



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Audit of EPA's Fiscal 2004 and 2003 Financial Statements

Audit Report 2005-1-00021

November 15, 2004



Abbreviations

EPA	Environmental Protection Agency
FFMIA	Federal Financial Management Improvement Act
FMFIA	Federal Managers' Financial Integrity Act
GPAS	Grant Payment Allocation System
IDOTS	Inter-Governmental Document Online Tracking System
IFMS	Integrated Financial Management System
JFMIP	Joint Financial Management Improvement Program
OARM	Office of Administration and Resources Management
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
ORBIT	OCFO Reporting and Business Intelligence Tool
OSS	Operations Systems Staff
QA	Quality Assurance
RSSI	Required Supplemental Stewardship Information
SSC	State Superfund Contracts

Cover photo: Provided by Cynthia R. Poteat, OIG
Waterfall, Juneau, Alaska



U.S. Environmental Protection Agency
Office of Inspector General

2005-1-00021
November 15, 2004

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 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/2005/20041115-2005-1-00021.pdf

Audit of EPA's Fiscal 2004 and 2003 Financial Statements

EPA Receives Unqualified Opinion

We rendered an unqualified, or clean, opinion on EPA's Consolidated Financial Statements for fiscal 2004 and 2003, meaning that they were fairly presented and free of material misstatement

Internal Control Reportable Conditions Noted

We identified the following reportable conditions

- EPA needs to improve financial management quality assurance.
- EPA could not ensure the accuracy of the unearned revenue accounts
- EPA did not timely record accounts receivable
- EPA did not promptly record marketable securities
- Accounting for contractor-held property needs improvement.
- Improvement is needed in EPA's accounting for obligations.
- Systems development for several systems needs improvement
- System certification and accreditation is needed.
- Weaknesses in system's change control procedures were noted.
- Automated Application Processing Controls could not be assessed.

Noncompliances With Laws and Regulations Noted

We noted the following noncompliances with laws and regulations, though none are considered to be substantial noncompliances

- EPA needs to continue improvements related to cost accounting.
- Difficulties in reconciling intragovernmental transactions continue
- EPA needs to strengthen security screening for non-Federal personnel.
- EPA is not in compliance in preparing the Statement of Transactions.

Agency Comments and Office of Inspector General Evaluation

In a memorandum received November 12, 2004, the Agency responded to our draft report, and generally agreed to take sufficient corrective actions



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D C 20460

OFFICE OF
INSPECTOR GENERAL

November 15, 2004

MEMORANDUM

SUBJECT Audit of EPA's Fiscal 2004 and 2003 Financial Statements
Report No. 2005-1-00021

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

TO Charles E. Johnson
Chief Financial Officer (2710A)

Attached is our audit report on the Environmental Protection Agency's (EPA's) fiscal 2004 and 2003 financial statements. The report reflects our view that the Agency continues not to be in full compliance with the managerial cost accounting standard, however, the level of compliance does not meet Office of Management and Budget's definition of substantial noncompliance. We also recognize that the Agency is in the process of making improvements. The audit report also addresses the deficit in the Superfund Trust Fund. During Fiscal 2004 and 2003, Trust Fund assets were not sufficient to cover appropriations to the EPA, leaving a deficit of approximately \$7.6 million and \$82.7 million in fiscal years 2004 and 2003 respectively. The audit report also contains other findings that describe issues the Office of Inspector General (OIG) has identified and corrective action 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) 566-0889.

Attachment

cc: See Appendix III, Report Distribution List

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Inspector General's Report on EPA's Fiscal 2004 and 2003 Financial Statements

The Administrator
U S. Environmental Protection Agency

We have audited the consolidating balance sheets of the U.S. Environmental Protection Agency (EPA, or the Agency) and its subsidiary funds, the Superfund Trust Fund (Superfund), and All Other Appropriated Funds (All Other), as of September 30, 2004 and 2003, and the related consolidating statements of net cost, changes in net position and financing, and consolidated statements of net cost by goal, custodial activity, and combined statements 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 auditing standards generally accepted in the United States of America, 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. In addition, the U.S. Treasury collects and accounts for excise taxes that are deposited into the Superfund and Leaking Underground Storage Tank Trust Funds.¹ 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.

As more fully described in Note 36 to the financial statements, the Superfund Trust Fund, managed by the U.S. Treasury Bureau of Public Debt, transferred funds to EPA in excess of the assets available to be transferred by \$7.6 million in fiscal 2004 and \$82.7 million in fiscal 2003. EPA's view is that the shortfalls will be covered by the collection of cost recoveries and receipt of interest income over time. In our opinion, because cost recoveries have declined and the

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

investment principal upon which the interest is earned has steadily decreased, any deficit and future financing will have to be covered almost entirely by appropriations from the Treasury's general fund in order for the Superfund Trust Fund to continue operations.

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 assets of the Agency's activities.

In our opinion, the consolidating financial statements present fairly, in all material respects, the consolidated and individual assets, liabilities, net position, net cost, net cost by goal, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activity of EPA and its subsidiary funds, the Superfund Trust Fund, and All Other Appropriated Funds, as of and for the years ended September 30, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America

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

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

We did not identify any material inconsistencies between the information presented in EPA's financial statements and the information presented in EPA's RSSI, Required Supplemental Information, and Management Discussion and Analysis. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report, as Required Supplemental Information, their intra-governmental assets and liabilities by Federal trading partner. We did find EPA continues to experience difficulties in reconciling some of its intragovernmental transactions due to some Federal entities not providing information for reconciliations (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 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 2004 Annual Report*, Section 1, Overview and Analysis (which addresses requirements for a Management's Discussion and Analysis), we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as

required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not express an opinion on such controls.

Reportable Conditions

Reportable conditions are internal control weakness matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the organization's ability to meet the OMB objectives for financial reporting discussed above. In evaluating the Agency's internal control structure, we identified 10 reportable conditions, as follows:

Financial Management Quality Assurance Process

EPA's Quality Assurance Guide, which is the framework for implementing the Agency's financial management quality assurance program, is out of date. EPA offices did not consistently review all required accounting events identified in the guide, and those reviews conducted were not sufficiently comprehensive. Financial Centers placed minimal emphasis on financial system functional reviews to support Federal Managers' Financial Integrity Act (FMFIA) certifications, and EPA has no central oversight of the Quality Assurance program. As a result, the program's effectiveness was minimized

Unearned Revenue and Superfund Unbilled Oversight Cost Accruals

Although EPA made financial improvements in fiscal 2004 by reconciling State Superfund Contracts' unearned revenue and implementing accelerated unbilled oversight cost accrual procedures, errors continued to occur in regional spreadsheet calculations. Regional calculations did not include the proper amounts of cumulative disbursements, resulting in a \$14 million understatement of unearned revenue. Regional billed oversight calculations did not follow all the new accrual procedures, resulting in a \$3 million understatement of the accrual, and the prior year's unbilled oversight accrual was overstated by \$10 million due to prior year errors

Supporting Documentation for Accounts Receivable

Finance offices were unable to record accounts receivable transactions promptly in the Integrated Financial Management System (IFMS) due to the Office of General/Regional Counsel and program offices not submitting documentation in a timely manner. Finance offices received documentation supporting the establishment of receivables up to 6 months after the agreements were executed. Further, we identified \$1,963,980 in fines and penalties that were unrecorded at the time of our audit. We noted numerous instances in which the finance offices requested support for previously unrecorded accounts receivable only after collected.

Recording of Marketable Securities

EPA did not promptly record marketable securities received from companies in settlement of debts. During fiscal 2004, the Agency received securities from three companies for settlement of debts under receivables recorded at four accounting offices. Of the four accounting offices, only one recorded receipt of non-cash assets. The accounting offices that did not record the receipt of non-cash assets either were not aware that marketable securities were received or stated that they were awaiting additional information from Headquarters.

Accounting for Contractor-Held Property

Contractor-held property acquisition values were understated by about \$6.9 million. When we attempted to tie the ending balances as shown on all the EPA Reports of Government-Owned/Contractor-Held Property documents to the September 30, 2004 general ledger balance for contractor-held property, we discovered that contractor-held balances did not include a \$6,883,574 contract. Also, the Agency improperly accounted for surplus contractor-held property in depreciation computations.

Accounting for Obligations

Obligations were not recorded in the proper accounting period. In one region and a finance center, we found 10 out of 16 obligations tested were recorded in fiscal 2005 but were actually fiscal 2004 obligations. Also, for one of the obligation transactions tested, involving an adjustment, the finance center had no supporting documentation. Further, in one region, four out of seven inactive unliquidated obligations were not deobligated in a timely manner.

Systems Development for Grant and Inter-Governmental Systems

The Operations Systems Staff of the Office of the Chief Financial Officer (OCFO) developed and implemented accounting systems without assessing the risks these systems pose to Agency assets, personnel, and operations. The staff also did not produce key documents for the Grant Payment Allocation System and Inter-Governmental Document Online Tracking System because they did not deem these systems to be major applications. However, since both systems are used to submit information into IFMS, EPA's main financial accounting system, we consider these systems to be major applications.

System Certification and Accreditation for Grant and Inter-Governmental Systems

OCFO's Operations Systems Staff did not ensure management controls were operating effectively by assessing and testing security controls for the Grant Payment Allocation System and Inter-Governmental Document Online Tracking System. Specifically the staff's policies and procedures could not provide reasonable assurance that applications achieved their intended results, resources were protected from fraud, waste, and abuse;

and applications followed applicable Agency policies and Federal guidelines. Also, we found four “high risk” security holes on a critical server hosting eight financial applications.

IFMS Change Control Procedures

In an August 24, 2004, audit report, *EPA Needs to Improve Change Controls for Integrated Financial Management System* (2004-P-00026), we reported a general breakdown of security controls related to software changes that could undermine the integrity of IFMS software libraries and financial system data. Weaknesses included inadequate segregation of change management duties, and inappropriate ID use. In response to the recommendations in our prior report, OCFO concurred with our recommendations and generally outlined appropriate corrective actions.

IFMS Automated Application Processing Controls

We continue to be unable to assess the adequacy of the automated application control structure as it relates to automated input, processing, and output controls for IFMS. Since IFMS applications have a direct and material impact on the Agency’s financial statements, assessing each application is necessary to determine the reliance we can place on the financial statements. During past financial statement audits, we attempted to evaluate controls without systems documentation, but these alternatives proved to be inefficient and impractical. OCFO has no plans to update the IFMS system documentation until it implements the new financial replacement software package, currently projected for fiscal 2008. Until the new system is in place, we cannot assess the adequacy of the automated internal control structure.

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 also reported other less significant matters involving the internal control structure and its operations in separate position papers during the course of our audit. We will not be issuing 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 FMFIA report that relate to the financial statements and identify material weaknesses disclosed by audit that were not reported in the Agency’s FMFIA report. EPA reports on Integrity Act decisions in EPA’s *Fiscal Year 2004 Annual Report*. For a discussion on Agency reported Integrity Act material weaknesses and corrective action strategy, please refer to EPA’s *Fiscal Year 2004 Annual Report*, Section III, FY 2004 Management Accomplishments and Challenges.

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 as part of the Integrity Act process, and our audit did not detect, any material weaknesses for fiscal 2004.

Tests of Compliance with Laws and Regulations

EPA management is responsible for complying with laws and regulations applicable to the Agency. As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as supplemented by an OMB Memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*. The OMB guidance requires that we evaluate compliance with Federal financial management system requirements, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to EPA.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. There are a number of ongoing investigations involving EPA's grantees and contractors that could disclose violations of laws and regulations, but a determination about these cases has not been made. In addition, the Agency reported that the approximately 9,000 confidential financial disclosure forms filed by EPA employees by November 1, 2004, will be reviewed by the deputy ethics officials no later than January 22, 2005. 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

FFMIA Noncompliance

Under FFMIA, we are required to report whether the Agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Bulletin No 01-02, as supplemented by an OMB memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*, substantially changed the guidance for determining whether or not an Agency substantially complied with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. The document is intended to focus Agency and auditor activities on the essential requirements of FFMIA. The document lists the specific requirements of FFMIA, as well as factors to consider in reviewing systems and for determining substantial compliance with FFMIA. It also provides guidance to Agency heads for developing corrective action plans to bring an Agency into compliance with FFMIA. To meet the FFMIA requirement, we performed tests of compliance with FFMIA section 803(a) requirements and used the OMB guidance, revised on January 4, 2001, for determining substantial noncompliance with FFMIA.

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

We recognize improvements OCFO has made in cost accounting and believe that while there are still noncompliance issues with cost accounting, those noncompliances do not meet OMB's definition of substantial noncompliance. However, 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.

We identified two other FFMIA noncompliances, related to reconciliation of intragovernmental transactions and strengthening practices regarding security screening for non-Federal personnel. However, these noncompliances do not meet the definition of substantial noncompliance as described in OMB guidance.

Our tests also noted one other instance of noncompliance with laws and regulations, related to the Treasury Financial Manual for preparation of Statement of Transactions. Subsequent to the completion of our audit work, the Agency took action to implement Treasury procedures for preparation of Statement of Transactions.

Attachment 2 provides additional details, as well as our recommendations on actions that should be taken on these matters. We have also 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:

- Reconciling and reporting intra-governmental 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 Statement of Transactions.
- Documentation and approval of journal vouchers.
- Assessing automated application processing controls for IFMS.
- Reconciling Unearned Revenue for State Superfund Contracts
- Managing EPA's Accounts Receivable

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

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

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

Agency Comments and OIG Evaluation

In a memorandum dated November 12, 2004, 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, stylized initial "P".

Paul C. Curtis, Director
Financial Audit
Office of Inspector General
U.S. Environmental Protection Agency
November 5, 2004

Reportable Conditions

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1 - EPA's Financial Management Quality Assurance Process Needs Improvement

EPA needs to improve its financial management quality assurance program. The Quality Assurance (QA) Guide, which is the framework for implementing this program, is out of date. EPA offices did not consistently review all accounting events identified in the guide, and when they did perform reviews the reviews were not as comprehensive as the guide suggests. The financial centers placed minimal emphasis on financial system functional reviews to support their FMFIA certifications, and EPA has no central oversight of the region and finance center implementation of the QA program. As a result, the effectiveness of the QA program was minimized.

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*, revised June 21, 1995. 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. However, EPA's QA Guide, dated August 1995, is outdated. The QA Guide does not reflect developments since August 1995, such as new authoritative guidance, modernization of the accounting systems, discontinuance of accounting functions (such as the imprest fund), and recent transfers of accounting functions from the regions to finance centers. Office of Financial Management, Financial Policy and Planning Staff recognized the need to update its QA Guide, and have dedicated one employee to update the guide. However, the guide is not expected to be completed until December 2006.

Some field locations did not complete reviews of accounting events. The QA Guide requires each location to conduct a review of each applicable accounting event at least once every 3 years. Three of the five Regions and three of the four Finance Centers we audited did not complete reviews of all applicable accounting events. Further, only one of the five regions performed a Superfund Cost Recovery Review in the last 3 years. Conflicting information in the QA Guide created uncertainty about the requirements to perform the Superfund Cost Recovery Review. As a result, EPA has not reviewed the internal controls of this high-risk area.

In examining eight regional and finance center quality assurance reviews, we found that the reviews on accounting events were more limited in scope than what was provided for in the QA Guide. The QA Guide provides control objectives and test procedures for each accounting event. By not following the guide, the limited reviews circumvented the guide's intent of determining whether control objectives were met.

The finance centers placed minimal emphasis on financial system functional reviews to support their FMFIA certifications. They did not perform the reviews required by OMB Circular A-127, *Financial Management Systems*, and Joint Financial Management Improvement Program (JFMIP) system standards. Two of the four finance centers did not perform any accounting system reviews in fiscal 2004.

While the Office of Financial Management, Financial Policy and Planning Staff develop and manage the QA program, no headquarters function was providing oversight of the Regional and Finance Center implementation of the QA program. No central oversight of the quality or

quantity of Regional and Finance Center QA workplans and reviews exists. EPA does not centrally coordinate the reviews among Regions and Finance Centers to ensure coverage of multi-location accounting events. EPA has not provided recent training on the FMFIA requirements and procedures for performing the reviews. Accounting staff in three locations indicated that they had not received FMFIA training in several years.

Recommendations

We recommend that the Office of the Chief Financial Officer:

1. Update and clarify the QA Guide and develop procedures to update the guide routinely to reflect changes in the organization, accounting events, internal control standards, and relevant accounting principles and standards
2. Provide increased oversight of the QA program to include: approving the QA workplans; monitoring regional and finance center review coverage and scope of reviews, providing feedback on reviews; and coordinating review coverage of multi-location accounting events.
3. Provide basic and refresher training to appropriate personnel on the FMFIA requirements and the Agency's QA process.

Agency Comment and OIG Evaluation

The OCFO believes the existing QA program is effective. OCFO also stated they are in the process of updating the QA Guide to incorporate new principles and standards and will develop an action plan to monitor the program and provide annual training.

We disagree with OCFO about the current effectiveness of the QA program. However, the Agency has agreed to implement our recommendations. When completed, and with proper oversight, the QA program will be effective.

2 - EPA Needs to Further Improve State Superfund Contracts' Unearned Revenue and Superfund Unbilled Oversight Cost Accruals

EPA made financial improvements in fiscal 2004 by reconciling State Superfund Contracts' (SSCs') unearned revenue and implementing accelerated unbilled oversight cost accrual procedures. However, errors continued to occur in the regional spreadsheet calculations, due to a lack of supervision and review. As a result, EPA could not ensure the accuracy of the unearned revenue and the unbilled oversight accounts, which totaled approximately \$43 million and \$52 million, respectively

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.

We found errors in both SSC unearned revenue and unbilled oversight calculations. Regional SSC calculations did not include the proper amounts of cumulative site disbursements, resulting in a \$14 million understatement of unearned revenue. Regional unbilled oversight calculations did not follow all the new accrual procedures, resulting in a \$3 million understatement of the accrual. In addition, the prior year's unbilled oversight accrual was overstated by \$10 million due to prior year errors.

EPA promptly reworked the calculations to correct the errors and made the necessary on-top adjustments to the financial statements. We believe that if the Agency increased supervision over the preparation of quarterly SSC calculations, the process would be greatly improved.

Recommendations

We recommend that the Office of the Chief Financial Officer have the Office of Financial Management:

4. Provide increased supervision of the quarterly SSC unearned revenue and unbilled oversight cost accruals.
5. Analyze whether centralizing and consolidating the accrual processes could improve the efficiency and accuracy of the accruals.

Agency Comment

The Agency agreed with our findings.

3 - Accounts Receivable Not Timely Recorded Due to Late Submission of Supporting Documentation

Finance offices were unable to record transactions promptly in IFMS due to the Office of General/Regional Counsel and program offices not submitting supporting documentation in a timely fashion

Finance offices received documentation supporting the establishment of receivables up to 6 months after the agreements were executed. Further, we identified \$1,963,980 in fines and penalties that were unrecorded at the time of our audit. After being informed of the unrecorded amounts, the finance offices requested the support and recorded the related receivable. In addition, we noted numerous instances in which the finance offices requested support for previously unrecorded accounts receivable only after being collected.

The Agency's Resource Management Directive System guidelines states that within 5 days of determining a debt is owed to the Agency, the responsible office must forward source documents to the finance office. For Superfund receivables, the Resource Management Directive System states that the Office of Regional Counsel is responsible for forwarding copies of all source documents to the Financial Management Office required to establish accounts receivable within 3 workdays.

During instances when valid receivables are not promptly recorded, the debtor may not be appropriately billed, interest may not accurately accrue, and the Agency may not be paid the total debt. Furthermore, receivable balances could be materially misstated on the financial statements due to unrecorded receivables.

Recommendations

We recommend that the Office of the Chief Financial Officer:

6. Require the Director, Office of Financial Management, to develop procedures for monthly reconciliations of accounts receivables established in IFMS to information tracked by Regional Hearing Clerks and program offices; this reconciliation should be documented and all outstanding receivables specifically identified for followup action.
7. Request the Office of General Counsel and program offices to
 - Strengthen existing policies and procedures requiring timely forwarding of billing documents to finance offices.
 - Implement procedures requiring Offices of Regional Counsel and program offices to expedite forwarding any outstanding agreement identified as a result of the Financial Management Office/Center's monthly reconciliations.
 - Develop a mechanism to track and document the forwarding of all billing documents to the Financial Management Offices/Centers, to ensure accountability.

Agency Comment and OIG Evaluation

OCFO believes the current policies and procedures adequately address the proper identification and recording requirements for accounts receivable. The OCFO did agree to collaborate with applicable Agency offices and programs, ensure existing policies are followed, and increase awareness on the importance of recording accounts receivable timely.

After we reported our initial findings to the Agency, they went through an intensive effort to identify and record receivables. Had the Agency's current policies and procedures been effectively applied, we would not have found unrecorded receivables and such an effort would not have been necessary.

4 - EPA Did Not Promptly Record Marketable Securities

EPA did not promptly record marketable securities received from companies in settlement of debts. During fiscal 2004, the Agency received securities from three companies for settlement of debts under receivables recorded at four accounting offices. Of the four accounting offices that received marketable securities, only one office recorded the receipt of non-cash assets. The accounting offices that did not record the receipt of non-cash assets either were not aware that marketable securities were received or stated that they were awaiting additional information from Headquarters

EPA has not established adequate reconciliation or followup procedures to ensure that marketable securities received are included in the financial statements. Agency procedures require finance offices to log securities received; however, there are no reconciliations performed to ensure that securities logged are forwarded to the appropriate finance office and properly recorded in the accounting system

The Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," states that monetary instruments shall be valued at fair market value when obtained. Agency policies and procedures also require the recording of marketable securities at their fair market value at the time of receipt.

Recommendations

We recommend that the Office of the Chief Financial Officer:

- 8 Require the Director, Office of Financial Management to strengthen procedures to ensure that receiving financial management offices have sufficient information to record securities
- 9 Require the Director, Office of Financial Management to develop reconciliation procedures to ensure marketable securities are recorded by the respective finance offices at fair market value when received. In conjunction with the preparation of quarterly financial statements, perform a reconciliation between amounts logged and those recorded in the general ledger to ensure a proper and complete non-cash asset balance.
- 10 Require the Directors, Financial Management Offices/Centers, to ensure staff record marketable securities upon receipt

Agency Comment

OCFO issued a policy on marketable securities in fiscal 2004 that documented roles and responsibilities and emphasized the need to strengthen processes. OCFO will evaluate the policy implementation in fiscal 2005 and identify improvements needed. OCFO also stated they will require quarterly Superfund Accounts Receivable analyses.

5 – Accounting for Contractor-Held Property Needs Improvement

Contractor-held property acquisition values were understated by about \$6.9 million. When we attempted to tie the ending balances as shown on all the EPA Reports of Government-Owned/Contractor-Held Property documents to the September 30, 2004, general ledger balance for contractor-held property, we discovered that contractor-held balances did not include a \$6,883,574 contract (Contract No. 68W04005).

Also, the Agency improperly accounted for surplused contractor-held property. The Agency computes depreciation on contractor-held property over its estimated useful life (10 years for Superfund site specific property, 5 years for other contractor-held property). The Agency considers surplused contractor-held property to be fully depreciated, without regard to acquisition dates or remaining useful life. For example, we found \$11.6 million of Superfund site specific property that was acquired no more than 8 years ago that was surplused and treated as if it had been fully depreciated. As a result, accumulated depreciation on the remaining property was understated and the loss associated with surplus property was not recorded. In addition, the Agency continued to compute depreciation expense on such property as if the property was never surplused, in effect, distributing the loss on disposal over several years.

Recommendations

We recommend that the Office of the Chief Financial Officer

11. Develop a methodology to reasonably estimate the net book value of all contractor-held property and the related accumulated depreciation balances to reflect their proper balances as of September 30, 2004.
12. Use the recalculated net book value of contractor-held property to compute fiscal 2004 depreciation expense.
13. Record the loss associated with surplus property.
14. Determine whether the \$6,883,574 for Contract No. 68W04005 should be added to the contractor-held general property acquisition value.

Agency Comment and OIG Evaluation

The Agency agreed with our findings and recommendations and made the appropriate adjustments to the financial statements.

6 - Improvement Needed in EPA's Accounting for Obligations

EPA needs to make improvements in its accounting for obligations. During fiscal 2004, we found:

- Obligations not recorded in the proper accounting period.
- Lack of documentation to support obligation accounting transactions
- Inactive unliquidated obligations that were not deobligated.

Fiscal 2004 Obligations Not Recorded in Proper Accounting Period

Financial management offices did not always record obligations in the correct accounting period. EPA's Comptroller Policy Announcement No. 86-09 states that individuals with obligational authority are responsible for ensuring that the valid obligating document is received by the servicing financial management offices within 3 working days of execution of the obligating document. However, in one region and a finance center, we found 10 out of 16 obligation transactions tested (62.5 percent, totaling \$1,036,139) were recorded in fiscal 2005 but were actually fiscal 2004 obligations. As a result, fiscal 2004 obligations were understated. The finance offices did not receive the 10 obligating documents from the originating offices until between 4 to 66 working days after the execution of the obligating document. If the documents were received more timely, these obligations could have been recorded in IFMS by the finance office or the Office of Financial Management's Reporting and Analysis Staff as fiscal 2004 transactions.

Lack of Documentation to Support Accounting Transactions

The Agency needs to ensure that adequate documentation is maintained for obligation transactions recorded in IFMS. For one of the obligation transactions we tested, we found that the finance center had no supporting documentation. The Agency learned that this debit transaction to general ledger account 4821 was an adjustment made the same day as the original transaction. Since the two transactions went into IFMS in the same nightly cycle, the transactions netted to the correct amount. Because the accountant did not consider this to be an after-the-fact adjustment, no standard voucher was prepared for the adjustment nor was it documented in the files.

Inactive Unliquidated Obligations Not Deobligated

In one region, we found that four out of seven inactive unliquidated obligations were not deobligated in a timely manner. Resources Management Directive System 2520, Chapter 3, and EPA's Comptroller Policy Announcement No. 96-04 require an annual review and certification of unliquidated obligations to ensure all current and prior year obligations are valid and viable. The funds were no longer needed for their intended purpose and could have been deobligated. The Agency agreed and deobligated the inactive miscellaneous obligations, totaling \$38,316. However, grant obligations (totaling \$2,283,274), which have been inactive for a period of 5 to 8 years since the last action, have not been deobligated.

Recommendations

We recommend that the Office of the Chief Financial Officer

- 15 Remind the financial management offices and finance centers that: (1) obligations should be entered into the accounting system promptly and for the proper accounting period, (2) adequate supporting documentation for all IFMS accounting entries should be maintained, and (3) Agency's policy and year-end closing instructions for the review of unliquidated obligations should be followed
- 16 Establish a policy requiring the financial management offices and finance centers to monitor obligations received during the first 15 days of October to determine whether the obligations should be reported in the prior fiscal year; report any adjustments for inclusion in the Agency's financial statements; and maintain adequate supporting documentation for adjustments.
17. Record the identified obligations of \$1,036,139 in the proper accounting period
18. Deobligate inactive obligations of \$2,283,274

Agency Comment and OIG Evaluation

OCFO recognized the importance of processing obligations and deobligations timely. However, they stated that grant obligations of \$2,283,274 cannot be deobligated until the grantee submits the final Financial Status Report and other related closeout information. OCFO also will not prepare the recommended adjustment for recording obligations because they stated the amount is not material to the financial statements.

We recognized that the amounts reported are not in and of themselves material to the financial statements or in comparison with the billions in outstanding obligations. What we are concerned about is that the internal controls and processes that allow such obligations and deobligations to go undetected by the Agency, if not corrected, would allow for potential material misstatements

7 – Systems Development for Grant and Inter-Governmental Systems Needs Improvement

OCFO's Operations Systems Staff (OSS) developed and implemented accounting systems without assessing the risks these systems pose to Agency assets, personnel, and operations, and consequently did not record results of assessments in key technical and security documentation as required. Specifically, OSS did not produce key documents (e.g., Risk Assessments, Security Plans, Disaster Recovery Plans, System Technical Documentation, and Cost Benefit Analyses) for the Grant Payment Allocation System (GPAS) and Inter-Governmental Document Online Tracking System (IDOTS). Further, GPAS did not comply with the following JFMIP technical requirements: (1) to produce complete installation, operating, and system maintenance documentation covering product installation and transaction entry procedures; and (2) to establish password expiration settings.

OSS did not follow EPA's system development policy when developing GPAS and IDOTS. OSS did not consider the Agency's policy to be applicable to GPAS or IDOTS, because it did not deem them to be major applications or core financial systems. OSS had not reviewed JFMIP guidelines or GPAS' current functionality to ensure it met applicable JFMIP standards.

OSS implemented GPAS and IDOTS to support fund payment allocation for grants and Interagency Agreements. Both GPAS and IDOTS interface and prepare input for submission into IFMS, EPA's main financial accounting system. Therefore, these systems are major applications, based on their association with IFMS and the significance of processed financial transactions. According to OSS officials, these systems processed \$1.4 billion in payments for fiscal 2004. GPAS has significant program implications because it processes approximately 89 percent of the grant payment transactions at EPA's Las Vegas Finance Center. Because of the critical functions performed by these systems and the special attention required by management to ensure they operate effectively, OSS should classify GPAS and IDOTS as major applications. As such, OSS should have documented a formal risk assessment before placing the systems into production, developed security plans, and followed Agency policy to produce necessary system documentation when developing these systems.

During audit field work, we alerted OSS that GPAS and IDOTS required risk assessments and security plans, and OSS provided draft security plans for both systems and subsequently approved these plans. Since we did not receive the approved security plans until after completing our field work, we defer a detailed review of the plans until the fiscal 2005 audit cycle. OSS did not provide risk assessment documentation for either system, but referenced a fiscal 2004 system review (self-assessment) of IDOTS, which had been conducted in conjunction with the Federal Information Security Management Act. Agency policy considers a "self-assessment" an adequate security review when the system has a risk assessment completed and documented as part of a General Support System Security Plan, but neither GPAS nor IDOTS had such risk assessments.

By not following EPA's system development policy, Agency officials have inadequate assurance these systems are providing the appropriate information on which to base decisions. In addition, vital documentation necessary for system operations and maintenance is not available. As such, serious doubt exists that the Agency could troubleshoot, correct, or recover from system-processing problems without the institutional knowledge residing with current OSS employees.

Recommendations

We recommend that the Office of the Chief Financial Officer have the Director, Office of Financial Services.

- 19 Conduct and document a formal risk assessment for GPAS and IDOTS
- 20 Conduct and document a formal review of GPAS' compliance with all applicable JFMIP system requirements
21. Direct Offices to follow Agency system development policy for all future system development efforts

Agency Comment and OIG Evaluation

The Director for OCFO's Office of Financial Services concurred with our recommendations and provided a corrective action plan that, when implemented, should adequately address most of the recommendations' intent. However, we expressed concerns that more needed to be done to ensure the risks associated with these systems were adequately assessed and documented. In response to our concerns, management.

- Classified GPAS and IDOTS as major applications.
- Updated its corrective action plan, indicating GPAS will undergo a system review (self-assessment).
- Indicated it would ensure the Office of Administration and Resource Management's General Support System Security Plan includes a formal risk assessment for both GPAS and IDOTS by September 1, 2005

8 - System Certification and Accreditation for Grant and Inter-Governmental Systems Needed

OSS did not ensure management controls were operating effectively by assessing and testing security controls for GPAS and IDOTS. Specifically, OSS current policies and procedures could not provide reasonable assurance that.

- Applications achieved their intended results;
- Resources were protected from fraud, waste, and abuse; and
- Applications followed applicable Agency policies and Federal guidelines.

Additionally, we found four “high risk” security holes on a critical server hosting eight financial applications. EPA’s Office of Administration and Resources Management manages the server, while OCFO’s OSS is responsible for the applications and the Oracle software on the server.

We reviewed the security certification and accreditation practices for GPAS and IDOTS. In addition, we used a vulnerability scanner to test for known system vulnerabilities and improperly configured security settings surrounding the server hosting these applications.

We found that none of the applications had undergone required certification and accreditation procedures prior to placement into operation. OSS indicated certification and accreditation was not applicable to IDOTS during its fiscal 2004 system review (self-assessment), nor had they completed a self-assessment of GPAS. Further, OSS had not developed or implemented procedures to: (1) identify, test, and implement operating system and application patches when available; and (2) conduct vulnerability-scanning tests on a regular basis to ensure the systems remain properly configured against known threats. Although OSS had certified, through its annual FMFIA review, that security controls were working as intended, management could not show that the controls had been tested.

Without periodically assessing and testing security controls, OSS has no assurance that these systems were processing financial transactions accurately. Combined, GPAS and IDOTS processed approximately \$1.4 billion in financial transactions for fiscal 2004. Our vulnerability-scanning test corroborated the importance of periodic testing, as it identified four known high-risk security holes on the server. A potential attacker could have exploited these high-risk vulnerabilities to gain control of the database or to shut down the application. We disclosed these vulnerabilities to OSS management, and it took immediate action to upgrade the server to mitigate the security threats.

Recommendations

We recommend that the Office of the Chief Financial Officer have the Director, Office of Financial Services:

- 22 Complete and document a formal certification and accreditation for GPAS and IDOTS.
- 23 Update IDOTS’ certification and accreditation status in the Agency’s system review (self-assessment) database and complete one for GPAS.

24. Develop and implement a formal patch management process to identify, test, and install system and application fixes/upgrades.
25. Implement a formal process to conduct vulnerability scanning and control testing on a regular basis

Agency Comment and OIG Evaluation

OCFO's Director for the Office of Financial Services concurred with our recommendations and provided corrective action plans that would adequately address the recommendations. In particular, management agreed to develop a Standard Operating Procedure to formalize the patch management process no later than November 17, 2004. Additionally, by December 14, 2004, OSS plans to develop a Standard Operating Procedure to ensure vulnerability scanning and control testing takes place on a regular basis.

However, management's response seemed to significantly rely on performing self-assessment reviews of system security, so we reiterated our concerns regarding the lack of formal certification testing of GPAS and IDOTS. In particular, we clarified that a system review (self-assessment) was not a sufficient basis to determine whether implemented controls were operating as intended, and that Federal guidelines and Agency policy required offices to conduct formal control testing. In response to our concerns, management indicated that a "Base" review, as outlined in the Agency's Risk Assessment Procedures, would be appropriate for both GPAS and IDOTS. This review includes completing the system review (self-assessment) and the General Support System's Security Plan, which supports the application and includes testing of controls. The Director stated OSS completed an IDOTS' system review (self-assessment) in August 2004, and planned to complete one for GPAS as well. Additionally, management indicated it would ensure the Office of Administration and Resource Management's General Support System Security Plan includes formal controls testing for both GPAS and IDOTS by September 1, 2005.

9 – Weaknesses in Change Control Procedures for Integrated Financial Management System

In an August 24, 2004, audit report, *EPA Needs to Improve Change Controls for Integrated Financial Management System* (2004-P-00026), we reported a general breakdown of security controls related to software changes that could undermine the integrity of IFMS software libraries and financial system data. Specifically:

- Change management duties had not been adequately segregated between contractor personnel to prevent any individual from controlling all critical stages of the process
- Individuals used an inappropriate ID or continued to have system access after no longer needing it.
- Management had not instituted a formal, structured change control process for IFMS to ensure software program modifications were properly authorized, tested, and approved.
- Management was not properly using its Change Management System to manage change activities for IFMS and provide technical direction to contract staff.

We made various recommendations to the Office of the Chief Financial Officer to improve IFMS controls:

- Management needs to perform a risk assessment of Endeavor, a commercial off-the-shelf product used to control IFMS' development, testing, and production libraries and software
- OCFO should develop a security plan for Endeavor.
- OCFO should establish a systematic process for (1) identifying key responsibilities of roles related to IFMS security and Endeavor contract administration, and (2) holding employees accountable for successful performance of those duties.

In responding to the prior report, OCFO concurred with our recommendations and generally outlined appropriate corrective actions to improve security and change controls over IFMS.

Agency Comment and OIG Evaluation

OCFO concurred with this finding, but disagreed that a "general breakdown of security controls" exists that could undermine the integrity of the financial system and data. Nonetheless, management agreed with our emphasis on the importance of change controls and stated its intent to better define key change control roles and responsibilities.

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

We continue to be unable to assess the adequacy of the automated application control structure as it relates to automated input, processing, and output controls for IFMS. Since IFMS applications have a direct and material impact on the Agency's financial statements, assessing each application is necessary to determine the reliance we can place on the financial statements. During past financial statement audits, we attempted to evaluate controls without systems documentation, but these alternatives proved to be inefficient and impractical.

Since 1995, Agency officials have maintained that the current level of documentation is sufficient for operations and will address systems documentation when they replace the core IFMS system with a JFMIP-compliant, commercial off-the-shelf financial software package. Nevertheless, Agency officials have taken actions on a number of our recommendations, including completing a system documentation analysis, developing updated accounts receivable documentation, and analyzing the process for creating a comprehensive IFMS data dictionary.

During our fiscal 2004 financial statement audit work, we evaluated OCFO's IFMS replacement activities and found that this project had not progressed beyond the planning stage. Last year, OCFO projected a target date of fiscal 2006 for replacing IFMS, but EPA's latest budget submission indicates OCFO has pushed the target date back to fiscal 2008. The target date was moved back to reflect recommended alternatives consistent with OMB's Line of Business initiative.

Although OCFO made no significant progress to replace IFMS during fiscal 2004, OCFO plans to conduct the following replacement activities during fiscal 2005:

- Develop an acquisition strategy;
- Draft a governance structure composed of a Governing Board, an Executive Steering Committee, and a Change Control Board;
- Draft a replacement system project plan;
- Develop a concept of operations document outlining the scope of the project using industry best practices; and
- Develop a system requirements list.

OCFO has no plans to update IFMS system documentation until it implements the new financial replacement software package. Until the new system is in place, we cannot assess the adequacy of the automated internal control structure.

Agency Comment

The Agency agreed with our finding.

Compliance with Laws and Regulations

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² We are reporting these noncompliance issues under FFMIA as they directly relate to FFMIA reporting requirements, however, we note that the issues do not meet the OMB criteria for substantial noncompliance under FFMIA

11 - EPA Continues Actions to Improve Cost Accounting

While EPA still does not produce reports that show the full costs of its outputs, during fiscal 2004 the Agency took actions that should help improve the quality of financial and performance information available to its managers. Since fiscal 1999, we have reported that EPA does not comply with the requirements of Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. We have taken this position largely because EPA has not produced general purpose financial reports that show the full cost of its outputs, as required by the Standard. However, in fiscal 2002, OCFO developed a plan to further expand cost accounting capabilities within EPA, and in early 2003 created reporting capabilities that could be used to determine the costs of its outputs. As a result, in 2003 we reported that although EPA was not in full compliance with the Standard, we no longer consider this issue to be a significant noncompliance. EPA continued to improve its cost accounting capabilities in fiscal 2004 by (1) deploying a business intelligence tool intended to integrate EPA's financial, administrative, and performance information, and (2) under the direction of OMB, beginning to establish a framework for decision making to guide EPA's future financial data integration efforts.

EPA Has Changed its Accounting Structure

Beginning October 1, 2003, EPA changed its accounting structure to accommodate the budgeting and accounting requirements under EPA's new Strategic Plan. Some of the major changes included

- Replacing EPA's 10 strategic goals with 5 goals
- Changing the Program Results Code budget and accounting structure so that major programs and subobjectives are no longer part of the Code
- Adding to the Program Results Code the Program/Projects that describe "what" the Agency does and activities to describe "how" the Agency does its work
- Taking steps to link subobjectives to the Program/Projects by the use of business rules

The subobjectives are important to EPA's cost accounting efforts because they reflect EPA's cost accounting outputs. Although EPA is still in the process of developing and implementing the business rules that will link the subobjectives to the Program/Projects, EPA has taken some significant steps toward providing decision-makers with useful financial data in a user-friendly manner.

EPA Launches New Financial Reporting Tool

OCFO's fiscal 2002 plan to expand cost accounting capabilities within EPA included the development of a new standard financial reporting tool. Work on this reporting tool began in fiscal 2003 and resulted in the December 2003 launch of Phase I of the OCFO Reporting and Business Intelligence Tool (ORBIT). This tool, which is EPA's first Agency-wide business intelligence application, is to have three phases of development, and has the following three major components.

- An executive “dashboard” that uses a graphical format to provide users with high-level operating, funding, and human resources information
- A suite of standard reports to provide users with significant finance, budget, and payroll information.
- A capability to allow advanced users to construct ad hoc queries.

In June 2004, OCFO began ORBIT developmental phase II, with a goal to provide users with additional organizational information that relates to specific business needs and processes. Developmental phase III is scheduled to begin in June 2005 and run through December 2006. The goal for this phase is to expand dashboard, programmatic, and reporting capabilities.

Financial Data Integration Initiative

Another step toward providing decision-makers with useful financial data is EPA’s financial data integration initiative. This initiative includes designing processes that will integrate financial data into day-to-day decisions using the following steps prescribed by OMB:

- Identify and monitor the key business lines that will be monitored and tracked
- Obtain accurate, relevant, and timely financial data that informs users about each business line.
- Present the financial information in a meaningful format that Agency senior officials and managers can use.
- Validate that senior officials and program managers are using these reports on a regular basis.

Based upon collaboration among OCFO stakeholders, business lines have been identified. During fiscal 2005, OCFO plans a series of roundtable discussions with stakeholders to identify key business questions, data needs, and data gaps related to each business line.

Both Statement of Federal Financial Accounting Standards No. 4 and OMB’s financial data integration initiatives are aimed at providing decision-makers with reliable and timely cost information. Therefore, as EPA progresses with OMB’s financial data integration steps, it should also move toward satisfying the requirements of the Standard. We look forward to monitoring the progress EPA makes toward financial data integration.

Recommendations

We recommend that the Office of the Chief Financial Officer.

26. Continue with current efforts to integrate financial data into management decision making.
27. Consider redefining EPA’s Statement of Federal Financial Accounting Standards No. 4 outputs so that they fit within the future financial data integration reports framework.

Agency Comment and OIG Evaluation

OFCO agreed with our findings and expressed that they are committed to ensuring that financial information is available for decision-making within the Agency. OCFO stated they are in the preliminary stages of redefining cost accounting needs and Statement of Federal Financial Accounting Standards No. 4 outputs. OCFO also stated that because the financial integration framework is in its conceptual stage, it is premature to make output commitments referencing this initiative at this time. The OIG will continue to report cost accounting as a noncompliance until such time as the Agency adheres to the Statement of Federal Financial Accounting Standards No. 4 and provides useful and timely financial data for decision-making.

12 - EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions

EPA continues to experience difficulties in reconciling some of its intragovernmental transactions due to some Federal entities not providing information for reconciliations. Without the proper confirmations from its trading partners, EPA has limited assurance that intragovernmental balances are accurate. EPA has experienced similar occurrences the past several years that prohibited the Agency from fully complying with the applicable requirements.

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, dated September 25, 2001, requires Federal agencies to reconcile and confirm intragovernmental assets, liabilities, and revenue with their trading partners quarterly. 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. However, 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. The *Federal Intragovernmental Transactions Accounting Policies Guide* was updated in September 2004, providing tools to facilitate quarterly reconciliation of intragovernmental activities. The Agency has taken action to reconcile its intragovernmental activity on a quarterly basis. As of year end, the Agency had \$187 million in unreconciled activity with four government agencies. OIG suggests that EPA continue its efforts in reconciling the Agency's intragovernmental transactions to comply with Federal financial reporting requirements.

Agency Comment

The Agency agreed with our findings.

13 - EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel

In the 2003 financial statement audit report, we concluded that EPA had taken all necessary actions to correct security weaknesses in the fiscal 1999 Remediation Plan except for establishing a background check program for non-Federal personnel. OCFO addressed the remaining weakness by issuing a policy to require the appropriate type of personnel security screening for Federal and non-Federal personnel accessing IFMS. However, EPA still does not have a target date for addressing security certification for contractor personnel.

In Audit Report 2004-P-00026, *EPA Needs to Improve Change Controls for Integrated Financial Management System*, dated August 24, 2004, we found that OCFO had granted some contractor staff-sensitive access rights to IFMS production software and data even though management had not requested nor received assurance that these individuals did not pose a significant risk to the integrity of the system. In light of those findings, we reviewed OCFO's 1999 Remediation Plan (last updated on August 30, 2004) to determine Office of Administration and Resources Management's (OARM's) latest commitment for establishing a security certification process for key personnel, as well as contractor and grantee personnel. While OARM plans to develop policy addressing security certifications for grantee personnel by July 2005, it has not identified a target date to address similar concerns with respect to contractor personnel.

OCFO concurred with our recommendations and generally outlined appropriate corrective actions to improve the certifying of contractor access to IFMS. However, OARM management did not concur with our recommendations concerning contractor background investigations, asserting that "suitability" background investigations of Federal contractors are not required. OARM stated its existing, interim procedures were sufficient to guide offices that chose to initiate background investigations. However, current EPA policy and Federal guidance strongly recommend screening comparable to that for Federal staff, and we strongly urge such screening.

Agency Comment and OIG Evaluation

OCFO agreed with our finding and, with respect to IFMS, stated that support contractors either received an acceptable suitability background investigation or have one currently in process. OCFO also stated that it will continue to work with OARM on addressing contractor security background checks, and will update its internal policy to align with any future Agency-level policy.

In addition to its current interim personnel screening policy, OARM stated it would institute the following new processes to help mitigate potential security risks: insert suitability criteria into contract requirements, require fingerprint and national criminal history checks; and implement commercial checks performed by private firms. However, OARM provided no specificity regarding its implementation strategy or projected milestone dates for us to determine the thoroughness and scope of these new processes. We will conduct followup work during the fiscal 2005 financial statement audit.

14 - EPA Continues to Improve Its Compliance with Reconciling Fund Balances with Treasury

The Agency continues to improve reconciling its Fund Balances with Treasury. The Agency has re-engineered its financial processes relating to preparing its cash Statement of Transactions and reconciling to Treasury's Statement of Differences. Most Agency locations we audited were properly preparing and reconciling the Statements. However, two of the nine locations we audited continued to include amounts on the Statement of Transactions that did not come from the Agency's accounting system. Subsequent to our audit work, the Agency informed us that one of these locations began reconciling Treasury's Statement of Difference. This reconciliation was not completed in time for our testing.

EPA Comptroller Policy and the Treasury Financial Manual require that the Statement of Transactions be prepared directly from its accounts [accounting system] promptly at the close of each accounting month. Further, EPA Comptroller Policy requires the reconciliation of cash differences between Treasury and EPA records each reporting period.

Recommendations

We recommend that the Office of the Chief Financial Officer.

- 28 Require that the quality assurance guide's Fund Balance with Treasury test procedures be modified to apply to all accounting points
- 29 Require that all accounting points perform the quality assurance testing procedures

Agency Comment and OIG Evaluation

The OCFO agreed with our findings and recommendations and provided training in September 2004 to implement Treasury procedures. OCFO will continue to monitor cash reconciliations to ensure they are properly completed.

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"> Automated Application Processing Controls for IFMS: Until EPA implements the planned replacement automated accounting system that addresses past issues, we will continue to disclose a reportable condition concerning the current accounting system and its automated application processing controls. Please see Attachment 1 for additional information. 	
<ul style="list-style-type: none"> Financial System Security Plans: 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. OCFO has concurred with our recommendations in this area, and we anticipate receiving further corrective action plans soon. Please see Attachment 2 for additional information. 	
<ul style="list-style-type: none"> Managerial Cost Accounting Standards: In our financial statements audits for the last 5 fiscal years, we reported that EPA did not comply with the managerial cost accounting standard. In our fiscal 2003 report, we found EPA was no longer in substantial noncompliance with the standard. During fiscal 2004, the Agency has taken actions which, when completed, will help to improve the quality of financial and performance information available to its managers. Please see Attachment 2 for additional information. 	
<ul style="list-style-type: none"> Reconciling Unearned Revenue for State Superfund Contracts: In fiscal 2004, the Agency improved its reconciliation process, but errors continued in some regions due to lack of adequate oversight. Please see Attachment 1 for additional information. 	

Audit Issue Areas with Corrective Actions in Process	
<ul style="list-style-type: none"> Preparation and Reconciliation of Statements of Transactions: The Agency continued to improve its procedures to reconcile cash with Treasury. However, we found some locations were not in full compliance with the procedures. Please see Attachment 2 for additional information. 	
<ul style="list-style-type: none"> Continued Improvement Needed in EPA's Interagency Agreement Invoice Approval Process: The Agency issued the needed guidance and developed a training plan for a stand-alone Interagency Agreement Project Officer training course. The Agency will begin training the Project Officers soon. We have no new recommendations in this area. 	
<ul style="list-style-type: none"> EPA Did Not Promptly Record Marketable Securities Received Again in fiscal 2004, EPA did not promptly record marketable securities received. EPA has not yet established adequate reconciliation or follow-up procedures. Please see Attachment 1 for additional information. 	
<ul style="list-style-type: none"> Further Improvements Needed in Managing EPA's Accounts Receivable In fiscal 2004, OCFO took some actions to improve timely recording of accounts receivable in IFMS, however, other offices still failed in a number of instances to provide documentation timely to EPA finance offices. We made several further recommendations in this area. Please see Attachment 1 for additional information. 	
<ul style="list-style-type: none"> EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions In fiscal 2004, the Agency continued to experience difficulties in reconciling some of its intragovernmental transactions due to some Federal entities not providing information for reconciliations. Please see Attachment 2 for additional information. 	
<ul style="list-style-type: none"> Plan of Action Developed for Documentation of Standard Vouchers In fiscal 2004, OCFO developed a plan of action to address our recommendation to establish written procedures for calculating the amount of monthly transfers from Treasury to EPA Trust Fund accounts and providing complete documentation to support the amount of the transfers. 	

EPA's Fiscal 2004 and 2003 Financial Statements

November 2004

***EPA's FY 2004 CFO
AUDITED FINANCIAL
STATEMENTS***



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

EPA's FY 2004 Financial Statements

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Note: All components of *EPA's FY2004 CFO Audited Financial Statements* are included in *EPA's FY 2004 Annual Report* (Publication Number: EPA-190-R-04-001. The "Overview and Analysis" section of this report serves as *Section I* of the Annual Report. The "Principal Financial Statements" section of this report is contained in *Section III* of the Annual Report.

**OVERVIEW
AND
ANALYSIS**

OVERVIEW AND ANALYSIS

Today's environmental challenges are very complex, and future challenges will likely be even more daunting. To continue to meet these challenges, the U.S. Environmental Protection Agency (EPA) has worked during FY 2004 to increase the pace of improvement and identify new and better ways to protect human health and the environment. By focusing on the results to be achieved and expanding collaboration, improving technology, and increasing market incentives, EPA is working to do more, and to do it faster and more cost efficiently.

In this report, the Agency reviews its FY 2004 progress toward achieving environmental results—improving the quality of air and water and preserving and protecting the land—while keeping the nation economically competitive. This document meets the requirements of the Government Performance and Results Act and other management legislation.¹

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

In FY 2004, with resource obligations of \$10.16 billion and 17,511 full-time-equivalent employees, EPA achieved significant results under each of the five long-term environmental goals established in its *2003 Strategic Plan*. To help measure EPA's annual progress and assess its success, Agency leaders established 79 critical performance goals at the beginning of FY 2004. EPA's progress toward these goals is reported in the chapters that follow. Because managing taxpayer dollars efficiently and effectively is key to delivering the greatest results to the American people, this report also presents a picture of the Agency's financial activities and achievements during the year.

The *FY 2004 Annual Report* contains three sections. Section I, Overview and Analysis, provides a broad picture of EPA's environmental and fiscal performance during FY 2004.^{*} It highlights EPA's environmental accomplishments and performance challenges, outlines the Agency's financial position at the end of FY 2004, discusses efforts to strengthen performance and manage for improved results, and describes how EPA is addressing management issues and audit recommendations. Section II, Performance Results, describes in greater detail the results that EPA—working with its federal, state, tribal, and local government partners—achieved under each of the Agency's five goals. It also discusses EPA's successes and challenges in meeting the Annual Performance Goals established in EPA's *FY 2004 Annual Plan*. Section III, FY 2004 Audited Financial Statements, summarizes EPA's financial activities and achievements and presents the Agency's annual financial statements as well as a summary of the independent audit conducted by EPA's Inspector General.

^{*} The Overview and Analysis also addresses requirements for a "Management's Discussion and Analysis" of the annual financial statements included in EPA's *FY 2004 Annual Report*. Because the *FY 2004 Annual Report* consolidates a number of specific reports, some required components of the "Management's Discussion and Analysis" are presented in greater detail elsewhere in this report. In particular, EPA's mission statement and organization chart appear at the front of the report. Section II discusses the Agency's performance goals and results. Section III presents EPA's financial statements, along with a discussion of systems, controls, and legal compliance.

OVERVIEW OF PERFORMANCE RESULTS

Throughout FY 2004, EPA collaborated closely with its partners to achieve better environmental results by improving approaches and using resources wisely. The section below describes key environmental and program results in protecting the nation's air, water, and land; summarizes how well the Agency did in meeting its FY 2004 performance goals, and discusses current performance challenges.

Environmental Accomplishments

The air is getting cleaner every year.

Clean Air and Global Climate Change Every year, state and federal criteria air pollutant programs established under the 1990 Clean Air Act Amendments prevent tens of thousands of premature mortalities, millions of incidences of chronic and acute illness, tens of thousands of hospitalizations and emergency room visits, and millions of lost work days.²

In FY 2004, EPA announced a new suite of rules, critical to achieving cleaner, healthier air. The Clean Air Rules of 2004 include the Clean Air Ozone Rules, Clean Air Fine Particle Rules, Clean Air Interstate Rule, and Clean Air Mercury Rule. EPA identified which areas of the country were and were not currently meeting the health-based ozone standard. EPA also issued a new rule classifying geographic areas by the severity of their ozone conditions and establishing a deadline for state and local governments to reduce ozone levels. In early 2005, the Agency will make similar geographic boundary determinations for the new particulate matter (PM) standard.

In addition, EPA issued the Clean Air Non-Road Diesel Rule, which requires strong pollution controls on diesel engines used in construction, agriculture, mining, and other industries. By combining tough exhaust standards with cleaner fuel requirements, the rule will reduce the sulfur content of diesel fuel by 99 percent and cut emission levels from nonroad diesel equipment by over 90 percent. This program is expected to provide dramatic health benefits each year, preventing 12,000 premature deaths and hundreds of thousands of respiratory problems. EPA estimates that the overall public health benefits of this rule outweigh the economic costs by 40 to 1.³ Combined with existing EPA programs, the new Clean Air Rules and Clean Air Non-Road Diesel Rule are estimated to bring well over half of the nation's nonattainment areas into attainment with the National Ambient Air Quality Standards for ozone and PM.⁴

In FY 2004, the Agency completed the first phase of a two-phase program for addressing large stationary sources of toxic air pollutants. The 96 Maximum Achievable Control Technology Standards completed and issued under this program have resulted in annual reductions of approximately 1.5 million tons of toxic air emissions and will achieve even greater reductions when all sources come into full compliance by 2007. In the second, risk-based phase of the air toxics program, EPA will emphasize a community-based approach to address local problems and reduce exposures to such pollutants as toxic chemicals, particulates, and asthma triggers.

Based on data obtained in FY 2004, EPA's climate protection programs again exceeded their goals for reducing greenhouse gas emissions.⁵ These programs remain on track to provide 40 percent of the greenhouse gas reductions required to meet the President's 18 percent greenhouse gas intensity improvement goal by 2012. Encouraged by the Agency's ENERGY STAR program, American consumers and businesses avoided greenhouse gas emissions equivalent to those from 15 million automobiles, while saving approximately \$8 billion on their energy bills⁶

EPA also continued important research on PM during FY 2004 that supports the association between exposure to PM and illness and death, specifically for asthmatic children and other susceptible groups.⁷ Scientists also found that PM_{2.5}, the component of PM smaller than 2.5 microns in diameter, penetrates most indoor environments easily. In FY 2004, EPA provided an estimate of the relationships between indoor concentrations of PM_{2.5} and people's exposure to particles from both indoor and outdoor sources.⁸ These research results will enable regulators to more accurately estimate the risks posed by personal exposure to PM_{2.5}.

Drinking water is safer and surface waters are cleaner.

Clean and Safe Water. The percentage of the population served by U.S. community water systems that met all health-based drinking water standards in effect in 1994 increased from 79 percent in 1993 to 90 percent in 2003. Although final FY 2004 drinking water data will not be available until January 2005, EPA expects that these critical gains have been maintained.

During FY 2004, EPA reviewed and approved new or revised water quality standards for 27 states and promulgated federal standards for Puerto Rico. By the end of FY 2004, 25 tribes had EPA-approved water quality standards in place. In addition, EPA supported states and tribes in developing biological and nutrient criteria that will enable them to adopt water quality standards that more fully protect aquatic life and water.

Despite ongoing challenges in issuing permits to protect surface water under the National Pollutant Discharge Elimination System (NPDES), in FY 2004, permits implementing effluent guidelines prevented the discharge of approximately 136 million pounds of pollutants into the nation's waters. This represents a cumulative total of 2.3 billion pounds since 1999.⁹ Part of this success is due to the states and EPA's issuance of permits at concentrated animal feeding operations to protect surface water from animal waste.

EPA and its state partners also continued to improve their understanding of water quality. In FY 2004, EPA released for public comment the second report on the condition of the nation's coastal resources, including estuaries, coastal wetlands, and coral reefs. In addition, in FY 2004 EPA and the states initiated the first national study of the ecological condition of small streams throughout the United States and will use the results to make program and resource decisions at the national and state levels. In April 2004, EPA published a "List of Beaches"¹⁰ that, for the first time, provided the names, locations, and monitoring status of beaches along the country's coastal and Great Lakes waters.

*Cleanup construction completed at 926 Superfund sites
since the early 1990s.*

Land Preservation and Restoration. In FY 2004, EPA completed cleanup (“construction completes”) and reduced risks posed to human health at 40 sites on the Superfund National Priorities List (NPL), including the 900th site on the list in Port Salerno, Florida. At the close of FY 2004, more than 83 percent of Superfund NPL sites and 84 percent of high-priority RCRA corrective action facilities had met Agency goals for human health indicators, meaning that controls are in place to prevent any unacceptable human exposures from occurring under current land and groundwater use. In addition, groundwater protection goals had been met at nearly 67 percent of Superfund sites and 70 percent of high-priority RCRA corrective action facilities

Love Canal Removed from Superfund List

On September 30, 2004, EPA removed the Love Canal site in Niagara County, New York, from the Superfund NPL. All cleanup work at the site has been completed, and follow-up monitoring conducted for the past 15 years confirms that cleanup goals have been reached. EPA and the New York State Department of Environmental Conservation have contained and secured wastes already in the canal so that they no longer leak into surrounding soils and groundwater and have revitalized properties in the neighborhood surrounding the canal.

The 70-acre Love Canal site encompasses a hazardous waste landfill where chemical waste products were disposed of from 1942 through 1952. In 1953, the original 16-acre hazardous waste landfill was covered, and a school and more than 200 homes were built nearby. Residents reported odors and residues as early as the 1960s; studies in the 1970s showed that numerous toxic chemicals were migrating from the landfill and contaminating nearby waterways. In 1978, New York Governor Hugh Carey ordered the purchase of residents' homes surrounding the canal. In 1978 and 1980, President Jimmy Carter declared two separate environmental emergencies and, as a result, approximately 950 families were evacuated from a 10-block area surrounding the canal. The emergency declaration area included neighborhoods adjacent to the site covering 350 acres. In 1980, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), also known as Superfund, which addresses abandoned hazardous waste sites, was passed largely due to the problems at Love Canal.

Today, the area known as Love Canal is once again a flourishing community. Forty acres are covered by a synthetic liner and clay cap and surrounded by a barrier drainage system. Contamination from the site is also controlled by a leachate collection and treatment facility. Neighborhoods to the west and north of the canal have been revitalized, with more than 200 formerly boarded-up homes renovated and sold to new owners, and 10 apartment buildings constructed. The area east of the canal has also been sold for light industrial and commercial redevelopment. The Love Canal site will continue to be monitored and remain eligible for cleanup work in the unlikely event that a change in site conditions should warrant such an action.

Under the Agency's waste prevention programs, underground storage tank releases were reduced to fewer than 5,000 by the middle of FY 2004 compared with more than 12,000 releases in FY 2003. EPA exceeded its FY 2004 goal of permitting or establishing approved controls to prevent dangerous releases to air, soil, and groundwater at 81 percent of the country's hazardous waste management facilities.

EPA's waste management and cleanup programs faced several challenges in FY 2004. The Superfund program faced a growing backlog of projects ready to begin construction, coupled with the challenge of funding several large and complex ongoing projects. During FY 2004, Superfund underwent a series of internal and external evaluations to explore this problem. As a result, the program has engaged in a public dialogue to identify and implement a series of reforms that will address these issues over the coming years.¹¹

Generation of municipal solid waste (MSW) remained stable,

at slightly less than 4.5 pounds per capita daily, while increases in the rate of recycling did not occur as projected. As a result, EPA is unlikely to reach its goal of 35 percent recycling by 2005,

and is extending this goal to 2008. To help increase recycling rates, EPA is targeting the paper, plastics, packaging, and organics segments of the MSW stream. For example, EPA launched its “Greenscapes” program in FY 2004 to foster composting of food and yard wastes—organic materials representing over 25 percent of MSW—and using the compost to landscape roads, highways, golf courses, ski resorts, and industrial and institutional facilities.

Healthy Communities and Ecosystems. Through FY 2004, EPA continued to reduce risks to communities, homes, workplaces, and ecosystems. The Agency reviewed new chemicals and pesticides before they were put on the market and older chemicals and pesticides already in use for unacceptable risks. EPA-screened chemicals now comprise more than 22 percent of the U.S. inventory of more than 76,000 commercial and/or industrial chemicals.¹² In 2004, EPA provided industry with tools to pre-screen new chemicals for adverse effects early in their development, saving resources and enhancing environmental protection and stewardship. In addition, more than 400 chemical companies and 100 industry consortia in FY 2004 committed to develop data for more than 2,200 chemicals produced or imported in quantities greater than 1 million pounds per year (high-production-volume, or HPV, chemicals). These hazard screening data will be available to the public and will cover 92 percent of the nation’s chemicals that EPA has identified as having incomplete hazard-screening data.¹³

EPA registered another 26 new safer pesticides in FY 2004.

In 2004, EPA met new standards for efficiency and new deadlines under the Pesticide Registration Improvement Act of 2003 (PRIA), allowing innovative and safer pesticide products to reach the marketplace faster, and exceeding its goal for registering alternatives to pesticides that may endanger human health and the environment. In 2004, for example, EPA registered one new active ingredient as an alternative for methyl bromide, a pesticide known to deplete the ozone layer and scheduled for phase-out. EPA also registered 10 new agricultural uses for already-registered active ingredients, as alternatives for methyl bromide.

Childhood lead poisoning has been reduced by half since the early 1990s.

EPA is also making progress toward protecting the health of vulnerable children—the incidence of childhood lead poisoning has been reduced by half since the early 1990s.¹⁴ In 2004, EPA began to focus outreach and education efforts on “hot spots” where the incidence of childhood lead poisoning remains high, often in disadvantaged urban centers. The Agency also completed a study providing significant new data on the aggregate exposures of preschool children to pollutants commonly found in their homes and daycare centers.

Administrator Leavitt leads Great Lakes Federal Task Force.

In May 2004, the President signed an Executive Order directing Administrator Leavitt to establish the Great Lakes Federal Task Force, comprising nine Cabinet agencies, the U.S. Army Corps of Engineers, and the Council on Environmental Quality, to coordinate the federal effort to improve water quality in the Great Lakes.¹⁵ The Order calls for regional collaboration to develop action plans to address priorities, identify resource needs, develop an implementation schedule, and facilitate a cohesive management process. During FY 2004, EPA worked with Canada to monitor conditions in the Great Lakes by tracking a number of indicators, such as polychlorinated biphenyl (PCB) concentrations in predator fish, atmospheric deposition of toxic

chemicals, and phosphorus levels in the water.¹⁶ Water quality monitoring conducted in 2003 of the Lake Erie Central Basin “dead zone” showed that phosphorus concentrations are approximately twice the target levels. EPA is conducting a study of this problem, believed to be linked to invasive species such as zebra mussels, and expects to issue the final report in FY 2005.

In FY 2004, EPA also protected and restored over 100,000 acres of estuarine habitat within the 28 estuaries of the National Estuary Program. In addition, the President announced an aggressive new national goal to achieve an overall increase of America's wetlands over the next 5 years. To reach this goal, EPA will be working to restore 6,000 acres and enhance an additional 6,000 acres of wetlands over the next 5 years (an average of 1,200 acres per year in each category).¹⁷

Compliance and Environmental Stewardship. EPA continued to promote compliance with environmental requirements, enforce environmental laws, and encourage environmental stewardship. The Agency estimates that enforcement actions concluded in FY 2004 will reduce, treat, or eliminate over 1 billion pounds of pollutants, with a total estimated reduction of 2.5 billion pounds since FY 2001. Eighty three percent of enforcement actions concluded in FY 2004 will result in increased environmental protection or improved long-term facility environmental management practices.

EPA also provided specialized compliance assistance to over 731,000 facilities, states, and other regulated entities to improve their understanding of requirements and environmental management practices. In FY 2004, 90 percent of the regulated community responding to compliance assistance center surveys indicated an improved understanding of environmental regulation, and 72 percent of the respondents improved environmental management practices as a result of the assistance.¹⁸

EPA's pollution prevention programs eliminated over 600 million pounds of hazardous chemicals in FY 2004.

Under EPA's Green Chemistry Challenge Award program, which provides Presidential recognition to industries achieving outstanding pollution prevention, 134 million pounds of hazardous chemicals were eliminated from the environment.¹⁹ EPA also worked with industry in its Design for the Environment program to develop cleaner, more environmentally friendly products. In FY 2004, Design for the Environment eliminated 63 million pounds of hazardous chemical use, saved 23 million gallons of water, and provided industry \$488,000 in cost savings.²⁰ Taken together, all of EPA's pollution prevention programs resulted in the elimination of over 600 million pounds of hazardous chemicals, saved 495 million gallons of water, and saved companies \$936,000.²¹ An additional benefit of the Agency's pollution prevention work was the elimination of 77 metric tons of carbon dioxide.

Vulnerability assessments completed on all major water systems.

Homeland Security

In FY 2004 EPA revised its Homeland Security Strategic Plan, which identifies the range of homeland security activities the Agency conducts, taking into account the evolving role of the U.S. Department of Homeland Security.²² The Agency also spent considerable time and effort

mapping out responsibilities and strategies to address recently issued Presidential Directives. More information on EPA's Homeland Security Program is available at www.epa.gov/homelandsecurity.

FY 2004 Progress in Homeland Security











- **Protecting Water Facilities From Terrorist Attacks:** EPA continued to assist the nation's drinking water and wastewater facilities in protecting infrastructure from terrorist and other intentional attacks. By the end of FY 2004, 100 percent of water systems serving at least 100,000 people had completed vulnerability assessments. EPA expects 100 percent of the nation's small systems to have assessments in place in 2005.
- **Improving Emergency Preparedness for Large-Scale Incidents:** EPA collaborated with its federal partners to enhance the incident command system across government and the private sector, assist states, and develop national policy and guidance on response coordination and emergency support. EPA field responders were trained to detect, analyze, and respond to chemical, biological, and radiological agents. In addition, the Agency's criminal enforcement personnel supported the U.S. Secret Service and FBI at designated National Special Security Events such as the G-8 Nations Summit, and supported the U.S. Capitol Police and FBI during the riot incident at the U.S. Capitol.
- **Developing the Nation's Ability to Respond to Chemical Terrorism:** EPA led a collaborative effort with nine federal agencies, numerous state agencies, private industry, emergency medical associations, and other organizations to increase understanding of the potential health effects from various levels of exposure to hazardous chemicals during a terrorist incident. In FY 2004, "Acute Exposure Guideline Levels" were proposed for 22 highly hazardous chemicals, bringing the cumulative total to 128 chemicals.
- **Eliminating Anthrax Spores:** EPA continued to spearhead scientific collaboration to measure the effectiveness of various liquid, gaseous, and vaporized chemical sporicides for eliminating anthrax spores resulting from a terrorist incident.

Improved scores under the President's Management Agenda.

The President's Management Agenda

EPA's leaders recognize that organizing the Agency and managing its work and resources as efficiently as possible will deliver the best results to the American people. The President's Management Agenda (PMA) provides a framework for assessing resource management efforts and ensuring that EPA is streamlined, responsive, and results-oriented. Building on its FY 2003 accomplishments, EPA made significant progress in implementing the PMA reforms for Strategic Management of Human Capital, Competitive Sourcing, Expanding E-Government, Improved Financial Performance, and Budget and Performance Integration. More information about the Agency's work under the PMA is available at www.epa.gov/pmaresults.

**EPA'S FY 2004 PROGRESS UNDER
THE PRESIDENT'S MANAGEMENT AGENDA**

INITIATIVE	STATUS ²³	PROGRESS	HIGHLIGHTS
Human Capital	 Yellow	 Green	<ul style="list-style-type: none"> Improved status score to "yellow" and received "green" progress score from the Office of Management and Budget (OMB) for 4 quarters in FY 2004. Achieved EPA's July 1, 2004, "Proud-To-Be" goals. Issued a revised "EPA Strategy for Human Capital" and made significant progress in implementing it. Developed and implemented a human capital accountability plan. Aligned all employee performance standards with the Agency's mission and <i>Strategic Plan</i>. Began implementing a plan to move from a two-level to a multi-level performance management system for Agency employees.
Competitive Sourcing	 Yellow	 Green	<ul style="list-style-type: none"> Improved status score to "yellow" and received "green" progress scores from OMB for 3 quarters in FY 2004. Achieved the Agency's July 1, 2004, "Proud-To-Be" goals. Began conducting EPA's first standard competition of Agency-wide Employee Benefit services in May 2004. However, EPA's participation in another government-wide initiative led to cancellation of this competition. Initiated a second standard competition, covering Agency-wide Vendor Payment services with completion expected in August 2005. Submitted a long-term competitive sourcing plan to OMB for review. Expanded EPA's Competitive Sourcing Council to include all major program offices, as well as other headquarters and regional offices.
Expanded E-Government	 Green	 Green	<ul style="list-style-type: none"> For the first time, achieved "green" status score from OMB for E-Government. Achieved EPA's July 1, 2004, "Proud-To-Be" goals. Participated in 17 of the 25 E-Government initiatives under the PMA. Led the architecture workgroup for the financial management piece of OMB's "Line of Business" efforts. Continued to serve as the federal agency lead for the E-Rulemaking initiative. Reached agreement on the core functions and architecture for the Federal Docket Management System (FDMS). Completed all 13 E-Government Memoranda of Understanding (MOUs) that EPA was required to complete in FY 2004. Implemented an Earned Value Management System (EVMS). Submitted the Critical Infrastructure Protection plan to OMB.
Improved Financial Performance	 Green	 Green	<ul style="list-style-type: none"> Maintained EPA's "green" status score. Received "green" progress scores from OMB for 4 quarters in FY 2004 and achieved the Agency's July 1, 2004, "Proud-To-Be" goals. Delivered EPA's FY 2004 Annual Report with audited financial statements by the required November 15, 2004, deadline, and met all required deadlines for the Agency's quarterly financial statements. Developed a framework and action plan to guide the Agency's future efforts in integrating financial and performance information for decision making. Worked with Treasury and OMB and reconciled variances in year-end Superfund Trust Fund resources, which have accumulated over the last 3-4 fiscal years. The Superfund Trust Fund account balance statements are now in agreement across all three agencies. Identified EPA's high-risk areas for erroneous payments, and expanded the scope of the Agency's erroneous payments review to determine that funds are used for their intended purpose.
Budget and Performance Integration	 Yellow	 Green	<ul style="list-style-type: none"> Received "green" progress scores for three out of four quarters in FY 2004. Did not achieve EPA's July 1, 2004, "Proud-To-Be" goals. Worked cooperatively with OMB on the FY 2006 Program Assessment Rating Tool (PART) process, completing 32 PART assessments to date. Developed OMB-approved efficiency measures for an additional 20 programs that have undergone a PART review. Developed a new streamlined, transparent process for reaching agreement on regional performance commitments, enabling EPA regions to consider targets across five national programs and engage more effectively with states and tribes.

Summary of Performance Data

In FY 2004, EPA met 78 percent of the annual performance goals (APGs) for which data are provided in this report. FY 2004 results to date reflect an improvement over the 73 percent of goals the Agency met in FY 2003.

In its *FY 2004 Annual Plan*, EPA committed to 79 APGs. However, because final data for 25 of these APGs will not be available until later in 2004 or beyond, these APGs are not included in the tallies provided in this report. They will be discussed in future annual reports. Figure 1 provides an update of results for prior years; charts presenting EPA's FY 2004 performance results and highlights of 4-year performance trends are provided with each chapter in Section II.

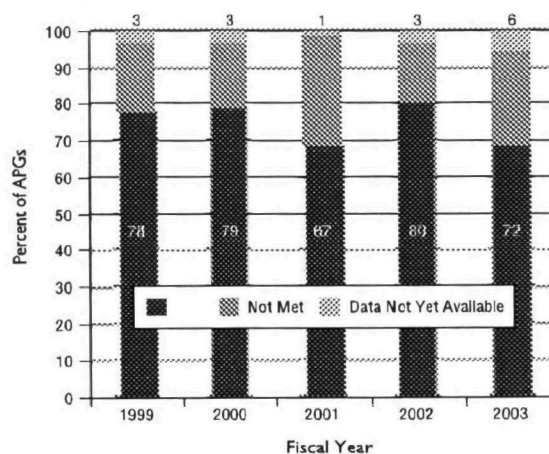
Despite EPA's and its partners' best efforts, the Agency was not able to meet all planned targets for FY 2004. EPA did not meet 12 of the 54 FY 2004 APGs for which performance data are currently available. However, the Agency does not expect this shortfall to compromise its ability to meet its longer-range goals and strategic objectives. EPA will consider these shortfalls as it adjusts its APGs and program strategies for FY 2005 and beyond. The performance data charts in Section II provide more complete information on missed targets, discuss efforts to meet future targets, and describe the Agency's progress toward its longer-range strategic goals and objectives.

FINANCIAL ANALYSIS

Administrator Leavitt's 500-Day Plan to "increase the velocity of environmental progress by implementing a better way" recognizes the importance of managing resources: *Managing Resources Wisely* is one of the plan's nine priorities. Key to the Administrator's principles for "a better way" is considering the benefits and costs of EPA actions. Agency managers rely on financial analyses as well as performance information to make planning and priority-setting decisions that influence results.

EPA's financial statements, presented in Section III, are an important aspect of accountability. They provide a snapshot of EPA's financial position at the end of FY 2004 and have been audited by the Office of Inspector General.

Figure 1: EPA's Updated Performance Results for Prior Years



During FY 2004, final performance results data became available for a number of APGs from prior years: 19 for FY 2003, two for FY 2002, one for FY 2001, and one for FY 1999. The above graph includes these additional results. Delays in reporting cycles and targets set beyond the fiscal year continue to affect four FY 2003 APGs, two FY 2002 APGs, one FY 2001 APG, two FY 2000 APGs, and two FY 1999 APGs.

FINANCIAL HIGHLIGHTS

- Received the 2003 President's Quality Award for Improved Financial Performance.
- Achieved greater financial accountability by maintaining a less than 1 percent erroneous payment rate.
- Earned an unqualified audit opinion on the FY 2004 financial statements.

Resources and Outlays

In FY 2004 EPA received \$8.41 billion in Congressional appropriations.²⁴ *EPA Financial Trends*²⁵ (Figure 2) shows a 5-year snapshot of the Agency's available and used resources. The *Statement of Budgetary Resources*, included in Section III, presents additional information on the Agency's resources.

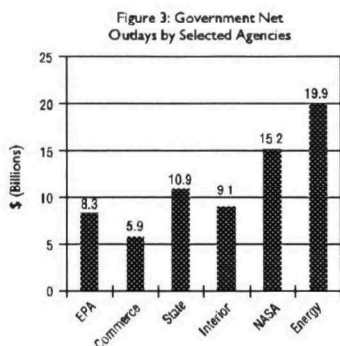


Figure 4: FY 2004 Obligations by Appropriation (Dollars in Thousands)

State & Tribal Assistant Grants	\$3,908,755 (36.6%)
All Other	\$4,769,489 (47.0%)
Superfund	\$1,477,137 (14.5%)
Total	\$10,155,381 (100%)

Grant programs comprise 58 percent of EPA's costs (Figure 5). Two State Revolving Funds (SRFs) that support the Agency's Clean and Safe Water goal (Figure 6) account for 43 percent of the Agency's grant awards. Other major EPA environmental grant programs include assistance to states and tribes, consistent with EPA's authorizing statutes, and research grants to universities and nonprofit institutions.

Figure 5: FY 2004 Cost Categories

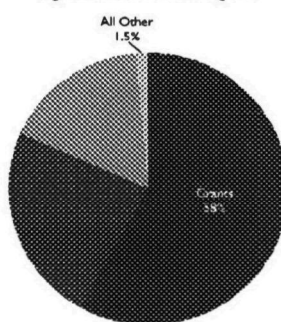
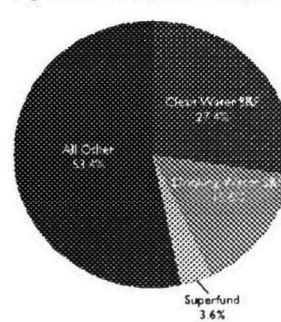
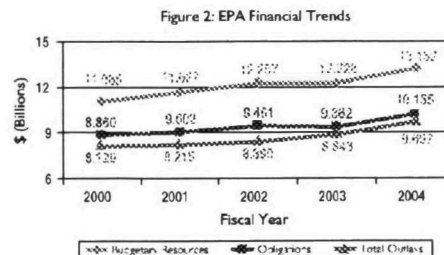


Figure 6: FY 2004 Major Grant Categories



Innovative Financing: Partnerships and the Environmental Finance Program

Over 25 percent of the Agency's funds go toward improving water quality. EPA leverages federal funds through several innovative environmental financing efforts, mutually beneficial public-private partnerships, such as SRFs and the Environmental Finance Program.

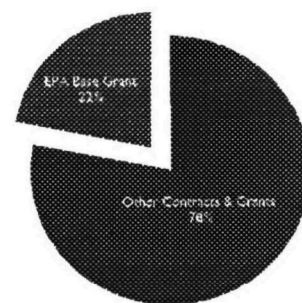


Collaboration and partnerships with the states help EPA manage its resources wisely to keep the nation's water clean and safe. As of early FY 2004, the Clean Water SRF had leveraged nearly \$21 billion in federal capitalization grants into more than \$43.5 billion in assistance to municipalities and other entities for wastewater projects. The Drinking Water SRF has leveraged \$6.4 billion in federal capitalization grants into more than \$8.1 billion available for drinking water assistance.

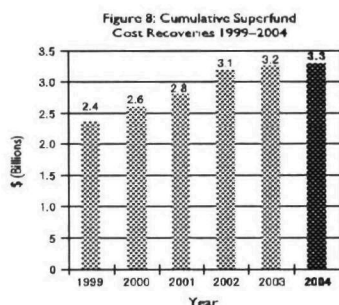
The Environmental Finance Program helps regulated entities find creative ways to fund environmental programs, projects, and activities. The program seeks to lower costs, increase investments, and build capacity via partnerships with state and local governments and the private sector. It provides leveraged financial outreach services to these partners through three distinct, but related, components: the federally chartered Environmental Financial Advisory Board; a network of nine university-based Environmental Finance Centers (EFCs); and an online database, the Environmental Financing Information Network. Additional information is available at www.epa.gov/efinpage.

To date, the EFC Network has provided education, technical assistance, and analytic support to public and private entities in 48 states. The EFCs accomplish this through leveraging base grants from EPA with up to 3.5 times as much in additional grants and contracts from other public and private clients (Figure 7).

Figure 7: EFCN Funding Sources



Superfund Cost Recovery

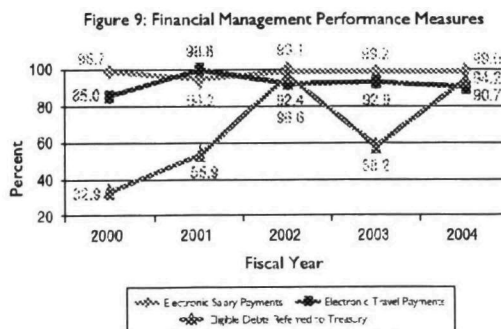


EPA applies consistent and certain enforcement to motivate compliance. One of the Agency's enforcement success stories is its Superfund program, which leverages funding to increase cleanup of contaminated sites.

Under Superfund, EPA may recover the cost of cleanups. Figure 8 shows that since 1980, EPA has collected \$3.28 billion in cost recoveries.²⁷ 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, 2004, EPA had established 444 special accounts with \$1.3 billion in receipts. These accounts earned an additional \$5.2 million in interest.²⁸

Measuring Financial Management Results

EPA tracks its performance in key financial management areas: processing payments; reconciling cash, along with managing accounts receivable; budgets; contracts; Superfund billings; and property. In FY 2004, the Agency generally met or exceeded its performance goals. Figure 9 presents results for three Agency performance measures that support the Administrator's e-government and improved financial management priorities.



As required by the Improper Payments Information Act (IPIA) of 2002 and the Office of Management and Budget (OMB) Memorandum M-03-07, EPA conducted a risk assessment on various programs in FY 2004 and identified a less than 1 percent error rate in payments (Figure 10). EPA will statistically sample and annually report on improper payments in the two SRFs previously covered under OMB Circular Number A-11, Section 57

Figure 10 IMPROPER PAYMENT REDUCTION OUTLOOK FOR FY 2004 – FY 2007 (dollars in millions)						
PROGRAM	FY 04 OUTLAYS	FY 04 Improper Payments %	FY 04 Improper Payments	FY 05 Improper Payments %	FY 06 Improper Payments %	FY 07 Improper Payments %
Clean Water and Drinking Water Revolving Funds	\$2,105	49%	\$10.3	45%	40%	35%

New Financial Management Initiatives

Timely, accurate information is critical for managing resources wisely. The Agency leverages technology and updates its systems to produce the information program managers need to make sound decisions. EPA is committed to managing its finances thoroughly and responsibly, and to using resources efficiently and effectively to further its progress in protecting human health and the environment.

LEVERAGING TECHNOLOGY

- **Data mining**—searching data for hidden correlations
- **Business Intelligence**—linking disparate databases and making data connections
- **Web technologies**—providing easy access to useful data
- **Defining business lines**—identifying and capturing data meaningfully for program management decision making
- **Integrating the *Strategic Plan* and the Budget**—using EPA’s strategic goal-based architecture as the basis for developing the Agency’s budget and tracking spending

IMPROVING RESULTS

To address increasingly complex environmental challenges, it is essential that EPA and its partners work together to establish goals and priorities, plan and budget to achieve results, measure their progress, and adjust strategies to improve their performance. In FY 2004, EPA continued to collaborate closely with states and tribes, strengthening vital partnerships with the Environmental Council of the States (ECOS) and the Tribal Caucus. The Agency also focused on improving how it conducts program evaluations and applies findings, tracks and measures its performance, addresses environmental data issues, and anticipates and plans for future trends and issues.

Strengthening Collaboration with Partners

Without the support and participation of states, tribes, and other federal agencies, EPA could not have achieved its FY 2004 accomplishments and will not achieve its long-term goals for protecting human health and the environment. EPA is committed to strengthening its partnerships and working collaboratively with states and tribes to focus on the most important work to be done and complement and leverage—not duplicate—efforts.

During FY 2004, EPA worked closely with ECOS to improve joint planning and priority-setting. EPA and states focused on aligning planning processes to enable states, tribes, and EPA regions to engage more meaningfully at the earliest stages of the Agency's annual planning; making EPA's planning process as open and inclusive as possible; streamlining processes and minimizing transaction costs; and improving communication, particularly in terms of defining roles, priorities, and accountability for results. This collaboration resulted in several significant reforms to the Agency's annual planning process.²⁹ In FY 2004, EPA:

- Developed Regional Plans that consider regional conditions, reflect regional, state, and tribal priorities, and link regional strategies and initiatives to the Agency's *Strategic Plan*.
- Expanded opportunities for states and tribes to engage in EPA's annual planning, inviting them to participate in planning and performance meetings and soliciting their input to FY 2005 guidance that will shape program priorities and commitments for the next 3 years.
- Implemented a streamlined process for developing annual regional performance commitments that actively engages states and tribes prior to and during regional-national program negotiations
- Funded with ECOS a Cooperative Agreement for conducting pilot projects to strengthen states' capabilities to manage for results and to improve joint regional-state planning. FY 2004 projects involved 22 states and 6 regions, pilot results are providing models for other states
- Worked with ECOS to improve Performance Partnership Agreements, grounding them in integrated planning and structuring them around essential elements to more clearly define state-EPA working relationships.

While the Agency worked with ECOS to improve collaboration overall, EPA program and regional offices, states, and tribes continued to achieve specific environmental results. EPA worked with the State of Michigan to reduce chemical hazards in Flint, Michigan, schools by auditing and collecting hazardous chemicals, including mercury and lead, and increasing the community's awareness of risks posed by chemicals in the area. Approximately 7,000 pounds of various chemicals were collected and disposed of in an environmentally safe manner. Colorado's State Department of Public Health and Environment prevented mercury releases to the air and land by working with automobile salvage yards to remove mercury switches from junk automobiles before they were dismantled, shredded, and melted at electric arc furnace steel mills.

EPA and Native American Tribes worked together to address key environmental problems in Indian Country. For example,

- EPA and more than 50 tribes have formed the Yukon River Inter-Tribal Watershed Council, which is building holistic programs to reduce contaminants in subsistence food sources, homes, and schools within tribal communities. In 2004, the Council completed a large-scale environmental plan to address contaminant issues on the Yukon River.
- EPA, the State of Idaho, and the Nez Perce Tribe signed a Memorandum of Agreement in FY 2004 to develop a Total Maximum Daily Load standard for sediments, temperature, nutrients, dissolved oxygen, and bacteria that will protect water quality on tribal lands. This effort provides a model for working in partnerships and leveraging resources to improve water quality.
- EPA conducted seven pollution prevention assessments at tribal clinics across California, Arizona, and Nevada to help reduce or eliminate mercury-containing devices and red bag medical waste, recycle metals and hazardous and solid waste; and substitute

environmentally preferable products, procedures, and best management practices for toxic cleaning, disinfection, and pest management substances. This ongoing partnership aims to virtually eliminate mercury-containing waste from these waste streams by 2005, reduce the overall volume of all wastes by 30 percent by 2005 and 50 percent by 2010, and identify further opportunities for preventing pollution and reducing hazardous waste.

EPA continues to cooperate closely with its federal partners. In FY 2004, EPA and the U.S. Food and Drug Administration (FDA) jointly developed a methylmercury fish advisory—for the first time merging their fish advisories to provide the public with comprehensive information in one document.³⁰ Based on the success of this endeavor, FDA and EPA intend to work together to address PCBs and other fish contamination concerns.

Using Program Evaluation and the PART

EPA relies on program evaluations and analyses to inform decisions, design effective strategies, and adjust approaches to improve results. During the FY 2006 budget formulation process, for example, EPA senior managers used the results of the Administration's Program Assessment Rating Tool (PART) reviews to identify needs for program improvement, justify resource requests, and guide decisions.

More EPA programs demonstrated results.

The PART process, which rates programs' effectiveness, was first used in FY 2002 for the development of EPA's FY 2004 budget. During that first year, only one of the programs "PARTed" received a rating of "adequate." In contrast, the following year (i.e., FY 2003 for the FY 2005 budget) 7 programs received ratings of "adequate" or "moderately effective." This improvement in PART ratings illustrates the commitment across EPA's workforce to designing and implementing programs that fully deliver environmental results. Ratings for programs assessed during FY 2004 for the FY 2006 budget will not be available until February 2005.

EPA continued developing efficiency measures that assess how program results relate to the resources and time spent to achieve those results. By the end of FY 2004, EPA had developed efficiency measures for 28 programs that have undergone PART assessments. For example, the Agency developed an efficiency measure for its drinking water program that tracks dollars spent per person receiving drinking water compliant with EPA's health-based drinking water standards. Under its water program, EPA will track the number of water bodies restored, improved, or protected per million dollars provided to states under the Clean Water State Revolving Fund. The Agency will also track cumulative tons of ozone-depleting potential-weighted emissions reduced per cumulative EPA and industry dollars spent. A complete list of measures developed during the FY 2004 and FY 2005 PART process can be found in Appendix C. Additional information on the PART process is available at www.whitehouse.gov/omb/part/index.html.

EPA conducted other types of program evaluations in FY 2004 as well. For example, the Agency assessed the influence and cost of Oregon's Toxics Use and Waste Reduction Assistance Program (TUWRAP), particularly TUWRAP's impact on compliance with hazardous waste requirements. The evaluation found that Oregon's site visits to provide technical assistance strongly influenced hazardous waste generator compliance, leading Oregon's Department of

Environmental Quality (DEQ) and EPA's Region 10 office to discuss how to incorporate TUWRAP into DEQ's overall compliance program. Appendix A contains a complete list of program evaluations completed in FY 2004.

Improving Environmental Indicators, Performance Measurement, and Data Quality

EPA issued its first *Draft Report on the Environment* in FY 2003 to present the best available indicators of the current state of the environment and provide a baseline of environmental information for measuring future performance. In FY 2004, the Agency initiated a national dialogue on the draft report to refine environmental indicator information and make it more useful to decision makers. Through a series of public meetings across the country with stakeholder groups and other interested parties, EPA gained ideas for improving indicators, filling key environmental data gaps, and meeting research needs. This information will help EPA shape the next *Report on the Environment*, to be issued in FY 2006.

As the Agency moves forward, EPA also intends to develop and use environmental indicators that can enhance our ability to manage for results in order to report more clearly on progress in achieving long-term environmental and human health goals. The Agency's strategic planning, work on environmental indicators, and development of the next *Report on the Environment*, are now being coordinated with this end in mind. The *Draft Report on the Environment* and information on the Agency's "Indicators Initiative" are available at <http://www.epa.gov/indicators>.

EPA made strides in measuring environmental outcomes.

EPA furthered its effort to focus annual performance goals and measures on environmental outcomes, rather than activity-based outputs. The percentage of annual performance goals that track environmental or intermediate outcomes increased from 44 percent in EPA's FY 2004 *Annual Performance Plan* to approximately 60 percent in its FY 2005 *Annual Performance Plan*. Likewise, the percentage of annual performance measures tracking outcomes increased to approximately 64 percent, up from 51 percent the previous year. In addition, in FY 2004 the Agency developed more than 20 new multi-year Measure Development and Implementation Plans to improve its measures over time. A variety of programs, representing all five of the Agency's strategic goals and including some programs assessed under the PART process, have adopted these plans.

Finally, EPA continued to ensure that its performance and financial data are reliable and complete. In FY 2004, EPA detected and corrected errors in environmental data, standardized reporting, and collaborated with federal,

New EPA Performance Measures Developed in FY 2004

- **Air Toxics** EPA will measure cumulative reductions in air toxic emissions, differentiating between cancer and noncancer risks reduced
- **Stratospheric Ozone** EPA will report every 5 years on chlorine and bromine (two key ozone-depleting chemicals) loadings in the atmosphere. Further, in 2050, EPA will report on the number of reductions in melanoma and nonmelanoma skin cancers and the number of premature deaths avoided
- **Pesticide Worker Protection** EPA will measure the number of occupational pesticide poisoning incidents to assess the effectiveness of the Agency's Worker Protection Standard for Agricultural Workers, established in 1995
- **Coastal and Ocean Waters** EPA will measure specific indicators of aquatic system health for coastal wetlands, and water clarity and dissolved oxygen in coastal waters at the national level.

state, and local data-sharing partners to exchange and integrate electronic data and information. For complete information on the quality of the data contained in Section II—Performance Results, see Appendix B.

Considering Future Trends and Looking Ahead

EPA recognizes the value of foresight in strategic planning. In FY 2004, the Agency revised its approach to conducting environmental futures analyses and incorporating findings into the Agency's strategic planning. EPA senior managers and staff identified significant environmental trends, demographic issues, transformative technologies, and industrial trends that might have consequences for environmental quality and EPA's work. Information gleaned from these discussions will provide the basis for a more in-depth analysis of emerging environmental trends, the results of which will better inform the Agency's planning and 2006 *Strategic Plan*.

In FY 2004, EPA also began projects to build staff capabilities for using futures analysis to increase environmental foresight and inform planning. One project developed a range of plausible forecasts of the growth of hydrogen micro-fuel cell technologies in the marketplace and their potential environmental impacts.

ADDRESSING MANAGEMENT ISSUES AND CHALLENGES

The Reports Consolidation Act of 2000³¹ authorizes agencies to consolidate various management reports and submit them as part of their annual reports. This section discusses EPA's progress in strengthening management practices to achieve program results. It includes the FY 2004 Integrity Act Report, which highlights the strategies implemented and progress made in addressing management concerns identified under the Federal Managers Financial Integrity Act (FMFIA);³² Management's Report on Audits, which summarizes the Agency's efforts to carry out corrective actions on audits issued by EPA's Office of the Inspector General (OIG); and a summary of the OIG's list of EPA's top management challenges facing the Agency along with a brief update on the Agency's progress to address each issue. A more detailed discussion of these issues can be found at <http://www.epa.gov/ocfo/finstatement/2004ar/2004ar.htm>.

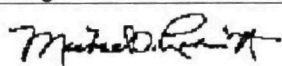
FY 2004 Integrity Act Report

In FY 2004, for the third year, EPA had no material weaknesses to report under FMFIA. During the year, the Agency resolved three of its less severe, internal Agency weaknesses,

reportable conditions that merit the attention of the Administrator (see chart "4 Year Trend of Material and Agency Level Weaknesses" below). To identify management issues and monitor progress in addressing them, Agency senior leaders use a system of internal and independent reviews and program evaluations, audits by the Government Accountability Office (GAO) and EPA's OIG, and performance measurement. These efforts help ensure that program activities are effectively carried out in accordance with applicable laws and sound management policy, and provide reasonable assurance that Agency resources are protected against fraud, waste, abuse, and mismanagement.

Fiscal Year 2004 Annual Assurance Statement

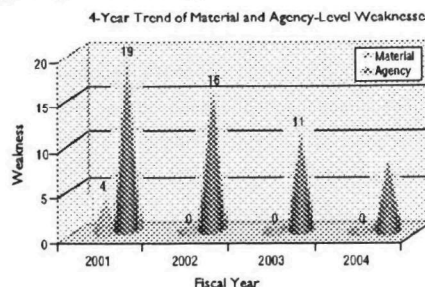
I am pleased to give an unqualified statement of assurance that the Agency's programs and resources are protected from fraud, waste, and mismanagement, based on EPA's annual self-assessment of its internal management and financial control systems.



Michael O. Leavitt
Administrator
November 2, 2004

OMB continues to recognize EPA's efforts to maintain effective and efficient management controls. Since June 2003, the Agency has maintained its "green" status score for Improved Financial Performance under the PMA. EPA's senior managers meet periodically during the course of the year to provide updates on the progress the Agency is making to resolve its current management challenges and to identify and discuss emerging management issues so that new issues can be addressed before they become serious problems.

In FY 2004, EPA made progress in addressing a wide range of major management challenges, thereby strengthening its ability to achieve environmental and human health results. The Agency's advancements in establishing and implementing effective management controls in environmental programs include:



- Using a comprehensive, integrated strategy to address risk from all sources of air toxics—major, area, and mobile In FY 2004, EPA completed all of its 10-year Maximum Achievable Control Technology standards This effort has already resulted in annual reductions of 1.5 million tons of toxic air emissions and is expected to achieve even greater reductions when all sources come into full compliance by 2007. Other aspects of the strategy include a focus on air toxics reductions in communities and working on mobile source regulations through reformulated gasoline, engine standards, and other efforts, as well as a voluntary diesel retrofit program.
- Addressing Laboratory Quality System Practices through EPA's Forum on Environmental Measurement of the Science Policy Council, which developed a policy directive ensuring and documenting the competency of Agency laboratories. Under the policy, EPA laboratories demonstrate on-going performance through independent external assessments, accreditation or certification, and inter-laboratory comparison studies of their operations
- Improving water quality by reducing the backlog of NPDES Permits³³ and setting priorities for water permits to achieve environmental results. In collaboration with states and regions, EPA continues to implement the Permitting for Environmental Results strategy to assess and identify opportunities for enhancing the integrity and efficiency of the NPDES program.
- Redesigning and modernizing EPA's Permit Compliance System to address expanded requirements of the NPDES permitting program and provide better information for the Agency's compliance and enforcement programs (e.g., tracking pollutant loadings, capturing information on storm water sources, and assessing the health of individual watersheds).

The Agency also addressed a number of challenges in administrative and management areas, which provide the infrastructure supporting EPA's ability to achieve results Following are examples of FY 2004 accomplishments toward continued improvement in effective management of resources

- Implementing a comprehensive approach to managing grant awards, which make up more than half of the Agency's budget ³⁴ Having issued policies to address competition and post-award monitoring, EPA implemented its Grants Management Training Plan to enhance the skills of personnel involved in grants management. EPA is also focusing efforts on improving grant recipients' understanding of federal grant requirements. In addition, EPA is the first agency to successfully enhance and deploy the Integrated Grants Management System, which fully automates grant processes in regional offices.
- Strengthening management controls to ensure that the Information Security Program collects data of sufficient quality for decision makers. Advancements include improved technology and hardware, along with new testing and evaluation processes and greater investments in information security training.

- Making significant progress in the area of human capital. In FY 2004, EPA achieved “green” progress and “yellow” status scores for successfully implementing the human capital portion of the PMA.³⁵ In addition, the Agency began documenting the relationship between every employee’s work and the Agency’s strategic goals to fulfill Agency commitments to the Office of Personnel Management and OMB. EPA has taken crucial steps in the areas of workforce planning and staff development, with particular emphasis on management development

The “Key Management Challenges” section in the Overview (which follows the “FY 2004 Management’s Report on Audits” section below) lists EPA’s Top 10 management challenges as identified by EPA’s OIG and others and summarizes actions EPA is taking to address these issues. More detailed information on the work being done to address the Agency’s management issues is available at <http://www.epa.gov/ocfo/finstatement/2004ar/2004ar.htm>.

FY 2004 Management’s Report on Audits

The Inspector General Act of 1978, as amended,³⁶ requires federal agencies to report to Congress on the status of their progress in carrying out audit recommendations. Audit management serves as a tool in assessing the Agency’s ability to meet its strategic objectives EPA continues to strengthen its audit management practices and has improved its ability to address and complete corrective actions in a timely manner.

In FY 2004, EPA was responsible for addressing OIG’s recommendations and tracking follow-up activities on 249 audits. The Agency achieved final action (i.e., completion of all corrective actions associated with an audit) on 136 audits, which include Program Evaluation/Program Performance Audits, Assistance Agreements Audits, Contracts Audits, and Single Audits. Results achieved during FY 2004 for the Agency’s audit management activities are summarized below. A listing of audits for which corrective actions have not been completed within a year can be found at <http://www.epa.gov/ocfo/finstatement/2004ar/2004ar.htm>.

- **Final Corrective Action Taken.** EPA completed final corrective actions on 15 performance and 121 financial audits. Of the 121 financial audits, OIG questioned costs of more than \$ 97 million (i.e., costs incurred by the Agency from contractors or grantees which may be ineligible by law or regulation, not supported by sufficient documentation; or unnecessary expenditures). After careful review, OIG and the Agency agreed to disallow approximately \$35 million of these questioned costs (i.e., either deny payment or seek reimbursement for payments already made). In the performance audit arena, EPA managers and the OIG did not identify funds that could be put to better use
- **Final Corrective Action Not Taken** As of the end of FY 2004, 112 audits were without final action and have not been fully resolved (excluding those audits with management decisions under administrative appeal by the grantee).
- **Final Corrective Action Not Taken Beyond 1 Year.** Of the 112 audits, EPA officials had not completed final action on 29 audits within 1 year after the management decision (i.e., the point at which the OIG and the Action Official reach agreement on the corrective action plan). Because of the complexity of the issues, it often takes Agency

management 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. At the end of FY 2004, 39 audits were in administrative appeal.

DISALLOWED COSTS & FUNDS PUT TO BETTER USE

October 1, 2003 – September 30, 2004

Category	Disallowed Costs (Financial Audits)		Better Use (Performance Audits)	
	Number	Value	Number	Value
A Audits with management decisions but without final action at the beginning of FY 2004	83	\$106,591,146	27	\$0
B Audits for which management decisions were made during FY 2004	113	\$ 3,007,793	25	\$0
(i) Management decisions with disallowed costs (23)				
(ii) Management decisions with no disallowed costs (90)				
C Total audits pending final action during FY 2004 (A+B)	196	\$109,598,939	52	\$0
D Final action taken during FY 2004	121	\$ 35,213,332	16	\$0
(i) Recoveries				
a) Offsets		\$ 7,993,454		
b) Collections		\$ 772,680		
c) Value of Property		\$ 0		
d) Other		\$ 11,196,584		
(ii) Write-offs		\$ 9,508,924		
(iii) Reinstated through grantee appeal		\$ 5,741,690		
(iv) Value of recommendations completed				\$0
Value of recommendations management decided should/could not be completed				\$0
E Audit reports needing final action at the end of FY 2004 (C-D)	75	\$ 74,385,607	37	\$0

Key Management Challenges

(Prepared by EPA's Office of the Inspector General)

EPA continues to make progress in addressing long-standing management challenges identified by the Office of the Inspector General (OIG). Results of a recent OIG survey indicate that EPA senior leaders are committed to strengthening strategic human capital management and linking human capital to program success. EPA continues to enhance its Information Security Program through risk assessments of its major systems, conducting internal and external penetration testing, and monitoring the Agency's firewall and intrusion detection system. EPA is also working closely with federal, state, and local counterparts to strengthen and effectively coordinate on Homeland Security issues.

While EPA continues to address the management challenges, sustained attention and management action must continue to correct outstanding issues. The following table identifies the top management challenges faced by the Agency and the relation of the issues to EPA's *Strategic Plan* and the President's Management Agenda.

EPA's Top Management Challenges Reported by the Office of Inspector General	FY 2002³⁷	FY 2003³⁸	FY 2004³⁹	Link to EPA's Strategic Goal	Link to President's Management Agenda
Linking Mission to Management: Development of outcome-based targets	.	.	.	Cross Goal	Budget and Performance Integration
Agency Efforts In Support of Homeland Security: Implementing a strategy to effectively coordinate and address threats	.	.	.	Cross Goal	
Superfund Evaluation and Policy Identification: Improving the usefulness of internal evaluations, and implementing program policy decisions			.	Goal 3	
Information Resource Management and Data Quality: Improving the quality of data used	.	.	.	Cross Goal	Expanded E-Government
EPA's Use of Assistance Agreements to Accomplish Its Mission: Improving Management of the billions in grant funding awarded by EPA	.	.	.	Cross Goal	Improved Financial Performance
Challenges In Addressing Air Toxics Program Phase 1 and Phase 2 Goals: Reducing air toxic emissions by improving approach and measures	.	.	.	Goal 1	
Human Capital Management: Implementing a strategy to develop staff	.	.	.	Cross Goal	Human Capital
Information Security: Protecting information systems by preventing intrusion and abuse.	.	.	.	Cross Goal	Expanded E-Government
Management of Biosolids: Improving sewage sludge management to sufficiently protect the public	.	.	.	Goal 2	
Backlog of National Pollutant Discharge Elimination System Permits: Addressing permit renewal backlog for water dischargers	.	.	.	Goal 2	
EPA's Working Relationship with States: Improving structure for working with states	.	.	†	Cross Goal	

¹ In FY 2004, EPA's Working Relationship with States was consolidated in item 1, Linking Mission to Management.

Highlights of EPA's Actions to Address OIG's Key Management Challenges

OIG's Top Management Challenges	Summary of EPA's Actions
Linking Mission and Management: <i>OIG believes that while EPA has begun linking costs to goals, it must continue to work with its partners to develop appropriate outcome measures and accounting systems that track environmental and human health results across the Agency's new goal structure. This information must then become an integral part of the Agency's decision-making process.</i>	<ul style="list-style-type: none"> Implemented a new financial architecture that provides greater program and project details in the Agency's accounting system Developed Regional Plans that link to Agency's Strategic Plan Implemented annual commitment system for regions and national programs
Agency Efforts in Support of Homeland Security: <i>EPA needs to develop better processes for ensuring security at Nationally Significant Events, assess vulnerability of water utilities and determine how to measure water security improvements, and better define the Agency's role in protecting air from terrorist threats.</i>	<ul style="list-style-type: none"> Revised the Homeland Security Strategic plan Established the Homeland Security Collaborative Network to coordinate and address high priority, cross-Agency technical and policy issues related to homeland security programs Developed a homeland security information management system <p>(see Overview for programmatic examples)</p>
Superfund Evaluation and Policy Identification: <i>OIG believes EPA faces significant challenges in its ability to meet effectively current and future Superfund needs and must establish a strong working relationship between states and tribes in order to achieve its environmental goals.</i>	<ul style="list-style-type: none"> Initiated an internal review of the Superfund program to identify opportunities for program efficiencies Worked to increase oversight of the Tribal Association on Solid Waste and Emergency Response cooperative agreement, in accordance with commitments to OIG Developing a program evaluation strategy to identify, develop, and select evaluation projects aimed at improving the efficiency and effectiveness of remedial programs
Information Resource Management and Data Quality: <i>EPA faces a number of challenges with the data it uses to make decisions and monitor progress against environmental goals.</i>	<ul style="list-style-type: none"> Improved data management and usage by providing tools and planning processes for effective data sharing, integration, and identification of key data gaps Developed and issued a policy directive to ensure and document the competency of Agency laboratories
EPA's Use of Assistance Agreements to Accomplish Its Mission: <i>EPA needs to improve oversight for awarding and administering assistance agreements to ensure effective and efficient use of resources. Recent OIG and GAO audits continue to identify problems in the use of assistance agreements.</i>	<ul style="list-style-type: none"> Developed a long-term Grants Management Plan which outlines the Agency's approach to effective grants management Implemented the Grants Management Training Plan to enhance the skills of EPA personnel involved in grants management Issued a comprehensive post-award monitoring policy (EPA Order 5700.6)
Challenges in Addressing Air Toxics Program Phase 1 and Phase 2 Goals: <i>While EPA has achieved its Phase 1 goal of issuing technology-based standards, there are concerns about EPA's efforts to assess and implement Phase 2, residual risk standards, as well as the accuracy of air toxics data used in measuring progress.</i>	<ul style="list-style-type: none"> Completed all MACT standards. This effort has already resulted in annual reductions of 1.5 million tons of toxic air emissions and will achieve even greater reductions when all sources come into full compliance by 2007. Developed an efficiency measure, "toxicity-weight emissions," to better understand risk reduction
Human Capital Management: <i>While EPA is making progress on human capital efforts, it must continue developing and implementing its Human Capital Strategy and focus on accountability and better communication of planned strategies.</i>	<ul style="list-style-type: none"> Established a comprehensive system of management controls <ul style="list-style-type: none"> Completed EPA's Human Capital Strategy Created a new office to oversee implementation of strategy Continued investment in workforce through developmental programs at the staff and managerial levels
Information Security: <i>Due to the dynamic nature of information security, EPA needs to continue its emphasis and vigilance on strong information security.</i>	<ul style="list-style-type: none"> Strengthened management controls to improve implementation of the Agency's security program and implemented testing and evaluation processes

	<ul style="list-style-type: none"> to verify their effectiveness Continued enhancing program through risk assessments, penetration testing, and monitoring of firewall and intrusion detection systems
Management of Biosolids: <i>Although EPA is directing renewed attention to biosolids, EPA needs to implement a national biosolids program and establish strong enforcement to meet CWA to reduce risks and maximize the beneficial use of sewage sludge</i>	<ul style="list-style-type: none"> Continues to meet statutory obligations under the Clean Water Act pertaining to sewage sludge (biosolids) Maintains an active presence in biosolids compliance and enforcement activities Published action plan in the Federal Register (68 FR 75531) to strengthen sewage sludge use and disposal program (e.g., field studies on land application, development of improved analytical methods)
Backlog of National Pollutant Discharge Elimination System Permits <i>While EPA is making progress in reducing the backlog, OIG is assessing the environmental impact of the backlog, how well the backlog measures reflect impacts, and how successful EPA and states have been at managing the backlog</i>	<ul style="list-style-type: none"> Developed and implemented the Permitting for Environmental Results strategy to focus scarce permit-writing resources on environmentally significant permits Streamlined the NPDES permitting process by developing tools to ensure efficiency (automated permit writing process) <p>(see Overview for programmatic results)</p>

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 (U.S. Environmental Protection Agency) 1997 Benefits and Costs of the Clean Air Act, 1970 to 1990 Final Report to Congress EPA 410/R-97-002 Office of Air and Radiation, Office of Policy, Planning and Evaluation U.S. Environmental Protection Agency, Washington, DC Available at: <http://www.epa.gov/oar/sect812/contsetc.pdf>

³ U.S. Environmental Protection Agency, Office of Air and Radiation May 2004 *Clean Air Nonroad Diesel Rule Summary* EPA 420-F-04-029 Available online at <http://www.epa.gov/oiaq/regs/nonroad/equip-hd/2004fr/420f04029.pdf>

⁴ "Clean Air Rules of 2004 Oral Testimony" EPA testimony as prepared for delivery before the U.S. Senate Committee on Environment and Public Works, Subcommittee on Clean Air, Climate and Nuclear Safety. April 10, 2004

⁵ Each of EPA's climate protection partnerships is designed to achieve long-term greenhouse gas emission reduction goals, which were set through an interagency process in 2001 and communicated to the Secretariat of the Framework Convention on Climate Change in the *U.S. Climate Action Report—2002*

⁶ U.S. Environmental Protection Agency September 2004 *Protecting the Environment—Together. ENERGY STAR and Other Voluntary Programs 2003 Annual Report* Available at http://www.energystar.gov/ia/news/downloads/annual_report_2003.pdf

⁷ Slaughter, J.C., et al. "Effects of Ambient Air Pollution on Symptom Severity and Medication Use in Children with Asthma" *Annals of Allergy, Asthma, and Immunology* 2003 91:346–53

⁸ U.S. Environmental Protection Agency 2004 *Use of Indoor-Outdoor Sulfur Concentrations to Estimate the Infiltration Factor, Personal Exposure Factor, Penetration Coefficient, and Deposition rate for Individual Homes*

⁹ Loading reductions are calculated and tracked using a spreadsheet maintained by the Office of Science and Technology U.S. EPA, Office of Science and Technology, *Loadings Reduction Spread Sheet for Direct Discharges from Point Sources Subject to Effluent Guidelines* (Washington, DC U.S. EPA, updated 2004)

¹⁰ U.S. Environmental Protection Agency, Office of Water March 2004 *National List of Beaches* EPA-823-R-04-004 Washington, DC Available at <http://www.epa.gov/waterscience/beaches>

¹¹ More information on the Agency's Superfund cleanup program's is available at <http://www.epa.gov/superfund>, <http://www.epa.gov/superfund/news/120daystudy.pdf>, and <http://www.epa.gov/oswet/docs/naceptdocs/NACEPTsuperfund-Final-Report.pdf>.

¹² U.S. Environmental Protection Agency, Office of Pollution Prevention and Toxics "TSCA New Chemicals Program" Internal monthly report by Chemical Abstract Services

¹³ U.S. Environmental Protection Agency, Office of Pollution Prevention and Toxics "High Production Volume Challenge Program, HPV Commitment Tracking System" Available at <http://www.epa.gov/chemrtk/viewsrch.htm>

¹⁴ Centers for Disease Control, National Center for Health Statistics *National Health and Nutrition Examination Survey 1999-2002* Available at <http://www.cdc.gov/nchs/nhanes.htm>

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- ¹⁵ Additional information regarding the Great Lakes, the Interagency Task Force and the Executive Order is available at <http://www.epa.gov/glnpo/taskforce/eo.html>
- ¹⁶ Data for 2004 will not be available until 2005 due to quality assurance issues and lags in aggregating U S and Canadian data Canadian data will be reported in 2005
- ¹⁷ More information is available at <http://www.whitehouse.gov/news/releases/2004/04/20040422-4.htm>
- ¹⁸ This information was collected through exit surveys completed by users of the National Compliance Assistance Centers U S Environmental Protection Agency, Office of Enforcement and Compliance Assurance "Compliance Assistance Results " Available at <http://www.assistancecenters.net/results>
- ¹⁹ U S Environmental Protection Agency, Office of Pollution Prevention and Toxics "Green Chemistry Challenge " Internal database Continually updated
- ²⁰ Electronic communication from Noramtech Corporation to EPA Design for Environment staff, November 20, 2002
- ²¹ U S Environmental Protection Agency, Office of Pollution Prevention and Toxics, Pollution Prevention and Toxics, Internal Pollution Prevention Tracking System, continually updated
- ²² Refer to *Sustained Progress in Addressing Management Issues* available at <http://www.epa.gov/ocfo/finstatement/2004ar/2004ar.htm>
- ²³ 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 that is based on criteria determined by OMB
- ²⁴ Public Law 108-199 H R 2673
- ²⁵ Section III, FY 2004 Statement of Budgetary Resources
- ²⁶ Section III, FY 2004 Statement of Net Costs
- ²⁷ US Department of the Treasury, FY 2004 Superfund Trust Fund Financial Statements
- ²⁸ EPA's Integrated Financial Management System
- ²⁹ Refer to *Sustained Progress in Addressing Management Issues* available at <http://www.epa.gov/ocfo/finstatement/2004ar/2004ar.htm>
- ³⁰ U S Department of Health & Human Services and U S Environmental Protection Agency "What You Need To Know About Mercury In Fish & Shellfish " EPA-823-R-04-005 March 2004 Available on the internet at <http://www.epa.gov/waterscience/fishadvice/advice.html>
- ³¹ Reports Consolidation Act of 2000 Public Law 106-531 (January 24, 2004)
- ³² Federal Managers Financial Integrity Act of 1982. Public Law 97-255 (September 8, 1982)
- ³³ U S Environmental Protection Agency, Office of Water "National Pollutant Discharge Elimination System (NPDES), Backlog Reduction " Available at <http://cfpub.epa.gov/npdes/permitissuance/backlog.cfm>
- ³⁴ U S Environmental Protection Agency Grants Information and Control System (GICS) database
- ³⁵ Executive Office of the President, Office of Management and Budget The *President's Management Agenda* Available at http://www.whitehouse.gov/omb/budintegration/pma_index.html
- ³⁶ Inspector General Act of 1978, as amended Public Law 95-542 (October 12, 1978)
- ³⁷ OIG Memorandum of September 6, 2002 to EPA Administrator, "EPA's Key Management Challenges "
- ³⁸ OIG Memorandum of May 22, 2003 to EPA Administrator, "EPA's Key Management Challenges "
- ³⁹ OIG Memorandum of April 21, 2004 to EPA Administrator, "EPA's Key Management Challenges "

**PRINCIPAL
FINANCIAL
STATEMENTS**

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1.
Environmental Protection Agency
Consolidating Balance Sheet
As of September 30, 2004 and 2003
(Dollars in Thousands)

	Superfund Trust Fund FY 2004	Superfund Trust Fund FY 2003	All Others FY 2004	All Others FY 2003	Combined Totals FY 2004
ASSETS					
Intragovernmental					
Fund Balance With Treasury (Note 2)	\$ 199,406	\$ 26,448	\$ 11,865,739	\$ 11,758,357	\$ 12,065,145
Investments (Notes 4 and 17)	2,217,334	2,516,147	2,317,164	2,114,684	4,534,498
Accounts Receivable, Net (Note 5)	27,212	34,665	89,267	119,941	116,479
Other (Note 6)	6,781	7,414	1,288	3,827	8,069
Total Intragovernmental	\$ 2,450,733	\$ 2,584,674	\$ 14,273,458	\$ 13,996,809	\$ 16,724,191
Cash and Other Monetary Assets (Note 3)	0	0	10	10	10
Accounts Receivable, Net (Note 5)	369,148	428,486	45,347	65,296	414,495
Loans Receivable, Net - Non-Federal (Note 7)	0	0	48,927	53,506	48,927
Property, Plant & Equipment, Net (Note 9)	47,821	45,855	625,542	579,471	673,363
Other (Note 6)	699	680	809	3,502	1,508
Total Assets	\$ 2,868,401	\$ 3,059,695	\$ 14,994,093	\$ 14,698,594	\$ 17,862,494
LIABILITIES					
Intragovernmental					
Accounts Payable & Accrued Liabilities (Note 8)	\$ 140,781	\$ 145,631	\$ 37,592	\$ 70,156	\$ 178,373
Debt Due to Treasury (Note 10)	0	0	24,101	21,189	24,101
Custodial Liability (Note 11)	0	0	52,216	78,776	52,216
Other (Note 12)	37,752	30,600	47,118	21,611	84,870
Total Intragovernmental	\$ 178,533	\$ 176,231	\$ 161,027	\$ 191,732	\$ 339,560
Accounts Payable & Accrued Liabilities (Note 8)	145,369	165,550	736,482	722,784	881,851
Pensions & Other Actuarial Liabilities (Note 14)	7,263	7,937	33,018	36,159	40,281
Environmental Cleanup Costs (Note 20)	0	0	8,407	8,880	8,407
Cashout Advances, Superfund (Note 15)	259,361	279,092	0	0	259,361
Commitments & Contingencies (Note 18)	0	0	1,625	18	1,625
Payroll & Benefits Payable (Note 33)	31,695	31,039	149,051	142,791	180,746
Other (Notes 12 and 13)	46,211	49,809	57,705	53,105	103,916
Total Liabilities	\$ 668,432	\$ 709,658	\$ 1,147,315	\$ 1,155,469	\$ 1,815,747
NET POSITION					
Unexpended Appropriations (Note 16)	\$ 0	\$ 0	\$ 10,860,136	\$ 10,768,236	\$ 10,860,136
Cumulative Results of Operations (Note 36)	2,199,969	2,350,037	2,986,642	2,774,889	5,186,611
Total Net Position	2,199,969	2,350,037	13,846,778	13,543,125	16,046,747
Total Liabilities and Net Position	\$ 2,868,401	\$ 3,059,695	\$ 14,994,093	\$ 14,698,594	\$ 17,862,494

The accompanying notes are an integral part of these statements.

1.
Environmental Protection Agency
Consolidating Balance Sheet
As of September 30, 2004 and 2003
(Dollars in Thousands)

	Combined Totals FY 2003	Intra-agency Elimination FY 2004	Intra-agency Elimination FY 2003	Consolidated Totals FY 2004	Consolidated Totals FY 2003
ASSETS					
Intragovernmental					
Fund Balance With Treasury (Note 2)	\$ 11,784,805	\$ 0	\$ 0	\$ 12,065,145	\$ 11,784,805
Investments (Notes 4 and 17)	4,630,831	0	0	4,534,498	4,630,831
Accounts Receivable, Net (Note 5)	154,606	(73,709)	(89,789)	42,770	64,817
Other (Note 6)	11,241	(6,749)	(7,269)	1,320	3,972
Total Intragovernmental	\$ 16,581,483	\$ (80,458)	\$ (97,058)	\$ 16,643,733	\$ 16,484,425
Cash and Other Monetary Assets (Note 3)	10	0	0	10	10
Accounts Receivable, Net (Note 5)	493,782	0	0	414,495	493,782
Loans Receivable, Net - Non-Federal (Note 7)	53,506	0	0	48,927	53,506
Property, Plant & Equipment, Net (Note 9)	625,326	0	0	673,363	625,326
Other (Note 6)	4,182	0	0	1,508	4,182
Total Assets	\$ 17,758,289	\$ (80,458)	\$ (97,058)	\$ 17,782,036	\$ 17,661,231
LIABILITIES					
Intragovernmental					
Accounts Payable & Accrued Liabilities (Note 8)	\$ 215,787	\$ (73,709)	\$ (89,789)	\$ 104,664	\$ 125,998
Debt Due to Treasury (Note 10)	21,189	0	0	24,101	21,189
Custodial Liability (Note 11)	78,776	0	0	52,216	78,776
Other (Note 12)	52,211	(6,749)	(7,269)	78,121	44,942
Total Intragovernmental	\$ 367,963	\$ (80,458)	\$ (97,058)	\$ 259,102	\$ 270,905
Accounts Payable & Accrued Liabilities (Note 8)	888,334	0	0	881,851	888,334
Pensions & Other Actuarial Liabilities (Note 14)	44,096	0	0	40,281	44,096
Environmental Cleanup Costs (Note 20)	8,880	0	0	8,407	8,880
Cashout Advances, Superfund (Note 15)	279,092	0	0	259,361	279,092
Commitments & Contingencies (Note 18)	18	0	0	1,625	18
Payroll & Benefits Payable (Note 33)	173,830	0	0	180,746	173,830
Other (Notes 12 and 13)	102,914	0	0	103,916	102,914
Total Liabilities	\$ 1,865,127	\$ (80,458)	\$ (97,058)	\$ 1,735,289	\$ 1,768,069
NET POSITION					
Unexpended Appropriations (Note 16)	\$ 10,768,236	\$ 0	\$ 0	\$ 10,860,136	\$ 10,768,236
Cumulative Results of Operations (Note 36)	5,124,926	0	0	5,186,611	5,124,926
Total Net Position	15,893,162	0	0	16,046,747	15,893,162
Total Liabilities and Net Position	\$ 17,758,289	\$ (80,458)	\$ (97,058)	\$ 17,782,036	\$ 17,661,231

The accompanying notes are an integral part of these statements.

2.
Environmental Protection Agency
Consolidating Statement of Net Cost
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	Superfund Trust Fund FY 2004	Superfund Trust Fund FY 2003	All Others FY 2004	All Others FY 2003	Combined Totals FY 2004
COSTS					
Intragovernmental	\$ 368,045	\$ 341,817	\$ 860,314	\$ 816,624	\$ 1,228,359
With the Public	1,262,540	1,246,427	6,387,327	6,427,497	7,649,867
Expenses from Other Appropriations (Note 23)	<u>82,776</u>	<u>75,597</u>	<u>(82,776)</u>	<u>(75,597)</u>	<u>0</u>
Total Costs	\$ 1,713,361	\$ 1,663,841	\$ 7,164,865	\$ 7,168,524	\$ 8,878,226
Less					
Earned Revenues, Federal (Note 19)	\$ 27,450	\$ 16,682	\$ 61,475	\$ 124,233	\$ 88,925
Earned Revenues, Non-Federal (Note 19)	<u>233,171</u>	<u>394,295</u>	<u>46,928</u>	<u>31,304</u>	<u>280,099</u>
Total Earned Revenues	<u>260,621</u>	<u>410,977</u>	<u>108,403</u>	<u>155,537</u>	<u>369,024</u>
NET COST OF OPERATIONS	<u>\$ 1,452,740</u>	<u>\$ 1,252,864</u>	<u>\$ 7,056,462</u>	<u>\$ 7,012,987</u>	<u>\$ 8,509,202</u>

	Combined Totals FY 2003	Intra- agency Eliminations FY 2004	Intra- agency Eliminations FY 2003	Consolidated Totals FY 2004	Consolidated Totals FY 2003
COSTS					
Intragovernmental	\$ 1,158,441	\$ (22,663)	\$ (20,240)	\$ 1,205,696	\$ 1,138,201
With the Public	7,673,924	0	0	7,649,867	7,673,924
Expenses from Other Appropriations (Note 23)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Costs	\$ 8,832,365	\$ (22,663)	\$ (20,240)	\$ 8,855,563	\$ 8,812,125
Less					
Earned Revenues, Federal (Note 19)	\$ 140,915	\$ (22,663)	\$ (20,240)	\$ 66,262	\$ 120,675
Earned Revenues, Non-Federal (Note 19)	<u>425,599</u>	<u>0</u>	<u>0</u>	<u>280,099</u>	<u>425,599</u>
Total Earned Revenues	<u>566,514</u>	<u>(22,663)</u>	<u>(20,240)</u>	<u>346,361</u>	<u>546,274</u>
NET COST OF OPERATIONS	<u>\$ 8,265,851</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 8,509,202</u>	<u>\$ 8,265,851</u>

The accompanying notes are an integral part of these statements.

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

	Clean Air	Clean and Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
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	\$ 22,062	\$ 8,316	\$ 247,813	\$ 40,673	\$ 15,355
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>

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal*
For the Year Ended September 30, 2003
(Dollars in Thousands)

	Clean Air	Clean and Safe Water	Safe Food	Prevent Pollution	Better Waste Management	Global Risks
COSTS						
Intragovernmental	\$ 84,961	\$ 139,303	\$ 31,028	\$ 54,492	\$ 409,312	\$ 35,643
With the Public	<u>532,480</u>	<u>3,817,701</u>	<u>97,848</u>	<u>281,634</u>	<u>1,581,550</u>	<u>219,692</u>
Total Costs	\$ 617,441	\$ 3,957,004	\$ 128,876	\$ 336,126	\$ 1,990,862	\$ 255,335
Less						
Earned Revenue, Federal	\$ 3,234	\$ 5,394	\$ 37	\$ 1,197	\$ 80,029	\$ 3,911
Earned Revenue, Non-Federal	<u>71</u>	<u>1,876</u>	<u>20,729</u>	<u>300</u>	<u>396,738</u>	<u>1,652</u>
Total Earned Revenue	\$ 3,305	\$ 7,270	\$ 20,766	\$ 1,497	\$ 476,767	\$ 5,563
Management Cost Allocation	<u>55,231</u>	<u>83,892</u>	<u>24,379</u>	<u>36,784</u>	<u>136,240</u>	<u>15,031</u>
NET COST OF OPERATIONS	<u>\$ 669,367</u>	<u>\$ 4,033,626</u>	<u>\$ 132,489</u>	<u>\$ 371,413</u>	<u>\$ 1,650,335</u>	<u>\$ 264,803</u>

* The agency implemented a 5-goal strategic plan structure for FY 2004 costs. FY 2003 costs are presented in the former 10-goal structure.

The accompanying notes are an integral part of these statements.

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

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

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal*
For the Year Ended September 30, 2003
(Dollars in Thousands)

	Environ. Information	Sound Science	Credible Deterrent	Effective Management	Not Assigned to Goals**	Consolidated Total
COSTS						
Intragovernmental	\$ 174,224	\$ 51,118	\$ 93,695	\$ 40,751	\$ 23,674	\$ 1,138,201
With the Public	191,351	293,552	325,968	343,036	(10,888)	7,673,924
Total Costs	\$ 365,575	\$ 344,670	\$ 419,663	\$ 383,787	\$ 12,786	\$ 8,812,125
Less						
Earned Revenue, Federal	\$ 126,261	\$ 1,198	\$ 272	\$ (100,428)	\$ (430)	\$ 120,675
Earned Revenue, Non-Federal	121	364	1,220	1,367	1,161	425,599
Total Earned Revenue	\$ 126,382	\$ 1,562	\$ 1,492	\$ (99,061)	\$ 731	\$ 546,274
Management Cost Allocation	26,018	28,766	76,507	(482,848)	0	0
NET COST OF OPERATIONS	\$ 265,211	\$ 371,874	\$ 494,678	\$ 0	\$ 12,055	\$ 8,265,851

* The agency implemented a 5-goal strategic plan structure for FY 2004 costs FY 2003 costs are presented in the former 10-goal structure

** See Note 30

The accompanying notes are an integral part of these statements.

4.
Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	Cumulative Results of Operations Superfund Trust Fund FY 2004	Cumulative Results of Operations Superfund Trust Fund FY 2003	Cumulative Results of Operations All Others FY 2004	Cumulative Results of Operations All Others FY 2003	Cumulative Results of Operations Consolidated Totals FY 2004*
Net Position - Beginning of Period	\$ 2,350,037	\$ 3,115,737	\$ 2,774,889	\$ 2,518,705	\$ 5,124,926
Prior Period Adjustments	0	0	0	0	0
Beginning Balances, as Adjusted	\$ 2,350,037	\$ 3,115,737	\$ 2,774,889	\$ 2,518,705	\$ 5,124,926
Budgetary Financing Sources					
Appropriations Received	0	0	0	0	0
Appropriations Transferred In/Out (Note 31)	0	0	0	0	0
Other Adjustments (Note 34)	0	0	0	0	0
Appropriations Used	0	0	8,162,544	7,496,463	8,162,544
Nonexchange Revenue (Note 35)	30,239	(49,692)	269,486	260,515	299,725
Transfers In/Out (Note 31)	(87,586)	(191,131)	67,779	111,614	(19,807)
Trust Fund Appropriations	1,257,537	632,307	(1,257,537)	(632,307)	0
Income from Other Appropriations (Note 23)	82,776	75,597	(82,776)	(75,597)	0
Total Budgetary Financing Sources	\$ 1,282,966	\$ 467,081	\$ 7,159,496	\$ 7,160,688	\$ 8,442,462
Other Financing Sources					
Transfers In/Out (Note 31)	(1)	84	(435)	287	(436)
Imputed Financing Sources (Note 32)	19,707	19,999	109,154	108,196	128,861
Total Other Financing Sources	\$ 19,706	\$ 20,083	\$ 108,719	\$ 108,483	\$ 128,425
Net Cost of Operations	(1,452,740)	(1,252,864)	(7,056,462)	(7,012,987)	(8,509,202)
Net Position - End of Period	\$ <u>2,199,969</u>	\$ <u>2,350,037</u>	\$ <u>2,986,642</u>	\$ <u>2,774,889</u>	\$ <u>5,186,611</u>

** This statement does not have any intra-agency eliminations for FY 2004 or 2003*

The accompanying notes are an integral part of these statements.

4.
Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	Cumulative Results of Operations Consolidated Totals FY 2003*	Unexpended Approps. All Others FY 2004	Unexpended Approps. All Others FY 2003	Consolidated Totals FY 2004*	Consolidated Totals FY 2003*
Net Position - Beginning of Period	\$ 5,634,442	\$ 10,768,236	\$ 10,923,889	\$ 15,893,162	\$ 16,558,331
Prior Period Adjustments	0	0	0	0	0
Beginning Balances, as Adjusted	\$ 5,634,442	\$ 10,768,236	\$ 10,923,889	\$ 15,893,162	\$ 16,558,331
Budgetary Financing Sources					
Appropriations Received	0	8,322,860	7,408,126	8,322,860	7,408,126
Appropriations Transferred In/Out (Note 31)	0	152	4,550	152	4,550
Other Adjustments (Note 34)	0	(68,568)	(71,866)	(68,568)	(71,866)
Appropriations Used	7,496,463	(8,162,544)	(7,496,463)	0	0
Nonexchange Revenue (Note 35)	210,823	0	0	299,725	210,823
Transfers In/Out (Note 31)	(79,517)	0	0	(19,807)	(79,517)
Trust Fund Appropriations	0	0	0	0	0
Income from Other Appropriations (Note 23)	0	0	0	0	0
Total Budgetary Financing Sources	\$ 7,627,769	\$ 91,900	\$ (155,653)	\$ 8,534,362	\$ 7,472,116
Other Financing Sources					
Transfers In/Out (Note 31)	371	0	0	(436)	371
Imputed Financing Sources (Note 32)	128,195	0	0	128,861	128,195
Total Other Financing Sources	\$ 128,566	\$ 0	\$ 0	\$ 128,425	\$ 128,566
Net Cost of Operations	(8,265,851)	0	0	(8,509,202)	(8,265,851)
Net Position - End of Period	\$ 5,124,926	\$ 10,860,136	\$ 10,768,236	\$ 16,046,747	\$ 15,893,162

* This statement does not have any intra-agency eliminations for FY 2004 or 2003

The accompanying notes are an integral part of these statements.

5.
Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	Superfund Trust Fund FY 2004	Superfund Trust Fund FY 2003	All Others FY 2004
BUDGETARY RESOURCES			
Budgetary Authority			
Appropriations Received	\$ 0	\$ 0	\$ 8,353,924
Borrowing Authority	0	0	5,554
Net Transfers	1,259,096	1,286,342	77,690
Unobligated Balances			
Beginning of Period	766,805	750,994	2,098,872
Net Transfers, Actual	0	0	(1,538)
Spending Authority from Offsetting Collections			
Earned and Collected	\$ 229,658	\$ 211,066	\$ 242,119
Receivable from Federal Sources	(7,853)	(1,728)	(15,303)
Change in Unfilled Customer Orders			
Advance Received	(44,218)	(41,608)	13,011
Without Advance from Federal Sources	5,978	5,259	1,310
Transfers from Trust Funds	0	(9,642)	51,666
Total Spending Authority from Collections	\$ 183,565	\$ 163,347	\$ 292,803
Recoveries of Prior Year Obligations (Note 26)	98,848	124,797	95,927
Temporarily Not Available Pursuant to Public Law (Note 26)	(7,464)	0	(790)
Permanently Not Available (Note 26)	0	(8,274)	(71,203)
Total Budgetary Resources (Note 25)	\$ <u>2,300,850</u>	\$ <u>2,317,206</u>	\$ <u>10,851,239</u>
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred			
Direct	\$ 1,328,864	\$ 1,373,144	\$ 8,416,742
Reimbursable	148,273	177,257	261,502
Total Obligations Incurred (Note 25)	\$ 1,477,137	\$ 1,550,401	\$ 8,678,244
Unobligated Balances			
Apportioned (Note 27)	823,694	766,786	2,080,155
Unobligated Balances Not Available (Note 27)	19	19	92,840
Total Status of Budgetary Resources	\$ <u>2,300,850</u>	\$ <u>2,317,206</u>	\$ <u>10,851,239</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS			
Obligations Incurred, Net	\$ 1,194,724	\$ 1,262,257	\$ 8,289,514
Obligated Balances, Net - Beginning of Period	1,838,503	2,021,759	9,582,216
Accounts Receivable	(5,886)	1,965	86,440
Unfilled Customer Orders from Federal Sources	77,685	71,707	226,184
Undelivered Orders, Unpaid	(1,374,232)	(1,612,994)	(9,093,405)
Accounts Payable	(266,926)	(299,181)	(857,634)
Total Outlays (Note 25)	\$ <u>1,463,868</u>	\$ <u>1,445,513</u>	\$ <u>8,233,315</u>
Disbursements	\$ 1,649,308	\$ 1,605,329	\$ 8,556,405
Collections	(185,440)	(159,816)	(323,090)
Less Offsetting Receipts (Note 28)	(74,063)	(146,502)	(1,276,778)
Net Outlays	\$ <u>1,389,805</u>	\$ <u>1,299,011</u>	\$ <u>6,956,537</u>

The accompanying notes are an integral part of these statements.

5.
Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	All Others FY 2003	Combined Totals FY 2004	Combined Totals FY 2003
BUDGETARY RESOURCES			
Budgetary Authority			
Appropriations Received	\$ 7,424,350	\$ 8,353,924	\$ 7,424,350
Borrowing Authority	0	5,554	0
Net Transfers	76,863	1,336,786	1,363,205
Unobligated Balances			
Beginning of Period	2,045,248	2,865,677	2,796,242
Net Transfers, Actual	0	(1,538)	0
Spending Authority from Offsetting Collections			
Earned and Collected	\$ 273,703	\$ 471,777	\$ 484,769
Receivable from Federal Sources	5,074	(23,156)	3,346
Change in Unfilled Customer Orders			0
Advance Received	(20,362)	(31,207)	(61,970)
Without Advance from Federal Sources	(28,473)	7,288	(23,214)
Transfers from Trust Funds	96,135	51,666	86,493
Total Spending Authority from Collections	\$ 326,077	\$ 476,368	\$ 489,424
Recoveries of Prior Year Obligations (Note 26)	114,437	194,775	239,234
Temporarily Not Available Pursuant to Public Law (Note 26)	0	(8,254)	0
Permanently Not Available (Note 26)	(76,182)	(71,203)	(84,456)
Total Budgetary Resources (Note 25)	<u>\$ 9,910,793</u>	<u>\$ 13,152,089</u>	<u>\$ 12,227,999</u>
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred			
Direct	\$ 7,539,595	\$ 9,745,606	\$ 8,912,739
Reimbursable	272,326	409,775	449,583
Total Obligations Incurred (Note 25)	\$ 7,811,921	\$ 10,155,381	\$ 9,362,322
Unobligated Balances			
Apportioned (Note 27)	2,011,471	2,903,849	2,778,257
Unobligated Balances Not Available (Note 27)	87,401	92,859	87,420
Total Status of Budgetary Resources	<u>\$ 9,910,793</u>	<u>\$ 13,152,089</u>	<u>\$ 12,227,999</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS			
Obligations Incurred, Net	\$ 7,371,407	\$ 9,484,238	\$ 8,633,664
Obligated Balances, Net - Beginning of Period	9,608,652	11,420,719	11,630,411
Accounts Receivable	118,037	80,554	120,002
Unfilled Customer Orders from Federal Sources	224,874	303,869	296,581
Undelivered Orders, Unpaid	(9,077,583)	(10,467,637)	(10,690,577)
Accounts Payable	(847,544)	(1,124,560)	(1,146,725)
Total Outlays (Note 25)	\$ 7,397,843	\$ 9,697,183	\$ 8,843,356
Disbursements	\$ 7,706,933	\$ 10,205,713	\$ 9,312,262
Collections	(309,090)	(508,530)	(468,906)
Less Offsetting Receipts (Note 28)	(643,956)	(1,350,841)	(790,458)
Net Outlays	<u>\$ 6,753,887</u>	<u>\$ 8,346,342</u>	<u>\$ 8,052,898</u>

The accompanying notes are an integral part of these statements.

6.
Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	Superfund Trust Fund FY 2004	Superfund Trust Fund FY 2003	All Others FY 2004
RESOURCES USED TO FINANCE ACTIVITIES:			
Budgetary Resources Obligated			
Obligations Incurred	\$ 1,477,137	\$ 1,550,401	\$ 8,678,244
Less Spending Authority from Offsetting Collections and Recoveries	<u>(282,413)</u>	<u>(288,144)</u>	<u>(388,730)</u>
Obligations, Net of Offsetting Collections	\$ 1,194,724	\$ 1,262,257	\$ 8,289,514
Less Offsetting Receipts (Note 28)	<u>(74,063)</u>	<u>(146,502)</u>	<u>(1,276,778)</u>
Net Obligations	\$ 1,120,661	\$ 1,115,755	\$ 7,012,736
Other Resources			
Transfers In/Out without Reimbursement, Property (Note 31)	\$ (1)	\$ 84	\$ 1
Imputed Financing Sources (Note 32)	19,707	19,999	109,154
Income from Other Appropriations (Note 23)	<u>82,776</u>	<u>75,597</u>	<u>(82,776)</u>
Net Other Resources Used to Finance Activities	\$ 102,482	\$ 95,680	\$ 26,379
 Total Resources Used To Finance Activities	 \$ 1,223,143	 \$ 1,211,435	 \$ 7,039,115
RESOURCES USED TO FINANCE ITEMS NOT PART OF NET COST OF OPERATIONS			
Change in Budgetary Resources Obligated	\$ 199,979	\$ 179,096	\$ (7,108)
Resources that Fund Prior Period Expenses (Note 29)	(2,243)	0	(11,612)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations			
Credit Program Collections Increasing Loan Liabilities for Guarantees of Subsidy Allowances	0	0	4,142
Offsetting Receipts Not Affecting Net Cost	74,063	146,502	19,241
Resources that Finance Asset Acquisition	(16,104)	(16,287)	(90,081)
Adjustments to Expenditure Transfers that Do Not Affect Net Cost	<u>(51,666)</u>	<u>(105,777)</u>	<u>51,666</u>
 Total Resources Used to Finance Items Not Part of the Net Cost of Operations	 \$ 204,029	 \$ 203,534	 \$ (33,752)
 Total Resources Used to Finance the Net Cost of Operations	 \$ 1,427,172	 \$ 1,414,969	 \$ 7,005,363

The accompanying notes are an integral part of these statements.

6.
Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	<u>Superfund Trust Fund FY 2004</u>	<u>Superfund Trust Fund FY 2003</u>	<u>All Others FY 2004</u>
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 (Note 29)	\$ 0	\$ 1,088	\$ 0
Increase in Environmental and Disposal Liability (Note 29)	0	0	1,244
Increase in Unfunded Contingencies (Note 29)	0	0	22,425
Up/Downward Reestimates of Subsidy Expense (Note 29)	0	0	0
Increase in Public Exchange Revenue Receivable	(41,446)	(205,844)	(18,491)
Increase in Workers Compensation Costs (Note 29)	<u>0</u>	<u>246</u>	<u>0</u>
Total Components of Net Cost of Operations that Requires or Generates Resources in the Future	\$ (41,446)	\$ (204,510)	\$ 5,178
Components Not Requiring/Generating Resources			
Depreciation and Amortization	7,939	8,915	39,852
Revaluation of Assets or Liabilities	0	0	0
Expenses Not Requiring Budgetary Resources	<u>59,075</u>	<u>33,490</u>	<u>6,069</u>
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	\$ 67,014	\$ 42,405	\$ 45,921
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	<u>25,568</u>	<u>(162,105)</u>	<u>51,099</u>
Net Cost of Operations	\$ <u>1,452,740</u>	\$ <u>1,252,864</u>	\$ <u>7,056,462</u>

The accompanying notes are an integral part of these statements.

6.
Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	All Others FY 2003	Consolidated Totals* FY 2004	Consolidated Totals* FY 2003
RESOURCES USED TO FINANCE ACTIVITIES:			
Budgetary Resources Obligated			
Obligations Incurred	\$ 7,811,921	\$ 10,155,381	\$ 9,362,322
Less Spending Authority from Offsetting Collections and Recoveries	(440,514)	(671,143)	(728,658)
Obligations, Net of Offsetting Collections	\$ 7,371,407	\$ 9,484,238	\$ 8,633,664
Less Offsetting Receipts (Note 28)	(643,956)	(1,350,841)	(790,458)
Net Obligations	\$ 6,727,451	\$ 8,133,397	\$ 7,843,206
Other Resources			
Transfers In/Out without Reimbursement, Property (Note 31)	\$ (84)	\$ 0	\$ 0
Imputed Financing Sources (Note 32)	108,196	128,861	128,195
Income from Other Appropriations (Note 23)	(75,597)	0	0
Net Other Resources Used to Finance Activities	\$ 32,515	\$ 128,861	\$ 128,195
Total Resources Used To Finance Activities	\$ 6,759,966	\$ 8,262,258	\$ 7,971,401
RESOURCES USED TO FINANCE ITEMS NOT PART OF NET COST OF OPERATIONS			
Change in Budgetary Resources Obligated	\$ 165,667	\$ 192,871	\$ 344,763
Resources that Fund Prior Period Expenses (Note 29)	0	(13,855)	0
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations			
Credit Program Collections Increasing Loan Liabilities for Guarantees of Subsidy Allowances	4,980	4,142	4,980
Offsetting Receipts Not Affecting Net Cost	11,649	93,304	158,151
Resources that Finance Asset Acquisition	(66,321)	(106,185)	(82,608)
Adjustments to Expenditure Transfers that Do Not Affect Net Cost	96,135	0	(9,642)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	\$ 212,110	\$ 170,277	\$ 415,644
Total Resources Used to Finance the Net Cost of Operations	\$ 6,972,076	\$ 8,432,535	\$ 8,387,045

** This statement did not have any intra-agency eliminations for FY 2004 or 2003*

The accompanying notes are an integral part of these statements.

6.
Environmental Protection Agency
Consolidating Statement of Financing
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	All Others FY 2003	Consolidated Totals* FY 2004	Consolidated Totals* FY 2003
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 (Note 29)	\$ 5,647	\$ 0	\$ 6,735
Increase in Environmental and Disposal Liability (Note 29)	(3,276)	1,244	(3,276)
Increase in Unfunded Contingencies (Note 29)	0	22,425	0
Up/Downward Reestimates of Subsidy Expense (Note 29)	170	0	170
Increase in Public Exchange Revenue Receivable	(1,706)	(59,937)	(207,550)
Increase in Workers Compensation Costs (Note 29)	4,591	0	4,837
Total Components of Net Cost of Operations that Requires or Generates Resources in the Future	\$ 5,426	\$ (36,268)	\$ (199,084)
Components Not Requiring/Generating Resources			
Depreciation and Amortization	36,289	47,791	45,204
Revaluation of Assets or Liabilities	0	0	0
Expenses Not Requiring Budgetary Resources	(804)	65,144	32,686
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	\$ 35,485	\$ 112,935	\$ 77,890
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period			
	<u>40,911</u>	<u>76,667</u>	<u>(121,194)</u>
Net Cost of Operations	\$ <u>7,012,987</u>	\$ <u>8,509,202</u>	\$ <u>8,265,851</u>

** This statement did not have any intra-agency eliminations for FY 2004 or 2003*

The accompanying notes are an integral part of these statements.

7.
Environmental Protection Agency
Consolidated Statement of Custodial Activity
For the Years Ended September 30, 2004 and 2003
(Dollars in Thousands)

	<u>FY 2004</u>	<u>FY 2003</u>
Revenue Activity:		
Sources of Collections		
Fines and Penalties	\$ 162,948	\$ 161,544
Other	24,463	5,793
Total Cash Collections	\$ 187,411	\$ 167,337
Accrual Adjustment	(24,865)	7,172
Total Custodial Revenue (Note 24)	\$ 162,546	\$ 174,509
Disposition of Collections:		
Transferred to Others (General Fund)	\$ 187,194	\$ 165,440
Increases/Decreases in Amounts to be Transferred	(24,648)	9,069
Total Disposition of Collections	\$ 162,546	\$ 174,509
 Net Custodial Revenue Activity (Note 24)	 \$ 0	 \$ 0

The accompanying notes are an integral part of these statements.

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

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

These consolidating financial statements have been prepared to report the financial position and results of operations of the U S. Environmental Protection Agency (EPA or Agency) for the Hazardous Substance Superfund (Superfund) Trust Fund and All Other Funds, as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The reports have been prepared from the financial system and records of the Agency in accordance with Form and Content of Agency Financial Statements, OMB Bulletin No. 01-09, and the EPA's accounting policies which are summarized in this note. In addition to the reports required by OMB Bulletin No. 01-09, 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 2004 the reporting entities are grouped as the Superfund Trust Fund and All Other Funds.

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.

The accompanying financial statements include the accounts of all funds described in this note. EPA uses an expense allocation methodology as a financial statement estimate to present EPA programs' full cost. This methodology is used because Superfund programs may charge some costs directly to the Superfund Trust Fund and charge the remainder of their costs to All Other Funds in the Agency-wide appropriations. These amounts are presented as Expenses from Other Appropriations on the Statement of Net Cost and as Income from Other Appropriations on the Statement of Changes in Net Position and the Statement of Financing. (See Note 23.)

In addition, specific general support services costs (e.g., rent, communications, utilities, and mail operations) initially charged to the Agency's Science and Technology (S&T) and Environment Programs and Management (EPM) appropriations, are allocated to the Superfund Trust Fund. During the year, these costs are allocated based on a ratio of Superfund direct labor hours to the Agency total of all direct labor hours, using budgeted or actual full-time equivalent personnel charged to these appropriations. Agency general support services cost charges to the Superfund Trust Fund may not exceed the ceilings established in its appropriation. (See Note 23.)

All Other Funds

All Other Funds include other Trust Fund appropriations, General Fund appropriations, Revolving Funds, Special Funds, the Agency Budgetary Clearing accounts, Deposit Funds, General Fund Receipt accounts, the Environmental Services Special Fund Receipt Account, the Miscellaneous Contributed Funds Trust Fund, and General Fund appropriations transferred from other federal agencies as authorized by the Economy Act of 1932. General Fund appropriation activities that no longer receive current definite appropriations but have unexpended authority are the Asbestos Loan Program and Energy, Research and Development. Detailed descriptions of All Other Funds are as follows:

The Leaking Underground Storage Tank (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 2005.

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.

The State and Tribal Assistance Grants (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

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 2004, 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

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.

The Office of Inspector General (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

The Buildings and Facilities 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.

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.

The Asbestos Loan Program was authorized by the Asbestos School Hazard Abatement Act of 1986 to finance control of asbestos building materials in schools. Funds have not been appropriated for this Program since FY 1993. For FY 1993 and FY1992, the program was funded by a subsidy appropriated from the General Fund for the actual cost of financing the loans, and by borrowing from Treasury for the unsubsidized portion of the loan. The Program Fund disburses the subsidy to the Financing Fund for increases in the subsidy. The Financing Fund receives the subsidy payment, borrows from Treasury and collects the asbestos loans. The Asbestos Loan Program is accounted for

under Treasury 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 Federal Insecticide, Fungicide and Rodenticide Act (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

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)

The Working Capital Fund (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 solely of Agency program offices. Accordingly, revenues generated by WCF and expenses recorded by the program offices for use of such services along with the related advances/liabilities, are eliminated on consolidation.

The 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.

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.

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.

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.

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.

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.

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.

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

Superfund

Congress adopts an annual appropriation amount to be available until expended for the Superfund Trust Fund. A transfer account for the Superfund Trust Fund has been established for purposes of carrying out the program activities. As the Agency disburses obligated amounts from the transfer account, the Agency draws down monies from the Superfund Trust Fund at Treasury to cover the amounts being disbursed.

All Other Funds

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

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 to offset costs incurred for providing the Agency administrative support for computer support and postage.

Funds transferred from other federal agencies are funded by a 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, deposit accounts, and receipt accounts receive no appropriated funds. Amounts are recorded to the clearing and deposit accounts pending further disposition. Amounts recorded to the receipt accounts capture amounts collected for or payable to the Treasury General Fund.

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."

Superfund

The Superfund program receives most of its funding through appropriations that may be used, within specific statutory limits, for operating and capital expenditures (primarily equipment). Additional financing for the Superfund program is obtained through: reimbursements from other federal agencies, 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.

All Other Funds

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. (See Note 2)

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 (See Note 5.)

Superfund

CERCLA as amended by SARA provides for the recovery of costs from PRPs. However, cost recovery expenditures are expensed when incurred since there is no assurance that these funds will be recovered.

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

The Agency also records accounts receivable from states for a percentage of Superfund site remedial action costs incurred by the Agency within those states. As agreed to under 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.

All Other Funds

The majority of receivables for All Other 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.

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 (See Note 6)

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. (See Note 7.)

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. (See Note 17.)

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 (See Note 9)

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 are 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.

In FY 1997, EPA's Working Capital Fund, a revenue generating activity, implemented requirements to capitalize software if the purchase price was \$100 thousand or more with an estimated useful life of 2 years or more. In FY 2001, the Agency began capitalizing software for All Other Funds 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 2003 and FY 2004, 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" (See Note 33)

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, 2004 and 2003, consist of the following:

	FY 2004			FY 2003		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Trust Funds:						
Superfund	\$ 199,406	\$	\$ 199,406	\$ 26,448	\$	\$ 26,448
LUST	14,825		14,825	34,008		34,008
Oil Spill & Misc.	10,222		10,222	5,581		5,581
Revolving Funds:						
FIFRA/Tolerance	4,913		4,913	1,826		1,826
Working Capital	53,560		53,560	57,780		57,780
Cr Reform Finan	492		492	492		492
Appropriated	11,639,189		11,639,189	11,526,823		11,526,823
Other Fund Types	136,646	5,892	142,538	111,599	20,248	131,847
Total	<u>\$ 12,059,253</u>	<u>\$ 5,892</u>	<u>\$ 12,065,145</u>	<u>\$ 11,764,557</u>	<u>\$ 20,248</u>	<u>\$ 11,784,805</u>

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

Status of Fund Balances:	FY 2004		FY 2003	
	Superfund	All Others	Superfund	All Others
Unobligated Amounts in Fund Balances				
Available for Obligation	\$ 823,694	\$ 2,080,155	\$ 766,786	\$ 2,011,471
Unavailable for Obligation	19	92,842	19	87,404
Net Receivables from Invested Balances	(2,381,849)	(89,725)	(2,579,726)	(66,574)
Balances in Treasury Trust Fund (Note 17)	188,182	13,256	866	12,377
Obligated Balance not yet Disbursed	1,569,360	9,638,406	1,838,503	9,582,206
Balances not subject to Obligation		130,805		131,473
Totals	<u>\$ 199,406</u>	<u>\$ 11,865,739</u>	<u>\$ 26,448</u>	<u>\$ 11,758,357</u>

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 2004 and FY 2003 no differences existed between Treasury's accounts and EPA's statements for fund balances with Treasury.

Note 3. Cash

As of September 30, 2004 and 2003, cash consists of an imprest fund of \$10 thousand

Note 4. Investments

As of September 30, 2004 and 2003, investments consist of the following.

		Cost	Unamortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value
<u>Superfund</u>						
Intragovernmental Securities:						
Non-Marketable	FY 2004	\$ 2,226,973	\$ 9,677	\$ 38	\$ 2,217,334	\$ 2,217,334
	FY 2003	\$ 2,507,927	\$ (8,183)	\$ 37	\$ 2,516,147	\$ 2,516,147
<u>All Others</u>						
Intragovernmental Securities:						
Non-Marketable	FY 2004	\$ 2,232,674	\$ (57,213)	\$ 27,277	\$ 2,317,164	\$ 2,317,164
	FY 2003	\$ 2,037,560	\$ (51,290)	\$ 25,834	\$ 2,114,684	\$ 2,114,684

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, 2004 and 2003, consist of the following:

	FY 2004		FY 2003	
	Superfund	All Others	Superfund	All Others
Intragovernmental Assets:				
Accounts & Interest Receivable	\$ 27,212	\$ 89,267	\$ 34,665	\$ 119,941
Non-Federal Assets:				
Unbilled Accounts Receivable	\$ 91,758	\$ 1,682	\$ 109,272	\$ 1,668
Accounts & Interest Receivable	911,452	104,269	815,119	113,130
Less Allowance for Uncollectibles	(634,062)	(60,604)	(495,905)	(49,502)
Total	\$ 369,148	\$ 45,347	\$ 428,486	\$ 65,296

The Allowance for Doubtful 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, 2004, consist of the following:

	Superfund	All Others	Combined Totals
Intragovernmental Assets:			
Advances to Federal Agencies	\$ 32	\$ 735	\$ 767
Advances to Working Capital Fund	6,749		6,749
Advances for Postage		553	553
Total Intragovernmental Assets	\$ 6,781	\$ 1,288	\$ 8,069
Non-Federal Assets:			
Travel Advances	\$ (53)	\$ (955)	\$ (1,008)
Letter of Credit Advances		271	271
Grant Advances		1,164	1,164
Other Advances	751	79	830
Operating Materials and Supplies	1	199	200
Inventory for Sale		51	51
Total Non-Federal Assets	\$ 699	\$ 809	\$ 1,508

Other Assets for September 30, 2003, consist of the following

	Superfund	All Others	Combined Totals
Intragovernmental Assets:			
Advances to Federal Agencies	\$ 146	\$ 3,233	\$ 3,379
Advances to Working Capital Fund	7,268		7,268
Advances for Postage		594	594
Total Intragovernmental Assets	\$ 7,414	\$ 3,827	\$ 11,241
Non-Federal Assets:			
Travel Advances	\$ (51)	\$ (918)	\$ (969)
Letter of Credit Advances		601	601
Grant Advances		1,544	1,544
Other Advances	731	95	826
Operating Materials and Supplies		217	217
Inventory for Sale		51	51
Securities Received in Settlement for Debt		1,912	1,912
Total Non-Federal Assets	\$ 680	\$ 3,502	\$ 4,182

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 present value of loans is the amount of the gross loan receivable less the present value of the subsidy. For All Other Funds, the loans receivable, allowances, and the nature and amounts of the subsidy expenses associated with the loans as of September 30, 2004 and 2003, are as follows:

	<u>FY 2004</u>			<u>FY 2003</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	\$ 25,243	\$	\$ 25,243	\$ 33,245	\$	\$ 33,245
Direct Loans Obligated After FY 1991	30,466	(6,782)	23,684	34,597	(14,336)	20,261
Total	\$ 55,709	\$ (6,782)	\$ 48,927	\$ 67,842	\$ (14,336)	\$ 53,506

* 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
Direct Loan Subsidy Expense - FY 2004	\$	\$	\$ 0
Downward Subsidy Reestimate - FY 2004	(2,660)	(2,894)	(5,554)
FY 2004 Totals	\$ (2,660)	(2,894)	(5,554)
Direct Loan Subsidy Expense - FY 2003	\$ 377	\$ 528	\$ 905
Downward Subsidy Reestimate - FY 2003	(170)	(201)	(371)
FY 2003 Totals	\$ 207	\$ 327	\$ 534

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, 2004

	Superfund	All Others	Combined Total
Intragovernmental:			
Accounts Payable to other Federal Agencies	\$ 1,602	\$ 206	\$ 1,808
Liability for Allocation Transfers	31,286		31,286
Expenditure Transfers Payable to other EPA Funds	69,793		69,793
Accrued Liabilities, Federal	38,100	37,386	75,486
Total	\$ 140,781	\$ 37,592	\$ 178,373
Non-Federal:			
Accounts Payable, Non-Federal	\$ 36,546	\$ 56,716	\$ 93,262
Advances Payable, Non-Federal	3	16	19
Interest Payable	-- *	41	41
Grant Liabilities	21,694	572,430	594,124
Other Accrued Liabilities, Non-Federal	87,126	107,279	194,405
Total	\$ 145,369	\$ 736,482	\$ 881,851

* Dashes indicate a balance below the rounding level of one thousand dollars

The Accounts Payable and Accrued Liabilities consist of the following as of September 30, 2003

	Superfund	All Others	Combined Total
Intragovernmental:			
Accounts Payable to other Federal Agencies	\$ 593	\$ 618	\$ 1,211
Liability for Allocation Transfers	20,017		20,017
Expenditure Transfers Payable to other EPA Funds	86,087		86,087
Accrued Liabilities, Federal	38,934	69,538	108,472
Total	\$ 145,631	\$ 70,156	\$ 215,787
Non-Federal:			
Accounts Payable, Non-Federal	\$ 45,880	\$ 71,160	\$ 117,040
Advances Payable, Non-Federal	3	13	16
Interest Payable	553	2	555
Grant Liabilities	21,714	545,872	567,586
Other Accrued Liabilities, Non-Federal	97,400	105,737	203,137
Total	\$ 165,550	\$ 722,784	\$ 888,334

Note 9. General Plant, Property and Equipment

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

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

	Superfund			All Others		
	Acquisition Value	Accumulated Depreciation	Net Book Value	Acquisition Value	Accumulated Depreciation	Net Book Value
EPA-Held Equipment	\$ 29,159	\$ (15,544)	\$ 13,615	\$ 159,685	\$ (97,249)	\$ 62,436
Software	7,432	(1,147)	6,285	98,202	(13,734)	84,468
Contractor-Held Property						
Superfund Site-Specific	31,328	(11,702)	19,626			
General	9,556	(1,261)	8,295	20,687	(6,422)	14,265
Land and Buildings				547,876	(114,184)	433,692
Capital Leases				49,956	(19,275)	30,681
Total	\$ 77,475	\$ (29,654)	\$ 47,821	\$ 876,406	\$ (250,864)	\$ 625,542

As of September 30, 2003, Plant, Property and Equipment consisted of the following:

	Superfund			All Others		
	Acquisition Value	Accumulated Depreciation	Net Book Value	Acquisition Value	Accumulated Depreciation	Net Book Value
EPA-Held Equipment	\$ 28,990	\$ (15,664)	\$ 13,326	\$ 158,199	\$ (97,785)	\$ 60,414
Software	3,649	(138)	3,511	53,888	(4,397)	49,491
Contractor-Held Property						
Superfund Site-Specific	40,505	(16,642)	23,863			
General	7,607	(2,452)	5,155	15,679	(6,429)	9,250
Land and Buildings				536,212	(100,826)	435,386
Capital Leases				41,535	(16,605)	24,930
Total	\$ 80,751	\$ (34,896)	\$ 45,855	\$ 805,513	\$ (226,042)	\$ 579,471

Note 10. Debt

The debt due to Treasury consists of the following as of September 30, 2004 and 2003

All Other Funds	FY 2004			FY 2003		
	<u>Beginning Balance</u>	<u>Net Borrowing</u>	<u>Ending Balance</u>	<u>Beginning Balance</u>	<u>Net Borrowing</u>	<u>Ending Balance</u>
Intragovernmental:						
Debt to Treasury	\$ <u>21,189</u>	\$ <u>2,912</u>	\$ <u>24,101</u>	\$ <u>24,290</u>	\$ <u>(3,101)</u>	\$ <u>21,189</u>

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, 2004

Other Liabilities – Intragovernmental	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Superfund – Current			
Employer Contributions & Payroll Taxes	\$ 1,918	\$ 1,918	
Other Advances	1,538		1,538
Advances, HRSTF Cashout	32,724		32,724
Deferred HRSTF Cashout	3		3
Superfund - Non-Current			
Unfunded FECA Liability		1,569	1,569
Total Superfund	\$ <u>36,183</u>	\$ <u>1,569</u>	\$ <u>37,752</u>
All Other – Current			
Employer Contributions & Payroll Taxes	\$ 8,842	\$ 8,842	
WCF Advances	6,749		6,749
Other Advances	1,984		1,984
Liability for Deposit Funds	(30)		(30)
Resources Payable to Treasury	1		1
Subsidy Payable to Treasury	437		437
All Other - Non-Current			
Payable to Treasury Judgment Fund *		22,000	22,000
Unfunded FECA Liability		7,135	7,135
Total All Other	\$ <u>17,983</u>	\$ <u>29,135</u>	\$ <u>47,118</u>

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Other Liabilities - Non-Federal			
Superfund – Current			
Unearned Advances, Non- Federal	\$ 46,211	\$	\$ 46,211
All Other – Current			
Unearned Advances, Non- Federal	\$ 10,613	\$	\$ 10,613
Liability for Deposit Funds, Non-Federal	5,601		5,601
All Other - Non-Current			
Capital Lease Liability		41,491	41,491
Total All Other	\$ 16,214	\$ 41,491	\$ 57,705

* This amount represents a Contract Disputes Act settlement paid by the Treasury Judgment Fund on EPA's behalf for which the Agency is liable

Other Liabilities consist of the following as of September 30, 2003:

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Other Liabilities – Intragovernmental			
Superfund – Current			
Employer Contributions & Payroll Taxes	\$ 1,379	\$	\$ 1,379
Other Advances	1,811		1,811
Advances, HRSTF Cashout	25,016		25,016
Deferred HRSTF Cashout	947		947
Superfund - Non-Current			
Unfunded FECA Liability		1,447	1,447
Total Superfund	\$ 29,153	\$ 1,447	\$ 30,600
All Other – Current			
Employer Contributions & Payroll Taxes	\$ 6,589	\$	\$ 6,589
WCF Advances	7,269		7,269
Other Advances	1,674		1,674
Liability for Deposit Funds	(515)		(515)
Resources Payable to Treasury	1		1
All Other - Non-Current			
Unfunded FECA Liability		6,593	6,593
Total All Other	\$ 15,018	\$ 6,593	\$ 21,611
Other Liabilities - Non-Federal			
Superfund – Current			
Unearned Advances, Non-Federal	\$ 49,809	\$	\$ 49,809
All Other – Current			
Unearned Advances, Non-Federal	\$ 5,044	\$	\$ 5,044
Liability for Deposit Funds, Non-Federal	12,261		12,261
All Other - Non-Current			
Capital Lease Liability		35,800	35,800
Total All Other	\$ 17,305	\$ 35,800	\$ 53,105

Note 13. Leases

Capital Leases:

The Capital Leases for All Other Funds as of September 30, 2004 and 2003, consist of the following:

Summary of Assets Under Capital Lease:	FY 2004	FY 2003
Real Property	\$ 40,913	\$ 40,913
Personal Property	2,606	622
Software License	6,437	
Total	<u>\$ 49,956</u>	<u>\$ 41,535</u>
Accumulated Amortization	<u>\$ 19,275</u>	<u>\$ 16,605</u>

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

During FY 2004 EPA entered into lease agreements for an IBM Supercomputer and Microsoft Office software. These leases terminate in 2006 and 2009, respectively. These charges are expended out of the Working Capital Fund.

The total future minimum lease payments of the capital leases are listed below.

<u>Future Payments Due:</u>	<u>All Others</u>
Fiscal Year	
2005	\$ 8,734
2006	8,716
2007	8,050
2008	7,821
2009	6,295
After 5 Years	<u>71,014</u>
Total Future Minimum Lease Payments	110,630
Less Imputed Interest	<u>(69,139)</u>
Net Capital Lease Liability	<u>\$ 41,491</u>
Liabilities not Covered by Budgetary Resources (See Note 12)	<u>\$ 41,491</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.

For All Other Funds, EPA has three direct operating leases for land and buildings housing scientific laboratories and/or computer facilities during FY 2004. 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 that expired in FY 2001 was extended until FY 2007. These charges are expended from the EPM appropriation. The total minimum future costs of operating leases are listed below.

Fiscal Year	Operating Leases, Land & Buildings --All Others	
2005	\$	87
2006		87
2007		81
2008		74
2009		74
Beyond 2009		698
Total Future Minimum Lease Payments	\$	1,101

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, 2004 and 2003, consists of the following:

	<u>FY 2004</u>		<u>FY 2003</u>	
	<u>Superfund</u>	<u>All Others</u>	<u>Superfund</u>	<u>All Others</u>
FECA Actuarial Liability	\$ 7,263	33,018	\$ 7,937	36,159

The FY 2004 present value of these estimated outflows are calculated using a discount rate of 4.883 percent in the first year, and 5.235 percent in the years thereafter. The estimated future costs are recorded as an unfunded liability.

Note 15. 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 16. Unexpended Appropriations, All Other Funds

As of September 30, 2004 and 2003, the Unexpended Appropriations consist of the following for All Other Funds:

Unexpended Appropriations:	FY 2004	FY 2003
Unobligated		
Available	\$ 1,911,797	\$ 1,797,410
Unavailable	39,591	41,667
Undelivered Orders	8,908,748	8,929,159
Total	<u>\$ 10,860,136</u>	<u>\$ 10,768,236</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 (Audited)

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. (See Note 36 for more information on the status of this trust fund.)

The following reflects the Superfund Trust Fund maintained by Treasury as of September 30, 2004 and 2003. 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 2004**Undistributed Balances**

	<u>EPA</u>	<u>Treasury</u>	<u>Combined</u>
Uninvested Fund Balance	\$ _____	\$ 188,182	\$ 188,182
Total Undisbursed Balance		188,182	188,182
Interest Receivable		38	38
Investments, Net	<u>2,402,074</u>	<u>(184,778)</u>	<u>2,217,296</u>
Total Assets	<u>\$ 2,402,074</u>	<u>\$ 3,442</u>	<u>\$ 2,405,516</u>

Liabilities & Equity

Liability for Allocation to CDC		11,061	11,061
Equity (Note 36)	<u>\$ 2,402,074</u>	<u>\$ (7,619)</u>	<u>\$ 2,394,455</u>
Total Liabilities and Equity	<u>\$ 2,402,074</u>	<u>\$ 3,442</u>	<u>\$ 2,405,516</u>

Receipts

Corporate Environmental	\$ _____	\$ 867	\$ 867
Cost Recoveries		74,063	74,063
Fines & Penalties	<u>_____</u>	<u>2,818</u>	<u>2,818</u>
Total Revenue		77,748	77,748
Appropriations Received		1,257,536	1,257,536
Interest Income	<u>_____</u>	<u>27,380</u>	<u>27,380</u>
Total Receipts	<u>\$ _____</u>	<u>\$ 1,362,664</u>	<u>\$ 1,362,664</u>

Outlays

Transfers to/from EPA, Net	\$ 1,256,790	\$ (1,256,790)	\$ 0
Transfers to CDC	<u>_____</u>	<u>(30,763)</u>	<u>(30,763)</u>
Total Outlays	<u>1,256,790</u>	<u>(1,287,553)</u>	<u>(30,763)</u>
Net Income	<u>\$ 1,256,790</u>	<u>\$ 75,111</u>	<u>\$ 1,331,901</u>

<u>SUPERFUND FY 2003</u>	<u>EPA</u>	<u>Treasury</u>	<u>Combined</u>
Undistributed Balances			
Uninvested Fund Balance	\$ _____	\$ 866	\$ 866
Total Undisbursed Balance		866	866
Interest Receivable		37	37
Investments, Net	<u>2,599,744</u>	<u>(83,634)</u>	<u>2,516,110</u>
Total Assets	<u>\$ 2,599,744</u>	<u>\$ (82,731)</u>	<u>\$ 2,517,013</u>
Liabilities & Equity			
Equity (Note 36)	<u>\$ 2,599,744</u>	<u>\$ (82,731)</u>	<u>\$ 2,517,013</u>
Total Liabilities and Equity	<u>\$ 2,599,744</u>	<u>\$ (82,731)</u>	<u>\$ 2,517,013</u>
Receipts			
Corporate Environmental	\$ _____	\$ (99,355)	\$ (99,355)
Cost Recoveries		146,502	146,502
Fines & Penalties	<u>_____</u>	<u>2,873</u>	<u>2,873</u>
Total Revenue		50,020	50,020
Appropriations Received		632,307	632,307
Interest Income	<u>_____</u>	<u>48,945</u>	<u>48,945</u>
Total Receipts	<u>\$ _____</u>	<u>\$ 731,272</u>	<u>\$ 731,272</u>
Outlays			
Transfers to EPA	\$ 1,283,223	\$ (1,283,223)	\$ 0
Transfers to CDC	<u>0</u>	<u>(80,200)</u>	<u>(80,200)</u>
Total Outlays	<u>1,283,223</u>	<u>(1,363,423)</u>	<u>(80,200)</u>
Net Income	<u>\$ 1,283,223</u>	<u>\$ (632,151)</u>	<u>\$ 651,072</u>

LUST (Audited)

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FYs 2004 and 2003 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 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	<u>\$ 89,725</u>	<u>\$ 2,240,698</u>	<u>\$ 2,330,423</u>
Liabilities & Equity			
Equity	\$ 89,725	\$ 2,240,698	\$ 2,330,423
Total Liabilities and Equity	<u>\$ 89,725</u>	<u>\$ 2,240,698</u>	<u>\$ 2,330,423</u>
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	<u>\$ _____</u>	<u>\$ 255,759</u>	<u>\$ 255,759</u>
Outlays			
Transfers to/from EPA, Net	\$ 75,552	\$ (75,552)	\$ 0
Total Outlays	<u>75,552</u>	<u>(75,552)</u>	<u>0</u>
Net Income	<u>\$ 75,552</u>	<u>\$ 180,207</u>	<u>\$ 255,759</u>

LUST FY 2003	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	\$ _____	\$ 12,377	\$ 12,377
Total Undisbursed Balance		12,377	12,377
Interest Receivable		25,834	25,834
Investments, Net	66,574	2,022,279	2,088,853
Total Assets	<u>\$ 66,574</u>	<u>\$ 2,060,490</u>	<u>\$ 2,127,064</u>
Liabilities & Equity			
Equity	\$ 66,574	\$ 2,060,490	\$ 2,127,064
Total Liabilities and Equity	<u>\$ 66,574</u>	<u>\$ 2,060,490</u>	<u>\$ 2,127,064</u>
Receipts			
Highway TF Tax	\$ _____	\$ 177,340	\$ 177,340
Airport TF Tax		12,241	12,241
Inland TF Tax		448	448
Refund Gasoline Tax		(2,064)	(2,064)
Refund Diesel Tax		(3,214)	(3,214)
Refund Aviation Tax		(274)	(274)
Total Revenue		184,477	184,477
Interest Income		64,447	64,447
Total Receipts	<u>\$ _____</u>	<u>\$ 248,924</u>	<u>\$ 248,924</u>
Outlays			
Transfers to/from EPA, Net	\$ 71,843	\$ (71,843)	\$ 0
Total Outlays	<u>71,843</u>	<u>(71,843)</u>	<u>0</u>
Net Income	<u>\$ 71,843</u>	<u>\$ 177,081</u>	<u>\$ 248,924</u>

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, 2004, there are currently five CERCLA Section 106(b) administrative claims. If the claimants are successful, the total losses on the administrative and judicial claims could amount to approximately \$68.0 million. The Environmental Appeals Board has not yet issued final decisions on any of these 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, 2004, there are three 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 \$7.9 to \$13.9 million. The largest claim (estimated range from \$6.0 to \$12.0 million, deemed reasonably possible) is an unasserted Contract Disputes Act matter which EPA will contest if asserted.

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, 2004, there are no material claims pending in the Treasury Judgment Fund.

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, 2004, the EPA has three sites that require clean up stemming from its activities. Costs amounting to \$1.22 million may be paid out of the Treasury Judgment Fund. One claimant's chance of success (\$1 20 million) is characterized as probable, the other two are characterized as reasonably possible.

Accrued Cleanup Cost:

The EPA has 12 sites that will require future clean up associated with permanent closure and two sites with clean up presently underway. The estimated costs are approximately \$8.4 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 2004 estimate for unfunded cleanup costs decreased by \$62 thousand from the FY 2003 estimate. There was a net decrease of \$535 thousand in funded cleanup costs from FY 2003 to FY 2004. EPA could also be potentially liable for cleanup costs, at a GSA-leased site; however, the amounts are not known.

Note 21. Superfund State Credits

Authorizing statutory language for Superfund and related federal regulations require states to enter into 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, 2004, the total remaining state credits have been estimated at \$5.4 million. The estimated ending credit balance on September 30, 2003 was \$9.6 million.

Note 22. 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, 2004, EPA had 15 outstanding preauthorized mixed funding agreements with obligations totaling \$34.0 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

Note 23. Income and Expenses from other Appropriations; 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. (See Note 1B, Reporting Entities, Superfund.)

During FYs 2004 and 2003, 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.

All of the expenses from EPM are distributed between EPA's two Reporting Entities: Superfund and All Other Funds. 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 2004</u>			<u>FY 2003</u>		
	Income From Other Appropriations	Expenses From Other Appropriations	Net Effect	Income From Other Appropriations	Expenses From Other Appropriations	Net Effect
Superfund	\$ 82,776	(82,776)	0	\$ 75,597	(75,597)	0
All Others	<u>(82,776)</u>	<u>82,776</u>	<u>0</u>	<u>(75,597)</u>	<u>75,597</u>	<u>0</u>
Total	\$ <u>0</u>	<u>0</u>	<u>0</u>	\$ <u>0</u>	<u>0</u>	<u>0</u>

In addition, the related general support services costs allocated to the Superfund Trust Fund from the S&T and EPM funds are \$14.1 million for FY 2004 and \$11.9 million for FY 2003.

Note 24. 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.

	FY 2004	FY 2003
Fines, Penalties and Other Miscellaneous Receipts Revenue	<u>\$ 162,546</u>	<u>\$ 174,509</u>
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts		
Accounts Receivable	\$ 103,847	\$ 117,191
Less Allowance for Doubtful Accounts	<u>(51,630)</u>	<u>(40,311)</u>
Total	<u>\$ 52,217</u>	<u>\$ 76,880</u>

Note 25. Statement of Budgetary Resources

Budgetary resources, obligations incurred, and outlays, as presented in the audited Statement of Budgetary Resources, are reconciled to amounts to be included in the Budget of the United States Government, FY 2006, as follows. The Budget of the United States Government with actual numbers for FY 2004 has not yet been published. We expect it will be published by March 2005, 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, will be included in EPA's FY 2005 financial statement disclosures

FY 2004	Budgetary Resources	Obligations	Outlays
<u>Superfund:</u>			
Statement of Budgetary Resources	\$ 2,300,850	\$ 1,477,137	\$ 1,463,868
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other			
Expired Funds *	5,885	5,903	
Reported for Budget of the U. S. Government	<u>\$ 2,306,735</u>	<u>\$ 1,483,040</u>	<u>\$ 1,463,868</u>
<u>All Other Funds:</u>			
Statement of Budgetary Resources	\$ 10,851,239	\$ 8,678,244	\$ 8,233,315
Funds Reported by Other Federal Entities	1,185	1,185	
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	622	(6,726)	
Expired and Immaterial Funds *	(91,468)	2,740	
Reported for Budget of the U. S. Government	<u>\$ 10,761,578</u>	<u>\$ 8,675,443</u>	<u>\$ 8,233,315</u>

Budgetary resources, obligations incurred, and outlays, as presented in the audited Statement of Budgetary Resources, are reconciled to amounts included in the Budget of the United States Government, FY 2005-Appendix (Budget Appendix), as follows The Budget Appendix with actual

numbers for FY 2003 was published after the audited financial statements were issued. In accordance with FASAB Technical Bulletin 2002-2, the applicable Budget Appendix amounts for FY 2003 are included below.

FY 2003	Budgetary Resources	Obligations	Outlays
<u>Superfund</u>			
Statement of Budgetary Resources	\$ 2,317,206	\$ 1,550,401	\$ 1,445,513
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other			1,313
Expired Funds *	2,114	2,133	
Reporting by other Agencies with Allocations	17,636	5,499	7,741
OMB-level Adjustment – appropriation temporarily not available, special account interest	(141,000)		
Rounding differences **	(1,956)	(33)	433
Budget of the United States Government, final	\$ 2,194,000	\$ 1,558,000	\$ 1,455,000
<u>All Other</u>			
Statement of Budgetary Resources	\$ 9,910,793	\$ 7,811,921	\$ 7,397,843
Funds Reported by Other Federal Entities	(353)		(36)
Adjustments to Unliquidated Obligations, Unfilled Customer Orders and Other	622		26
Expired and Immaterial Funds *	(83,946)	4,142	
Rounding differences **	(1,116)	(63)	167
Budget of the United States Government, final	\$ 9,826,000	\$ 7,816,000	\$ 7,398,000

* 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 26. 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:

Superfund	FY 2004	FY 2003
Recoveries of Prior Year Obligations-downward adjustments of prior years' obligations	\$ 98,848	\$ 124,797
Not Available-rescinded authority	(7,464)	(8,274)

All Others	FY 2004	FY 2003
Recoveries of Prior Year Obligations-downward adjustments of prior years' obligations	\$ 95,927	\$ 114,437
Temporarily Not Available-rescinded authority	(790)	
Permanently Not Available		
Payments to Treasury	(2,641)	(3,101)
Rescinded authority	(49,099)	(49,362)
Canceled authority	(19,463)	(23,719)
Total Permanently Not Available	\$ (71,203)	\$ (76,182)

Note 27. Unobligated Balances Available

The availability of unobligated balances consists of the following as of September 30, 2004 and 2003. 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.

Superfund	FY 2004	FY 2003
Unexpired Unobligated Balance	\$ 823,694	\$ 766,786
Expired Unobligated Balance	19	19
Total	\$ 823,713	\$ 766,805
All Others		
Unexpired Unobligated Balance	\$ 2,080,155	\$ 2,011,471
Expired Unobligated Balance	92,840	87,401
Total	\$ 2,172,995	\$ 2,098,872

Note 28. Offsetting Receipts

Distributed offsetting receipts credited to the general fund, special fund, or trust fund receipt accounts offset gross outlays. For FYs 2004 and 2003, the following receipts were generated from these activities:

Superfund	FY 2004	FY 2003
Trust Fund Recoveries	\$ 74,063	\$ 146,502
Total	\$ 74,063	\$ 146,502
All Others		
Special Fund Environmental Service	\$ 13,688	\$ 11,649
Downward Re-estimates of Subsidies	5,554	-- *
Trust Fund Appropriation	1,257,536	632,307
Total	\$ 1,276,778	\$ 643,956

* Not reported as part of Offsetting Receipts in FY 2003 FY 2003 downward re-estimates were \$371 thousand

Note 29. 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 2004 and 2003, the following line items are reconciled to the increases or decreases in those liabilities

Statement of Financing lines FY 2004:	Superfund	All Others	Combined Total
Resources that fund prior period expenses	(2,243)	(11,612)	(13,855)
Components requiring or generating resources in future periods			
Increases in environmental liabilities		1,244	1,244
Increase in contingencies		22,425	22,425
Total	\$ (2,243)	\$ 12,057	\$ 9,814
Increases (Decreases) in Liabilities Not Covered by Budgetary Resources and Reconciling Items			
Unfunded Annual Leave Liability	\$ (1,690)	\$ (5,339)	\$ (7,029)
Unfunded Contingent Liability		1,607	1,607
Unfunded Judgment Fund Liability		22,000	22,000
Unfunded Workers Compensation Liability	122	542	664
Actuarial Workers Compensation Liability	(675)	(3,140)	(3,815)
Unfunded Clean-up Costs Liability		61	61
Allowance for Subsidy		(3,097)	(3,097)
Subsidy re-estimates		(577)	(577)
Total	\$ (2,243)	\$ 12,057	\$ 9,814

Statement of Financing lines FY 2003:

	Superfund	All Others	Combined Total
Components requiring or generating resources in future periods			
Increase in annual leave liability	\$ 1,088	\$ 5,647	\$ 6,735
Increases in environmental liabilities		(3,276)	(3,276)
Increase in workers compensation costs	246	4,591	4,837
Total	<u>\$ 1,334</u>	<u>\$ 6,962</u>	<u>\$ 8,296</u>
Increases (Decreases) in Liabilities Not Covered by Budgetary Resources and Reconciling Items			
Unfunded Annual Leave Liability	\$ 1,088	\$ 5,888	\$ 6,976
Unfunded Contingent Liability		(2)	(2)
Unfunded Workers Compensation Liability	7	191	198
Actuarial Workers Compensation Liability	239	4,400	4,639
Subsidy Payable to Treasury		(371)	(371)
Unfunded Clean-up Costs Liability		(3,274)	(3,274)
Allowance for subsidy		201	201
Subsidy re-estimates		(71)	(71)
Total	<u>\$ 1,334</u>	<u>\$ 6,962</u>	<u>\$ 8,296</u>

Note 30. Costs Not Assigned to Goals

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.

FY 2003's Statement of Net Cost by Goal has \$12.8 million in gross costs not assigned to goals. This amount is comprised of decreases of \$3.3 million in environmental cleanup costs, \$1.4 million in bad debt expenses, and \$1.2 million in capitalized overhead charges, offset by increases of \$0.4 million in undistributed federal payroll-related costs, \$3.8 million in depreciation expenses not assigned, \$0.2 million in imputed costs, \$0.3 million in other unfunded expenses, and \$14.0 million in operating program expenses.

Note 31. Transfers-In and Out, Statement of Changes in Net Position**Appropriation Transfers, In/Out:**

For FYs 2004 and 2003, 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	Superfund FY 2004	Superfund FY 2003	All Others FY 2004	All Others FY 2003
GSA Building Fund			(1,538)	
Appalachian Regional Commission			60	
EPM	\$	\$	1,630	\$ 4,550
Total Appropriation Transfers	\$	\$	152	\$ 4,550
Net Transfers from Invested Funds	1,256,790	1,283,223	75,552	71,843
Transfers to Other Agencies	(5,157)	(5,155)		
Allocations Rescinded	7,463	8,274	448	470
Total of Net Transfers on Statement of Budgetary Resources	\$ 1,259,096	\$ 1,286,342	\$ 76,152	\$ 76,863

Transfers- In/Out Without Reimbursement, Budgetary:

For FY 2004 and 2003, 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	Superfund FY 2004	Superfund FY 2003	All Others FY 2004	All Others FY 2003
Transfers-in(out), expenditure, Superfund to S&T fund	\$ (44,433)	\$ (85,608)	\$ 44,433	\$ 85,608
Transfers-in(out), expenditure, Superfund to OIG fund	(13,136)	(12,659)	13,136	12,659
Transfers-out, nonexpenditure, from Superfund to other federal agencies	(5,157)	(5,155)		
Transfer-out, expenditure, to Superfund Special Accounts		(9,642)		
Transfers-out, nonexpenditure, from Treasury trust fund to CDC	(30,763)	(80,200)		
Transfers-in, nonexpenditure, Oil Spill			16,113	15,480
Transfer-in(out), cancelled funds	5,903	2,133	(5,903)	(2,133)
Total Transfers in(out) without Reimbursement, Budgetary	\$ (87,586)	\$ (191,131)	\$ 67,779	\$ 111,614

Transfers In/Out without Reimbursement, Other Financing Sources:

For FYs 2004 and 2003, Transfers In/Out without Reimbursement under Other Financing Sources on the Statement of Changes in Net Position are comprised of transfers of property, plant and equipment between EPA funds and transfers 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	Superfund FY 2004	Superfund FY 2003	All Others FY 2004	All Others FY 2003
Transfer-in(out) of property, between Superfund and EPM	\$ (1)	\$ 84	\$ 1	\$ (84)
Transfers of negative subsidy, transfer-in paid and funded in year following transfer-(out)			(436)	371
Total Transfers in(out) without Reimbursement, Budgetary	\$ (1)	\$ 84	\$ (435)	\$ 287

Note 32. 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 2004 were \$19.7 million and \$106.3 million for Superfund and All Other Funds, respectively. For FY 2003, the estimates for Superfund and All Other Funds were \$17.8 million and \$103.2 million, respectively.

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 2004 entries for Judgment Fund payments for Superfund and All Other Funds totaled \$23.6 thousand and \$2.8 million, respectively. For FY 2003, entries for Judgment Fund payments for Superfund and All Other Funds totaled \$2.2 million and \$5 million, respectively.

Note 33. Payroll and Benefits Payable

Payroll and benefits payable to EPA employees for the years ending September 30, 2004 and 2003, consist of the following:

FY 2004 Payroll & Benefits Payable	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total
Superfund – Current			
Accrued Funded Payroll & Benefits	\$ 5,307	\$	\$ 5,307
Withholdings Payable	4,059		4,059
Employer Contributions Payable-TSP	282		282
Other Post-employment Benefits Payable	3		3
Accrued Unfunded Annual Leave		22,044	22,044
Total - Superfund - Current	\$ 9,651	\$ 22,044	\$ 31,695
All Other Funds - Current			
Accrued Funded Payroll and Benefits	\$ 24,538	\$	\$ 24,538
Withholdings Payable	18,712		18,712
Employer Contributions Payable-TSP	1,301		1,301
Other Post-employment Benefits Payable	33		33
Accrued Funded Leave, WCF	320		320
Accrued Unfunded Annual Leave		104,147	104,147
Total - All Other Funds - Current	\$ 44,904	\$ 104,147	\$ 149,051
FY 2003 Payroll & Benefits Payable			
Superfund - Current			
Accrued Funded Payroll and Benefits	\$ 4,097	\$	\$ 4,097
Withholdings Payable	3,007		3,007
Employer Contributions Payable-TSP	197		197
Other Post-employment Benefits Payable	3		3
Accrued Unfunded Annual Leave		23,735	23,735
Total - Superfund - Current	\$ 7,304	\$ 23,735	\$ 31,039
All Other Funds - Current			
Accrued Funded Payroll and Benefits	\$ 17,645	\$	\$ 17,645
Withholdings Payable	14,366		14,366
Employer Contributions Payable-TSP	940		940
Other Post-employment Benefits Payable	33		33
Accrued Funded Leave, WCF	320		320
Accrued Unfunded Annual Leave		109,487	109,487
Total - All Other Funds - Current	\$ 33,304	\$ 109,487	\$ 142,791

Note 34. 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 for All Other Funds.

	FY 2004	FY 2003
Rescissions to General Appropriations	\$ 49,105	\$ 48,147
Canceled General Authority	19,463	23,719
Total Other Adjustments	\$ 68,568	\$ 71,866

Note 35. Nonexchange Revenue, Statement of Changes in Net Position

The Nonexchange Revenue, Budgetary Financing Sources, on the Statement of Changes in Net Position for FYs 2004 and 2003 consists of the following items

FY 2004	Superfund	All Others	Combined Total
Interest on Trust Fund Investments	\$ 27,380	\$ 66,762	\$ 94,142
Tax Revenue, Net of Refunds	867	188,997	189,864
Fines and Penalties Revenue	1,992	(19)	1,973
Special Receipt Fund Revenue		13,746	13,746
	<hr/>	<hr/>	<hr/>
Total Nonexchange Revenue	\$ 30,239	\$ 269,486	\$ 299,725
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
FY 2003	Superfund	All Others	Combined Total
Interest on Trust Fund Investments	\$ 48,945	\$ 64,447	\$ 113,392
Tax Revenue, Net of Refunds*	(99,355)	184,477	85,122
Fines and Penalties Revenue	718		718
Special Receipt Fund Revenue		11,591	11,591
	<hr/>	<hr/>	<hr/>
Total Nonexchange Revenue	\$ (49,692)	\$ 260,515	\$ 210,823
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

* In FY 2003 the Superfund trust fund refunded \$99,355 thousand in previously accrued corporate environmental taxes

Note 36. Superfund Trust Fund Balances

In FY 2004, the EPA received an appropriation for Superfund of \$1,257.5 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, 2004 and 2003, the Treasury Trust Fund has a liability to EPA for previously appropriated funds of \$2,402.1 million and \$2,599.7 million, respectively.

During FY 2004 and 2003, 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 and \$82.7 million at the end of FY 2004 and 2003, respectively. The Agency expects the Trust Fund to continue to receive revenues from cost recoveries and investment interest. In EPA's view the shortfall will be covered by the collection of cost recoveries and receipt of interest income to the Trust Fund over time. This is evidenced by FY 2004's shortfall reduction of \$75.1 million from the shortfall at the end of FY 2003.

**Environmental Protection Agency
Required Supplemental Information
As of September 30, 2004
(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 2004).

Trading Partner Code	Agency	Investments		Accounts Receivable		Other Assets	
		<u>Superfund</u>	<u>All Others</u>	<u>Superfund</u>	<u>All Others</u>	<u>Superfund</u>	<u>All Others</u>
4	Government Printing Office					12	701
11	Executive Office of the President				123		
12	Department of Agriculture			214	13		
13	Department of Commerce				912	4	67
14	Department of Interior			13,243	(168)		
15	Department of Justice			102	5	58	
17	Department of the Navy			99	316		
18	U S Postal Service			166			553
19	Department of State			(274)	(41)		
20	Department of the Treasury	2,217,334	2,317,164	56	103		
21	Department of the Army			9,840	233		
31	Nuclear Regulatory Commission			2	1		
45	Equal Employment Opportunity Commission				(95)		
47	General Services Administration			(3)	380		
49	National Science Foundation				36		
57	Department of the Air Force			11	8		
61	Consumer Product Safety Commission				8		
64	Tennessee Valley Authority				(5)		
68	EPA (between Superfund and All Others)				73,709	6,749	

Trading Partner Code	Agency	Investments		Accounts Receivable		Other Assets	
		Superfund	All Others	Superfund	All Others	Superfund	All Others
69	Department of Transportation			(18)	3,948		
70	Department of Homeland Security			(2)	4,273		
71	Overseas Private Investment Corporation				(13)		
72	Agency for International Development				602		
75	Department of Health and Human Services			288	1,119		
80	National Aeronautics and Space Administration				175		
86	Department of Housing and Urban Development				192		
89	Department of Energy			(62)	562		
95	Independent Agencies				(26)	(58)	
96	US Army Corps of Engineers			126	1,497		
97	US Department of Defense			924	537		
99	Treasury General Fund				443		
0	Unassigned			2,500	420	16	(33)
Total		\$ 2,217,334	2,317,164\$	27,212	89,267\$	6,781	1,288

3.

Intragovernmental Liabilities

Trading Partner Code	Agency	Accounts Payable		Accrued Liabilities		Other Liabilities	
		Superfund	All Others	Superfund	All Others	Superfund	All Others
3	Library of Congress			16	168		(54)
4	Government Printing Office			38	1,163	(9)	1,145
5	General Accounting Office					(367)	(1)
10	The Judiciary						(18)
11	Executive Office of the President				22		16
12	Department of Agriculture			414	854	2,285	1,254
13	Department of Commerce	(1,702)		295	2,223		(1,033)
14	Department of Interior	(96)		2,463	3,188	49	937
15	Department of Justice	617		8,444	50	571	(2,971)
16	Department of Labor	1,609		112	446	1,569	3,869
17	Department of the Navy	351		(40)	4	1,814	118
18	United States Postal Service				322	14	(216)

Trading Partner Code	Agency	Accounts Payable		Accrued Liabilities		Other Liabilities	
		<u>Superfund</u>	<u>All Others</u>	<u>Superfund</u>	<u>All Others</u>	<u>Superfund</u>	<u>All Others</u>
19	Department of State				100		(20)
20	Department of the Treasury			153	140	143	22,004
21	Department of the Army			27		3,278	(17)
24	Office of Personnel Management			112	725	1,412	6,953
31	US Nuclear Regulatory Commission			6	11		
33	Smithsonian Institution			2	37		(26)
36	Dept of Veterans Affairs			176	128		(1,051)
45	EEOC				29		
47	General Services Administration			19	12,301	10,775	(12,147)
49	National Science Foundation				113		26
57	Department of the Air Force					9,701	
59	Nat'l Foundation on Arts and Humanities						
64	Tennessee Valley Authority				95		70
68	EPA (between Superfund and All Others)	69,793		3,916			6,749
69	Department of Transportation			4,895	133		11,112
70	Department of Homeland Security	14,428		1,542	65		(851)
72	Agency for International Development				3		
73	Small Business Administration				17		100
75	Department of Health and Human Services	11,078		1,071	6,459		6,065
80	National Aeronautics and Space Administration			22	232		(8)
86	Department of Housing and Urban Development						231
89	Department of Energy			459	3,739	5	273
93	Federal Mediation Service				8		
95	Independent Agencies				1,561	1,460	3,019
96	US Army Corps of Engineers	1,659	189	13,403	1,038		50
97	Office of the Secretary of Defense	(351)		207	1,238	7,269	(1,475)
99	Treasury General Fund	6,081				506	2,768
0	Unassigned	(786)	17	348	774	(2,723)	247
	Total	\$ 102,681	206	\$ 38,100	37,386	\$ 37,752	47,118

For All Other Funds remaining intragovernmental liabilities, \$24,101 thousand in Debt is assigned to the Department of the Treasury (trading partner Code 20), and \$52,216 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, the DOL, and the 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.

	<u>Superfund</u>	<u>All Others</u>
Intragovernmental Earned Revenue	\$ 27,450	\$ 61,475
Associated Costs to generate above Revenue (Budget Functional Classification 304)	\$ 27,450	\$ 61,475

5.
Environmental Protection Agency
Required Supplemental Information
Supplemental Statement of Budgetary Resources-All Other Funds
As of September 30, 2004
(Dollars in Thousands)

	STAG	EPM	S & T	FIFRA	LUST	Other	Total
BUDGETARY RESOURCES							
Budgetary Authority							
Appropriations Received	\$ 3,900,400	\$ 2,293,578	\$ 786,588	\$ 0	\$ 0	\$ 1,373,358	\$ 8,353,924
Borrowing Authority	0	0	0	0	0	5,554	5,554
Net Transfers	0	1,630	0	0	76,000	60	77,690
Other							
Unobligated Balances							
Beginning of Period	1,400,831	295,696	294,234	890	3,896	103,325	2,098,872
Net Transfers, Actual	0	0	0	0	0	(1,538)	(1,538)
Anticipated Transfers Balance							
Spending Authority-Offsetting Collections							
Earned and Collected	11,684	44,308	6,409	22,220	4	157,494	242,119
Receivable from Federal Sources	0	(10,084)	64	0	0	(5,283)	(15,303)
Change in Unfilled Customer Orders							
Advance Received	0	486	833	4,129	0	7,563	13,011
Without Advance from Federal Sources	0	222	(1,748)	0	0	2,836	1,310
Transfers from Trust Funds	0	0	38,680	0	0	12,986	51,666
Total Spending Auth from Collections	11,684	34,932	44,238	26,349	4	175,596	292,803
Recoveries of Prior Year Obligations	71,427	12,545	6,382	40	225	5,308	95,927
Temporarily Not Available	0	0	(264)	0	(448)	(78)	(790)
Permanently Not Available	(23,012)	(31,953)	(5,596)	0	0	(10,642)	(71,203)
Total Budgetary Resources	\$ 5,361,330	\$ 2,606,428	\$ 1,125,582	\$ 27,279	\$ 79,677	\$ 1,650,943	\$ 10,851,239
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred							
Direct	\$ 3,908,755	\$ 2,223,938	\$ 832,230	\$ 0	\$ 73,390	\$ 1,378,429	\$ 8,416,742
Reimbursable	0	50,565	7,958	24,747	0	178,232	261,502
Total Obligations Incurred	3,908,755	2,274,503	840,188	24,747	73,390	1,556,661	8,678,244
Unobligated Balances							
Apportioned	1,452,575	257,752	269,948	2,532	6,287	91,061	2,080,155
Exempt from Apportionment							
Unobligated Balances Not Available	0	74,173	15,446	0	0	3,221	92,840
Total Status of Budgetary Resources	\$ 5,361,330	\$ 2,606,428	\$ 1,125,582	\$ 27,279	\$ 79,677	\$ 1,650,943	\$ 10,851,239
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS							
Obligations Incurred, Net	\$ 3,825,644	\$ 2,227,026	\$ 789,568	\$ (1,642)	\$ 73,161	\$ 1,375,757	\$ 8,289,514
Obligated Balances, Net - Beginning	8,352,080	640,523	474,874	904	84,307	29,528	9,582,216
Accounts Receivable	0	12,019	68,396	0	0	6,025	86,440
Unfilled Customer Orders-Federal Sources	0	125,112	9,020	0	0	92,052	226,184
Undelivered Orders	(7,753,563)	(637,253)	(519,995)	(1,197)	(76,189)	(105,208)	(9,093,405)
Accounts Payable	(518,598)	(190,062)	(93,122)	(1,151)	(8,817)	(45,884)	(857,634)
Total Outlays	\$ 3,905,563	\$ 2,177,365	\$ 728,741	\$ (3,086)	\$ 72,462	\$ 1,352,270	\$ 8,233,315
Disbursements	\$ 3,917,246	\$ 2,222,158	\$ 789,628	\$ 23,263	\$ 72,466	\$ 1,531,644	\$ 8,556,405
Collections	(11,683)	(44,793)	(60,887)	(26,349)	(4)	(179,374)	(323,090)
Less. Offsetting Receipts	0	0	0	0	0	(1,276,778)	(1,276,778)
Net Outlays	\$ 3,905,563	\$ 2,177,365	\$ 728,741	\$ (3,086)	\$ 72,462	\$ 75,492	\$ 6,956,537

6.
Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Balance Sheet
As of September 30, 2004
(Dollars in Thousands)

	<u>Unaudited</u>
ASSETS	
Intragovernmental	
Fund Balance With Treasury	\$ 53,560
Accounts Receivable, Net Federal	24,233
Other	555
Total Intragovernmental	\$ 78,348
General Property, Plant and Equipment, Net	16,693
Other Non Federal Assets	53
Total Assets	\$ 95,094
LIABILITIES	
Intragovernmental	
Accounts Payable & Accrued Liabilities, Federal	\$ 1,378
Other Federal Liabilities	30,413
Total Intragovernmental	\$ 31,791
Accounts Payable & Accrued Liabilities, Non Federal	24,969
Payroll and Benefits Payable Non Federal	1,451
Capital Lease Liability	6,727
Total Liabilities	\$ 64,938
NET POSITION	
Cumulative Results of Operations	\$ 30,156
Total Net Position	30,156
Total Liabilities and Net Position	\$ 95,094

6.
Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Net Cost
For the Year Ended September 30, 2004
(Dollars in Thousands)

	<u>Unaudited</u>
COSTS	
Intragovernmental	\$ 70,739
With the Public	71,923
Total Costs	\$ 142,662
Less	
Earned Revenues, Federal	140,244
Earned Revenues, Non Federal	0
Total Earned Revenues	\$ 140,244
NET COST OF OPERATIONS	\$ 2,418

Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Changes in Net Position
For the Year Ended September 30, 2004
(Dollars in Thousands)

	<u>Unaudited</u>
Net Position - Beginning of Period	\$ 31,770
Prior Period Adjustments	0
Beginning Balances, as adjusted	\$ 31,770
Other Financing Sources	
Transfers In/Out	0
Imputed Financing Sources	804
Total Other Financing Sources	\$ 804
Net Cost of Operations	(2,418)
Net Position - End of Period	\$ 30,156

6.
Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Budgetary Resources
For the Year Ended September 30, 2004
(Dollars in Thousands)

	Unaudited
BUDGETARY RESOURCES	
Budgetary Authority	
Appropriations Received	\$ 0
Borrowing Authority	
Net Transfers	
Other	
Unobligated Balances	
Beginning of Period	22,324
Spending Authority from Offsetting Collections	
Earned and Collected	\$ 140,268
Receivable from Federal Sources	0
Change in Unfilled Customer Orders	
Advance Received	7,564
Without Advance from Federal Sources	(2,991)
Transfers from Trust Funds	0
Total Spending Authority from Offsetting Collections	144,841
Recoveries of Prior Year Obligations	1,352
Permanently Not Available	0
Total Budgetary Resources	\$ 168,517
STATUS OF BUDGETARY RESOURCES	
Obligations Incurred	
Reimbursable	\$ 163,897
Unobligated Balances	
Apportioned	4,620
Unobligated Balances Not Available	0
Total Status of Budgetary Resources	\$ 168,517
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS	
Obligations Incurred, Net	\$ 17,704
Obligated Balances, Net - Beginning of Period	35,457
Accounts Receivable	114
Unfilled Customer Orders from Federal Sources	23,091
Undelivered Orders	(38,710)
Accounts Payable	(33,436)
Total Outlays	\$ 4,220
Disbursements	\$ 152,052
Collections	(147,832)
Less Offsetting Receipts	0
Net Outlays	\$ 4,220

6.
Environmental Protection Agency
Required Supplemental Information
Working Capital Fund
Supplemental Statement of Financing
For the Year Ended September 30, 2004
(Dollars in Thousands)

	<u>Unaudited</u>
RESOURCES USED TO FINANCE ACTIVITIES:	
Budgetary Resources Obligated	
Obligations Incurred	\$ 163,897
Less Spending Authority from Offsetting Collections and Recoveries	(146,193)
Obligations Net of Offsetting Collections and Recoveries	\$ 17,704
Other Resources	
Transfers In/Out Without Reimbursement, Property	\$ 0
Imputed Financing Sources	804
Net Other Resources Used to Finance Activities	\$ 804
 Total Resources Used To Finance Activities	 \$ 18,508
RESOURCES USED TO FINANCE ITEMS NOT PART OF NET COST OF OPERATIONS	
Change in Budgetary Resources Obligated	\$ (10,185)
Resources that Fund Prior Period Expenses	(130)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	0
Resources that Finance the Acquisition of Assets	(10,732)
Other Resources or Adjustments to Net Obligated	
Resources that Do Not Affect Net Cost of Operations	0
Total Resources Used to Finance Items Not Part of Net Cost of Operations	\$ (21,047)
 Total Resources Used to Finance the Net Cost of Operations	 \$ (2,539)
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	
Components Requiring or Generating Resources in Future Periods	
Increase in Annual Leave Liability	\$ 0
Increase in Exchange Revenue Receivable from the Public	0
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	\$ 0
Components Not Requiring or Generating Resources	
Depreciation and Amortization	\$ 4,933
Revaluation of Assets or Liabilities	0
Other Expenses Not Requiring Budgetary Resources	24
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	\$ 4,957
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	\$ 4,957
Net Cost of Operations	\$ 2,418

7.
**Environmental Protection Agency
Required Supplemental Stewardship Information
For the Year Ended September 30, 2004
(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. The Environmental Protection Agency's (EPA) Office of Research and Development, however, is unique among scientific institutions in this country in combining research, analysis, and the integration of scientific information across the full spectrum of health and ecological issues and across both risk assessment and risk management. Science enables us to identify the most important sources of risk to human health and the environment, and by so doing, informs our priority-setting, ensures credibility for our policies, and guides our deployment of resources. It gives us the understanding and technologies we need to detect, abate, and avoid environmental problems. Science provides the crucial underpinning for EPA decisions and challenges us to apply the best available science and technical analysis to our environmental problems and to practice more integrated, efficient and effective approaches to reducing environmental risks.

Among the Agency's highest priorities are research programs that address the effects of the environment on children's health; the 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 2004, the full cost of the Agency's Research and Development activities totaled over \$673 million. Below is a breakout of the expenses (dollars in thousands):

	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>
Programmatic Expenses	541,117	555,794	559,218	593,295	581,323
Allocated Expenses	59,523	90,039	123,307	106,971	91,675

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 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>
Construction Grants	55,766	63,344	149,841	15,845	48,948
Clean Water SRF	1,564,894	1,548,270	1,389,048	1,295,394	1,407,345
Safe Drinking Water SRF	588,116	728,921	708,528	842,936	802,629
Other Infrastructure Grants	212,124	282,914	367,259	582,091	341,767
Allocated Expenses	266,299	424,999	576,536	493,349	410,129

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, 2004, the Agency possesses the following land and land rights

Superfund Sites with Easements

Beginning Balance	31
Additions	1
Withdrawals	<u>0</u>
Ending Balance	<u>32</u>

Superfund Sites with Land Acquired

Beginning Balance	25
Additions	2
Withdrawals	<u>2</u>
Ending Balance	<u>25</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 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>
Training and Awareness Grants	49,265	48,697	49,444	47,827	48,416
Fellowships	9,570	11,451	8,728	6,572	7,553
Allocated Expenses	6,472	9,744	12,827	9,808	8,826

8.
Environmental Protection Agency
Required Supplemental Information
For the Year Ended September 30, 2004

IMPROPER PAYMENTS INFORMATION ACT OF 2002 (IPIA) REPORT

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, as defined by the IPIA as payments exceeding \$10 million and 2.5% of program payments. The error rates for EPA's largest programs were as follows

<u>Program</u>	<u>Erroneous Pay</u>	<u>Error Rate</u>
Clean Water and Drinking Water State Revolving Funds	\$10 3 million	.49%

Where erroneous payments exceed \$10 million, each Agency must identify the reasons why its programs are at risk. In addition, the two EPA programs identified above, being former Section 57 programs, require a corrective action plan. EPA prepared corrective action plans for the Clean Water and Drinking Water State Revolving Funds. We also recognize there are areas that require further EPA review. In particular, EPA must:

- 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 new Performance Accountability Report (PAR) reporting requirements for improper payments, and
- Implement and operate the Agency's audit recovery program.

II STATISTICAL SAMPLING PROCESS For the initial action plan submitted to OMB on May 28, 2004, EPA pulled a statistical sample of approximately 300 payments out of a population of 45,000 grant payments. Based on additional instructions from OMB, EPA expanded its initial review to incorporate findings from program and auditor reviews and audits of the two state revolving funds.

III CORRECTIVE ACTION PLANS. In order to meet OMB's objectives, EPA 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. Planned actions in each of the areas are as follows.

A. Grants: EPA began collecting information on grants management findings to include erroneous payment (i.e., funding is not being utilized for the intended purpose) in calendar year 2004. Based on information in the Grantee Compliance Tracking Systems, EPA will prepare statistical reports on the number of recipients where erroneous payments were found. In addition, comparisons will be made to the total recipient population to determine if there are particular types of recipients who are more likely to have erroneous payment problems.

The Office of Grants and Debarment will complete an erroneous payment review by February 28, 2005, covering calendar year 2004. This review will identify whether or not "high risk" grant areas exist and will develop, as appropriate, corrective action plans to be implemented in the years ahead.

In FY 2005 EPA will be revising its policy on compliance, review, and monitoring. This policy provides guidance and protocols to EPA headquarters and regional offices on how to conduct advanced monitoring reviews. As part of these revisions, EPA will propose that offices evaluate the extent and nature of grantee monitoring of sub-recipients. For example, how frequently do grantees monitor/evaluate sub-recipients and what have been the results of this monitoring. The expanded monitoring is designed to assist the Agency in expanding its improper payment identification, beyond recipients to sub-recipients. The Agency anticipates the compliance policy changes will be effective starting in calendar year 2006.

B Contracts EPA continues to take appropriate action as needed to reduce or eliminate improper payments. The appropriate Contracts Officer Representatives or On Scene Coordinators are notified of all improper payments discovered. In FY 2004, there were 8 improper payments due to an error in the billing number used to retrieve the banking information for a contractor. Billing numbers received on contracts are now verified prior to entering information in Contract Payment System. Keying errors are reviewed by the staff and efforts are made to prevent or detect these types of errors in the future. The problem of credit invoice and refunds processed is closely reviewed to prevent this type of occurrence in the future.

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 2003, from January through September, EPA found 25 improper payments in the 24,056 payments processed for contracts. For FY 2004, there have been 21 improper payments found as of July 31, 2004, in the 20,417 payments processed. Considering that there is not a full year to compare, the number of improper payments is decreasing. The percentage of proper payments is 99.9%.

Additional 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 is currently underway.

The continued pro-active process of reviewing and implementing changes as needed when an improper payment occurs should continue to reduce the number of improper payments. The Contracts 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. There have been 19 improper payments identified from the 14,772 invoices paid from January through July 2004. Eleven improper payments have been attributed to selection of incorrect vendor codes. 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. Six of the improper payments were identified as duplicate payments on invoices the vendor submitted twice. The edits in Small Purchase Information Tracking System have been enhanced to prevent this in the future. All invoices marked past due are being reviewed to determine if they are duplicate invoices.

A tracking mechanism was put in place in January 2004 to gather improper payment data in anticipation that purchase order payments would be included in the erroneous payment process in 2004. The result of this

tracking system provides the data for a monthly Improper Payment Report. The report provides information on each improper payment

D Payroll: By December 31, 2004, the Payroll Workgroup will:

- 1 Review Payroll internal control documentation
- 2 Conduct personnel interviews to verify/test whether internal controls are understood and being utilized.
3. Summarize the results of the review of the internal controls.
4. Submit recommendations to reduce improper payments.

Additionally, by the end of the second quarter FY 2005, the workgroup will develop a corrective action plan/best practices

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 REDUCTION OUTLOOK FY 2004 – FY 2007
(dollars in millions)

PROGRAM	FY 04 OUTLAYS	FY 04 IP %	FY 04 IP \$	FY 05 IP %	FY 06 IP %	FY 07 IP %
Clean Water and Drinking Water Revolving Funds	\$2,105 (est)	49%	10.3	45%	.40%	35%

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

BSI has received data from the Integrated Financial Management System and begun its field work to identify and collect contract overpayments. BSI hopes to complete its fieldwork by the end of the first quarter FY 2005. Once improper payments are identified, EPA will work with BSI to strengthen payment processes and internal controls to prevent further occurrences.

VI. ENSURING MANAGEMENT ACCOUNTABILITY: As previously outlined in the corrective action plans, the Agency is moving to strengthen already strong internal controls in key payment processes. Information on erroneous payments from reviews and audits for the two state revolving funds, 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 systems are sufficient to reduce improper payments to targeted levels.

VIII. STATUTORY AND REGULATORY BARRIERS: Currently, EPA is determining what information exists within our current review process that looks at sub-recipients invoices and financial operations. We will determine to what extent we can gather information from a sample to develop baseline numbers without interfering with current federal/state cooperative relationships.

IX. CONCLUSIONS: In the 1st quarter of FY 2005, we will

- A. Continue monitoring for improper payments in the two State Revolving Funds,
- B. Research payments to sub-recipient in the two State Revolving Funds; and
- C. Research payments by grantee types to determine if some are more susceptible to creating improper payments.

Agency's Response to Draft Report

MEMORANDUM

SUBJECT: Draft Audit Report: Response to Audit of EPA's Fiscal Years 2004 and 2003
Financial Statements

FROM: Charles E. Johnson /s/
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 Environmental Protection Agency's Draft Financial Statement Audit Report for the fiscal years ended 2004 and 2003. The attached provides the Office of Chief Financial Officer (OCFO) perspective on the observations and related recommendations noted by the audit team. OCFO respects the hard work the Office of Inspector General (OIG) put into this audit and looks forward to working collectively in the future on financial management issues. We also appreciate being recognized for various actions and initiatives the OCFO has taken to anticipate and resolve financial statement audit issues.

OCFO views the work done today of significant benefit to the Agency's financial information needs and decision-making processes. As we move forward in identifying a solution for replacing the legacy financial management system, our collaboration will be all-important during the development and implementation of a complex project that will evolve over the next several years.

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

Attachment

cc Mike Ryan

Response to Draft Audit Report of EPA's Fiscal 2004 and 2003 Financial Statements

General Comments

The following represents OCFO's general comments.

1. At a Glance

In general, while this section identifies specific observations noted during the audit, it lacks context and is misleading on the magnitude of the issues. As a result, the following changes are recommended:

Internal Control Reportable Conditions Noted:

2nd bullet - Additional reconciliations needed for Superfund Contract transactions

3rd bullet - Strengthen accounts receivable process.

4th bullet - Promptly record marketable securities

Noncompliance With Laws and Regulations Noted

1st bullet - Continue improvements related to cost accounting

2nd bullet - Continue progress in reconciling intragovernmental transactions

3rd bullet - Strengthen security screening for non-Federal personnel

4th bullet - Continue to improve processes in preparing the Statement of Transactions

2. Page 12, Paragraph 3, 2nd Sentence.

Revise to state "The QA Guide requires each location to conduct a review "

3. Page 14, Paragraph 1—"However, errors continued to occur in the regional spreadsheet calculations, due to a lack of supervision."

We recommend that the statement "lack of supervision" be deleted While additional control and management may be one factor contributing to the issue, there may be other factors which could come into play. We feel that citing supervision as the only factor relating to this issue is not a fair representation, and could be misleading to the reader

4. Page 18, Agency Comment.

Revise to state "The agency agreed with our findings and made the appropriate adjustments to the financial statements, including the \$6.9 million."

5. Page 20, Agency Comment and OIG Evaluation

We recommend that the last paragraph containing the OIG evaluation be deleted. While we agree that internal controls are one factor contributing to the issue, there may be other factors which could come into play. We feel that citing controls as the only factor relating to this issue is not a fair representation, and could be misleading to the reader

6. Page 25, last sentence before Agency Comment and OIG Evaluation.

We recommend that the sentence, "We should receive OCFO's written corrective action plan, including projected milestone dates, by November 22, 2004," be deleted. Since this Report will be used by many different readers over an extended period of time, including a date so close to the Report date is not relevant information and may cause confusion to readers

7. Organizational Name Change: OCFO's Financial Services Division is now an Office. The proper name of this office is Office of Financial Services

8. Page 26, Automated Application Processing Controls for Integrated Financial Management System Could Not Be Assessed, 4th paragraph.

Modify to state, "OCFO plans to conduct the following financial systems replacement activities during fiscal year 2005."

9. Page 30, EPA Continues Actions to Improve Cost Accounting, Agency Comment, last sentence.

Replace with, "OCFO is in the preliminary stages of redefining its cost accounting needs and SFFAS No 4 outputs. Because the financial data integration framework is in its conceptual stage, it is premature to make output commitments referencing this initiative at this time."

10. Page 32, EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel, Agency Comment.

Include information provided by the Office of Administration and Resources Management. "OARM is also committed to mitigating potential security risks at the Agency level. OARM has interim procedures that guide offices through the security screening process OARM is also implementing several improved processes, such as insertion of suitability criteria into contract requirements; fingerprint and national criminal history checks; and commercial checks performed by private firms."

Reportable Conditions

1. EPA's Financial Management Quality Assurance Process Needs Improvement

OIG Recommends:

1. Update and clarify the QA Guide and develop procedures to update the guide routinely to reflect changes in the organization, accounting events, internal control standards, and relevant accounting principles and standards.
2. Provide increased oversight of the QA program to include: approving the QA work plans; monitoring regional and finance center review coverage and scope of reviews; providing feedback on reviews, and coordinating review coverage of multi-location accounting events.
3. Provide basic and refresher training to appropriate personnel on the FMFIA requirements and the Agency's QA process

Agency Comments:

OCFO oversees the efforts performed in the Agency's finance community and believes the existing Quality Assurance program is effective. While there is always room for improvement, OCFO is in the process of updating the Quality Assurance Guide, incorporating new principles and standards. In addition, OCFO will develop an action plan to monitor the program and provide annual training.

Action Office: OCFO/Office of Financial Management

2. EPA Needs to Further Improve State Superfund Contracts' (SSC) Unearned Revenue and Superfund Unbilled Oversight Cost Accruals

OIG Recommends:

1. Provide increased supervision of the quarterly SSC unearned revenue and unbilled oversight cost accruals.
2. Analyze whether centralizing and consolidating the accrual processes could improve the efficiency and accuracy of the accruals

Agency Comments:

As the OIG acknowledges, during Fiscal Year 2004 OCFO automated several processes and made procedural improvements that resulted in more accurate SSC unearned revenue and unbilled oversight cost information. The oversight employed and frequent communications within the Agency's finance community significantly reduced the level of effort required for

year-end adjustments and confirmed that adequate internal controls exists. OCFO remains committed to continual progress in these two areas.

OCFO consolidated some aspects of unearned revenue accruals and will explore additional opportunities in concert with pending realignment of Agency financial duties

Action Offices: OCFO/Office of Financial Management & Office of Financial Services

3. Accounts Receivable Not Timely Recorded Due to Late Submission of Supporting Documentation

OIG Recommends:

1. Require the Director, Office of Financial Management, to develop procedures for monthly reconciliations of accounts receivables established in [the agency's financial management system] to information tracked by Regional Hearing Clerks and program offices; this reconciliation should be documented and all outstanding receivables specifically identified for follow-up action.
2. Request the Office of General Counsel and program offices to:
 - Strengthen existing policies and procedures requiring timely forwarding of billing documents to finance offices.
 - Implement procedures requiring Offices of Regional Counsel and program offices to expedite forwarding any outstanding agreement identified as a result of the Financial Management Office/Center's monthly reconciliations
 - Develop a mechanism to track and document the forwarding of all billing documents to the Financial Management Offices/Centers, to ensure accountability.

Agency Comments:

OCFO believes the current policies and procedures adequately address the proper identification and recording requirements for accounts receivable. OCFO along with the finance community reviewed more than 2,500 administrative actions totaling \$245.6 million and determined that less than 0.010 percent of the documents amounting to \$452,691.00, or 0.002 percent were not recorded timely in the accounting system. Although the amounts are immaterial for financial reporting, OCFO will collaborate with applicable agency offices and programs, ensure existing policies are followed, and increase awareness on the importance of recording accounts receivable timely

Action Office: OCFO/Office of Financial Management

4. EPA Did Not Promptly Record Marketable Securities

OIG Recommends:

- 1 Require the Director, Office of Financial Management to strengthen procedures to ensure that receiving financial management offices have sufficient information to record securities
2. Require the Director, Office of Financial Management to develop reconciliation procedures and ensure marketable securities are recorded by the respective finance offices at fair market value when received In conjunction with the preparation of quarterly financial statements, perform reconciliation between amounts logged and those recorded in the general ledger to ensure a proper and complete non-cash asset balance.
- 3 Require the Directors, Financial Management Offices/Centers, to ensure staff record marketable securities upon receipt

Agency Comments:

In FY 2004, OCFO issued the marketable securities policy that documented roles and responsibilities and emphasized the need to strengthen processes associated with recording marketable securities. Historically, EPA receives very few securities each year in settlement of debts In FY 2005, OCFO will evaluate policy implementation and identify and resolve needed improvements. In addition, existing marketable securities policy and procedures will be updated to require quarterly Superfund Accounts Receivables analyses

Action Office: OCFO/Office of Financial Management

5. Accounting for Contractor-Held Property Needs Improvement

OIG Recommends:

- 1 Develop a methodology to reasonably estimate the net book value of all contractor-held property and the related accumulated depreciation balances to reflect their proper balances as of September 30, 2004
- 2 Use the recalculated net book value of contractor-held property to compute fiscal 2004 depreciation expense
- 3 Record the loss associated with surplus equipment
- 4 Determine whether the \$6,883,574 for contract 68W04005 should be added to the contractor-held general property acquisition value.

Agency Comments:

OCFO and the Office of Administration and Resources Management modified the methodology for estimating net book value, depreciation expense, acquisition value, and accumulated depreciation for all contractor-held property. This methodology was applied and resulted in accurate reporting in FY 2004 and continuing into the future.

Action Offices: Office of Administration and Resources Management & OCFO/Office of Financial Management

6. Improvement Needed in EPA's Accounting for Obligations

OIG Recommends:

- 1 Remind the financial management offices and finance centers that: (1) obligations should be entered into the accounting system promptly and for the proper accounting period, (2) adequate supporting documentation for all Integrated Financial Management Systems accounting entries should be maintained, and (3) Agency's policy and year-end closing instructions for the review of unliquidated obligations should be followed.
2. Establish a policy requiring the financial management offices and finance centers to monitor obligations received during the first 15 days of October to determine whether the obligations should be reported in the prior fiscal year, report any adjustments for inclusion in the Agency's financial statements, and maintain adequate supporting documentation for adjustments.
3. Record the identified obligations of \$1,036,139 in the proper accounting period
- 4 Deobligate inactive obligations of \$2,283,274.

Agency Comments:

OCFO has a strong set of policy and procedures regarding obligations and recognizes the importance of processing related documents timely and in the proper accounting period. Through year-end instructions and weekly communications, OCFO will continue requiring the finance community and program offices to regularly review obligations and determine those funds available for deobligation, and particularly at year-end -- review and report material amounts recorded after the close of the fiscal year.

Please note that the 14 documents cited by OIG represent only 0.03% of the Agency's approximately 36,000 obligation documents. The \$1.2 million represents only 0.01% of the EPA's almost \$11.5 billion in unliquidated obligations.

While the OCFO understands the need for accurate recording of obligations, the

recommended adjustment of \$1,036,139 will not be prepared since the amount has no material impact on the financial statements. However, OCFO will ensure that there are strong internal controls over obligations and deobligations in order to prevent material misstatements

The Grant Obligations of \$2,283,274 are unavailable for deobligation until the grantee submits the final Financial Status Report and other related closeout information to the Project Officer.

Action Office: OCFO/Office of Financial Management

7. Systems Development for Grant and Inter-Governmental Applications Need Improvement

OIG Recommends:

1. Conduct and document a formal risk assessment for Grant Payment Allocation System (GPAS) and Inter-Governmental Document Online Tracking System (IDOTS)
2. Conduct and document a formal review of GPAS' compliance with all applicable Joint Financial Management Improvement Program system requirements.
- 3 Direct Offices to follow Agency system development policy for all future system development efforts.

Agency Comments:

OCFO conducted a risk assessment in August 2004 and October 2004 on GPAS and IDOTS, respectively. OCFO will conduct and document a formal review of GPAS' compliance with all applicable and relevant Joint Financial Management Improvement Program requirements. In addition, an office-wide Standard Operating Procedure will be developed to insure that all future system development efforts, including enhancements, follow relevant agency system development policy

Action Offices: OCFO/Office of Financial Management & Office of Financial Services

8. System Certification and Accreditation for Grant and Inter-Governmental Systems Needed

OIG Recommends:

- 1 Complete and document a formal certification and accreditation for GPAS and IDOTS

2. Update IDOTS' certification and accreditation status in the Agency's system review (self-assessment) database and complete one for GPAS.
3. Develop and implement a formal patch management process to identify, test, and install system and application fixes/upgrades
4. Implement a formal process to conduct vulnerability scanning and control testing on a regular basis.

Agency Comments:

A formal certification was completed in August 2004 on IDOTS and will be completed in October 2004 on GPAS. The accreditation documents were included with the security plans signed in September 2004. OCFO will develop a Standard Operating Procedure that will formalize the patch management process in November 2004. In addition, procedures will be developed to assure vulnerability scanning and control testing takes place on a regular basis. These efforts will be coordinated with the OIG

Action Offices: OCFO/Office of Financial Management & Office of Financial Services

9. Weaknesses in Change Control Procedures for Integrated Financial Management System

OIG Recommends:

OIG reported concerns about security controls related to software changes that could undermine the integrity of IFMS software libraries and financial system data. Specifically.

- Change management duties had not been adequately segregated between contractor personnel to prevent any individual from controlling all critical stages of the process.
- Individuals used an inappropriate ID or continued to have system access after no longer needing it.
- Management had not instituted a formal, structured change control process for IFMS to ensure software program modifications were properly authorized, tested, and approved
- Management was not properly using its Change Management System to manage change activities for IFMS and provide technical direction to contract staff.

We made various recommendations to the Office of the Chief Financial Officer to improve IFMS controls:

- Management needs to perform a risk assessment of Endeavor, a commercial off-the-shelf product used to control IFMS' development, testing, and production libraries and software.

- OCFO should develop a security plan for Endeavor.
- OCFO should establish a systematic process for (1) identifying key responsibilities of roles related to IFMS security and Endeavor contract administration, and (2) holding employees accountable for successful performance of those duties

Agency Comments:

The OCFO agrees with the OIG on the importance of change controls but does not believe there is general breakdown of security controls that could undermine the integrity of our financial system and data. Although the OCFO makes every effort to ensure that key change control roles and responsibilities are clearly defined and employed by our trained system experts, the OCFO acknowledges that there is always room for improvement. To this end, we continually initiate actions that will enhance our existing controls. For example, OCFO recently developed an automated annual security recertification process, grounded in the concept of least privilege and proper separation of duties. Furthermore, to ensure that the Change Management System (CMS) continues to be a valuable tool to us in our change control process, actions are currently underway to replace the antiquated Change Management System.

Action Office: OCFO/Office of Financial Management

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

OIG Recommends:

Although OCFO made no significant progress to replace IFMS during fiscal 2004, OCFO plans to conduct the following replacement activities during fiscal year 2005:

- Develop an acquisition strategy;
- Draft a governance structure composed of a Governing Board, an Executive Steering Committee, and a Change Control Board,
- Draft a replacement system project plan;
- Develop a concept of operations document outlining the scope of the project using industry best practices, and
- Develop a system requirements list

Agency Comments:

Consistent with the Office of Management and Budget's Line of Business initiative, the OCFO has a planned target date of 2008 for replacing the Agency's financial management system. However, in the interim, we maintain that the current level of documentation is sufficient for operations. To support pending financial systems replacement, the OCFO is in

the process of developing an acquisition strategy, governance structure, replacement system project plan, and a concept of operations document.

Action Offices: Several offices within the OCFO

Federal Financial Management Improvement Act Noncompliance Issues

11. EPA Continues Actions to Improve Cost Accounting

OIG Recommends:

1. Continue with current efforts to integrate financial data into management decision-making.
2. Consider redefining EPA's Statement of Federal Financial Accounting Standards (SFFAS) No 4 outputs so that they fit within the future financial data integration reports framework.

Agency Comments:

OCFO remains committed to insuring that financial information is available for decision-making within the Agency. The efforts to date, as acknowledged by the OIG, moves the Agency further along in defining program specific financial information needs and enhancing decision-making capabilities. During FY 2005, OCFO will continue making progress in this area

OCFO is in the preliminary stages of redefining its cost accounting needs and SFFAS No 4 outputs. Because the financial data integration framework is in its conceptual stage, it is premature to make output commitments referencing this initiative at this time.

Action Office: OCFO/Office of Financial Management

12. EPA Continues to Experience Difficulties in Reconciling Intragovernmental Transactions

OIG Recommends:

OIG suggests that EPA continue its efforts in reconciling the Agency's intragovernmental transactions to comply with Federal financial reporting requirements

Agency Comments:

OCFO, as acknowledged by the OIG, continues to make strides in reconciling the Agency's intra-governmental transactions and complying with Federal financial reporting

requirements. Although this requirement is a major issue government-wide, EPA performs exceptionally well.

Action Office: OCFO/Office of Financial Management

13. EPA Needs to Strengthen Practices Regarding Security Screening for Non-Federal Personnel

OIG Recommends:

EPA does not have a target date for addressing security certification for contractor personnel

Agency Comments:

The OIG identified that EPA had taken several necessary actions to correct security issues and implement the FY 1999 Remediation plan, to include issuing a policy on personnel security screening processes. The OIG noted the policy was fully implemented, except for establishing a background check program for non-Federal personnel. OCFO has outlined appropriate corrective actions concerning contractors' access to IFMS and assures that all contractors receive suitable background investigations or that security investigations are in process. The Office of Administration and Resources Management (OARM) is also committed to mitigating potential security risks at the Agency level. OARM has interim procedures that guide offices through the security screening process. OARM is also implementing several improved processes, such as insertion of suitability criteria into contract requirements; fingerprint and national criminal history checks; and commercial checks performed by private firms. Existing internal controls, combined with planned improved processes, ensure that EPA's security screening process is solid and meets future goals.

Action Offices: Office of Administration and Resources Management & OCFO/Office of Financial Management

Other Noncompliance Issue

14. EPA Continues to Improve its Compliance with Reconciling Fund Balances with Treasury

OIG Recommends:

1. Require that the quality assurance guide's Fund Balance with Treasury test procedures be modified to apply to all accounting points.
2. Require that all accounting points perform the quality assurance testing procedures

Agency Comments:

OCFO provided training in September 2004 and each finance office instituted the appropriate reconciliation procedures. As acknowledged by the OIG, EPA took action to implement Treasury procedures consistent with Agency policy during the fiscal year. OCFO will continue to monitor cash reconciliations to ensure they are properly completed.

Action Offices: OCFO/Office of Financial Management & Office of Financial Services

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