the 8-hour standard.

In other cases the lessons EPA has learned from its FY 2001 performance, although not specifically affecting goals or targets, will influence program strategies for the future. For example, to achieve clean water, the Agency is continuing to meet its goals for the issuance of effluent limitations guidelines. However, the Agency recognizes as a continuing challenge its capability to adequately document actual loadings reductions given the limited data available. To help address this problem and implement an overall loadings reductions strategy, EPA will take steps in FY 2002 to determine the number of facilities in each major program. This will greatly improve the Agency's capability to model expected reductions and validate these models using the limited data available.

Lessons learned in FY 2001 were similarly helpful in reevaluating the Agency's Great Lakes Program. Preliminary 2001 data show dissolved oxygen concentrations in Lake Erie's central basin to be near the worst observed during the past 5 years, despite international success in reducing phosphorus loadings. To understand and address this puzzling challenge, EPA's Great Lakes Program is shifting program emphasis to develop missing information such as external phosphorus load calculations, to research further the biological effects, to publicize the problem, and to integrate research and management efforts through the Lake Erie Lake Management Plan.

Finally, the unexpected and tragic events of September 11, 2001, have raised new concerns about the safety of the Agency's workforce. Like other federal agencies, in FY 2002 EPA will implement a national initiative to address security vulnerabilities and risks at all of its facilities. This work might lead to the identification of new performance goals and measures under a number of EPA's strategic goals.

FINANCIAL ANALYSIS

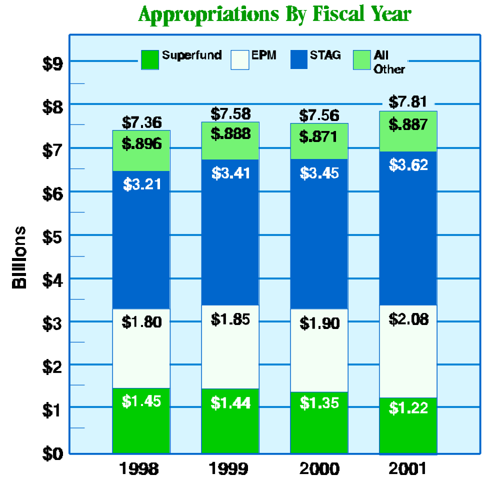
EPA continues to focus on integrating financial information with program performance information to strengthen its planning, analysis, and accountability process. A key goal is to provide program managers with timely and useful cost information and financial analysis to better inform the decision-making process and ensure taxpayer dollars are used effectively and efficiently in protecting the environment and public health.

The financial statements provided in Section IV are one important example of Agency accountability, in that they provide a snapshot of EPA's financial position at the end of the fiscal year. These financial statements are prepared in accordance with established federal accounting standards and audited by EPA's OIG. The discussion that follows is a supplement to the financial statements and describes EPA's resources and how they are used to accomplish the Agency's mission.

FY 2001 Budgetary Resources: EPA Appropriations

Any discussion of finances begins with the appropriations process. An appropriation is a legal authority to spend funds for purposes designated in an appropriations act. Congress appropriates funding for EPA in annual legislation covering appropriations for the Department of Veterans Affairs, the Department of Housing and Urban Development, and Independent Agencies. For FY 2001 EPA's appropriated resources totaled $7.8 billion. As indicated in the chart, three appropriations—Environmental Programs and Management (EPM), State and Tribal Assistance Grants (STAG), and Superfund—continue to make up a substantial portion of the Agency's resources. The EPM appropriation funds most of the Agency's payroll and infrastructure. As its title implies, STAG primarily funds grants to state and tribal partners for carrying out their environmental programs. The Superfund appropriation funds cleanup of abandoned hazardous waste sites. Finally, "All Other" EPA appropriations include funding for Science and Technology, Buildings and Facilities, Office of Inspector General, and a number of smaller appropriation accounts.

Appropriations By Fiscal Year



Obligations and Costs

For FY 2001 EPA is reporting both obligations and costs incurred in performance of its 10 goals. This presentation should provide a better link between the funds budgeted and the resources actually used to accomplish each goal.

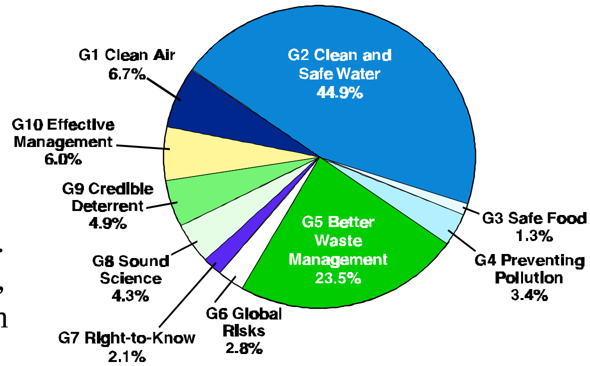
EPA's EPA's budget execution can be viewed in two ways: as obligations and as costs. Obligations reflect legal authority and commitments to incur costs on the part of the government. For example, an obligation is recognized when the government awards a contract or a grant. In contrast, costs are recognized when the contractor actually delivers the requested goods or services. By reporting obligations, EPA can show the use of its budgetary resources in terms of contractual commitments made to achieve its environmental goals, and costs measure the obligated resources actually consumed during the reporting period in achieving its goals.

FY 2001 OBLIGATIONS BY GOAL (Dollars in Millions)													
Appropriation	**G-1**	**G-2**	**G-3**	**G-4**	**G-5**	**G-6**	**G-7**	**G-8**	**G-9**	**G-10**	**Reim.**	**Other**	**Total**
State & Tribal Assistance Grants	218	3,006	0	100	73	127	0	0	72	0	30	0	3,626
All Other	341	574	95	199	274	207	167	337	304	367	268	31*	3,164
Superfund	0	0	0	0	1,354	0	4	3	15	71	136	634**	2,217
TOTAL	**559**	**3,580**	**95**	**299**	**1,701**	**334**	**171**	**340**	**391**	**438**	**434**	**665**	**9,007**
% of Total	*6.21*	*39.75*	*1.05*	*3.32*	*18.89*	*3.71*	*1.90*	*3.77*	*4.34*	*4.86*	*4.82*	*7.38*	*100.00*
NOTE: Actual costs are reflected in Section IV - Annual Financial Statements													

* The $31 million for the All Other appropriations row represents transfers from other federal agencies.
** The $634 million for the Superfund row represents a payment from general revenues to the Hazardous Substance Superfund.

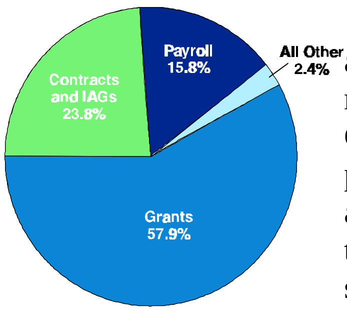
FY 2001 obligations incurred in connection with EPA's 10 goals are presented in the FY 2001 Obligations by Goal chart.[5] FY 2001 costs incurred to achieve the Agency's 10 goals total $8.1 billion and are summarized in the Costs by Goal chart.[6]

FY 2001 Gross Costs by Goal



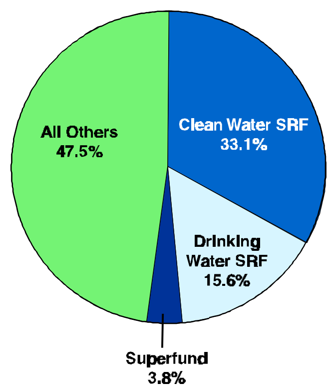
EPA's obligations and costs are largely incurred for services performed outside the Agency. As illustrated in the FY 2001 Cost Categories chart, more than 80 percent of EPA's costs are in the form of contracts or grants.

FY 2001 Cost Categories



Most of EPA's costs are associated with grant programs, and nearly half of the Agency's grants are awarded from two state revolving funds (SRFs). The Clean Water SRF (CWSRF) provides assistance for wastewater and other water projects, such as those dealing with nonpoint sources, estuaries, and storm water. The Drinking Water SRF (DWSRF) provides financing for improvements to community water systems to assist compliance with the Safe Drinking Water Act and also allows states to use grant funds for other activities that support their drinking water programs. (See Section II, Goal 2, for more information on the SRFs.)

FY 2001 Major Grant Categories



Funding for both is awarded as grants to states and tribes, which then make loans to municipalities and other entities for construction of infrastructure projects, purchases of land or conservation easements, and implementation of other water quality activities. Additional funds from state match and leveraged bond proceeds expand the capital available in the SRFs to address priority water quality and public health needs, while loan repayments and earnings ensure funding

[5] The total obligations in the chart differ from amounts reported in the Agency's financial statements in Section IV because of different accounting and presentation requirements. The basis for the chart is consistent with Office of Management and Budget (OMB) budgetary guidance, whereas the financial statements are based on generally accepted accounting principles.

[6] The chart indicates EPA's gross costs. EPA's "net" costs are reported in Section IV, under "Statement of Net Costs". "Net" costs are defined as the gross costs offset by associated exchange revenues, e.g. Superfund cost recoveries and user fees.

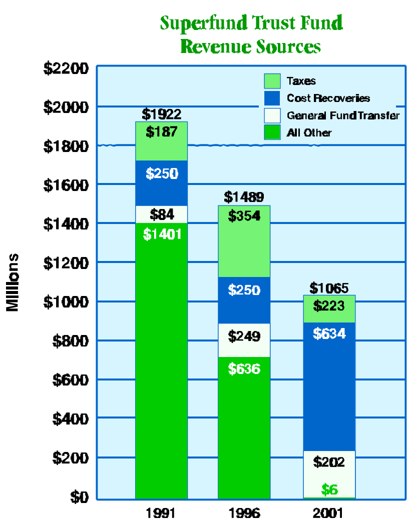
for these activities far into the future. The flexibility and revolving nature of the SRFs have provided states with a powerful tool to apply needed funding toward their clean water and drinking water infrastructure needs.

Through 2001 CWSRFs have turned $18 billion in federal capitalization grants into over $34 billion in assistance to municipalities and other entities for water projects. In recent years CWSRFs have directed $3 billion to $4 billion in loan assistance to water projects. Approximately $200 million of these funds are used each year to prevent polluted runoff, making the CWSRF an effective tool in addressing nonpoint source problems.

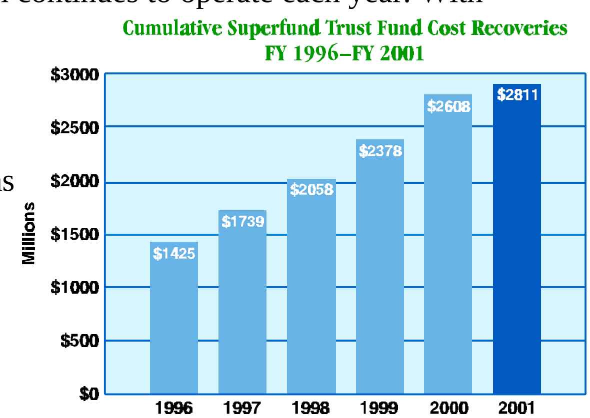
Likewise the newer DWSRFs have turned $3.6 billion in federal capitalization grants into over $3.8 billion in loan assistance, of which $1.3 billion was provided in assistance in FY 2001 alone. States have also used $576 million of their DWSRF grants to fund other programs and activities that enhance water system management and protect sources of drinking water.

The large dollar volume of these two grant programs is the reason that more than 44 percent of EPA's costs are incurred in connection with its Clean and Safe Water goal. Other grant programs include categorical assistance to states and tribes, consistent with EPA's authorizing statutes, and research grants to universities and other nonprofit institutions.

Superfund Financial Trends



The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) established the Superfund Program and the Hazardous Substance Response Trust Fund, now known as the Superfund. The Superfund Program addresses the remediation of hazardous waste from abandoned sites around the country and emergency response for new spills and other incidents. Prior to FY 1996 the bulk of Superfund financing consisted of special taxes. Although CERCLA has not been reauthorized since it expired in 1995, the Superfund Program continues to operate each year. With CERCLA's expiration, the taxing authority also expired, resulting in a shift of Superfund financing sources as shown in the Cumulative Superfund Trust Fund Cost Recoveries, FY 1996 through FY 2001 chart. Appropriations from general revenues now constitute the largest share of Superfund trust fund

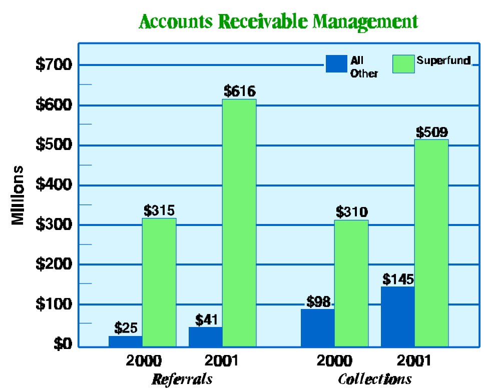


revenues. At the same time cost recovery revenues have increased markedly since FY 1991, when the cumulative total stood at $359 million.

Despite declining revenues to the Superfund Trust Fund, special account revenues have continued to grow. Under CERCLA Section 122(b)(3), EPA may retain and use the proceeds it receives under settlement agreements to conduct response actions at Superfund sites. Funds received under these settlements are subsequently placed in interest-bearing, site-specific accounts known as special accounts. Until recently only the future cost (or "cashout") component could be placed in a special account, and any corresponding past cost (or cost recovery) amounts were deposited in the Superfund Trust Fund. Based on a recent legal opinion by EPA's Office of General Counsel, however, it was determined that both past and future cost amounts could be placed in special accounts. Combining these amounts will make more resources readily available without an appropriation for EPA-lead site responses and to reimburse responsible parties for response work performed at sites pursuant to settlement agreements with the Agency.

As of September 30, 2001, EPA had established 197 special accounts with $878 million in receipts. These accounts earned an additional $135 million in interest. At the end of FY 2001, EPA had disbursed $326 million from its special accounts and had unliquidated obligations of $118 million and an unexpended balance of $569 million.

Accounts Receivable and Debt Management



Improvement in management of the federal government's debt portfolio has been a concern of Congress in the past decade and is manifested in the 1996 passage of the Debt Collection Improvement Act, which supplemented previous authorities for debt management. EPA's accounts receivable do not approach the level of other major federal creditor agencies. The Agency, nonetheless, manages a gross debt portfolio that exceeded $1 billion in each of the past 3 fiscal years.

More than three-fourths of EPA's accounts receivable are Superfund-related. Effective management of Superfund debts requires close collaboration between two EPA offices (the Office of the Chief Financial Officer and the Office of Enforcement and Compliance Assurance) and the U.S. Department of Justice (DOJ). As illustrated in the Accounts Receivable Management chart, EPA experienced a significant increase in collection of all debts, delinquent and nondelinquent, from 2000 to 2001. In addition EPA has greatly stepped up its referral actions of delinquent debts to the appropriate collection organizations the U.S. Department of Treasury for non-Superfund debts and DOJ for Superfund-related debts), which are set up to take more aggressive collection action.

Innovative Environmental Financing: The Advantage of Public Private Partnerships

EPA has several innovative environmental financing initiatives which enable the Agency to leverage federal funds through mutually beneficial public-private partnerships. Two examples are the Environmental Finance Program and the Brownfields Program.

The Environmental Finance Program employs leveraging to extend its reach and magnify its impact. The program has three related components that furnish financial outreach services to Agency customers and the regulated community. First, the Environmental Financial Advisory Board (EFAB), a federally chartered advisory committee, provides innovative ideas and recommendations to EPA's Administrator and program offices on ways to lower the costs of, and increase investments in, environmental and public health protection. Second, the Environmental Finance Center (EFC) Network consisting of nine university-based programs in eight EPA regions, delivers targeted technical assistance to smaller communities on the "how-to-pay" issues of providing safe and reliable environmental services that meet standards. Third, the Environmental Financing Information Network (EFIN), through its popular website and other means, catalogues the results of the Advisory Board and the EFC Network and presents valuable summaries of over 350 environmental finance tools and 1,000 abstracts and case studies of environmental finance publications.

A good example of how the components work together to leverage results is presented by the EFC Directors who serve on the Advisory Board as expert witnesses, thereby bringing their unique perspective on finance issues and opportunities for the Board to consider and pass along to EPA. Another innovative example is the *charrette*, a panel of experts tailored to address a community's particular finance problem. After listening to the community, the panel exchanges questions and answers and then presents recommendations for actions the community should take. The panel is composed of finance experts and has often included EFAB members. Typically participating communities would not have access to advice of this caliber, and many communities have followed panel recommendations, saving significant resources in implementing their projects. EPA further leverages the *charrettes* by documenting their results and making them available as case studies through the EFC and EFIN web sites.

The Brownfields Program, one of EPA's most successful public-private partnerships, leveraged more than $3.73 billion in public and private investments and resulted in more than 17,000 jobs in cleanup, construction, and redevelopment through the third quarter of FY 2001. "Brownfields" are abandoned, idle, or under-used industrial and commercial properties where redevelopment or expansion is complicated by real or perceived contamination. The primary goal of EPA's Brownfields Program is to provide states, tribes, and local governments with the tools and financial assistance needed to assess, clean up, and redevelop Brownfields properties. Since 1995, 2,594 properties have been assessed using federal funds and 876 properties have been assessed using leveraged funds. The 46 job training and development demonstration pilots have trained at least 700 participants, and more than 75 percent of the graduates have obtained employment to date. (See Section II, Goal 5, for more information.)

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PRINCIPAL FINANCIAL STATEMENTS

CONTENTS

Financial Statements

Notes to Financial Statements

Notes to Financial Statements (continued)

Supplemental Information Requested by OMB

Required Supplemental Information

Required Supplemental Stewardship Information

Environmental Protection Agency
Consolidating Balance Sheet
As of September 30, 2001 and 2000 *(FY 2000 Restated-See Note 37*)*
(Dollars in Thousands)

	Superfund Trust Fund FY 2001	Superfund Trust Fund FY 2000*	All Others FY 2001	All Others FY 2000*	Combined Totals FY 2001
ASSETS					
Intragovernmental:					
Fund Balance with Treasury (Note 2)	$ 6,706	$ 37,397	$ 11,272,374	$ 11,059,256	$ 11,279,080
Investments (Note 4)	3,724,044	3,960,313	1,778,818	1,593,357	5,502,862
Accounts Receivable, Net (Notes 5 and 37)	31,178	40,671	69,977	80,824	101,155
Other (Note 6)	5,521	21,789	4,386	7,452	9,907
Total Intragovernmental	$ 3,767,449	4,060,170	13,125,555	12,740,889	16,893,004
Accounts Receivable, Net (Note 5)	466,038	617,039	75,027	87,895	541,065
Loans Receivables, Net - Non Federal (Note 7)	0	0	75,552	89,128	75,552
Cash (Note 3)	0	0	0	48	0
Inventory & Property Received in Settlement (Note 8)	0	5,086	253	347	253
Property, Plant and Equipment, Net (Note 9)	16,515	13,581	526,893	473,028	543,408
Other (Note 6)	8,878	750	875	1,712	9,753
Total Assets	$ 4,258,880	$ 4,696,626	$ 13,804,155	$ 13,393,047	$ 18,063,035
LIABILITIES					
Intragovernmental:					
Accounts Payable (Note 37)	$ 65,809	$ 121,920	$ 1,118	$ 1,506	$ 66,927
Accrued Liabilities	57,728	51,748	40,541	50,580	98,269
Custodial Liability (Note 11)	0	0	77,778	102,469	77,778
Debt (Note 10)	0	0	31,124	37,922	31,124
Other (Note 12)	21,308	8,848	27,507	28,849	48,815
Total Intragovernmental	144,845	182,516	178,068	221,326	322,913
Accounts Payable	39,878	46,066	91,083	84,956	130,961
Accrued Liabilities	97,857	145,358	564,191	631,909	662,048
Cashout Advances & Deferrals, Superfund (Note 15)	394,699	372,586	0	0	394,699
Payroll and Benefits Payable (Note 33)	35,111	32,832	163,730	151,363	198,841
Pensions and Other Actuarial Liabilities (Note 14)	7,731	6,637	31,902	27,036	39,633
Environmental Cleanup Costs (Note 20)	0	0	14,528	15,499	14,528
Commitments and Contingencies (Note 18)	3,778	5,000	6,020	2,950	9,798
Other (Note 12 and Note 13)	27,659	30,192	60,536	49,147	88,195
Total Liabilities	751,558	821,187	1,110,058	1,184,186	1,861,616
NET POSITION					
Unexpended Appropriations (Note 16)	0	0	10,358,961	10,119,838	10,358,961
Cumulative Results of Operations (Note 37)	3,507,322	3,875,439	2,335,136	2,089,023	5,842,458
Total Net Position (Note 37)	3,507,322	3,875,439	12,694,097	12,208,861	16,201,419
Total Liabilities and Net Position	$ 4,258,880	$ 4,696,626	$ 13,804,155	$ 13,393,047	$ 18,063,035

* Intragovernmental Accounts Receivable and Payable and Cumulative Results of Operations restated for FY 2000 - see Note 37.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidating Balance Sheet
As of September 30, 2001 and 2000 *(FY 2000 Restated-See Note 37*)*
(Dollars in Thousands)

	Combined Totals FY 2000*	Intra-agency Elimination FY 2001	Intra-agency Elimination FY 2000*	Consolidated Totals FY 2001	Consolidated Totals FY 2000
ASSETS					
Intragovernmental:					
Fund Balance with Treasury (Note 2)	$ 11,096,653	$ 0	$ 0	$ 11,279,080	$ 11,096,653
Investments (Note 4)	5,553,670	0	0	5,502,862	5,553,670
Accounts Receivable, Net (Notes 5 and 37)	121,495	(48,128)	(50,644)	53,027	70,851
Other (Note 6)	29,241	(5,739)	(6,510)	4,168	22,731
Total Intragovernmental	16,801,059	(53,867)	(57,154)	$ 16,839,137	16,743,905
Accounts Receivable, Net (Note 5)	704,934	0	0	541,065	704,934
Loans Receivables, Net - Non Federal (Note 7)	89,128	0	0	75,552	89,128
Cash (Note 3)	48	0	0	0	48
Inventory & Property Received in Settlement (Note 8)	5,433	0	0	253	5,433
General Property, Plant and Equipment, Net (Note 9)	486,609	0	0	543,408	486,609
Other (Note 6)	2,462	0	0	9,753	2,462
Total Assets	$ 18,089,673	$ (53,867)	0 (57,154)	$ 18,009,168	$ 18,032,519
LIABILITIES					
Intragovernmental:					
Accounts Payable (Note 37)	$ 123,426	$ (45,271)	$ (46,453)	21,656	$ 76,973
Accrued Liabilities	102,328	(3,241)	(4,191)	95,028	98,137
Custodial Liability (Note 11)	102,469	0	0	77,778	102,469
Debt (Note 10)	37,922	0	0	31,124	37,922
Other (Note 12)	37,697	(5,355)	(6,510)	43,460	31,187
Total Intragovernmental	403,842	(53,867)	(57,154)	$ 269,046	346,688
Accounts Payable	131,022	0	0	130,961	131,022
Accrued Liabilities	777,267	0	0	662,048	777,267
Cashout Advances & Deferrals, Superfund (Note 15)	372,586	0	0	394,699	372,586
Payroll and Benefits Payable (Note 33)	184,195	0	0	198,841	184,195
Pensions and Other Actuarial Liabilities (Note 14)	33,673	0	0	39,633	33,673
Environmental Cleanup Costs (Note 20)	15,499	0	0	14,528	15,499
Commitments and Contingencies (Note 18)	7,950	0	0	9,798	7,950
Other (Note 12 and Note 13)	79,339	0	0	88,195	79,339
Total Liabilities	2,005,373	(53,867)	(57,154)	1,807,749	1,948,219
NET POSITION					
Unexpended Appropriations (Note 16)	10,119,838	0	0	10,358,961	10,119,838
Cumulative Results of Operations (Note 37)	5,964,462	0	0	5,842,458	5,964,462
Total Net Position (Note 37)	16,084,300	0	0	16,201,419	16,084,300
Total Liabilities and Net Position	$ 18,089,673	$ (53,867)	$ (57,154)	$ 18,009,168	$ 18,032,519

* Intragovernmental Accounts Receivable and Payable and Cumulative Results of Operations restated for FY 2000 - see Note 37.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Clean Air	Clean and Safe Water	Safe Food	Prevent Pollution	Better Waste Management	Global Risks
COSTS:						
Federal	$ 87,360	$ 156,900	$ 30,210	$ 41,065	$ 465,452	$ 39,816
With the Public	458,256	3,482,906	77,687	236,933	1,442,650	186,919
Total Costs	545,616	3,639,806	107,897	277,998	1,908,102	226,735
Less:						
Earned Revenues	702	4,966	17,051	1,545	510,905	7,286
Total Revenue	702	4,966	17,051	1,545	510,905	7,286
Management Cost Allocation	65,958	77,128	33,657	42,067	103,802	23,282
NET COST OF OPERATIONS	$ 610,872	$ 3,711,968	$ 124,503	$ 318,520	$ 1,500,999	$ 242,731

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Year Ended September 30, 2000-*Restated (See Note 34)*
(Dollars in Thousands)

	Clean Air	Clean and Safe Water	Safe Food	Prevent Pollution	Better Waste Management	Global Risks
COSTS:						
Federal (Note 34)	$ 62,400	$ 134,808	$ 18,372	$ 29,823	$ 387,651	$ 30,549
With the Public	462,922	3,209,971	80,003	231,151	1,478,910	179,880
Total Costs	525,322	3,344,779	98,375	260,974	1,866,561	210,429
Less:						
Earned Revenues	219	5,794	21,247	4,180	336,253	6,939
Total Revenue	219	5,794	21,247	4,180	336,253	6,939
Management Cost Allocation (Note 34)	53,522	73,540	21,779	34,754	135,265	15,755
NET COST OF OPERATIONS (Note 34)	$ 578,625	$ 3,412,525	$ 98,907	$ 291,548	$ 1,665,573	$ 219,245

Detailed descriptions of the above Goals are provided in *EPA's FY 2001 Annual Report, Section II – GPRA Performance Results by Strategic Goal*.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Right to Know	Sound Science	Credible Deterrent	Effective Management	Not Assigned to Goals*	Consolidated Totals
COSTS:						
Federal	$ 41,540	$ 58,804	$ 100,116	$ 66,461	$ 29,438	$ 1,117,162
With the Public	126,154	290,056	299,021	424,036	(60,977)	6,963,641
Total Costs	167,694	348,860	399,137	490,497	(31,539)	8,080,803
Less:						
Earned Revenues	324	706	786	4,330	(1,898)	546,703
Total Revenue	324	706	786	4,330	(1,898)	546,703
Management Cost Allocation	30,017	47,331	62,925	(486,167)	0	0
NET COST OF OPERATIONS	$ 197,387	$ 395,485	$ 461,276	**$** 0	**$** (29,641)	$ 7,534,100

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Year Ended September 30, 2000-*Restated (see Note 34)*
(Dollars in Thousands)

	Right to Know	Sound Science	Credible Deterrent	Effective Management	Not Assigned to Goals*	Consolidated Totals
COSTS:						
Federal (Note 34)	$ 22,120	$ 42,324	$ 52,421	$ 125,211	$ 120,149	$ 1,025,828
With the Public	114,439	286,882	317,423	339,874	25,346	6,726,801
Total Costs	136,559	329,206	369,844	465,085	145,495	7,752,629
Less:						
Earned Revenues	338	1,490	495	1,694	3,335	381,984
Total Revenue	338	1,490	495	1,694	3,335	381,984
Management Cost Allocation (Note 34)	22,752	30,676	75,348	(463,391)	0	0
NET COST OF OPERATIONS (Note 34)	$ 158,973	$ 358,392	$ 444,697	$ 0	$ 142,160	$ 7,370,645

* *See Note 30.*

Detailed descriptions of the above Goals are provided in *EPA's FY 2001 Annual Report, Section II – GPRA Performance Results by Strategic Goal*.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidating Statement of Net Cost
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated-See Note 34)*
(Dollars in Thousands)

	Superfund Trust Fund FY 2001	Superfund Trust Fund FY 2000*	All Others FY 2001	All Others FY 2000*	Combined Total FY 2001
COSTS:					
Intragovernmental (Note 34)	$ 426,499	$ 353,782	$ 710,290	$ 689,140	$ 1,136,789
With the Public	1,179,013	1,259,464	5,784,628	5,467,337	6,963,641
Expenses from Other Appropriations (Note 23)	103,654	31,270	(103,654)	(31,270)	0
Total Costs	1,709,166	1,644,516	6,391,264	6,125,207	8,100,430
Less:					
Earned Revenues	488,397	307,200	77,933	91,878	566,330
Total Revenue	488,397	307,200	77,933	91,878	566,330
NET COST OF OPERATIONS (Note 34)	$ 1,220,769	$ 1,337,316	$ 6,313,331	$ 6,033,329	$ 7,534,100

* Restated amounts - See Note 34.

Environmental Protection Agency
Consolidating Statement of Net Cost
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated-See Note 34)*
(Dollars in Thousands)

	Combined Total FY 2000*	Intra-agency Eliminations FY 2001	Intra-agency Eliminations FY 2000	Consolidated Totals FY 2001	Consolidated Totals FY 2000*
COSTS:					
Intragovernmental (Note 34)	$ 1,042,922	$ (19,627)	$ (17,094)	$ 1,117,162	$ 1,025,828
With the Public	6,726,801	0	0	6,963,641	6,726,801
Expenses from Other Appropriations (Note 23)	0	0	0	0	0
Total Costs	$ 7,769,723	$ (19,627)	$ (17,094)	$ 8,080,803	$ 7,752,629
Less:					
Earned Revenues	399,078	(19,627)	(17,094)	546,703	381,984
Total Revenue	399,078	(19,627)	(17,094)	546,703	381,984
NET COST OF OPERATIONS (Note 34)	$ 7,370,645	$ 0	$ 0	$ 7,534,100	$ 7,370,645

* Restated amounts - See Note 34.

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated*-See Notes 34 & 37)*
(Dollars in Thousands)

	Superfund Trust Fund FY 2001	Superfund Trust Fund FY 2000*	All Others FY 2001	All Others FY 2000*	Combined Totals FY 2001
Net Cost of Operations (Note 34)	$ 1,220,769	$ 1,337,316	$ 6,313,331	$ 6,033,329	$ 7,534,100
Financing Sources (Other Than Exchange Revenues):					
Appropriations Used	0	0	6,867,762	6,632,631	6,867,762
Taxes & Non-Exchange Interest (Note 17)	226,861	240,808	276,346	260,272	503,207
Other Non-Exchange Revenue	2,775	1,192	11,878	12,958	14,653
Imputed Financing (Notes 32 and 34)	13,686	12,534	77,855	70,384	91,541
Trust Fund Appropriations (Note 17)	633,603	700,000	(633,603)	(700,000)	0
Transfers-In (Note 31 and 37)	0	9,707	62,861	64,995	62,861
Transfers-Out (Notes 31 and 37)	(127,927)	(124,200)	0	(990)	(127,927)
Income from Other Appropriations (Note 23)	103,654	31,270	(103,654)	(31,270)	0
Net Results of Operations before Accounting Changes for Trust Funds, Cashout Interest, & Transfers	(368,117)	(466,005)	246,114	275,651	(122,003)
Cumulative Effect of Trust Fund Accounting Changes on Net Results of Operations (Note 35)	0	2,656,831	0	91,596	0
Cumulative Effect of Cashout Interest Accounting Changes on Net Results of Operations (Note 36)	0	85,382	0	0	0
Cumulative Effect of Expenditure Transfer Accounting Changes on Net Results of Operations (Note 37)	0	(45,188)	0	45,188	0
Net Change in Cumulative Results of Operations	(368,117)	2,231,020	246,114	412,435	(122,003)
Increases/(Decreases) in Unexpended Appropriations	0	(2,656,831)	239,122	42,874	239,122
Change in Net Position	(368,117)	(425,811)	485,236	455,309	117,119
Net Position - Beginning of Period (Note 37)	3,875,439	4,301,250	12,208,861	11,753,552	16,084,300
Net Position - End of Period (Note 37)	$ 3,507,322	$ 3,875,439	$ 12,694,097	$ 12,208,861	$ 16,201,419

* FY 2000 Net Cost of Operations and Imputed Financing are restated - See Note 34.
Also FY 2000 Transfers-in, Transfers-out, and Ending Net Position are restated; with an addtional Accounting Change for Expenditure Transfers. - See Note 37.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated*-See Notes 34 and 37)*
(Dollars in Thousands)

	Combined Totals FY 2000*	Intra-agency Eliminations FY 2001	Intra-agency Eliminations FY 2000*	Consolidated Totals FY 2001	Consolidated Totals FY 2000*
Net Cost of Operations (Note 34)	$ 7,370,645	$ 0	$ 0	$ 7,534,100	$ 7,370,645
Financing Sources (Other Than Exchange Revenues):					
Appropriations Used	6,632,631	0	0	6,867,762	6,632,631
Taxes & Non-Exchange Interest (Note 17)	501,080	0	0	503,207	501,080
Other Non-Exchange Revenue	14,150	0	0	14,653	14,150
Imputed Financing (Notes 32 and 34)	82,918	0	0	91,541	82,918
Trust Fund Appropriations (Note 17)	0	0	0	0	0
Transfers-In (Notes 31 and 37)	74,702	(47,894)	(49,990)	14,967	24,712
Transfers-Out (Notes 31 and 37)	(125,190)	47,894	49,990	(80,033)	(75,200)
Income from Other Appropriations (Note 23)	0	0	0	0	0
Net Results of Operations before Accounting Changes for Trust Funds, Cashout Interest, & Transfers	(190,354)	0	0	(122,003)	(190,354)
Cumulative Effect of Trust Fund Accounting Changes on Net Results of Operations (Note 35)	2,748,427	0	0	0	2,748,427
Cumulative Effect of Cashout Interest Accounting Changes on Net Results of Operations (Note 36)	85,382	0	0	0	85,382
Cumulative Effect of Expenditure Transfer Accounting Changes on Net Results of Operations (Note 37)	0	0	0	0	0
Net Change in Cumulative Results of Operations	2,643,455	0	0	(122,003)	2,643,455
Increases/(Decreases) in Unexpended Appropriations	(2,613,957)	0	0	239,122	(2,613,957)
Change in Net Position	29,498	0	0	117,119	29,498
Net Position - Beginning of Period (Note 37)	16,054,802	0	0	16,084,300	16,054,802
Net Position - End of Period (Note 37)	$ 16,084,300	$ 0	$ 0	$ 16,201,419	$ 16,084,300

* FY 2000 Net Cost of Operations and Imputed Financing are restated - See Note 34.
Also FY 2000 Transfers-in, Transfers-out, and Ending Net Position are restated; with an additional Accounting Change for Expenditure Transfers. - See Note 37.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Superfund Trust Fund	All Others	Combined Totals
Budgetary Resources			
Budget Authority	$ 1,288,437	$ 7,245,878	$ 8,534,315
Unobligated Balances, Beginning of Period	450,538	1,774,158	2,224,696
Net Transfers, Prior Period Balances	0	1,003	1,003
Spending Authority from Offsetting Collections	348,758	303,972	652,730
Adjustments (Note 26)	196,644	18,095	214,739
Total Budgetary Resources (Note 25)	$ 2,284,377	$ 9,343,106	$ 11,627,483
Status of Budgetary Resources			
Obligations Incurred (Note 25)	$ 1,570,056	$ 7,431,802	$ 9,001,858
Unobligated Balances Available - Apportioned (Note 27)	714,321	1,791,475	2,505,796
Unobligated Balances Not Available (Note 27)	0	119,829	119,829
Total, Status of Budgetary Resources (Note 25)	$ 2,284,377	$ 9,343,106	$ 11,627,483
Outlays (Note 25)			
Obligations Incurred (Note 25)	$ 1,570,056	$ 7,431,802	$ 9,001,858
Less: Spending Authority from Offsetting Collections and Adjustments	(545,402)	(380,786)	(926,188)
Subtotal	$ 1,024,654	$ 7,051,016	$ 8,075,670
Obligated Balance, Net - Beginning of Period	2,283,790	9,289,444	11,573,234
Obligated Balance Transferred, Net	0	0	
Less: Obligated Balance, Net - End of Period (Note 28)	(2,108,696)	(9,324,855)	(11,433,551)
Total Outlays (Note 25)	$ 1,199,748	$ 7,015,605	$ 8,215,353

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated*-See Note 34)*
(Dollars in Thousands)

	Superfund Trust Fund FY 2001	Superfund Trust Fund FY 2000*	All Others FY 2001	All Others FY 2000*
Obligations and Nonbudgetary Resources				
Obligations Incurred	$ 1,570,056	$ 1,701,337	$ 7,431,802	$ 7,158,665
Less: Spending Authority for Offsetting Collections and Adjustments				
Earned Reimbursements				
Collected	(311,271)	(108,997)	(227,827)	(230,981)
Receivable from Federal Sources	3,716	13,324	6,306	20,720
Change in Unfilled Customer Orders (Decreases)/Increases	(41,203)	(17,846)	(36,273)	(54,653)
Transfers from Trust Funds	0	(9,642)	(46,178)	(46,358)
Recoveries of Prior Year Obligations	(196,644)	(201,660)	(76,814)	(111,767)
Imputed Financing for Cost Subsidies (Notes 32 and 34)	13,686	12,534	77,855	70,384
Income from Other Appropriations (Note 23)	103,654	31,270	(103,654)	(31,270)
Transfers-in/(out) of Nonmonetary Assets	0	39	0	0
Exchange Revenue Not in the Entity's Budget	(182,013)	(215,449)	(2,072)	(3,088)
Total Obligations as Adjusted and Nonbudgetary Resources	959,981	1,204,910	7,023,145	6,771,652
Resources that Do Not Fund Net Cost of Operations				
Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Provided - (Increases)/Decreases	145,931	143,536	(117,998)	(74,345)
Change in Unfilled Customer Orders, etc.	41,203	17,846	36,273	53,227
Costs Capitalized on the Balance Sheet - (Increases)/Decreases				
General Plant, Property and Equipment	(8,306)	(3,827)	(74,092)	(107,711)
Purchases of Inventory	0	0	52	(68)
Adjustments to Costs Capitalized on the Balance Sheet	(40)	0	(4)	153
Collections that Decrease Credit Program Receivables or Increase Credit Program Liabilities	0	0	7,722	5,014
Adjustment for Trust Fund Outlays that Do Not Affect Net Cost	(47,894)	(38,090)	(587,424)	(652,268)
Total Resources that Do Not Fund Net Costs of Operations	130,894	119,465	(735,471)	(775,998)
Components of Costs that Do Not Require or Generate Resources				
Depreciation and Amortization	4,031	3,654	19,333	20,651
Bad Debt Related to Uncollectible Non-Credit Reform Receivables	133,761	3,075	2,881	1,518
Revaluation of Assets and Liabilities	0	0	0	(165)
Loss (Gain) on Disposition of Assets	(9,426)	(813)	895	0
Other Expenses not Requiring Budgetary Resources	699	45	(5,686)	3,409
Total Costs That Do Not Require Resources	129,065	5,961	17,423	25,413
Financing Sources Yet to be Provided (Note 29)	829	6,980	8,234	12,262
Net Costs of Operations (Note 34)	$ 1,220,769	$ 1,337,316	$ 6,313,331	$ 6,033,329

* Imputed Financing and Net Cost of Operations restated for FY 2000 - See Note 34.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2001 and 2000 *(FY 2000 Restated*-See Note 34)*
(Dollars in Thousands)

	Consolidated Totals FY2001**	Consolidated Totals FY 2000* **
Obligations and Nonbudgetary Resources		
Obligations Incurred	$ 9,001,858	$ 8,860,002
Less: Spending Authority for Offsetting Collections and Adjustments		
Earned Reimbursements		
Collected	(539,098)	(339,978)
Receivable from Federal Sources	10,022	34,044
Change in Unfilled Customer Orders (Decreases)/Increases	(77,476)	(72,499)
Transfers from Trust Funds	(46,178)	(56,000)
Recoveries of Prior Year Obligations	(273,458)	(313,427)
Imputed Financing for Cost Subsidies (Notes 32 and 34)	91,541	82,918
Income from Other Appropriations (Note 23)	0	0
Transfers-in/(out) of Nonmonetary Assets	0	39
Exchange Revenue Not in the Entity's Budget	(184,085)	(218,537)
Total Obligations as Adjusted and Nonbudgetary Resources	7,983,126	7,976,562
Resources that Do Not Fund Net Cost of Operations		
Change in Amount of Goods, Services, and Benefits Ordered but Not		
Yet Provided - (Increases)/Decreases	27,933	69,191
Change in Unfilled Customer Orders, etc.	77,476	71,073
Costs Capitalized on the Balance Sheet - (Increases)/Decreases		
General Plant, Property and Equipment	(82,398)	(111,538)
Purchases of Inventory	52	(68)
Adjustments to Costs Capitalized on the Balance Sheet	(44)	153
Collections that Decrease Credit Program Receivables or Increase		
Credit Program Liabilities	7,722	5,014
Adjustment for Trust Fund Outlays that Do Not Affect Net Cost	(635,318)	(690,358)
Total Resources that Do Not Fund Net Costs of Operations	(604,577)	(656,533)
Components of Costs that Do Not Require or Generate Resources		
Depreciation and Amortization	23,364	24,305
Bad Debt Related to Uncollectible Non-Credit Reform Receivables	136,642	4,593
Revaluation of Assets and Liabilities	0	(165)
Loss (Gain) on Disposition of Assets	(8,531)	(813)
Other Expenses not Requiring Budgetary Resources	(4,987)	3,454
Total Costs That Do Not Require Resources	146,488	31,374
Financing Sources Yet to be Provided (Note 29)	9,063	19,242
Net Costs of Operations (Note 34)	$ 7,534,100	$ 7,370,645

* Imputed Financing and Net Cost of Operations restated for FY 2000 - See Note 34.
** This statement did not have any intra-agency eliminations for FY 2001 or FY 2000.

The accompanying notes are an integral part of these statements.

Environmental Protection Agency
Consolidated Statement of Custodial Activity
For the Years Ended September 30, 2001 and 2000
(Dollars in Thousands)

	FY 2001	FY 2000
Revenue Activity:		
Sources of Collections:		
Fines and Penalties	114,830	76,850
Other	$ 31,754	$ 18,418
Total Cash Collections	146,584	95,268
Accrual Adjustment	(24,692)	(8,678)
Total Custodial Revenue (Note 24)	121,892	86,590
Disposition of Collections:		
Transferred to Others (General Fund)	147,045	97,730
Increases/(Decreases) in Amounts To Be Transferred	(25,153)	(11,140)
Total Disposition of Collections	121,892	86,590
Net Custodial Revenue Activity (Note 24)	$ 0	$ 0

The accompanying notes are an integral part of these statements.

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

These consolidating financial statements have been prepared to report the financial position and results of operations of the Environmental Protection Agency (Agency) for the Hazardous Substance Superfund (Superfund) Trust Fund and All Other Funds, 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 books and records of the Agency in accordance with "Form and Content for Agency Financial Statements," specified by the Office of Management and Budget (OMB) in Bulletin 01-09, and the Agency's accounting policies which are summarized in this note. In addition, to the guidance in Bulletin 01-09, the Statement of Net Cost has been prepared by the EPA strategic goals. These statements are therefore different from the financial reports also prepared by the Agency pursuant to OMB directives that are used to monitor and control the Agency's use of budgetary resources.

B. Reporting Entities

The Environmental Protection Agency 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 2001, the reporting entities are grouped as Hazardous Substance Superfund and All Other Funds.

Hazardous Substance Superfund

In 1980, the Hazardous Substance Superfund, commonly referred to as the Superfund Trust Fund, 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 Agency allocates funds from its appropriation to other Federal agencies to carry out the Act. 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. Throughout this process, cleanup activities may be supported by shorter term removal actions to reduce immediate risks. Removal actions may include removing contaminated material from the site, providing an alternative water supply to people living nearby, and installing security measures. NPL cleanups and removals are conducted and financed by the Agency, private parties, or other Federal agencies. The Superfund Trust Fund includes the Treasury collections and investment activity. The Superfund Trust Fund is accounted for under Treasury symbol number 8145.

All Other Funds

All Other Funds include other Trust Fund appropriations, General Fund appropriations, Revolving Funds, Special Funds, the Agency Budgetary Clearing accounts, Deposit Funds, General Fund Receipt accounts, the Environmental Services Special Fund Receipt Account, the Miscellaneous Contributed Funds Trust Fund, and General Fund appropriations transferred from other Federal agencies as authorized by the Economy Act of 1932. Trust Fund appropriations are the Leaking Underground Storage Tank (LUST) Trust Fund and the Oil Spill Response Trust Fund. General Fund appropriations are the State and Tribal Assistance Grants (STAG), Science and Technology (S&T), Environmental Programs and Management (EPM), Office of Inspector General (IG), Buildings and Facilities (B&F), and Payment to the Hazardous Substance Superfund. General Fund appropriation activities that no longer receive current definite appropriations but have unexpended authority are the Asbestos Loan Program and Energy, Research and Development. Revolving Funds include the FIFRA Revolving Fund and Tolerance Revolving Fund which receive no direct appropriations; however, they do collect fees from public industry as a source of reimbursement for the services provided. In addition to FIFRA and Tolerance, a Working Capital Fund (WCF) was established and designated as a franchise fund to provide computer operations support and postage service for the Agency. A Special Fund was established to collect the Exxon Valdez settlement as a result of the Exxon Valdez oil spill. All Other Funds are as follows:

The LUST Trust Fund 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 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 0.1 cent a gallon tax on motor fuels which will expire in 2005, and is accounted for under Treasury symbol number 8153.

The Oil Spill Response Trust Fund was authorized by the Oil Pollution Act (OPA) of 1990. 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 of 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. The Oil Spill Response Trust Fund is accounted for under Treasury symbol number 8221.

The State and Tribal Assistance Grants (STAG) appropriation 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. STAG is accounted for under Treasury symbol 0103.

The Science and Technology (S&T) appropriation finances salaries; travel; science; technology; research and development activities including laboratory and center 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 2001, Superfund research costs were appropriated in Superfund and transferred to S&T to allow for proper accounting of the costs. Scientific and technological activities for environmental issues 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. The Science and Technology appropriation is accounted for under Treasury symbol 0107.

The Environmental Programs and Management (EPM) appropriation includes funds for salaries, travel, contracts, grants, and cooperative agreements for pollution abatement, control, and compliance activities and administrative activities of the operating programs. Areas supported from this appropriation include Clean Air; Clean and Safe Water; Preventing Pollution and Reducing Risk in Communities, Homes, Workplaces, and Ecosystems; Better Waste Management, Restoration of Contaminated Waste Sites, and Emergency Response; Reduction of Global and Cross Border Environmental Risks; Americans' Right to Know About Their Environment; Sound Science; Improved Understanding of Environmental Risk; and Greater Innovation to Address Environmental Problems; Credible Deterrent to Pollution and Greater Compliance with the Law; and Effective Management. The Environmental Programs and Management appropriation is accounted for under Treasury symbol 0108.

The Office of Inspector General appropriation 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 Trust Fund and the Leaking Underground Storage Tank Trust Funds are appropriated under those Trust Fund accounts and are transferred to the Office of Inspector General account. The audit function provides contract, internal and performance, and financial and grant audit services. The Office of Inspector General appropriation is accounted for under Treasury symbol 0112 and includes expenses incurred and reimbursed from the appropriated trust funds being accounted for under Treasury symbols 8145 and 8153.

The Buildings and Facilities appropriation provides for the construction, repair, improvement, extension, alteration, and purchase of fixed equipment or facilities that are owned or used by the Environmental Protection Agency. The Buildings and Facilities appropriation is accounted for under Treasury symbol 0110.

The Payment to the Hazardous Substance Superfund appropriation authorizes appropriations from the General Fund of the Treasury to finance activities conducted through Hazardous Substance

Superfund. Payment to the Hazardous Substance Superfund is accounted for under Treasury symbol 0250.
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 Fund disburses the subsidy to the Financing Fund for increases in subsidy. The Financing Fund receives the subsidy payment, borrows from Treasury and collects the asbestos loans. The Asbestos Loan Program is accounted for under Treasury symbol 0118 for the subsidy and administrative support, under Treasury symbol 4322 for loan disbursements, loans receivable and loan collections on post FY 1991 loans, and under Treasury symbol 2917 for pre FY 1992 loans receivable and loan collections.

The FIFRA Revolving Fund was authorized by the Federal Insecticide, Fungicide and Rodenticide Act of 1972 as amended and as amended by the Food Quality Protection Act of 1996. Fees are paid by industry to offset costs of accelerated reregistration, expedited processing of pesticides, and establishing tolerances for pesticide chemicals in or on food and animal feed. The FIFRA Revolving Fund is accounted for under Treasury symbol number 4310.

The Tolerance Revolving Fund was authorized in 1963 for the deposit of tolerance fees. Fees are paid by industry for Federal services of pesticide chemicals in or on food and animal feed. Effective January 2, 1997, fees collected are now being collected and deposited in the Reregistration and Expedited Processing Revolving Fund (4310). The fees collected prior to this date are accounted for under Treasury symbol number 4311.

The Working Capital Fund (WCF) includes two activities: computer support services and postage. WCF derives revenue from these activities based upon a fee for services. WCF’s customers currently consist solely of Agency program offices. Accordingly, revenues generated by WCF and expenses recorded by the program offices for use of such services, along with the related advances/liabilities, are eliminated on consolidation. The WCF is accounted for under Treasury symbol 4565.

The Exxon Valdez Settlement Fund 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 the oil spill. The Exxon Valdez Settlement fund is accounted for under Treasury symbol number 5297.

Allocations and appropriations transferred to the Agency from other Federal agencies include funds from the Appalachian Regional Commission and the Department of Commerce which provide economic assistance to state and local developmental activities, the Agency for International Development which provides assistance on environmental matters at international levels, and from the General Services Administration which provides funds for rental of buildings, and operations, repairs, and maintenance of rental space. The transfer allocations are accounted for under Treasury symbols 0200, 1010, and 4542; and the appropriation transfers are accounted for under 0108.

Clearing Accounts include the Budgetary suspense account, Unavailable Check Cancellations and Overpayments, and Undistributed OPAC Payments and Collections. Clearing accounts are accounted for under Treasury symbols 3875, 3880, and 3885.

Deposit funds include Fees for Ocean Dumping; Nonconformance Penalties; Clean Air Allowance Auction and Sale; Advances without Orders; and Suspense and payroll deposits for Savings Bonds, and State and City Income Taxes Withheld. Deposit funds are accounted for under Treasury symbols 6050, 6264, 6265, 6266, 6275, and 6500.

General Fund Receipt Accounts include Hazardous Waste Permits; Miscellaneous Fines, Penalties and Forfeitures; General Fund Interest; Interest from Credit Reform Financing Accounts; Fees and Other Charges for Administrative and Professional Services; and Miscellaneous Recoveries and Refunds. General Fund Receipt accounts are accounted for under Treasury symbols 0895, 1099, 1435, 1499, 3200, and 3220.

The Environmental Services Receipt account 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 appropriation and to the EPM appropriation to meet the expenses of the programs that generate the receipts. Environmental Services are unavailable receipts accounted for under Treasury symbol 5295.

The Miscellaneous Contributed Funds Trust Fund includes gifts for pollution control programs that are usually designated for a specific use by the donor and deposits from pesticide registrants to cover the costs of petition hearings when such hearings result in unfavorable decisions to the petitioner. Miscellaneous Contributed Funds Trust Fund is accounted for under Treasury symbol 8741.

The accompanying financial statements include the accounts of all funds described in this note. The expense allocation methodology is a financial statement estimate that presents EPA's programs at full cost. Superfund may charge some costs directly to the fund and charge the remainder of the costs to the All Other Funds in the Agency-wide appropriations. These amounts are presented as Expenses from Other Appropriations on the Statement of Net Cost and as Income from Other Appropriations on the Statement of Changes in Net Position and the Statement of Financing.

The Superfund Trust Fund is allocated to general support services costs (such as rent, communications, utilities, mail operations, etc.) that were initially charged to the Agency's S&T and EPM appropriations. During the year, these costs are allocated from the S&T and EPM appropriations to the Superfund Trust Fund based on a ratio of direct labor hours, using budgeted or actual full-time equivalent personnel charged to these appropriations, to the total of all direct labor hours. Agency general support services cost charges to the Superfund Trust Fund may not exceed the ceilings established in the Superfund Trust Fund appropriation. The related general support services costs charged to the Superfund Trust Funds were $56.3 million for FY 2000 and $53.5 million for FY 2001.

C. Budgets and Budgetary Accounting

Superfund

Congress adopts an annual appropriation amount to be available until expended for the Superfund Trust Fund. A transfer account for the Superfund 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 Trust Fund at Treasury to cover the amounts being disbursed.

All Other Funds

Congress adopts an annual appropriation amount for the LUST Trust Fund and for the Oil Spill Response Trust Fund to remain available until expended. A transfer account for the 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 LUST Trust Fund at Treasury to cover the amounts being disbursed. The Agency draws down all the appropriated monies from the Treasury's Oil Spill Liability trust fund to the Oil Spill Response Trust Fund when Congress adopts the appropriation amount. Congress adopts an annual appropriation for STAG, Buildings and Facilities, and for Payments to the Hazardous Substance Superfund to be available until expended; adopts annual appropriations for S&T, EPM and for the Office of the Inspector General to be available for two 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 by a combination from two sources: one for the long term costs of the loans and another for the remaining non-subsidized portion of the loans. Congress adapted a one 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 was financed under a permanent indefinite borrowing authority established with the Treasury. A permanent indefinite appropriation is available to finance the costs of subsidy re-estimates that occur after the year in which the loan was disbursed. In FY 2000, subsidy increases totaled $3,580 thousand which became an indefinite appropriation in FY 2001. In FY 2001, subsidy increases equaled $272 thousand for loans disbursed from FY 1992 authority. The increases in subsidy will be appropriated in FY 2002. Also in FY 2001, subsidy decreases totaled $1,313 thousand for loans disbursed from FY 1993 authority; the decreases in subsidy will be deposited with Treasury in FY 2002.

Funding of the FIFRA and the Tolerance Revolving 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 collected to offset costs incurred for providing the Agency administrative support for computer support and postage.

Funds transferred from other Federal agencies are funded by a non expenditure 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, Deposit accounts, and Receipt accounts receive no budget. The amounts are recorded to the Clearing and Deposit accounts pending further disposition. Amounts recorded to the

Receipt accounts capture amounts receivable to or collected for the General Fund of the U.S. Treasury.

D. Basis of Accounting

Superfund and All Other Funds

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. All interfund balances and transactions have been eliminated.

E. Revenues and Other Financing Sources

Superfund

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 under Inter-Agency Agreements (IAGs), state cost share payments under Superfund State Contracts (SSCs), and settlement proceeds from Potentially Responsible Parties (PRPs), under CERCLA Section 122(b)(3), placed in special accounts. Special accounts were previously limited to settlement amounts for future costs; however, beginning in FY 2000, 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 special accounts, continue to be deposited in the Superfund Trust Fund.

All Other Funds

The majority of All Other Funds appropriations receive funding needed to support programs through appropriations, which may be used, within statutory limits, for operating and capital expenditures. Under Credit Reform provisions, the Asbestos Loan Program received funding to support the subsidy cost of loans through appropriations which may be used with statutory limits. The Asbestos Direct Loan Financing fund, an off-budget fund, receives additional funding to support the outstanding loans through collections from the Program fund for the subsidized portion of the loan. The last year Congress provided appropriations to make new loans was 1993. The FIFRA and the Tolerance Revolving Funds receive funding, which is now deposited with the FIFRA Revolving Fund, through fees collected for services provided. The FIFRA Revolving Fund also receives 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 on Consolidation. The Exxon Valdez Settlement Fund received funding through reimbursements.

Appropriations are recognized as Other Financing Sources when earned, i.e., 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

Superfund and All Other Funds

The Agency does not maintain cash in commercial bank accounts. Cash receipts and disbursements are handled by Treasury. The funds maintained with Treasury are Appropriated Funds, Revolving Funds and Trust Funds. These funds have balances available to pay current liabilities and finance authorized purchase commitments.

G. Investments in U.S. Government Securities

All Other Funds

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.

H. Marketable Equity Securities

Superfund

During FY 1993 and FY 1996, the Agency received marketable equity securities, valued at a total of $5.1 million from a company in settlement of Superfund cost recovery actions, which were sold during FY 2001. 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.

I. Notes Receivable

Superfund

In FY 2001, the Agency received a note receivable valued at $8.1 million, from a company in settlement of Superfund cost recovery actions. The Agency records notes receivable at their face value and any accrued interest as of the date of receipt.

J. Accounts Receivable and Interest Receivable

Superfund

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) as amended by the Superfund Amendments and Reauthorization Act (SARA) provides for the recovery of costs from potentially responsible parties (PRPs). However, cost recovery expenditures are expensed when incurred since there is no assurance that these funds will be recovered.

It is the Agency's policy to record 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 Superfund State Contracts (SSCs), cost sharing arrangements under SSCs 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% or 50% of site remedial action costs. States may pay the full amount of their share in advance, or incrementally throughout the remedial action process. Allowances for uncollectible state cost share receivables have not been recorded, because the Agency has not had collection problems with these agreements.

All Other Funds

The majority of receivables for All Other Funds represent interest receivable for Asbestos and FIFRA and both accounts receivable and interest receivable to the General Fund of the Treasury.

K. Loans Receivable

All Other Funds

Loans are accounted for as receivables after funds have been disbursed. The amount of Asbestos Loan Program loans obligated but not disbursed is disclosed in Note 6. 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.

L. Appropriated Amounts Held by Treasury

Superfund and All Other Funds

For the Superfund and LUST Trust Funds, and for amounts appropriated to the Office of Inspector General from the Superfund and LUST Trust Funds, cash available to the Agency that is not needed immediately for current disbursements remains in the respective Trust Funds managed by Treasury. At the end of FY 2001, approximately $2.8 billion remained in the Treasury managed Superfund Trust Fund and approximately $83.5 million remained in the LUST Trust Fund to meet the Agency's disbursement needs. During FY 2000, the funds' balances were $2.7 billion and $86.2 million, respectively.

M. Advances and Prepayments

Superfund and All Other Funds

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.

N. Property, Plant, and Equipment

Superfund and All Other Funds

The Fixed Assets Subsystem (FAS), implemented in FY 1997, maintains EPA-held personal, real property, and capital software records in accordance with Statement of Federal Financial Accounting Standards Number Six, "Accounting for Property, Plant and Equipment,"(SFFAS No. 6). The FAS automatically generates depreciation entries monthly based on acquisition dates. Purchases of EPA-held and contractor-held personal property are capitalized if it is valued at $25 thousand or more and has an estimated useful life of at least two years. Prior to implementing FAS, depreciation was taken on a modified straight-line basis over a period of six years depreciating 10% the first and sixth year, and 20% in years two through five. This modified straight-line method is still used for contractor-held property. All EPA-held personal property purchased before the implementation of FAS was assumed to have an estimated useful life of five years. New acquisitions of EPA-held personal property are depreciated using the straight-line method over the specific assets with useful lives, ranging from two to 15 years.

In FY1997, EPA implemented requirements to capitalize software if the purchase price was $100,000 or more with an estimated useful life of two years or more for the Working Capital Fund, which is a revenue generating activity. In FY 2001, the Agency began capitalizing software for All Other Funds whose acquisition value is $500,000 or more in accordance with the provisions of SFFAS No. 10, "Accounting for Internal Use Software.". Software is depreciated using the straight-line method over the specific assets' useful lives ranging from two to 10 years.

Real property consists of land, buildings, and capital and leasehold improvements. Real property, other than land, is capitalized when the value is $75 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 are valued at actual costs. Depreciation for real property is calculated using the straight-line method over the specific assets' useful lives, ranging from 10 to 102 years. Leasehold improvements are amortized over the lesser of their useful lives or the unexpired lease terms. Additions to property and improvements not meeting the capitalization criteria, expenditures for minor alterations, and repairs and maintenance are expensed as incurred.

O. Liabilities

Superfund and All Other Funds

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 collection of revenue for services provided. 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

All Other Funds

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

All Other Funds

The Asbestos Loan Program makes periodic interest payments to Treasury based on its debt to Treasury. At the end of FY 2001 and FY 2000, there was no outstanding interest payable to Treasury since payment was made through September 30.

R. Accrued Unfunded Annual Leave

Superfund and All Other Funds

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 the Statement of Financial Position as a component of "Other Liabilities-Governmental." As of September 30, 2001, the unfunded leave liability for the Superfund Trust Fund was $20.4 million, and for All Other Funds, it was $98.2 million. During FY 2000, these liabilities were $19.6 million for the Superfund Trust Fund and $93.2 million for All Other Funds.

S. Retirement Plan

Superfund and All Other Funds

Agency employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). From October 1, 2000 to the pay period beginning prior to January 1, 2001, employees contributed 7.4% and 1.2% to CSRS and FERS, respectively. The employee contribution rates were rolled back as of January 1, 2001 to 7% and .8%, respectively. The Agency contributed 8.51% to CSRS employees' and 10.7% for FERS employees' retirement plans.

On January 1, 1987, the 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 were allowed to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to the Agency employees which automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For most employees hired after December 31, 1983, the Agency also contributes the employer's matching share for Social Security.

With the issuance of "Accounting for Liabilities of the Federal Government" (SFFAS-5), which was effective for the FY 1997 financial statements, accounting and reporting standards were established for liabilities relating to the Federal employee benefit programs (Retirement, Health Benefits and Life Insurance). SFFAS-5 requires that employing agencies recognize the cost of pensions and other retirement benefits during their employees' active years of service. SFFAS-5 requires that the Office of Personnel Management, as administrator of the Civil Service Retirement and Federal Employees Retirement Systems, the Federal Employees Health Benefits Program, and the Federal Employees Group Life Insurance Program, provide EPA with the 'Cost Factors' to compute EPA's liability for each program.

Note 2. Fund Balances with Treasury

Fund Balances with Treasury as of September 30, 2001 and 2000, consist of the following (in thousands):

	FY 2001			FY 2000		
	Entity Assets	**Non-Entity Assets**	**Total**	**Entity Assets**	**Non-Entity Assets**	**Total**
Trust Funds:						
Superfund	$ 6,706	$ 0	$ 6,706	$ 37,397	$ 0	$ 37,397
LUST	18,158	0	18,158	1,300	0	1,300
Oil Spill	3,165	0	3,165	3,106	0	3,106
Revolving Funds:						
FIFRA	3,465	0	3,465	5,442	0	5,442
Tolerance	31	0	31	22	0	22
Working Capital	51,267	0	51,267	52,509	0	52,509
Appropriated	11,088,824	0	11,088,824	10,913,471	0	10,913,471
Other Fund Types	88,218	19,246	107,464	76,338	7,068	83,406
Total	$ 11,259,834	$ 19,246	$ 11,279,080	11,089,585	$ 7,068	$ 11,096,653

Entity fund balances include balances that are available to pay current liabilities and to finance authorized purchase commitments. Also, Entity Assets, Other Fund Types consist of the Environmental Services Receipt account. The Environmental Services Receipt account is a special fund receipt account. Upon Congress appropriating the funds, EPA will use the receipts in the Science and Technology appropriation and the Environmental Programs and Management appropriation.

The non-entity Other Fund Type consist of clearing accounts and deposit funds. These funds are awaiting documentation for the determination of proper accounting disposition.

Note 3. Cash

In All Others, as of September 30, 2000, Cash consisted of imprest funds totaling $48 thousand. All imprest funds were closed out in fiscal year 2001.

Note 4. Investments

As of September 30, 2001 and 2000, investments consisted of the following:

		Cost	Unamortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value
Superfund						
Intragovernmental Securities:						
Non-Marketable	FY 2001	$ 3,630,186	$ (33,967)	$ 59,891	$ 3,724,044	$ 3,724,044
	FY 2000	$ 4,126,450	$ 166,180	$ 43	$ 3,960,313	$ 3,960,313
All Others						
Intragovernmental Securities:						
Non-Marketable	FY 2001	$ 1,703,909	$ (52,551)	$ 22,358	$ 1,778,818	$ 1,778,818
	FY 2000	$ 1,669,665	$ 76,334	$ 26	$ 1,593,357	$ 1,593,357

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 these securities to cash as soon as practicable.

Note 5. Accounts Receivable

The Accounts Receivable for September 30, 2001 and 2000, consist of the following:

	FY 2001		FY 2000	
	Superfund	All Others	Superfund	All Others
Intragovernmental Assets:				
Accounts & Interest Receivable	$ 31,178	$ 69,977	$ 40,671	$ 80,824
Total	**$ 31,178**	**$ 69,977**	**$ 40,671**	**$ 80,824**
Non-Federal Assets:				
Unbilled Accounts Receivable	$ 86,470	$ 1,668	$ 88,209	$ 0
Accounts & Interest Receivable	949,566	133,787	883,938	155,581
Less: Allowance for Uncollectibles	(569,998)	(60,428)	(355,108)	(67,686)
Total	**$ 466,038**	**$ 75,027**	**$ 617,039**	**$ 87,895**

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

During FY 2001, an analysis of unbilled Federal accounts receivable revealed that approximately $10 million of receivables could not be substantiated as valid reimbursements receivable from specific Federal agencies. The net receivables were reduced by that amount. Of the total reductions, $2.8 million affected Superfund receivables, $3.6 million affected expired All Other Funds, and $3.6 million were charged against All Other Funds canceled as of September 30, 2001.

In addition, a non-Federal debtor owing $239 million in Superfund receivables declared bankruptcy. That amount was therefore added to the allowance for uncollectibles for non-Federal receivables in FY 2001.

Note 6. Other Assets

Other Assets for September 30, 2001, consist of the following:

	Superfund Trust Fund	All Others	Combined Totals	Intra-agency Eliminations	Consolidated Totals
Intragovernmental Assets:					
Advances to Federal Agencies	$ 166	$ 4,265	$ 4,431	$ (384)	$ 4,047
Advances to Working Capital Fund	5,355	0	5,355	(5,355)	0
Advances for Postage	0	121	121	0	121
Total Intragovernmental Assets	**$ 5,521**	**$ 4,386**	**$ 9,907**	**$ (5,739)**	**$ 4,168**
Non-Federal Assets:					
Travel Advances	$ 7	$ (854)	$ (847)	$ 0	$ (847)
Letter of Credit Advances	0	315	315	0	315
Grant Advances	0	1,322	1,322	0	1,322
Other Advances	769	92	861	0	861
Bank Card Payments	1	0	1	0	1
Deposit on Returnable Containers	0	0	0	0	0
Prepaid Rent	0	0	0	0	0
Bankruptcy Settlement*****	8,101	0	8,101	0	8,101
Total Non-Federal Assets	**$ 8,878**	**$ 875**	**$ 9,753**	**$ 0**	**$ 9,753**

*****Bankruptcy Settlement: A promissory note in the amount of $8.1 million was issued to the Superfund in a bankruptcy settlement by Joy Global, Inc. Interest rate is 10.75 per annum with future payment date of April 30, 2006.

Other Assets for September 30, 2000, consist of the following:

	Superfund Trust Fund	All Others	Combined Totals	Intra-agency Eliminations	Consolidated Totals
Intragovernmental Assets:					
Advances to Federal Agencies	$ 15,279	$ 7,409	$ 22,688	$ 0	$ 22,688
Advances to Working Capital Fund	6,510	0	6,510	(6,510)	0
Advances for Postage	0	43	43	0	43
Total Intragovernmental Assets	**$ 21,789**	**$ 7,452**	**$ 29,241**	**$ (6,510)**	**$ 22,731**
Non-Federal Assets:					
Travel Advances	$ (18)	$ (916)	$ (934)	$ 0	$ (934)
Letter of Credit Advances	0	599	599	0	599
Grant Advances	0	1,945	1,945	0	1,945
Other Advances	767	75	842	0	842
Bank Card Payments	1	0	1	0	1
Deposit on Returnable Containers	0	(2)	(2)	0	(2)
Prepaid Rent	0	11	11	0	11
Total Non-Federal Assets	**$ 750**	**$ 1,712**	**$ 2,462**	**$ 0**	**$ 2,462**

Note 7. Loans Receivable, Net - Non-Federal

Asbestos Loan Program loans disbursed from obligations made prior to FY 1992 are net of an allowance 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. The Act 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 present value of loans is the amount of the gross loan receivable less the present value of the subsidy.

An analysis of loans receivable and the nature and amounts of the subsidy and administrative expenses associated entirely with Asbestos Loan Program loans as of September 30, 2001 and 2000, is provided in the following sections.

	FY 2001			FY 2000		
	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	$ 49,683	$ 0	$ 49,683	$ 58,114	$ 0	$ 58,114
Direct Loans Obligated After FY 1991	42,779	(16,910)	25,869	46,909	(15,895)	31,014
Total	**$ 92,462**	**$ (16,910)**	**$ 75,552**	**$ 105,023**	**$ (15,895)**	**$ 89,128**

* 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 Post Credit Reform Loans:

	Interest Differential	Expected Defaults	Fee Offsets	Total
Direct Loan Subsidy Expense - FY 2001	$ 1,227	$ 2,353	$ 0	$ 3,580
Direct Loan Subsidy Expense - FY 2000	$ 2,640	$ 0	$ 0	$ 2,640

Note 8. Inventory and Property Received in Settlement, Net

The Inventory and Related Property at September 30, 2001 and 2000, consisted of the following:

	FY 2001		FY 2000	
	Superfund	**All Others**	**Superfund**	**All Other**
Operating Materials and Supplies Held for Use in Normal Operations	$ 0	$ 253	$ 0	$ 306
Securities Received in Settlement	0	0	5,086	$ 41
Total	$ 0	$ 253	$ 5,086	$ 347

The securities represented assets received during a bankruptcy proceeding, and were all sold in FY2001.

Note 9. General Plant, Property and Equipment

Superfund property, plant and equipment, consists of personal property items held by contractors and the Agency. EPA also has property funded by various other Agency appropriations. The property funded by these appropriations are presented in the aggregate under "All Others" and consists of software; real, EPA-Held and Contractor-Held personal, and capitalized-leased property.

As of September 30, 2001, Plant, Property and Equipment consisted of the following:

	Superfund			All Others		
	Acquisition Value	**Accumulated Depreciation**	**Net Book Value**	**Acquisition Value**	**Accumulated Depreciation**	**Net Book Value**
EPA-Held Equipment	$ 23,832	$ (15,031)	$ 8,801	$ 161,253	$ (105,484)	$ 55,769
Software	559	(5)	554	10,398	(148)	10,250
Contractor-Held Equipment	9,422	(2,262)	7,160	16,752	(7,647)	9,105
Land and Buildings	0	0	0	500,854	(76,951)	423,903
Capital Leases	0	0	0	40,992	(13,126)	27,866
Total	$ 33,813	$ (17,298)	$ 16,515	$ 730,249	$ (203,356)	$ 526,893

As of September 30, 2000, Plant, Property and Equipment consisted of the following:

	Superfund			All Others		
	Acquisition Value	**Accumulated Depreciation**	**Net Book Value**	**Acquisition Value**	**Accumulated Depreciation**	**Net Book Value**
EPA-Held Equipment	$ 24,733	$ (16,313)	$ 8,420	$ 134,893	$ (86,883)	$ 48,010
Software	0	0	0	550	0	550
Contractor-Held Equipment	8,814	(3,653)	5,161	34,103	(27,551)	6,552
Land and Buildings	0	0	0	461,817	(73,430)	388,387
Capital Leases	0	0	0	40,992	(11,463)	29,529
Total	$ 33,547	$ (19,966)	$ 13,581	$ 672,355	$ (199,327)	$ 473,028

Note 10. Debt

The Debt consisted of the following as of September 30, 2001 and 2000:

		FY 2001			FY 2000	
All Others	**Beginning Balance**	**Net Borrowing**	**Ending Balance**	**Beginning Balance**	**Net Borrowing**	**Ending Balance**
Other Debt:						
Debt to Treasury	$ 37,922	$ (6,798)	$ 31,124	$ 37,922	$ 0	$ 37,922
Classification of Debt:						
Intra-governmental Debt			$ 31,124			$ 37,922
Total			$ 31,124			$ 37,922

Note 11. Custodial Liability

Custodial Liability represents the amount of net accounts receivable that, when collected, will be deposited to the General Fund of the Treasury. Included in the custodial liability are amounts for fines and penalties, interest assessments, repayments of loans, and miscellaneous other accounts receivable.

Note 12. Other Liabilities

The Other Liabilities, both intragovernmental and non-Federal, for September 30, 2001 are as follows:

Other Liabilities - Intragovernmental	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Superfund - Current			
Employer Contributions & Payroll Taxes	$ 2,682	0	$ 2,682
Other Advances	1,045	0	1,045
Advances, HRSTF Cashout	15,208	0	15,208
Deferred HRSTF Cashout	947	0	947
Resources Payable to Treasury	0	0	0
Superfund - Non-Current			
Unfunded FECA Liability	0	1,426	1,426
Total Superfund	$ 19,882	$ 1,426	$ 21,308
All Other - Current			
Employer Contributions & Payroll Taxes	$ 11,935	$ 0	$ 11,935
WCF Advances	5,355	0	5,355
Other Advances	2,646	0	2,646
Liability for Deposit Funds	(85)	0	(85)
Resources Payable to Treasury	2	0	2
Subsidy Payable to Treasury	1,313	0	1,313
All Other - Non-Current			
Unfunded FECA Liability	0	6,341	6,341
Total All Other	$ 21,166	$ 6,341	$ 27,507

Other Liabilities - Non-Federal	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Superfund - Current			
Unearned Advances, Non- Federal	$ 27,659	0	27,659
Total Superfund	$ 27,659	$ 0	$ 27,659
All Other - Current			
Unearned Advances, Non- Federal	$ 4,275	$ 0	$ 4,275
Deferred Credits	0	0	0
Liability for Deposit Funds, Non-Federal	19,331	0	19,331
All Other - Non-Current			
Capital Lease Liability	0	36,930	36,930
Total All Other	$ 23,606	$ 36,930	$ 60,536

The Other Liabilities, both intragovernmental and non-Federal, for September 30, 2000, are as follows:

Other Liabilities - Intragovernmental	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Superfund - Current			
Employer Contributions & Payroll Taxes	$ 2,900	$ 0	$ 2,900
Other Advances	1,681	0	1,681
Advances, HRSTF Cashout	2,414	0	2,414
Deferred HRSTF Cashout	437	0	437
Resources Payable to Treasury	61	0	61
Superfund - Non-Current			
Unfunded FECA Liability	0	1,355	1,355
Total Superfund	$ 7,493	$ 1,355	$ 8,848
All Other - Current			
Employer Contributions & Payroll Taxes	$ 12,690	$ 0	$ 12,690
WCF Advances	6,510	0	6,510
Other Advances	3,638	0	3,638
Liability for Deposit Funds	(20)	0	(20)
Resources Payable to Treasury	(33)	0	(33)
All Other - Non-Current			
Unfunded FECA Liability	0	6,064	6,064
Total All Other	$ 22,785	$ 6,064	$ 28,849

Other Liabilities - Non-Federal*	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Superfund - Current			
Unearned Advances, Non- Federal	$ 30,192	$ 0	$ 30,192
Total Superfund	$ 30,192	$ 0	$ 30,192
All Other - Current			
Unearned Advances, Non- Federal	$ 4,729	$ 0	$ 4,729
Deferred Credits			
Liability for Deposit Funds	6,833		6,833
All Other - Non-Current			
Capital Lease Liability		37,585	37,585
Total All Other	$ 11,562	$ 37,585	$ 49,147

***** For FY 2000, the Other Liabilities - non-Federal category included amounts reported separately in FY 2001 as “Payroll and Benefits Payable.” The portion of this note for FY 2000 is re-stated accordingly. See Note 33 for items included in the Other Liabilities, non-Federal category, in FY 2000 statements.

Note 13. Leases

The Capital Leases as of September 30, 2001 and 2000, consist of the following:

Capital Leases, All Other Funds:

Summary of Assets Under Capital Lease:	**FY 2001**	**FY 2000**
Real Property	$ 40,913	$ 40,913
Personal Property	79	79
Total	$ 40,992	$ 40,992
Accumulated Amortization	$ 13,126	$ 11,463

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). EPA has one capital lease for a xerox copier that expires in FY 2002. The real property leases terminate in fiscal years 2010, 2013, and 2025. The charges are expended out of the Environmental Programs and Management (EPM) appropriation. The total future minimum lease payments of the capital leases are listed below.

Future Payments Due:	**All Others**
Fiscal Year	
2002	$ 6,303
2003	6,295
2004	6,295
2005	6,295
2006	6,295
After 5 Years	89,899
Total Future Minimum Lease Payments	121,382
Less: Imputed Interest	(84,461)
Difference in Lease Payments to be corrected FY 2002	9
Net Capital Lease Liability	$ 36,930
Liabilities not Covered by Budgetary Resources (See Note 12)	$ 36,930

Operating Leases:

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

EPA has five direct operating leases for land and buildings housing scientific laboratories and/or computer facilities during FY 2001. Most 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). Two of these operating leases expire in FY 2002. Two others expire in fiscal years 2017 and 2020. Respectively, the fifth lease expired in FY 2001 and is extended on a monthly basis. The charges are expended out of the EPM appropriation. The total minimum future costs of operating leases are listed below.

Fiscal Year	Superfund	All Others	Total Land & Buildings
2002	$ 0	$ 2,102	$ 2,102
2003	0	74	74
2004	0	74	74
2005	0	74	74
2006	0	74	74
Beyond 2006	0	920	920
Total Future Minimum Lease Payments	$ 0	$ 3,318	$ 3,318

Note 14. Pension and Other Actuarial Liabilities

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, 2001 and 2000, consisted of the following:

	FY 2001		FY 2000	
	Superfund	All Other	Superfund	All Other
FECA Actuarial	$ 7,731	$ 31,902	$ 6,637	$ 27,036

The FY 2001 present value of these estimates was calculated using a discount rate of 5.21 percent. The estimated future costs are recorded as an unfunded liability.

Note 15. Cashout Advances and Deferrals, Superfund

Cashouts are funds received by EPA, a state, or another Potentially Responsible Party 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 16. Unexpended Appropriations

As of September 30, 2001 and 2000, the Unexpended Appropriations consisted of the following for All Other Funds:

Unexpended Appropriations:	**FY 2001**	**FY 2000**
Unobligated		
Available	$ 1,635,071	$ 1,518,675
Unavailable	64,930	83,396
Undelivered Orders	8,658,960	8,517,767
Total	$ 10,358,961	$ 10,119,838

Note 17. Amounts Held by Treasury

Amounts Held by Treasury for Future Appropriations consists of amounts held in trusteeship by the U.S. Department of Treasury in the "Hazardous Substance Superfund Trust Fund" (Superfund) and the "Leaking Underground Storage Tank Trust Fund" (LUST).

Superfund (Audited)

Superfund is supported primarily by an environmental tax on corporations, cost recoveries of funds spent to clean up hazardous waste sites, and fines and penalties. Prior to December 31, 1995, the fund was also supported by other taxes on crude and petroleum and on the sale or use of certain chemicals. The authority to assess those taxes and the environmental tax on corporations also expired on December 31, 1995, and has not been renewed by Congress. It is not known if or when such taxes will be reassessed in the future.

The following reflects the Superfund Trust Fund maintained by the U.S. Department of Treasury as of September 30, 2001 and 2000. The amounts contained in these statements have been provided by the Treasury and are audited. Outlays represent amounts received by EPA's Superfund Trust Fund; such funds are eliminated on consolidation with the Superfund Trust Fund maintained by Treasury.

SUPERFUND FY 2001

	EPA	Treasury	Combined
Undistributed Balances			
Available for Investment	$ 0	$ 768	$ 768
Unavailable for Investment	0	0	0
Total Undisbursed Balance	0	768	768
Interest Receivable	0	59,891	59,891
Investments, Net of Discounts	2,837,243	826,910	3,664,153
Total Assets	$ 2,837,243	$ 887,569	$ 3,724,812
Liabilities & Equity			
Debt	$ 0	$ 0	$ 0
Equity	2,837,243	887,569	3,724,812
Total Liability and Equity	$ 2,837,243	$ 887,569	$ 3,724,812
Receipts			
Petroleum-Imported	$ 0	$ 2,471	$ 2,471
Petroleum-Domestic	0	(12)	(12)
Crude and Petroleum	0	0	0
Certain Chemicals	0	32	32
Imported Substances	0	5	5
Corporate Environmental	0	3,861	3,861
Cost Recoveries	0	202,132	202,132
Fines & Penalties	0	2,112	2,112
Total Revenue	0	210,601	210,601
Appropriations Received	0	633,603	633,603
Interest Income	0	220,504	220,504
Total Receipts	0	1,064,708	1,064,708
Outlays			
Transfers to EPA	1,227,360	(1,227,360)	0
Transfers to CDC	0	(74,835)	(74,835)
Total Outlays	1,227,360	(1,302,195)	(74,835)
Net Income	$ 1,227,360	$ (237,487)	$ 989,873

SUPERFUND FY 2000	**EPA**	**Treasury**	**Combined**
Undistributed Balances			
Available for Investment	$ 0	$ 1,986	$ 1,986
Unavailable for Investment	0	0	0
Total Undisbursed Balance	0	1,986	1,986
Interest Receivable	0	43	43
Investments, Net of Discounts	2,770,969	1,189,301	3,960,270
Total Assets	$ 2,770,969	$ 1,191,330	$ 3,962,299
Liabilities & Equity			
Debt	$ 0	$ 0	$ 0
Equity	2,770,969	1,191,330	3,962,299
Total Liability and Equity	$ 2,770,969	$ 1,191,330	$ 3,962,299
Receipts			
Petroleum-Imported	$ 0	$ 176	$ 176
Petroleum-Domestic	0	2	2
Crude and Petroleum	0	(561)	(561)
Certain Chemicals	0	2,166	2,166
Imported Substances	0	606	606
Corporate Environmental	0	2,679	2,679
Cost Recoveries	0	230,508	230,508
Fines & Penalties	0	725	725
Total Revenue	0	236,301	236,301
Appropriations Received	0	700,000	700,000
Interest Income	0	235,740	235,740
Total Receipts	0	1,172,041	1,172,041
Outlays			
Transfers to EPA	1,628,891	(1,628,891)	0
Total Outlays	1,628,891	(1,628,891)	0
Net Income	$ 1,628,891	$ (456,850)	$ 1,172,041

LUST (Audited)

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FY 2001 $40 thousand of the fund's receipts were from cost recoveries. The following represents LUST Trust Fund as maintained by the U.S. Department of Treasury. The amounts contained in these statements have been provided by Treasury and are audited. Outlays represent appropriations received by EPA's LUST Trust Fund; such funds are eliminated on consolidation with the LUST Trust Fund maintained by Treasury.

FISCAL YEAR 2001 LUST

	EPA	Treasury	Combined
Undistributed Balances			
Available for Investment	$ 0	$ 12,211	$ 12,211
Unavailable for Investment	0	0	0
Total Undisbursed Balance	0	12,211	12,211
Taxes Receivable	0	0	0
Interest Receivable	0	22,358	22,358
Investments, Net of Discounts	83,460	1,673,000	1,756,460
Total Assets	$ 83,460	$ 1,707,569	$ 1,791,029
Liabilities & Equity			
Accrued Liabilities	$ 0	$ 0	$ 0
Equity	83,460	1,707,569	1,791,029
Total Liability and Equity	$ 83,460	$ 1,707,569	$ 1,791,029
Receipts			
Highway TF Tax	$ 0	$ 167,408	$ 167,408
Airport TF Tax	0	16,114	16,114
Inland TF Tax	0	582	582
Refund Gasoline Tax	0	(834)	(834)
Refund Diesel Tax	0	(1,584)	(1,584)
Refund Aviation Tax	0	(19)	(19)
Refund Aviation Fuel Tax	0	(123)	(123)
Cost Recovery	0	40	40
Audit Adjustment	0	0	0
Gross Revenue	0	181,584	181,584
Less: Reimbursement to General Fund	0	0	0
Net Revenue	0	181,584	181,584
Interest Income	0	94,802	94,802
Net Receipts	0	276,386	276,386
Outlays			
Transfers to EPA	74,617	(74,617)	0
Total Outlays	74,617	(74,617)	0
Net Income	$ 74,617	$ 201,769	$ 276,386

FISCAL YEAR 2000 LUST

	EPA	Treasury	Combined
Undistributed Balances			
Available for Investment	$ 0	$ (725)	$ (725)
Unavailable for Investment	0	0	0
Total Undisbursed Balance	0	(725)	(725)
Taxes Receivable	0	221	221
Interest Receivable	0	26	26
Investments, Net of Discounts	86,283	1,506,348	1,592,631
Total Assets	$ 86,283	$ 1,505,870	$ 1,592,153
Liabilities & Equity			
Accrued Liabilities	$ 0	$ 2,892	$ 2,892
Equity	86,283	1,502,978	1,589,261
Total Liability and Equity	$ 86,283	$ 1,505,870	$ 1,592,153
Receipts			
Highway TF Tax	$ 0	$ 172,659	$ 172,659
Airport TF Tax	0	16,380	16,380
Inland TF Tax	0	612	612
Audit Adjustment	0	(1,710)	(1,710)
Gross Revenue	0	187,941	187,941
Less: Reimbursement to General Fund	0	(6,625)	(6,625)
Net Revenue	0	181,316	181,316
Interest Income	0	78,956	78,956
Net Receipts	0	260,272	260,272
Outlays			
Transfers to EPA	65,718	(65,718)	0
Total Outlays	65,718	(65,718)	0
Net Income	$ 65,718	$ 194,554	$ 260,272

Note 18. 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 §106(a), EPA issues administrative orders that require parties to clean up contaminated sites. CERCLA §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 §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.

There are currently three CERCLA §106(b) administrative claims and one pending lawsuit. If the claimants are successful, the total losses on the administrative and judicial claims could amount to approximately $25.8 million and $3.8 million, respectively. The Environmental Appeals Board has not yet issued final decisions on the administrative claims; therefore, a definite estimate of the amount of the contingent loss cannot be made. The claimants' chance of success in all three of these outstanding claims overall is characterized as reasonably possible. The claimants' chance of success in the pending lawsuit is also reasonably possible.

All Other

There were no material litigation, asserted or unasserted claims or assessments involving all other appropriated funds of the Agency.

Judgement Fund

In cases that are paid by the U.S. Treasury Judgement 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 judgement is assessed and the Judgement 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 judgement, the liability will be reduced and an imputed financing source recognized. See Interpretation of Federal Financial Accounting Standards No. 2, Accounting for Treasury Judgement Fund Transactions.

As of September 30, 2001, $3.8 million of Superfund related claims and $6.0 million of All Other funds' claims were accrued as contingent liabilities under these criteria. Other contingent liabilities exist under 27 cases of which anticipated amounts for attorney fees alone cannot be estimated or known at this time. These amounts are believed to be less than material.

In addition, EPA is party to certain pending litigation upon which EPA believes it has a reasonable legal position. $25.6 million of Judgement Fund claims in addition to the above accrued amounts are pending.

In the opinion of EPA's management and General Counsel, the ultimate resolution of any legal actions still pending will not materially affect EPA's operations or financial position.

Note 19. Grant Accrual

The EPA has revised the methodology for calculating the accrued grant expense for the Fiscal Year 2001 financial statements using a model based on historical grant payments and a survey of major grantees on billing practices. Average days of accrual at year end for sample grantees were determined from survey results and were used with average daily billings as determined by historical payment data to project the year end accrual for the sample group. The accrual for the sample group was then projected to provide the year end accrual for all grants. For FY 2001, the accrual for Superfund is $16.9 million and the All Other grant accrual is $476.7 million. IN FY 2000, the accrual for Superfund was $43.0 million and the All Other accrual was $507.6 million. In the Statement of Net Cost by Goal, the grant accrual amounts are included in "Not Assigned to Goals."

Note 20. Environmental Cleanup Costs

The EPA has four sites that require clean up stemming from its activities. Costs amounting to $98 thousand for three of these sites will be paid out of the Treasury Judgement Fund. (The $98 thousand represents the lower end of three separate range estimates, of which the maximum of the ranges would total $110 thousand.) EPA estimates cleanup on the one other site will cost approximately $20 thousand. 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.

Accrued Cleanup Cost

The EPA has 14 sites that will require future clean up associated with permanent closure and one site with clean up presently underway. The estimated costs will be approximately $14.5 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 2001 estimate for unfunded cleanup costs decreased by $5.8 million from the FY 2000 estimate. This represents a change of approximately 41 percent due in large part to the funding of cleanup at several Research Triangle Park (RTP) facilities associated with the ongoing consolidation at RTP. Of the $14.5 million in estimated cleanup costs, approximately $9.5 million represents the estimated expense to close the current RTP facility. These costs will be incurred within the next two years. The remaining amount represents the future decontamination and decommissioning costs of EPA's other research facilities. There was a net increase of approximately $4.8 million in funded cleanup costs from FY 2000 to FY 2001. EPA could also be potentially liable for cleanup costs, at a GSA-leased site; however, the amounts are not known.

Note 21. Superfund State Credits

Authorizing statutory language for Superfund and related Federal regulations require States to enter into Superfund State Contracts (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 ten percent cost share for remedial action costs incurred at privately owned or operated sites, and at least fifty 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, 2001, total remaining State credits have been estimated at $10.7 million. The estimated ending credit balance on September 30, 2000 was $12.6 million.

Note 22. Superfund Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, Potentially Responsible Parties (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 Section 111(a)(2) of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980. Under Section 122(b)(1) of CERCLA, as amended by the Superfund Amendments and Reauthorization Act (SARA) of 1986, a PRP 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, 2001, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling $41.1 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 23. Income and Expenses from other Appropriations

The Statement of Net Cost reports program costs that include the full costs of the program outputs and 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 Fiscal Year 2001, EPA had one appropriation which funded a variety of programmatic and non-programmatic activities across the Agency, subject to statutory requirements. The Environmental Programs and Management (EPM) appropriation was created to fund personnel compensation and benefits, travel, procurement, and contract activities.

All of the expenses from EPM were distributed among EPA's two Reporting Entities: Superfund and All Others. 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 net effect of the Statement of Net Costs.

	FY 2001			FY 2000		
	Income From Other Appropriations	**Expenses From Other Appropriations**	**Net Effect**	**Income From Other Appropriations**	**Expenses From Other Appropriations**	**Net Effect**
Superfund	$ 103,654	$ (103,654)	$ 0	$ 31,270	$ (31,270)	$ 0
All Others	(103,654)	103,654	0	(31,270)	31,270	0
Total	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

Note 24. Custodial Non-Exchange Revenues

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 responsible parties' willingness and ability to pay.

	FY2001	FY2000
Fines, Penalties and Other Misc Revenue (EPA)	$ 121,892	$ 86,590
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts		
Accounts Receivable	$ 123,966	$ 154,803
Less: Allowance for Doubtful Accounts	46,186	52,336
Total	$ 77,780	$ 102,467

Note 25. Statement of Budgetary Resources

Reconciliations of budgetary resources, obligations incurred, and outlays, as presented in the audited Statements of Budgetary Resources, to amounts included in the Budget of the United States Government for the years ended September 30, 2001 and 2000, are as follows:

FY 2001	**Budgetary Resources**	**Obligations Incurred**	**Outlays**
Superfund			
Statement of Budgetary Resources	$ 2,284,377	$ 1,570,056	$ 1,199,748
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	(3,650)	13,813	0
Budget of the United States Government	$ 2,280,727	$ 1,583,869	$ 1,199,748
All Other			
Statement of Budgetary Resources	$ 9,343,106	$ 7,431,802	$ 7,015,605
Less: Funds Reported by Other Federal Entities	(26,148)	(25,677)	(25,342)
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	(5,229)	(5,229)	0
Budget of the United States Government	$ 9,311,729	$ 7,400,896	$ 6,990,263

FY 2000	**Budgetary Resources**	**Obligations Incurred**	**Outlays**
Superfund			
Statement of Budgetary Resources	$ 2,151,875	$ 1,701,337	$ 1,526,587
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	(328)	(1,744)	1,000
Budget of the United States Government	$ 2,151,547	$ 1,699,593	$ 1,527,587
All Other			
Statement of Budgetary Resources	$ 8,932,823	$ 7,158,665	$ 6,602,265
Less: Funds Reported by Other Federal Entities	(24,778)	(23,835)	(24,545)
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	66,618	67,907	57
Budget of the United States Government	$ 8,974,663	$ 7,202,737	$ 6,577,777

Note 26. Adjustments

Adjustments for FY 2001and FY 2000 are represented by the following categories:

Superfund	**FY 2001**	**FY 2000**
Recoveries of Prior Year Obligations	$ 196,644	$ 201,660
Less: Cancelled Authority	0	2,288
Total	$ 196,644	$ 199,372

All Others		FY 2001		FY 2000
Recoveries of Prior Year Obligations	$	76,815	$	111,767
Adjustments to Beginning Unobligated Balances		0		615
Less: Payments to Treasury		(6,798)		0
Rescinded Authority		(15,668)		(28,848)
Canceled Authority		(36,254)		(55,687)
Total	$	18,095	$	27,847

Note 27. Unobligated Balances Available

Availability of unobligated balances ae shown comparatively for FY 2001 and FY 2000. The unexpired authority is available to be apportioned by the Office of Management and Budget for new obligations at the beginning of FY 2001. Expired authority is available for upward adjustments of obligations incurred as of the end of the fiscal year.

Superfund		FY 2001		FY 2000
Unexpired Unobligated Balance	$	714,321	$	449,538
Expired Unobligated Balance		0		1,000
Total	$	714,321	$	450,538
All Others				
Unexpired Unobligated Balance	$	1,791,475	$	1,644,998
Expired Unobligated Balance		119,829		129,160
Total	$	1,911,304	$	1,774,158

Note 28. Obligated Balance, Net - End of Period

The following unpaid undelivered orders are included in the Obligated Balance, Net - End of Period for FY 2001 and FY 2000.

Superfund		FY 2001		FY 2000
Undelivered Orders, Unpaid	$	1,915,743	$	2,091,767
All Others				
Undelivered Orders, Unpaid	$	8,787,505	$	8,657,913

Note 29. Statement of Financing

Increases in Unfunded Liabilities relate to changes in unfunded annual leave, environmental liabilities, contingent liabilities and the Federal Employees Compensation Act (FECA) special benefit fund. For Superfund and All Others, the changes are reflected in Financing Sources Yet to Be Provided.

		FY2001		FY2000
Financing Sources Yet to Be Provided				
Superfund	$	829	$	6,980
All Others		8,234		12,262
Total	$	9,063	$	19,242

Note 30. Costs Not Assigned to Goals

FY 2001's Statement of Net Cost by Goal has $(31.5) million in gross costs not assigned to goals. Grant accruals are part of the "Costs Not Assigned to Goals." The FY 2001 amount is comprised of a decrease of $57.0 million to the year-end grant accruals (see Note 19); partially offset by $19.7 million in bad debt expense not assigned to goals, $2.4 million in interest on Treasury borrowing, $3.1 million in undistributed imputed costs, and $0.3 million in miscellaneous expenses.

For FY 2000's Statement of Net Cost by Goal, $145.5 million in gross costs were not assigned to goals. This amount was comprised of a $106.4 million increase to the year-end grant accruals, $15.2 million in unfunded expenses, $19.9 million in depreciation expenses that were not assigned, $3.0 million in bad debt expense, and $1 million in miscellaneous expenses.

Note 31. Transfers-in and out, Statement of Changes in Net Position

The consolidated amounts shown as transfers-in on the Statement of Changes in Net Position are comprised of transfers from other Federal agencies in accordance with applicable legislation. The consolidated amounts shown as transfers-out are nonexpenditure transfers to other Hazardous Substance Superfund allocation agency funds, such as HHS and Labor. Elimination transactions consist of intra-agency transfers between EPA funds.

Note 32. Imputed Financing

In accordance with Statement of Federal Financial Accounting Standard No. 5 (Liabilities of the Federal Government), Federal agencies must recognize the portion of employees' pensions and other retirement benefits to be paid by the Office of Personnel Management (OPM) trust funds. These amounts are recorded as imputed costs and imputed financing for the 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 2001 were $13.4 million and $76.5 million for Superfund and All Other Funds, respectively. For FY 2000, the revised estimates (see Note 34) were $12.5 million and $70.4 million for Superfund and All Other Funds, respectively.

In addition to the pension and retirement benefits described above, in FY 2001 EPA also recorded imputed costs and financing for Treasury Judgement Fund payments on behalf of the agency. Entries are in accordance with the Interpretation of Federal Financial Accounting Standards No. 2, Accounting for Treasury Judgement Fund Transactions. These entries totaled $0.3 million and $1.3 million for Superfund and All Other Funds, respectively.

Note 33. Payroll and Benefits Payable

The amounts that relate to payroll and benefits payable to EPA employees for the years ending September 30, 2001 and 2000 are detailed in the following tables. For FY 2000, these amounts were included with Other Liabilities, non-Federal. The FY 2000 portion of this note has been drawn from the prior year's note on Other Liabilities.

FY 2001 Payroll and Benefits Payables	**Covered by Budgetary Resources**	**Not Covered by Budgetary Resources**	**Total**
Superfund - Current			
Accrued Funded Payroll and Benefits	$ 8,361	$ 0	$ 8,361
Withholdings Payable	5,935	0	5,935
Employer Contributions Payable, non Federal (TSP)	372	0	372
Other Post-employment Benefits Payable	3	0	3
Accrued Unfunded Annual Leave	0	20,440	20,440
Total - Superfund - Current	**$ 14,671**	**$ 20,440**	**$ 35,111**
All Other Funds - Current			
Accrued Funded Payroll and Benefits	$ 37,099	$ 0	$ 37,099
Withholdings Payable	26,410	0	26,410
Employer Contributions Payable, non Federal (TSP)	1,645	0	1,645
Other Post-employment Benefits Payable	33	0	33
Accrued Funded Leave, WCF	320	0	320
Accrued Unfunded Annual Leave	0	98,223	98,223
Total - All Other Funds - Current	**$ 65,507**	**$ 98,223**	**$ 163,730**

FY 2000 Payroll and Benefits Payables		Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
Superfund - Current						
Accrued Funded Payroll and Benefits	$	7,499	$	0	$	7,499
Withholdings Payable		5,777		0		5,777
Other Post-employment Benefits Payable		3		0		3
Accrued Unfunded Annual Leave		0		19,553		19,553
Total - Superfund - Current	$	**13,279**	$	**19,553**	$	**32,832**
All Other Funds-Current						
Accrued Funded Payroll and Benefits	$	32,570	$	0	$	32,570
Withholdings Payable		25,278		0		25,278
Other Post-employment Benefits Payable		44		0		44
Accrued Funded Annual Leave, WCF		320		0		320
Accrued Unfunded Annual Leave		0		93,151		93,151
Total -All Other Funds - Current	$	**58,212**	$	**93,151**	$	**151,363**

Note 34. Restatement of Imputed Costs and Financing for Prior Years

In fiscal years 1998, 1999, and 2000, the imputed costs and financing recognized on EPA's financial statements differed from the calculations stipulated in OPM's Financial Management Letters issued annually. Because these errors resulted in offsetting differences in costs and financing sources, they had no effect on Net Position. However, Intragovernmental Costs on the Statement of Net Cost and Imputed Financing on the Statements of Changes in Net Position and Financing were misstated for those fiscal years. The table below shows the differences in thousands for each fiscal year.

	Imputed Costs and Financing for FY 1998	Imputed Costs and Financing for FY 1999	Imputed Costs and Financing for FY 2000
Superfund:			
Corrected Amounts	$ 12,422	$ 12,851	$ 12,534
Amounts on Statements	30,155	31,437	32,063
Difference	$ (17,733)	$ (18,586)	$ (19,529)
All Other:			
Corrected Amounts	$ 74,970	$ 71,839	$ 70,384
Amounts on Statements	161,853	165,232	168,659
Difference	$ (86,883)	$ (93,393)	$ (98,275)

In accordance with the Statement of Federal Financial Accounting Standard No. 21 (Reporting Corrections of Errors and Changes in Accounting Principles), the amounts for imputed costs and financing are restated in the Statements of Net Cost, the Statement of Changes in Net Position, and the Statement of Financing presented for FY 2000. Since this error has no effect on Net Position, the beginning Net Position does not need to be restated for either FY 2000 or FY 2001. The effect on the applicable lines of FY 2000's statements, in thousands, is presented below:

	Superfund FY 2000 statements	Superfund FY 2000 Restated	Difference	All Other FY 2000 statements	All Other FY 2000 Restated	Difference	Consolidated FY 2000 Total Difference
Statement of Net Cost:							
Costs: Intragovernmental	$ 373,311	$ 353,782	$ 19,529	$ 787,415	$ 689,140	$ 98,275	$117,804
Total Costs	$1,664,045	$1,644,516	$ 19,529	$6,223,482	$6,125,207	$ 98,275	$117,804
Net Cost of Operations	$1,356,845	$1,337,316	$ 19,529	$6,131,604	$6,033,329	$ 98,275	$117,804
Statement of Changes in Net Position:							
Net Cost of Operations	$1,356,845	$1,337,316	$ 19,529	$6,131,604	$6,033,329	$ 98,275	$117,804
Imputed Financing	$ 32,063	$ 12,534	$ 19,529	$ 168,659	$ 70,384	$ 98,275	$117,804
Statement ofFinancing:							
Imputed Financing for Cost Subsidies	$ 32,063	$ 12,534	$ 19,529	$ 168,659	$ 70,384	$ 98,275	$117,804
Net Cost of Operations	$1,356,845	$1,337,316	$ 19,529	$6,131,604	$6,033,329	$ 98,275	$117,804

The amounts reduced (in thousands) on the restated Statement of Net Costs by Goal for FY 2000 are:

	Intragovernmental Costs	Management Cost Allocation	Net Cost of Operations
Clean Air	$ 11,793	$ 1,633	$ 13,426
Clean and Safe Water	18,672	2,245	20,917
Safe Food	4,914	665	5,579
Prevent Pollution	7,862	1,061	8,923
Better Waste management	27,209	4,127	31,336
Global Risks	3,931	481	4,412
Right to Know	5,109	695	5,804
Sound Science	6,879	937	7,816
Credible Deterrent	17,292	2,299	19,591
Effective Management	14,143	(14,143)	0
Total Reduction	$ 117,804	$ 0	$ 117,804

Note 35. Change in Accounting for Trust Funds in FY 2000

During FY 2000, in compliance with Statement of Federal Financial Accounting Standard No. 7 (Accounting for Revenue and Other Financing Sources), the U. S. Standard General Ledger Board issued definitive guidance for trust fund accounting and added new Standard General Ledger accounts to further distinguish trust fund transactions from other funds. As of FY 2000, the EPA implemented these changes for all trust funds. These changes eliminate the use of Unexpended Appropriations and Appropriations Used for trust funds, and indicate the inclusion of only the Cumulative Results of Operations account in Net Position for trust funds.

The changes affected transactions in this manner: In lieu of increases to Unexpended Appropriations, amounts appropriated or transferred to the trust funds are recorded in new accounts as Trust Fund Financing Sources-Transfers In. Amounts transferred out no longer decrease Unexpended Appropriations, but are recorded in new accounts as Trust Fund Financing Sources -Transfers Out. These new accounts are reported on the Statement of Changes in Net Position as Other Financing Sources, and are closed out at year end to Cumulative Results of Operations. Expenditures from trust funds are still reported as expenses or purchases of capital assets and reflected in budgetary expenditures, but are no longer reported as increases to Appropriations Used and decreases to Unexpended Appropriations.

The cumulative effect of these changes on the accounts was to move all balances as of October 1, 1999 in Unexpended Appropriations for trust funds into Cumulative Results of Operations. This cumulative effect is reported on a separate line on the Statement of Changes in Net Position for fiscal year 2000. The decreases to Unexpended Appropriations for trust funds are detailed below:

	Superfund	All Other
Hazardous Substance Superfund No-Year Trust Fund	$ 2,607,783	$ 0
Superfund Annual Funds	49,048	0
Leaking Underground Storage Tank Trust Fund	0	81,830
Oil Spill Response Trust Fund	0	9,690
Miscellaneous Contributed Funds Trust Fund	0	76
Totals	$2,656,831	$91,596

Note 36. Change in Accounting for Cashout Interest, Superfund for FY 2000

Per an agreement dated October 3, 1996 between the Office of Management and Budget (OMB) and the EPA, the EPA is allowed additional budget authority for interest earnings on Cashout (Special Account) collections for Superfund. Prior to FY 2000, the authority for interest earnings had previously been classified as Cashout Advances and Deferrals, Superfund, on the Consolidating Balance Sheet and as Spending Authority from Offsetting Collections on the Combined Statement of Budgetary Resources . In FY 2000, the beginning balance for interest earnings on Special Accounts was reclassified from Cashout Advances and Deferrals, Superfund to Net Position on the Consolidating Balance Sheet for Superfund. The change is consistent with guidance from OMB to treat the interest as permanently appropriated and is consistent with definitive guidance for trust fund accounting issued by the U. S. Standard General Ledger Board. This change is also in compliance with Statement of Federal Financial Accounting Standard No. 7 (Accounting for Revenue and Other Financing Sources).

For FY 2000 and 2001, interest earnings that became available during the fiscal years are recorded in Trust Fund Financing Sources - Transfers In for EPA, and are then eliminated against Treasury's Transfers-Out in the consolidation of the Treasury and EPA funds. Current year's earnings are included as Budget Authority on the Combined Statement of Budgetary Resources for Superfund.

Note 37. Change in Accounting for Expenditure Transfers

In fiscal year 2000, Treasury implemented changes in accounting for expenditure transfers from trust funds to eligible fund symbols. These changes allowed the transfers to be recorded as financing sources rather than unexpended or expended appropriations. In addition, new receivable and payable accounts provided the mechanism to record invested financing sources available to cover expenditures until the actual transfers could be completed at a later date.

In accordance with this change, in FY 2001 EPA established new intra-agency accounts receivable and payable accounts for transfers between Superfund and the IG and Science & Technology funds. For comparative purposes, the FY 2000 Balance Sheet and Statement of Changes in Net Position are restated to show $46.5 million of activity that reflects the cumulative effect of these new accounts. Specifically, the All Others intragovernmental receivables and the Superfund intragovernmental accounts payable were both increased by $46.5 million for FY 2000, with offsetting amounts reported in the respective cumulative results of operations on the Balance Sheet. On the Statement of Changes in Net Position, an accounting change for FY 2000 was reported which restated ending net position for Superfund and All Others for FY 2000. Of this change, $45.2 million represents the beginning balance changes for FY 2000 and $1.3 million was added to All Others transfers-in and Superfund transfers-out to reflect the changes in activity relating solely to FY 2000.

Environmental Protection Agency
Required Supplemental Information
As of September 30, 2001
(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.

Intragovernmental Assets

Intragovernmental amounts represent transactions between all federal departments and agencies and are reported by trading partner (entities that EPA did business with during FY 2001).

EPA confirmed its investment balances with the Bureau of the Public Debt, Department of the Treasury. In addition, EPA sent out requests to trading partners to reconcile and confirm intragovernmental receivables and transfers. Responses or inquiries were received from the Department of Defense, Department of the Interior, Department of Commerce, Department of the Treasury, Nuclear Regulatory Commission and the National Science Foundation.

Trading Partner Code	Agency	Investments		Accounts Receivable		Other	
		Superfund	All Other	Superfund	All Other	Superfund	All Other
04	Government Printing Office	$ 0	$ 0	$ 0	$ 0	$ 56	$ 1,529
11	Executive Office of the President				11		
12	Department of Agriculture			425	97		
13	Department of Commerce			17	96	2	27
14	Department of Interior			13,539	794		
15	Department of Justice			81			
17	Department of the Navy			111	810		
18	U. S. Postal Service			16			122
19	Department of State				154		2,418
20	Department of the Treasury			75	104		
21	Department of the Army			8,806	127		
45	Equal Employment Opportunity Commission				121		
47	General Services Administration			175	36		

Trading Partner Code	Agency	Investments		Accounts Receivable		Other	
		Superfund	All Other	Superfund	All Other	Superfund	All Other
49	National Science Foundation				14		
57	Department of the Air Force			604	110		
58	Federal Emergency Management Agency				957		
61	Consumer Product Safety Commission				1		
64	Tennessee Valley Authority				15		
68	EPA (between Superfund and All Other)				48,128	5,448	291
69	Department of Transportation				8,927		
72	Agency for International Development				1,937		
75	Department of Health and Human Services			245	868		
80	National Aeronautics and Space Administration				39		
86	Department of Housing and Urban Development				149		
89	Department of Energy			85	469		
96	US Army Corps of Engineers			87	4,460		
97	US Department of Defense			6,912	219		
99	Treasury Managed Trust Funds	3,724,044	1,778,818		1,313		
00	Unassigned	0	0	0	21	15	(1)
Total		$3,724,044	$1,778,818	$31,178	$69,977	$5,521	$4,386

Intragovernmental Liabilities

EPA received a few requests for intragovernmental liabilities reconciliation from trading partners. EPA was able to confirm balances with the National Science Foundation (49), the Department of Commerce (13), Tennessee Valley Authority (64), the Office of Personnel Management (24), the Department of the Treasury (20), and the Department of Labor (16).

Trading Partner Code	Agency	Accounts Payable		Accrued Liabilities		Other Liabilities	
		Superfund	All Other	Superfund	All Other	Superfund	All Other
03	Library of Congress	$ 0	$ 0	$ 6	$ 157	$ 0	$ 0
04	Government Printing Office			45	1,146		(6)
11	Executive Office of the President				26		
12	Department of Agriculture			68	1,199	2,085	48
13	Department of Commerce	1,035		699	2,071		140
14	Department of Interior	901		4,611	2,593		81
15	Department of Justice	617		3,418	50	1,067	
16	Department of Labor	2,258		53	43	1,426	6,341
17	Department of the Navy			218	440	102	24
18	United States Postal Service				7	14	
19	Department of State				628		
20	Department of the Treasury			41	226		
21	Department of the Army					3,258	
24	Office of Personnel Management			45	426	1,964	8,742
31	US Nuclear Regulatory Commission				6		20
33	Smithsonian Institution			6	31		
45	EEOC				20		
47	General Services Administration			3,619	17,258	6,875	(87)
49	National Science Foundation			7	241		
56	Central Intelligence Agency				21		
57	Department of the Air Force					2,760	45
58	Federal Emergency Management Agency	15,317		16			
64	Tennessee Valley Authority			1	198		16
68	EPA (between Superfund and All Others)	44,759	512	3,241			5,355
69	Department of Transportation			6,287	141		
73	Small Business Administration				10		

Trading Partner Code	Agency	Accounts Payable		Accrued Liabilities		Other Liabilities	
		Superfund	All Other	Superfund	All Other	Superfund	All Other
75	Department of Health and Human Services	16		12,793	6,639		
80	National Aeronautics and Space Administration				212		
86	Department of Housing and Urban Development				4		1,849
88	National Archives & Records Administration				1		
89	Department of Energy			392	4,537		47
91	Department of Education				4		
95	Independent Agencies			11	8		
96	US Army Corps of Engineers	881	422	21,381	1,287		331
97	Office of the Secretary of Defense	3	125		174	1,044	56
99	Treasury General Fund					690	4,507
00	Unassigned	22	59	770	737	23	(2)
Total		$65,809	$1,118	$57,728	$40,541	$21,308	$27,507

For All Other Funds' remaining intragovernmental liabilities, $31,124 thousand in Debt is assigned to the Department of the Treasury (trading partner Code 20), and $77,778 thousand in Custodial Liability is assigned to the Treasury General Fund (trading partner Code 99).

Intragovernmental Revenues and Costs

EPA's intragovernmental earned revenues are not reported by trading partners because they are below OMB's threshold of $500 million.

	Superfund	All Others
Intragovernmental Earned Revenue	$37,241	$57,444
Associated Costs to generate Above Revenue (Budget Functional Classification 304)	37,241	57,444

Environmental Protection Agency
Required Supplemental Information
Supplemental Statement of Budgetary Resources
As of September 30, 2001
(Dollars in Thousands)

	Unaudited						
	STAG	**Environ-mental Programs & Management**	**Science & Technology**	**FIFRA**	**LUST Trust Fund**	**Miscellaneous All Other**	**Consolidated All Other**
Budgetary Resources:							
Budget Authority	$ 3,649,325	$ 2,091,490	$ 697,000	$ 0	$ 71,795	$ 736,268	$ 7,245,878
Unobligated Balances - Beginning of the Period	1,218,633	270,917	180,150	4,596	4,331	95,531	1,774,158
Net Transfers, Prior Year Balance	0	1,107	0	0	0	(104)	1,003
Spending Authority from Offsetting Collections	29,855	51,154	37,592	15,701	40	169,630	303,972
Adjustments	27,154	(14,349)	844	196	2,290	1,960	18,095
Total Budgetary Resources	$ 4,924,967	$ 2,400,319	$ 915,586	$ 20,493	$ 78,456	$ 1,003,285	$ 9,343,106
Status of Budgetary Resources:							
Obligations Incurred	$ 3,625,653	$ 2,093,381	$ 714,645	$ 18,576	$ 72,236	$ 907,311	$ 7,431,802
Unobligated Balances - Available	1,299,314	214,529	175,274	1,917	6,134	94,307	1,791,475
Unobligated Balances-Not Available	0	92,409	25,667	0	86	1,667	119,829
Total Status of Budgetary Resources	$ 4,924,967	$ 2,400,319	$ 915,586	$ 20,493	$ 78,456	$ 1,003,285	$ 9,343,106
Outlays:							
Obligations Incurred	$ 3,625,653	$ 2,093,381	$ 714,645	$ 18,576	$ 72,236	$ 907,311	$ 7,431,802
Less: Spending Authority from Offsetting Collections and	64,992	70,515	46,657	15,897	2,330	180,395	380,786
Obligated Balance, Net - Beginning of the Period	7,874,156	750,109	500,950	1,544	83,976	78,709	9,289,444
Less: Obligated Balance, Net - End of the Period	7,917,132	783,265	492,591	1,547	83,186	47,134	9,324,855
Total Outlays	$ 3,517,685	$ 1,989,710	$676,347	$ 2,676	$ 70,696	$ 758,491	$ 7,015,605

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Balance Sheet
As of September 30, 2001
(Dollars in Thousands)

ASSETS		**Unaudited**
Intragovernmental:		
Fund Balance With Treasury	$	51,267
Accounts Receivable, Net		20,332
Other		121
Total Intragovernmental		71,720
Inventory and Related Property, Net		14
General Property, Plant and Equipment, Net		14,353
Other		2
Total Assets	$	86,089
LIABILITIES		
Intragovernmental:		
Accrued Liabilities	$	1,987
Advances from Other EPA Funds		37,422
Other		94
Total Intragovernmental		39,503
Accounts Payable		2,746
Accrued Liabilities		13,287
Other		1,845
Total Liabilities	$	57,381
NET POSITION		
Cumulative Results of Operations		28,708
Total Net Position		28,708
Total Liabilities and Net Position	$	86,089

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Net Cost
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Unaudited
COSTS:	
Intragovernmental	$ 15,409
With the Public	104,190
Total Costs	119,599
Less:	
Earned Revenues	(124,819)
Net Cost of Operations	$ (5,220)

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Changes in Net Position
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Unaudited
Net Cost of Operations	$ 5,220
Financing Sources (Other Than Exchange Revenues):	
Imputed Financing	1,704
Transfers-In	0
Transfers-Out	0
Net Results of Operations	$ 6,924
Prior-Period Adjustments	0
Net Change in Cumulative Results of Operations	$ 6,924
Net Position - Beginning of the Period	21,784
Net Position - End of the Period	$ 28,708

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Budgetary Resources
For the Year Ended September 30, 2001
(Dollars in Thousands)

	Unaudited
Budgetary Resources	
Unobligated Balances, Beginning of the Period	$ 21,820
Spending Authority from Offsetting Collections	125,706
Adjustments	2,990
Total Budgetary Resources	$ 150,516
Status of Budgetary Resources	
Obligations Incurred	$ 127,482
Unobligated Balances Available	23,034
Total, Status of Budgetary Resources	$ 150,516
Outlays	
Obligations Incurred	$ 127,482
Less: Spending Authority from Offsetting Collections and Adjustments	(128,696)
Subtotal	(1,214)
Obligated Balance, Net - Beginning of the Period	30,688
Less: Obligated Balance, Net - End of the Period	(28,232)
Total Outlays	$ 1,242

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Financing
For the Year Ended September 30, 2001
(Dollars in Thousands)

Obligations and Nonbudgetary Resources	**Unaudited**
Obligations Incurred	$ 127,482
Less: Spending Authority for Offsetting Collections and Adjustments	
Earned Reimbursements	
Collected	(125,394)
Receivable from Federal Sources	498
Change in Unfilled Orders - (Decreases)/Increases	(810)
Recoveries from Prior Year Obligations	(2,990)
Financing Imputed for Cost Subsidies	1,704
Total Obligations as Adjusted and Nonbudgetary Resources	$ 490
Resources that Do Not Fund Net Cost of Operations	
Change in Amount of Goods, Services and Benefits Ordered but Yet Received or Provided - (Increases)/Decreases	(2,256)
Change in Unfilled Customers Orders, etc. - Increases/(Decreases)	810
Costs Capitalized on the Balance Sheet	
General Plant, Property and Equipment	(9,227)
Purchases of Inventory	32
Total Resources that Do Not Fund Net Costs of Operations	$ (10,641)
Components of Costs of Operations that Do Not Require or Generate Resources	
Depreciation and Amortization	4,396
Loss on Disposition of Assets	124
Total Costs That Do Not Require Resources	4,520
Financing Sources Yet to be Provided	411
Net Costs of Operations	**$ (5,220)**

INVESTMENT IN THE NATION'S RESEARCH AND DEVELOPMENT:

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 both risk assessment and risk management. Science 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 and technologies we need to detect, abate, and avoid environmental problems. Science provides the crucial underpinning for EPA decisions and challenges us to apply the best available science and technical analysis to our environmental problems and to practice more integrated, more efficient, and more effective approaches to reducing environmental risks.

Among the Agency's highest priorities are research programs that address the effects of the environment on children's health, 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 2001, the full cost of the Agency's Research and Development activities totaled almost $646 million. Below is a breakout of the expenses (dollars in thousands):

	FY 1998	FY 1999	FY 2000	FY 2001
Programmatic Expenses	507,828	543,777	541,117	555,794
Allocated Expenses	53,322	58,728	59,523	90,039

INVESTMENT IN THE NATION'S INFRASTRUCTURE:

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

<u>Construction Grants Program</u>: 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. Beyond 1990, EPA shifted the focus of municipal financial assistance from grants to loans that are provided by State Revolving Funds.

State Revolving Funds: The Environmental Protection Agency 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 is also 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 1998	FY 1999	FY 2000	FY 2001
Construction Grants	444,817	414,528	55,766	63,344
Clean Water SRF	1,109,017	925,744	1,564,894	1,548,270
Safe Drinking Water SRF	94,936	387,429	588,116	728,921
Other Infrastructure Grants	138,363	245,606	212,124	282,914
Allocated Expenses	187,649	213,117	266,299	424,999

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, 2001, the Agency possesses the following land and land rights:

Superfund Sites with Easements	
Beginning Balance	25
Additions	4
Withdrawals	0
Ending Balance	29
Superfund Sites with Land Acquired	
Beginning Balance	23
Additions	2
Withdrawals	0

Ending Balance	25

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 1998	FY 1999	FY 2000	FY 2001
Training and Awareness Grants	39,131	46,630	49,265	48,697
Fellowships	11,084	10,239	9,570	11,451
Allocated Expenses	5,273	6,142	6,472	9,744

Appendix II

Agency's Response to Draft Report

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

FEB 12 2002

OFFICE OF THE
CHIEF FINANCIAL OFFICER

MEMORANDUM

SUBJECT: Response to the Draft Audit Report on EPA's Fiscal 2001 and 2000 Financial Statements

FROM: Joseph L. Dillon
Comptroller

TO: Paul C. Curtis
Project Manager
Financial Audit Division

Attached is our response to the Fiscal 2001 and 2000 Financial Statement Draft Audit Report. We appreciate the opportunity to respond to this audit. We also appreciate the OIG's recognition of our improvement in the preparation process of the fiscal 2001 financial statements and of our significant progress in the resolution of prior financial statement audit issues.

If you have any questions concerning our response to the draft audit report findings, please contact Juliette McNeil, Director of the Financial Management Division at 564-4905.

Attachment

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RESPONSE TO DRAFT AUDIT REPORT ON EPA'S FISCAL 2001 AND 2000 FINANCIAL STATEMENTS

REPORTABLE CONDITIONS

1 -- EPA Did Not Implement Accounting for Internal Use Software Standard Timely

***Agency Comments*:**

Comments will be forthcoming after we meet.

2 -- Additional Improvements Needed in EPA's Interagency Agreement Invoice Approval Process

Agency Comments:

The Draft Audit report acknowledged corrective actions that we have underway in response to the OIG's earlier recommendations and did not make new recommendations. Our remaining corrective action is to implement an automated project officer notification system to replace our current manual system. We plan to complete that action by April 30, 2002, which will close out the earlier recommendations.

3 -- Automated Application Processing Controls for Integrated Financial Management System could not be assessed.

***Agency Comments*:**

The Draft Audit stated that the steps EPA is taking indicate that the Agency is moving in a credible fashion towards replacing IFMS. The report did note that "until the new system is in place and [the OIG has] a chance to audit it, [the OIG] cannot assess the adequacy of the automated internal control structure." We appreciate the OIG's recognition of our progress on the IFMS replacement project.

COMPLIANCE WITH LAWS AND LAWS AND REGULATIONS

Substantial Noncompliance with Federal Financial Management Improvement Act

4 -- EPA Did Not Comply with Managerial Cost Accounting Standard

***Agency Comments*:**

As we stated in earlier communications, we believe we are complying with the Managerial Cost Accounting Standards. Currently, we are preparing a response to the points raised in the Inspector General's December 12, 2001, memorandum to the Administrator regarding the impasse over FFMIA compliance. Because the issues stated in the Draft Audit are essentially the same as in your letter to the Administrator, we will address those issues in our response to the December 12 memorandum.

Other Noncompliance Issue with Federal Financial Management Improvement Act

5 -- EPA Continues to Experience Difficulties in Reconciling Intra-Governmental Transactions.

***Agency Comment*:**

The OIG suggested that EPA continue its proactive efforts in reconciling the Agency's intra-governmental transactions to comply with Federal financial reporting requirements. We appreciate the OIG's acknowledgment of our efforts and of our dependency on other agencies' actions to enable us to fully comply.

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

OFFICE OF THE
CHIEF FINANCIAL OFFICER

FEB 25 2002

MEMORANDUM

SUBJECT: Response to the Draft Audit Report on EPA's Fiscal 2001 and 2000 Financial Statements–Finding on Accounting for Internal Use Software

FROM: Joseph L. Dillon
Comptroller

TO: Paul C. Curtis
Project Manager
Financial Audit Division

In our February 12, 2002, response to the Draft Audit Report on EPA's Fiscal 2001 and 2000 Financial statements, we reserved comment on your finding regarding accounting for internal use software until our offices had a further opportunity to discuss that subject. We appreciate the time that you and your staff have taken to work with us to address our concerns.

We are now forwarding our comments, which should be included in the Agency comments section of the audit report and in the Appendix for the Agency's Response to the Draft Report.

Please contact Juliette McNeil, Director, Financial Management Division, at 564-4905, if you have any questions about our response.

Attachment

DRAFT AUDIT REPORT ON EPA'S FISCAL 2001 AND 2000 FINANCIAL STATEMENTS--RESPONSE TO REPORTABLE CONDITION NO. 1 "EPA Did Not Implement Accounting for Internal Use Software Standard Timely"

OCFO acknowledges that SFFAS No. 10 was implemented at the end of the fiscal year. However, by doing so, EPA was able to use the most recent guidance on this subject and develop more accurate and complete costs. For example, EPA was able to: 1) take advantage of "Implementation Guidance on SFFAS No. 10," issued in May 2001; 2) utilize the most recent (late fiscal year 2001) OMB Information Technology Exhibit 53 and Exhibit 300b issuances; and 3) capture actual FY 2001 contracts costs rather than relying solely on end of fiscal year cost estimates provided by system owners.

OCFO undertook a comprehensive review to identify all internal use software subject to the standard. This included briefings and interviews with EPA systems owners, as well as a review of software project plans, purchase requisitions, invoices, and payments. The ensuing amount for capitalized software systems costs of $10.8 million, and the related depreciation, reflect verifiable and compliant software balances. For those systems not capitalized, we determined that the cost either did not meet the $500,000 dollar threshold or did not meet the capitalization criteria established by SFFAS No. 10.

Finally, the OCFO review provided for a consistent application of the requirements of SFFAS No.10 and we are confident that the resultant amounts are accurate and reliable. Our detailed and complete documentation has been provided to your office.

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