



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Audit of EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

Audit Report 2006-1-00015

November 14, 2005



Abbreviations

| | |
|-------|---|
| CFC | Cincinnati Finance Center |
| EPA | Environmental Protection Agency |
| FFMIA | Federal Financial Management Improvement Act |
| FMFIA | Federal Managers' Financial Integrity Act |
| GAO | Government Accountability Office |
| IFMS | Integrated Financial Management System |
| IPAC | Intra-Governmental Payment and Collection |
| OARM | Office of Administration and Resources Management |
| OCFO | Office of the Chief Financial Officer |
| OFM | Office of Financial Management |
| OFS | Office of Financial Services |
| OHR | Office of Human Resources |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| PAR | Personnel Action Request |
| QA | Quality Assurance |
| QAR | Quality Assurance Review |
| RSSI | Required Supplementary Stewardship Information |
| SSC | State Superfund Contract |

Cover photo: Provided by Wanda Whitfield, OIG.
New Orleans Riverwalk, New Orleans, Louisiana.



At a Glance

Catalyst for Improving the Environment

Why We Did This Audit

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

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

Background

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

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

To view the full report, click on the following link:

www.epa.gov/oig/reports/2006/20051114-2006-1-00015.pdf

Audit of EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

EPA Receives Unqualified Opinion

We rendered an unqualified, or clean, opinion on EPA's Consolidated Financial Statements for fiscal 2005 and 2004, meaning that they were fairly presented and free of material misstatement.

Internal Control Reportable Conditions Noted

EPA converted to a new payroll system in fiscal 2005. While EPA was able to resolve many issues arising from the conversion, we noted several reportable conditions. Most significantly, EPA made inappropriate payments to separated (transferred, retired, or resigned) employees and made excess salary payments to current employees. These conditions occurred because EPA's automated controls and manual processes were not effective in identifying and preventing these overpayments, or alerting EPA officials to take corrective actions in a timely manner.

In addition to these conditions, we noted seven other reportable conditions including overstated State Superfund Contract unearned revenue and unbilled Superfund oversight costs, improperly adjusted general ledger accounts, inadequate documentation for adjustments made to entries in EPA's Integrated Financial Management System (IFMS), and uncorrected data that IFMS rejected.

Noncompliance With Laws and Regulations Noted

The Agency still is in noncompliance with laws and regulations relating to implementing the cost accounting standard and reconciling intragovernmental transactions, though we do not consider EPA to be in substantial noncompliance.

Agency Comments and Office of Inspector General Evaluation

In a memorandum received on November 10, 2005, from the Chief Financial Officer, the Agency agreed with the issues raised and stated it has begun to evaluate the best methods to address each issue to achieve a timely resolution.



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

OFFICE OF
INSPECTOR GENERAL

November 14, 2005

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal 2005 and 2004 Consolidated Financial Statements
Report No. 2006-1-00015

FROM: Paul C. Curtis 
Director, Financial Audit (2422T)

TO: Lyons Gray
Chief Financial Officer (2710A)

CC: Luis A. Luna
Assistant Administrator for
Administration and Resources Management (3101A)

Attached is our audit report on the Agency's fiscal 2005 and 2004 consolidated financial statements. Management is presenting the financial statements for fiscal 2005 and 2004 in a consolidated format which is a change from prior years' presentations where the Superfund Trust Fund was presented separately. The Agency continues to make improvements in cost accounting; however, it is still not in full compliance with the managerial cost accounting standard. In our view, the level of compliance does not meet the Office of Management and Budget's definition of substantial noncompliance. 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 EPA position. EPA managers in accordance with established EPA audit resolution procedures will make final determinations on matters in this audit report. Accordingly, the findings described in this audit report are not binding upon EPA in any enforcement proceeding brought by EPA or the Department of Justice. We have no objections to the further release of this report to the public.

In accordance with EPA Manual 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 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) 566-2523, or Melissa Heist, Assistant Inspector General, Office of Audit, at (202) 566-0899.

Attachment

cc: See Appendix III, Report Distribution List

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Inspector General's Report on EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

The Administrator
U.S. Environmental Protection Agency

We have audited the consolidated balance sheets of the U.S. Environmental Protection Agency (EPA, or the Agency) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, net cost by goal, changes in net position, financing and custodial liability, and the combined statement of budgetary resources for the years then ended. These financial statements are the responsibility of EPA's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

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

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

In our opinion, the consolidated financial statements present fairly, including the accompanying notes, in all material respects, the consolidated assets, liabilities, net position, net cost, net cost by goal, changes in net position, reconciliation of net cost to budgetary obligations, custodial activity, and combined budgetary resources of EPA, as of and for the years ended September 30, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

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

We inquired of EPA's management as to its methods for preparing Required Supplementary Stewardship Information (RSSI), Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis, and reviewed this information for consistency with the financial statements. The Supplemental Information includes the unaudited Superfund Trust Fund financial statements for fiscal 2005 and 2004, which are being presented for additional analysis and are not a required part of the basic financial statements. Management has elected to omit certain disclosures required by OMB Circular A-136, *Financial Reporting Requirements*, that accounting principles generally accepted in the United States have determined are necessary. However, our audit was not designed to express an opinion and, accordingly, we do not express an opinion on EPA's RSSI, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis.

We did not identify any material inconsistencies between the information presented in EPA's consolidated financial statements and the information presented in EPA's RSSI, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis. OMB Circular A-136, *Financial Reporting Requirements*, requires agencies to report, as Required Supplementary Information, their intra-governmental assets and liabilities by Federal trading partner. We found that EPA was able to reconcile its records with its trading partners, except for Health and Human Services (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, determining whether internal controls had been placed in operation, assessing control risk, and performing 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. 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 controls related to performance measures presented in *EPA's Fiscal Year 2005 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 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 weaknesses 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 controls 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 nine reportable conditions, as follows:

Payroll Internal Controls

EPA inappropriately made payroll payments to separated (transferred, retired, or resigned) employees. EPA's controls over processing time and attendance records for separated employees were not effective in identifying and preventing overpayments because automated controls were not implemented and manual controls were not followed. In particular, PeoplePlus' automated controls do not allow timekeepers to halt all future payments or limit the number of default payroll payments to separated employees with a single transaction. Manual processes, such as processing personnel action requests and reviewing exception reports, did not effectively alert EPA officials to take corrective actions in a timely manner. As a result of the identified weaknesses, EPA made approximately \$74,000 in payroll payments to separated employees for which the Agency must attempt to recover the funds.

Excess Salary Payments

EPA employees received salary payments in excess of the biweekly maximum earnings limitations prescribed in Federal regulations. Under 5 CFR §550.105, an employee may receive premium pay only to the extent that the payment does not cause the total of his or her basic pay and premium pay for any biweekly pay period to exceed the greater of: the maximum biweekly rate of basic pay for a GS-15 (including any applicable locality-based comparability payment under section 5304 or similar provision of law and any applicable special rate of pay under 5 U.S.C. 5305 or similar provision of law), or the biweekly rate payable for Level V of the Executive Schedule.

State Superfund Contract and Superfund Unbilled Oversight Accruals

We found errors on the third quarter State Superfund Contract calculation spreadsheet and/or the Superfund unbilled oversight spreadsheet in 9 of 10 regions. These errors led to overstating State Superfund Contract unearned revenue by \$31 million and unbilled oversight by \$14 million. Although the Office of the Chief Financial Officer (OCFO) required the regions to certify that they reviewed their accrual calculations, the certification process did not prevent or discover the errors. As a result, EPA could not ensure the accuracy of the unearned revenue and the unbilled oversight accounts.

General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center

EPA's general ledger accounts for accounts receivable and allowance for doubtful accounts were materially misstated because certain regional offices did not properly adjust those accounts when transferring receivables to the Cincinnati Finance Center.

Quality Assurance Reviews

While EPA made several advances to improve the financial management quality assurance (QA) program performed by the regions and finance centers, problems continue in its Quality Assurance Reviews (QARs). We found the QARs performed were limited in scope and less comprehensive than the QA Guide suggests. We also found that the reviews did not adequately document the work performed or other methods used to evaluate internal controls and accounting events. Further, we found that QARs were not performed for all applicable accounting events. As a result, there is limited assurance that the QARs provide a sufficient basis to evaluate and certify the assessment of internal accounting and administrative controls.

Distribution of Budget Clearing Accounts

The fiscal 2005 year-end distribution of amounts recorded in a budget clearing account was overstated. The Agency treated charge backs on collections on certain Interagency Agreements as if they were distributions rather than reductions in receipts.

Documentation of Adjustments to IFMS Entries

EPA made adjustments to entries in the Integrated Financial Management System (IFMS), the Agency's accounting system, without proper and adequate documentation. During our review of collections and receivables recorded in various EPA regions, we found 33 adjustments to entries in IFMS – totaling \$89,446,286 – that were not supported by sufficient documentation, such as schedules of collections or IFMS screen prints. The documentation did not always identify other relevant documents, such as the consent decree, which was the basis for the adjustment. We also found three adjustments – totaling \$47,540,900 – where documentation supporting the change was not easily accessible. EPA staff had documentation to support the adjustment, but did not attach it to the entry or otherwise provide an audit trail to locate the support. These entries also did not contain evidence of an adequate review to ensure the adjustments were reasonable and supported.

Correcting Rejected Transactions

The OCFO did not correct PeoplePlus data that the IFMS rejected during the transfer process in a timely manner. We identified nonprocessed transactions in a suspense file that existed for several pay periods without management action. Federal requirements stipulate that agencies promptly record, classify, and account for transactions to prepare timely accounts and reliable financial reports. Without having the processes in place to reconcile and correct data that failed to transfer from PeoplePlus to IFMS, the financial statements could be misstated.

Contingency Plans for Financial Applications

A review conducted by a contracted public accounting firm noted that contingency plans did not fully comply with EPA or Federal guidelines for several OCFO applications at the Research Triangle Park campus in North Carolina. The firm identified where EPA had not documented: (1) key contingency plan elements, (2) critical hardware and software requirements, and (3) primary and secondary contacts. These weaknesses occurred because of inconsistency in training for relevant contingency planning officials. Incomplete contingency plans could present significant challenges for EPA should an unforeseen event occur, particularly since the organization may believe these systems have sufficiently documented procedures to expedite recovery. Further, without adequate planning, management may not be able to mitigate the negative effects of interrupted operations and determine how long specific operations may be suspended or postponed.

Attachment 1 describes each of the above reportable conditions in more detail, and contains our recommendations on actions that should be taken to correct these conditions. We have reported less significant matters regarding internal controls in the form of position papers during the course of the audit. We will not issue a separate management letter.

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

OMB Bulletin No. 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.

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

For financial statement audit purposes, OMB defines material weaknesses in internal control as 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.

The Agency did not report, and our audit did not detect, any material weaknesses for fiscal 2005.

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. A number of ongoing investigations involving EPA's grantees and contractors could disclose violations of laws and regulations, but a determination about these cases has not been made. In addition, the Agency reported that the approximately 9,000 confidential financial disclosure forms filed by EPA employees by November 1, 2005, will be reviewed by the deputy ethics officials no later than January 23, 2006. Since the Agency has not had time to review such reports and disclose matters that would require further inquiry, resolution, or reporting, we did not perform any tests or additional inquiries about those reports. Had the Agency been able to review the reports and we had been able to perform tests or make additional inquiries, matters may have come to our attention that would require reporting.

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 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 did not disclose any instances where the Agency's financial management systems did not substantially comply with the applicable Federal accounting standard.

As described in Attachment 3, OCFO has redefined its cost accounting outputs and made other improvements. However, during Fiscal Year 2005, the Agency was not in compliance with Statement of Federal Financial Accounting Standards No. 4 that requires EPA to provide full costs per output to management in a timely fashion. Subsequent to completing our audit work, the Agency developed a report to show full costs of its outputs; we will evaluate that report during Fiscal Year 2006.

We identified a FFMIA noncompliance related to reconciliation of intragovernmental transactions. However, this noncompliance does not meet the definition of substantial noncompliance as described in OMB guidance. Attachment 2 provides additional details, as well as recommendations on actions that should be taken on this matter.

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

Prior Audit Coverage

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

- Complying with FFMIA requirements.
- Reconciliation and reporting intragovernmental transactions, assets and liabilities by Federal trading partner.
- Complying with Statement of Federal Financial Accounting Standards No. 4, including accounting for the cost to achieve goals and identifying and allocating indirect costs.
- Interagency Agreement invoice approval process.
- Documenting EPA's IFMS.
- Complying with Federal financial management system security requirements.
- Preparation and reconciliation of Statements of Transactions.
- Documentation and approval of journal and standard vouchers.
- Reconciling Unearned Revenue for State Superfund Contracts.
- Managing Accounts Receivable.
- Recording of Marketable Securities.
- Accounting for Obligations.
- Accounting for Contractor-Held Property.
- Assessing automated application processing controls for IFMS.
- Security Screenings for Non-Federal Personnel.
- Change Control Procedures for IFMS.
- System Certification, Accreditation, and Development for Grant and Inter-Governmental Systems.
- Compliance of financial system security plans.

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

Agency Comments and OIG Evaluation

In a memorandum dated November 10, 2005, OCFO responded to our draft report.

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

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

A handwritten signature in black ink, reading "Paul C. Curtis". The signature is written in a cursive style with a large initial "P" and "C".

Paul C. Curtis
Director, Financial Audit
Office of Inspector General
U.S. Environmental Protection Agency
November 9, 2005

Reportable Conditions

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1 - EPA Should Improve Payroll Internal Controls

EPA inappropriately made payroll payments to separated (transferred, retired, or resigned) employees. Specifically, EPA's controls over processing time and attendance records for separated employees were not effective in identifying and preventing overpayments because automated controls were not implemented and manual controls were not followed. In particular, PeoplePlus' automated controls do not allow timekeepers to halt all future payments or limit the number of default payroll payments to separated employees with a single transaction. In addition, manual processes, such as processing personnel action requests (PAR) and reviewing exception reports, did not effectively alert EPA officials to take corrective actions in a timely manner. As a result of the identified weaknesses, EPA made approximately \$74,000 in payroll payments to separated employees for which the Agency must attempt to recover the funds.

PeoplePlus Automated Controls Need Improvement

Automated controls in PeoplePlus do not allow timekeepers to stop all future payments to separated employees by entering the "DTNPY" code just one time. To prevent PeoplePlus from inappropriately paying separated employees, the system currently requires the timekeeper to re-enter this code every pay period until the human resources department processes the PAR, separating the employee from EPA. The DTNPY code is a time reporting code used for separated employees to tell the system not to pay them. We also found that timekeepers did not consistently enter the code into PeoplePlus each pay period, which contributed to several instances where employees received payroll payments although they separated from EPA.

This problem is compounded by the fact that EPA does not limit the number of payments it makes to separated employees. EPA's management chose to configure the PeoplePlus system to pay employees for working their standard hours (e.g., 80 hours for a full-time employee) by default, even if a timesheet was not submitted (entered and attested to by an employee, timekeeper, or manager) for multiple pay periods. As a result of these two issues, a separated employee could receive payroll payments after leaving EPA for every pay period that the timekeeper does not enter the time reporting code into PeoplePlus until the human resources department processes the PAR.

Processing of Personnel Action Requests Needs Improvement

The time required to process PARs resulted in delays in deactivating separated employees' time and attendance records. The Office of Human Resources (OHR) developed procedures to process personnel actions for term appointments and transferred employees without a PAR and informal procedures to do the same for retiring employees. The procedures allow OHR to initiate the necessary transaction to deactivate separated employees' future time and attendance records. However, the procedures were not implemented across the Agency and not consistently followed where they were implemented. As a result, the manual preparation of the PAR by the EPA office and the OHR processing, in several cases, took from 1 to 3 months to complete. Furthermore, in almost all the cases where the Agency made overpayments to separated employees, the PAR was processed after the employee separated from EPA.

Use of Exception Reports Needs Improvement

EPA offices did not effectively use the PeoplePlus-generated “Missing Time & Attendance” report to identify employees without entered or certified and approved time and attendance records. EPA implemented this standard report in PeoplePlus to provide offices a tool to manage their employees’ time and attendance records. However, offices did not run the reports in a timely manner nor take actions to prevent inappropriate payments. Therefore, in May 2005, the OCFO issued OFM Policy Announcement No. 05-05, *Responsibility of Supervisors to Approve Time and Attendance*, to compensate employees despite missing or unapproved biweekly time and attendance information.

Policy Announcement No. 05-05 states that “employees who fail to enter their time will be paid based upon their standard hours (default hours). Employees who have entered time that was not approved by his/her supervisor will be paid based upon the time reported (mass approval). When employees are paid based upon their default hours or the mass approval process, supervisors should ensure PeoplePlus corrections are made, and then indicate their approval by signing the Time Certification Reports. The Regional Comptroller/Program Management Officer certifies that the appropriate actions were taken by the supervisor and then sends, by fax, the appropriate signed report to the Washington Finance Center before the end of the following pay period.

We examined the Mass Approval Time and Attendance Reports and Default Hours Reports for the pay period ending July 9, 2005. We found that:

- The Washington Finance Center used the mass approval process to complete the PeoplePlus pay calculation for 21 Headquarters and regional offices, but did not receive required mass approval certifications from 10 offices and an 11th submitted the certification late.
- For default hours, employees in 14 Headquarters and regional offices were paid based on their standard hours; however, the required default hours certifications were not received from 9 offices and 2 other offices submitted the certifications late.

We believe the failure of Agency managers to comply with Policy Announcement No. 05-05 is an internal control weakness that could contribute to Agency employees being improperly compensated.

Our review of Default Hours Reports identified other concerns. We found that:

- Separated employees were listed on multiple Default Hours Reports.
- The OCFO also did not generate or provide Default Hours Reports for program offices for seven pay periods during fiscal 2005. Based on a preliminary review, Agency officials estimated that there were 72 instances (totaling approximately \$74,000) where employees were paid after separation from EPA. This approximation is most likely understated because the Agency’s preliminary review excluded seven pay periods from fiscal 2005.

- Offices certified Default Hours Reports that contained separated employees, but did not have the timekeeper correct each employee's time and attendance record to prevent payment or annotate on the report that the employee had left the Agency.

Recommendations

We recommend that the OCFO and the Office of Administration and Resources Management (OARM) work together to:

1. Develop and implement a policy that would hold the supervisors and Regional Comptrollers/Program Management Officers accountable for ensuring that all required procedures associated with the processing of payroll and personnel actions are properly followed in a timely manner.

We recommend that the OCFO have the Director, Office of Financial Services (OFS):

2. Modify PeoplePlus and associated procedures to enable timekeepers to enter the DTNPY code into PeoplePlus one time to stop the system from making any future payments to separated employees.
3. Develop and implement procedures to facilitate identifying separated employees and implement an automated control to limit the number of default payments to these employees.
4. Complete the analysis of default payments for all fiscal 2005 pay periods to determine the number of payroll payments to separated employees and take appropriate action to collect the overpayment.

We recommend that the OARM have the Director, OHR:

5. Reinforce the use of established standard operating procedures to process PARs for separated term appointments and transferred employees, and implement the process across the entire Agency.
6. Formalize and implement the standard operating procedures for processing PARs for retiring employees and implement the process across the entire Agency.
7. Reinforce with Agency Officials that they need to (1) forward written resignation notices to OHR immediately upon receipt, and (2) prepare and forward PARs in a timely manner to prevent overpayments.

Agency Comment and OIG Evaluation

The OCFO and OARM generally concurred with our findings and recommendations. The Agency indicated that it would continue to validate payroll system internal controls, enforce existing procedures, and take further corrective action as needed. However, the Agency's response did not address the need for an automated control. Based on the problems described above, the current procedures have not been effective in identifying and preventing inappropriate payments to separated employees. Therefore, we believe improvement is needed in this area and that the Agency should implement automated controls to limit the potential harm caused by a breakdown in the current manual procedures.

2 - EPA Employees Received Excess Salary Payments

Because the internal controls for EPA's PeoplePlus system did not effectively identify and prevent excess salary payments, Agency employees received salary payments in excess of the biweekly maximum earnings limitations prescribed in Federal regulations. Under 5 CFR §550.105, an employee may receive premium pay only to the extent that the payment does not cause the total of his or her basic pay and premium pay for any biweekly pay period to exceed the greater of:

- 1) The maximum biweekly rate of basic pay for a GS-15 (including any applicable locality-based comparability payment under section 5304 or similar provision of law and any applicable special rate of pay under 5 U.S.C. 5305 or similar provision of law); or
- 2) The biweekly rate payable for Level V of the Executive Schedule.

We examined individual employee gross salary payments for two pay periods. We found 37 employees received salary payments totaling \$14,891 in excess of the biweekly maximum earning limitation for one pay period, and 24 employees received excess salary payments totaling \$5,152 for the other pay period. The Agency has recently advised us that it has developed a manual process for checking for overpayments. However, due to the late receipt of this information, we have not been able to verify the process or its effectiveness.

Recommendations

We recommend that the OCFO:

8. Develop and implement an automated control which would prevent employee salary payments in excess of maximum earnings limitations.
9. Verify that all overpayments have been researched for their cause and amount, and if due back to the Government, receivables established.

Agency Comment and OIG Evaluation

The OCFO agreed with the issues we raised and stated that it is initiating enhancements to broaden the scope of automated controls to replace existing manual controls. It plans to continue to evaluate the results as part of its payroll review process.

3 - Improvement Needed for State Superfund Contract and Superfund Unbilled Oversight Accruals

EPA needs to improve its oversight of State Superfund Contract (SSC) and Superfund unbilled oversight accruals. We found errors on the third quarter SSC calculation spreadsheet and/or the unbilled oversight spreadsheet in 9 of 10 regions. These errors led to overstating SSC unearned revenue by \$31 million and unbilled oversight by \$14 million. Although the OCFO required the regions to certify that they reviewed their accrual calculations, the certification process did not prevent or discover the errors. As a result, EPA could not ensure the accuracy of the unearned revenue and the unbilled oversight accounts.

When EPA assumes the lead for a Superfund site remedial action in a State, the SSC clarifies EPA's and the State's responsibilities to complete the remedial action. EPA records a liability (unearned revenue) when billing a State for its share of the estimated site costs, and recognizes earned revenue when costs are incurred on the site. EPA incurs oversight costs while overseeing cleanup work being performed and paid for by potentially responsible parties at Superfund sites. EPA seeks to recover its oversight costs from the potentially responsible parties in a settlement agreement and recognizes revenue when it bills oversight costs. The unbilled oversight accrual is an asset established to properly match revenues and expenses.

EPA developed a review and certification process as a result of last year's position paper entitled "EPA Needs to Further Improve State Superfund Contracts' Unearned Revenue and Superfund Unbilled Oversight Cost Accruals." However, the number of errors found during the cumulative third quarter spreadsheets indicates that EPA's oversight of the accruals was not effective. For SSC unearned revenue, we found errors in cumulative disbursements, cumulative billings, and formula changes in the SSC calculation. For the unbilled oversight accruals, in addition to missing formulas, we found errors in formulas, cost amounts, billing percentages, and untimely accrual entries. EPA could have detected these errors with an effective review process. EPA needs to reassess its oversight and develop further instruction for preparing and reviewing these accrual calculations.

Recommendations

We recommended that the OCFO have the Director, OFM:

10. Provide more complete instructions and clarification to the regional offices to ensure the regions have an adequate preparation and review process.
11. Supplement the regional review process for SSC and Unbilled Oversight accruals with a centralized review function.

Agency Response and OIG Evaluation

OCFO agreed with the OIG recommendations. OCFO stated that it made considerable progress towards assuring consistency with the SSC and Superfund unbilled oversight accrual issues. OCFO stated it will explore options for centralizing these accrual processes.

4 - Regions Should Make General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center

EPA's general ledger accounts for accounts receivable and allowance for doubtful accounts were materially misstated because certain regional offices did not properly adjust those accounts when transferring receivables to the Cincinnati Finance Center (CFC).

The Agency is in the process of consolidating financial operations into four finance centers. As part of this process, 5 of 10 regions had transferred accounts receivables to CFC by September 30, 2005. During our review of CFC's allowance for doubtful accounts, we noted that a Region had an allowance for doubtful accounts balance of \$130,763,195 even though it did not have a receivables balance. Another Region had erroneously reduced its receivable balance in excess of the balance available, resulting in a negative balance of \$2,914,484. Because of the transfers to CFC, the accounts receivable and allowance balances at those accounting points should have been adjusted to reflect a \$0 balance.

These errors resulted because the regional accounts receivable staff did not properly review the general ledger account balances or perform analytical reviews that would have exposed the discrepancies. We did note that the agency has made the appropriate adjustments to the financial statements to adjust the allowance for doubtful accounts.

The Government Accountability Office's (GAO) *Standards for Internal Controls in the Federal Government*, dated November 1999, identified "control activities" as one of the five standards of internal control. According to GAO, management reviews (analytical reviews) at the functional or activity level are commonly performed internal control activities. *GAO's Internal Control Management and Evaluation Tool*, dated August 2001, identified the following analytical reviews as common control activities: 1) managers at all activity levels review performance reports, analyze trends, and measure results against targets, and 2) both financial and program managers review and compare financial, budgetary, and operational performance to planned or expected results.

Recommendations

We recommended that the OCFO have the Director, OFM:

12. Require quarterly general ledger analytical reviews for finance centers and/or accounting points with receivable balances or activity.
13. Ensure appropriate adjustments are made to general ledger account balances when regional activity is transferred to finance centers.

Agency Comments and OIG Evaluation

The Agency agreed with the audit issues raised. The Agency stated it successfully transferred 5 of 10 regions' accounts receivable functions to one finance center. An account analysis identified several accounting point balances that required adjustments that were subsequently

reflected in the financial statements. As the Agency progresses in moving the accounts receivable functions from the remaining five regions, OCFO agreed to continue to monitor appropriate general ledger accounts.

5 - EPA's Quality Assurance Reviews Need Further Improvement

While EPA made several advances to improve the financial management QA program performed by the regions and finance centers, the Agency must continue to improve its QARs. The OCFO updated the QA Guide in September 2005, increased oversight of the QA program, and provided Federal Managers' Financial Integrity Act training to appropriate personnel. However, we found the QARs performed were limited in scope and less comprehensive than the QA Guide suggests. We also found that the reviews did not adequately document the work performed or other methods used to evaluate internal controls and accounting events. Further, we found that QARs were not performed for all applicable accounting events. As a result, there is limited assurance that the QARs provide a sufficient basis to evaluate and certify the assessment of internal accounting and administrative controls.

EPA's quality assurance program was designed to implement the requirements of the *Federal Managers' Financial Integrity Act of 1982* and OMB Circular No. A-123, *Management Accountability and Control*. EPA's revised QA Guide describes a structured approach to conduct quality assurance reviews and provides a model framework for evaluating and reporting on finance office compliance with internal control standards and relevant accounting principles and standards. In addition, the OCFO's Fiscal Year 2005 Quality Assurance Workplan guidance recommends the regions and finance centers ensure that the QARs test the accounting events as appropriate, and document the rationale for any accounting events not tested.

During our analysis, we found QARs performed in fiscal 2005 that were more limited in scope than what was indicated in the QA Guide. The QA Guide provides specific control objectives and test procedures for each accounting event. For example, for accounts receivable, the QA Guide identifies 8 control objectives and 19 test procedures to evaluate internal controls. However, one accounts receivable QAR addressed only one control objective and test procedure. In another QAR, for property, only 1 control objective and test procedure were addressed, while the QA guide identified 10 objectives and 21 test procedures.

In addition, the QAR work was not adequately documented. The QA Guide states that workpapers should provide written evidence of the work performed, support the validity of conclusions reached, and provide a record of the methodology used. The QAR workpapers we reviewed did not document objectives of the review, the nature and extent of work performed, conclusions reached, and appropriate cross-references to other workpapers. We also noticed that the QAR workpapers we reviewed did not document other methods used to evaluate internal controls and accounting events, such as monthly travel audits.

We found that a regional office performed QARs for only 7 of the 13 applicable accounting events during the last 3 years. The QA Guide requires QARs to be performed for all applicable accounting events at least once every 3 years.

Recommendations

We recommend that the OCFO have the Director, OFM, to continue to improve the QA program by requiring field locations to:

14. Perform more comprehensive QARs that define and address all the control objectives for applicable accounting events.
15. Adequately document the work performed and methods used to evaluate internal controls.
16. Perform a QAR for each applicable accounting event at least once every 3 years.

Agency Comments and OIG Evaluation

The Agency agreed with the audit issues raised. OCFO believes it has made significant progress with the QA program and will conduct a training class in December 2005 for Agency finance personnel.

6 - EPA Could Improve the Distribution of the Budget Clearing Accounts

The fiscal 2005 year-end distribution of amounts recorded in a budget clearing account was overstated. The Agency treated charge backs on collections on certain Interagency Agreements as if they were distributions rather than reductions in receipts.

The Cincinnati Finance Center records all Intra-Governmental Payment and Collection (IPAC) transactions in a budget clearing account pending interagency agreement Project Officer approval/disapproval. Once approved, the payment is removed from the clearing account and recorded in the appropriate account. EPA is required by the U.S. Treasury to reconcile and distribute budget clearing accounts by the end of the fiscal year. EPA has also adopted procedures to allocate costs. EPA's Year End Closing Instructions state "the amounts being recorded, at the end of the fiscal year need to be prorated among applicable appropriations in order to provide a more realistic distribution of charges via IPAC."

At year end, the Cincinnati Finance Center distributed \$37,608,039 from the clearing account to expenditure accounts in various U.S. Treasury funds. Included in the distribution was \$15,334,554 that should have been recorded as cash receipts, but was processed through IPAC as expenditures. As a result, the amounts recorded in expenditure and receivable accounts were overstated, and the amount recorded in the cash receipt account was understated by \$15,334,554.

Recommendations

We recommend the OCFO have the Cincinnati Finance Center:

17. Remove any receipt transactions from the year end distribution of the clearing account.

We recommend the OCFO have OFM's Reporting and Analysis Staff:

18. Record an on-top adjustment to the financial statements to correct the \$15,334,554 error and properly reflect expenditure, receivable, and receipt activity.

Agency Comments and OIG Evaluation

The Agency agreed with the audit issues raised and made the appropriate accounting adjustments to the financial statements.

7 - Documentation of Adjustments to IFMS Entries Needs Improvement

EPA made adjustments to entries in the IFMS, the Agency's accounting system, without proper and adequate documentation. During our review of collections and receivables recorded in various EPA regions, we found 33 adjustments to entries in IFMS – totaling \$89,446,286 – that were not supported by sufficient documentation, such as schedules of collections or IFMS screen prints. The documentation did not always identify other relevant documents, such as the consent decree, which was the basis for the adjustment. We also found three adjustments – totaling \$47,540,900 – where documentation supporting the change was not easily accessible. EPA staff had documentation to support the adjustment, but did not attach it to the entry or otherwise provide an audit trail to locate the support. These entries also did not contain evidence of an adequate review to ensure the adjustments were reasonable and supported.

EPA Comptroller Policy Announcement 93-02 requires “that all financial transactions recorded in the accounting system be supported by adequate source documentation, and that this documentation be easily accessible.” These requirements apply to initial transactions entered into IFMS and to adjustments made to the entries. According to Policy Announcement 93-02:

“‘Adequately documented’ means an independent individual competent in accounting and possessing reasonable knowledge of EPA’s operations should be able to examine the documentation and reach substantially the same conclusions as the persons who made and/or approved the entry.”

“‘Easily accessible’ means the entry should contain sufficient information to identify the supporting documentation, and the documentation should be organized and filed in a manner to facilitate its retrieval.”

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

Lack of adequate supporting documentation may raise questions about the validity and integrity of the financial information contained in IFMS. Failure to require adequate documentation before adjusting entries are input in the Agency's accounting system increases the risk of fraud, waste, and abuse by increasing the possibility that unauthorized or inaccurate information is entered.

Recommendations

We recommend that the OCFO:

19. Require adequate documentation to support all adjustments to entries in IFMS. This documentation should include an adjustment date and justification for the correction, be easily accessible, and reference the original entry.

20. Require all adjustments to entries in IFMS be properly reviewed to ensure the policies are followed.

Agency Comments and OIG Evaluation

The Agency agreed with the audit issues raised.

8 - EPA Needs to Improve Correction of Rejected Transactions

The OCFO did not correct PeoplePlus data that the IFMS rejected during the transfer process. We identified nonprocessed transactions in a suspense file that existed for several pay periods without management action. This occurred because the OCFO had not corrected and cleared PeoplePlus transactions transferred to IFMS in a timely manner. Federal requirements stipulate that agencies promptly record, classify, and account for transactions to prepare timely accounts and reliable financial reports. Without having the processes in place to reconcile and correct data that failed to transfer from PeoplePlus to IFMS, the financial statements could be misstated.

EPA accumulates nonprocessed data in a suspense file during data transfer between the two systems. Our review determined that the OCFO had not timely corrected nonprocessed data for the following group of items in the suspense file:

- Non-processed payroll transactions for 16 EPA employees remained in the suspense file because the employees did not have assigned Fixed Account Numbers in PeoplePlus. Our review indicated that some of the transactions go back as far as pay period 2, which ended October 16, 2004. The total of these transactions is \$177,786 and the OCFO took no action to correct/reprocess the transactions.

Recommendation

We recommend that the OCFO have the Director, OFS:

21. Establish and implement policies and procedures to ensure the identification and timely processing of non-processed/rejected payroll transactions between PeoplePlus and IFMS.

Agency Comment and OIG Evaluation

The Director, OFS, concurred with our recommendation and indicated that the office took action to correct the payroll records for the 16 employees with missing Fixed Account Numbers.

9 - EPA Needs to Improve Contingency Plans for Financial Applications

A review conducted by a contracted public accounting firm noted that contingency plans did not fully comply with EPA or Federal guidelines for several OCFO applications at the Research Triangle Park campus in North Carolina. The firm identified where EPA had not documented: (1) key contingency plan elements, (2) critical hardware and software requirements, and (3) primary and secondary contacts. These weaknesses occurred because of inconsistency in training for relevant contingency planning officials. Incomplete contingency plans can present significant challenges for EPA should an unforeseen event occur, particularly since the organization may believe these systems have sufficiently documented procedures to expedite recovery. Further, without adequate planning, management may not be able to mitigate the negative effects of interrupted operations.

The contracted public accounting firm's review identified the following specific contingency plan weaknesses:

- The Budget Automation System is not referenced in the OCFO's Office of Budget contingency plan. Agency officials did not fully document key contingency elements, such as an emergency telephone list and a listing of vendors, suppliers, and other service providers in the *OCFO Annual Planning and Budget Division Disaster Preparedness and Recovery Guide - Budget Automation System*.
- The PeoplePlus contingency plan does not identify the primary and secondary contacts, although the information is included in the Critical Applications Disaster Recovery Plan. Neither plan specifies which of the two plans takes priority should an outage occur.
- The firm noted inconsistency as to whether an application contingency plan was prepared for applications not subscribing to the National Computer Center Disaster Recovery Service. If a contingency plan was prepared, the level of detail within the plan was not consistent. For example, the Travel Manager +, Financial Data Warehouse, and Bank Card systems do not have separate contingency plans. Although the security plans for these systems address contingency planning, these security plans do not document detailed steps to recover application hardware, software, and telecommunications, nor do the plans identify alternative processing locations for the applications.

Recommendations

We recommend that the OCFO:

22. Have responsible office directors provide training to all application owners on the importance of developing, maintaining, and testing contingency plans in accordance with EPA and Federal guidelines and ensure the plans clearly define necessary recovery steps for each application.

23. Have the Director, Office of Budget, revise the Budget Automation System's contingency plan to contain (a) complete contact information for key personnel, and (b) alternate processing and return to normal operations procedures.
24. Have the Director, OFS, revise the PeoplePlus' contingency plan so it clearly describes whether the PeoplePlus plan or the Critical Applications Disaster Recovery Plan takes precedence during a recovery process.
25. Have the Director, OFM, revise contingency plans for all of their applications not subscribing to the National Computer Center Disaster Recovery Services (e.g., Financial Data Warehouse), in accordance with relevant Federal and EPA criteria and best practices.

Agency Comments and OIG Evaluation

The OCFO concurred with our recommendations and provided details on corrective measures that would address some of the recommendations.

Compliance with Laws and Regulations

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Federal Financial Management Improvement Act Noncompliance Issue ¹

10 - EPA Should Continue Efforts to Reconcile Intragovernmental Transactions 28

¹ We are reporting this noncompliance issue under FFMIA as it directly relates to FFMIA reporting requirements; however, the issue does not meet the OMB criteria for substantial noncompliance under FFMIA.

10 - EPA Should Continue Efforts to Reconcile Intragovernmental Transactions

While EPA improved reconciliations of its intragovernmental transactions during fiscal 2005, the Agency was unable to reconcile a material difference of \$149 million with one Federal agency – the Department of Health and Human Services. Without the proper confirmations from its trading partners, EPA has limited assurance that intragovernmental balances are accurate. EPA had experienced similar occurrences in the past that prohibited it from fully complying with the applicable requirements.

Intragovernmental transactions have been classified by the Government Accountability Office as a Government-wide material weakness due to the lack of standardization in recording and processing intragovernmental activities. To resolve the issue, OMB established standard business rules (Memorandum M-03-01, October 4, 2002) to be used in intragovernmental exchange activities. OMB Circular A-136, *Financial Reporting Requirements*, which was updated August 2005, requires Federal agencies to report intragovernmental assets, liabilities, revenue, and certain reporting entities with their trading partners. This information is to be presented in the financial statements as Required Supplementary Information and should agree with line items reported on the balance sheet.

The U.S. Treasury's *Federal Intragovernmental Transactions Accounting Policies Guide* was updated in July 2005 and provides Government-wide accounting policies for Federal agencies to account for and reconcile intragovernmental transactions. The Guide provides tools (procedures and examples) to facilitate quarterly reconciliation of intragovernmental activities. EPA has taken action to reconcile its intragovernmental activity on a quarterly basis. At yearend, the Agency had one material difference of \$149 million in unreconciled activity with the Department of Health and Human Services.

Recommendation

We recommend that the OCFO:

26. Require OFM to continue its efforts in reconciling the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

Agency Comments and OIG Evaluation

The Agency agreed with the audit issue raised and believes that the unreconciled amount was a result of differing accounting methodologies between agencies. The Agency stated that will continue efforts to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

Status of Prior Audit Report Recommendations

EPA's position is that "audit follow-up is an integral part of good management," and "corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations." The Chief Financial Officer is the Agency Audit Follow-Up Official and is responsible for ensuring that corrective actions are implemented. To resolve long-standing audit recommendations, the Deputy Chief Financial Officer formed an Audit Follow-Up Council in July 2000. The Council reviews the progress on audit findings, discusses approaches to resolving audit issues, and provides coordination and support across OCFO on audit-related matters. Council membership consists of the Deputy Chief Financial Officer, the OCFO Audit Follow-Up Coordinator, and all of the OCFO Office Directors.

The Agency has continued to make substantial progress in completing corrective actions from prior years. These issue areas from prior financial statement audits, with corrective actions in process, are listed in the following table.

| Audit Issue Areas with Corrective Actions in Process |
|--|
| <ul style="list-style-type: none"> <p>• Automated Application Processing Controls for IFMS: EPA has made progress towards replacing IFMS. However, until EPA implements the planned replacement automated accounting system that addresses past issues, we will continue to disclose a reportable condition concerning documentation of the current accounting system and its automated application processing controls.</p> |
| <ul style="list-style-type: none"> <p>• EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel: An audit report issued during fiscal 2004 found that there are still some weaknesses regarding contractor access to IFMS. The Agency's 1999 Remediation Plan is still not completely implemented. The Agency expects to issue policy on security certifications for contractor and grantee personnel in October 2006.</p> |
| <ul style="list-style-type: none"> <p>• EPA Continues Actions to Improve Cost Accounting: Since our last report, EPA has redefined its cost accounting outputs, improved the OCFO's Reporting and Business Intelligence Tool, continued to make progress in its data integration efforts, and has recently developed a report to show the full costs of its outputs. However, because the Agency did not produce reports that show the full costs of its outputs during fiscal 2005, the Agency was still not in full compliance with Statement of Federal Financial Accounting Standards No. 4, <i>Managerial Cost Accounting Concepts and Standards for the Federal Government</i>, although we do not consider the noncompliance to be substantial.</p> |

| Audit Issue Areas with Corrective Actions in Process |
|---|
| <ul style="list-style-type: none"> <p>• Further Improvement Needed for State Superfund Contract and Superfund Unbilled Oversight Accruals: EPA developed a review and certification process as a result of the fiscal 2005 Reportable Condition, but oversight of the accruals was still not effective. Please see Attachment 1 for additional information.</p> |
| <ul style="list-style-type: none"> <p>• EPA Did Not Promptly Record Marketable Securities: The Agency began performing quarterly reconciliations of noncash assets in fiscal 2005 in response to our finding in fiscal 2004. However, we found an instance where marketable securities received from one company in settlement of debts for receivables at one region were not recorded promptly. We made recommendations to the Agency during this year's audit to improve its reconciliation procedures, but have not included it as a Reportable Condition in Attachment 1 because we found only one nonmaterial instance of a problem.</p> |
| <ul style="list-style-type: none"> <p>• EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions: EPA improved reconciliations of its intragovernmental transactions during fiscal 2005; however, the Agency was unable to reconcile a material difference with one Federal agency. Please see Attachment 2 for additional information.</p> |
| <ul style="list-style-type: none"> <p>• Weaknesses in Change Control Procedures for Integrated Financial Management System: EPA has a Plan of Action and Milestones to correct these weaknesses. The Agency reports that a number of actions have been completed, and the remaining actions are targeted for completion by March 31, 2006.</p> |

EPA's Fiscal 2005 and 2004 Consolidated Financial Statements

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**MANAGEMENT'S
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ANALYSIS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

The U.S. Environmental Protection Agency (EPA) and its state and local partners are making great progress in improving air quality; ensuring clean, safe water; and restoring and protecting the land. For example:

- Today, the air is the cleanest it has been in 30 years: total emissions of the six principal air pollutants—lead, ozone, particulate matter, carbon monoxide, sulfur dioxide, and nitrogen dioxide—decreased by more than 48 percent.
- More than 90 percent of the nation's population served by community water systems receives drinking water that meets all health-based standards—up from 79 percent a decade ago.
- Two percent of America's children have blood lead levels above 10 micrograms per deciliter, compared to 90 percent in the 1970s.
- In the last decade, more than 1,000 contaminated sites began cleanup operations, and recycling and composting of municipal solid waste has increased more than ten-fold.
- Industrial releases of 332 chemicals tracked since 1988 are down by nearly 50 percent, a reduction of 1.55 billion pounds.
- Pesticides that pose the greatest risks to human health and the environment have been regulated to meet tough new health standards.

The nation's environment is steadily improving; however, there is more to do and much of it is very complex and costly. This report reviews progress EPA made toward its goals during FY 2005. It fulfills the requirements of the Government Performance and Results Act and other management legislation¹ for reporting on performance and demonstrating results.

EPA's Long-Term Strategic Goals

1. Clean Air and Global Climate Change
2. Clean and Safe Water
3. Land Preservation and Restoration
4. Healthy Communities and Ecosystems
5. Compliance and Environmental Stewardship

To help measure EPA's annual progress, Agency leaders established 84 annual performance goals at the beginning of FY 2005. The chapters that follow describe EPA's progress toward meeting these annual goals. This report also presents a picture of the Agency's financial activities and achievements during the year, because managing taxpayer dollars efficiently and effectively is critical to delivering the greatest results to the American people.

MISSION AND ORGANIZATION

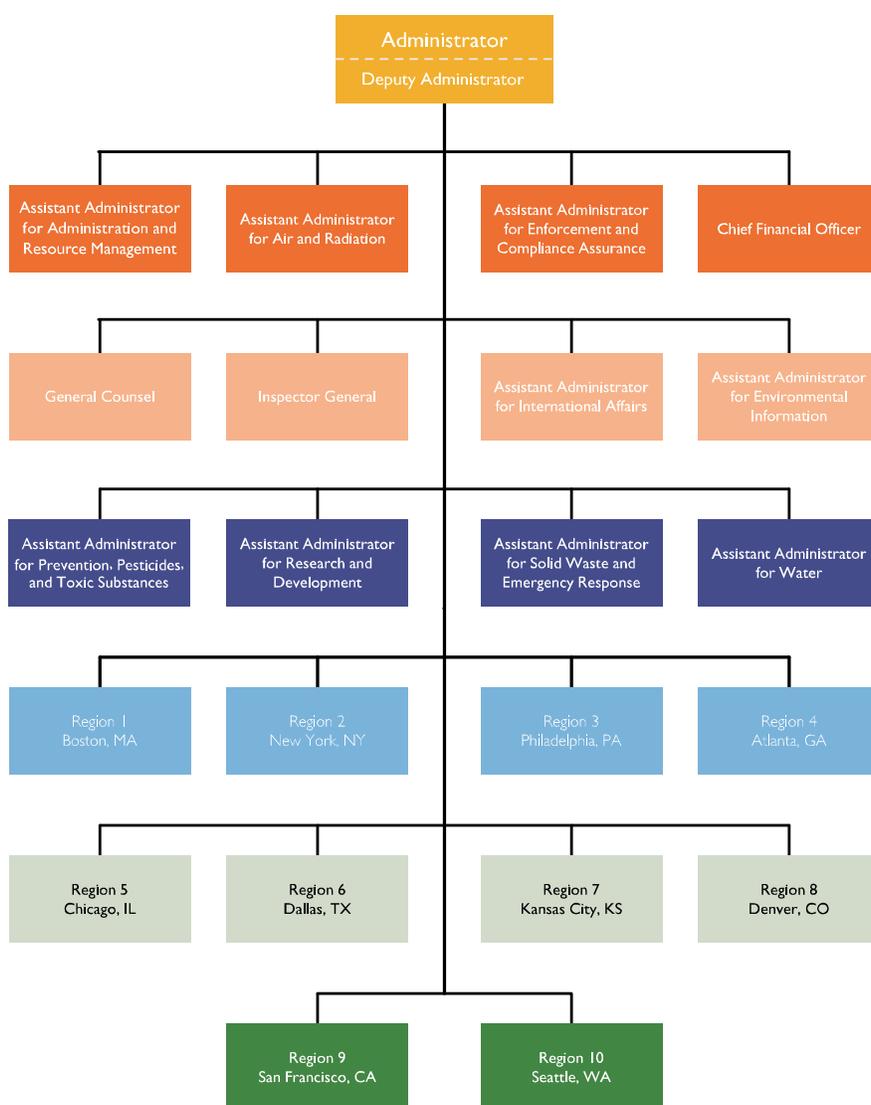
EPA's mission is: "To protect human health and the environment." To achieve its mission, the Agency assesses environmental conditions and works with its partners and stakeholders to identify, understand, and solve current and future environmental problems. EPA develops and enforces regulations that implement environmental laws

to protect America's air, water, and land. It works with the regulated community to provide assistance and incentives for complying with environmental laws.

EPA employs approximately 18,000 people across the country, including its headquarters offices in Washington, DC, 10 regional offices, and more than a dozen laboratories. The Agency's staff is highly educated and technically trained; more than half are engineers, scientists, and policy analysts. In addition, EPA employs legal, public affairs, financial, information management, and computer specialists. EPA Administrator, Stephen L. Johnson, who was appointed by the President of the United States, is the first career scientist to lead the Agency.

U.S. Environmental Protection Agency

The mission of the Environmental Protection Agency is to protect human health and the environment.



EPA Offices

- **Office of the Administrator** - provides overall supervision of the Agency and is responsible directly to the President of the United States.
- **Office of Administration and Resources Management** - manages EPA's human, financial, and physical resources.
- **Office of Air and Radiation** - oversees the air and radiation protection activities, including national programs, technical policies, and regulations.
- **Office of the Chief Financial Officer** - manages and coordinates EPA's planning, budgeting, and accountability processes and provides financial management services.
- **Office of Enforcement & Compliance Assurance** - delivers compliance with U.S. environmental laws and promotes pollution prevention.
- **Office of Environmental Information** - advances the creation, management, and use of information as a strategic resource at EPA.
- **Office of General Counsel** - provides legal service to all organizational elements of the Agency.
- **Office of Inspector General** - conducts audits, evaluations, and investigations of Agency programs and operations.
- **Office of International Affairs** - manages Agency involvement in international policies and programs that cut across Agency offices and regions and acts as the focal point on international environmental matters.
- **Office of Prevention, Pesticides and Toxic Substances** - regulates pesticides and chemicals to protect public health and the environment, and promotes innovative programs to prevent pollution.
- **Office of Research and Development** – meets programs' research and development needs and conducts an integrated research and development program for the Agency.
- **Office of Solid Waste and Emergency Response** - provides policy, guidance, and direction for safely managing waste; preparing for and preventing chemical and oil spills, accidents, and emergencies; and cleaning up and reusing contaminated property. Provides technical assistance to all levels of government to safeguard the air, water, and land from the uncontrolled spread of waste.
- **Office of Water** - develops national programs, technical policies, and regulations relating to drinking water, water quality, ground water, pollution source standards, and the protection of wetlands, marine, and estuarine areas.
- **Research Triangle Park (RTP), North Carolina** - the Agency's center for research on how humans and ecosystems are exposed to various pollutants, the extent of that exposure, and the health and ecological effects which result from such exposure. RTP is also the hub of EPA's air pollution programs under the Clean Air Act and home of the EPA National Computer Center.
- **Regional Offices** - EPA has 10 regional offices, each responsible for several states and territories.

HIGHLIGHTS OF FY 2005 PERFORMANCE

In FY 2005, with resource obligations of \$10.13 billion and 17,486 full-time-equivalent employees, EPA achieved significant results under each of the five long-term environmental goals established in its *2003-2008 Strategic Plan*. This section highlights the Agency's accomplishments and continuing challenges under each of its strategic goals. It also discusses progress under the Agency's homeland security programs and the President's Management Agenda. Detailed performance information is presented in Section II of this report.

Significant Environmental Accomplishments and Challenges

Goal 1: Clean Air and Global Climate Change. In FY 2005, EPA issued the Clean Air Interstate Rule (CAIR), which when fully implemented is expected to dramatically reduce pollution in the eastern United States by cutting power plant emissions of sulfur dioxide by more than 70 percent and nitrogen oxides by more than 60 percent. EPA estimates that CAIR could result in annually preventing approximately 17,000 premature deaths, 1.7 million lost workdays, 500,000 lost school days, 22,000 nonfatal heart attacks, and 12,300 hospital admissions at full implementation in 2015.²

EPA also released a rule designed to reduce mercury emissions from power plants. This rule, known as the Clean Air Mercury Rule (CAMR), is intended to provide a flexible multi-pollutant approach to reducing mercury emissions from power plants. Like CAIR, the CAMR limits emissions by using a market-based, cap and trade program that will permanently cap utility mercury emissions in two phases. The first phase is expected to reduce emissions from 48 tons to 31 tons by 2010, and the second phase is expected to achieve a reduction of

EPA Responds to Hurricanes Katrina and Rita

In August and September of 2005 EPA emergency response personnel partnered with the Federal Emergency Management Agency and state and local agencies to assess damages, test health and environmental conditions, and coordinate cleanup from Hurricanes Katrina and Rita. EPA served as the lead agency for cleaning up hazardous materials, including oil and gasoline. National and regional Emergency Operations Centers were activated 24 hours a day. Additional information about EPA's hurricane response activities can be found at www.epa.gov/katrina/index.html.

- **Environmental Health Needs & Habitability Assessment.** EPA and the Centers for Disease Control and Prevention (CDC) formed a joint task force to advise local and state officials of the potential health and environmental risks associated with returning to the city of New Orleans. The initial Environmental Health Needs & Habitability Assessment was issued September 17, 2005.
- **Air Sampling.** Soon after Hurricane Katrina, EPA began collecting air quality data to assess possible health risks to clean-up workers and inhabitants of New Orleans.
- **Water Sampling.** EPA and local agencies sampled and performed a variety of biological and chemical tests on floodwaters. EPA made the results of these tests available to the public.
- **Fuel Waivers.** EPA issued emergency waivers of certain fuel standards in affected areas to address disruptions to the fuel supply due to refinery and pipeline infrastructure damage in the Gulf Region.
- **Superfund Sites.** EPA's emergency response team conducted initial assessments of the status of Superfund sites in areas affected by Hurricane Katrina. EPA teams are currently conducting more detailed, on-site inspections at these sites.
- **Disposal of Hazardous Waste and Other Debris.** Along with the U.S. Army Corps of Engineers, EPA worked on the disposal of the enormous amounts of hazardous waste and other debris left behind by Hurricane Katrina, establishing several sites for debris collection. During September 2005, the EPA team collected over 50,000 unsecured or abandoned containers of potentially hazardous wastes.

70 percent from current levels. As a result of this action, the United States is now the only country in the world to regulate mercury emissions from coal-burning power plants.³

EPA launched a “Clean Diesel Campaign” in FY 2005 as well. The Clean Diesel Campaign consists of both regulatory and voluntary efforts to reduce emissions from new and existing diesel engines by 2014. Many geographic areas in the country have not met the national standards for particulate matter and/or ozone. The campaign contains components to help those areas reduce emissions of these pollutants from diesel engines used in construction, agriculture and port equipment, waste haulers, locomotives, fire trucks, and ambulances. EPA’s campaign is expected to help reduce the impacts of pollution on populations that are especially susceptible to the effects of diesel exhaust, including children, the elderly, and the chronically ill.

EPA’s CAIR and CAMR rules are critical components of the Agency’s strategy to achieve the greatest reductions in air toxics emissions. The Agency’s Air Toxics Program is also working to address requirements of the Clean Air Act Amendments (e.g., issuance of final standards for 70 stationary area source categories of toxic air pollution). EPA has completed 15 area source standards and is working to develop standards for an additional 25 area source categories, projected for completion in 2008. These 40 standards will address more than 90 percent of the 1990 baseline of toxic air pollutant emissions from area sources. The Agency has been and will continue to monitor progress in this area through its management integrity process, which tracks important management challenges.⁴

In FY 2005, EPA helped owners and managers of office buildings understand and achieve the benefits of good indoor air quality, thereby improving the health and productivity of office workers. The national cost of poor indoor air quality, including lost worker productivity, direct medical costs for those whose health is adversely affected, and damage to equipment and materials, runs to tens of billions of dollars per year.⁵ EPA estimates that approximately 150,000 office workers experienced improved air quality in their workplaces, meeting the Agency’s FY 2005 annual performance goal.

Goal 2: Clean and Safe Water. The importance of safe drinking water supplies for protecting public health has never been more evident than in the aftermath of Hurricane Katrina, which occurred late in FY 2005. In early September, EPA, state and local officials, systems operators, and volunteers worked around the clock to assist more than 895 drinking water systems in repairing their infrastructure and restore sources of safe drinking water for all people in the affected region. In FY 2006, EPA will assess the impact of Hurricane Katrina on the Agency’s progress towards achieving its 2008 drinking water protection goal.

EPA and its state partners attained water quality standards in eight percent of waters previously identified by the states as impaired, exceeding the Agency’s FY 2005 annual performance goal of two percent. Also in 2005, permits implementing effluent guidelines under EPA’s National Pollution Discharge Elimination System prevented the discharge of 26 billion pounds of pollutants, nearly double the amount removed in 2002 before new storm water and Concentrated Animal Feeding Operations regulations as well as new effluent guidelines took effect.

EPA issued the National Coastal Condition Report II (NCCR II) in January 2005.⁶ The second in a series of environmental assessments of U.S. coastal waters and the Great Lakes, the report assesses 100 percent of the nation's estuaries in the contiguous 48 states and Puerto Rico. The NCCR II is based on data gathered by a variety of federal, state, and local sources, including more than 50,000 samples taken between 1997 and 2000 in all continental seacoasts and Puerto Rico. The NCCR II's data for FY 2005 indicate that the overall ecological health of coastal waters improved, meeting the Agency's FY 2005 annual performance goal.

Finally, in addition to improving the quality of drinking and surface water data and information (see Section III of this report for more information on these data improvements), EPA completed data collection for the first wadeable streams assessment. This is the first time a national assessment of ecological conditions in small streams has been conducted using a random sampling, statistically valid approach. States worked with EPA to conduct monitoring using the same methods at each sampling site so that the results can be compared across the country. A report on small stream conditions, scheduled to be released in March 2006, will establish baseline conditions for tracking ecological trends over time in small streams nationwide. EPA intends to follow this report with nationwide assessments of lakes, large rivers, wetlands, and other water types.

Goal 3: Land Preservation and Restoration. In FY 2005, EPA completed the cleanup ("construction completes") of 40 sites on the Superfund National Priorities List (NPL), for a cumulative total of 966 sites—more than 64 percent of the sites on the NPL. At sites with groundwater contamination, migration of contamination was brought under control at an additional 23 sites in FY 2005, for a cumulative total of 898, or 70 percent, of such sites on the NPL.⁷ Among the challenges facing the Agency in FY 2006 is the need to balance limited resources between beginning construction at an increasing number of Superfund projects, and continuing long-term remedial actions at several ongoing, large and complex sites.

Under the Resource Conservation and Recovery Act (RCRA) Program, the Agency met its FY 2005 goal for increasing the number of RCRA hazardous waste management facilities with permits or other approved controls in place, and EPA expects to bring 95 percent of facilities under approved controls by FY 2008. Under the RCRA corrective action program, more than 96 percent of high-priority RCRA hazardous waste facilities have met Agency goals for having controls in place to prevent any human exposures from occurring under current land and groundwater use, and more than 78 percent have met goals for having controls in place to prevent groundwater migration. Under the Agency's Leaking Underground Storage Tank Program, 6,181 cleanups were completed by the end of March 2005.⁸ Data for the end of the year, which were undergoing a quality assurance/quality control check at the time this report was published, indicate that the Agency's state partners completed 14,583 underground storage tank cleanups, meeting the Agency's FY 2005 goal of 14,500.⁹

While recycling has increased in this country in general, recycling of specific materials has grown even more: 42 percent of all paper, 40 percent of all plastic soft drink bottles, 55 percent of all aluminum beer and soft drink cans, 57 percent of all steel

packaging, and 52 percent of all major appliances are now recycled.¹⁰ To achieve national recycling goals, the Agency continued to develop alliances with manufacturers, communities, and governments to: (1) foster a new recycling infrastructure, which will reclaim valuable materials, and (2) address the increasing variety and volume of obsolete electronic products entering the waste stream. Although recycling rates were lower than expected in FY 2003 (the last year for which the Agency has data), EPA expects that these collaborative efforts will encourage higher recycling rates in future years. In FY 2006, EPA will be initiating a challenge to major industries to encourage the “early retirement” of devices containing mercury.

Goal 4: Healthy Communities and Ecosystems. To protect human health and the environment from pesticide use, EPA reassessed risks posed by older chemicals and established new risk mitigation measures where needed. By the end of FY 2005, the Agency had reassessed 80 percent of the 9,721 pesticide tolerance levels requiring reassessment under the Food Quality and Protection Act.¹¹ In addition, EPA registered 14 new reduced risk pesticides, increasing the number of safer alternatives to older, more dangerous pesticides to 143.¹²

EPA identifies and addresses risks posed by chemicals already in commerce through its High Production Volume (HPV) Challenge Program. Under this program, the Agency will complete work by the end of calendar year 2005 to provide the public with critical health and environmental effects data on more than 2,200 chemicals encountered in communities every day. In FY 2005, more than 360 chemical companies and 100 industry consortia volunteered to provide data for 1,397 HPV chemicals directly to EPA, and to provide data for 854 chemicals to the European component of the program – the International Council of Chemical Associations HPV Initiative¹³. Data for 300 of those chemicals will be publicly available by the end of 2005. EPA continues to encourage companies to sponsor additional HPV chemicals, and is obtaining data on un-sponsored “orphan” chemicals by issuing Test Rules under the Toxic Substances Control Act.

In FY 2005, EPA led a collaborative effort to develop guidelines on the potential health effects from various levels of exposure to hazardous chemicals during an accidental spill or a terrorist incident. The Agency partnered with nine federal agencies, numerous state agencies, private industry, academia, emergency medical associations, unions, and other organizations in the private sector as well as international participants on this project. In FY 2005, Acute Exposure Guideline Levels (AEGLs) were proposed for 32 highly hazardous chemicals, bringing the cumulative total to 165 chemicals. These guideline levels are meant to address the millions of pounds of highly toxic chemicals used in industry and routinely stored at fixed sites or shipped over road or rail in single containers of 50,000 to 300,000 pounds or more. AEGL values, including those proposed in 2005, were used in responding to the environmental devastation caused by Hurricane Katrina.

In 2005, the Centers for Disease Control released data demonstrating major reductions in the incidence of childhood lead poisoning—from approximately 900,000 children with elevated blood lead levels in the early 1990s to 310,000 children from 1999 to 2002.¹⁴ To virtually eliminate childhood lead poisoning by 2010, EPA focused its FY 2005 outreach and education efforts on remaining “hot spots,” often

disadvantaged urban areas where the incidence of childhood lead poisoning remains high. In FY 2006, the Agency will be revamping its strategies and expanding its regulatory and voluntary tools to address the remaining population of children at risk for lead poisoning.

EPA continues to make progress on improving and protecting the health of ecosystems in the Great Lakes. The Great Lakes Index, indicating overall ecosystem condition in the Great Lakes, improved in FY 2005. Long-term concentrations of PCBs in predator fish and trends of toxic chemicals in the air are declining faster than targeted. Cumulatively, 3.7 million cubic yards of contaminated sediments have been remediated, including 345,000 cubic yards in 2004. However, phosphorus concentrations in the Lake Erie Basin increased slightly. Although EPA has not met the target of delisting three Areas of Concerns (AOC), significant progress has been made towards delisting of two AOCs for FY 2006.

EPA and its partners also protected and restored 103,959 acres of estuarine habitat within the 28 estuaries of the National Estuary Program in FY 2005. This acreage includes critical estuarine, riparian, and coastal wetlands, which help support many commercially valuable fisheries and the economic, environmental, and aesthetic functions on which coastal populations depend for their livelihood. EPA faces significant challenges in continuing to restore and protect estuaries as more difficult projects remain.

Goal 5: Compliance and Environmental Stewardship. In FY 2005, more than 1.1 billion pounds of pollutants were reduced, treated, or eliminated as a result of Agency enforcement actions. For example, EPA settled a Clean Air Act enforcement case against the Ohio Edison Company that will reduce more than 212,000 tons per year of emissions of harmful sulfur dioxide and nitrogen oxides from several of its plants. The company is required to install pollution controls and carry out other measures expected to cost approximately \$1.1 billion. In addition, three enforcement actions taken in FY 2005 under the Clean Water Act will significantly reduce pollutants entering the Chesapeake Bay. One of the actions was taken with the District of Columbia Water and Sewer Authority and will lead to the elimination of 3.2 billion gallons a year of untreated sewage to the Anacostia and Potomac Rivers and cost the company an estimated \$1.5 billion¹⁵.

In an example of one of the Agency's criminal enforcement actions, criminal prosecution was taken against the owners of AAR Contractors, Inc. for conducting illegal asbestos operations at more than 1,500 sites, including schools, hospitals, and churches, in upstate New York. More than 500 workers were exposed to potentially deadly asbestos-related diseases. The company owners received the two longest jail sentences in environmental crimes history, 25 and 19½ years, along with almost \$23 million in restitution¹⁶.

Finally, EPA has been working to replace the Agency's Permit Compliance System (PCS), which tracks Clean Water Act results for use in permitting, compliance and enforcement programs¹⁷. This project has been a top management challenge for a number of years and the Agency is now close to resolving it. Actions taken include working with states on interim solutions during development of the new system and

adding capabilities to better track pollutant loadings, capture information on storm water sources of pollution, and assess the health of individual watersheds. In September 2005, EPA completed development of the replacement system (ICIS-NPDES) and officially moved into the testing phase. The first states are scheduled to begin accessing the system by March 2006.

Homeland Security

Three years ago EPA assumed significant new responsibilities in homeland security work needed to protect human health and the environment from intentional harm. EPA now plays a lead role in supporting the protection of critical water infrastructure and coordinating development of national capabilities and strategies to address chemical, biological and radiological contamination from a terrorist event. In FY 2005, the Agency conducted the following key work to understand and communicate the potential health effects of exposure to hazardous chemicals during an accidental spill or terrorist incident; to help water systems understand and address their vulnerability to intentional attacks; and, to enhance the nation's decontamination and emergency response capabilities:

EPA's FY 2005 Progress in Homeland Security

- Developed a Web-based system to quickly identify hazards and characterize risks in emergencies.
- Completed vulnerability assessments for nearly all of nation's drinking water systems.
- Worked with other federal agencies to establish a National Decontamination Team and Strategy.
- Trained EPA field responders in detecting, analyzing, and responding to chemical, biological, and radiological agents.
- Established health effects guidelines for 32 highly hazardous chemicals.

- Developing a Web-Based System to Identify Hazards and Characterize Risks in Emergencies: In 2005, EPA began developing a Web-based system to quickly identify hazards, assess exposure to humans, and characterize risks during an emergency response. This Emergency Consequence Assessment Tool (ECAT) will help in preparing for and rapidly responding to terrorist incidents by integrating a variety of relevant information on the hazards and exposures for a specific situation. ECAT will be expanded to include a variety of scenarios and contaminants and will eventually be used to inform the general public and scientific community.
- Protecting Critical Water Infrastructure from Terrorist Acts: EPA continued to assist the nation's drinking water systems in protecting their infrastructure from terrorist and other intentional attacks. By the end of FY 2005, all of the 467 publicly and privately owned drinking water systems serving at least 100,000 people, and 100 percent of the nation's 444 medium-sized drinking water systems (those that serve 50,000 to 99,999 people) had completed vulnerability assessments. Furthermore, approximately 95 percent of the nation's small-sized community drinking water systems that serve populations of 3,301 to 49,999 people had completed vulnerability assessments. The Agency will continue to

work with the small drinking water systems and its partners to ensure 100 percent of these systems have completed vulnerability assessments.

- Enhancing the Nation's Decontamination Capabilities: During FY 2005, EPA worked with other federal agencies, including the Department of Homeland Security, to enhance the nation's decontamination capabilities by establishing a National Decontamination Team and by developing and implementing a National Decontamination Strategy. Additionally, EPA improved capabilities for characterizing chemical components that might be intentionally released during incidents of national significance by standardizing analytical method validation and determining laboratory training requirements.
- Training EPA Field Responders: In 2005, EPA improved the Agency's capability to respond to multiple chemical, biological, and radiological incidents. EPA field responders and National Response System personnel received extensive response-related training: scientific and technical training for detecting, analyzing and responding to chemical, biological, and radiological agents and training in managing incident command system responses.
- Establishing Health Effects Guidelines for Exposure to Hazardous Chemicals: In FY 2005, Acute Exposure Guideline Levels (AEGs) were proposed for 32 highly hazardous chemicals. Some of these guideline levels are critical for responding to terrorist incidents when making decisions on evacuation, shelter-in-place, worker entry, decontamination, protective equipment, and monitoring and detection efforts.

The President's Management Agenda

Since 2001, the President's Management Agenda (PMA) has challenged federal agencies to improve performance, manage for results, and better serve the American people (see www.whitehouse.gov/results). During FY 2005, EPA made progress under each of the seven PMA initiatives: Human Capital, Competitive Sourcing, Expanded E-Government, Improved Financial Performance, Budget and Performance Integration, Eliminating Improper Payments, and Research and Development.

Each quarter, the Office of Management and Budget (OMB) releases an executive scorecard that rates progress and overall status under each of the PMA initiatives using a color-coded "stop-light" system. As of September 2005, the EPA achieved three green scores for progress on implementation and one green score on the status of Improved Financial Performance initiatives. In addition to tracking PMA progress on a quarterly basis, each federal agency establishes yearly goals for where they would be "Proud to Be" on the status of PMA initiative implementation. The Proud to Be milestones and goals are set every July and assessed during the third quarter PMA Scorecard process. More information about the Agency's work under the PMA is available at www.epa.gov/pmaresults.

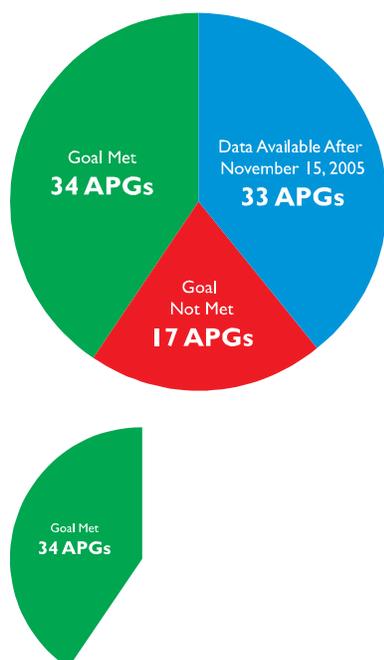
**EPA's FY 2005 Progress Under
The President's Management Agenda
(Scorecard ratings current as of the 4th Quarter of FY 2005)**

| INITIATIVE | STATUS ¹⁸ | PROGRESS | PROUD TO BE II (07/05) RESULTS | HIGHLIGHTS |
|--|---|---|---|--|
| Human Capital |  Yellow |  Yellow | <p>"Yellow" EPA did not meet its goal of "Green" for P2B2</p> <p>EPA has set a goal of "Green" for P2B3</p> | <ul style="list-style-type: none"> In FY 2005, EPA transitioned its employees to a new five-level Performance Appraisal and Recognition System (PARS). During Q4, EPA trained all Agency leaders on the new system, and assessed the system against OPM required elements to identify areas in need of improvement. EPA revised and updated the HC Accountability plan to integrate assessments of office level HC activities and compliance with the Merit System Principles. EPA analyzed the results of the FY 2004 Federal Human Capital Survey and developed and began implementing a plan of action for disseminating results and targeting areas for improvement to leadership Agency-wide. As of the end of the Q4 FY 2005, EPA demonstrated that 100 percent of Agency employees are covered by the PARS. |
| <p>EPA's Challenges in Human Capital -- A cultural change is needed to strengthen EPA executives', managers', and employees' understanding of the connection between personal "on the job" performance and the Agency's ability to meet its strategic environmental goals. Additionally, the Agency must clearly differentiate levels of performance among employees and reward employees appropriately, based on the results they deliver and the way those results contribute the Agency's overall mission.</p> | | | | |
| Competitive Sourcing |  Yellow |  Yellow | <p>"Yellow" EPA met its goal for P2B2</p> <p>EPA has set a goal of "Green" for P2B3</p> | <ul style="list-style-type: none"> The Agency completed six "streamlined" competitions for small activities that covered about 26 Full Time Equivalent (FTE) positions in the areas of information technology and clerical services. The Agency retained the work in all six competitions. EPA also announced an additional seven "streamlined" competitions encompassing the work of about 39 FTE performing information technology services. The Agency completed a standard competition for vendor payments, which involved 26 FTE. As a result, the work will continue to be performed by EPA employees at the Finance Center in NC and achieve about \$3.5 million in savings over the next five years. EPA completed creation of a Competitive Sourcing Plan identifying and scheduling approximately 800 FTE for competition between 2005 and 2008. |
| <p>EPA's Challenges in Competitive Sourcing -- EPA must overcome cultural reluctance to consider competitive sourcing as a means of more efficiently and effectively delivering government services. Once decisions are made to compete a particular organizational function, managers involved in the competitions must be held accountable for timely follow-through on their commitments.</p> | | | | |
| Expanded E-Government |  Yellow |  Yellow | <p>"Green" EPA met its goal of "Green" for P2B2"</p> <p>EPA has set a goal of "Green" for P2B3</p> | <ul style="list-style-type: none"> Cost, schedule and performance for adherence with earned value management for major IT investments are less than 10%. EPA's E-Gov Implementation Plan is approved and accepted. 100% of EPA's IT systems are secure. EPA's IT systems are installed in accordance with security configurations. E-Rulemaking deployed four agencies in the Federal Docket Management System. Late deployment of the fifth agency is the sole reason for the yellow score in progress and status. To date E-Payroll completed scheduled modifications and testing of all necessary interfaces to ensure a migration to the Defense Finance and Accounting Service by March 2006. |
| <p>EPA's Challenges in E-Gov -- Successful performance in Human Capital, Competitive Sourcing, Budget and Performance Integration, Financial Performance, and Research and Development Investment will require development and integration of government-wide solutions embedded in numerous E-Gov projects. These interdependencies create special challenges for ensuring that EPA adopts E-Gov solutions as part of its strategic plan for success in each PMA area.</p> | | | | |

| INITIATIVE | STATUS ¹⁸ | PROGRESS | PROUD TO BE II (07/05) RESULTS | HIGHLIGHTS |
|--|---|---|---|---|
| Improved Financial Performance |  Green |  Green | <p>"Green" EPA met its goal of "Green" for P2B2"</p> <p>EPA has set a goal of "Green" for P2B3</p> | <ul style="list-style-type: none"> EPA maintained a green rating for both progress and status for all four quarters of FY 2005. EPA is one of only three federal agencies to maintain a green rating for 10 or more successive quarters (since FY 2003). The Agency delivered its FY 2005 Performance and Accountability Report with audited financial statements by the required November 15, 2005, deadline and met all required deadlines for the its quarterly financial statements. EPA is expanding the use of financial information by integrating additional financial information into EPA's decisionmaking processes, with an initial focus on grants. |
| EPA's Challenges in Improved Financial Performance -- No challenges at this time. | | | | |
| Budget and Performance Integration |  Yellow |  Green | <p>"Yellow" EPA did not meet its goal of "Green" for P2B2.</p> <p>EPA has set a goal of "Green" for P2B3.</p> | <ul style="list-style-type: none"> The Agency received green progress scores for all four quarters in FY 2004. EPA worked cooperatively with OMB on the FY 2005 Program Assessment Rating Tool (PART) process, completing 43 PART assessments to date. At the conclusion of the FY2005 PART Appeals process, EPA has developed efficiency measures for 35 of 43 completed PART programs. Held meetings with EPA's senior leadership throughout the year to discuss the integration of budget, performance, and in particular the PART as a means to better manage the Agency's resources and deliver environmental results. EPA has developed a process in alignment with the Enacted Budget identifying impacts of Congressional action on planned performance; specifically related to the targets associated with EPA's GPRA/PART annual and long-term performance measures. EPA senior leaders assess these impacts as part of their decisionmaking. |
| EPA's Challenges in Budget and Performance Integration (BPI) -- EPA must continue to develop appropriate OMB-approved measures that gauge the efficiency of an environmental program's administration. Each program evaluated by the PART is required to have at least one OMB-approved efficiency measure. Currently 35 of 43 PARTed programs have OMB-approved efficiency measures. | | | | |
| Eliminating Improper Payments |  Yellow |  Green | <p>EPA did not have a goal for P2B2.</p> <p>EPA has set a goal of "Green" for P2B3.</p> | <ul style="list-style-type: none"> EPA successfully demonstrated that it has a low incidence of erroneous payments and was upgraded to a "yellow" status and "green" progress score during FY 2005. EPA's FY 2005 error rate for its two State Revolving Funds was 0.16 percent, which surpassed the target error rate of 0.45 percent. EPA documented its approach for conducting a statistical sample of sub-recipient payments in two states in FY 2006. |
| EPA's Challenges in Eliminating Improper Payments: No challenges at this time. | | | | |
| Research and Development Investment Criteria |  Red |  Yellow | <p>"Red" EPA did not meet its goal of "Yellow" for P2B2</p> <p>EPA has set a goal of "Yellow" for P2B3</p> | <ul style="list-style-type: none"> EPA held four independent, external reviews of the following research programs: Drinking Water, Human Health, Ecological and Particulate Matter. The Agency participated in the FY 2005 (formerly known as the FY 2007) PART process with two new PART assessments for Human Health Research and Drinking Water Research, and two PART reassessments for PM Research and Ecological Research. EPA's FY 2007 Annual Research Planning process expanded to include regular discussions about resources and performance in the context of the R&D Investment Criteria. |
| EPA's Challenges in Research and Development -- EPA's research and development programs do not yet have acceptable performance and efficiency measures for research programs. This has resulted in less than successful performance on the PMA Scorecard for the Research and Development Investment Criteria Initiative and a negative impact on EPA's performance on the Budget and Performance Integration Initiative. EPA continues to work with its research community and OMB to develop measures that are meaningful to environmental program managers and clearly illustrate performance over time. | | | | |

Summary of Performance Data

EPA's FY 2005 Performance Results



Goals Met. In its FY 2005 *Annual Plan*, EPA committed to 84 annual performance goals (APGs). In FY 2005, the Agency met 34 of these APGs, 67 percent of the APGs for which data were available at the time this report was published. FY 2005 results to date reflect a decrease in the number of APGs met from FY 2004 results; last year, EPA met 76 percent of its APGs for which data were available. EPA has significantly exceeded its targets for a number of its FY 2005 APGs. For example, the Agency restored eight percent of the nation's impaired waterbodies in accordance with Water Quality Standards, significantly exceeding its FY 2005 goal of two percent (APG 2.13). This achievement is partly due to the work EPA and states have done to refine water quality assessments, which now more accurately reflect improvements in impaired waterbodies. In another case, EPA greatly exceeded its cumulative goal of reducing by 11 percent the households on tribal lands lacking access to basic sanitation. By increasing coordination with other federal agencies to more effectively fund and implement infrastructure programs, the Agency and its partners have achieved a cumulative 34 percent reduction in the number of households lacking access to wastewater sanitation (APG 2.15).



Goals Not Met. Despite their best efforts, however, EPA and its partners were not able to meet all planned targets for FY 2005. EPA did not meet 17 of the 51 FY 2005 APGs for which performance data were available. The Agency is considering the various causes of these shortfalls as it adjusts its annual goals and program strategies for FY 2006 and beyond.

There are a number of reasons for these missed goals. In some cases the APGs were new in FY 2005—a part of EPA’s effort to develop more meaningful goals and measures—and the Agency overestimated its ability to achieve annual results. For example, EPA anticipated improvements in water quality to reduce the levels of contaminants in fish, leading to a one percent decrease in waterbodies with fish consumption advisories (APG 2.8). EPA fell short of achieving this APG, and the Agency is assessing the information it has received to determine a more realistic future target.

External factors also contributed to missing APGs. For example, the Agency had anticipated reducing nitrogen, phosphorus, and sediment loadings from entering the Chesapeake Bay (APG 4.18). However, such external factors as continued growth in human and farm animal populations in the region and rainfall levels affect the Agency’s success in reducing existing nutrient loading levels. In other cases, EPA relies on the efforts of its federal, state and local partners to help achieve annual goals, and the actions of the Agency’s partners are a significant factor in performance results. For example, the Agency and its partners did not meet the goal for improving water and sanitation systems in the US-Mexico border region; funding for this effort was delayed pending development of a new system for setting project priorities in the region (APG 4.12). EPA recognizes that, as a result of missing several such APGs, the Agency may not be on track for reaching its longer term objective for protecting ecosystems. Despite these difficulties, EPA and its partners continue to work together to ensure progress in meeting these goals and achieving the objective.

Improved data can also contribute to missed goals. For example, EPA set a cumulative goal that by FY 2005 water quality assessed in 80 percent of the water segments in each of 462 watersheds across the nation would meet water quality standards (APG 2.12). In fact, however, the number of watersheds meeting these standards has decreased slightly since FY 2002. EPA attributes this regression to new data that more accurately reflect watershed condition, including adjustments for fish consumption advisories and increased environmental stresses on watersheds that not only impair waters that were once clean, but also further degrade waters already impaired. As its data improve, EPA is gaining a more accurate picture of environmental baseline conditions and progress achieved. Based on this information, the Agency expects to continue adjusting its performance goals and targets to achieve results.

Summary of FY 2005 Performance Results by Goal

| Result | Goal 1 | Goal 2 | Goal 3 | Goal 4 | Goal 5 | ESP | Total |
|--|-----------|-----------|----------|-----------|----------|----------|-----------|
| Met | 5 | 6 | 2 | 13 | 2 | 6 | 34 |
| Not Met | 0 | 2 | 3 | 7 | 4 | 1 | 17 |
| Data Available After November 15, 2005 | 14 | 10 | 2 | 6 | 1 | 0 | 33 |
| Total | 19 | 18 | 7 | 26 | 7 | 7 | 84 |

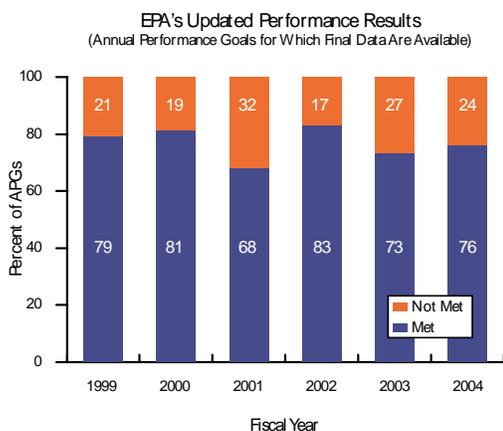


Data Unavailable. Because final end-of-year data were not available when this report went to press, EPA is not yet able to report on 33 of its 84 APGs, an increase over the 25 APGs for which data were not available in EPA's FY 2004 report. This difference is largely due to the Agency's increased focus on achieving longer-term environmental and human health outcomes, rather than activity-based outputs. Environmental outcome results may not become apparent within a federal fiscal year, and assessing environmental improvement often requires multiyear information. As a result, EPA may not yet have the data required to determine whether an FY 2005 APG such as improving water quality to reduce contaminants in fish, leading to higher consumption of safe fish (APG 2.8), has been met. Many variables are involved in evaluating progress toward this goal, including the bioaccumulative nature of mercury, which affects the time it takes fish to rid their bodies of this contaminant.

In many cases, reporting cycles—including some which are legislatively mandated—do not correspond with the federal fiscal year on which this report is based. Data reported biennially or on a calendar year basis, for example, are not yet available for this report. In some cases, such as for certain compliance and enforcement information, the Agency has adjusted data collection and QA/QC processes to meet the November 15 date for submitting this report. To provide as much information as possible on its progress toward achieving its goals, however, EPA continues to present the most current data available.

Furthermore, EPA obtains performance data from local, state, and tribal agencies, all of which require time to collect the information and review it for quality. Often, EPA is unable to obtain complete end-of-year information from all sources in time to meet the deadline for this report. The Agency is working to reduce such delays in reporting, however, by capitalizing on new information technologies to exchange and integrate electronic data and information, improve data quality and reliability, and reduce the burden on its partners.

Data Now Available. The Agency is now able, however, to report data from previous years that became available in FY 2005. Final performance results data became available for 20 of the 25 FY 2004 APGs on which the Agency did not report in its *FY 2004 Annual Report*. Of these 20 FY 2004 APGs, EPA met 14. For example, the Agency met its FY 2004 goals for reducing greenhouse gas emissions and SO₂ emissions, as well as sulfur and nitrogen deposition and ambient concentrations. EPA can now report achieving 56 (76 percent) of the 79 FY 2004 APGs for which it has data. For FY 2003, EPA can now report achieving 45 (79 percent) of the 64 APGs for which it has performance data. Delays in reporting cycles and targets set beyond the fiscal year continue to affect one APG in FY 2003, FY 2002, and FY 1999.



Note: During FY 2005, final performance results data became available for a number of APGs from prior years: 20 for FY 2004, three for FY 2003, one for FY 2002, one for FY 2001, two for FY 2000, and one for FY 1999.

Improving Measures and Adjusting Targets. EPA is continuing to develop better and more meaningful measures of its performance. In FY 2005, for example, the Agency introduced more than 30 new or improved performance measures. Equipped with better data, EPA is also adjusting performance targets to reflect an improved understanding of current conditions and the outcomes to be achieved. For example, the Agency is adjusting its target for the improvement in air quality over time for the fine particle (PM_{2.5}) standard (APG 1.3). This goal was established in FY 2004 using initial targets while the Agency collected baseline data. Based on the FY 2004 results which significantly exceed the target, however, the Agency will adjust its target for FY 2006. Similarly, in FY 2006 EPA will be adjusting targets for reducing exposure to unhealthy levels of ozone (APG 1.6). EPA will continue to benefit from improved data, revising annual performance measures and adjusting targets to provide a more useful assessment of its progress.

IMPROVING RESULTS

EPA is continuing its efforts to focus more clearly on the results it wants to achieve, orient its programs around environmental outcomes, and develop better measures for assessing performance. Building on previous years' work, the Agency strengthened its collaboration with states and tribes to improve joint planning and priority-setting; develop innovative, effective approaches to environmental problems; and track and assess progress. In addition, EPA is working to expand its use of program evaluation; address data gaps and other information issues; strengthen its strategic planning; and resolve its management challenges reported by the Office of Inspector General (OIG) and Government Accountability Office.

Strengthening Collaboration with Partners

Protecting human health and the environment is a shared responsibility. In FY 2005, EPA continued important work with its partners in environmental protection – states, tribes, and other federal agencies – to ensure a national focus on the most important problems and the most efficient and effective use of scarce resources.

- In FY 2005, EPA and the Environmental Council of the States (ECOS) established a “Partnership and Performance Workgroup” to continue the Agency’s work to improve joint state-EPA planning and priority-setting. The workgroup explored ways to support state strategic planning, expand the use of Performance Partnership Grants as a planning and management tool, and improve states’ and EPA regional offices’ dialogue on regional planning and priority-setting.
- EPA also funded a second Cooperative Agreement with ECOS for conducting pilot projects in 15 states to strengthen states’ capabilities to manage for results and improve joint regional-state planning. For example, an Illinois pilot project is developing a stakeholder consultation process for considering innovative environmental programs.
- The Agency enhanced its Annual Commitment System (ACS), launched in FY 2004 to assist EPA managers in engaging states and tribes in setting annual regional performance goals. In FY 2005, the Agency improved the system to track actual regional performance against agreed-upon program measures and commitments. EPA’s regional offices are also able to use the ACS to track state and tribal contributions to regional performance.
- On September 26, 2005, EPA Administrator Steven Johnson reaffirmed the Agency’s formal Indian Policy, established in 1984. By this action, EPA recognized that the United States has a unique legal relationship with tribal governments based on the Constitution, treaties, statues, Executive Orders, and court decisions. This relationship includes recognition of the right of tribes as sovereign governments to self-determination, and an acknowledgment of the federal government’s trust responsibility to tribes.
- In FY 2005 EPA continued to work with tribes on a government-to-government basis to protect the land, air, and water in Indian country. In June, the Grand Traverse Band of Chippewa Indians hosted the seventh National Tribal Environmental Conference for Environmental Management, attended by more than 750 tribal, federal, and state officials to share solutions on ongoing environmental and public health problems in Indian country.

Enhancing Tribal Environmental Management

- EPA is providing funding to enhance tribal capacity for environmental management. Strengthening tribal programs improves the Agency’s program implementation and enables tribes to develop holistic multimedia programs that reflect their traditional use of natural resources.
- As of FY 2005, 96 percent of tribes (549 tribes) have access to EPA funds for hiring environmental program staff, managing environmental activities, and implementing multimedia environmental programs in Indian country.¹⁹ This represents an increase of approximately 7 percent a year since 1996, when 36 percent of tribes had access.

Achieving Results Through Grant Programs

Grants are a key tool for achieving EPA's mission. Each year EPA awards approximately one-half of its budget in grants to state, tribal, and local governments; educational institutions; and nonprofit organizations. The Agency has been working to ensure the grants EPA awards support its strategic goals, and that results achieved through grants are closely tracked and monitored.

In FY 2005, EPA issued a policy for awarding grants (EPA Order No.: 5700.7) that requires EPA offices to:

- Link results to EPA's Strategic Plan.
- Describe expected outputs and outcomes in grant announcements, work plans, and performance reports.
- Consider how the results from completed grant projects contribute to the Agency's programmatic goals and objectives.

In addition, for the first time, this report lists specific grants that contributed to the achievement of EPA's FY 2005 annual performance goals (see Section II).

Using Program Evaluation and the PART

EPA uses the results of program assessments, audits, and evaluations to adjust approaches, improve results, allocate resources, and ensure the most effective and efficient use of taxpayer dollars. In recent budget processes, for example, EPA senior managers used the results of Program Assessment Rating Tool (PART) assessments to identify opportunities for program improvement, justify resource requests, and guide decisionmaking.

The PART is a series of diagnostic questions used to assess and evaluate programs across a set of performance-related criteria, including program design and purpose, strategic planning, program management and results. To date, EPA and OMB have conducted PART reviews for 43 of the Agency's programs. PART reviews in 2005 included both new assessments of the indoor air, lead, oceans, surface water protection, oil spill and other programs, and reassessments from previous years.

The PART assessment was first used in 2002 in developing EPA's FY 2004 budget. During that year, only 1 of EPA's 11 assessed programs was rated able to demonstrate results. In EPA's third year of PART assessments (2004 for the FY 2006 budget) 24 of 32 programs were rated "adequate or "moderately effective." This improvement in PART ratings shows EPA's commitment to designing and implementing programs that maximize resource efficiency and deliver environmental results. Section II of this report lists PART assessments conducted under each of the Agency's five strategic goals, identifies performance measures associated with the PART, and reports FY 2005 results for the measures where data are currently available. Future PART measures are listed in a separate table in Section II, along with the year EPA expects to begin reporting data against them. Ratings for programs assessed during 2005 for the FY 2007 budget will be available in February 2006. Additional information on PART assessments and EPA's progress in making program improvements will be available in February 2006 at www.whitehouse.gov/omb/part.

EPA and its OIG also conducted other types of program evaluations and audits (Appendix B contains a list by strategic goal of program evaluations and audits completed in FY 2005). For example, working with the Compliance Committee of ECOS and representatives from state agencies, EPA completed an evaluation of an

enforcement tool—the State Review Framework—which the Agency developed to assess state enforcement performance. The evaluation found that, overall, the framework is effective as a tool for evaluating state enforcement and compliance assurance programs on a nationwide basis. The evaluation also recommended ways to improve data collection and state performance interpretation under the framework. EPA intends to make the recommended improvements and apply the framework across all 50 states to: (1) evaluate whether state enforcement and compliance assurance programs are providing a consistent level of environmental and public health protection across states; and, (2) work collaboratively with states to ensure that authorized state agencies meet agreed-upon enforcement performance goals.

The Agency's OIG contributes to EPA's mission to improve human health and environmental protection by assessing the effectiveness of EPA's program management and results, developing recommendations for improvement, and ensuring that Agency resources are used as intended. In FY 2005, an OIG report found that air toxic monitoring was conducted in only ten percent of areas with the estimated highest health risks from exposure to toxic air pollutants. EPA has since begun using the National Air Toxics Assessment to identify and prioritize high-risk areas to be monitored. The Agency also modified its air toxics grant criteria to better address high-risk areas and emphasize methods for analyzing ambient air toxics conditions.

Improving Environmental Indicators, Performance Measurement, and Data Quality

In June 2003, EPA's *Draft Report on the Environment* established baseline information on environmental conditions in the United States and their potential effects on human health. Since then, the Agency has been working to improve the indicator information, fill key gaps in environmental data, and make the information more accessible to the public.

**Data in
FY 2005 Performance and Accountability Report
Are Complete and Reliable**

EPA determined that the performance information in this report is complete and reliable and no material inadequacies are present, as defined by OMB Circular A-11.²⁰ For more information on the data sources used in FY 2005 performance measures, see Section II of this report. Appendix C contains additional information on the quality of the data in this report.

In FY 2005, EPA issued for public comment a set of indicators for the Agency's next *Report on the Environment*, to be released in 2006. A scientific peer-review conducted in July elicited expert opinion on whether the indicators are supported by data that are technically sound, meet the established indicator definition and criteria, and help answer key questions on the current state of the environment. Over the next year, EPA plans to use these indicators in developing the Agency's long-term measures of success for its *2006-2011 Strategic Plan*. More information on the Agency's "Indicators Initiative" is available at www.epa.gov/indicators.

EPA also continued to focus annual performance goals and measures on environmental outcomes and program efficiencies, instead of on activity-based outputs. In EPA's FY 2006 Annual Performance Plan, approximately 65 percent of the annual performance goals track environmental or intermediate outcomes.

In addition, the Agency worked to align its annual performance measures with new performance and efficiency measures developed during OMB's 2005 PART process. In FY 2005, EPA developed a strategy for implementing new PART measures while reporting on the goals and measures in the Agency's FY 2005 Annual Plan. This process is another step in EPA's ongoing efforts to establish a set of measures that clearly defines environmental outcomes and achieves EPA's Budget and Performance Integration goals under the PMA.

| |
|--|
| <p>Improved Performance Measures Developed in FY 2005</p> <p>These new measures will help EPA describe trends over time, and demonstrate the results of specific environmental programs.</p> |
| <ul style="list-style-type: none"> • <u>Tribal Access to Safe Drinking Water</u>: EPA will measure the number of households on tribal lands lacking access to safe drinking water. • <u>Water Pollutant Loadings Per Program Dollar Spent</u>: EPA will estimate loadings of water pollutants removed per program dollar spent, including discharges to surface water such as municipal storm water and combined sewer overflows. • <u>Contamination Levels at Superfund Sites</u>: EPA will determine whether contamination levels at a Superfund site fall within the levels specified by EPA as safe, or if they do not, whether adequate controls are in place to prevent unacceptable human exposure to contamination. |

In FY 2005, EPA continued to improve its ability to collect and use reliable and complete performance and financial data. EPA worked to detect and correct errors in environmental data, standardize reporting, and exchange and integrate electronic data and data quality information among its federal, state, and local data-sharing partners. Over the past year, the Agency completed all corrective actions for an Agency-level weakness in data management practices. Recent efforts include ensuring that data management policies and procedures are planned, maintained, and revised as appropriate. For example, the Agency changed the structure and operating procedures of its Quality Information Council to better fulfill its role as the information policymaking body.

Considering Future Trends and Looking Ahead

As EPA looks to the future, Agency managers are focusing on several priorities. First, the Agency is striving to accelerate the pace of environmental progress by looking beyond rules and regulations to consider other solutions. Effective legislation, such as Clear Skies, puts mechanisms in place to achieve large-scale national protections. The Agency is committed to working cooperatively with its partners to support legislation over regulation, results over methods, and partnerships over conflicts to accelerate progress and usher in a new area of environmental protection.

EPA is also working to foster a culture of environmental stewardship through partnerships and innovative approaches to environmental issues. In the coming years, the Agency will promote collaboration, voluntary programs, and outreach as tools for

strengthening stewardship. EPA will also focus on opportunities to leverage environmental protection actions to create opportunities for economic growth. Efforts such as Brownfields, for example, not only reduce pollution, but revitalize valuable land and strengthen local economies. In the coming years, while the Agency will maintain its vigilance in enforcing existing laws and regulations, it will also strive to approach new challenges with flexibility and enthusiasm.

To meet these challenges and make informed decisions in a rapidly changing, complex world, EPA leaders need to be aware of the environmental consequences of future social, economic, and technological change. Several years ago, the Agency began conducting “futures analysis” to help its leaders anticipate future environmental challenges and plan strategically to avoid problems.

In FY 2005, EPA continued to identify significant environmental and industrial trends, demographic issues, and transformative technologies that have implications for environmental protection. EPA senior managers and staff identified areas for increased focus under each of the Agency’s five strategic goals—for example: (1) international increases in transboundary pollution, especially particulate matter; (2) water scarcity and its impact on water quality; (3) increased levels of pharmaceuticals in the waste stream due to the nation’s aging population; and, (4) the environmental implications of genomics. In the spring of 2005, the Agency sought input on future issues from state environmental commissioners at an ECOS meeting and from tribal environmental professionals at the Seventh National Tribal Conference on Environmental Management. All of this input will be vital as the Agency considers the most significant future issues and develops its *2006-2011 Strategic Plan*.

INTERNAL CONTROLS, FINANCIAL MANAGEMENT SYSTEMS, AND COMPLIANCE WITH LAWS AND REGULATIONS

This section discusses EPA’s progress in strengthening its management practices and the internal controls the Agency relies on to assure the integrity of its programs and operations. It includes the Administrator’s unqualified Statement of Assurance for FY 2005.

Federal Managers’ Financial Integrity Act

The Federal Managers’ Financial Integrity Act (FMFIA) requires agencies to establish and maintain management controls and financial systems that provide reasonable assurance that federal programs and operations are protected from fraud, waste, abuse, and misappropriation of federal funds. FMFIA holds agency heads accountable for correcting deficiencies and requires them annually to identify and report internal control and accounting systems problems and planned remedies.

**Fiscal Year 2005
Annual Assurance Statement**

I am pleased to give an unqualified statement of assurance that the Environmental Protection Agency's (EPA) programs and resources are protected from fraud, waste, abuse, and mismanagement. Based on EPA's annual self-assessment of its internal controls, I can reasonably assure that there are no material weaknesses in the Agency's control.



Stephen L. Johnson
Administrator

October 28, 2005

Date

Based on EPA's self-assessment of its internal controls and financial systems, Agency managers have determined that the Agency's controls are achieving their intended objectives. The Administrator's unqualified Statement of Assurance for FY 2005 follows.

To identify management issues and monitor progress in addressing them, EPA's senior leaders use a system of internal program evaluations and independent audit reviews

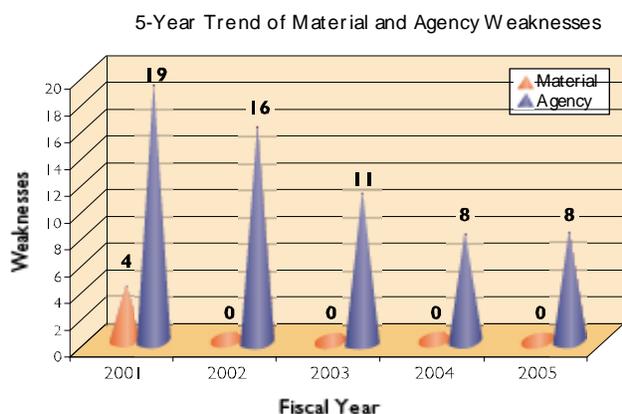
conducted by the Government Accountability Office, EPA's OIG, and other oversight organizations to assess program effectiveness. In FY 2005, for the 4th year, EPA has no material weaknesses to report under FMFIA. Material weaknesses are reportable conditions that could significantly impair or threaten fulfillment of the Agency's mission and must be reported to the President and Congress. While the Agency reported no new material weaknesses, EPA currently has a number of less severe, internal Agency-level weaknesses for which it is tracking progress. During the year, EPA added two new Agency-level weaknesses to its list and closed two of its existing Agency-level weaknesses in the areas of data management and water permitting. Half of the Key Management Challenges identified by OIG are also current Agency-level weaknesses. The Reports Consolidation Act of 2000 requires the Inspector General to identify, briefly assess, and report annually the most serious management and performance challenges facing the Agency (see Section III of this report).

**EPA's Key Management Challenges
Reported by
the Office of Inspector General**

1. Linking Mission and Management
2. Agency Efforts in Support of Homeland Security
3. Superfund Evaluation and Policy Identification
4. Information Resources Management and Data Quality
5. EPA's Use of Assistance Agreements to Accomplish Its Mission
6. Challenges in Addressing Air Toxics Programs
7. Human Capital Management
8. Information Systems Security

Section III of this report provides more detailed information on OIG's Key Management Challenges and EPA's response.

OMB has recognized EPA's efforts to maintain effective and efficient internal controls. Since September 2003, EPA has maintained a green status score for Improved Financial Performance under the President's Management Agenda. EPA has also received a progress score of green for Budget and Performance Integration for all but one consecutive quarter since June 2002.



Inspector General Act Amendments of 1988

The Inspector General (IG) Act Amendments require federal agencies to report to Congress on their progress in carrying out audit recommendations.

EPA's Audit Follow-up Activities: In FY 2005, EPA was responsible for addressing OIG recommendations and tracking follow-up activities on 396 audits. The Agency achieved final action (completing all corrective actions associated with an audit) on 248 audits, including Program Evaluation/Program Performance, Assistance Agreement, Contracts, and Single audits. EPA's FY 2005 audit management activities are summarized below.

- ***Final Corrective Action Taken.*** EPA completed final corrective actions on 55 audits with disallowed and better use dollars. Of these 55 audits, OIG questioned costs of more than \$14.8 million. After careful review, OIG and the Agency agreed to disallow approximately \$7.9 million of these questioned costs. In addition, the Agency also completed final corrective action on 193 audits.
- ***Final Corrective Action Not Taken.*** At the end of FY 2005, 148 audits were without final action and not yet fully resolved. (This total excludes audits with management decisions under administrative appeal by the grantee.)
- ***Final Corrective Action Not Taken Beyond One Year.*** Of the 148 audits, EPA officials had not completed final action on 30 audits within 1 year after the management decision (the point at which OIG and the Action Official reach agreement on the corrective action plan). Because the issues to be addressed may be complex, Agency managers often require more than 1 year after management decisions are reached with OIG to complete the agreed-upon corrective actions.
- ***Audits Awaiting Decision on Appeal.*** EPA regulations allow grantees to appeal management decisions on financial assistance audits that seek monetary reimbursement from the recipient. In the case of an appeal, EPA must not take action to collect the account receivable until the Agency issues a decision on the appeal. In FY 2005, 33 audits were in administrative appeal.

EPA Audits Involving Disallowed Costs and Funds Put to Better Use: As required by the IG Act Amendments, the following table presents information on audits that involve disallowed costs and funds put to better use.

| DISALLOWED COSTS & FUNDS PUT TO BETTER USE | | | | |
|---|------------------|--------------|-------------------------|-------------|
| October 1, 2004 September 30, 2005 | | | | |
| Category | Disallowed Costs | | Funds Put to Better Use | |
| | Number | Value | Number | Value |
| A. Audits with management decisions but without final action at the beginning of FY 2005. | 67 | \$74,329,390 | 0 | \$ 0 |
| B. Audits for which management decisions were made during FY 2005: | 237 | \$ 4,488,195 | 4 | \$2,868,844 |
| (i) Management decisions with disallowed costs (45) | | | | |
| (ii) Management decisions with no disallowed costs (192) | | | | |
| C. Total audits pending final action during FY 2005. (A+B) | 304 | \$78,817,585 | 4 | \$2,868,844 |
| D. Final action taken during FY 2005: | 245 | \$ 7,560,083 | 3 | \$ 866,548 |
| (i) Recoveries | | | | |
| a) Offsets | | \$ 939,846 | | |
| b) Collections | | \$ 3,849,707 | | |
| c) Value of Property | | \$ 0 | | |
| d) Other | | \$ 1,526,025 | | |
| (ii) Write-offs. | | \$ 388,228 | | |
| (iii) Reinstated through grantee appeal | | \$ 856,277 | | |
| (iv) Value of recommendations completed. | | | | \$ 0 |
| (v) Value of recommendations management decided should/could not be completed. | | | | \$ 0 |
| E. Audit reports needing final action at the end of FY 2005. (C - D) | 59 | \$71,257,502 | 1 | \$2,002,296 |

EPA uses audit management as a tool in assessing its progress and its ability to meet its strategic objectives. The Agency is continuing to strengthen its audit management practices and is working to address issues and complete corrective actions in a timely manner.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agencies' financial management systems substantially comply with federal financial management system requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger. In response to the FY 1999 financial statement audit, EPA implemented an FFMIA remediation plan to improve the Agency's financial management systems in order to comply with federal financial system requirements. Currently, EPA has completed all but two corrective actions: security certification policy for contractor personnel, and security certification policy for grantee personnel. EPA anticipates completing these actions by the first quarter of FY 2007. The Agency continues to improve cost accounting and reconciliation of intragovernmental transactions. EPA has no substantial noncompliance findings.

The Agency is in the process of developing a modern financial system infrastructure to help EPA better manage the resources that support our environmental mission, more accurately measure the true costs of environmental programs, and better inform the public. The new system will be implemented in FY 2008. Detailed plans for this project are available at www.epa.gov/ocfo/modernization/index.htm.

Federal Information Security Management Act

Federal Information Security Management Act (FISMA) directs federal agencies to conduct annual evaluations of information security programs and practices. It provides a comprehensive framework for ensuring the effectiveness of information security controls over information resources that support Federal operations and assets. Agencies must report annually to OMB on the effectiveness of their information security programs, which includes an independent evaluation by the Inspector General. Agencies also report quarterly to OMB on the status of remediation of weaknesses found.

EPA's FISMA Report for FY 2005, dated October 7, 2005, highlights the results of the Agency's annual security program reviews and was completed by EPA's Chief Information Officer, senior agency program officials, and Inspector General. The report reflects EPA's continued efforts to ensure that information assets are protected and secured in a manner consistent with the risk and magnitude of the harm resulting from the loss, misuse, or unauthorized access to or modification of information. In FY 2005, EPA reported no significant deficiencies in its information security systems under FISMA.

Government Management Reform Act – Audited Financial Statements

The Government Management Reform Act (GMRA) of 1994 amended the requirements of the Chief Financial Officers (CFO) Act of 1990 by requiring the annual preparation and audit of agency-wide financial statements. EPA's statements are audited by the Inspector General, who issues an audit report on the principal financial statements, internal controls, and compliance with laws and regulations.

For six consecutive years, the Agency submitted timely financial statements with a clean audit opinion—another important aspect of accountability. These statements (presented in Section IV of this report) provide a snapshot of the Agency's financial position at the end of fiscal year.

FINANCIAL ANALYSIS

EPA's financial management strategy focuses on running environmental programs in a fiscally responsible manner to assure that resources are used wisely and effectively to protect human health and the environment. In FY 2005, the Agency continued its efforts to improve its financial management systems and processes, data quality and accessibility, and accountability. These improvements strengthen EPA managers' ability to use financial analyses as well as performance information to make

FINANCIAL HIGHLIGHTS

- Maintained green status score for Improved Financial Performance PMA initiative.
- Maintained "green" progress score for Budget/Performance Integration and Eliminating Improper Payments PMA initiatives.
- Maintained a less than one percent erroneous payment rate.
- Made progress integrating budget and performance data.
- Supported E-Government and Human Capital PMA initiatives.
- Earned an unqualified audit opinion on the FY 2005 financial statements.

priority-setting decisions that influence resource planning and environmental results. (See Section IV for more detailed information on financial strategies and initiatives.)

Measuring Financial Management Results

The Agency measures its financial management effectiveness against external and internal standards. External standards include the President’s Management Agenda (PMA) initiatives, the Program Assessment Rating Tool (PART), audited financial statements, and Government-wide Financial Performance Metrics. Internally, the Agency tracks its performance in key financial management areas: processing payments and reconciling cash, as well as managing accounts receivable, obligations, budgets, contracts, Superfund billings, and property.

EPA has maintained its green score for the PMA Improved Financial Performance initiative by continuously setting and meeting higher performance goals. In FY 2005, EPA produced accurate and timely accelerated interim quarterly financial statements, completed Quality Assurance Reviews to ensure the accuracy of Agency financial data, and automated preparation of the Statement of Net Costs by Goal.

The PMA initiative on Eliminating Improper Payments is focused on identifying, preventing, and eliminating erroneous payments. As required by the Improper Payments Information Act (IPIA) of 2002 and the Office of Management and Budget (OMB) Memorandum M-03-07, EPA samples and annually reports on improper payments in the two State Revolving Funds (SRFs) previously covered under OMB Circular A-11, Section 57. For FY 2005, the Agency assessed a statistical sample of direct state payments and judgemental sub-recipient payments. EPA’s samples identified a less than 1 percent error rate in payments. The chart below provides 2 years of actual performance as well as planned reduction targets.

| Improper Payment Reduction Outlook for FY 2004–FY 2007 (dollars in millions) | | | | | | | | | |
|---|--------------------|-----------------------------------|---------------------------------|--------------------|-----------------------------------|---------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| PROGRAM | FY 2004 OUTLAYS | FY 2004 Improper Payments % | FY 2004 Improper Payments | FY 2005 OUTLAYS | FY 2005 Improper Payments % | FY 2005 Improper Payments | FY 2006 Improper Payments % | FY 2007 Improper Payments % | FY 2008 Improper Payments % |
| Clean Water and Drinking Water SRFs | \$2,182 | .47% | \$10.3* | \$1,928 | Actual 0.16% Target .45% | \$3.1 | .40% | .35% | .30% |

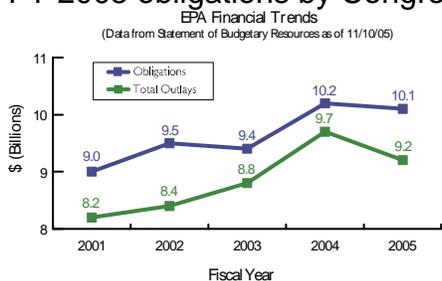
*Approximately \$10 million of the \$10.3 million identified as erroneous payments was attributable to states prematurely drawing down funds for allowable expenses.

In FY 2005, the Agency met or exceeded the standard for four of the government-wide performance metrics and has an action plan to improve performance for the other five metrics. Additionally, EPA generally met or exceeded internal performance goals. Over 99.9 percent of the Agency’s contracts were paid on time and EPA received \$330 thousand in purchase card rebates from the purchase card contractor. The chart below presents results for three internal Agency performance measures that support the EPA’s E-government and improved financial performance priorities. To further improve efficiency and consistency, EPA is realigning major accounting functions and customer service responsibilities from 14 locations to four *Finance Centers of Excellence*. The Agency reached the 50 percent mark in the consolidation this year and plans to complete it by December 2006.



Resources and Outlays

In FY 2005 EPA received \$8.03 billion in Congressional appropriations.²¹ *EPA Financial Trends*²² (shown below) shows a 5-year snapshot of the Agency's used resources. The *Statement of Budgetary Resources*, included in Section IV, presents additional information on the Agency's resources. The next chart below shows EPA's FY 2005 obligations by Congressional appropriation.

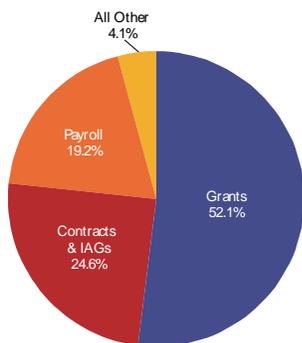


FY 2005 Obligations by Appropriation (Dollars in Millions)
(Data from Statement of Budgetary Resources as of 11/10/05)

| | |
|---------------------------------|--------------------------|
| State & Tribal Assistant Grants | \$3,608.5 (35.6%) |
| Superfund | \$1,544.9 (15.3%) |
| All Other | \$4,971.0 (49.1%) |
| Total | \$10,124.4 (100%) |

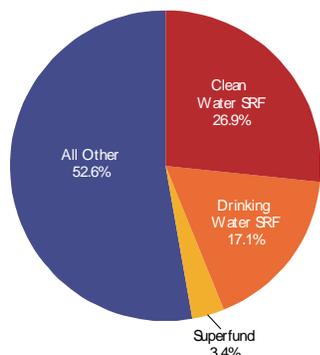
EPA works with its partners in the public and private sectors to accomplish its mission and uses a variety of funding mechanisms—including grants, contracts, innovative financing, and collaborative networks—to protect human health and the environment. The chart below depicts EPA's costs (expenses for services rendered or activities performed) by spending category.²³

FY 2005 Cost Categories
(Data as of 11/10/05—Reconciles to Statement of Net Cost)



The majority of EPA's costs are for grant programs (see chart below). The Clean Water and Drinking Water SRF grants supporting the Agency's Clean and Safe Water goal account for 43 percent of EPA's grant awards. Other major environmental grant programs include assistance to states and tribes, consistent with EPA's authorizing statutes, and research grants to universities and nonprofit institutions.

FY 2005 Major Grant Categories
(Data as of 11/10/05—reconciles to Statement of Net Cost & Stewardship Report)

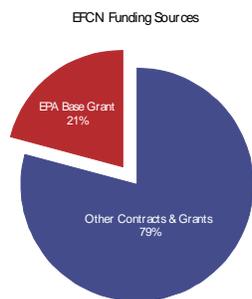


Innovative Financing: Partnerships and the Environmental Finance Program

EPA leverages federal funds through several innovative environmental financing efforts, mutually beneficial public-private partnerships, such as SRFs and the Environmental Finance Program, and Superfund program cost recoveries.

EPA uses collaboration and partnerships with the states to wisely manage its resources for keeping the nation's water clean and safe. As of early FY 2006, the Clean Water SRF had leveraged nearly \$23 billion in federal capitalization grants into more than \$52 billion in assistance to municipalities and other entities for wastewater projects. As of early FY 2006, the Drinking Water SRF had leveraged \$6.5 billion in federal capitalization grants into more than \$11 billion in assistance for drinking water infrastructure. (Note: The current FY 2005 Drinking Water SRF data includes information from 50 DWSRF Programs, including partial data from New York. The remaining data for New York is expected at the end of November 2005).

The Environmental Finance Program helps regulated parties find ways to pay for environmental activities. The program works to lower costs, increase investments, and build financial capacity. It provides leveraged financial outreach to governments and the private sector via an Environmental Financial Advisory Board, an online database, and a network of nine university-based Environmental Finance Centers (EFCs). To date, this network has provided educational, technical, and analytic support in 48 states. For every dollar that EPA has invested in it, the network has invested 3.67 dollars in project work (see chart below). Additional information on the program is available at www.epa.gov/efinpage.



One of the Agency’s compliance and enforcement success stories is its Superfund program, which leverages funding to increase cleanup of contaminated sites. Under Superfund, EPA may recover the cost of cleanups. Since 1980, EPA has collected \$3.34 billion in cost recoveries (\$63 million collected in FY 2005). EPA also retains and uses the proceeds received under settlement agreements to conduct cleanup activities, placing these funds in interest-bearing, site-specific special accounts. With careful management, EPA uses and leverages these resources to the fullest extent possible. As of September 30, 2005, EPA had established 540 special accounts with \$1.5 billion in receipts. These accounts have earned \$206 million in cumulative interest.²⁴

New Financial Management Initiatives

Committed to providing managers with timely, accurate information critical for managing resources wisely, the Agency leverages technology and updates its systems to produce the information needed to make sound decisions. In the near term, the enhanced internal control requirements in OMB Circular A-123 will strengthen EPA’s existing management integrity efforts and provide a platform to broaden our scope and expand our focus on programmatic efficiency and effectiveness. This activity will complement efforts planned or underway to achieve economies of scale and develop and enhance financial information tools to meet the decisionmaking needs of EPA managers.

- | <u>LEVERAGING TECHNOLOGY</u> |
|---|
| <ul style="list-style-type: none"> • E-government – leveraging technology to gain efficiencies across government • Financial accountability – integrating budget and performance data, providing more precise information about program costs, and identifying areas for improvement • Modern resource management systems – implementing 21st century tools to manage Agency resources • Data warehousing and reporting – searching data for latent correlations and providing easy access to useful data • Security – protecting data against today’s threats |

Additionally, the Agency is expanding the use of financial information by integrating additional financial information into EPA’s decisionmaking processes, with an initial focus on grants data. EPA also successfully conducted the first Competitive Sourcing “Standard Competition” for vendor payment services. The Agency’s Research Triangle Park Finance Center bested the private sector contractors’ bids for providing these services, resulting in savings to the Agency of \$3.5 million over 5 years.

¹ The Federal Managers Financial Integrity Act, the Inspector General Act Amendments, the Government Management Reform Act, the Chief Financial Officers Act, and the Reports Consolidation Act.

² EPA Announces Landmark Clean Air Interstate Rule (Agency Press Release, 3/10/05).

³ EPA Announces First-Ever Rule to Reduce Mercury Emissions from Power Plants (3/15/05).

⁴ For more information on the toxics program see www.epa.gov/ttn/atw/urban/urbanpg.html.

⁵ *Clearing the Air: Asthma and Indoor Air Exposures*. ISBN 0-309-06496. January 2000.

⁶ A copy of the report can be found at www.epa.gov/owow/oceans/nccr2.

⁷ More information on EPA's Superfund Program can be found at www.epa.gov/superfund/index.htm.

⁸ Memorandum from Cliff Rothenstein, Director, EPA Office of Underground Storage Tanks to Underground Storage Tanks/Leaking Underground Storage Tanks Division Directors in EPA Regions 1-10, June 2, 2005, "FY 2005 Semi Annual Mid-Year Activity Report."

⁹ Preliminary end-of-year data provided by EPA's Office of Underground Storage Tanks, November 9, 2005.

¹⁰ Additional information about EPA's recycling programs can be found at www.epa.gov/epaoswer/non-hw/muncpl/recycle.htm.

¹¹ For additional information on EPA authorities for conducting work under the Food Quality Protection Act go to www.epa.gov/pesticides/regulating/tolerances.htm.

¹² For additional information on pesticide registration and assessment go to www.epa.gov/pesticides/index.htm.

¹³ For additional information on the high production chemical program go to www.epa.gov/chemrtk/volchall.htm.

¹⁴ Centers for Disease Control, National Center for Health Statistics. *National Health and Nutrition Examination Survey: 1999-2002: May 2005*. More information is available at www.cdc.gov/mmwr/preview/mmwrhtml/mm5420a5.htm.

¹⁵ More information can be found at www.epa.gov/compliance/resources/cases/civil.

¹⁶ More information can be found at www.epa.gov/compliance/resources/cases/criminal.

¹⁷ More information on PCS is available at www.epa.gov/compliance/data/systems/water/pcssys.html.

¹⁸ The Office of Management and Budget (OMB) regularly releases an executive scorecard which rates each federal agency's overall status and progress in implementing the PMA initiatives. The scorecard ratings use a color-coded system based on criteria determined by OMB.

¹⁹ US EPA, American Indian Environmental Office. "Target 1 Program Performance Report." Goal 5, Objective 5.3 Reporting System.

²⁰ It is important to note that the Safe Drinking Water Information System (SDWIS) has been identified as an Agency-level Weakness under the Federal Managers Financial Integrity Act, with corrective action to be completed in 2007. The data are not considered materially inadequate, however, per OMB's definition. The Verification and Validation section of the *Annual Performance Plan and Congressional Justification* has details on data limitations associated with SDWIS.

²¹ Public Law 108-447 H.R. 4818.

²² Section IV, FY 2005 Statement of Budgetary Resources.

²³ Section IV, FY 2005 Statement of Net Costs.

²⁴ EPA's Integrated Financial Management System.

**PRINCIPAL
FINANCIAL
STATEMENTS**

Principal Financial Statements

Financial Statements

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1.
Environmental Protection Agency
Consolidated Balance Sheet
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-----------------------------|-----------------------------|
| ASSETS | | |
| Intragovernmental | | |
| Fund Balance With Treasury (Note 2) | \$ 12,139,207 | \$ 12,065,145 |
| Investments (Notes 4 and 17) | 4,811,065 | 4,534,498 |
| Accounts Receivable, Net (Note 5) | 66,060 | 42,770 |
| Other (Note 6) | <u>2,335</u> | <u>1,320</u> |
| Total Intragovernmental | \$ 17,018,667 | \$ 16,643,733 |
| Cash and Other Monetary Assets (Note 3) | 10 | 10 |
| Accounts Receivable, Net (Note 5) | 374,668 | 414,495 |
| Loans Receivable, Net - Non-Federal (Note 7) | 39,347 | 48,927 |
| Property, Plant & Equipment, Net (Note 9) | 708,716 | 673,363 |
| Other (Note 6) | <u>2,789</u> | <u>1,508</u> |
| Total Assets | <u>\$ 18,144,197</u> | <u>\$ 17,782,036</u> |
| LIABILITIES | | |
| Intragovernmental | \$ | \$ |
| Accounts Payable & Accrued Liabilities (Note 8) | 119,836 | 104,664 |
| Debt Due to Treasury (Note 10) | 21,744 | 24,101 |
| Custodial Liability (Note 11) | 142,347 | 52,216 |
| Other (Note 12) | <u>106,530</u> | <u>78,121</u> |
| Total Intragovernmental | \$ 390,457 | \$ 259,102 |
| Accounts Payable & Accrued Liabilities (Note 8) | 730,278 | 881,851 |
| Pensions & Other Actuarial Liabilities (Note 14) | 39,380 | 40,281 |
| Environmental Cleanup Costs (Note 20) | 6,989 | 8,407 |
| Cashout Advances, Superfund (Note 15) | 270,811 | 259,361 |
| Commitments & Contingencies (Note 18) | 1,950 | 1,625 |
| Payroll & Benefits Payable (Note 32) | 190,394 | 180,746 |
| Other (Notes 12 and 13) | <u>98,064</u> | <u>103,916</u> |
| Total Liabilities | <u>\$ 1,728,323</u> | <u>\$ 1,735,289</u> |
| NET POSITION | | |
| Unexpended Appropriations (Note 16) | \$ 11,007,589 | \$ 10,860,136 |
| Cumulative Results of Operations | <u>5,408,285</u> | <u>5,186,611</u> |
| Total Net Position | <u>16,415,874</u> | <u>16,046,747</u> |
| Total Liabilities and Net Position | <u>\$ 18,144,197</u> | <u>\$ 17,782,036</u> |

2.
Environmental Protection
Consolidated Statement of Net Cost
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-----------------------------------|-----------------------------------|
| COSTS | | |
| Intragovernmental | \$ 1,238,395 | \$ 1,205,696 |
| With the Public | <u>7,259,027</u> | <u>7,649,867</u> |
| Total Costs | \$ 8,497,422 | \$ 8,855,563 |
| Less: | | |
| Earned Revenues, Federal (Note 19) | \$ 105,653 | \$ 66,262 |
| Earned Revenues, Non-Federal (Note 19) | <u>357,824</u> | <u>280,099</u> |
| Total Earned Revenues | \$ <u>463,477</u> | \$ <u>346,361</u> |
| NET COST OF OPERATIONS | \$ <u><u>8,033,945</u></u> | \$ <u><u>8,509,202</u></u> |

3.
Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2005
(Dollars in Thousands)

| | <u>Clean Air</u> | <u>Clean & Safe Water</u> | <u>Land Preservation & Restoration</u> | <u>Healthy Communities & Ecosystems</u> | <u>Compliance & Environmental Stewardship</u> |
|-------------------------------|--------------------------|-------------------------------|--|---|---|
| Costs: | | | | | |
| Intragovernmental | \$ 186,667 | \$ 209,631 | \$ 376,717 | \$ 280,492 | \$ 174,321 |
| With the Public | <u>803,822</u> | <u>3,297,570</u> | <u>1,639,157</u> | <u>992,360</u> | <u>539,857</u> |
| Total Costs | <u>990,489</u> | <u>3,507,201</u> | <u>2,015,874</u> | <u>1,272,852</u> | <u>714,178</u> |
| Less: | | | | | |
| Earned Revenue, Federal | 20,295 | 15,444 | 42,567 | 15,638 | 12,000 |
| Earned Revenue, non Federal | <u>2,205</u> | <u>2,570</u> | <u>312,487</u> | <u>32,509</u> | <u>1,353</u> |
| Total Earned Revenue | <u>22,500</u> | <u>18,014</u> | <u>355,054</u> | <u>48,147</u> | <u>13,353</u> |
| NET COST OF OPERATIONS | <u>\$ 967,989</u> | <u>\$ 3,489,187</u> | <u>\$ 1,660,820</u> | <u>\$ 1,224,705</u> | <u>\$ 700,825</u> |

| | <u>Not Assigned to Goals</u> | <u>Consolidated Totals</u> |
|-------------------------------|----------------------------------|----------------------------|
| Costs: | | |
| Intragovernmental | \$ 10,567 | \$ 1,238,395 |
| With the Public | <u>(13,739)</u> | <u>7,259,027</u> |
| Total Costs | <u>\$ (3,172)</u> | <u>\$ 8,497,422</u> |
| Less: | | |
| Earned Revenue, Federal | (291) | 105,653 |
| Earned Revenue, non Federal | <u>6,700</u> | <u>357,824</u> |
| Total Earned Revenue | <u>\$ 6,409</u> | <u>\$ 463,477</u> |
| NET COST OF OPERATIONS | <u>\$ (9,581)</u> | <u>\$ 8,033,945</u> |

3.
Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2004
(Dollars in Thousands)

| | <u>Clean Air</u> | <u>Clean and Safe Water</u> | <u>Land Preservation & Restoration</u> | <u>Healthy Communities & Ecosystems</u> | <u>Compliance & Environmental Stewardship</u> |
|-------------------------------|--------------------------|---------------------------------|--|---|---|
| COSTS | | | | | |
| Intragovernmental | \$ 168,684 | \$ 177,573 | \$ 411,593 | \$ 257,208 | \$ 159,492 |
| With the Public | <u>774,151</u> | <u>3,835,046</u> | <u>1,610,080</u> | <u>885,982</u> | <u>557,567</u> |
| Total Costs | \$ 942,835 | \$ 4,012,619 | \$ 2,021,673 | \$ 1,143,190 | \$ 717,059 |
| Less: | | | | | |
| Earned Revenue, Federal | \$ 21,092 | \$ 6,320 | \$ 19,877 | \$ 7,117 | \$ 13,857 |
| Earned Revenue, Non-Federal | <u>970</u> | <u>1,996</u> | <u>227,936</u> | <u>33,556</u> | <u>1,498</u> |
| Total Earned Revenue | \$ <u>22,062</u> | \$ <u>8,316</u> | \$ <u>247,813</u> | \$ <u>40,673</u> | \$ <u>15,355</u> |
| NET COST OF OPERATIONS | <u>\$ 920,773</u> | <u>\$ 4,004,303</u> | <u>\$ 1,773,860</u> | <u>\$ 1,102,517</u> | <u>\$ 701,704</u> |

| | <u>Not Assigned to Goals</u> | <u>Consolidated Total</u> |
|-------------------------------|----------------------------------|-------------------------------|
| COSTS | | |
| Intragovernmental | \$ 31,146 | \$ 1,205,696 |
| With the Public | <u>(12,959)</u> | <u>7,649,867</u> |
| Total Costs | \$ 18,187 | \$ 8,855,563 |
| Less: | | |
| Earned Revenue, Federal | \$ (2,001) | \$ 66,262 |
| Earned Revenue, Non-Federal | <u>14,143</u> | <u>280,099</u> |
| Total Earned Revenue | \$ <u>12,142</u> | \$ <u>346,361</u> |
| NET COST OF OPERATIONS | <u>\$ 6,045</u> | <u>\$ 8,509,202</u> |

4.
Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | Cumulative Results of Operations FY 2005 | Cumulative Results of Operations FY 2004 | Unexpended Appropriations FY 2005 | Unexpended Appropriations FY 2004 | Consolidated Totals FY 2005 | Consolidated Totals FY 2004 |
|--|---|---|--|--|--|--|
| Net Position - Beginning of Period | \$ 5,186,611 | \$ 5,124,926 | \$ 10,860,136 | \$ 10,768,236 | \$ 16,046,747 | \$ 15,893,162 |
| Prior Period Adjustments | | | | | | |
| Beginning Balances, as Adjusted | <u>\$ 5,186,611</u> | <u>\$ 5,124,926</u> | <u>\$ 10,860,136</u> | <u>\$ 10,768,236</u> | <u>\$ 16,046,747</u> | <u>\$ 15,893,162</u> |
| Budgetary Financing Sources: | | | | | | |
| Appropriations Received | \$ - | \$ - | \$ 8,005,446 | \$ 8,322,860 | \$ 8,005,446 | \$ 8,322,860 |
| Appropriations Transferred In/Out (Note 30) | - | - | 4,702 | 152 | 4,702 | 152 |
| Other Adjustments (Note 33) | - | - | (75,450) | (68,568) | (75,450) | (68,568) |
| Appropriations Used | 7,787,245 | 8,162,544 | (7,787,245) | (8,162,544) | - | - |
| Nonexchange Revenue (Note 34) | 318,662 | 299,725 | - | - | 318,662 | 299,725 |
| Transfers In/Out (Note 30) | 11,136 | (19,807) | - | - | 11,136 | (19,807) |
| Trust Fund Appropriations | | | | | | |
| Total Budgetary Financing Sources | <u>\$ 8,117,043</u> | <u>\$ 8,442,462</u> | <u>\$ 147,453</u> | <u>\$ 91,900</u> | <u>\$ 8,264,496</u> | <u>\$ 8,534,362</u> |
| Other Financing Sources: | | | | | | |
| Transfers In/Out (Note 30) | \$ 436 | \$ (436) | \$ - | \$ - | \$ 436 | \$ (436) |
| Imputed Financing Sources (Note 31) | 138,140 | 128,861 | - | - | 138,140 | 128,861 |
| Total Other Financing Sources | <u>\$ 138,576</u> | <u>\$ 128,425</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 138,576</u> | <u>\$ 128,425</u> |
| Net Cost of Operations | (8,033,945) | (8,509,202) | - | - | (8,033,945) | (8,509,202) |
| Net Change | 221,674 | 61,685 | 147,453 | 91,900 | 369,127 | 153,585 |
| Net Position - End of Period | <u><u>\$ 5,408,285</u></u> | <u><u>\$ 5,186,611</u></u> | <u><u>\$ 11,007,589</u></u> | <u><u>\$ 10,860,136</u></u> | <u><u>\$ 16,415,874</u></u> | <u><u>\$ 16,046,747</u></u> |

5.
Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|----------------------|----------------------|
| BUDGETARY RESOURCES | | |
| Budgetary Authority: | | |
| Appropriations Received | \$ 8,032,620 | \$ 8,353,924 |
| Borrowing Authority | 436 | 5,554 |
| Net Transfers | 1,348,725 | 1,336,786 |
| Unobligated Balances: | | |
| Beginning of Period | 2,996,708 | 2,865,677 |
| Net Transfers, Actual | | (1,538) |
| Spending Authority from Offsetting Collections: | | |
| Earned and Collected | \$ 557,692 | \$ 471,777 |
| Receivable from Federal Sources | 5,311 | (23,156) |
| Change in Unfilled Customer Orders: | | |
| Advance Received | 37,615 | (31,207) |
| Without Advance from Federal Sources | 118,144 | 7,288 |
| Transfers from Trust Funds Collected | 69,572 | 67,959 |
| Transfers from Trust Funds, Anticipated | (20,890) | (16,293) |
| Total Spending Authority from Collections | \$ 767,444 | \$ 476,368 |
| Recoveries of Prior Year Obligations (Note 25) | 174,641 | 194,775 |
| Temporarily Not Available Pursuant to Public Law (Note 25) | (11,141) | (8,254) |
| Permanently Not Available (Note 25) | (78,244) | (71,203) |
| Total Budgetary Resources (Note 24) | <u>\$ 13,231,189</u> | <u>\$ 13,152,089</u> |
| STATUS OF BUDGETARY RESOURCES | | |
| Obligations Incurred: | | |
| Direct | \$ 9,573,696 | \$ 9,745,606 |
| Reimbursable | 550,737 | 409,775 |
| Total Obligations Incurred (Note 24) | \$ 10,124,433 | \$ 10,155,381 |
| Unobligated Balances: | | |
| Apportioned (Note 26) | 3,018,689 | 2,903,849 |
| Unobligated Balances Not Available (Note 26) | 88,067 | 92,859 |
| Total Status of Budgetary Resources | <u>\$ 13,231,189</u> | <u>\$ 13,152,089</u> |
| RELATIONSHIP OF OBLIGATIONS TO OUTLAYS | | |
| Obligations Incurred, Net | \$ 9,182,350 | \$ 9,484,238 |
| Obligated Balances, Net - Beginning of Period | 11,207,776 | 11,420,719 |
| Accounts Receivable | 64,972 | 80,554 |
| Unfilled Customer Orders from Federal Sources | 422,012 | 303,869 |
| Undelivered Orders, Unpaid | (10,636,009) | (10,467,637) |
| Accounts Payable | (987,090) | (1,124,560) |
| Total Outlays (Note 24) | <u>\$ 9,254,011</u> | <u>\$ 9,697,183</u> |
| Disbursements | \$ 9,918,889 | \$ 10,205,713 |
| Collections | (664,878) | (508,530) |
| Less: Offsetting Receipts (Note 27) | (1,334,508) | (1,350,841) |
| Net Outlays | <u>\$ 7,919,503</u> | <u>\$ 8,346,342</u> |

6.
Environmental Protection Agency
Consolidated Statement of Financing
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|------------------|------------------|
| RESOURCES USED TO FINANCE ACTIVITIES: | | |
| Budgetary Resources Obligated | | |
| Obligations Incurred | \$ 10,124,433 | \$ 10,155,381 |
| Less: Spending Authority from Offsetting | | |
| Collections and Recoveries | (942,084) | (671,143) |
| Obligations, Net of Offsetting Collections | \$ 9,182,349 | \$ 9,484,238 |
| Less: Offsetting Receipts (Note 27) | (1,334,508) | (1,350,841) |
| Net Obligations | \$ 7,847,841 | \$ 8,133,397 |
| Other Resources: | | |
| Imputed Financing Sources (Note 31) | 138,140 | 128,861 |
| Net Other Resources Used to Finance Activities | \$ 138,140 | \$ 128,861 |
| Total Resources Used To Finance Activities | \$ 7,985,981 | \$ 8,262,258 |
| RESOURCES USED TO FINANCE ITEMS | | |
| NOT PART OF NET COST OF OPERATIONS | | |
| Change in Budgetary Resources Obligated | \$ (33,501) | \$ 192,871 |
| Resources that Fund Prior Period Expenses (Note 28) | (1,120) | (13,855) |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations: | | |
| Liabilities for Guarantees of Subsidy Allowances | 4,337 | 4,142 |
| Offsetting Receipts Not Affecting Net Cost | 87,031 | 93,304 |
| Resources that Finance Asset Acquisition | (137,277) | (106,185) |
| Total Resources Used to Finance Items Not Part of the Net Cost of Operations | \$ (80,530) | \$ 170,277 |
| Total Resources Used to Finance the Net Cost of Operations | \$ 7,905,451 | \$ 8,432,535 |

6.
Environmental Protection Agency
Consolidated Statement of Financing
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD | <u>FY 2005</u> | <u>FY 2004</u> |
|---|-----------------------------------|-----------------------------------|
| Components Requiring or Generating Resources in Future Periods: | | |
| Increase in Annual Leave Liability (Note 28) | \$ 3,889 | \$ - |
| Increase in Environmental and Disposal Liability (Note 28) | 99 | 1,244 |
| Increase in Unfunded Contingencies (Note 28) | 1,525 | 22,425 |
| Up/Downward Reestimates of Subsidy Expense (Note 28) | 3 | - |
| Increase in Public Exchange Revenue Receivable | (101,645) | (59,937) |
| Other (Note 35) | <u>1,969</u> | <u>-</u> |
| Total Components of Net Cost of Operations that Requires or Generates Resources in the Future | \$ (94,160) | \$ (36,268) |
| Components Not Requiring/Generating Resources: | | |
| Depreciation and Amortization | 39,760 | 47,791 |
| Expenses Not Requiring Budgetary Resources | <u>182,894</u> | <u>65,144</u> |
| Total Components of Net Cost of Operations that Will Not Require or Generate Resources | \$ 222,654 | \$ 112,935 |
| Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period | <u>\$ 128,494</u> | <u>\$ 76,667</u> |
| Net Cost of Operations | <u><u>\$ 8,033,945</u></u> | <u><u>\$ 8,509,202</u></u> |

7.
Environmental Protection Agency
Statement of Custodial Activity
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-------------------|-------------------|
| Revenue Activity: | | |
| Sources of Collections | | |
| Fines and Penalties | \$ 141,087 | \$ 162,948 |
| Other | (53,836) | 24,463 |
| Total Cash Collections | <u>\$ 87,251</u> | <u>\$ 187,411</u> |
| Accrual Adjustment | 63,565 | (24,865) |
| Total Custodial Revenue (Note 23) | <u>\$ 150,816</u> | <u>\$ 162,546</u> |
| Disposition of Collections: | | |
| Transferred to Others (General Fund) | \$ 87,334 | \$ 187,194 |
| Increases/Decreases in Amounts to be Transferred | 63,482 | (24,648) |
| Total Disposition of Collections | <u>\$ 150,816</u> | <u>\$ 162,546</u> |
| Net Custodial Revenue Activity (Note 23) | <u>\$ -</u> | <u>\$ -</u> |

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

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

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

B. Reporting Entities

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

For FY 2005, the accompanying financial statements are grouped and presented in a consolidated manner. The accompanying financial statements include the accounts of all funds described in this note by their respective Treasury fund group.

General Fund Appropriations (Treasury Fund Groups 0000 – 3999)

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

b. Science and Technology (S&T) Appropriation: The S&T appropriation, Treasury fund group 0107, finances salaries, travel, science, technology, research and development activities including laboratory 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 2005, Superfund research costs were appropriated in Superfund and transferred to S&T to allow for proper accounting of the

costs. Environmental scientific and technological activities and programs include Clean Air; Clean and Safe Water; Americans Right to Know About Their Environment; Better Waste Management; Preventing Pollution and Reducing Risk in Communities, Homes, Workplaces, and Ecosystems; and Safe Food.

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

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

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

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

g. *Asbestos Loan Program:* The Asbestos Loan Program is accounted for under Treasury fund group 0118 for the subsidy and administrative support; under Treasury fund group 4322 for loan disbursements, loans receivable and loan collections on post FY 1991 loans; and under Treasury fund group 2917 for pre FY 1992 loans receivable and loan collections.

The Asbestos Loan Program was authorized by the Asbestos School Hazard Abatement Act of 1986 to finance control of asbestos building materials in schools. Funds have not been appropriated for this Program since FY 1993. For FY 1993 and FY 1992, 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 the subsidy. The Financing Fund receives the subsidy payment, borrows from Treasury and collects the asbestos loans.

h. *Allocations and Appropriations transferred to the Agency:* Allocations and appropriations transferred to the Agency from other federal agencies include funds from the Appalachian Regional Commission, which provides economic assistance to state and local developmental activities, and the Agency for International Development, which provides assistance on

environmental matters at international levels. The transfer allocations are accounted for under Treasury fund group 0200 and the appropriation transfers are accounted for under 0108.

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

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

Revolving Funds (Treasury Fund Group 4000 – 4999)

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

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

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

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

Special Funds (Treasury Fund Group 5000 - 5999)

a. Environmental Services Receipt Account: The Environmental Services Receipt account, Treasury fund group 5295, was established for the deposit of fee receipts associated with environmental programs, including radon measurement proficiency ratings and training, motor vehicle engine certifications, and water pollution permits. Receipts in this special fund will be appropriated to the S&T and the EPM appropriations to meet the expenses of the programs that generate the receipts.

b. Exxon Valdez Settlement Fund: The Exxon Valdez Settlement Fund, Treasury fund group 5297, has funds available to carry out authorized environmental restoration activities. Funding is derived from the collection of reimbursements under the Exxon Valdez settlement as a result of an oil spill.

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

Deposit funds (Treasury Fund Group 6000 – 6999)

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. These funds are accounted for under Treasury fund groups 6050, 6264, 6265, 6266, 6275 and 6500.

Trust Funds (Treasury Fund Group 8000 – 8999)

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

b. Leaking Underground Storage Tank (LUST) Trust Fund: The LUST Trust Fund, Treasury fund group 8153, was authorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA) as amended by the Omnibus Budget Reconciliation Act of 1990. The LUST appropriation provides funding to respond to releases from leaking underground petroleum tanks. The Agency oversees cleanup and enforcement programs which are implemented by the states. Funds are allocated to the states through cooperative agreements to clean up those sites posing

the greatest threat to human health and the environment. Funds are used for grants to non-state entities including Indian tribes under Section 8001 of the Resource Conservation and Recovery Act. The program is financed by a one cent a gallon tax on motor fuels which will expire in 2011.

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

d. *Miscellaneous Contributed Funds Trust Fund:* The Miscellaneous Contributed Funds Trust Fund, Treasury fund group 8741, includes gifts for pollution control programs that are usually designated for a specific use by donors and/or deposits from pesticide registrants to cover the costs of petition hearings when such hearings result in unfavorable decisions to the petitioner.

C. Budgets and Budgetary Accounting

General Funds

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

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

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

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

Revolving Funds

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

Funding of the WCF is provided by fees collected from other Agency appropriations and other federal agencies to offset costs incurred for providing Agency administrative support for computer support and postage.

Special Funds

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

Exxon Valdez uses funding collected from reimbursement from the Exxon Valdez settlement.

Deposit Funds

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

Trust Funds

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

D. Basis of Accounting

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

E. Revenues and Other Financing Sources.

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

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

The majority of all other funds receive funding needed to support programs through appropriations, which may be used, within statutory limits, for operating and capital expenditures. However, under Credit Reform provisions, the Asbestos Loan Program received funding to support the subsidy cost of loans through appropriations which may be used 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 Pesticide Registration funds receive funding through fees collected for services provided and interest on invested funds. The WCF receives revenue through fees collected for services provided to Agency program offices. Such revenue is eliminated with related Agency program expenses upon consolidation of the Agency's financial statements. The Exxon Valdez Settlement Fund receives funding through reimbursements.

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

F. Funds with the Treasury

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

G. Investments in U.S. Government Securities

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

H. Notes Receivable

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

I. Marketable Securities

The Agency records marketable securities at cost as of the date of receipt. Marketable securities are held by Treasury and reported at their cost value in the financial statements until sold (see Note 6).

J. Accounts Receivable and Interest Receivable

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

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

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

The Agency also records accounts receivable from states for a percentage of Superfund site remedial action costs incurred by the Agency within those states. As agreed to under SSCs, cost sharing arrangements may vary according to whether a site was privately or publicly operated at the time of hazardous substance disposal and whether the Agency response action was removal

or remedial. SSC agreements are usually for 10 percent or 50 percent of site remedial action costs. 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.

K. Advances and Prepayments

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

L. Loans Receivable

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

M. Appropriated Amounts Held by Treasury

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

N. Property, Plant, and Equipment

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

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

Superfund contractor-held property used as part of the remedy for site-specific response actions is capitalized in accordance with the Agency's capitalization threshold. This property is part of the remedy at the site and eventually becomes part of the site itself. Once the response action has been completed and the remedy implemented, EPA will retain control of the property, e.g., pump

and treat facility, for 10 years or less, and will transfer its interest in the facility to the respective state for mandatory operation and maintenance – usually 20 years or more. Consistent with EPA’s 10 year retention period, depreciation for this property will be based on a 10 year life. However, if any property is transferred to a state in a year or less, this property will be charged to expense. If any property is sold prior to EPA relinquishing interest, the proceeds from the sale of that property shall be applied against contract payments or refunded as required by the Federal Acquisition Regulations.

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 is valued at actual cost. Depreciation for real property is calculated using the straight-line method over the specific asset’s useful life, ranging from 10 to 102 years. Leasehold improvements are amortized over the lesser of their useful life or the unexpired lease term. Additions to property and improvements not meeting the capitalization criteria, expenditures for minor alterations, and repairs and maintenance are expensed as incurred.

Software for Working Capital Fund, a revenue generating activity, is capitalized if the purchase price was \$100 thousand or more with an estimated useful life of 2 years or more. All other funds capitalize software whose acquisition value is \$500 thousand 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 asset’s useful life ranging from 2 to 10 years.

O. Liabilities

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

P. Borrowing Payable to the Treasury

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

Q. Interest Payable to Treasury

The Asbestos Loan Program makes periodic interest payments to Treasury based on its debt to Treasury. At the end of FY 2004 and FY 2005, there was no outstanding interest payable to Treasury since payment was made through September 30.

R. Accrued Unfunded Annual Leave

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

S. Retirement Plan

There are two primary retirement systems for federal employees. Employees hired prior to January 1, 1984, may participate in the Civil Service Retirement System (CSRS). On January 1, 1984, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, elected to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which the Agency automatically contributes one percent of pay and matches any employee contributions up to an additional four percent of pay. The Agency also contributes the employer's matching share for Social Security.

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

T. Prior Period Adjustments

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

Note 2. Fund Balances with Treasury

Fund Balances with Treasury as of September 30, 2005 and 2004, consist of the following:

| | <u>FY 2005</u> | | | <u>FY 2004</u> | | |
|-------------------------|----------------------|--------------------------|----------------------|----------------------|--------------------------|----------------------|
| | <u>Entity Assets</u> | <u>Non-Entity Assets</u> | <u>Total</u> | <u>Entity Assets</u> | <u>Non-Entity Assets</u> | <u>Total</u> |
| Trust Funds: | | | | | | |
| Superfund | \$ 213,797 | \$ - | \$ 213,797 | \$ 199,406 | \$ - | \$ 199,406 |
| LUST | 17,613 | - | 17,613 | 14,825 | - | 14,825 |
| Oil Spill & Misc. | 9,169 | - | 9,169 | 10,222 | - | 10,222 |
| Revolving Funds: | | | | | | |
| FIFRA/Tolerance | 7,970 | - | 7,970 | 4,913 | - | 4,913 |
| Working Capital | 69,401 | - | 69,401 | 53,560 | - | 53,560 |
| Cr. Reform Finan. | 489 | - | 489 | 492 | - | 492 |
| Appropriated | 11,655,287 | - | 11,655,287 | 11,639,189 | - | 11,639,189 |
| Other Fund Types | 157,303 | 8,178 | 165,481 | 136,646 | 5,892 | 142,538 |
| Total | \$ 12,131,029 | \$ 8,178 | \$ 12,139,207 | \$ 12,059,253 | \$ 5,892 | \$ 12,065,145 |

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

| Status of Fund Balances: | <u>FY 2005</u> | <u>FY 2004</u> |
|---|-----------------------|-----------------------|
| Unobligated Amounts in Fund Balances: | | |
| Available for Obligation | \$ 3,018,690 | \$ 2,903,849 |
| Unavailable for Obligation | 88,066 | 92,861 |
| Net Receivables from Invested Balances | (2,278,343) | (2,471,574) |
| Balances in Treasury Trust Fund (Note 17) | 19,965 | 201,438 |
| Obligated Balance not yet Disbursed | 11,136,112 | 11,207,766 |
| Non-Budgetary FBWT | 154,717 | 130,805 |
| Totals | \$ 12,139,207 | \$ 12,065,145 |

The funds available for obligation may be apportioned by the OMB for new obligations at the beginning of the following fiscal year. Funds unavailable for obligation are mostly balances in expired funds, which are available only for adjustments of existing obligations. For FY 2005 and FY 2004 no differences existed between Treasury's accounts and EPA's statements for fund balances with Treasury.

Note 3. Cash

As of September 30, 2005 and 2004, cash consists of an imprest fund of \$10 thousand.

Note 4. Investments

As of September 30, 2005 and 2004 investments consist of the following:

| | | Cost | Unamortized (Premium) Discount | Interest Receivable | Investments, Net | Market Value |
|--------------------------------------|---------|--------------|---|--------------------------------|-----------------------------|-------------------------|
| Intragovernmental Securities: | | | | | | |
| Non-Marketable | FY 2005 | \$ 4,762,154 | \$ (16,261) | \$ 32,650 | \$ 4,811,065 | \$ 4,811,065 |
| Non-Marketable | FY 2004 | \$ 4,459,647 | \$ (47,536) | \$ 27,315 | \$ 4,534,498 | \$ 4,534,498 |

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

Note 5. Accounts Receivable

The Accounts Receivable for September 30, 2005 and 2004, consist of the following:

| | <u>FY 2005</u> | <u>FY 2004</u> |
|------------------------------------|--------------------------|--------------------------|
| Intragovernmental Assets: | | |
| Accounts & Interest Receivable | \$ <u>66,060</u> | \$ <u>42,770</u> |
| Non-Federal Assets: | | |
| Unbilled Accounts Receivable | \$ 89,818 | \$ 93,440 |
| Accounts & Interest Receivable | 1,092,376 | 1,015,721 |
| Less: Allowance for Uncollectibles | <u>(807,526)</u> | <u>(694,666)</u> |
| Total | \$ <u>374,668</u> | \$ <u>414,495</u> |

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

Note 6. Other Assets

Other Assets for September 30, 2005 and 2004, consist of the following:

| Intragovernmental Assets: | <u>FY 2005</u> | <u>FY 2004</u> |
|---|------------------------|------------------------|
| Advances to Federal Agencies | \$ 1,102 | \$ 767 |
| Advances to WCF | 827 | - |
| Advances for Postage | 406 | 553 |
| Total Intragovernmental Assets | <u>\$ 2,335</u> | <u>\$ 1,320</u> |
| Non-Federal Assets: | | |
| Travel Advances | \$ (898) | \$ (1,008) |
| Letter of Credit Advances | 9 | 271 |
| Grant Advances | 1,710 | 1,164 |
| Other Advances | 946 | 830 |
| Operating Materials and Supplies | 183 | 200 |
| Inventory for Sale | 204 | 51 |
| Securities Received in Settlement of Debt | 635 | - |
| Total Non-Federal Assets | <u>\$ 2,789</u> | <u>\$ 1,508</u> |

Note 7. Loans Receivable, Net - Non-Federal

Asbestos Loan Program loans disbursed from obligations made prior to FY 1992 are net of allowances for estimated uncollectible loans, if an allowance was considered necessary. Loans disbursed from obligations made after FY 1991 are governed by the Federal Credit Reform Act, which mandates that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, anticipated delinquencies, and defaults) associated with direct loans be recognized as an expense in the year the loan is made. The net loan present value is the gross loan receivable less the subsidy present value. The amounts as of September 30, 2005 and 2004, are as follows:

| | <u>FY 2005</u> | | | <u>FY 2004</u> | | |
|---|--|--------------------------|--|--|--------------------------|--|
| | 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 | \$ 18,118 | \$ - | \$ 18,118 | \$ 25,243 | \$ - | \$ 25,243 |
| Direct Loans Obligated After FY 1991 | 26,427 | (5,198) | 21,229 | 30,466 | (6,782) | 23,684 |
| Total | <u>\$ 44,545</u> | <u>\$ (5,198)</u> | <u>\$ 39,347</u> | <u>\$ 55,709</u> | <u>\$ (6,782)</u> | <u>\$ 48,927</u> |

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

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

| | Interest Rate Re-estimate | Technical Re-estimate | Total |
|---------------------------------------|--------------------------------------|----------------------------------|----------------|
| Downward Subsidy Reestimate - FY 2005 | \$ (233) | \$ (203) | \$ (436) |
| Upward Subsidy Reestimate – FY 2005 | 129 | 128 | 257 |
| FY 2005 Totals | \$ (104) | (75) | (179) |
| Downward Subsidy Reestimate - FY 2004 | \$ (2,660) | \$ (2,894) | \$ (5,554) |
| FY 2004 Totals | \$ (2,600) | (2,894) | (5,554) |

Note 8. Accounts Payable and Accrued Liabilities

The Accounts Payable and Accrued Liabilities are current liabilities and consist of the following amounts as of September 30, 2005 and 2004.

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-----------------------|-----------------------|
| Intragovernmental: | | |
| Accounts Payable to other Federal Agencies | \$ 774 | \$ 1,808 |
| Liability for Allocation Transfers | 19,878 | 31,286 |
| Accrued Liabilities, Federal | 99,184 | 71,570 |
| Total Intragovernmental | \$ 119,836 | \$ 104,664 |
| Non-Federal: | | |
| | <u>FY 2005</u> | <u>FY 2004</u> |
| Accounts Payable, Non-Federal | \$ 105,027 | \$ 93,262 |
| Advances Payable, Non-Federal | 24 | 19 |
| Interest Payable | 7 | 41 |
| Grant Liabilities | 449,206 | 594,124 |
| Other Accrued Liabilities, Non-Federal | 176,014 | 194,405 |
| Total Non-Federal | \$ 730,278 | \$ 881,851 |

Note 9. General Plant, Property and Equipment

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

As of September 30, 2005 and 2004, Plant, Property and Equipment consist of the following:

| | FY 2005 | | | FY 2004 | | |
|------------------------|--------------------------|---------------------------------|-----------------------|--------------------------|---------------------------------|-----------------------|
| | Acquisition Value | Accumulated Depreciation | Net Book Value | Acquisition Value | Accumulated Depreciation | Net Book Value |
| EPA-Held Equipment | \$ 194,410 | \$ (109,683) | \$ 84,727 | \$ 188,844 | \$ (112,793) | \$ 76,051 |
| Software | 146,132 | (19,777) | 126,355 | 105,634 | (14,881) | 90,753 |
| Contractor Held Equip. | 56,746 | (22,706) | 34,040 | 61,571 | (19,385) | 42,186 |
| Land and Buildings | 558,689 | (122,012) | 436,677 | 547,876 | (114,184) | 433,692 |
| Capital Leases | 50,111 | (23,194) | 26,917 | 49,956 | (19,275) | 30,681 |
| Total | \$ 1,006,088 | \$ (297,372) | \$ 708,716 | \$ 953,881 | \$ (280,518) | \$ 673,363 |

Note 10. Debt

The debt due to Treasury consists of the following as of September 30, 2005 and 2004:

| All Other Funds | FY 2005 | | | FY 2004 | | |
|---------------------------|--------------------------|----------------------|-----------------------|--------------------------|----------------------|-----------------------|
| | Beginning Balance | Net Borrowing | Ending Balance | Beginning Balance | Net Borrowing | Ending Balance |
| Intragovernmental: | | | | | | |
| Debt to Treasury | \$ 24,101 | \$ (2,357) | \$ 21,744 | \$ 21,189 | \$ 2,912 | \$ 24,101 |

Note 11. Custodial Liability

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

Note 12. Other Liabilities

Other Liabilities consist of the following as of September 30, 2005:

| Other Liabilities – Intragovernmental | Covered by Budgetary Resources | Not Covered by Budgetary Resources | Total |
|--|---|---|-------------------|
| Current | | | |
| Employer Contributions & Payroll Taxes | \$ 12,731 | \$ - | \$ 12,731 |
| WCF Advances | 17,392 | - | 17,392 |
| Other Advances | 4,737 | - | 4,737 |
| Advances, HRSTF Cashout | 41,207 | - | 41,207 |
| Deferred HRSTF Cashout | 60 | - | 60 |
| Liability for Deposit Funds | (82) | - | (82) |
| Resources Payable to Treasury | 1 | - | 1 |
| Non-Current | | | |
| Unfunded FECA Liability | - | 8,484 | 8,484 |
| Payable to Treasury Judgment Fund | - | 22,000 | 22,000 |
| Total Intragovernmental | \$ 76,046 | \$ 30,484 | \$ 106,530 |
| Other Liabilities - Non-Federal | | | |
| Current | | | |
| Unearned Advances, Non-Federal | \$ 59,388 | - | \$ 59,388 |
| Liability for Deposit Funds, Non-Federal | (70) | - | (70) |
| Non-Current | | | |
| Other Liabilities | - | 30 | 30 |
| Capital Lease Liability | - | 38,716 | 38,716 |
| Total Non-Federal | \$ 59,318 | \$ 38,746 | \$ 98,064 |

Other Liabilities consist of the following as of September 30, 2004:

| Other Liabilities – Intragovernmental | Covered by Budgetary Resources | Not Covered by Budgetary Resources | Total |
|--|---|---|------------------|
| Current | | | |
| Employer Contributions & Payroll Taxes | \$ 10,760 | - | \$ 10,760 |
| Other Advances | 3,522 | - | 3,522 |
| Advances, HRSTF Cashout | 32,724 | - | 32,724 |
| Deferred HRSTF Cashout | 3 | - | 3 |
| Liability for Deposit Funds | (30) | - | (30) |
| Resources Payable to Treasury | 1 | - | 1 |
| Subsidy Payable to Treasury | 437 | - | 437 |
| Non-Current | | | |
| Unfunded FECA Liability | - | 8,704 | 8,704 |
| Payable to Treasury Judgment Fund* | - | 22,000 | 22,000 |
| Total Intragovernmental | \$ 47,417 | \$ 30,704 | \$ 78,121 |

| Other Liabilities - Non-Federal | Covered by Budgetary Resources | Not Covered by Budgetary Resources | Total |
|--|---|---|-------------------|
| Current | | | |
| Unearned Advances, Non-Federal | \$ 56,824 | \$ - | \$ 56,824 |
| Liability for Deposit Funds, Non-Federal | 5,601 | - | 5,601 |
| Non-Current | | | |
| Capital Lease Liability | - | 41,491 | 41,491 |
| Total Non-Federal | \$ 62,425 | \$ 41,491 | \$ 103,916 |

Note 13. Leases

Capital Leases:

The Capital Leases:

| Summary of Assets Under Capital Lease: | <u>FY 2005</u> | <u>FY 2004</u> |
|---|-------------------------|-------------------------|
| Real Property | \$ 40,913 | \$ 40,913 |
| Personal Property | 2,761 | 2,606 |
| Software License | 6,437 | 6,437 |
| Total | \$ <u>50,111</u> | \$ <u>49,956</u> |
| Accumulated Amortization | \$ 23,194 | \$ 19,275 |

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

EPA also has capital leases terminating in FY 2007 for seven shuttle buses. These leases are expended out of the EPM appropriation.

EPA has two capital leases expended out of the Working Capital Fund. The capital leases are for an IBM Supercomputer and MicroSoft Office software. These leases terminate in 2006 and 2009, respectively.

During FY 2005, EPA entered into a capital lease for a Storage Area Network. The lease terminates in FY 2007 and payments are expended from the EPM appropriation. The total future minimum capital lease payments are listed below.

| <u>Future Payments Due:</u> | |
|---|--------------------------------|
| Fiscal Year | Capital Leases |
| 2006 | \$ 8,888 |
| 2007 | 8,147 |
| 2008 | 7,866 |
| 2009 | 6,295 |
| 2010 | 6,101 |
| After 5 Years | <u>64,912</u> |
| Total Future Minimum Lease Payments | \$ 102,209 |
| Less: Imputed Interest | <u>(63,493)</u> |
| Net Capital Lease Liability | \$ <u>38,716</u> |
| Liabilities not Covered by Budgetary Resources (See Note 12) | \$ <u><u>38,716</u></u> |

Operating Leases:

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

EPA has three direct operating leases for land and buildings housing scientific laboratories and/or computer facilities. 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. Two of these leases expire in FYs 2017 and 2020. A third lease, originally expired in FY 2001, was extended until FY 2007. These charges are expended from the EPM appropriation. The total minimum future operating lease costs are listed below.

| <u>Fiscal Year</u> | <u>Operating Leases, Land and Buildings</u> |
|--|--|
| 2006 | \$ 87 |
| 2007 | 81 |
| 2008 | 74 |
| 2009 | 74 |
| 2010 | 74 |
| Beyond 2010 | <u>624</u> |
| Total Future Minimum Lease Payments | \$ <u><u>1,014</u></u> |

Note 14. Pension and Other Actuarial Liabilities

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

The FECA Actuarial Liability at September 30, 2005 and 2004, consists of the following:

| | FY 2005 | FY 2004 |
|---------------------------------|----------------|----------------|
| FECA Actuarial Liability | \$ 39,380 | \$ 40,281 |

The FY 2005 present value of these estimated outflows are calculated using a discount rate of 4.528 percent in the first year, and 5.02 percent in the years thereafter. The estimated future costs are recorded as an unfunded liability.

Note 15. Cashout Advances

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

Note 16. Unexpended Appropriations

As of September 30, 2005 and 2004, the Unexpended Appropriations consist of the following:

| Unexpended Appropriations: | <u>FY 2005</u> | <u>FY 2004</u> |
|-----------------------------------|-----------------------------|-----------------------------|
| Unobligated | | |
| Available | \$ 1,887,884 | \$ 1,911,797 |
| Unavailable | 40,328 | 39,591 |
| Undelivered Orders | 9,079,377 | 8,908,748 |
| Total | <u>\$ 11,007,589</u> | <u>\$ 10,860,136</u> |

Note 17. Amounts Held by Treasury

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

Superfund (Unaudited)

Superfund is supported primarily by general revenues, cost recoveries of funds spent to clean up hazardous waste sites, interest income, and fines and penalties. Prior to December 31, 1995, the fund was also supported by other taxes on crude oil 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 Treasury as of September 30, 2005 and 2004. The amounts contained in these notes have been provided by Treasury and are audited. As indicated, a portion of the outlays represents amounts received by EPA's Superfund Trust Fund; such funds are eliminated on consolidation with the Superfund Trust Fund maintained by Treasury.

| SUPERFUND FY 2005 | EPA | Treasury | Combined |
|-------------------------------------|---------------------|---------------------|---------------------|
| Undistributed Balances | | | |
| Uninvested Fund Balance | \$ - | \$ 7,212 | \$ 7,212 |
| Total Undisbursed Balance | - | 7,212 | 7,212 |
| Interest Receivable | - | 4,180 | 4,180 |
| Investments, Net | 2,204,850 | 88,163 | 2,293,013 |
| Total Assets | \$ 2,204,850 | \$ 99,555 | \$ 2,304,405 |
| Liabilities & Equity | | | |
| Equity | \$ 2,204,850 | \$ 99,555 | \$ 2,304,405 |
| Total Liabilities and Equity | \$ 2,204,850 | \$ 99,555 | \$ 2,304,405 |
| Receipts | | | |
| Corporate Environmental | \$ - | \$ 3,663 | \$ 3,663 |
| Cost Recoveries | - | 62,978 | 62,978 |
| Fines & Penalties | - | 2,428 | 2,428 |
| Total Revenue | - | 69,069 | 69,069 |
| Appropriations Received | - | 1,247,477 | 1,247,477 |
| Interest Income | - | 52,540 | 52,540 |
| Total Receipts | \$ - | \$ 1,369,086 | \$ 1,369,086 |
| Outlays | | | |
| Transfers to/from EPA, Net | \$ 1,261,913 | \$ (1,261,913) | - |
| Total Outlays | 1,261,913 | (1,261,913) | - |
| Net Income | \$ 1,261,913 | \$ 107,173 | \$ 1,369,086 |

In FY 2005, the EPA received an appropriation for Superfund of \$1,260.6 million. Treasury's Bureau of Public Debt (BPD), the manager of the Superfund Trust Fund assets, records a liability to EPA for the amount of the appropriation. BPD does this to indicate those trust fund assets that have been assigned for use and, therefore, are not available for appropriation. As of September 30, 2005 and 2004, the Treasury Trust Fund has a liability to EPA for previously appropriated funds of \$2,204.9 million and \$2,402.1 million, respectively.

| SUPERFUND FY 2004 | EPA | Treasury | Combined |
|-------------------------------------|---------------------|---------------------|---------------------|
| Undistributed Balances | | | |
| Uninvested Fund Balance | \$ - | \$ 188,182 | \$ 188,182 |
| Total Undisbursed Balance | - | 188,182 | 188,182 |
| Interest Receivable | - | 38 | 38 |
| Investments, Net | 2,402,074 | (184,778) | 2,217,296 |
| Total Assets | \$ 2,402,074 | \$ 3,442 | \$ 2,405,516 |
| Liabilities & Equity | | | |
| Liability for Allocation to CDC | - | 11,061 | 11,061 |
| Equity | \$ 2,402,074 | \$ (7,619) | \$ 2,394,455 |
| Total Liabilities and Equity | \$ 2,402,074 | \$ 3,442 | \$ 2,405,516 |
| Receipts | | | |
| Corporate Environmental | \$ - | \$ 867 | \$ 867 |
| Cost Recoveries | - | 74,063 | 74,063 |
| Fines & Penalties | - | 2,818 | 2,818 |
| Total Revenue | - | 77,748 | 77,748 |
| Appropriations Received | - | 1,257,536 | 1,257,536 |
| Interest Income | - | 27,380 | 27,380 |
| Total Receipts | \$ - | \$ 1,362,664 | \$ 1,362,664 |
| Outlays | | | |
| Transfers to EPA | \$ 1,256,790 | \$ (1,256,790) | \$ - |
| Transfers to CDC | - | (30,763) | (30,763) |
| Total Outlays | 1,256,790 | (1,287,553) | (30,763) |
| Net Income | \$ 1,256,790 | \$ 75,111 | \$ 1,331,901 |

During FY 2004, the Superfund Trust Fund revenue from cost recoveries and investment interest was less than anticipated. In addition, in FY 2003 the Internal Revenue Service issued approximately \$99.4 million in corporate net tax refunds that were previously deposited in the Trust Fund. Due to these circumstances, the amount appropriated to EPA for Superfund activities exceeded the assets available for appropriation in the Trust Fund by \$7.6 million at the end of FY 2004.

LUST (Unaudited)

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FYs 2005 and 2004 there were no fund receipts from cost recoveries. The following represents the LUST Trust Fund as maintained by Treasury. The amounts contained in these notes have been provided by Treasury 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.

| LUST FY 2005 | EPA | Treasury | Combined |
|-------------------------------------|------------------|---------------------|---------------------|
| Undistributed Balances | | | |
| Uninvested Fund Balance | \$ - | \$ 12,754 | \$ 12,754 |
| Total Undisbursed Balance | - | 12,754 | 12,754 |
| Interest Receivable | - | 28,470 | 28,470 |
| Investments, Net | 86,584 | 2,398,823 | 2,485,407 |
| Total Assets | \$ 86,584 | \$ 2,440,047 | \$ 2,526,631 |
| Liabilities & Equity | | | |
| Equity | \$ 86,584 | \$ 2,440,047 | \$ 2,526,631 |
| Total Liabilities and Equity | \$ 86,584 | \$ 2,440,047 | \$ 2,526,631 |
| Receipts | | | |
| Highway TF Tax | \$ - | \$ 182,953 | \$ 182,953 |
| Airport TF Tax | - | 11,034 | 11,034 |
| Inland TF Tax | - | 456 | 456 |
| Refund Gasoline Tax | - | (1,760) | (1,760) |
| Refund Diesel Tax | - | (2,643) | (2,643) |
| Refund Aviation Fuel | - | (342) | (342) |
| Refund Aviation Tax | - | (30) | (30) |
| Cost Recoveries | - | 1,455 | 1,455 |
| Total Revenue | - | 191,123 | 191,123 |
| Interest Income | - | 77,666 | 77,666 |
| Total Receipts | \$ - | \$ 268,789 | \$ 268,789 |
| Outlays | | | |
| Transfers to/from EPA, Net | \$ 69,440 | \$ (69,440) | \$ - |
| Total Outlays | 69,440 | (69,440) | - |
| Net Income | \$ 69,440 | \$ 199,349 | \$ 268,789 |

| LUST FY 2004 | EPA | Treasury | Combined |
|-------------------------------------|------------------|---------------------|---------------------|
| Undistributed Balances | | | |
| Uninvested Fund Balance | \$ - | \$ 13,256 | \$ 13,256 |
| Total Undisbursed Balance | - | 13,256 | 13,256 |
| Interest Receivable | - | 27,277 | 27,277 |
| Investments, Net | 89,725 | 2,200,165 | 2,289,890 |
| Total Assets | \$ 89,725 | \$ 2,240,698 | \$ 2,330,423 |
| Liabilities & Equity | | | |
| Equity | \$ 89,725 | \$ 2,240,698 | \$ 2,330,423 |
| Total Liabilities and Equity | \$ 89,725 | \$ 2,240,698 | \$ 2,330,423 |
| Receipts | | | |
| Highway TF Tax | \$ - | \$ 180,763 | \$ 180,763 |
| Airport TF Tax | - | 11,678 | 11,678 |
| Inland TF Tax | - | 454 | 454 |
| Refund Gasoline Tax | - | (1,535) | (1,535) |
| Refund Diesel Tax | - | (2,136) | (2,136) |
| Refund Aviation Tax | - | (227) | (227) |
| Total Revenue | - | 188,997 | 188,997 |
| Interest Income | - | 66,762 | 66,762 |
| Total Receipts | \$ - | \$ 255,759 | \$ 255,759 |
| Outlays | | | |
| Transfers to/from EPA, Net | \$ 75,552 | \$ (75,552) | \$ - |
| Total Outlays | 75,552 | (75,552) | - |
| Net Income | \$ 75,552 | \$ 180,207 | \$ 255,759 |

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

As of September 30, 2005, there are currently four CERCLA Section 106(b) administrative claims and one contract claim. If the claimants are successful, the total losses on the administrative and judicial claims could amount to approximately \$38.2 million. The Environmental Appeals Board has not yet issued final decisions on any of the administrative claims; therefore, a definite estimate of the amount of the contingent loss cannot be made. The claimants' chance of success overall is characterized as reasonably possible.

All Other Funds:

As of September 30, 2005, there are five claims which may be considered threatened litigation involving all other appropriated funds of the Agency. If the claimants are successful, the total losses of the claims are estimated to range from \$5.9 to \$15.9 million. The largest claim (estimated range from \$2 to \$12 million, deemed reasonably possible) is a Fifth Amendment taking claim arising out of a Clean Water Act enforcement action.

Judgment Fund:

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

As of September 30, 2005, there are no material claims pending in the Treasury Judgment Fund. However, EPA has a \$22 million liability to the Treasury Judgment Fund for a payment made by the Fund to settle a contract dispute claim.

Note 19. Exchange Revenues, Statement of Net Cost

Exchange revenues on the Statement of Net Cost include income from services provided, interest revenue (with the exception of interest earned on trust fund investments), and miscellaneous earned revenue.

Note 20. Environmental Cleanup Costs

As of September 30, 2005, EPA has two sites that require clean up stemming from its activities. Costs amounting to \$18 thousand may be paid out of the Treasury Judgment Fund. (The \$18 thousand represents the lower end of a range estimate, of which the maximum of the range will total \$30 thousand.) Both claimants' chance of success is characterized as reasonably possible. Additionally EPA has one site (\$80 thousand) characterized as remote chance of success. EPA also holds title to a site in Edison, New Jersey which was formerly an Army Depot. While EPA did not cause the contamination, the Agency could potentially be liable for a portion of the cleanup costs. However, it is expected that the Department of Defense and General Services Administration will bear all or most of the cost of remediation. In addition, EPA has one site that has an unfunded environmental liability of \$30 thousand

Accrued Cleanup Cost:

The EPA has 13 sites that will require future clean up associated with permanent closure. The estimated costs will be approximately \$7 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 2005 estimate for unfunded cleanup costs decreased by \$1.4 million from the FY 2004 estimate. This decrease is due in large part to completion of cleanup at one facility. EPA could also be potentially liable for cleanup costs, at a GSA-leased site; however, the amounts are not known.

Note 21. State Credits

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

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2005, the total remaining state credits have been estimated at \$10.1 million. The estimated ending credit balance on September 30, 2004 was \$5.4 million.

Note 22. Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2005, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling \$31 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. Custodial Revenues and Accounts Receivable

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

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-------------------|-------------------|
| Fines, Penalties and Other Miscellaneous Receipts | \$ <u>150,816</u> | \$ <u>162,546</u> |
| Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts | | |
| Accounts Receivable | \$ 167,533 | \$ 103,847 |
| Less: Allowance for Uncollectible Accounts | <u>(51,954)</u> | <u>(51,630)</u> |
| Total | \$ <u>115,579</u> | \$ <u>52,217</u> |

Note 24. Statement of Budgetary Resources

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2005 Statement of Budgetary Resources, will be reconciled to the amounts included in the FY 2006 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2005 has not yet been published. We expect it will be published by March 2006, and it will be available on the OMB website at www.whitehouse.gov/omb/budget/fy2006. The actual amounts published for the year ended September 30, 2004 are included in EPA's FY 2005 financial statement disclosures.

| FY 2004 | Budgetary Resources | Obligations | Outlays |
|--|------------------------|----------------------|---------------------|
| Statement of Budgetary Resources | \$ 13,152,089 | \$ 10,155,381 | \$ 9,697,183 |
| Funds Reported by Other Federal Entities | 622 | (6,727) | - |
| Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other | 19,899 | 6,322 | 6,108 |
| Expired and Immaterial Funds* | (86,572) | 8,644 | (7) |
| Superfund payment received from BPD recorded in 68X2050 | (1,257,536) | - | - |
| Rounding Differences** | 498 | 1,380 | (284) |
| Reported for Budget of the U. S. Government | \$ 11,829,000 | \$ 10,165,000 | \$ 9,703,000 |

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

** Balances are rounded to millions in the Budget Appendix.

Note 25. Recoveries and Resources Not Available, Statement of Budgetary Resources

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

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|---------------------------|---------------------------|
| Recoveries of Prior Year Obligations-downward adjustments of prior years' obligations | \$ <u>174,641</u> | \$ <u>194,775</u> |
| Temporarily Not Available-rescinded authority | <u>(11,141)</u> | <u>(8,254)</u> |
| Permanently Not Available: | | |
| Payments to Treasury | (2,793) | (2,641) |
| Rescinded authority | (64,018) | (49,099) |
| Canceled authority | <u>(11,433)</u> | <u>(19,463)</u> |
| Total Permanently Not Available | \$ <u>(78,244)</u> | \$ <u>(71,203)</u> |

Note 26. Unobligated Balances Available

The availability of unobligated balances consists of the following as of September 30, 2005 and 2004. Unexpired unobligated balances are available to be apportioned by the OMB for new obligations at the beginning of the following fiscal year. The expired unobligated balances are only available for upward adjustments of existing obligations.

| | <u>FY 2005</u> | <u>FY 2004</u> |
|-------------------------------|----------------------------|----------------------------|
| Unexpired Unobligated Balance | \$ 3,011,341 | \$ 2,903,849 |
| Expired Unobligated Balance | 95,415 | 92,859 |
| Total | \$ <u>3,106,756</u> | \$ <u>2,996,708</u> |

Note 27. Offsetting Receipts

Distributed offsetting receipts credited to the general fund, special fund, or trust fund receipt accounts offset gross outlays. For FYs 2005 and 2004, the following receipts were generated from these activities:

| | <u>FY 2005</u> | <u>FY 2004</u> |
|------------------------------------|----------------------------|----------------------------|
| Trust Fund Recoveries | \$ 66,419 | \$ 74,063 |
| Special Fund Environmental Service | 20,176 | 13,688 |
| Downward Re-estimates of Subsidies | 436 | 5,554 |
| Trust Fund Appropriation | <u>1,247,477</u> | <u>1,257,536</u> |
| Total | <u>\$ 1,334,508</u> | <u>\$ 1,350,841</u> |

Note 28. Statement of Financing

Specific components requiring or generating resources in future periods and resources that fund expenses recognized in prior periods are related to changes in liabilities not covered by budgetary resources. For FYs 2005 and 2004, the following line items are reconciled to the increases or decreases in those liabilities.

| Statement of Financing lines: | <u>FY 2005</u> | <u>FY 2004</u> |
|--|------------------------|------------------------|
| Resources that fund prior period expenses | (1,120) | (13,855) |
| Components requiring or generating resources in future periods: | | |
| Increases in environmental liabilities | 99 | 1,244 |
| Increase in contingencies | 1,525 | 22,425 |
| Increase in annual leave liabilities | 3,889 | - |
| Up/downward re-estimates of subsidy exp. | 3 | - |
| Total | <u>\$ 4,396</u> | <u>\$ 9,814</u> |
| Increases (Decreases) in Liabilities Not Covered by Budgetary Resources and Reconciling Items | | |
| Unfunded Annual Leave Liability | \$ 4,092 | \$ (7,029) |
| Unfunded Contingent Liability | 325 | 1,607 |
| Unfunded Judgment Fund Liability | - | 22,000 |
| Unfunded Workers Compensation Liability | (220) | 664 |
| Actuarial Workers Compensation Liability | (901) | (3,815) |
| Unfunded Clean-up Costs Liability | 1,269 | 61 |
| Unfunded Environmental Liability | 30 | - |
| Allowance for Subsidy | - | (3,097) |
| Subsidy re-estimates | <u>(199)</u> | <u>(577)</u> |
| Total | <u>\$ 4,396</u> | <u>\$ 9,814</u> |

Note 29. Costs Not Assigned to Goals

FY 2005's Statement of Net Cost by Goal has \$3 million in gross costs not assigned to goals. This amount is comprised of decreases of \$0.2 million in overhead costs, \$22 million in operating expenses, \$0.7 million in unfunded expenses; offset by increases of \$16 million in

undistributed payroll costs, \$0.3 in depreciation expenses, \$0.6 million in other expenses, and \$3 million in loss on disposition of assets.

FY 2004's Statement of Net Cost by Goal has \$18.2 million in gross costs not assigned to goals. This amount is comprised of decreases of \$5.7 million in unfunded cleanup costs, \$5.6 million in overhead costs, \$27.0 million in other unfunded expenses and \$2.9 in subsidy expense; offset by increases of \$13.8 million in undistributed federal payroll costs, \$3.7 million in depreciation expense, \$40.1 million in operating expenses, and \$1.8 million change in actuarial liability.

Note 30. Transfers-In and Out, Statement of Changes in Net Position

Appropriation Transfers, In/Out:

For FYs 2005 and 2004, the Appropriation Transfers under Budgetary Financing Sources on the Statement of Changes in Net Position are comprised of nonexpenditure transfers that affect Unexpended Appropriations for non-invested appropriations. These amounts are included in the Budget Authority, Net Transfers and Prior Year Unobligated Balance, Net Transfers lines on the Statement of Budgetary Resources. Detail of the Appropriation Transfers on the Statement of Changes in Net Position and a reconciliation with the Statement of Budgetary Resources follow:

| Fund/Type of Account | <u>FY 2005</u> | <u>FY 2004</u> |
|--|----------------------------|----------------------------|
| GSA Building Fund | \$ - | \$ (1,538) |
| Appalachian Regional Commission | - | 60 |
| S & T | (992) | - |
| EPM | 5,694 | 1,630 |
| Total Appropriation Transfers | <u>\$ 4,702</u> | <u>\$ 152</u> |
| Net Transfers from Invested Funds | 1,328,667 | 1,332,342 |
| Transfers to Other Agencies | 4,736 | (5,157) |
| Allocations Rescinded | <u>10,620</u> | <u>7,911</u> |
| Total of Net Transfers on Statement of Budgetary Resources | <u><u>\$ 1,348,725</u></u> | <u><u>\$ 1,335,248</u></u> |

Transfers In/Out Without Reimbursement, Budgetary:

For FYs 2005 and 2004 Transfers In/Out under Budgetary Financing Sources on the Statement of Changes in Net Position consist of transfers to or from other federal agencies and between EPA funds. These transfers affect Cumulative Results of Operations. Detail of the transfers-in and transfers-out, expenditure and nonexpenditure, follows:

| Type of Transfer/Funds | <u>FY 2005</u> | <u>FY 2004</u> |
|--|-------------------------|---------------------------|
| Transfers-out, nonexpenditure to other federal agencies | \$ (4,736) | \$ (5,157) |
| Transfers-out, nonexpenditure, from Treasury trust fund to CDC | - | (30,763) |
| Transfers-in, nonexpenditure, Oil Spill | 15,872 | 16,113 |
| Total Transfers in (out) without Reimbursement, Budgetary | \$ <u>11,136</u> | \$ <u>(19,807)</u> |

Transfers In/Out without Reimbursement, Other Financing Sources:

For FYs 2005 and 2004 Transfers In/Out without Reimbursement under Other Financing Sources on the Statement of Changes in Net Position are comprised of negative subsidy to a special receipt fund for the credit reform funds. The amounts reported on the Statement of Changes in Net Position are as follows:

| Type of Transfer/Funds | <u>FY 2005</u> | <u>FY 2004</u> |
|---|-----------------------|------------------------|
| Transfers of negative subsidy, transfer-in paid and funded in year following transfer-(out) | \$ - | \$ (436) |
| Transfers-out of prior year negative subsidy to be paid following year | 436 | - |
| Total Transfers in (out) without Reimbursement, Budgetary | \$ <u>436</u> | \$ <u>(436)</u> |

Note 31. Imputed Financing

In accordance with SFFAS 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 OPM trust funds. These amounts are recorded as imputed costs and imputed financing for each agency. Each year the OPM provides federal agencies with cost factors to calculate these imputed costs and financing that apply to the current year. These cost factors are multiplied by the current year's salaries or number of employees, as applicable, to provide an estimate of the imputed financing that the OPM trust funds will provide for each agency. The estimates for FY 2005 were \$129.7 million. For FY 2004, the estimates were \$126 million.

In addition to the pension and retirement benefits described above, EPA also records imputed costs and financing for Treasury Judgment Fund payments on behalf of the agency. Entries are made in accordance with the Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions." For FY 2005 entries for Judgment Fund payments totaled \$8.4 million. For FY 2004, entries for Judgment Fund payments totaled \$2.8 million.

Note 32. Payroll and Benefits Payable

Payroll and benefits payable to EPA employees for the years ending September 30, 2005 and 2004, consist of the following:

| FY 2005 Payroll & Benefits Payable | Covered by Budgetary Resources | Not Covered by Budgetary Resources | Total |
|---|---------------------------------------|---|-------------------|
| Accrued Funded Payroll & Benefits | \$ 30,881 | \$ - | \$ 30,881 |
| Withholdings Payable | 26,977 | - | 26,977 |
| Employer Contributions Payable-TSP | 1,896 | - | 1,896 |
| Other Post-employment Benefits Payable | 36 | - | 36 |
| Accrued Unfunded Leave, WCF | 320 | - | 320 |
| Accrued Unfunded Annual Leave | - | 130,284 | 130,284 |
| Total - Current | \$ 60,110 | \$ 130,284 | \$ 190,394 |
| FY 2004 Payroll & Benefits Payable | | | |
| Accrued Funded Payroll and Benefits | \$ 29,845 | \$ - | \$ 29,845 |
| Withholdings Payable | 22,771 | - | 22,771 |
| Employer Contributions Payable-TSP | 1,583 | - | 1,583 |
| Other Post-employment Benefits Payable | 36 | - | 36 |
| Accrued Funded Leave, WCF | 320 | - | 320 |
| Accrued Unfunded Annual Leave | - | 126,191 | 126,191 |
| Total - Current | \$ 54,555 | \$ 126,191 | \$ 180,746 |

Note 33. Other Adjustments, Statement of Changes in Net Position

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

| | FY 2005 | FY 2004 |
|---------------------------------------|------------------|------------------|
| Rescissions to General Appropriations | \$ 64,017 | \$ 49,105 |
| Canceled General Authority | 11,433 | 19,463 |
| Total Other Adjustments | \$ 75,450 | \$ 68,568 |

Note 34. Nonexchange Revenue, Statement of Changes in Net Position

The Nonexchange Revenue, Budgetary Financing Sources, on the Statement of Changes in Net Position for FYs 2005 and 2004 consists of the following items:

| | <u>FY 2005</u> | <u>FY 2004</u> |
|------------------------------------|--------------------------|--------------------------|
| Interest on Trust Fund Investments | \$ 130,206 | \$ 94,142 |
| Tax Revenue, Net of Refunds | 194,786 | 189,864 |
| Fines and Penalties Revenue | (26,506) | 1,973 |
| Special Receipt Fund Revenue | <u>20,176</u> | <u>13,746</u> |
| Total Nonexchange Revenue | <u>\$ 318,662</u> | <u>\$ 299,725</u> |

Note 35. Other, Statement of Financing

The Other balance of \$1.9 million in the Statement of Financing represents a portion of the 1993 Cost Recovery received from the Uniroyal bankruptcy judgment that was transferred from the Treasury Managed Receipt Account 20X8145.4 to the Superfund Trust Account 68-20X8145 in FY 2005. The transfer was necessary in order to execute an expenditure that was ordered from a February 2005 consent decree.

**Environmental Protection Agency
Required Supplementary Information
As of September 30, 2005
(Dollars in Thousands)
(Unaudited)**

1. 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.

2. 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 2005).

| Trading Partner Code | Agency | Investments | Accounts Receivable | Other Assets |
|-------------------------------------|---|--------------------|----------------------------|---------------------|
| 4 | Government Printing Office | - | - | 957 |
| 11 | Executive Office of the President | - | 752 | - |
| 12 | Department of Agriculture | - | 194 | - |
| 13 | Department of Commerce | - | 945 | 134 |
| 14 | Department of Interior | - | 13,707 | - |
| 15 | Department of Justice | - | 392 | - |
| 16 | Department of Labor | - | 5 | - |
| 17 | Department of the Navy | - | 135 | - |
| 18 | U. S. Postal Service | - | 169 | 406 |
| 19 | Department of State | - | (326) | - |
| 20 | Department of the Treasury | 4,811,065 | 1,828 | - |
| 21 | Department of the Army | - | 9,950 | - |
| 29 | Federal Trade Commission | - | 5 | - |
| 31 | Nuclear Regulatory Commission | - | 375 | - |
| 36 | Department of Veteran Affairs | - | 11 | - |
| 45 | Equal Employment Opportunity Commission | - | (101) | - |
| 47 | General Services Administration | - | 301 | - |
| 49 | National Science Foundation | - | 36 | - |
| 57 | Department of the Air Force | - | 222 | - |
| 61 | Consumer Product Safety Commission | - | 8 | - |
| 64 | Tennessee Valley Authority | - | (5) | - |

| Trading Partner Code | Agency | Accounts Investments Receivable | Other Assets |
|-------------------------------------|--|--|-------------------------|
| 69 | Department of Transportation | - | 3,704 |
| 70 | Department of Homeland Security | - | 23,670 |
| 71 | Overseas Private Investment Corporation | - | (13) |
| 72 | Agency for International Development | - | (581) |
| 75 | Department of Health and Human Services | - | 8,256 |
| 80 | National Aeronautics and Space Administration | - | 175 |
| 86 | Department of Housing and Urban Development | - | 67 |
| 89 | Department of Energy | - | 3,026 |
| 91 | Department of Education | - | 144 |
| 95 | Independent Agencies | - | 726 |
| 96 | US Army Corps of Engineers | - | (7,687) |
| 97 | US Department of Defense | - | 3,581 |
| 99 | Treasury General Fund | - | 210 |
| 00 | Unassigned | - | 2,179 |
| Total | | \$ 4,811,065 | 66,060 |
| | | | 2,335 |

3. Intragovernmental Liabilities

| Trading Partner Code | Agency | Accounts Payable | Accrued Liabilities | Other Liabilities |
|-------------------------------------|--------------------------------------|-----------------------------|--------------------------------|------------------------------|
| 3 | Library of Congress | - | 107 | 98 |
| 4 | Government Printing Office | - | 1,040 | 1,957 |
| 10 | The Judiciary | - | - | (18) |
| 11 | Executive Office of the President | - | 41 | 16 |
| 12 | Department of Agriculture | - | 785 | 1,851 |
| 13 | Department of Commerce | 888 | 4,704 | 4,468 |
| 14 | Department of Interior | 901 | 5,612 | 4,894 |
| 15 | Department of Justice | 617 | 5,858 | 9,865 |
| 16 | Department of Labor | 2,258 | 1,220 | 8,506 |
| 17 | Department of the Navy | - | 836 | 2,641 |
| 18 | United States Postal Service | - | 164 | 97 |
| 19 | Department of State | - | 22 | - |
| 20 | Department of the Treasury | - | 155 | 36,425 |
| 21 | Department of the Army | - | - | 2,992 |

| Trading Partner Code | Agency | Accounts Payable | Accrued Liabilities | Other Liabilities |
|-------------------------------------|--|-----------------------------|--------------------------------|------------------------------|
| 24 | Office of Personnel Management | - | 625 | 10,170 |
| 31 | US Nuclear Regulatory Commission | - | 13 | 17 |
| 33 | Smithsonian Institution | - | 28 | 125 |
| 36 | Department of Veterans Affairs | - | 506 | 147 |
| 45 | EEOC | - | 22 | - |
| 47 | General Services Administration | - | 42,299 | 28,323 |
| 49 | National Science Foundation | - | 539 | 50 |
| 50 | Securities and Exchange | - | - | (11,377) |
| 57 | Department of the Air Force | - | - | 9,936 |
| 59 | Nat'l Foundation on Arts and Humanities | - | 33 | - |
| 63 | Labor Relations Board | - | - | 3 |
| 64 | Tennessee Valley Authority | - | 54 | 375 |
| 69 | Department of Transportation | - | 4,077 | 11,441 |
| 70 | Department of Homeland Security | 15,178 | 2,303 | (44,126) |
| 72 | Agency for International Development | - | - | 183 |
| 73 | Small Business Administration | - | 121 | 100 |
| 75 | Department of Health and Human Services | 16 | 8,773 | 10,684 |
| 80 | National Aeronautics and Space Administration | - | 336 | 153 |
| 86 | Department of Housing and Urban Development | - | 3 | 615 |
| 89 | Department of Energy | - | 5,149 | 2,530 |
| 93 | Federal Mediation Service | - | 9 | - |
| 95 | Independent Agencies | - | 6 | 16,632 |
| 96 | US Army Corps of Engineers | 782 | 11,531 | (177) |
| 97 | Office of the Secretary of Defense | - | 2,323 | (734) |
| 99 | Treasury General Fund | - | - | 3,318 |
| 00 | Unassigned | 12 | (110) | (5,650) |
| Total | | \$ 20,652 | 99,184 | 106,530 |

For remaining intragovernmental liabilities \$21,744 thousand in Debt is assigned to the Department of the Treasury (trading partner Code 20), and \$142,347 thousand in Custodial Liability is assigned to the Treasury General Fund (trading partner Code 99).

EPA has confirmed the year-end intragovernmental fiduciary assets, liabilities, revenue, and expenses with the BPD, DOL, and OPM. EPA has also contacted several other federal agencies to confirm nonfiduciary intragovernmental balances for year-end as required.

4. 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.

| | | |
|---|----|---------|
| Intragovernmental Earned Revenue | \$ | 105,653 |
| Associated Costs to generate above Revenue (Budget Functional Classification 304) | \$ | 105,653 |

5.
Environmental Protection Agency
Required Supplementary Information
Supplemental Statement of Budgetary Resources (Unaudited)
As of September 30, 2005
(Dollars in Thousands)

| | <u>STAG</u> | <u>EPM</u> | <u>S&T</u> | <u>FIFRA</u> | <u>LUST</u> | <u>OTHER</u> | <u>TOTAL</u> |
|--|---------------------|---------------------|---------------------|-------------------|------------------|---------------------|----------------------|
| BUDGETARY RESOURCES | | | | | | | |
| Budgetary Authority: | | | | | | | |
| Appropriations Received | \$ 3,604,182 | \$ 2,313,409 | \$ 750,350 | \$ - | \$ - | \$ 1,364,679 | \$ 8,032,620 |
| Borrowing Authority | - | - | - | - | - | 436 | 436 |
| Net Transfers | - | 5,694 | (992) | - | 70,000 | 1,274,023 | 1,348,725 |
| Unobligated Balances: | | | | | | | |
| Beginning of Period | 1,452,575 | 331,925 | 285,394 | 2,533 | 6,287 | 917,994 | 2,996,708 |
| Spending Authority from Offsetting Collections: | | | | | | | |
| Earned and Collected | \$ 7,801 | \$ 63,476 | \$ 8,758 | \$ 23,857 | \$ 17 | \$ 453,783 | \$ 557,692 |
| Receivable from Federal Sources | - | 5,651 | (155) | - | - | (185) | 5,311 |
| Change in Unfilled Customer Orders: | | | | | | | |
| Advance Received | - | 2,107 | (334) | 4,159 | - | 31,683 | 37,615 |
| Without Advance from Federal Sources | - | 132,679 | (2,300) | - | - | (12,235) | 118,144 |
| Transfers from Trust Funds Collected | - | - | 55,942 | - | - | 13,630 | 69,572 |
| Transfers from Trust Funds, Anticipated | - | - | (20,134) | - | - | (756) | (20,890) |
| Total Spending Authority from Collections | \$ 7,801 | \$ 203,913 | \$ 41,777 | \$ 28,016 | \$ 17 | \$ 485,920 | \$ 767,444 |
| Recoveries of Prior Year Obligations | 42,734 | 14,880 | 4,994 | 101 | 376 | 111,556 | 174,641 |
| Temporarily Not Available Pursuant to Public Law | - | - | (289) | - | (560) | (10,292) | (11,141) |
| Permanently Not Available | (28,833) | (24,892) | (10,636) | - | - | (13,883) | (78,244) |
| Total Budgetary Resources | <u>\$ 5,078,459</u> | <u>\$ 2,844,929</u> | <u>\$ 1,070,598</u> | <u>\$ 30,650</u> | <u>\$ 76,120</u> | <u>\$ 4,130,433</u> | <u>\$ 13,231,189</u> |
| STATUS OF BUDGETARY RESOURCES | | | | | | | |
| Obligations Incurred: | | | | | | | |
| Direct | \$ 3,608,484 | \$ 2,315,355 | \$ 825,674 | \$ - | \$ 70,660 | \$ 2,753,523 | \$ 9,573,696 |
| Reimbursable | 26 | 157,961 | 6,726 | 25,663 | - | 360,361 | 550,737 |
| Total Obligations Incurred | <u>\$ 3,608,510</u> | <u>\$ 2,473,316</u> | <u>\$ 832,400</u> | <u>\$ 25,663</u> | <u>\$ 70,660</u> | <u>\$ 3,113,884</u> | <u>\$ 10,124,433</u> |
| Unobligated Balances: | | | | | | | |
| Apportioned | 1,469,949 | 297,045 | 220,896 | 4,987 | 5,460 | 1,020,352 | 3,018,689 |
| Unobligated Balances Not Available | - | 74,568 | 17,302 | - | - | (3,803) | 88,067 |
| Total Status of Budgetary Resources | <u>\$ 5,078,459</u> | <u>\$ 2,844,929</u> | <u>\$ 1,070,598</u> | <u>\$ 30,650</u> | <u>\$ 76,120</u> | <u>\$ 4,130,433</u> | <u>\$ 13,231,189</u> |
| RELATIONSHIP OF OBLIGATIONS TO OUTLAYS | | | | | | | |
| Obligations Incurred, Net | \$ 3,557,975 | \$ 2,254,523 | \$ 785,629 | \$ (2,454) | \$ 70,267 | \$ 2,516,410 | \$ 9,182,350 |
| Obligated Balances, Net - Beginning of Pd | 8,272,160 | 690,182 | 535,704 | 2,348 | 85,008 | 1,622,374 | 11,207,776 |
| Accounts Receivable | - | 17,670 | 48,106 | - | - | (804) | 64,972 |
| Unfilled Customer Orders from Federal Sources | - | 257,791 | 6,720 | - | - | 157,501 | 422,012 |
| Undelivered Orders, Unpaid | (7,855,707) | (746,822) | (530,333) | (1,413) | (76,486) | (1,425,248) | (10,636,009) |
| Accounts Payable | (395,439) | (198,864) | (97,460) | (1,536) | (8,042) | (285,749) | (987,090) |
| Total Outlays | <u>\$ 3,578,989</u> | <u>\$ 2,274,480</u> | <u>\$ 748,366</u> | <u>\$ (3,055)</u> | <u>\$ 70,747</u> | <u>\$ 2,584,484</u> | <u>\$ 9,254,011</u> |
| Disbursements | \$ 3,586,790 | \$ 2,340,064 | \$ 812,732 | \$ 24,961 | \$ 70,763 | \$ 3,083,579 | \$ 9,918,889 |
| Collections | (7,801) | (65,584) | (64,366) | (28,016) | (16) | (499,095) | (664,878) |
| Less: Offsetting Receipts | - | - | - | - | - | (1,334,508) | (1,334,508) |
| Net Outlays | <u>\$ 3,578,989</u> | <u>\$ 2,274,480</u> | <u>\$ 748,366</u> | <u>\$ (3,055)</u> | <u>\$ 70,747</u> | <u>\$ 1,249,976</u> | <u>\$ 7,919,503</u> |

6.
Environmental Protection Agency
Required Supplementary Information
Working Capital Fund Condensed Statements
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

Balance Sheet

| | (Unaudited) | (Audited) |
|--|--------------------------|--------------------------|
| | <u>FY 2005</u> | <u>FY 2004</u> |
| ASSETS | | |
| Intragovernmental | | |
| Fund Balance With Treasury | \$ 69,401 | \$ 53,559 |
| Accounts Receivable, Net | 55,100 | 27,874 |
| Other | <u>509</u> | <u>555</u> |
| Total Intragovernmental | \$ 125,010 | \$ 81,988 |
| Accounts Receivable, Net | 4 | - |
| Property, Plant & Equipment, Net | 14,159 | 20,426 |
| Other | <u>205</u> | <u>53</u> |
| Total Assets | <u>\$ 139,378</u> | <u>\$ 102,467</u> |
| LIABILITIES | | |
| Intragovernmental | | |
| Accounts Payable & Accrued Liabilities | \$ 28,071 | \$ 29,788 |
| Other | <u>67,191</u> | <u>30,413</u> |
| Total Intragovernmental | \$ 95,262 | \$ 60,201 |
| Accounts Payable & Accrued Liabilities | 14,226 | 11,108 |
| Payroll & Benefits Payable | 1,556 | 1,451 |
| Other | <u>4,986</u> | <u>6,726</u> |
| Total Liabilities | <u>\$ 116,030</u> | <u>\$ 79,486</u> |
| NET POSITION | | |
| Cumulative Results of Operations | <u>\$ 23,348</u> | <u>22,981</u> |
| Total Net Position | <u>\$ 139,378</u> | <u>102,467</u> |

6.
Environmental Protection Agency
Required Supplementary Information
Working Capital Fund Condensed Statements
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

Statement of Cost

| FY 2005 (Unaudited) Product or Business Line | Cost of Goods and Services Provided | Related Exchange Revenue | Excess of Costs Over/(Under) Exchange Revenue |
|---|--|---|--|
| Data Processing | \$ 182,720 | \$ 183,105 | \$ (385) |
| Postage | <u>2,171</u> | <u>2,154</u> | <u>17</u> |
| (Profit)/Loss from Operations | \$ <u>184,891</u> | \$ <u>185,259</u> | \$ <u>(368)</u> |
| Imputed Costs | | | 779 |
| Net (Profit)/Loss | | \$ | <u>411</u> |

| FY 2004 (Audited) Product or Business Line | Cost of Goods and Services Provided | Related Exchange Revenue | Excess of Costs Over/(Under) Exchange Revenue |
|---|--|---|--|
| Data Processing | \$ 150,829 | \$ 141,445 | \$ 9,384 |
| Postage | <u>2,586</u> | <u>2,581</u> | <u>5</u> |
| (Profit)/Loss from Operations | \$ <u>153,415</u> | \$ <u>144,026</u> | \$ <u>9,389</u> |
| Imputed Costs | | | 804 |
| Net (Profit)/Loss | | \$ | <u>10,193</u> |

**Environmental Protection Agency
Required Supplementary Stewardship Information (Unaudited)
For the Year Ended September 30, 2005
(Dollars in Thousands)**

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 the risk assessment and risk management paradigm. Research enables us to identify the most important sources of risk to human health and the environment, and by so doing, informs our priority-setting, ensures credibility for our policies, and guides our deployment of resources. It gives us the understanding and technologies we need to detect, abate, and avoid environmental problems. Research also provides the crucial underpinning(s) for EPA decisions and challenges us to apply the best available science and technical analysis to our environmental problems and to practice more integrated, efficient and effective approaches to reducing environmental risks.

Among the Agency's highest priorities are research programs that address the environmental effects on children's health; the development of alternative techniques for prioritizing chemicals for further testing through computational toxicology; the provision of near-term, appropriate, affordable, reliable, tested, and effective technologies and guidance for potential threats to homeland security; the potential risks of unregulated contaminants in drinking water; the health effects of air pollutants such as particulate matter; and the protection of the nation's ecosystems. For FY 2005, the full cost of the Agency's Research and Development activities totaled over \$741 million. Below is a breakout of the expenses (dollars in thousands):

| | <u>FY 2001</u> | <u>FY 2002</u> | <u>FY 2003</u> | <u>FY 2004</u> | <u>FY 2005</u> |
|-----------------------|----------------|----------------|----------------|----------------|----------------|
| Programmatic Expenses | 555,794 | 559,218 | 593,295 | 581,323 | 628,467 |
| Allocated Expenses | 90,039 | 123,307 | 106,971 | 91,675 | 112,558 |

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

INVESTMENT IN THE NATION'S INFRASTRUCTURE:

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

Construction Grants Program: During the 1970s and 1980s, the Construction Grants Program was a source of Federal funds, providing more than \$60 billion of direct grants for the construction of public wastewater treatment projects. These projects, which constituted a

significant contribution to the nation's water infrastructure, included sewage treatment plants, pumping stations, and collection and intercept sewers, rehabilitation of sewer systems, and the control of combined sewer overflows. The construction grants led to the improvement of water quality in thousands of municipalities nationwide.

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

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

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

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

| | <u>FY 2001</u> | <u>FY 2002</u> | <u>FY 2003</u> | <u>FY 2004</u> | <u>FY 2005</u> |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| Construction Grants | 63,344 | 149,841 | 15,845 | 48,948 | 21,148 |
| Clean Water SRF | 1,548,270 | 1,389,048 | 1,295,394 | 1,407,345 | 1,127,883 |
| Safe Drinking Water SRF | 728,921 | 708,528 | 842,936 | 802,629 | 715,060 |
| Other Infrastructure Grants | 282,914 | 367,259 | 582,091 | 341,767 | 385,226 |
| Allocated Expenses | 424,999 | 576,536 | 493,349 | 410,129 | 402,853 |

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

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, 2005, the Agency possesses the following land and land rights:

Superfund Sites with Easements

| | |
|-------------------|-----------|
| Beginning Balance | 32 |
| Additions | 1 |
| Withdrawals | - |
| Ending Balance | <u>33</u> |

Superfund Sites with Land Acquired

| | |
|-------------------|-----------|
| Beginning Balance | 25 |
| Additions | 4 |
| Withdrawals | - |
| Ending Balance | <u>29</u> |

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):

| | <u>FY 2001</u> | <u>FY 2002</u> | <u>FY 2003</u> | <u>FY 2004</u> | <u>FY 2005</u> |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|
| Training and Awareness Grants | 48,697 | 49,444 | 47,827 | 48,416 | 46,750 |
| Fellowships | 11,451 | 8,728 | 6,572 | 7,553 | 10,195 |
| Allocated Expenses | 9,744 | 12,827 | 9,808 | 8,826 | 10,199 |

1.
Environmental Protection Agency
Supplemental Information (Unaudited)
Balance Sheet for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|---|----------------------------|----------------------------|
| ASSETS | | |
| Intragovernmental | | |
| Fund Balance With Treasury (Note S1) | \$ 213,797 | \$ 199,406 |
| Investments | 2,297,193 | 2,217,334 |
| Accounts Receivable, Net | 28,160 | 27,212 |
| Other | 9,859 | 6,781 |
| Total Intragovernmental | <u>\$ 2,549,009</u> | <u>\$ 2,450,733</u> |
| Cash and Other Monetary Assets | | |
| Accounts Receivable, Net | 260,736 | 369,148 |
| Property, Plant & Equipment, Net | 49,530 | 47,821 |
| Other | 1,533 | 699 |
| Total Assets | <u>\$ 2,860,808</u> | <u>\$ 2,868,401</u> |
| LIABILITIES | | |
| Intragovernmental | | |
| Accounts Payable & Accrued Liabilities | \$ 105,386 | \$ 140,781 |
| Custodial Liability | 26,763 | - |
| Other | 46,809 | 37,752 |
| Total Intragovernmental | <u>\$ 178,958</u> | <u>\$ 178,533</u> |
| Accounts Payable & Accrued Liabilities | 126,898 | 145,369 |
| Pensions & Other Actuarial Liabilities | 7,037 | 7,263 |
| Cashout Advances, Superfund (Note S2) | 270,811 | 259,361 |
| Payroll & Benefits Payable | 35,597 | 31,695 |
| Other | 43,392 | 46,211 |
| Total Liabilities | <u>\$ 662,693</u> | <u>\$ 668,432</u> |
| NET POSITION | | |
| Cumulative Results of Operations | <u>2,200,115</u> | <u>2,199,969</u> |
| Total Net Position | <u>2,200,115</u> | <u>2,199,969</u> |
| Total Liabilities and Net Position | <u>\$ 2,862,808</u> | <u>\$ 2,868,401</u> |

**Environmental Protection Agency
Supplemental Information (Unaudited)
Statement of Net Cost for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)**

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|---------------------|---------------------|
| COSTS | | |
| Intragovernmental | \$ 330,839 | \$ 368,045 |
| With the Public | 1,250,009 | 1,262,540 |
| Expenses from Other Appropriations (Note S5) | <u>90,167</u> | <u>82,776</u> |
| Total Costs | \$ 1,671,015 | \$ 1,713,361 |
| Less: | | |
| Earned Revenues, Federal | \$ 24,827 | \$ 27,450 |
| Earned Revenues, Non-Federal | <u>312,052</u> | <u>233,171</u> |
| Total Earned Revenues | \$ <u>336,879</u> | \$ <u>260,621</u> |
| Net Cost of Operations | <u>\$ 1,334,136</u> | <u>\$ 1,452,740</u> |

Environmental Protection Agency
Supplemental Information (Unaudited)
Statement of Changes in Net Position for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | Cumulative Results of Operations FY 2005 | Cumulative Results of Operations FY 2004 |
|--|---|---|
| | <u> </u> | <u> </u> |
| Net Position - Beginning of Period | \$ 2,199,969 | \$ 2,350,037 |
| Beginning Balances, as Adjusted | \$ 2,199,969 | \$ 2,350,037 |
| | | |
| Budgetary Financing Sources: | | |
| Nonexchange Revenue | \$ 29,697 | \$ 30,239 |
| Transfers In/Out | (53,418) | (87,586) |
| Trust Fund Appropriations | 1,247,477 | 1,257,537 |
| Income from Other Appropriations (Note S5) | 90,167 | 82,776 |
| Total Budgetary Financing Sources | <u>\$ 1,313,923</u> | <u>\$ 1,282,966</u> |
| | | |
| Other Financing Sources: | | |
| Transfers In/Out | \$ - | \$ (1) |
| Imputed Financing Sources | <u>20,359</u> | <u>19,707</u> |
| Total Other Financing Sources | \$ 20,359 | \$ 19,706 |
| | | |
| Net Cost of Operations | (1,334,136) | (1,452,740) |
| | | |
| Net Change | 146 | (150,068) |
| | | |
| Net Position - End of Period | <u><u>\$ 2,200,115</u></u> | <u><u>\$ 2,199,969</u></u> |

Environmental Protection Agency
Supplemental Information (Unaudited)
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)

| | <u>FY 2005</u> | <u>FY 2004</u> |
|--|---------------------|---------------------|
| BUDGETARY RESOURCES | | |
| Budgetary Authority: | | |
| Net Transfers | \$ 1,274,023 | \$ 1,259,096 |
| Unobligated Balances: | | |
| Beginning of Period | 823,713 | 766,805 |
| Spending Authority from Offsetting Collections: | | |
| Earned and Collected | \$ 250,487 | \$ 229,658 |
| Receivable from Federal Sources | 648 | (7,853) |
| Change in Unfilled Customer Orders: | | |
| Advance Received | 25,798 | (44,218) |
| Without Advance from Federal Sources | 5,789 | 5,978 |
| Total Spending Authority from Collections | \$ 282,722 | \$ 183,565 |
| Recoveries of Prior Year Obligations | 104,852 | 98,848 |
| Temporarily Not Available Pursuant to Public Law | (10,060) | (7,464) |
| Total Budgetary Resources (Note S6) | <u>\$ 2,475,250</u> | <u>\$ 2,300,850</u> |
| STATUS OF BUDGETARY RESOURCES | | |
| Obligations Incurred: | | |
| Direct | \$ 1,369,647 | \$ 1,328,864 |
| Reimbursable | 175,211 | 148,273 |
| Total Obligations Incurred | \$ 1,544,858 | \$ 1,477,137 |
| Unobligated Balances: | | |
| Apportioned | 930,373 | 823,694 |
| Unobligated Balances Not Available | 19 | 19 |
| Total Status of Budgetary Resources | <u>\$ 2,475,250</u> | <u>\$ 2,300,850</u> |
| RELATIONSHIP OF OBLIGATIONS TO OUTLAYS | | |
| Obligations Incurred, Net | \$ 1,157,284 | \$ 1,194,724 |
| Obligated Balances, Net - Beginning of Period | 1,569,360 | 1,838,503 |
| Accounts Receivable | (5,240) | (5,886) |
| Unfilled Customer Orders from Federal Sources | 83,474 | 77,685 |
| Undelivered Orders, Unpaid | (1,320,488) | (1,374,232) |
| Accounts Payable | (225,698) | (266,926) |
| Total Outlays | \$ 1,258,692 | \$ 1,463,868 |
| Disbursements | \$ 1,534,977 | \$ 1,649,308 |
| Collections | (276,285) | (185,440) |
| Less: Offsetting Receipts | (64,964) | (74,063) |
| Net Outlays (Note S6) | <u>\$ 1,193,728</u> | <u>\$ 1,389,805</u> |

**Environmental Protection Agency
Supplemental Information (Unaudited)
Statement of Financing for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)**

| | FY 2005 | FY 2004 |
|---|----------------|----------------|
| RESOURCES USED TO FINANCE ACTIVITIES: | | |
| Budgetary Resources Obligated | | |
| Obligations Incurred | \$ 1,544,858 | \$ 1,477,137 |
| Less: Spending Authority from Offsetting | | |
| Collections and Recoveries | (387,574) | (282,413) |
| Obligations, Net of Offsetting Collections | \$ 1,157,284 | \$ 1,194,724 |
| Less: Offsetting Receipts | (64,964) | (74,063) |
| Net Obligations | \$ 1,092,320 | \$ 1,120,661 |
| Other Resources | | |
| Transfers In/Out without Reimbursement, | | |
| Property | \$ - | \$ (1) |
| Imputed Financing Sources | 20,359 | 19,707 |
| Income from Other Appropriations (Note S5) | 90,167 | 82,776 |
| Net Other Resources Used to Finance Activities | \$ 110,526 | \$ 102,482 |
| | | |
| Total Resources Used To Finance Activities | \$ 1,202,846 | \$ 1,223,143 |
| | | |
| RESOURCES USED TO FINANCE ITEMS NOT PART OF NET COST OF OPERATIONS | | |
| Change in Budgetary Resources Obligated | \$ 82,049 | \$ 199,979 |
| Resources that Fund Prior Period Expenses | (278) | (2,243) |
| Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations: | | |
| Offsetting Receipts Not Affecting Net Cost | 64,964 | 74,063 |
| Resources that Finance Asset Acquisition that Do Not Affect Net Cost | (17,588) | (16,104) |
| | (48,682) | (51,666) |
| | | |
| Total Resources Used to Finance Items Not Part of the Net Cost of Operations | \$ 80,465 | \$ 204,029 |
| | | |
| Total Resources Used to Finance the Net Cost of Operations | \$ 1,283,311 | \$ 1,427,172 |
| | | |
| | | |
| | | |
| | | |
| | | |

**Environmental Protection Agency
Supplemental Information (Unaudited)
Statement of Financing for Superfund Trust Fund
For the Periods Ending September 30, 2005 and 2004
(Dollars in Thousands)**

| | FY 2005 | FY 2004 |
|---|---------------------|---------------------|
| COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD | | |
| Components Requiring or Generating Resources in Future Periods: | | |
| Increase in Annual Leave Liability | \$ 990 | \$ - |
| Increase in Public Exchange Revenue Receivable | (87,714) | (41,446) |
| Other (Note S8) | 1,969 | - |
| Total Components of Net Cost of Operations that Requires or Generates Resources in the Future | \$ (84,755) | \$ (41,446) |
| Components Not Requiring/Generating Resources: | | |
| Depreciation and Amortization | 7,849 | 7,939 |
| Expenses Not Requiring Budgetary Resources | 127,730 | 59,075 |
| Total Components of Net Cost of Operations that Will Not Require or Generate Resources | \$ 135,579 | \$ 67,014 |
| Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period | \$ 50,824 | \$ 25,568 |
| Net Cost of Operations | \$ 1,334,136 | \$ 1,452,740 |
| | | |
| | | |
| | | |
| | | |
| | | |
| | | |

**Environmental Protection Agency
Supplemental Information (Unaudited)
Related Notes to Superfund Trust Financial Statements**

Note S1. Fund Balance with Treasury for Superfund Trust

Fund Balances with Treasury as of September 30, 2005 and 2004 consist of the following:

| | FY 2005 | | FY 2004 |
|---------------------|----------------|----|----------------|
| Fund Balance | \$ 213,797 | \$ | 199,406 |

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

| Status of Fund Balances: | FY 2005 | | FY 2004 |
|--|----------------|----|----------------|
| Unobligated Amounts in Fund Balances: | | | |
| Available for Obligation | \$ 930,373 | \$ | 823,694 |
| Unavailable for Obligations | 19 | | 19 |
| Net Receivables from Invested Balances | (2,191,759) | | (2,381,849) |
| Balances in Treasury Trust Fund | 7,212 | | 188,182 |
| Obligated Balance not yet Disbursed | 1,467,952 | | 1,569,360 |
| Totals | \$ 213,797 | \$ | 199,406 |

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

Note S2. Cashout Advances, Superfund

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

Note S3. Superfund State Credits

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

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2005, the total remaining state credits have been estimated at \$10.1 million. The estimated ending credit balance on September 30, 2004 was \$5.4 million.

Note S4. Superfund Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse the PRPs a certain percentage of their total response action costs. EPA's authority to enter into mixed funding agreements is provided under CERCLA Section 111(a)(2). Under CERCLA Section 122(b)(1), as amended by SARA, PRPs may assert a claim against the Superfund Trust Fund for a portion of the costs they incurred while conducting a preauthorized response action agreed to under a mixed funding agreement. As of September 30, 2005, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling \$31 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

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

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

During FYs 2005 and 2004, the EPM appropriation funded a variety of programmatic and non-programmatic activities across the Agency, subject to statutory requirements. This appropriation was created to fund personnel compensation and benefits, travel, procurement, and contract activities.

This distribution is calculated using a combination of specific identification of expenses to Reporting Entities, and a weighted average that distributes expenses proportionately to total programmatic expenses. As illustrated below, this estimate does not impact the consolidated totals of the Statement of Net Cost or the Statement of Changes in Net Position.

| | <u>FY 2005</u> | | | <u>FY 2004</u> | | |
|--------------|---|---|-----------------------|---|---|-----------------------|
| | Income From Other Appropriations | Expenses From Other Appropriations | Net Effect | Income From Other Appropriations | Expenses From Other Appropriations | Net Effect |
| Superfund | \$ 90,167 | (90,167) | - | \$ 82,776 | (82,776) | - |
| All Others | <u>(90,167)</u> | <u>90,167</u> | <u>-</u> | <u>(82,776)</u> | <u>82,776</u> | <u>-</u> |
| Total | \$ <u>-</u> | <u>-</u> | <u>-</u> | \$ <u>-</u> | <u>-</u> | <u>-</u> |

In addition, the related general support services costs allocated to the Superfund Trust Fund from the S&T and EPM funds are \$6.9 million for FY 2005 and \$14.1 million for FY 2004.

Note S6. Statement of Budgetary Resources, Superfund

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2005 Statement of Budgetary Resources, will be reconciled to the amounts included in the FY 2006 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2005 has not yet been published. We expect it will be published by March 2006, and it will be available on the OMB website at www.whitehouse.gov/omb/budget/fy2006. The actual amounts published for the year ended September 30, 2004 are included in EPA's FY 2005 financial statement disclosures.

| FY 2004 | Budgetary Resources | Obligations | Outlays |
|--|--------------------------------|----------------------------|----------------------------|
| Statement of Budgetary Resources | \$ 2,300,850 | \$ 1,477,137 | \$ 1,463,868 |
| Funds Reported by Other Federal Entities | 18,714 | 5,137 | 6,108 |
| Expired Funds* | 5,885 | 5,904 | - |
| Rounding Differences** | <u>(449)</u> | <u>(178)</u> | <u>24</u> |
| Reported for Budget of the U. S. Government | \$ <u>2,325,000</u> | \$ <u>1,488,000</u> | \$ <u>1,470,000</u> |

* Expired funds are not included in Budgetary Resources Available for Obligation and Total New Obligations in the Budget Appendix (lines 23.90 and 10.00).

** Balances are rounded to millions in the Budget Appendix.

Note S7. Superfund Eliminations

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

| | <u>FY 2004</u> | <u>FY 2005</u> |
|-------------------------------|-----------------------|-----------------------|
| Advances | | \$ |
| 6,749 | | |
| Expenditure Transfers Payable | \$48,903 | \$69,793 |
| Accrued Liabilities | \$ 6,398 | \$ 3,916 |
| Expenses | | \$29,674 |
| \$22,663 | | |
| Transfers | | \$49,097 |
| \$52,008 | | |

Note S8. Other, Statement of Financing

The Other balance of \$1.9 million in the Statement of Financing represents a portion of the 1993 Cost Recovery received from the Uniroyal bankruptcy judgment that was transferred from the Treasury Managed Receipt Account 20X8145.4 to the Superfund Trust Account 68-20X8145 in FY 2005. The transfer was necessary in order to execute an expenditure that was ordered from a February 2005 consent decree.

2.
**Environmental Protection Agency
Supplemental Information (Unaudited)
Financial Management Plans and Reports (OMB Circular A-11, Section 52.4a)
For the Year Ended September 30, 2005**

The information contained in this section addresses the U.S. Environmental Protection Agency's (EPA's) compliance with the Office of Management and Budget (OMB) Circular A-11, Section 52.4(a). These issues, including financial management goals and strategies, financial management performance, and financial management systems framework, are discussed below.

FINANCIAL MANAGEMENT GOALS AND STRATEGIES

EPA has assembled a talented cadre of financial managers whose strategic vision and tactical planning have expanded the financial management frontier within EPA. Based on their vision, the Agency embarked on an ambitious program of improvements in financial management processes, information quality and accessibility, and the financial management system. In addition, EPA successfully planned and implemented financial management initiatives in response to new legislation and new or revised requirements from central guidance agencies. With such a future-and results-oriented culture already established, it was easy for EPA to embrace the principle of continuous improvement embodied in the President's Management Agenda (PMA).

EPA constantly reassesses its financial management goals and its progress in achieving them. Externally, our success is measured by:

- our continued ability to meet the evolving PMA standards for a "Green" status score for the initiative on Improved Financial Performance,
- our continued progress toward a "Green" status score for the initiative on Budget and Performance Integration, and
- our upgrade from a "Red" to "Yellow" status score for the initiative on Eliminating Improper Payments.

In addition, EPA has met major financial management milestones that support the maintenance of a "Green" status score for the initiative on E-Government and a "Green" progress score for the initiatives on Human Capital and Competitive Sourcing. Although EPA is proud of its record of success, it recognizes that it must continue to "push the envelope" in order to help the Agency achieve its environmental objectives in a cost effective manner.

In the near term, the enhanced internal control requirements in OMB Circular A-123 will strengthen our existing management integrity efforts and provide a platform to broaden our scope and expand our focus on programmatic efficiency and effectiveness. This activity will complement efforts planned or underway to achieve economies of scale and develop and enhance financial information tools to meet the decision making needs of EPA managers.

EPA's financial management strategy focuses on running environmental programs in a fiscally responsible manner, so that government's resources are used wisely and effectively to protect human health and the environment. Implementation of the strategy requires effective stewardship of the Agency's resources by:

- carefully overseeing, capturing, and recording the full costs of transactions,
- maintaining strong internal controls and proper accounting practices,
- maintaining clean audit opinions,
- producing timely, accurate financial information,
- making timely and appropriate payments, and
- ensuring that resources are appropriately expended and linked to results.

Year after year, EPA has set ambitious milestones and sought innovative and efficient techniques to continually improve and achieve strong performance. The Agency's vision for improving its financial management performance consists of continuing improvement efforts in the areas described below.

- **Streamline Financial Management Processes**—EPA is implementing more responsive financial management processes to utilize the Agency's resources more effectively and meet the needs of financial managers. A consolidation of financial functions is currently underway, and a modern financial management system framework is in the development phase.
- **Develop Useful Information for Decision Making**—EPA managers make decisions every day that directly and indirectly affect the Agency's ability to protect human health and the environment. EPA's challenge under the PMA is to ensure that decision makers have access to the financial information necessary for informed decisions. To accomplish this, EPA established a strategic approach to enhance the decision making in grants management; redefined the Agency's accounting output to better capture cost information; worked to integrate budget and performance data; and provided a Web-based reporting tool (ORBIT) to more managers.
- **Improve Financial Operations and Increase Accountability**—Continuous improvement is central to all financial management activities in EPA: internal control programs, financial management operations and practices, and customer service. In FY 2006, EPA will add the Integrated Financial Management System (IFMS) as a new business line in the Working Capital Fund on a pilot basis, and will establish base-line performance measures and build on internal controls to enhance business operations. This change will allow regional and Headquarters offices to receive better information on the financial management costs associated with their programs.
- **Provide Support to Other PMA Initiatives**—As an Agency that strives for continuous improvement, EPA supports financial efficiencies for other PMA initiatives such as competition, technical innovation, and a knowledgeable and competent workforce. To foster competition and to encourage continual evaluation of the Agency's problem solving capabilities, competitive sourcing initiatives are incorporated into financial management proposals to foster the highest quality of cost-effective services. E-gov initiatives, like competitive sourcing initiatives, look beyond EPA's current capabilities and consider how to meet future needs.

EPA's initiatives are reliant upon an effective workforce that proactively examines environmental challenges and offers versatile solutions.

- **Develop the Competencies and Leadership to Meet Future Financial Management Requirements**—The ability to establish and achieve ambitious targets and goals is crucial to continuous improvement, and the key to achieving the Agency's financial management goals is our employees. To ensure that EPA continues to have the skills, the vision, and the leadership it needs to meet current and future financial management requirements, the Office of the Chief Financial Officer (OCFO) has developed and implemented a human capital strategy. During FY 2005, OCFO focused on hiring strategies that take into account both current and long-term skill needs. Training and development of existing staff in core competency and leadership areas continues to be a high priority.

EPA has laid the foundation to develop many of the tools that will support the Agency in the coming years. For instance, a high-level vision has been established to replace legacy system that integrate how the Agency captures and conveys financial and performance information. In addition, EPA will ensure that the Agency's internal controls are effective in achieving the Agency's strategic goals. Building upon this foundation, EPA expects to continue demonstrating that its financial management operations, programs, and staff are flexible and adaptable enough to meet current and future financial management needs.

FINANCIAL MANAGEMENT PERFORMANCE

This section summarizes EPA's progress in improving financial management performance and describes EPA's approach for ensuring continuing favorable audit opinions and plans for developing and maintaining relevant and timely financial reporting practices.

Streamline Financial Management Processes

Consolidation of Financial Functions. To take the Agency to the next level of performance, EPA is re-aligning financial functions from regional offices into *Finance Centers of Excellence* to focus on major accounting functions and customer service responsibilities. By consolidating these functions from 14 locations to the four finance centers, EPA will improve efficiency by streamlining operations; increasing uniformity and consistency in the interpretation and application of policies, rules, and regulations; eliminating communication problems; and saving tax-payers dollars. During FY 2005, three regions transferred some or all of their finance operations for grants, travel, and accounts receivable to the *Centers of Excellence*. In addition, major union issues were resolved. The remaining accounting functions will be transferred to the four *Centers of Excellence* by the end of CY 2006.

Financial System Modernization. EPA plans to implement a state of the art financial system in 2008 to replace IFMS, the core accounting system. The new system environment will support the Financial Management Line of Business by providing that the system be operated by a *Center of Excellence* outside EPA. During FY 2005, a Financial System Modernization Team was staffed, focus groups were created to develop requirements for the new system, and an acquisition strategy and Concept of Operations (CONOPS) were developed. The CONOPS and other documents are available at the EPA Internet at <http://www.epa.gov/ocfopage/>.

Develop Useful Information for Decision-Making

Budget and Performance Integration. Budget and performance integration (BPI) is a key component of EPA's quest for better performance, increased accountability, better informed decision making, and more transparent, comprehensive reporting of environmental results to the public. This initiative aligns the management of EPA's financial and human resources with the effective delivery of environmental results.

A comprehensive Agency-wide performance measurement improvement strategy was developed to promote improved measures through consideration of environmental indicators, assessment of program management requirements, and establishment of measurement implementation plans. This strategy has supported the efforts of the program offices to establish more outcome-oriented annual performance goals and measures as well as efficiency measures. EPA is in the process of revising its Strategic Plan under the Government Performance and Results Act (GPRA) covering the timeframe from 2006-2011. The Strategic Plan will be the basis for EPA's FY 2008 President's Request and for the FY 2007 execution and performance reporting under GPRA. Our goals for this revision include strengthening the linkage between and integration of budget and cost information, enhancing the availability and use of this information in setting priorities and making resource allocation decisions, and in promoting accountability for results within the Agency.

The Performance Accountability Report (PAR), which consolidates Agency-wide programmatic performance information, is one of the primary methods for sharing EPA's progress on environmental protection with citizens and EPA employees, and therefore must describe a clear, comprehensive picture of EPA's major achievements. EPA is redesigning the PAR as part of a larger effort to merge information systems housing performance data with those containing budget data. This effort will enhance public access to highly technical information, make that information more meaningful to EPA employees, and increase the public's understanding of the costs and expected results from EPA's programs.

The most recent PMA Scorecard (September 30, 2005) rated EPA "Yellow" for status and "Green" for progress made in reaching BPI milestones and goals during the Fourth Quarter. EPA continues its efforts to improve performance measurement and integrate budget and performance information to manage and deliver the Agency's environmental protection results. The Program Assessment Rating Tool (PART) administered by the Office of Management and Budget (OMB), is a core element of the BPI initiative and a systematic method of assessing the performance of program activities across the federal government. As a diagnostic tool, the PART is used to evaluate program performance and identify areas for program improvement. Programs subject to a PART assessment are required to have OMB-approved annual, long-term efficiency measures. The PART assessments process has heightened the Agency's attention, adoption, and utilization of new performance and efficiency measures to strengthen resource and program management and deliver environmental results.

Since many of these efficiency measures are new – adopted as recently as the FY 2006 budget formulation process – the Agency does not, in all cases, have data to support these measures. Currently, the Agency has completed PART assessments of 32 programs (including 12 new programs in the FY 2006 annual planning and budgeting process), covering more than 60

percent of the Agency's budget. The Agency has OMB-approved efficiency measures for 28 of the 32 programs that were assessed by the PART during the FY 2004, FY 2005, and FY 2006 budget formulation processes. For those measures currently without data, the Agency is working hard to collect the necessary data and establish performance baselines and ambitious targets.

The Agency made significant progress in developing outcome-oriented performance and efficiency measures and in demonstrating the ability to calculate the marginal cost of changing performance goals. As a result of the PART exercise, organizations across the Agency have an increased awareness and dedication to program performance by using performance data to inform management of their environmental programs. Through these initiatives and other actions to tie Agency resources to performance and results, EPA can point to significant accomplishments against the PMA's standards of success.

Data Integration. In a complementary PMA effort to produce useful information, EPA has undertaken a multi-office data integration effort highlighting the use of financial information to improve program efficiency and ensure sound financial management. The development and application of the Agency's strategic plan for Data Integration is an iterative process.

Given the magnitude and complexity of EPA's mission, the Agency has committed to focusing on one business process at a time. Grants management was chosen as the first area for review. EPA is focused on reviewing and understanding the integration of financial and grants management information. The Agency's focus on linking grants management and financial data will produce better information to ensure that projects funded by grants achieve EPA's environmental objectives and grant recipients are technically competent to carry out the work.

EPA has developed baselines, targets, and milestones to measure its success. The collective implementation and completion of these milestones will help to ensure the integration of IFMS (or its replacement) and Integrated Grants Management System (IGMS) data, ultimately resulting in the elimination of duplicate data entry and maximum availability of Pre-Award and Post-Award data.

In FY 2006, the Agency will focus on finalizing the Dun and Bradstreet Data Universal Numbering System Number Integration task under the Vendor Table Integration milestone; defining the requirements of an Integrated Reporting Platform; and configuring the Websphere application integration interface under the IGMS/IFMS Interface milestone. In addition, the Agency will refine its baseline estimate of unliquidated obligations for closed (or expired) grants by reconciling the remaining (99) unmatched records between IGMS and IFMS. EPA also will continue its efforts to finalize the identification of FY 2004 erroneous payments to non-profit recipients.

In future efforts, the Agency anticipates undertaking similar analyses of other key risk areas, including debt management, contracts management, and relevant areas captured by the CFO metrics.

Chief Financial Officers (CFO) Council Government-wide Metrics. The CFO Council Metric Tracking System (MTS) has been tracking government-wide results with nine metrics in six financial management categories for all CFO Act Agencies since FY 2003. During the fourth

quarter of FY 2005, MTS tracked Agency performance, and EPA has achieved a “Green” status for four of the CFO Council Government-wide Metrics tracked by MTS. We have corrective action plans are in place for the remaining metrics.

OCFO Reporting and Business Intelligence Tool (ORBIT). ORBIT assimilates EPA’s financial, administrative, and program performance information and provides an enterprise-wide, Web-based interface to assist Agency managers in making more informed decisions about their programs and operations. In FY 2005, EPA established program and regional office information centers and developed core budgeting and financial standard reports for ORBIT. This initiative provided the Agency business consistency and a common platform to build the same reports using the same data parameters from the same data source. EPA also worked to develop ORBIT’s Commitment Tracking Module, which will make program performance data more readily available across the Agency and establish the foundation to emphasize the linkage of cost and performance information. Finally, EPA implemented a new version of ORBIT, which added a new data source for budget and financial reports, enhanced functionality.

For FY 2006, Phase III development will focus on business intelligence analytics, program cost accounting reporting, resources management, customization of program and regional "information centers," and will begin to provide available Commitment System performance data and PART assessment information. An outreach campaign will help the Agency executives, managers, and staff to integrate ORBIT into daily management and decision processes.

Improve Financial Operations and Increase Accountability

Eliminating Improper Payments. The PMA initiative on Eliminating Improper Payments is focused on identifying, preventing, and eliminating erroneous payments. An improper payment occurs when federal funds are paid to the wrong person or entity, the recipient is paid an incorrect amount, or the recipient uses the funds improperly. This initiative is important because taxpayers need to know that the government is using their tax dollars for their intended purpose. Although the magnitude of improper payments government-wide is unknown, 17 agencies reported over \$45 billion of improper payments in 41 programs in FY 2004.

The Improper Payments Information Act of 2002 (IPIA) and subsequent guidance from OMB required federal agencies to analyze the risk of improper payments for their highest risk programs and prepare corrective action plans for those programs with significant risk. Significant risk is defined as improper payments to either primary recipients or their sub-recipients in excess of 2.5 percent of total program dollars and \$10 million.

To comply with IPIA requirements, EPA assessed its rate of improper payments in FY 2003 by performing risk assessments on grants, contracts, payroll, and travel cards/purchase cards. All four areas were determined to be “low risk” for improper payments based on the legal guidelines. Across all programs, EPA’s error rate for primary recipients was less than 1 percent. In addition, the findings confirmed strong business management practices throughout the Agency.

Even though EPA's improper payments were minimal, EPA espouses the notion of continuous improvement. Because the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DWSRF) are former Section 57 programs, EPA is required to submit an IPIA corrective action plan for them. The Agency's corrective action proposed to reduce the error rate of improper payments in the CWSRF and DWSRF from 0.51% to 0.35% over a three-year period.

EPA's challenge for the CWSRF and DWSRF improper payments initiative is to broaden the scope of payment reviews. Through FY 2004, the Agency reviewed only direct payments and found an error rate of 0.00 percent. For FY 2005, EPA is including a judgmental sample of sub-recipient payments in the review process. In FY 2006, EPA will conduct statistically valid samples of grants payments to sub-recipients in New Hampshire and South Carolina and assess the results of a Single Audit in Texas.

Consistent with IPIA requirements, EPA implemented a recovery audit program. Although the final report is not due until the end of October, preliminary results indicate that the error rate was less than 0.01 percent. (For more information on this initiative see the IPIA Report on page 86.)

Clean Audit Opinions. Because a clean audit opinion is a top management priority, all financial statements have been submitted timely and with clean opinions for the last five years. EPA's approach to guarantee that the Agency obtains clean audit opinions in the future is as follows:

- **Strengthen the Quality Assurance Program.** EPA's Quality Assurance Program focuses on management's responsibility for internal control through effective quality assurance processes and reviews. In FY 2005, EPA revised its Quality Assurance Guide (QA Guide) to reflect new or revised government-wide requirements and EPA policies and procedures. The QA Guide is available at the OCFO website. To continue the QA program's success, OCFO is conducting a training class in December 2005 for Agency finance personnel.
- **Automate the Statement Preparation Process.** The Agency is in the process of developing an automated procedure for identifying abnormal general ledger balances. Implementing the new procedure will ensure the reliability of the underlying data and allow EPA to shift resources from the mechanics of report preparation to detailed transaction analysis and explanation of results.
- **Resolve Audit Issues Quickly and Completely.** The Office of Inspector General (OIG) made 32 audit recommendations subsumed under ten reportable conditions, none of which is material, and four noncompliance issues in its audit report on the FY 2004 financial statements. EPA submitted corrective action plans for all reportable conditions and compliance issues within ten months of OIG's FY 2004 Financial Statements Audit. EPA will continue to emphasize quick resolution of audit issues and implementation of corrective actions that avoid recurrences.

- **Implement OMB Circular A-123 Aggressively.** EPA is evaluating its existing internal control programs to comply with the standards defined in OMB Circular A-123, Management's Responsibility for Internal Control. EPA has developed and submitted to OMB an implementation plan that ultimately will provide reasonable assurance that internal controls for financial reporting are adequate to carry out the Agency's mission effectively and efficiently. EPA's approach to implementing OMB Circular A-123 involves the following four steps: (1) Incorporate new requirements into the Agency's existing management integrity process and communicate changes to Agency managers and staff; (2) Conduct a high-level assessment and identify areas of risk and concern in the Agency's management integrity process by applying the fine control standard outlined in OMB Circular A-123; (3) Develop test plans and evaluate results in key risk areas and areas of concern agreed to by the Senior Management Council; and (4) Take necessary action to establish the ability to provide reports of reasonable assurance. In the future EPA will use its Quality Assurance Program in conjunction with the implementation of OMB Circular A-123 to ensure that internal controls are in place and adequate to ensure that the Agency's strategic goals are achieved.

Relevant and Timely Financial Reporting Practices. EPA has successfully managed its financial statement acceleration effort, which is critical to achieving a clean audit opinion. If this information is to be optimally useful to Agency managers, Congress, and others, data must be produced as quickly as possible after the reporting period ends. The Agency adopted government-wide "best practices," such as ensuring senior management commitment, tracking progress, using estimates and accruals to facilitate reporting, and holding bi-weekly audit status meetings with the Chief Financial Officer and the Inspector General. In FY 2005, EPA produced accurate and timely accelerated interim quarterly financial statements, completed Quality Assurance Reviews to ensure the accuracy of Agency financial data, and automated preparation of the Statement of Net Costs by Goal.

EPA will continue to produce accelerated audited statements, timely, accurate, and useful interim statements, and timely financial data to assess program costs and aid the annual budget formulation process. To make financial data more readily available for reconciliation purposes, EPA will utilize ORBIT, EPA's business intelligence reporting tool. EPA's Closing Package, needed for the preparation of the Financial Report (FR) of the U. S. government will continue to be submitted to an Internet-based application used to aid in the preparation of the FR in accordance with Government-wide Financial Reporting System (GFRS) requirements. Furthermore, EPA is working towards automating preparation of the Statement of Budgetary Resources and Intra-governmental (Trading Partner) report data. By consistently meeting the accelerated due dates for the Annual Report and completing interim financial statements (first quarterly, subsequently monthly), EPA provides timely and reliable information to the public.

Provide Support to Other PMA Activities

Competitive Sourcing. EPA utilizes competitive sourcing to ensure effective use of the federal workforce and the highest quality of services. In FY 2005, as part of the first Agency standard competition, 26 employees providing vendor payment services were placed in head-to-head competition against private sector businesses. EPA's finance center at Research Triangle Park (RTP) convincingly demonstrated that its process for handling the Agency's vendor

payments is the most cost-effective for EPA. As a result, the Agency will consolidate all vendor payment services, currently done in eight locations, into RTP. This streamlined, consolidated approach to the work is expected to save EPA approximately \$3.5 million over a five-year period.

E-Gov. EPA made great strides this year to advance finance related e-government and line of business initiatives based on the PMA.² EPA's Financial Management System Framework leverages today's technology to support efficiencies across government. A general theme is gaining economies of scale by reducing the number of financial systems operated by individual agencies. Instead, agencies will purchase hosting and other services from external providers. E-gov initiatives are discussed below in the Financial Management Systems section.

Human Capital Management. All financial managers linked their performance standards to the five goals in the Agency's Strategic Plan. In addition, we adopted the new Performance Appraisal Management System for managers and employees.

Develop Leadership and Provide Staff with Adequate Tools

OCFO Human Capital Strategy. OCFO continues to implement its Human Capital Strategy. During FY 2005, OCFO established a workforce team to assist in developing the action plan to enhance communication of Human Capital initiatives throughout OCFO. OCFO completed a comprehensive review of its workforce requirements, identified skills and competencies needed for success, and established training programs to address skill gaps. For example, OCFO initiated a series of project management courses leading to a Project Management Certificate. As a result, several participants in this training have assumed leadership roles in high-visibility projects or management activities within OCFO. In addition, OCFO focused on aligning its hiring strategies with its strategic workforce plan. Offices within OCFO were challenged to develop hiring plans that address both current and long-term skill needs. OCFO expanded its use of alternative means to fill vacancies through details, term positions, and telework arrangements. In addition, OCFO continues to target a diverse student population for internships and other part-time positions and take advantage of the Agency's entry-level programs. Consequently, OCFO benefits from their contributions.

FINANCIAL MANAGEMENT SYSTEMS FRAMEWORK

Nowhere is EPA's commitment to continuous improvement more apparent than in the Agency's financial management system. The system architecture contributed to EPA's winning of the 2003 Presidential Quality Award for Improved Financial Performance. EPA is in the process of developing a modern financial system infrastructure to help EPA better manage the resources that support our environmental mission, more accurately measure the true costs of environmental programs, and better inform the public. EPA's new system architecture will be based on commercial off-the-shelf software that complies with today's standards for usability, functionality, security, and internal controls. Our long term vision for financial systems is laid out in detail at <http://www.epa.gov/ocfo/modernization/index.htm>. Readers are referred in

² See "Expanding E-Government: Partnering for a Results Oriented Government" issued by the White House December 2004 http://www.whitehouse.gov/omb/budintegration/expanding_egov12-2004.pdf

particular to the Concept of Operations (CONOPS) for the Financial System Modernization Project posted on this website.

Financial Management Line of Business. The Financial Management Line of Business, sometimes termed e-finance, seeks to achieve process improvements and cost savings in acquisition, development, implementation, operation of the financial management systems through shared services, joint procurements, consolidation, and other means; standardize business processes and data elements; promote seamless data exchange among federal agencies; and strengthen internal controls through real-time interoperability of core financial systems. To achieve these goals, federal agencies will purchase financial system hosting services from a *Center of Excellence* (external host) in either the public or private sector. EPA's financial management systems vision and strategy follow this approach.

Financial System Modernization. EPA plans to implement a state of the art financial system in FY 2008. IFMS is EPA's current core financial system. It dates back to the late 1980s. Over the years it has been enhanced to meet various growing needs. At the same time, government-wide requirements have become far more stringent. For example, today's greater emphasis on financial accountability, internal controls, and security coupled with the accelerated deadlines for agency financial statements place increasing stress on the legacy system. Today's market offers a range of modern products that have been certified as acceptable for use by federal agencies.³

EPA's objectives for the new core financial system include aligning with the government-wide Financial Management Line of Business; improving agency financial performance through streamlining and automation; improving financial service to internal and external customers; facilitating compliance with today's information security standards; improving financial accountability; and improving integration of budget and performance.

In FY 2005, EPA developed an acquisition strategy to obtain hosting services from a *Center of Excellence*, financial system software, and a contractor to implement the new core financial system. To support the acquisition and guide system development, a Financial System Modernization Team was staffed, focus groups were created to develop requirements for the new system, and a Concept of Operations (CONOPS) was developed. The CONOPS and other documents are available on the EPA Internet. Vendor selection is scheduled for spring 2006, and full implementation of the new system is scheduled for 2008.

E-Payroll. E-Payroll seeks to gain economies of scale by reducing the number of civilian agencies that process their own payroll. In FY 2005, EPA implemented a fully integrated, Web-based payroll-human resource system. The new system uses commercial software to streamline and automate business processes and provides the technical foundation for EPA's participation in e-payroll. EPA made technical preparations to migrate the payroll processing portion of the payroll-human resources system to the Defense Financial and Accounting Service (DFAS), scheduled for completion in FY 2006. In addition, EPA began preparations for migrating certain human resource processing functions to a central service center pursuant to the Human Resources Line of Business.

³ See <<http://www.jfmip.gov/jfmip/>>.

E-Travel. E-Travel seeks to reduce the costs of processing employee travel by using centralized electronic travel service providers to automate the entire process from making reservations to reimbursing travelers. In FY 2005, EPA selected a service provider and began implementing the service provider's reservations process. Full implementation is scheduled for the end of CY 2006.

Data Warehousing and Reporting Tools. Data Warehousing and Reporting Tools bring data from different applications to user desktops to guide management resource decisions and to link cost with performance. In FY 2005, EPA rolled out a flexible Administrative Data Mart (ADAM) to serve as a source for ORBIT and added new reports to the ORBIT menu. FY 2006 and FY 2007 efforts will focus on business intelligence analytics and improved reports.

Budget and Planning. One of the major financial tools used by the Agency for improving financial performance and budget management is the Budget Automation System (BAS). BAS accomplishes "horizontal fusion" of budget and performance data throughout the 10 EPA regions and headquarters program offices, totaling 2,507 users. By using cutting-edge database technology, BAS provides Agency-wide, real-time access to budget planning, formulation, and analysis tools. BAS links budget dollars directly to the achievement of the Agency's strategic goals and objectives, which directly supports EPA's Government Performance Results Act (GPRA) compliance efforts.

Cost Recovery and Imaging. The existing application summarizes spending on Superfund cleanup sites and supports the recovery of the costs. EPA is exploring options for replacing this system with a more modern commercial product.

Application Integration. Application integration middleware is the switchboard mechanism that allows applications to communicate with each other without costly system specific interfaces. In FY 2005, EPA implemented an application integration tool as part of the deployment of our Web-based integrated payroll-human resource system and ADAM and developed a strategy for linking other information.

In conclusion, EPA expects to remain in the forefront of federal financial management. Further, the Agency will maximize the benefits from its PMA initiatives to ultimately protect the environment and save taxpayers' dollars.

3.
Environmental Protection Agency
Supplemental Information (Unaudited)
Improper Payments Information Act of 2002 (IPIA) Report
For the Year Ended September 30, 2005

I. RISK ASSESSMENTS: After reviewing and sampling disbursements made in the highest risk susceptible inventories, EPA determined that its programs do not have “significant erroneous payments,” defined by the IPIA as payments exceeding \$10 million and 2.5% of program payments. Because the Clean Water and the Drinking Water State Revolving Funds (SRFs) are former Section 57 programs, EPA is required to submit an IPIA corrective action plan for them. The Agency’s corrective action proposed to reduce the error rate of improper payments in the SRFs from 0.51 percent to 0.35 percent over a three-year period. EPA surpassed the FY 2005 target of 0.45 percent. The error rates for these two programs were as follows:

Program: Clean Water and Drinking Water SRFs

| Fiscal Year | Outlays | Erroneous Payments | Error Rate |
|-------------|----------------------|--------------------|--------------|
| 2004 | \$2.1 billion | \$10.3 million | 0.47 percent |
| 2005 | \$1.9 billion (est.) | \$3.1 million | 0.16 percent |

II. STATISTICAL SAMPLING PROCESS: In FY 2005, EPA revised its corrective action plan for the two SRFs. Based on the FY 2005 Measurement Plan approved by OMB, EPA pulled a statistical random sample of 252 direct payments from a population of 8,538 direct grant payments (126 transactions for each SRF). The error rate for the direct payment sample was 0.00 percent. Additionally, the Agency committed to reviewing a judgmental sample of at least 100 sub-recipient level payment transactions for each SRF during FY 2005. Only \$3.1 million of the \$555.1 million sub-recipient SRF payments reviewed were erroneous (0.23 percent). In FY 2006, EPA will provide OMB with a statistical methodology for sampling sub-recipient payments. The Agency plans to review a statistical sample of sub-recipient payments for each SRF in South Carolina and New Hampshire as well as a statistical sample of direct grant payments.

III. CORRECTIVE ACTION PLANS: In order to meet OMB’s objectives, EPA initially conducted additional risk assessments by forming four subgroups with expertise in grants, contracts, payroll, and travel/purchase credit cards to review internal controls, identify and measure high risk areas, and develop corrective action plans for each subject area. Updated planned actions in each of the areas are as follows:

A. Grants: As described in section II, EPA will continue reviewing direct and sub-recipient SRF payments. In the FY 2005 corrective action plan for the Clean Water and Drinking Water SRFs, EPA also committed to:

- Continue to review and enhance internal controls, as needed, in the Agency’s overall payment processes,
- As part of the post award process, continue to monitor payments made to sub-recipients,

- Comply with reporting requirements for improper payments, and
- Implement and operate the Agency's audit recovery program.

In FY 2005, the Office of Grants and Debarments (OGD) identified modifications needed to enable tracking erroneous payments by grant recipient in the Grantee Compliance Database. These modifications will allow tracking and maintaining data on the dollar value of erroneous payments by grant recipient.

During FY 2005, OGD performed an erroneous payments review for calendar year (CY) 2004 using judgmental risk-based sampling to select 267 grant recipients for administrative reviews including 111 non-profit grantees. Only 19 of these non-profit grantees had potential erroneous payments. All identified erroneous payments have been recovered

Preliminary results of the review of CY 2004 non-profit recipient reports provided the following results:

| Review/Audit Results | Dollars |
|--|-----------|
| All potential erroneous payments cited | \$650,799 |
| Questioned costs determined allowable | \$1,789 |
| Actual erroneous payments (unallowable costs) | \$4,575 |
| Costs that have been recovered | \$4,575 |
| Costs still in recipient appeal process (no final determination – may not to be erroneous) | \$644,435 |

In FY 2006 the OGD will complete the final identification of CY 2004 non-profit recipient erroneous payments still in the appeal process. They will implement modifications to the Grantee Compliance Database to enable capturing questioned costs and confirmed erroneous payments by grant recipient. OGD will introduce a new statistical sampling approach for the review of CY 2005 non-profit grantee monitoring/audit reports for erroneous payments and will identify reduction targets based on the results of this review. Those results also will be used to develop a performance monitoring metric that will serve as the baseline against which future results can be measured. EPA also reports on these OGD initiatives for the Improved Financial Management Initiative of the President's Management Agenda.

- B. Contracts: EPA continues to take appropriate action as needed to reduce or eliminate improper payments. The appropriate Contracting Officer Representatives or On Scene Coordinators are notified of all improper payments discovered. In January 2003, EPA implemented a monthly Improper Payment Report. The report categorizes the number of improper payments per month and provides information on each improper payment including the reason. In FY 2005, EPA identified 21 improper payments (0.01 percent error rate) due to keypunch errors or invoice error. Billing numbers received on contracts are now verified prior to entering information in Contract Payment System. Staff review identified keying errors and efforts are made to prevent or detect these types of errors in the future.

| Fiscal Year | Number of Erroneous Payments | Erroneous Payments (Dollars in Thousands) | Error Rate for Dollars |
|--------------------|-------------------------------------|--|-------------------------------|
| 2003 * | 25 (of 24,056) | \$206.1 | 0.02 percent |
| 2004 | 21 (of 24,886) | \$748.5 | 0.08 percent |
| 2005 | 21 (of 26,305) | \$121.5 | 0.01 percent |

* FY 2003 only included data from January through September.

Other actions include the addition of an improper payment review element for the Quality Assurance Review for invoices and the initiation of the Recovery Audit process which was completed in October 2005. The Audit Recovery contractor reviewed 86,217 contract payments totaling \$51.6 million and found 11 erroneous payments (\$12 thousand) – less than a 0.02 percent error rate.

The continued proactive process of reviewing and implementing changes as needed when an improper payment occurs should continue to reduce the number of improper payments. The Contracting Officer Representatives, On-Scene Coordinators or Contracting Officers will continue to be notified of all improper payments that involve their contract. Suggested actions will be provided and if the problem continues, actions will be elevated. Previously documented keying errors are being noted by the staff at EPA to assist in the detection by the initial data entry personnel as well as the sample reviewer and the certifying officer.

C. Commodity Payments: Since no high risk areas have been identified, no corrective action is required. EPA continues to take appropriate action as needed to reduce or eliminate any improper payments. The Recovery Audit contractor reviewed 249,879 invoices paid totaling \$124.0 million and found 41 improper payments (\$129 thousand) – less than a 0.10 percent error rate. These improper payments have been attributed to duplicate payments, returns not deducted, overpayments, and cash discounts not taken. The payment and certifying staff have been alerted to this fact and are making an effort to double check all vendor codes to prevent this in the future. All invoices marked past due are being reviewed to determine if they are duplicate invoices.

EPA put a tracking mechanism in place in January 2004 to gather improper payment data in anticipation that purchase order payments would be included in the erroneous payment process. The tracking system provides the data for a monthly Improper Payment Report. In FY 2005, 40 (of 42,698) commodity payments were erroneous. The improper payments represent \$416 thousand of the \$239 million payments processed (error rate of 0.17 percent).

D. Payroll: A payroll workgroup completed the following tasks:

1. Reviewed Payroll internal control documentation.
2. Reviewed personnel interviews to verify/test whether internal controls are understood and being utilized.
3. Summarized the results of the review of the internal controls.

EPA continues to provide training to its managers and staff in this area.

E. Travel Card/Purchase Card: The Agency will continue to monitor the charge card transactions and employee accounts using the tools described above to ensure that the cards are used in accordance with the Agency policies and procedures.

The Agency will continue to monitor the issuance of purchase cards to ensure that spending limits and span of control are kept to a minimum. The Office of Acquisition Management is in the process of implementing a monitoring program that is to be performed by each of the Senior Resource Officials in the Agency. This program will mandate that each office perform yearly reviews of the purchases made within their program offices. These reviews will ensure the integrity of the purchase card program.

IV. IMPROPER PAYMENT (IP) REDUCTION OUTLOOK FY 2004 – FY 2008 (Dollars in millions)

| Program | FY 2004 Outlays | FY 2004 IP % | FY 2004 IP \$ | FY 2005 Outlays | FY 2005 IP % | FY 2005 IP \$ | FY 2006 Outlays | FY 2006 IP % | FY 2006 IP \$ | FY 2007 Outlays | FY 2007 IP % | FY 2007 IP \$ | FY 2008 Outlays | FY 2008 IP % | FY 2008 IP \$ |
|-------------------------------------|------------------|--------------|---------------|-----------------|-----------------------------------|---------------|-----------------|--------------|---------------|-----------------|--------------|---------------|-----------------|--------------|---------------|
| Clean Water and Drinking Water SRFs | \$2,182 (actual) | 0.47 | \$10.3 | \$1,928 (est.) | 0.45 target 0.16 actual | \$3.1 | \$1,580 (est.) | 0.40 | \$6.3 (est.) | \$1,543 (est.) | 0.35 | \$5.4 (est.) | \$1,565 (est.) | 0.30 | \$4.7 (est.) |

Approximately \$10 million of the FY 2004 improper payments were due to states drawing funds too soon. The states have taken appropriate action to improve their internal controls so fund draws are properly timed.

V. RECOVERY AUDIT PROGRAMS: The Agency hired a contractor, Business Strategy, Inc (BSI), to conduct the recovery audit. BSI completed its preliminary interviews as part of the discovery phase of its work. This phase involved discussions with key individuals in the contract obligation and payment process and individuals knowledgeable about EPA's financial system.

BSI analyzed data received from the Integrated Financial Management System and in September 2005 completed its field work to identify and collect contract overpayments. BSI completed its final Recovery Audit report at the end of October 2005. As reported above in the Contracts and Commodities sections, BSI did not uncover any material erroneous payments (only \$130 thousand identified).

| Dollars in Millions | | | | | | |
|---------------------|--|-------------------------------------|---------------------------------|---|---------------------------|-------------------------------|
| Agency Component | Amount Subject to Review for FY 2005 Reporting | Actual Amount Reviewed and Reported | Amounts Identified for Recovery | Amounts Identified / Actual Amount Reviewed | Amounts Recovered FY 2005 | Amounts Recovered Prior Years |
| Contracts | \$4,284.8 | \$51.6 | \$0.01 | 0.02 percent | \$0.01 | N/A |
| Commodities | \$2,175.2 | \$124.0 | \$0.12 | 0.10 percent | \$0.129 | N/A |

In the first quarter of FY 2006, EPA will work with BSI to further strengthen payment processes and internal controls to prevent erroneous payments. The Agency will suggest to OMB that future Recovery Audit reviews be performed at three to five year intervals.

VI. ENSURING MANAGEMENT ACCOUNTABILITY: As previously outlined in the corrective action plans, the Agency continues to strengthen already strong internal controls in key payment processes. Information on erroneous payments from reviews and audits for the two SRFs, our largest grant programs, is reported quarterly to management in both the Office of Water and the Office of the Chief Financial Officer. In all cases, action is taken with the appropriate officials to ensure improper payments are recovered and to avoid future improper payments.

VII. INFORMATION SYSTEMS AND INFRASTRUCTURE: The Agency's information system and related processes are sufficient to reduce improper payments to targeted levels.

VIII. STATUTORY AND REGULATORY BARRIERS: Currently, EPA includes in the Office of Water's SRF state review process examination of sub-recipient invoices. The Agency also reviews audit reports on sub-recipient financial operations. In FY 2006, we will determine to what extent we can gather erroneous payment information from Single Audit Act reports. EPA's challenge for the SRF improper payments initiative is to broaden the scope of payment reviews. Through FY 2004, the Agency reviewed only direct payments. For FY 2005, EPA included a judgmental sample of sub-recipient payments in the review process. In FY 2006, EPA will conduct statistically valid samples of grants payments to sub-recipients in New Hampshire and South Carolina and assess the results of a Single Audit Act report for Texas.

IX. CONCLUSIONS: EPA is exceeding its erroneous payment reduction targets. The Agency has committed to the following FY 2006 erroneous payment actions:

- Provide to OMB a detailed sampling methodology for South Carolina and New Hampshire SRF sub-recipient payments;
- Review documentation for the State of Texas Single Audit Act report as a basis for determining whether such audits can be used to identify improper payments issues;
- Provide results of South Carolina and New Hampshire reviews, and direct payment reviews;
- Provide results of reviews of payments made to non-profit grantees;
- Assess the final October 2005 results of the recovery audit and establish reduction and recovery targets, if appropriate; and
- Report on improper payments in the Performance and Accountability Report (PAR)

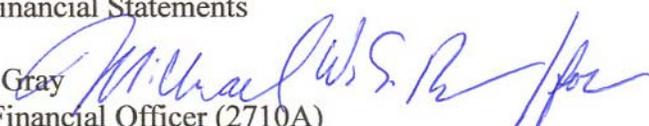
Agency's Response to Draft Report

NOV 10 2005

OFFICE OF THE
CHIEF FINANCIAL OFFICER

MEMORANDUM

SUBJECT: Draft Audit Report: Response to Audit of EPA's Fiscal Years 2005 and 2004 Financial Statements

FROM: Lyons Gray 
Chief Financial Officer (2710A)

TO: Paul C. Curtis, Director
Financial Audit (2422T)

My staff and I thank you for the opportunity to respond to the Draft Audit Report of the Environmental Protection Agency's Fiscal Year 2005 and 2004 Financial Statements. The Office of the Chief Financial Officer's (OCFO) perspective on the audit's observations and recommendations is provided in the attached document.

We agree with the audit issues raised. EPA has effective internal controls with strong policies and procedures in place and I believe that corrective actions will strengthen compliance with existing policies and procedures. We are evaluating the best method to address each issue that will achieve a timely resolution of audit issues.

As a result of increased vigilance in FY 2005, our internal assessments uncovered some areas that required strengthening. We worked proactively to devise and implement long-term corrective actions for these issues. We believe the issues raised by the OIG during the FY 2005 audit validated our internal "self assessments" and corrective actions. We appreciate OIG acknowledgement of our efforts and progress in this audit report.

We look forward to another productive year working with the OIG. If you have any questions, please contact Lorna McAllister, Director of the Office of Financial Management at 202-564-4905.

Attachment

Cc: Mike Ryan
Maryann Froehlich
Lorna M. McAllister
Dennis Nolan
OCFO Office Directors
OFM Staff Directors

OCFO's Response to the FY 2005 and FY 2004 Draft Audit Report

Reportable Conditions

1. Payroll Internal Controls

OIG found that EPA made payroll payments to separated employees. OIG recommends that OCFO work with EPA's Administration and Resources Management office to ensure proper processing of personnel actions, modify automated controls, and reinforce existing controls.

At the beginning of FY 2005, OCFO implemented a new time and attendance system. OCFO made significant strides to assure system transparency to the Agency and compliance with established payroll policies and procedures. In FY 2006, OCFO will continue to validate payroll system internal controls, enforce existing procedures, and take further corrective actions as necessary.

2. Excess Salary Payments

OIG found the OCFO's payroll system made excess salary payments to employees totaling \$14,891 of a \$54 million bi-weekly payroll, which equates to .04% of total payroll.

OCFO has automated internal controls in place for the majority of potential causes for salary overpayments and manual controls in place for many others. OCFO is initiating enhancements to broaden the scope of automated controls to replace existing manual controls. We will continue to evaluate the results as part of our bi-weekly payroll review process.

3. Superfund State Contract (SSC) and Superfund Unbilled Oversight Accruals

The OIG noted areas where increased oversight would improve the management of SSC and Superfund unbilled oversight accruals.

In the past year, OCFO made considerable progress towards assuring consistency with SSC and Superfund unbilled oversight accrual calculations. As OCFO continues its efforts to consolidate accounting operations, we will explore options for centralizing these accrual processes.

4. General Ledger Account Adjustments for Receivables Transferred to Cincinnati Finance Center

OIG Identified regional offices' accounts receivable and allowance for doubtful accounts that needed adjustment during an OCFO functional and consolidation process.

As part of the process to consolidate EPA's financial operations into four finance centers, the Agency successfully transferred five of the ten regions' accounts receivable functions to one finance center. An account analysis identified accounting point balances that required adjustments that are reflected in the financial statements. As the Agency progresses in transferring the accounts receivable functions from the remaining five regions, OCFO will continue to monitor appropriate general ledger accounts and assist the Financial Management Officers in resolving account balance issues.

5. Quality Assurance (QA) Reviews

The OIG recommends increased oversight of the QA program activity to ensure comprehensive reviews and adequate documentation.

In FY 2005, OCFO made significant progress with the QA program. OCFO updated and published the QA Guide on the EPA intranet. It reflects current policies, procedures, and approaches to evaluating accounting functions. In addition, OCFO conducted a specialized session on QA reviews and their relationship to the revised OMB Circular A-123 requirements. To continue the QA program's success, OCFO is conducting a training class in December 2005 for Agency finance personnel.

6. Distribution of the Budget Clearing Accounts

OIG identified interagency transactions that were inappropriately distributed.

In this instance, EPA billed other agencies and two transactions were returned two days prior to the close of the fiscal year. EPA reissued the bills in October 2005 and the FY 2005 financial statements reflect the appropriate accounting adjustments.

7. Documentation of Adjustments to the Integrated Financial Management System (IFMS) Entries

The OIG noted instances of adjusting entries made without proper or adequate documentation.

OCFO's Policy Announcement 93-02, dated November 13, 1992, requires adequate source documentation to support all financial transactions. OCFO will insist that Financial Management Officers ensure that all adjusting transactions entered into the Agency's accounting system be adequately documented and easily accessible in accordance with the Policy Announcement.

8. Correcting Rejected Transactions

OIG observed instances of rejected data transfers between PeoplePlus (PPL) and IFMS that were not resolved in a timely manner.

OCFO took action to identify and correct the rejected data for 16 employees. The Office of Human Resources implemented a control that should prevent a reoccurrence.

9. Contingency Plans for Financial Applications

OIG noted instances where contingency plans for financial systems did not fully comply with Federal or EPA continuity guidelines.

OCFO remains firmly committed to securing its system and data in a cost effective manner and in compliance with Federal guidance, EPA policy, and best practices. In FY 2006, OCFO will revise current contingency plans to clearly state the critical operations, supporting resources, and alternate processing procedures for the financial systems identified by the OIG.

Federal Financial Management Improvement Act (FFMIA) Noncompliance Issues

10. Intragovernmental Transactions

As OIG acknowledged, OCFO greatly improved reconciliations of its intragovernmental transactions during FY 2005. However, at year end, EPA was unable to reconcile a large difference with one Federal agency.

EPA believes this is a result of differing accounting methodologies between agencies. EPA will continue efforts to reconcile the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

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