U.S. Environmental Protection Agency

Fiscal Year

2012

Agency Financial Report

ABOUT THIS REPORT

For fiscal year (FY) 2012, EPA is producing an *Agency Financial Report (AFR),* an *Annual Performance Report (APR),* and an *FY 2012 Financial and Program Performance Highlights*, in accordance with OMB Circular A-136, *Financial Reporting Requirements*.

EPA's *AFR* includes fiscal and high-level performance results that allow the President, Congress, and the public to evaluate the Agency's accomplishments for each fiscal year beginning October 1 through September 30. The *FY 2012 AFR* contains EPA's *FY 2012 Financial Statements Audit Report* and *FY 2012 Management Integrity Act Report*. These reports present the Administrator's assurance statement on the soundness of the Agency's internal controls for financial and programmatic activities and report on progress toward addressing Office of Inspector General audit recommendations.

EPA's *FY 2012 APR* provides information on the Agency's performance and progress toward achieving the goals established in its *FY 2011–2015 Strategic Plan* and FY 2012 performance budget. The *APR* is prepared according to the requirements set forth in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. EPA will produce the *FY 2012 APR* in conjunction with the FY 2014 Congressional Budget Justification and will post it on the Agency's website at http://www.epa.gov/planandbudget/annualplan/fy2014.html by February 4, 2013.

Additionally, EPA will publish an online *Financial and Program Performance Highlights* presenting key financial and performance information from both the AFR and APR in a brief, nontechnical, user-friendly format. The *Highlights* will be posted on the Agency's website at http://www.epa.gov/planandbudget/.

How the Report Is Organized

Administrator's Letter

The Administrator's letter transmits EPA's *FY 2012 AFR* from the Agency to the President and Congress. The letter assures financial and performance data presented in the *AFR* is reliable and complete. The letter also assures that the report communicates significant internal control weaknesses and actions the EPA is taking to resolve them.

Section I—Management's Discussion and Analysis

The Management's Discussion and Analysis contains information on EPA's mission and organizational structure; selected Agency performance results; an analysis of the financial statements and stewardship figures; information on systems, legal compliance, and controls; and other management initiatives.

Section II—Financial Section

The Financial Section includes the Message from the Chief Financial Officer and the Agency's financial statements, related Independent Auditor's Report, and other information on the Agency's financial management.

Section III—Other Accompanying Information

This section provides additional material, as specified under OMB Circular A-136*, Financial Reporting Requirements*. The subsection titled "Management Challenges and Integrity Weaknesses" discusses EPA's progress toward strengthening management practices to achieve program results and presents the Inspector General's list of top management challenges and the Agency's response.

Appendices

The appendices include links to relevant Agency websites and a glossary of acronyms and abbreviations.

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ADMINISTRATOR'S LETTER

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

I am pleased to submit the U.S. Environmental Protection Agency's *Fiscal Year 2012 Agency Financial Report,* the first of three related reporting components. The remaining two reports, the *Fiscal Year 2012 Financial and Program Performance Highlights* and the *Fiscal Year 2012 Annual Performance Report,* will be available in February 2013. This agency financial report presents the EPA's detailed financial information, accounting for the use of funds entrusted to us to fulfill our mission to protect human health and the environment. It also provides information on the agency's priorities, strengths and challenges. The financial and performance data presented in this report are reliable, complete and up-to-date. The significant progress the Agency made on high priority work is highlighted below.

Cleaner and More Fuel Efficient Cars and Trucks

The EPA, working closely with the Department of Transportation, finalized a plan that will reduce greenhouse-gas emissions from model year 2017-25 cars and trucks by 2 billion metric tons, save consumers between $5,700-$7,400 dollars in fuel costs per vehicle compared to an average increase in vehicle cost of $1,800, and reduce the United States' use of foreign oil. Overall cars will average 54.5 miles per gallon by 2025. This was all done working together with DOT and the trucking and automobile industry.

The Chesapeake Bay and Great Lakes

Tremendous progress was made this year with the integration of strong state-level plans into the overall Chesapeake Bay plan. As these plans are now implemented, the bay will see significantly improved restoration efforts. With the Great Lakes Restoration Initiative, we have been able to build a strong interagency effort to make progress in clean-up efforts for the Great Lakes that had been stalled.

Urban Sustainability and Integrated Water Quality Planning

Around the world, cities are facing serious challenges, including growing populations, greater demands for services, strained infrastructure systems and tighter budgets and resources. Local leaders are addressing these challenges with innovative investments in sustainable infrastructure projects. The Joint Initiative on Urban Sustainability – a public-private partnership supporting investment in sustainable urban infrastructure that President Obama and President Rousseff announced in March 2011 – brings together government, community and industry leaders from the U.S. and Brazil to generate economic growth, create jobs, eradicate poverty and protect the environment by increasing investment in green infrastructure and city-scale green-technology strategies. Domestically, the EPA collaborated with the U.S. Conference of Mayors to develop a new integrated planning process with cities to facilitate the fuller coordination of waste water and stormwater cleanup work with green infrastructure. This will enable more sustainable practices, lower costs and improved priority setting.

Management

At the EPA, we continue to make every effort to be more efficient, effective and accountable and to eliminate waste wherever it is found. We are strengthening our internal controls to ensure that the EPA achieves its financial and programmatic objectives in the most cost-effective manner.

During FY 2012, the Office of the Inspector General identified one new material weakness, which has since been corrected by the agency. We also are addressing a number of less-severe weaknesses and significant deficiencies for which corrective actions are under way. My assurance statement, provided under the Federal Managers' Financial Integrity Act, appears in Section I, "Management's Discussion and Analysis." Section III, "Other Accompanying Information," provides additional information on the EPA's internal-control weaknesses.

The EPA's strong focus on management and meeting human-health and environmental challenges also requires collaboration among many parties, including Congress, other federal agencies, states, tribes and communities. The EPA is committed to working with our partners and stakeholders to address these challenges.

Future Direction

The EPA will continue to lead our nation's efforts to protect our air, water and land. We will put our expertise and energy to work to meet our responsibilities for enforcing the nation's environmental laws, and we will collaborate with our state, tribal and local partners to find solutions for our most significant environmental challenges. Increased collaboration, stronger focus on prevention and improved partnerships with states and tribes are a key to the future. Our work as One EPA provides a solid foundation for our future success, and I have tremendous confidence in the talent and spirit of our work force. Indeed, the EPA's dedicated men and women are committed to fostering healthier families, cleaner communities and a stronger America.

Respectfully,

Lisa P. Jackson

Section I

Management’s Discussion and Analysis

ABOUT EPA

History and Purpose

EPA was established over 40 years ago with the purpose of consolidating a variety of federal research, monitoring, standard-setting, and enforcement activities into one agency to ensure protection of the environment and human health. Ever since, EPA has been a prominent force in fostering a cleaner, healthier environment for the nation.

The Birth of EPA

Reorganization Plan No. 3 was an executive order submitted to Congress on July 9, 1970, by President Richard Nixon. The order consolidated components from different federal agencies to form the EPA, "a strong, independent agency" that would establish and enforce federal environmental protection laws." Reorganization Plan No. 3 was sent to Congress, consistent with the provisions of chapter 9 of title 5 of the United States Code. The Reorganization Plan was enacted in Public Law 98-614.

EPA and its federal, state, local, international and community partners and stakeholders have made significant progress in protecting and sustaining the nation's health and environment, from regulating vehicle emissions to ensuring that drinking water is safe; from cleaning up toxic waste to assessing and ensuring the safety of chemicals; and from reducing greenhouse gas emissions to encouraging conservation, reuse, and recycling. Millions of people across the country have adopted a "greener" way of living. In all sectors of society, individuals are making choices to conserve resources, prevent pollution, and reduce impacts on the environment.

But despite the historic environmental advances EPA has made, much work remains. The environmental problems the country faces today are often more complex than those of years past, and implementing solutions—both nationally and globally—is more challenging. These environmental concerns and other obstacles drive the Agency's commitment to ensure that communities; individuals; businesses; and state, local, and tribal governments all have access to accurate information to help them manage human health and environmental risks.

EPA

- ✓ ***Develops and enforces regulations***
- ✓ ***Gives grants to states, local communities and tribes***
- ✓ ***Studies environmental issues***
- ✓ ***Sponsors partnerships***
- ✓ ***Teaches people about the environment***
- ✓ ***Publishes information***

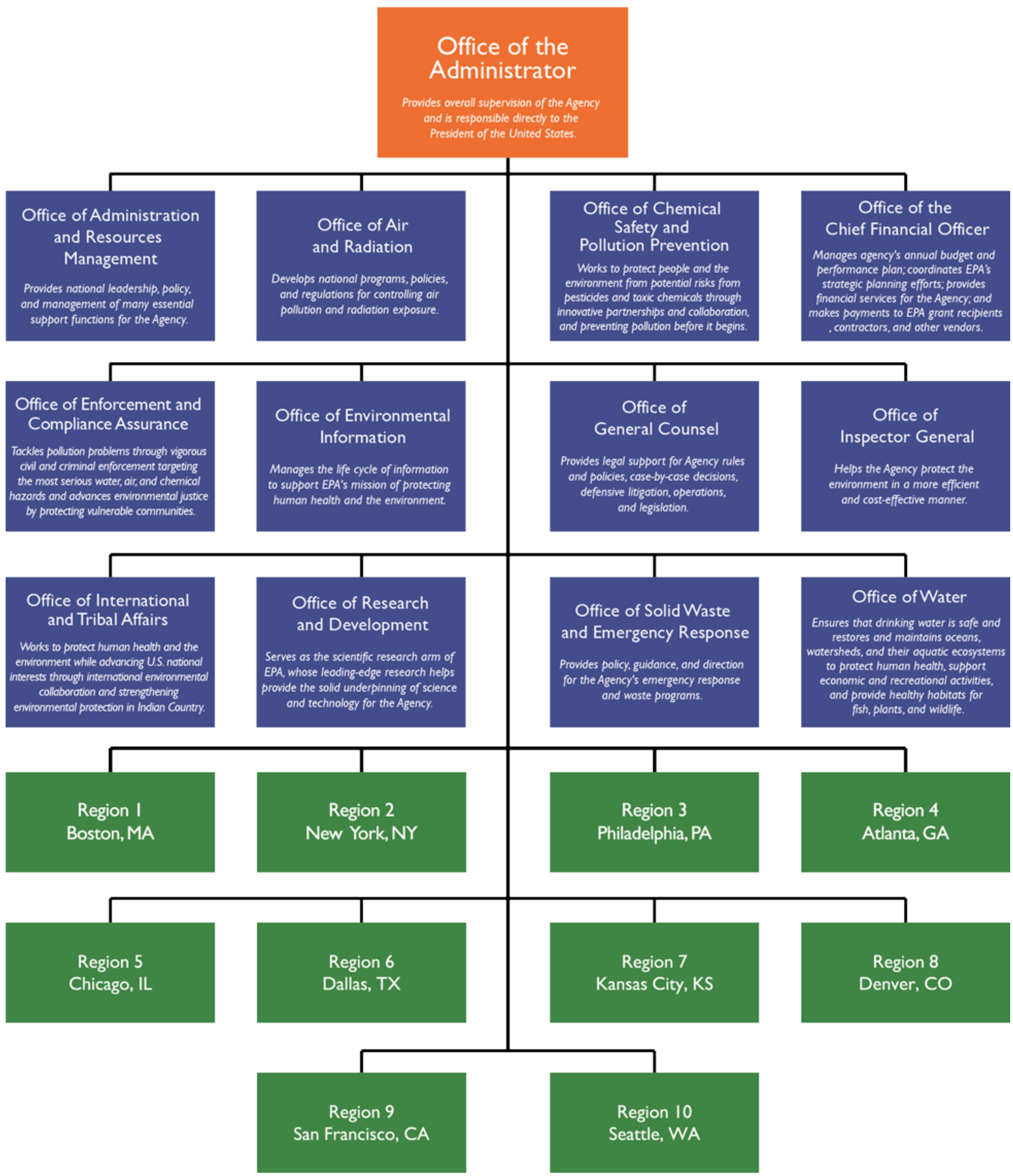
Mission

EPA's mission is "to protect human health and the environment." As America's environmental steward, EPA leads the nation's environmental science, research, education, assessment, and enforcement efforts. Maintaining its core values of science, transparency, and the rule of law, the Agency is strongly committed to meeting growing environmental protection needs. EPA's science provides the foundation for Agency decision-making and the basis for understanding and preparing to address future environmental needs and issues. Increased transparency is vital for improving programmatic and financial performance. By making environmental information both available and understandable, EPA advances its work and furthers public trust in its operations.

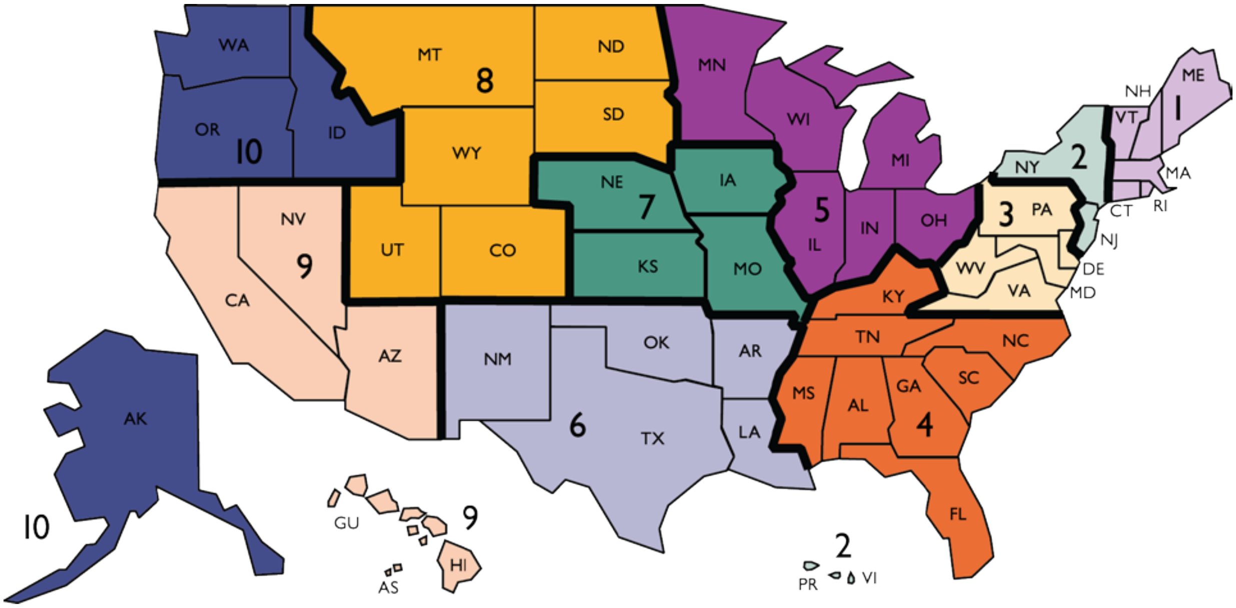
Organization

EPA's headquarters are located in Washington, D.C. Together, EPA's headquarters, 10 regional offices, and more than a dozen laboratories and field offices across the country employ 17,000 men and women. The Agency's employees are highly educated and technically trained; more than 50 percent are engineers, scientists, and policy analysts. Many other talented individuals in scores of vital occupations—from legal and public affairs to finance and information technology—make up the Agency's workforce.

U.S. Environmental Protection Agency



Regional Map



Collaborating With Partners and Stakeholders

Addressing today's complex environmental issues requires transparency and cooperative action; establishing and enhancing working partnerships among all levels of government and with private industry and nonprofit organizations; and leveraging EPA's resources with those of other federal agencies and state, local, and tribal partners. EPA, the states, and the tribes largely share responsibility for implementing environmental laws and policies to protect human health and the environment. EPA understands that government alone cannot begin to address all of the nation's environmental challenges.

A Framework for Performance Management

To carry out its mission to protect human health and the environment, and in compliance with the Government Performance and Results Modernization Act, EPA develops a five-year *Strategic Plan* (http://www.epa.gov/planandbudget/strategicplan.html), which establishes the Agency's long-term strategic goals, supporting objectives and measures. To promote achievement of the long-term goals, objectives, and measures, EPA commits the Agency to a suite of annual performance measures through preparation of an *Annual Performance Plan and Budget*. EPA reports its results against these annual performance measures and discusses progress toward longer term objectives and measures in its *Annual Performance Report*, which the Agency presents in its *Congressional Budget Justification*. More information on EPA's Performance Management Framework can be found at http://www.epa.gov/aboutepa/ocfo.html#Planning.

EPA's Performance Management System

EPA strives to communicate performance results in relation to associated resources. In February 2012, the Agency further integrated FY 2011 results and performance trend information into its *FY 2011 Annual Performance Report* and *FY 2013 Congressional Budget Justification*, providing additional context and support for our resource requests.

EPA is also committed to using performance information to manage its programs and inform decision-making. During FY 2012, EPA's Deputy Administrator held meetings with senior leadership quarterly to discuss progress on Agency priority goals and twice to review and discuss the full suite of the Agency's performance measures.

2012 PROGRAM PERFORMANCE

During FY 2012, EPA and its partners achieved significant results under the long-term environmental goals and cross-cutting fundamental strategies established in the Agency's *FY 2011–2015 Strategic Plan*.

Detailed FY 2012 performance results by strategic goal will be presented in EPA's *FY 2012 Annual Performance Report*, which the Agency will issue with its *FY 2014 Congressional Budget Justification* and post on its website at http://www.epa.gov/planandbudget/annualplan/fy2014.html by February 4, 2013.

STRATEGIC GOALS

Goal 1: Taking Action on Climate Change and Improving Air Quality
Goal 2: Protecting America's Waters
Goal 3: Cleaning Up Communities and Advancing Sustainable Development
Goal 4: Ensuring the Safety of Chemicals and Preventing Pollution
Goal 5: Enforcing Environmental Laws

CROSS-CUTTING FUNDAMENTAL STRATEGIES

Expanding the Conversation on Environmentalism
Working for Environmental Justice and Children's Health
Advancing Science, Research and Technological Innovation
Strengthening State, Tribal and International Partnerships
Strengthening EPA's Workforce and Capabilities

Strategic Goals

Goal 1: Taking Action on Climate Change and Improving Air Quality

As part of EPA's mission to protect human health and the environment, the Agency develops national programs, policies, and regulations for controlling air pollution and radiation exposure. In 2009, EPA's Administrator identified taking action on climate change and improving air quality as a top Agency priority.

In August 2012, EPA and the Department of Transportation's National Highway Traffic Safety Administration finalized national greenhouse gas emission standards for light-duty trucks and cars, representing progress toward reducing carbon pollution in the United States and addressing climate change. The final standards, which were developed through extensive engagement with automakers, the United Auto Workers, consumer groups, environmental and energy experts, states, and the public, increased fuel economy standards to the equivalent of 54.5 mpg and are projected to reduce greenhouse gas emissions by 6 billion metric tons over the life of the program—more than the total amount of carbon dioxide emitted by the United States in 2010. EPA anticipates that the new fuel-efficiency standards will require investment in advanced technologies and support high-quality domestic jobs in the auto industry.

In June 2012, EPA proposed updates to its national air quality standards for harmful fine particle pollution, including soot. Based on an extensive body of scientific evidence, including many large studies, findings suggest fine particle pollution, known as $PM_{2.5}$, causes negative health impacts at lower levels than previously assumed. Specifically, EPA's proposal would strengthen the annual health standard for $PM_{2.5}$ to a level within a range of 12 to 13 micrograms per cubic meter from the current annual standard of 15 micrograms per cubic meter. Reductions in $PM_{2.5}$, which have major economic benefits with comparatively low costs, have direct health benefits such as decreased mortality rates and fewer incidents of heart attack, stroke, and childhood asthma.

In FY 2012, EPA issued final Mercury and Air Toxics Standards (MATS), the first national standards that require power plants to limit emissions of mercury and other toxic air pollutants, such as arsenic, acid gas, nickel, selenium, and cyanide. Power plants, the largest U.S. source of several harmful pollutants, are responsible for about 50 percent of mercury emissions and 77 percent of acid gas emissions. They are also the leading source of emissions of other toxics, including arsenic, nickel, selenium, and hexavalent chromium. MATS will reduce air pollution by relying on widely available, proven controls already in use at more than half of the nation's coal-fired power plants. EPA estimates that the new safeguards will prevent as many as 11,000 premature deaths and 4,700 heart attacks per year. The standards will also help America's children grow up healthier—preventing 130,000 cases of asthma and about 6,300 fewer cases of acute bronchitis among children each year.

In FY 2011, EPA highlighted the development of the Cross-State Air Pollution Rule (CASPR), which would require states to significantly improve air quality by reducing power plant emissions that contribute to ozone and/or fine particle pollution in other states. On August 21, 2012, the U.S. Court of Appeals for the District of Columbia Circuit issued an opinion that will vacate CASPR. EPA has filed a petition seeking en banc rehearing of the U.S. Court of Appeals for the D.C. Circuit. By filing a petition, EPA awaits the court's decision on whether to rehear the case before the full D.C. Circuit Court of Appeals. In the interim, EPA will continue to implement the Clean Air Interstate Rule.

Goal 2: Protecting America's Waters

EPA coordinates with states, tribes, and other partners to ensure that our drinking water is safe and that aquatic ecosystems are sustained for economic and recreational activities, while providing a healthy habitat for fish, plants, and wildlife. In FY 2012, EPA worked to strengthen the technical, managerial, and financial capabilities of small drinking water systems, thus helping improve drinking water quality. In FY 2012, EPA exceeded its annual target, ensuring that more than 94 percent of the population has safe drinking water that meets all applicable health-based standards.

Pollution resulting from wastewater and stormwater runoff and nonpoint sources remains a top priority for the Agency. Overflowing wastewater systems can release untreated sewage and harmful pollutants into local waterways, and nonpoint source pollution from agricultural runoff remains the primary cause of damage in over 75 percent of America's impaired waters. Collectively, these sources of runoff contain a variety of harmful pollutants that can threaten communities' water quality and contribute to disease outbreaks, beach and shellfish bed closings, and fishing or swimming advisories.

In June 2012, EPA issued the Integrated Municipal Stormwater and Wastewater Planning Approach Framework in an effort to assist local governments in meeting their Clean Water Act obligations. Developed by EPA and a variety of stakeholders, the Framework outlines flexibility in pursuing innovative, cost-saving solutions, such as green infrastructure, and helps communities develop plans that prioritize and sequence their investments in storm- and wastewater infrastructure.

In FY 2012, EPA worked closely with the U.S. Department of Agriculture to ensure that federal resources—including both Section 319 grants and Farm Bill funds—are managed in a coordinated manner to protect water quality from agricultural pollution sources. EPA is currently revising the 319 grant guidelines to ensure that states have updated Nonpoint Source Management Programs, which are important for setting state priorities.

Goal 3: Cleaning Up Communities and Advancing Sustainable Development

One of EPA's top priorities is to support sustainable, thriving communities by reducing waste, minimizing the use of virgin resources, and cleaning up contaminated sites. To date, over 2 million previously contaminated acres are available for communities to reclaim for ecological, recreational, commercial, and residential purposes. In FY 2012, EPA helped return 10,800 sites previously contaminated sites to communities for reuse. In addition, the Agency continued to assess its progress in several key land cleanup programs. For example, while confirmed releases at underground storage tanks have decreased, EPA's ability to maintain the pace of tanks cleanups faces several major challenges. To better characterize these challenges, EPA completed the National LUST Cleanup Backlog: A Study of Opportunities, which reviewed the cleanup program of 14 states across the nation.

EPA will use the findings of this study to work with states to encourage more efficient ways to address the backlog of site cleanups. In addition, under the Federal Facilities Site Evaluation Project, EPA worked closely with other federal agencies and state partners to make cleanup determinations for over 95 percent of the 514 federally owned sites which had not appeared to have been fully assessed.

EPA also developed new tools and policies to enhance its RE-Powering America's Land: Siting Renewable Energy on Potentially Contaminated Land and Mine Sites Initiative. The purpose of this program is to encourage siting renewable energy facilities on thousands of current and formerly contaminated properties across the nation, with the goal of decreasing the amount of green space used for development, reducing greenhouse gas emissions, and providing economic benefits (including job creation) to local communities.

In FY 2012, EPA advanced a new sustainable materials management program, an approach that focuses on reducing the materials we use and their associated environmental impacts over the entire life cycle. EPA partners with federal agencies and corporate stakeholders through the Food Recovery Challenge, the Federal Green Challenge, and the Used Electronics Challenge program.

Throughout FY 2012, EPA implemented innovative techniques to address environmental concerns on tribal lands and with international partners. One such program—Border 2012—is a 10-year collaboration between the United States and Mexico to improve the environment and protect the health of the nearly 14 million people living along the U.S.–Mexico border. The program, which has now been updated to Border 2020, resulted in the cleanup, removal, and proper disposal of more than 12 million scrap tires and 570 tons of used electronics; improved water quality and environmental health through the completion of infrastructure projects that benefited more than seven million residents; and improved air quality through implementation of diesel truck/bus retrofitting programs.

EPA also finalized the Policy on Consultation and Coordination with Indian Tribes on May 4, 2011, after extensive consultation and coordination with tribes. Since August 2011, EPA has initiated 121 and completed 98 consultations with tribal governments on such topics as regulations, policies, and permitting.

Goal 4: Ensuring the Safety of Chemicals and Preventing Pollution

In FY 2012, EPA took a number of actions to ensure that chemicals used for agriculture, manufacturing, and construction are safe and do not pose potential risks to human health or the environment. EPA also participated in domestic and international partnerships and collaborations to reduce waste; conserve energy and natural resources; and leave homes, schools, and workplaces cleaner and safer.

Through FY 2012, EPA and authorized states certified 124,523 firms under the Lead Renovation, Repair, and Painting Rule, which took effect in April 2010 and aims to protect children from risks associated with lead-based paint present in many American homes. As one indication of progress, in FY 2012, the Centers for Disease Control's National Health and Nutrition Examination Survey reported that the prevalence of elevated blood lead levels (>5µg/dL) among children under 6 years old has decreased from 4.1 percent in 2003–2006 to 2.6 percent in 2007–2010.

Also in FY 2012, EPA invested in research activities that better characterize human exposure to contaminants. One of these activities—finalizing the non-cancer health assessment for dioxins—was last reviewed in the 1980s and contributes to a range of Agency initiatives, including establishing cleanup levels at Superfund sites. Dioxins can be released into the environment through forest fires, backyard burning of trash, certain industrial activities, and residue from past commercial burning of waste. EPA also reported to Congress on its progress in implementing April 2011 recommendations made by the National Research Council (NRC) to improve the Integrated Risk Information System (IRIS), which provides health effects information on chemicals to which the public may be exposed, providing a critical part of the scientific foundation for EPA's decisions to protect public health.

Following NRC recommendations, new IRIS assessments are more transparent and concise and provide detailed information on the evaluation and analysis techniques employed.

In FY 2012, EPA exceeded its annual target for reviewing and, where appropriate, challenging and declassifying, confidential data claims under the Toxic Substances Control Act (TSCA). To date, more than 10,000 of the 22,483 existing Confidential Business Information (CBI) cases have been addressed. EPA also increased the availability of TSCA 8(e) chemical hazard filings through the Chemical Data Access Tool, which now includes 18,410 submissions, including 612 newly declassified CBI documents. EPA is also working to promote transparency through its Design for the Environment (DfE) program by issuing and placing on its website a list of 450 chemicals that meet the criteria for the DfE Safer Product Labeling Program, which may assist manufacturers in the DfE evaluation process for their specific products. As part of the Enhanced Chemicals Management Program, the Agency also has conducted stakeholder meetings to obtain input on potential tools that might be useful to users or customers of TSCA data, including state and local governments, community groups, and industry.

In FY 2012, EPA participated in the E3: Economy, Energy and the Environment program partnerships, which help small to medium-sized manufacturers improve operation productivity, energy efficiency, and environmental performance. E3 brings federal agencies and state and local communities together to promote sustainable manufacturing and growth through innovative technology, thereby improving regional economies through job retention and reducing environmental impacts. E3 partnerships are now in place in 24 states and have resulted in the completion of 160 facility assessments.

In June 2012, the EPA Administrator, as the alternate Head of Delegation for the United States, attended the United Nations Conference on Sustainable Development, commonly known as Rio+20, a historic opportunity for world leaders, nongovernmental organizations, the private sector, and government officials to define pathways to a safer, more equitable, cleaner, greener, and more prosperous world for all. The EPA Administrator worked to advance U.S. positions and interests in promoting a global green economy and supported an improved institutional framework for sustainable development, with a focus on enhanced U.N. operations, including strengthening the United Nations Environment Programme.

Goal 5: Enforcing Environmental Laws

EPA works to ensure compliance with environmental laws and requirements to protect human health and the environment and, when warranted, takes civil or criminal enforcement action. Over the past year, EPA finalized a number of key cases and worked to make environmental information more accessible to the public. EPA is developing a comprehensive plan to convert to 21st-century electronic reporting technology. This effort will require some short-term investments but is expected to provide substantial long-term benefits for industry, states, EPA, and the public, while improving public access to environmental information.

In February 2012, EPA, the Department of Justice, and the U.S. Coast Guard finalized a $90 million settlement with MOEX Offshore 2007 LLC for alleged Clean Water Act violations resulting from the Deepwater Horizon oil spill. According to the settlement, approximately $45 million will go directly to Mississippi, Texas, Florida, Louisiana, and Alabama in the form of penalties or expedited environmental projects, including $20 million to facilitate land acquisition projects in several Gulf states. These projects will preserve and protect habitat and resources important to water quality and other environmental features of the Gulf of Mexico region. EPA, the Department of Justice, and the U.S. Coast Guard continue to pursue enforcement actions against those who are responsible for the Deepwater Horizon oil spill.

In April 2012, EPA and DOJ announced an innovative environmental agreement with Ohio-based Marathon Petroleum Company (MPC), estimated to reduce harmful air pollution by approximately 5,400 tons per year. In addition to other activities outlined in the consent decree, MPC has agreed to install state-of-the-art controls on combustion devices known as flares, and to cap the volume of waste gas it will send to its flares at the company's six refineries in the United States—marking a first for the refining industry. MPC will also pay a $450,000 civil penalty to resolve Clean Air Act violations and $10,000 to resolve violations of the Emergency Planning and Community Right-to-Know Act and the Comprehensive Environmental Response, Compensation, and Liability Act. As an environmental mitigation project, MPC is required to control the sludge-handling system at its Detroit refinery, estimated to reduce at least 15 tons per year of volatile organic compounds and at least one ton per year of benzene.

In the largest criminal penalty to date under the Federal Insecticide, Fungicide, and Rodenticide Act, which governs the manufacture, distribution, and sale of pesticides, Scotts Miracle-Gro Company, a producer of pesticides for commercial and consumer lawn and garden uses, will pay a $4 million fine and perform community service for 11 violations. In addition to other charges, Scotts pleaded guilty to illegally applying insecticides that are toxic to birds to its wild bird food products, falsifying pesticide registration documents, distributing pesticides with misleading and unapproved labels, and distributing unregistered pesticides. Scotts will also contribute $500,000 to organizations in Ohio that support the protection of bird populations and habitats through conservation, research, and education.

EPA's enforcement program also launched the Clean Water Act Pollutant Loading Tool, which allows the public to identify and compare the annual pollutant discharge amounts for Clean Water Act direct dischargers. This data release is a key component of EPA's Clean Water Act Action Plan, which seeks to sharpen focus on the most relevant Clean Water Act dischargers. EPA released 2007–2010 data in a website that includes an interactive mapping application and a comparative feature that helps evaluate actual releases against other data sources, such as the Toxic Release Inventory. In addition to showing the actual discharge amounts for each pollutant, the tool provides toxicity-weighted data—allowing users to normalize pounds released with an accepted EPA hazard ranking model.

American Recovery and Reinvestment Act of 2009 (ARRA) Reporting

Since the end of FY 2009, EPA has tracked program performance for six key ARRA-funded environmental programs that invest in clean water and drinking water projects, implement diesel emission reduction technologies, clean up leaking underground storage tanks, revitalize and reuse brownfields, and clean up Superfund sites. To date, these ARRA-funded programs have:

- Completed construction at 1,336 clean water projects and 915 drinking water projects;
- Retrofitted, replaced, or retired 27,700 diesel engines;
- Made 963 acres of brownfields properties ready for reuse;
- Completed cleanup at 2,449 leaking underground storage tanks; and
- Achieved project completion at 33 Superfund sites.

ARRA-funded projects have provided substantial environmental and economic benefits to communities across the country and have created several thousand jobs. As of FY 2012, many ARRA-funded grant and loan programs are coming to a close and will no longer have new results. Some long-term construction projects will take years to complete, however. To ensure accountability and demonstrate progress toward meeting the Agency's remaining ARRA goals, EPA will continue to provide quarterly performance updates at http://www.epa.gov/recovery/plans.html#quarterly.

FINANCIAL ANALYSIS AND STEWARDSHIP INFORMATION

Sound Financial Management: Good for the Environment, Good for the Nation

EPA carries out its mission to protect human health and the environment while adhering to the highest standards for financial management.

- Clean audit opinion. For the 13th consecutive year, EPA's Office of Inspector General (OIG) issued an unqualified ("clean") opinion on the Agency's financial statements. This means that EPA's financial statements are presented fairly in all material aspects, and they conform to generally accepted accounting principles used by the federal government. In simple terms, a clean opinion means the Agency's numbers are reliable and accurate.

- New financial management system. In FY 2012, EPA launched a new financial management system called Compass, replacing EPA's legacy financial system that had been used for the past 22 years. Compass serves as the foundation for the introduction of future components to establish a unified and integrated systems infrastructure that will evolve to effectively centralize the resource footprint, simplify Agency systems architecture, and leverage new features (built in to Compass) across the national organization.

- Compliance with federal financial systems requirements. EPA is compliant with the Federal Financial Management Improvement Act, which means the Agency's financial systems substantially comply with federal system requirements and accounting standards.

Highlighted below are some of EPA's most significant financial achievements in FY 2012:

- **Conference spending and oversight.** In FY 2012, the Agency implemented guidance to preclude excess conference spending. This internal control promotes efficiency Agencywide by instituting a rigorous system for tracking, reviewing, and approving conference-related activities.

- **Timely payments.** EPA paid 92.69 percent of its invoices on time and 100 percent of its grant payments electronically. Additionally, the improper payment rate was less than 0.07 percent on these payments, which means the correct amount was paid to the correct recipient in nearly every instance.

- **Improved Working Capital Fund (WCF) efficiencies.** In FY 2012, EPA decreased FY 2012 information technology costs paid through the WCF by $11.5 million. EPA accomplished this by reconfiguring service contracts paid through the WCF that lowered costs without affecting the quality of service.

- **Integrated performance results in budget justification.** EPA developed a new performance measures table that includes eight years of trend data on performance results and out-year targets. The table enhanced context for performance and budgeting. The Agency also implemented a new automated data quality records tool that strengthened the quality, accuracy, completeness, and transparency of performance data presented in the Annual Performance Report and budget.

- **Indirect rate and annual allocation rates.** During FY 2012, EPA's continued development and preparation of cost recovery packages resulted in significant gains for the Agency. EPA recovered approximately $74 million in Superfund indirect costs and collected $2.7 million in interagency indirect costs.

- **Balanced checkbook.** The Agency general ledger matches the fund balance records maintained by the Department of the Treasury. This match translates to greater integrity of financial reports and budget results.

- **Improved financial management of contracts.** In FY 2012, the Agency launched a new mandatory Agencywide online training module focused on proper financial management of its contracts. The purpose of the course is to help the Agency's contracting officer representatives fully and properly utilize contract funds and reduce the Agency's unpaid balances.

Financial Condition and Results

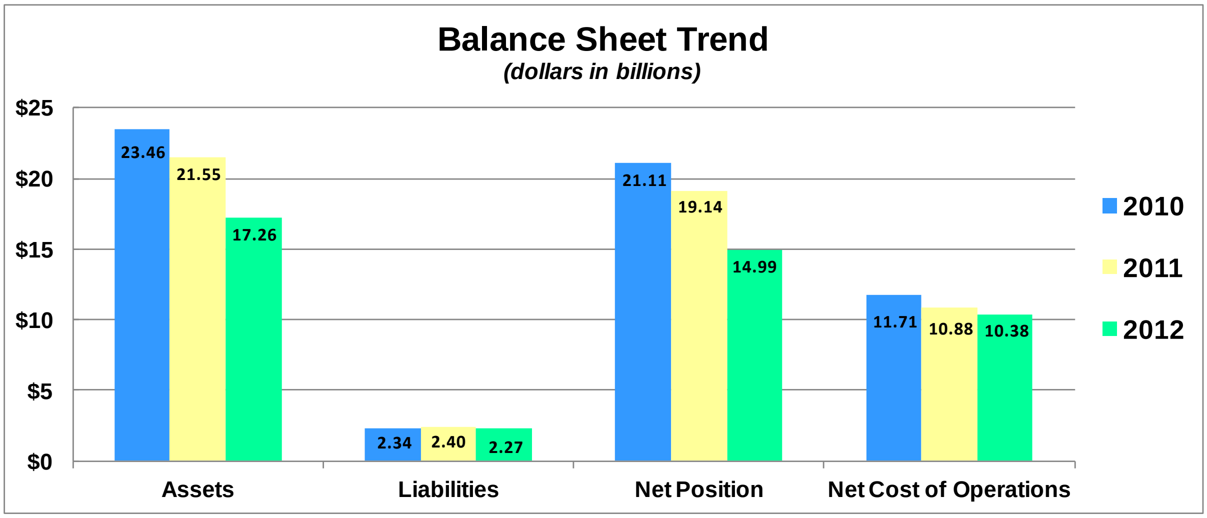
Financial statements are formal financial records that document the EPA's activities at the transaction level, where a "financial event" occurs. A financial event is any occurrence having financial consequences to the federal government related to the receipt of appropriations or other financial resources; acquisition of goods or services; payments or collections; recognition of guarantees, benefits to be provided, and other potential liabilities; or other reportable financial activities.

The EPA prepares four consolidated statements, including: 1) Balance Sheet, 2) Statement of Net Cost, 3) Statement of Changes in Net Position, and 4) Statement of Custodial Activity, and one combined statement, the Statement of Budgetary Resources. Together, these statements with their accompanying notes provide the complete picture of the EPA's financial situation. Reviewers can glean a snapshot of the EPA's overall financial condition by examining key pieces of information from these statements. The complete statements with accompanying notes, as well as the auditor's opinion, are available in Section II of this report.

Key Terms

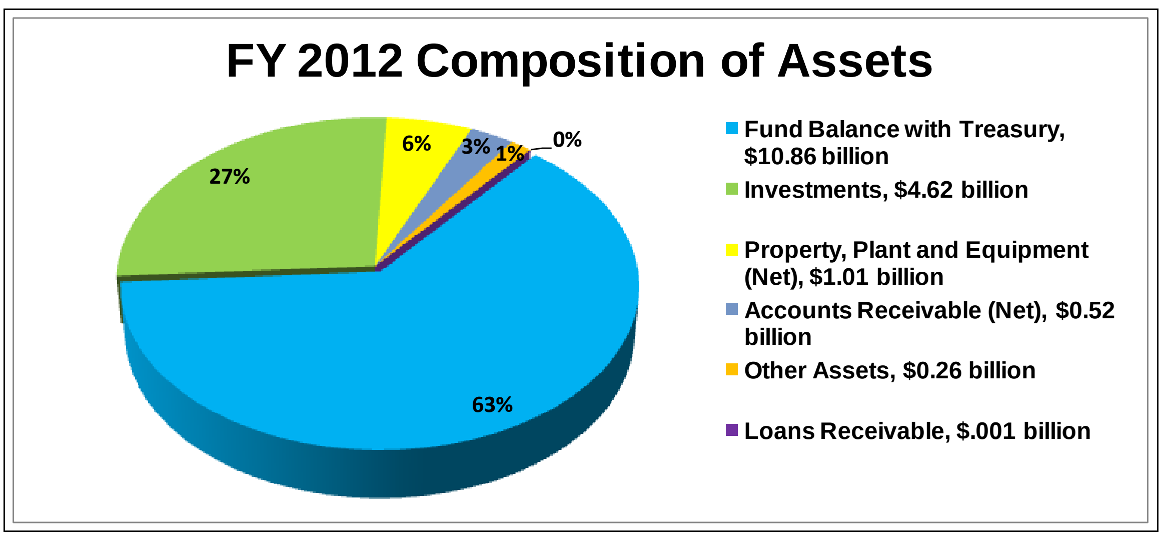
- **Assets:** What the EPA owns and manages.
- **Liabilities:** Amounts the EPA owes because of past transactions or events.
- **Net Position:** The difference between the EPA's assets and liabilities.
- **Net Cost of Operations:** The difference between the costs incurred by the EPA's programs and the EPA's revenues.

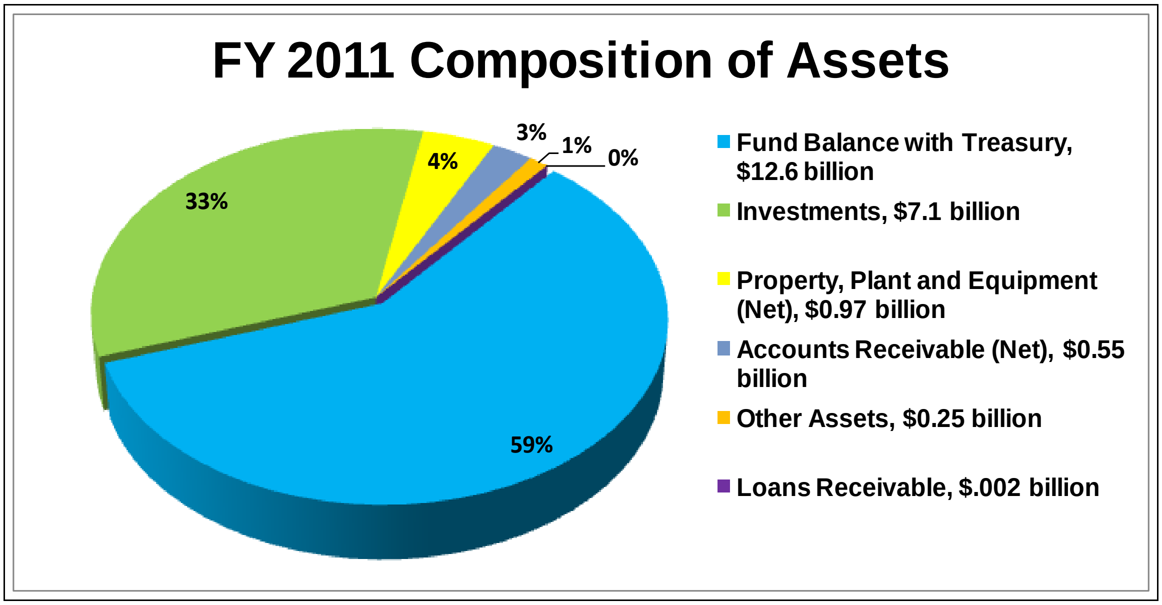
The **Balance Sheet** displays assets, liabilities and net position as of September 30, 2012, and September 30, 2011. The **Statement of Net Cost** shows the EPA's gross cost to operate, minus exchange revenue earned from its activities. Together, these two statements provide information about key components of the EPA's financial condition—assets, liabilities, net position and net cost of operations. The chart that follows depicts the Agency's financial activity levels since FY 2010.



Assets—What the EPA Owns and Manages

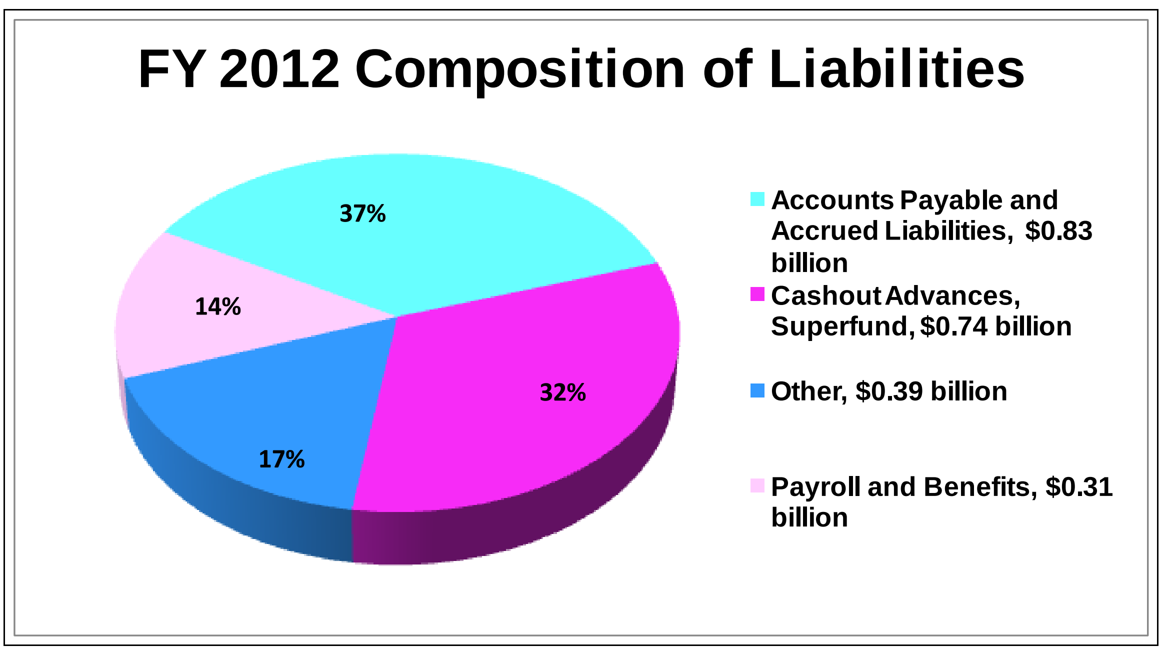
The EPA's assets totaled $17.26 billion at the end of FY 2012, a decrease of $4.3 billion from the FY 2011 level. In FY 2012, almost 90 percent of EPA's assets fall into two categories: Fund Balance with Treasury and Investments. All of the EPA's investments are backed by U.S. government securities. The graphs that follow compare the Agency's FY 2012 and FY 2011 assets by major categories.

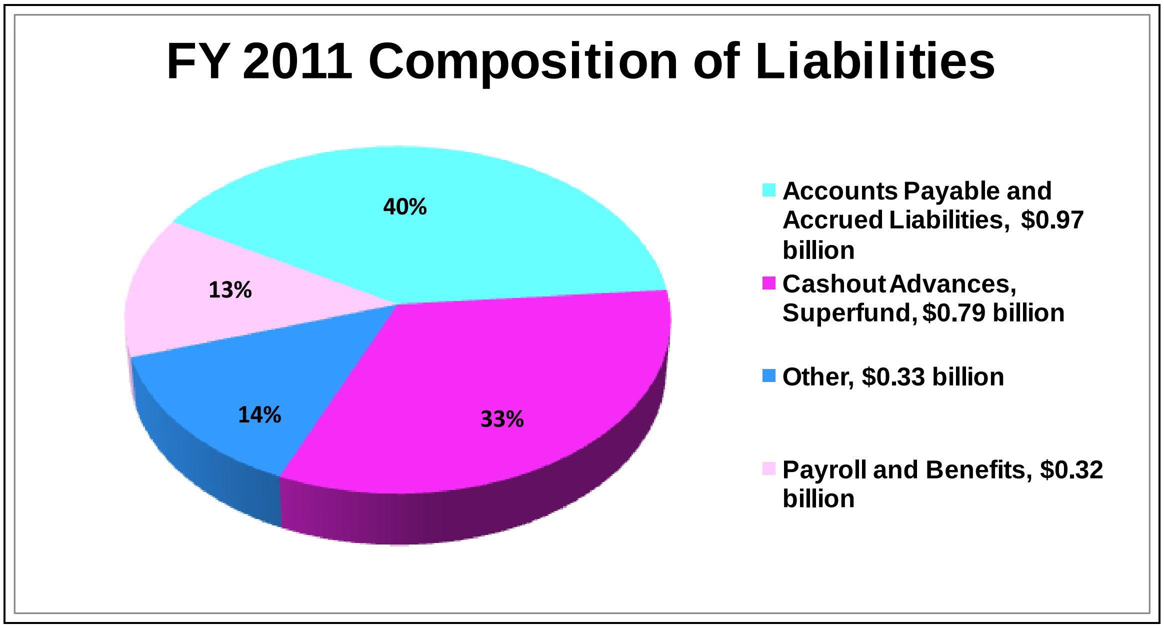




Liabilities—What the EPA Owes

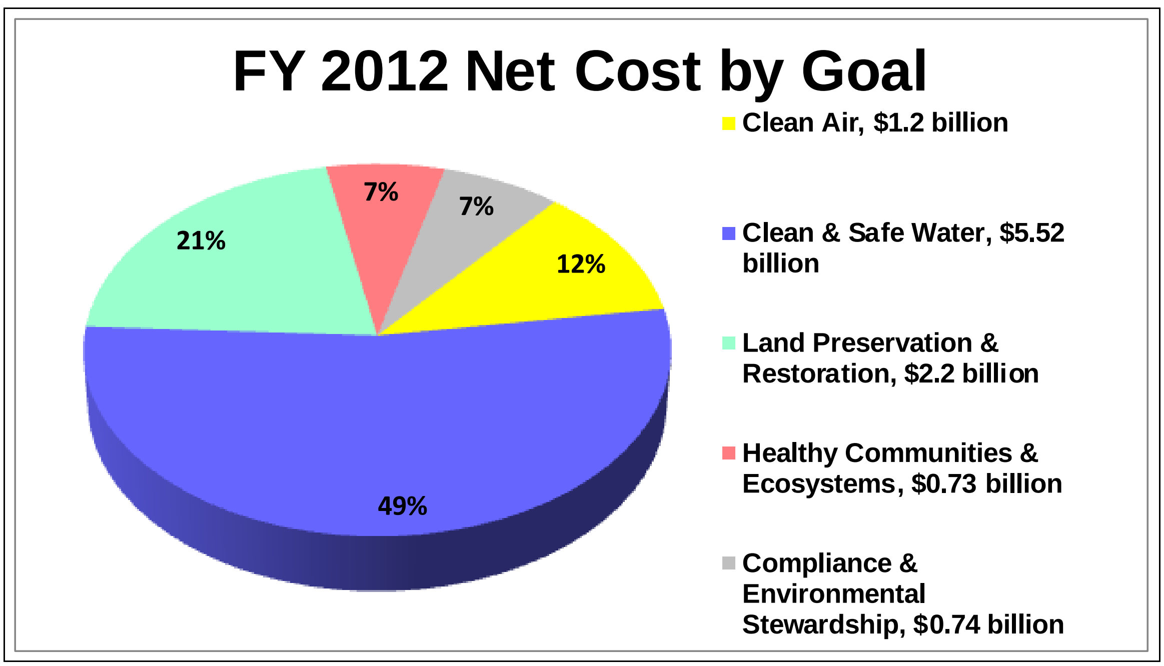
The EPA's liabilities were $2.27 billion at the end of FY 2012, marking a decrease of $134 million from the FY 2011 level. In FY 2012, the EPA's largest liability, its combined accounts payable and accrued liabilities represents 37 percent of what the Agency owes. The next largest category, representing 32 percent of the EPA's liabilities, covers Superfund cashout advances that include funds paid by the EPA for cleanup of contaminated sites under the Superfund program. The remaining two categories represent 31 percent of the Agency's liabilities. Payroll and benefits payable include salaries, pensions and other actuarial liabilities. Other liabilities include the EPA's debt due to Treasury, custodial liabilities that are necessary to maintain assets for which the EPA serves as custodian, environmental cleanup costs and other miscellaneous liabilities. The graphs that follow compare FY 2012 and FY 2011 liabilities by major categories.

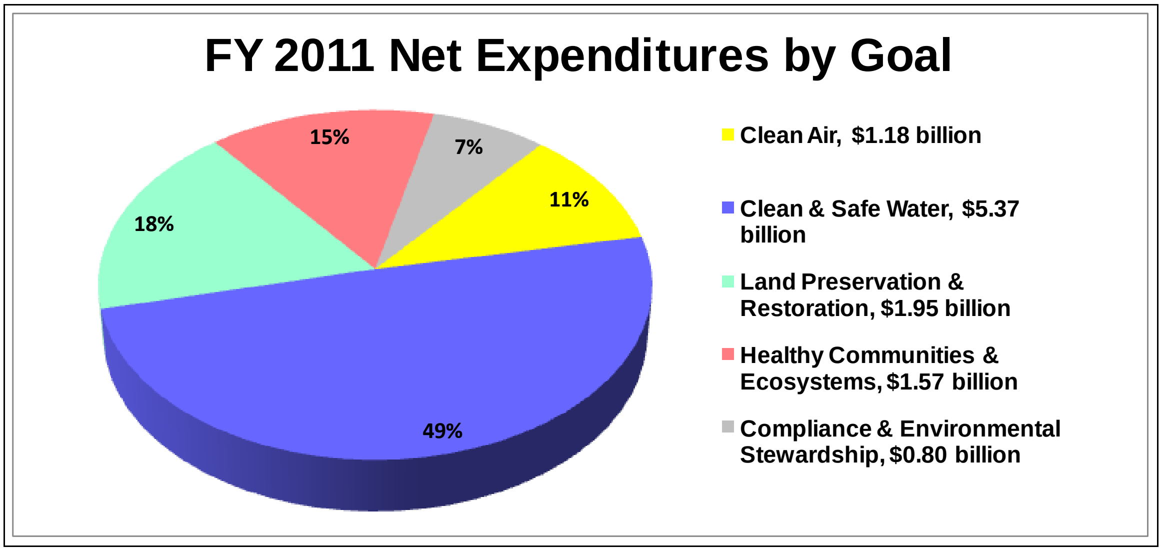




Net Cost of Operations—How the EPA Used Its Funds

The graphs that follow show how the EPA's funds are expended among its five program goal areas in FY 2012 and FY 2011:

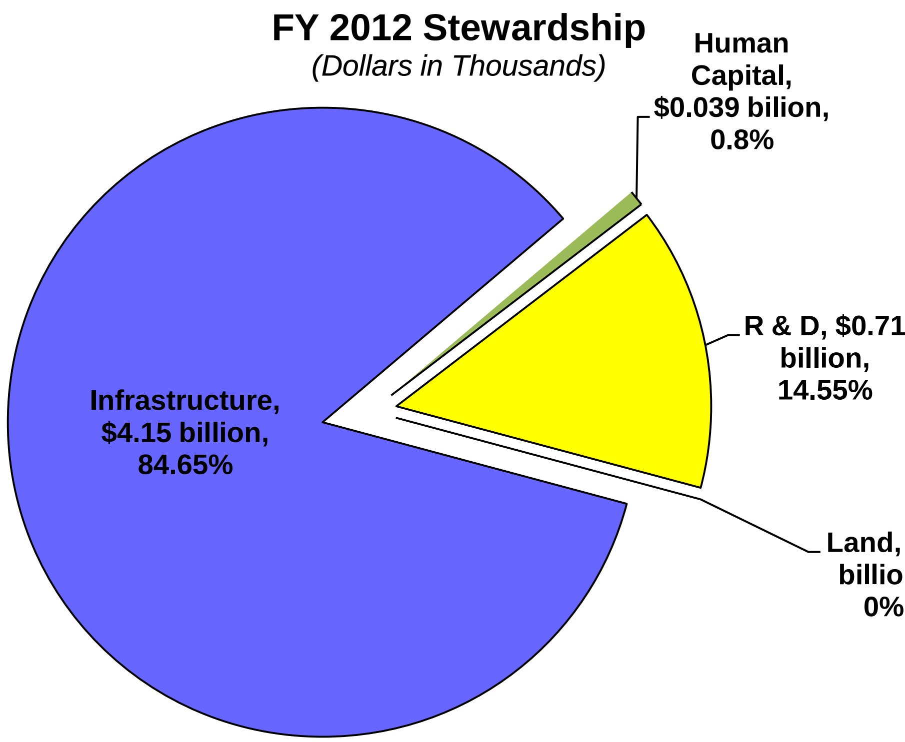




Responsible Financial Stewardship

EPA serves as a steward on behalf of the American people. The chart below presents two categories of stewardship: Stewardship Land and Research and Development, Infrastructure, and Human Capital. In FY 2012, the EPA devoted a total of $4.91 billion to its stewardship activities.

Per Federal Accounting Standards Advisory Board, stewardship investments consist of expenditures made by the Agency for the long-term benefit of the nation that do not result in the federal government acquiring tangible assets.



- Infrastructure efforts focus on clean water and drinking water facilities. The EPA funds construction of wastewater treatment projects and provides grants to states to support wastewater and drinking water treatment facilities. The EPA devoted nearly $4.15 billion in FY 2012 to projects to ensure that people have clean, safe drinking water.

- Research and development activities enable the EPA to identify and assess important risks to human health and the environment. This critical research investment provides the basis for the EPA's regulatory work, including regulations to protect children's health and at-risk communities, drinking water, and the nation's ecosystems.

- Human capital includes the EPA's educational outreach and research fellowships, both of which are designed to enhance the nation's environmental capacity.

- Land includes contaminated sites to which the EPA acquires title under the Superfund authority. This land needs remediation and cleanup because its quality is well below any usable and manageable standards. To gain access to contaminated sites, the EPA acquires easements that are in good and usable condition. These easements also serve to isolate the site and restrict usage while the cleanup is taking place.

A detailed discussion of this information is available in the Required Supplementary Stewardship Information located in Section III of this report.

Financial Management for the Future

As challenges to the environment grow, sound stewardship of EPA's financial resources becomes increasingly critical to the Agency's ability to protect the environment and human health locally, nationally, and internationally. Reliable, accurate, and timely financial information is essential to ensure cost-effective decisions for addressing land, water, air and ecosystem issues.

To strengthen EPA's financial stewardship capabilities, EPA's Office of the Chief Financial Officer focuses on the fundamental elements of financial management: people and systems.

People: EPA leverages every available tool to recruit the best people with the necessary skills to meet tomorrow's financial challenges. Staff members are trained in financial analysis and forecasting to understand financial data and what the data means. EPA is integrating financial information into everyday decision-making so that the Agency maximizes the use of its resources.

Systems: In FY 2012, EPA implemented a component-based approach to managing its financial systems. The Agency put in place a new financial system designed to improve EPA's financial stewardship by strengthening accountability, data integrity, and internal controls. The system, called Compass, is based on a commercial-off-the-shelf software solution that addresses EPA's most critical business needs, including:

- General Ledger
- Accounts Payable
- Accounts Receivable
- Property
- Project Cost
- Intra-Governmental Transactions
- Budget Execution

Compass provides core budget execution and accounting functions, including posting updates to ledgers and tables as transactions are processed and generating source data for the preparation of financial statements and budgetary reports. Compass is integrated with 15 Agency systems that support diverse functions, such as budget planning, execution, and tracking; recovery of Superfund site-specific cleanup costs; property inventory; Agency travel; payroll time and attendance; document and payment tracking; and research planning. Compass is a web-based, open architecture application managed at the CGI Federal Phoenix Data Center, a certified shared service provider in compliance with the Financial Management Line of Business.

Beyond the launch of the core financial system, the financial systems modernization strategy builds upon Compass through the implementation of additional components, subject to future review by OMB:

- Human Resources, Payroll, and Time and Attendance
- Budget Formulation
- Superfund Imaging and Cost Accounting
- Payment Systems

EPA plans to migrate its human resources, payroll, and time and attendance systems to an OMB Human Resources Line of Business approved shared service provider.

Compass is leveraging increases in the EPA's wide area network bandwidth, as well as its implementation of a trusted Internet connection, to facilitate more efficient transaction processing.

Limitations of the Principal Financial Statements

EPA prepared the principal financial statements to report the financial position and results of operations of the Agency, pursuant to the requirements of 31 U.S.C. 3515 (b). While EPA has prepared the statements from the books and records of the entity in accordance with U.S. generally accepted accounting principles for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The statements should be read with the understanding that they are for a component of the U.S. government, a sovereign entity.

IMPROVING MANAGEMENT AND RESULTS

Office of Inspector General Audits, Evaluations, and Investigations

EPA's OIG contributes to the Agency's mission to protect human health and the environment by assessing the efficiency and effectiveness of EPA's program management and results; ensuring that Agency resources are used as intended; developing recommendations for improvements and cost savings; and providing oversight and advisory assistance in helping EPA carry out its Recovery Act objectives. In FY 2012, OIG identified key management challenges and internal control weaknesses and provided over 1,216 recommendations accounting for more than $475 million in potential savings and recoveries and more than 234 actions taken by EPA for improvement from OIG recommendations. OIG audits, evaluations, and investigations accounted for 148 criminal, civil, or administrative enforcement actions.

OIG also contributes to the integrity of and public confidence in the Agency's programs and to the security of its resources by preventing and detecting possible fraud, waste, and abuse and pursuing judicial and administrative remedies. For example, in response to OIG recommendations, the Agency: agreed to establish and enforce expectations for Radiation Network (RadNet) operations readiness; improve planning and management of parts availability and monitor the installation of the remaining RadNet monitors; develop and implement policies and procedures for the Great Lakes National Program Office that address establishing accounts receivable, recording in-kind contributions, completing final accounting, and reviewing the financial capability of nonfederal sponsors; issue guidance requiring that the results of all grant improper payment determinations and recaptures be reported; correct the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) financial statements to reflect the proper payroll and benefits payable amounts and closely monitor the payroll and benefit accruals for FIFRA at year-end; include in the annual regional review of states' checklists an assessment of the coordination between state Drinking Water State Revolving Funds (DWSRF) and enforcement programs; create a national intended-use plan review checklist that includes a requirement to assess coordination between state DWSRF and enforcement programs; identify and implement actions to enhance coordination among regional and state DWSRF and Public Water System Supervision programs; establish a process to resolve disagreements with regions on protectiveness determinations; and improve the consistency, thoroughness, and communication of Office of Superfund Remediation and Technology Innovation reviews and better define protectiveness determinations. Additionally, OIG Recovery Act work accounted for cost savings, questioned costs, recoveries, and forfeitures of $16.8 million during FY 2012, and more than $28.3 million cumulatively since FY 2009.

Grants Management

EPA met or exceeded major performance metrics, including grant closeout and competition goals, under its second long-term Grants Management Plan (2009–2013), which builds on the progress made under the first Grants Management Plan (2003–2008) and will prevent the recurrence of a grants management weakness.

Grants Management Performance Measures for EPA			
Performance Measure	**Target**	**Progress in FY 2012**	**Progress in FY 2011**
Percentage of eligible grants closed out	90%	94% in 2011	93.4% in 2010
	99%	99% in 2010 and earlier	99.5% in 2009 and earlier
Percentage of new grants subject to the competition policy that are competed	90%	97%	96%

ACCOUNTABILITY: SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Federal Managers' Financial Integrity Act (FMFIA)

FMFIA requires agencies to conduct annual evaluations of their internal controls over programs and financial systems and report the results to the President and Congress. In addition, agencies are required to report on the effectiveness of internal controls over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations in accordance with the requirements of Appendix A of *OMB Circular A-123.*

Each year, EPA's national program and regional offices conduct assessments and submit annual assurance letters attesting to the soundness of the internal controls within their organizations. These assurance letters provide the basis for the Administrator's annual statement of assurance on the adequacy of EPA's internal controls over programmatic operations and financial systems. Over the past three years, the Agency has taken several actions that strengthened its compliance with FMFIA For instance, the Agency completed comprehensive on-site Management Integrity Compliance Reviews of all regional and program offices. This three-year effort helped ensure that the Agency better complies with the five GAO internal control standards, and yielded results used to improve the Agency's technical guidance to senior managers. Additionally, the Agency developed mandatory on-line training for senior managers and the Agency's management integrity advisors. The training was designed to help EPA senior managers fulfill their responsibilities for developing and strengthening EPA's internal controls over financial, administrative, and programmatic operations, and to enhance management integrity advisors understanding of the Agency's management integrity program.

To evaluate its internal controls over financial reporting (as required by *OMB Circular A-123,* Appendix A), the Agency reviewed 10 key financial processes and 266 key controls. Based on this evaluation, no new material weaknesses were identified. Subsequent to the Agency's review, EPA's OIG identified one new material weakness, which was corrected by the Agency, and 10 new significant deficiencies during the FY 2012 financial statement audit. But based on the Administrator's FY 2012 statement of assurance is provided below. Based on the results of the Agency's and OIG's FY 2012 evaluations, the Administrator can provide reasonable assurance on the adequacy and effectiveness of EPA's internal controls over programs and financial systems, and the Agency's internal controls over financial operations were found to be operating effectively and efficiently.

Fiscal Year 2012 Annual Assurance Statement

The U.S. Environmental Protection Agency conducted its FY 2012 assessment of the effectiveness of internal controls over programmatic operations and financial activities, as well as conformance of financial systems to government-wide standards. The assessment was conducted in compliance with the *Federal Managers' Financial Integrity Act*; OMB Circular A-123, *Management's Responsibility for Internal Control;* and other applicable laws and regulations.

Based on the results of the EPA's assessment and no findings of material weaknesses, I am providing reasonable assurance that the agency's internal controls over programmatic operations were operating effectively and financial systems conformed to government-wide standards as of September 30, 2012.

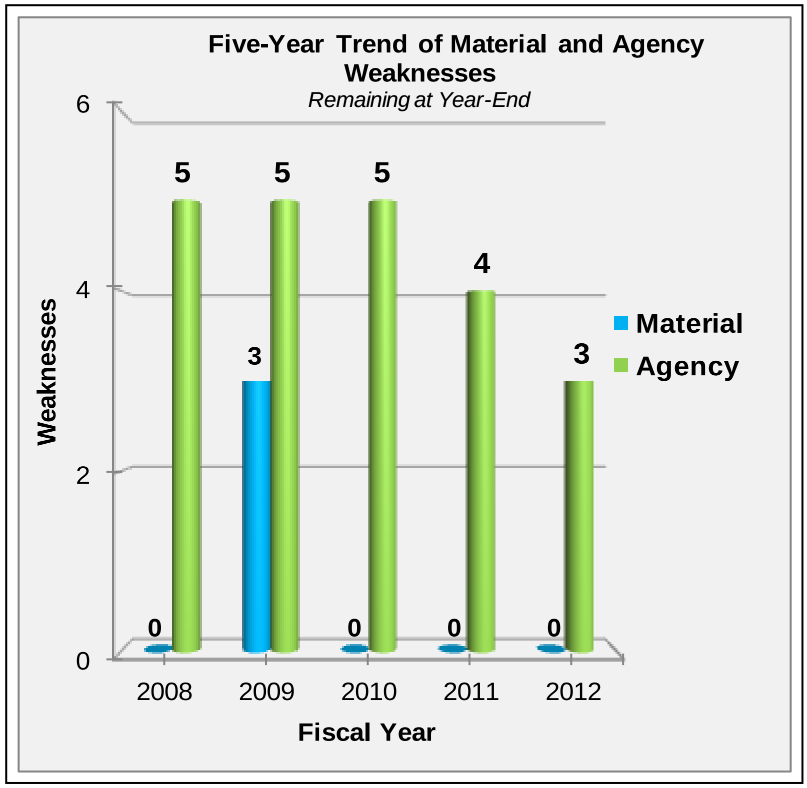
In addition, the EPA assessed the effectiveness of internal controls over financial activities and found no material weaknesses as of June 30, 2012. Subsequently, the agency's Inspector General identified Compass System Limitations as a material weakness. The EPA has corrected this weakness. As a result, internal controls were operating effectively as of September 30, 2012, and no other material weaknesses were found in the design or operation of the internal controls over financial reporting. I am providing reasonable assurance that the EPA's internal controls over financial activities were operating effectively.

Lisa P. Jackson
Administrator

11/15/2012
Date

Management Assurances

For FY 2012, one material weakness was identified by the OIG and subsequently corrected by the Agency. EPA is addressing a number of less severe weaknesses for which corrective actions are underway. Section III of this report provides details about corrective actions underway to rectify weaknesses and deficiencies. EPA will continue monitoring progress toward correcting these issues. The accompanying graph depicts EPA's progress toward correcting its material and Agency-level weaknesses since 2008.



EPA continues to emphasize the importance of maintaining effective internal controls. In FY 2012, the Agency conducted internal program compliance reviews of program and regional offices to help inform and strengthen its FMFIA implementation. Additionally, the Agency provided online training for senior managers and designated staff designed to help them fulfill their roles and responsibilities for maintaining an effective internal controls program.

Federal Financial Management Improvement Act (FFMIA)

FFMIA requires that agencies implement and maintain financial management systems that comply with 1) federal financial management system requirements, 2) applicable federal accounting standards, and 3) the U.S. Government Standard General Ledger. Annually, Agency heads are required to assess and report on whether these systems comply with FFMIA.

EPA's FY 2012 assessment included the following:

- A-123 review found no significant deficiencies.
- OIG's FY 2012 financial statement audit identified one new material weaknesses related to financial management systems. (Section II of this AFR includes the OIG's audit report. Section III of this AFR discusses the Agency's position on OIG's finding.)
- The Agency's annual Federal Information Security Management Act Report did not disclose any material weaknesses.
- The Agency conducted other systems-related activities, including:
    - Third-party control assessments and documentation quality assurance checks.
    - Network scanning for vulnerabilities.
    - Annual certification for access to the Agency's accounting system
    - Completion of security self-assessments with the online Automated System Security Evaluation and Remediation Tracking tool for the accounting system

Based on the assessment described above, the Agency is in compliance with the FFMIA for FY 2012.

Federal Information Security Management Act (FISMA)

FISMA directs federal agencies to annually evaluate the effectiveness of their information security programs and practices and submit a report—including an independent evaluation by the Inspector General (IG)—to the Department of Homeland Security (DHS), OMB, and Congress. Agencies also report quarterly and monthly to DHS and OMB on the status of particular aspects of the information security program.

EPA's Chief Information Officer, senior Agency program officials, and the IG's FY 2012 FISMA Report and FY 2012 FISMA audit status meetings cite no material weakness in information security. The FY 2012 report, however, noted where EPA needs to make significant improvements in continuous monitoring management, configuration management, and risk management. EPA has been making improvements through FY 2012 and will continue to focus efforts through FY 2013 in these areas. The Agency plans to focus on the other Administration Priorities (APs) for information security in FY 2013 to progress on meeting the AP standards.

Inspector General Act Amendments of 1988—Audit Management

EPA uses the results of OIG audits and evaluations to assess its progress toward meeting its strategic goals and to make corrections and adjustments to improve program effectiveness and efficiency. The Agency is continuing to strengthen its audit management, addressing audit follow-up issues and working to complete corrective actions expeditiously and effectively to improve environmental results.

During FY 2012, for example, EPA revised its audit management policy, "EPA Manual 2750, Audit Management Procedures," to clarify roles and responsibilities; ensure consistent audit management and follow-up practices Agencywide; and promote timely, efficient, and effective resolution of OIG as well as Government Accountability Office and Defense Contract Audit Agency (DCAA) findings and recommendations. Completion of this manual culminates an 18-month joint effort between the Agency and OIG. EPA continued the effort it initiated in FY 2009 to conduct quality assurance reviews of national program and regional offices to promote sound audit management and increase Agency awareness of, accountability for, and completion of outstanding unimplemented OIG recommendations. The end of FY 2012 marked EPA's completion of a full round of regional and headquarters office reviews. Additionally, the Agency continues to issue quarterly reports highlighting the status of management decisions and corrective actions. Shared with program office and regional managers throughout EPA, the quarterly reports promote timely audit follow-up and completion of corrective actions.

In FY 2012, EPA was responsible for addressing OIG recommendations and tracking follow-up activities for 433 OIG reports. The Agency achieved final action (completing all corrective actions associated with the audit) on 198 audits, including program evaluation/program performance, assistance agreement, and single audits. This total excludes DCAA audits issued after January 1, 2009; these audits are discussed in a separate section below. EPA's FY 2012 management activities for audits along with associated dollars are represented in the following table*:

Category	Disallowed Costs (Financial Audits)		Funds Put To Better Use (Performance Audits)	
	Number	Value	Number	Value
A. Audits with management decisions but without final action at the beginning of the period	48	$ 22,829,725	67 *	$ 109,637,195
B. Audits for which management decisions were made during the period (i) Management decisions with disallowed costs (18) and with better use funds (3) (ii) Management decisions with no disallowed costs (79) and with no better use funds (44)	162	$ 2,475,708	53	$ 47,262,147
C. Total audits pending final action during the period (A+B)	210	$ 25,305,433	119	$ 156,889,342
D. Final action taken during the period: (i) Recoveries a) Offsets b) Collection c) Value of Property d) Other (ii) Write-Offs (iii) Reinstated Through Grantee Appeal (iv) Value of recommendations completed (v) Value of recommendations management decided should/could not be completed	161	$ 6,304,701 $ 4,532 $ 273,239 $ 0 $ 614,737 $ 100 $ 5,412,093	37	$ 16,586,000 $ 16,586,000
E. Audits without final action at end of period (C-D)	49	$ 19,000,732	82	$ 140,313,342

**Any differences in number of reports and amounts of disallowed costs or funds put to better use between this report and our previous AFR results from corrections made to data in our audit tracking system.*

EPA's FY 2012 management activities for audits without final corrective action are summarized below:

- **Final Corrective Action Not Taken.** Of the 433 audits that EPA tracked, a total of 219—including program evaluation/program performance, assistance agreement, contracts, and single audits—were without final action and not yet fully resolved at the end of FY 2012. (The 16 audits with management decisions under administrative appeal by the grantee are not included in the 219 total; see discussion below.)

- **Final Corrective Action Not Taken Beyond One Year.** Of the 219 unresolved audits, EPA officials had not completed final action on 56 (five of which involve multiple offices) within one year of the management decision (the point at which OIG and the Action Official reach agreement on the corrective action plan). Because the issues to be addressed may be complex, Agency managers often require more than one year after management decisions are reached with the OIG to complete the agreed-on corrective actions. These audits are listed below by category—audits of program performance, single audits, and assistance agreements—and identified by title and responsible office. Additional details are available on EPA's website at http://www.epa.gov/planandbudget/.

Audits of Program Performance. Final action for program performance audits occurs when all corrective actions have been implemented, which may require more than a year if corrections are complex and lengthy. Some audits include recommendations requiring action by more than one office. EPA is tracking 40 audits in the program performance category (five of which involve multiple offices):

Office of Administration and Resources Management

9-P00087+	EPA Plans for Managing Counter Terrorism/Emergency Response Equipment and Protecting Critical Assets
10-P00002	Review of Hotline Complaint on Employee Granted Full-Time Work-at-Home Privilege
11-P00015+	Audit of EPA's Fiscal 2010 and 2009 Consolidated Financial Statements
11-P00031+	EPA Needs to Strengthen Internal Controls for Determining Workforce Levels

Office of Air and Radiation

2005-P00010	Evaluation of CAA Title V Operating Permit Quality
9-P00087+	EPA Plans for Managing Counter Terrorism/Emergency Response Equipment and Protecting Critical Assets
10-P00154	Key Activities in EPA's Integrated Urban Air Toxics Strategy Remain Unimplemented
11-P00010	Energy Star Label Needs to Assure Superior Energy Conservation Performance
11-R00179	EPA Needs to Better Document Project Delays for Recovery Act Diesel Emission Reduction Act Grants

Office of Chemical Safety and Pollution Prevention

10-P00066	EPA Needs a Coordinated Plan to Oversee Its Toxic Substances Control Act Responsibilities

Office of the Chief Financial Officer

9-P00087+	EPA Plans for Managing Counter Terrorism/Emergency Response Equipment and Protecting Critical Assets
10-100029	Audit of 2009 and 2008 (Restated) Consolidated Financial Statements
10-P00177+	Appointment Business Process
11-100015+	Audit of EPA's Fiscal 2010 and 2009 Consolidated Financial Statements
11-P00031+	EPA Needs to Strengthen Internal Controls for Determining Workforce Levels
11-P00223	Review of Travel Controls
11-P00362	EPA Needs to Reexamine How It Defines Its Payment Recapture Audit Program

Office of Enforcement and Compliance Assurance

2001-P00013	State Enforcement Effectiveness- National Audit
2005-P00024	Priority Enforcement and Compliance Assurance Universe
2007-P00027	Benchmarking Other Organizations Statistically Valid Compliance Practices
10-P00007	EPA Oversight and Policy for High Priority Violations of Clean Air Act Need Improvement
10-P00224+	EPA Should Revise Outdated or Inconsistent EPA-State Clean Water Act Memoranda of Agreement
10-P00230	Data Quality Audit of ECHO System Phase II

Office of Environmental Information

2007-P00008	EPA Could Improve Controls over Mainframe Software
10-P00146	Improvements Needed in Key EPA Information System Security Practices
10-P00177+	Appointment Business Process
11-P00277	EPA Has Taken Steps to Address Cyber Threats but Key Actions Remain Incomplete

Office of Research and Development

10-P00176	EPA's Office of Research and Development Performance Measures Need Improvement
11-N00199	EPA's Small Business Innovative Research Awards Should Include Additional Certifications to Reduce Risk
11-P00333	Office of Research and Development Needs to Improve Its Method of Measuring Administrative Savings
11-P00386	Office of Research and Development Should Increase Awareness of Scientific Integrity Policies

Office of Solid Waste and Emergency Response

2007-P00002	Asbestos Cleanup in Libby Montana
8-P00265	EPA Should Continue Efforts to Reduce Unliquidated Obligations in Brownfields Pilot Grants
10-P00042	Lack of Final Guidance on Vapor Intrusion Impedes Efforts to Address Indoor Air Risks

11-P00171	EPA Needs an Agency-Wide Plan to Provide Tribal Solid Waste Management Capacity Assistance
11-P00173	EPA Promoted the Use of Coal Ash Products With Incomplete Risk Information

Office of Water

9-P00223	EPA Needs to Accelerate Adoption of Numeric Nutrient Water Quality Standards
10-P00081	EPA Needs Procedures to Address Delayed Earmark Projects
10-P00224+	EPA Should Revise Outdated or Inconsistent EPA-State Clean Water Act Memoranda of Agreement
11-P00001	EPA Lacks Internal Controls to Prevent Misuse of Emergency Drinking Water Facilities

Region 1

2009-P00119	Improved Management of Special Accounts Will Make More Funds Available

Region 2

2007-P00016	Ringwood Mines/Landfill Superfund Site

Region 3

10-P00055	Changes in Conditions at Wildcat Landfill Superfund Site in Delaware Call for Increased EPA Oversight

Region 4

11-P00221	Oversight of North Carolina's Renewals of Thermal Variances
11-P00228	EPA Should Reduce Unliquidated Obligations Under Expense Reimbursements Grants

Region 9:

2008-P00196	Making Better Use of Stringfellow SF Special Accounts

+ Indicates audits involving more than one office

Single Audits. Final action for single audits occurs when nonmonetary compliance actions are completed. Achieving final action may require more than a year if the findings are complex or the grantee does not have the resources to take corrective action. Single audits are conducted of nonprofit organizations, universities, and state and local governments. EPA is tracking completion of corrective action on 12 single audits for the period beginning October 1, 2012.

Region 2

2007-300139	State of New York, FY 2006

Region 6

11-300322	New Mexico Environment Department FY 2010

Region 9:

9-300234	Guam Waterworks Authority FY 2008
10-300164	Guam Waterworks Authority FY 2009
10-300208	City of Nogales FY 2008

Region 10

2002-300009	Iliama Village Council
2002-300042	Iliama Village Council
2003-300047	Stevens Village Council
2003-300117	Stevens Village Council
2003-300145	Circle Village Council
2006-300167	State of Alaska - FY 2003
2006-300168	State of Alaska - FY 2004

Audits of Assistance Agreements. Reaching final action for assistance agreement audits may require more than a year, as the grantee may appeal, refuse to repay, or be placed on a repayment plan that spans several years. EPA is tracking four audits in this category:

Region 2
1989-901299 Nassau County, NY
1990-001119 Nassau County NY

Region 3
2001-100101 Center for Chesapeake Communities (CCC) Assist. Agreements

Region 5
2008-200039 Village of Laurelville, Ohio

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 2012, 16 audits were in administrative appeal. When these audits are out of appeal and all issues have been resolved, they will be captured in audit follow-up data reported in EPA's *AFR*.

DCAA Audits

Prior to January 1, 2009, DCAA audits of EPA contracts were requested by EPA's OIG and the results included in OIG's Semiannual Report to Congress. EPA will continue to track and report on these and other OIG audits (included in the IG Act summary above) until they are resolved and final actions are taken. Beginning January 1, 2009, however, EPA's Office of Acquisition Management assumed responsibility for requesting DCAA audits. Accordingly, these audits are now reported separately from OIG audits. Following is an overview of DCAA audit activity for the period October 1, 2011, through September 30, 2012.

Summary of Audit Activities for the Period Ending September 30, 2012

During this reporting period, Agency management was accountable for monitoring 71 DCAA audits. The Agency achieved final action on 25 audits. EPA's FY 2012 management activities for DCAA audits and associated dollars are represented in the following table:

Category	Disallowed Costs (Financial Audits)		Funds Put To Better Use (Performance Audits)	
	Number	Value	Number	Value
A. Audits with management decisions but without final action at the beginning of the period	0	$ 0	0	$ 0
B. Audits for which management decisions were made during the period (i) Management decisions with disallowed costs (8) (ii) Management decisions with no disallowed costs (18)	26	$ 333,704	0	$ 0
C. Total audits pending final action during the period (A+B)	26	$ 333,704	0	$ 0

D. Final action taken during the period: (i) Recoveries a) Offsets b) Collection c) Value of Property d) Other (ii) Write-Offs (iii) Reinstated Through Grantee Appeal (iv) Value of recommendations completed (v) Value of recommendations management decided should/could not be completed	25	$ 333,704 $ 0 $ 0 $ 0 $ 333,704 $ 0 $ 0	0	$ 0 $ 0 $ 0	
E. Audits without final action at end of period (C-D)	1	$ 0	0	$ 0	

Final Corrective Action Not Taken on DCAA Audit Report
Of the 71 DCAA audits that EPA tracked, a total of 46 were without final action and not yet fully resolved at the end of FY 2012.

DCAA Audits Awaiting Decision on Appeal

As of September 30, 2012, no management decisions were in administrative appeal status.

DCAA Audits Without Management Decision in 180 Days

As of September 30, 2012, EPA was tracking no DCAA reports for which EPA is the cognizant Agency and for which a management decision has not been reached more than 180 days from the date of the report.

Section II

Financial Section

Message from the Chief Financial Officer

The EPA's Agency Financial Report presents the performance and financial results that the agency achieved during fiscal year 2012. It provides information on the agency's accomplishments and challenges in protecting human health and the environment, use of the financial resources entrusted to us, and progress toward addressing key management challenges. During FY 2012, the agency continued to demonstrate efficient, effective and accountable administration and make innovative improvements to increase efficiency and reduce costs.

As required by Office of Management and Budget Circular A-123 and the Federal Managers' Financial Integrity Act, we conducted an annual assessment of the effectiveness of internal controls over financial reporting and programmatic operations. Based on the results of the agency's FY 2012 evaluation and reviews, the Administrator can provide reasonable assurance on the adequacy and effectiveness of the agency's internal controls over programs, financial activities and financial systems.

In FY 2012, the EPA launched Compass, the agency's new, re-scoped financial system on time and within budget. Compass serves as the foundation for a unified and integrated systems infrastructure for the agency to support sound financial management. Redesigned policies and procedures led to the successful conversion of over 11 million records (or 100 percent of the target legacy system data) to Compass, helping to ensure smooth operations for the agency.

To strengthen agency programs and operations, the EPA issued the newly revised policy for agency audit management and follow-up during FY 2012. The updated manual provides a consolidated resource for audit management guidance, ensuring consistent procedures across the agency. The updated manual – designed to promote timely, efficient and effective resolution of audit findings and recommendations – reflects a collaborative effort among agency program offices and regions, along with our Office of Inspector General.

During FY 2012, the agency developed a new payment process in response to an OMB directive requiring agencies to expedite payments to small businesses within 15 calendar days. Given our excellent on-time payment record and ability to elevate small business invoices for fast-track processing, the EPA was able to comply with this directive prior to the OMB deadline while maintaining effective management controls.

To ensure that the agency is effectively managing its resources, the EPA developed and implemented guidance to reduce conference spending during the fiscal year. This guidance establishes new internal controls that promote efficiency agencywide by instituting a rigorous system for tracking, reviewing and approving conference-related activities.

As Chief Financial Officer, I take seriously my responsibility to provide informed financial analysis to agency leaders and the public. As we start the new fiscal year, we will uphold our commitment to financial excellence, move money out faster for projects and ensure taxpayers' dollars are utilized effectively in fulfilling our mission to protect human health and the environment. We achieved great things this fiscal year, and I look forward to continuing our success through collaboration with our partners and stakeholders and implementing innovative, cross-cutting strategies to help meet the challenges ahead.

B J Bennett

Barbara J. Bennett
Chief Financial Officer
November 15, 2012

Principal Financial Statements

Financial Statements

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2. Consolidated Statement of Net Cost
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Superfund Financial Statements and Related Notes

Environmental Protection Agency
Consolidated Balance Sheet
As of September 30, 2012 and 2011
(Dollars in Thousands)

		FY 2012		FY 2011
ASSETS				
Intragovernmental:				
Fund Balance With Treasury (Note 2)	$	10,856,475	$	12,662,541
Investments (Note 4)		4,620,231		7,112,197
Accounts Receivable, Net (Note 5)		28,216		35,518
Other (Note 6)		252,837		251,803
Total Intragovernmental	$	15,757,759	$	20,062,059
Cash and Other Monetary Assets (Note 3)		10		10
Accounts Receivable, Net (Note 5)		491,122		514,190
Loans Receivable, Net - Non-Federal (Note 7)		136		2,107
Property, Plant & Equipment, Net (Note 9)		1,010,021		966,799
Other (Note 6)		3,134		2,566
Total Assets	$	**17,262,182**	**$**	**21,547,731**
Stewardship PP& E (Note 11)				
LIABILITIES				
Intragovernmental:				
Accounts Payable and Accrued Liabilities (Note 8)		55,021		52,448
Debt Due to Treasury (Note 10)		1,063		2,593
Custodial Liability (Note 12)		118,900		56,703
Other (Note 13)		117,520		132,910
Total Intragovernmental	$	292,504	$	244,654
Accounts Payable & Accrued Liabilities (Note 8)	$	775,281	$	916,766
Pensions & Other Actuarial Liabilities (Note 15)		46,905		44,833
Environmental Cleanup Costs (Note 22)		21,560		20,838
Cashout Advances, Superfund (Note 16)		735,837		790,069
Commitments & Contingencies (Note 18)		25,180		10,180
Payroll & Benefits Payable (Note 33)		266,727		272,335
Other (Note 13)		105,068		103,989
Total Liabilities	$	2,269,062	$	2,403,664
NET POSITION				
Unexpended Appropriations - Other Funds (Note 17)		9,811,870		11,462,598
Cumulative Results of Operations - Earmarked Funds (Note 19)		4,504,199		7,027,163
Cumulative Results of Operations - Other Funds		677,051		654,306
Total Net Position		14,993,120		19,144,067
Total Liabilities and Net Position	**$**	**17,262,182**	**$**	**21,547,731**

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

Environmental Protection Agency
Consolidated Statement of Net Cost
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)

	FY 2012	FY 2011
COSTS		
Gross Costs (Note 20)	$ 10,905,272	$ 11,577,224
Less:		
Earned Revenue (Note 20)	521,826	698,331
NET COST OF OPERATIONS (Note 20)	**$ 10,383,446**	**$ 10,878,893**

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

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2012
(Dollars in Thousands)

	Clean Air	Clean & Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
Costs:					
Intragovernmental	$ 184,695	$ 380,760	$ 358,603	$ 184,459	$ 216,865
With the Public	1,027,551	5,177,804	2,175,713	593,659	605,163
Total Costs (Note 20)	1,212,246	5,558,564	2,534,316	778,118	822,028
Less:					
Earned Revenue, Federal	12,171	8,220	79,371	12,092	5,877
Earned Revenue, non Federal	1,372	33,654	255,421	37,106	76,542
Total Earned Revenue (Notes 20)	13,543	41,874	334,792	49,198	82,419
NET COST OF OPERATIONS (Note 20)	**$ 1,198,703**	**$ 5,516,690**	**$ 2,199,524**	**$ 728,920**	**$ 739,609**

	Consolidated Totals
Costs:	
Intragovernmental	$ 1,325,382
With the Public	9,579,890
Total Costs (Note 20)	10,905,272
Less:	
Earned Revenue, Federal	117,731
Earned Revenue, non Federal	404,095
Total Earned Revenue (Notes 20)	521,826
NET COST OF OPERATIONS (Note 20)	**$ 10,383,446**

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

Environmental Protection Agency
Consolidated Statement of Net Cost by Goal
For the Period Ending September 30, 2011
(Dollars in Thousands)

	Clean Air	Clean & Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
Costs:					
Intragovernmental	$ 159,456	$ 252,748	$ 390,431	$ 335,757	$ 192,243
With the Public	1,035,680	5,125,894	2,180,996	1,289,505	614,514
Total Costs (Note 20)	1,195,136	5,378,642	2,571,427	1,625,262	806,757
Less:					
Earned Revenue, Federal	13,586	7,333	124,874	12,010	3,607
Earned Revenue, non Federal	1,034	1,458	494,249	38,725	1,455
Total Earned Revenue (Notes 20)	14,620	8,791	619,123	50,735	5,062
NET COST OF OPERATIONS (Note 20)	**$ 1,180,516**	**$ 5,369,851**	**$ 1,952,304**	**$ 1,574,527**	**$ 801,695**

	Consolidated Totals
Costs:	
Intragovernmental	$ 1,330,635
With the Public	10,246,589
Total Costs (Note 20)	11,577,224
Less:	
Earned Revenue, Federal	161,410
Earned Revenue, non Federal	536,921
Total Earned Revenue (Notes 20)	698,331
NET COST OF OPERATIONS (Note 20)	**$ 10,878,893**

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

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Period Ending September 30, 2012
(Dollars in Thousands)

		FY 2012 Earmarked Funds		FY 2012 All Other Funds		FY 2012 Consolidated Total
Cumulative Results of Operations:						
Net Position - Beginning of Period		7,027,163		654,306		7,681,469
Beginning Balances, as Adjusted	$	7,027,163	$	654,306	$	7,681,469
Budgetary Financing Sources:						
Appropriations Used		-		9,814,392		9,814,392
Nonexchange Revenue - Securities Investment (Note 35)		87,454		-		87,454
Nonexchange Revenue - Other (Note 35)		200,069		-		200,069
Transfers In/Out (Note 31)		(2,418,773)		32,018		(2,386,755)
Trust Fund Appropriations		1,075,367		(1,075,367)		-
Total Budgetary Financing Sources	$	(1,055,883)	$	8,771,043	$	7,715,160
Other Financing Sources (Non-Exchange)						
Imputed Financing Sources (Note 32)		26,337		141,806		168,143
Other Financing Sources		(76)		-		(76)
Total Other Financing Sources	$	26,261	$	141,806	$	168,067
Net Cost of Operations		(1,493,342)		(8,890,104)		(10,383,446)
Net Change		(2,522,964)		22,745		(2,500,219)
Cumulative Results of Operations	$	**4,504,199**	$	**677,051**	$	**5,181,250**

		FY 2012 Earmarked Funds		FY 2012 All Other Funds		FY 2012 Consolidated Total
Unexpended Appropriations:						
Net Position - Beginning of Period		-		11,462,598		11,462,598
Beginning Balances, as Adjusted		-		11,462,598		11,462,598
Budgetary Financing Sources:						
Appropriations Received		-		8,251,902		8,251,902
Appropriations Transferred In/Out (Note 31)		-		5		5
Other Adjustments (Note 34)		-		(88,243)		(88,243)
Appropriations Used		-		(9,814,392)		(9,814,392)
Total Budgetary Financing Sources		-		(1,650,728)		(1,650,728)
Total Unexpended Appropriations		-		9,811,870		9,811,870
TOTAL NET POSITION	**$**	**4,504,199**	**$**	**10,488,921**	**$**	**14,993,120**

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

Environmental Protection Agency
Consolidating Statement of Changes in Net Position
For the Periods Ending September 30, 2011
(Dollars in Thousands)

	FY 2011 Earmarked Funds	FY 2011 All Other Funds	FY 2011 Consolidated Total
Cumulative Results of Operations:			
Net Position - Beginning of Period	7,152,382	617,456	7,769,838
Beginning Balances, as Adjusted	$ 7,152,382	$ 617,456	$ 7,769,838
Budgetary Financing Sources:			
Appropriations Used	-	10,287,988	10,287,988
Nonexchange Revenue - Securities Investment (Note 35)	120,429	-	120,429
Nonexchange Revenue - Other (Note 35)	184,984	-	184,984
Transfers In/Out (Note 31)	(17,068)	35,410	18,342
Trust Fund Appropriations	1,156,073	(1,156,073)	-
Total Budgetary Financing Sources	$ 1,444,418	$ 9,167,325	$ 10,611,743
Other Financing Sources (Non-Exchange)			
Donations and Forfeitures of Property	-	50	50
Transfers In/Out (Note 31)	1	76	77
Imputed Financing Sources (Note 32)	29,661	148,993	178,654
Total Other Financing Sources	$ 29,662	$ 149,119	$ 178,781
Net Cost of Operations	(1,599,299)	(9,279,594)	(10,878,893)
Net Change	(125,219)	36,850	(88,369)
Cumulative Results of Operations	**$ 7,027,163**	**$ 654,306**	**$ 7,681,469**

	FY 2011 Earmarked Funds	FY 2011 All Other Funds	FY 2011 Consolidated Total
Unexpended Appropriations:			
Net Position - Beginning of Period	-	13,342,784	13,342,784
Beginning Balances, as Adjusted	$ -	$ 13,342,784	$ 13,342,784
Budgetary Financing Sources:			
Appropriations Received	-	8,583,238	8,583,238
Appropriations Transferred In/Out (Note 31)	-	1,750	1,750
Other Adjustments (Note 34)		(177,186)	(177,186)
Appropriations Used	-	(10,287,988)	(10,287,988)
Total Budgetary Financing Sources	-	(1,880,186)	(1,880,186)
Total Unexpended Appropriations	-	11,462,598	11,462,598
TOTAL NET POSITION	**$ 7,027,163**	**$ 12,116,904**	**$ 19,144,067**

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

Environmental Protection Agency
Combined Statement of Budgetary Resources
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)

	FY 2012	FY 2011
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:	$ 3,497,850	$ 4,626,341
Unobligated balance brought forward, October 1, as adjusted	3,497,850	4,626,341
Recoveries of Prior Year Unpaid Obligations (Note 27)	571,576	270,664
Other changes in unobligated balance	(31,639)	(179,693)
Unobligated balance from prior year budget authority, net	4,037,787	4,717,312
Appropriations (discretionary and mandatory)	11,948,399	10,020,838
Spending authority from offsetting collections (discretionary and mandatory)	583,051	750,277
Total Budgetary Resources (Note 26)	$ 16,569,237	$ 15,488,427
STATUS OF BUDGETARY RESOURCES		
Obligations incurred (Note 26)	$ 13,782,833	$ 11,990,577
Unobligated balance, end of year:		
Apportioned (Note 28)	2,609,127	3,326,812
Unapportioned	177,277	171,038
Total unobligated balance, end of period	2,786,404	3,497,850
Total Status of Budgetary Resources	$ 16,569,237	$ 15,488,427
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations, Brought Forward, October 1 (gross)	$ 12,774,894	$ 13,872,909
Uncollected customer payments from Federal Sources, brought forward, October 1	(438,428)	(439,956)
Obligated balance, start of year (net), before adjustments	12,336,466	13,432,953
Obligated balance, start of year (net), as adjusted	12,336,466	13,432,953
Obligations incurred	13,782,833	11,990,577
Outlays (gross)	(14,674,309)	(12,817,928)
Change in uncollected customer payments from Federal sources	(132,914)	1,528
Recoveries of prior year unpaid obligations	(571,576)	(270,664)
Obligated balance, end of period		
Unpaid obligations, end of year (gross)	11,311,842	12,774,894
Uncollected customer payments from Federal sources, end of year	(305,514)	(438,428)
Obligated balance, end of period (net)	$ 11,006,328	$ 12,336,466
BUDGET AUTHORITY AND OUTLAYS, NET:		
Budget authority, gross (discretionary and mandatory)	$ 12,531,450	$ 10,771,115
Actual offsetting collections (discretionary and mandatory)	(715,965)	(751,805)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(132,914)	1,528
Budget authority, net (discretionary and mandatory)	$ 11,682,571	$ 10,020,838
Outlays, gross (discretionary and mandatory) (Note 26)	$ 14,674,309	$ 12,817,928
Actual offsetting collections (discretionary and mandatory) (Note 26)	(715,965)	(751,805)
Outlays, net (discretionary and mandatory)	13,958,344	12,066,123
Distributed offsetting receipts (Notes 26 and 30)	(1,163,736)	(1,291,761)
Agency outlays, net (discretionary and mandatory)	$ 12,794,608	$ 10,774,362

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

Environmental Protection Agency
Statement of Custodial Activity
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)

	FY 2012	FY 2011
Revenue Activity:		
Sources of Cash Collections:		
Fines and Penalties	$ 172,938	$ 126,212
Other	(51,707)	(4,024)
Total Cash Collections	$ 121,231	$ 122,188
Accrual Adjustment	62,980	4,163
Total Custodial Revenue (Note 25)	$ 184,211	$ 126,351
Disposition of Collections:		
Transferred to Others (General Fund)	$ 121,234	$ 122,910
Increases/Decreases in Amounts to be Transferred	62,977	3,441
Total Disposition of Collections	$ 184,211	$ 126,351
Net Custodial Revenue Activity (Note 25)	**$ -**	**$ -**

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

Note 1. Summary of Significant Accounting Policies

A. Reporting Entities

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

The FY 2012 financial statements are presented on a consolidated basis for the Balance Sheet, Statements of Net Cost, Changes in Net Position and Custodial Activity and a combined basis for the Statement of Budgetary Resources. These financial statements include the accounts of all funds described in this note by their respective Treasury fund group.

B. Basis of Presentation

These accompanying financial statements have been prepared to report the financial position and results of operations of the U. S. Environmental Protection Agency (EPA or Agency) as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The reports have been prepared from the financial system and records of the Agency in accordance with Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, and the EPA accounting policies, which are summarized in this note. The Statement of Net Cost has been prepared with cost segregated by the Agency's strategic goals.

C. Budgets and Budgetary Accounting

1. General Funds

Congress adopts an annual appropriation for State and Tribal Assistance Grants (STAG), Buildings and Facilities (B&F), and for Payments to the Hazardous Substance Superfund to be available until expended, as well as annual appropriations for Science and Technology (S&T), Environmental Programs and Management (EPM) and for the Office of Inspector General (OIG) to be available for 2 fiscal years. When the appropriations for the General Funds are enacted, Treasury issues a warrant to the respective appropriations. As the Agency disburses obligated amounts, the balance of funds available to the appropriation is reduced at Treasury.

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

Funds transferred from other federal agencies are processed as non-expenditure transfers. As the Agency disburses the obligated amounts, the balance of funding available to the appropriation is reduced at Treasury.

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

2. Revolving Funds

Funding of the Reregistration and Expedited Processing Fund (FIFRA) and Pesticide Registration Funds (PRIA) 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 Working Capital Fund (WCF) is provided by fees collected from other Agency appropriations and other federal agencies to offset costs incurred for providing Agency administrative support for computer and telecommunication services, financial system services, employee relocation services, and postage.

3. Special Funds

The Environmental Services Receipt Account obtains fees associated with environmental programs.

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

4. Deposit Funds

Deposit accounts receive no appropriated funds. Amounts are recorded to the deposit accounts pending further disposition. These are not EPA's funds.

5. Trust Funds

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

D. Basis of Accounting

Generally Accepted Accounting Principles (GAAP) for Federal entities is the standard prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard-setting body for the Federal government. The financial statements are prepared in accordance with GAAP for Federal entities.

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

E. Revenues and Other Financing Sources

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

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

Most of the 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 receives funding to support the subsidy cost of loans through appropriations which may be used within statutory limits. The Asbestos Direct Loan Financing fund 4322, an off-budget fund, receives additional funding to support the outstanding loans through collections from the Program fund 0118 for the subsidized portion of the loan.

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

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

F. Funds with the Treasury

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

G. Investments in U.S. Government Securities

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

H. Notes Receivable

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

I. Marketable Securities

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

J. Accounts Receivable and Interest Receivable

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

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

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

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

K. Advances and Prepayments

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

L. Loans Receivable

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

M. Appropriated Amounts Held by Treasury

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

N. Property, Plant, and Equipment

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

A purchase of EPA-held or contract personal property is capitalized if it is valued at $25 thousand or more and has an estimated useful life of at least 2 years. For contractor held property, depreciation is 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. Detailed records are maintained and accounted for in contractor systems, not in FAS for contractor held property. Acquisitions of EPA-held personal property are depreciated using the straight-line method over the specific asset’s useful life, ranging from 2 to 15 years.

Personal property also consists of capital leases. To be defined as a capital lease, it must, at its inception, have a lease term of two or more years and the lower of the fair value or present value of the minimum lease payments must be $75 thousand or more. Capital leases may also contain real property (therefore considered in the real property category as well), but these need to meet an $85 thousand capitalization threshold. In addition, the lease must meet one of the following criteria: transfers ownership to EPA, contains a bargain purchase option, the lease term is equal to 75 percent or more of the estimated economic service life, or the present value of the lease and other minimum lease payments equal or exceed 90 percent of the fair value.

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

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

Real property consists of land, buildings, capital and leasehold improvements and capital leases. Real property, other than land, is capitalized when the value is $85 thousand or more. Land is capitalized regardless of cost. Buildings are valued at an estimated original cost basis, and land is valued at fair market value if purchased prior to FY 1997. Real property purchased after FY 1996 is valued at actual cost. Depreciation for real property is calculated using the straight-line method over the specific asset’s useful life, ranging from 10 to 102 years. Leasehold improvements are amortized over the lesser of their useful life or the unexpired lease term. Additions to property and improvements not meeting the capitalization criteria, expenditures for minor alterations, and repairs and maintenance are expensed when incurred.

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

O. Liabilities

Liabilities represent the amount of monies or other resources that are more likely than not to be paid by the Agency as the result of an Agency transaction or event that has already occurred and can be reasonably estimated. 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 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.

R. Accrued Unfunded Annual Leave

Annual, sick and other leave is expensed as taken during the fiscal year. Sick leave earned but not taken is not accrued as a liability. Annual leave earned but not taken as of the end of the fiscal year is accrued as an unfunded liability. Accrued unfunded annual leave is included in Note 33 as a component of “Payroll and Benefits Payable.”

S. Retirement Plan

There are two primary retirement systems for federal employees. Employees hired prior to January 1, 1987, may participate in the Civil Service Retirement System (CSRS). On January 1, 1984, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, elected to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which the Agency automatically contributes one percent of pay and matches any employee contributions up to an additional four percent of pay. The Agency also contributes the employer’s matching share for Social Security.

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

T. Prior Period Adjustments and Restatements

Prior period adjustments, if any, are 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.

U. Recovery Act Funds

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (Recovery Act). The Act was enacted to create jobs in the United States, encourage technical advances, assist in modernizing the nation's infrastructure, and enhance energy independence. The EPA was charged with the task of distributing funds to invest in various projects aimed at creating advances in science, health, and environmental protection that will provide long-term economic benefits.

EPA manages almost $7.22 billion in Recovery Act funded projects and programs that will help achieve these goals, offer resources to help other “green” agencies, and administer environmental laws that will govern Recovery activities. As of September 30, 2012, EPA has paid out $6.9 billion.

EPA, in collaboration with states, tribes, local governments, territories and other partners, is administering the funds it received under the Recovery Act through four appropriations. The funds include:

- State and Tribal Assistance Grants (STAG) that in turn include:
    - $4 billion for assistance to help communities with water quality and wastewater infrastructure needs and $2 billion for drinking water infrastructure needs (Clean Water and Drinking Water State Revolving Fund programs and Water Quality Planning program);
    - $100 million for competitive grants to evaluate and clean up former industrial and commercial sites (Brownfields program);
    - $300 million for grants and loans to help regional, state and local governments, tribal agencies, and non-profit organizations with projects that reduce diesel emissions (Clean Diesel programs);
- $600 million for the cleanup of hazardous sites (Superfund program);
- $200 million for cleanup of petroleum leaks from underground storage tanks (Leaking Underground Storage Tank program); and
- $20 million for audits and investigations conducted by the Inspector General (IG).

The vast majority of the contracts awarded under the Recovery Act will be entered into using competitive contracts. EPA is committed fully to ensuring transparency and accountability throughout the Agency in spending Recovery Act funds in accordance with OMB guidance.

EPA set up a Stimulus Steering Committee that meets to review and report on the status of the distribution of the Recovery Act Funds to ensure transparency and accuracy. EPA also developed a Stewardship Plan which is an Agency-level risk mitigation plan that sets out the Agency's Recovery Act risk assessment, internal controls and monitoring activities. The Stewardship Plan is divided into seven functional areas: grants, interagency agreements, contracts, human capital/payroll, budget execution, performance reporting and financial reporting. The Stewardship Plan was developed around Government Accountability Office (GAO) standards for internal control. Under each functional area, risks are assessed and related control, communication and monitoring activities are identified for each impacted program. The Plan is a dynamic document and will be updated as revised OMB guidance is issued or additional risks are uncovered.

EPA has the three-year EPM treasury symbol 6809/100108 that was established to track the appropriate operation and maintenance of the funds. EPA’s other Recovery Act programs are the following: Office of Inspector General, treasury symbol 6809/120113; State and Tribal Assistance

Grants, treasury symbol 6809/100102; Payment to the Superfund, treasury symbol 6809/100249; Superfund, treasury symbol 6809/108195; and Leaking Underground Storage Tank, treasury symbol 6809/108196.

V. Deepwater Horizon Oil Spill

On April 20, 2010 the Deepwater Horizon drilling rig exploded, releasing large volumes of oil into the Gulf of Mexico. As a responsible party, BP is required by the 1990 Oil Pollution Act to fund the cost of the response and cleanup operations. In FY 2011, the EPA worked on the cleanup effort in conjunction with the U.S. Coast Guard who was named the lead Federal On-Scene Coordinator and continues to assist the Department of Justice on the pending civil litigation.

W. Use of Estimates

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2. Fund Balance with Treasury (FBWT)

Fund Balance with Treasury as of September 30, 2012 and 2011, consists of the following:

	FY 2012			FY 2011		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Trust Funds:						
Superfund	$ 95,604	$ -	$ 95,604	$ 114,540	$ -	$ 114,540
LUST	35,310	-	35,310	60,558	-	60,558
Oil Spill & Misc.	4,682	-	4,682	4,085	-	4,085
Revolving Funds:						
FIFRA/Tolerance	4,808	-	4,808	3,571	-	3,571
Working Capital	68,319	-	68,319	68,776	-	68,776
Cr. Reform Finan.	599	-	599	390	-	390
Appropriated	10,300,004	-	10,300,004	12,086,770	-	12,086,770
Other Fund Types	338,748	8,401	347,149	314,522	9,329	323,851
Total	**$ 10,848,074**	**$ 8,401**	**$ 10,856,475**	**$ 12,653,212**	**$ 9,329**	**$ 12,662,541**

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 2012**		**FY 2011**
Unobligated Amounts in Fund Balance:				
Available for Obligation	$	2,609,126	$	3,326,812
Unavailable for Obligation		177,277		171,038
Net Receivables from Invested Balances		(3,269,572)		(3,485,275)
Balances in Treasury Trust Fund (Note 37)		(994)		1,310
Obligated Balance not yet Disbursed		11,005,812		12,336,466
Non-Budgetary FBWT		334,826		312,190
Totals	$	**10,856,475**	$	**12,662,541**

The funds available for obligation may be apportioned by 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 2012 and FY 2011 no differences existed between Treasury's accounts and EPA's statements for fund balances with Treasury.

Note 3. Cash and Other Monetary Assets

As of September 30, 2012 and 2011, the balance in the imprest fund was $10 thousand.

Note 4. Investments

As of September 30, 2012 and 2011 investments related to Superfund and LUST consist of the following:

			Cost		**Amortized (Premium) Discount**		**Interest Receivable**		**Investments, Net**		**Market Value**
Intragovernmental Securities:											
Non-Marketable	FY 2012	$	4,509,646		(103,614)		6,971	$	4,620,231	$	4,620,231
Non-Marketable	FY 2011	$	6,959,480	$	(137,103)	$	15,614	$	7,112,197	$	7,112,197

CERCLA, as amended by SARA, authorizes EPA to recover monies to clean up Superfund sites from responsible parties (RPs). Some RPs file for bankruptcy under Title 11 of the U.S. Code. In bankruptcy settlements, EPA is an unsecured creditor and is entitled to receive a percentage of the assets remaining after secured creditors have been satisfied. Some RPs satisfy their debts by issuing securities of the reorganized company. The Agency does not intend to exercise ownership rights to these securities, and instead will convert them to cash as soon as practicable (see Note 6). All investments in Treasury securities are earmarked funds (see Note 19).

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

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

Note 5. Accounts Receivable, Net

The Accounts Receivable as of September 30, 2012 and 2011 consist of the following:

		FY 2012		FY 2011
Intragovernmental:				
Accounts & Interest Receivable	$	29,027	$	35,518
Less: Allowance for Uncollectibles	$	(811)	$	-
Total	$	**28,216**	$	**35,518**
Non-Federal:				
Unbilled Accounts Receivable	$	139,138	$	159,170
Accounts & Interest Receivable		2,036,177		2,176,215
Less: Allowance for Uncollectibles		(1,684,193)		(1,821,195)
Total	**$**	**491,122**	**$**	**514,190**

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

Note 6. Other Assets

Other Assets as of September 30, 2012 and 2011 consist of the following:

Intragovernmental:		FY 2012		FY 2011
Advances to Federal Agencies	$	252,537	$	251,649
Advances for Postage		300		154
Total	**$**	**252,837**	**$**	**251,803**
Non-Federal:				
Travel Advances	$	202	$	486
Other Advances		2,625		1,838
Operating Materials and Supplies		140		140
Inventory for Sale		167		102
Total	**$**	**3,134**	**$**	**2,566**

Note 7. Loans Receivable, Net

Loans Receivable consists of Asbestos Loan Program loans disbursed from obligations made prior to FY 1992 and are presented net of allowances for estimated uncollectible loans, if an allowance was considered necessary. Loans disbursed from obligations made after FY 1991 are governed by the Federal Credit Reform Act, which mandates that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, anticipated delinquencies, and defaults) associated with direct loans be recognized as an expense in the year the loan is made. The net loan present value is the gross loan receivable less the subsidy present value. The amounts as of September 30, 2012 and 2011 are as follows:

	FY 2012			FY 2011		
	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	$ -	-	$ -	$ 44	$ -	$ 44
Direct Loans Obligated After FY 1991	496	(360)	136	2,194	(131)	2,063
Total	**$ 496**	**$ (360)**	**$ 136**	**$ 2,238**	**$ (131)**	**$ 2,107**

* 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).

During FY 2008, the EPA made a payment within the U.S. Treasury for the Asbestos Loan Program based on an upward re-estimate of $33 thousand for increased loan financing costs. It was believed that the payment only consisted of "interest" costs and, as such, an automatic apportionment, per OMB Circular A-11, Section 120.83, was deemed appropriate. However, approximately one third ($12 thousand) of the $33 thousand re-estimate was for increased "subsidy" costs which requires an approved apportionment by OMB before any payment could be made. Therefore, the payment resulted in a minor technical Antideficiency Act (ADA) violation. On October 13, 2009, EPA transmitted, as required by OMB Circular A-11, Section 145, written notifications to the (1) President, (2) President of the Senate, (3) Speaker of the House of Representatives, (4) Comptroller General, and (5) the Director of OMB. On May 18, 2011, EPA sent a supplemental letter to the OMB Director to further identify the names of the persons responsible for the violation, and that they were not suspected of willfully or knowingly violating the ADA.

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

	Interest Rate Re-estimate	Technical Re-estimate	Total
Upward Subsidy Reestimate – FY 2012	$ 247	$ 85	$ 332
Downward Subsidy Reestimate - FY 2012			-
FY 2012 Totals	**$ 247**	**$ 85**	**$ 332**
Upward Subsidy Reestimate – FY 2011	$ 104	$ 39	$ 143
Downward Subsidy Reestimate - FY 2011			-
FY 2011 Totals	**$ 104**	**$ 39**	**$ 143**

Schedule for Reconciling Subsidy Cost Allowance Balances
(Post-1991 Direct Loans)

		FY 2012		FY 2011
Beginning balance of the subsidy cost allowance	$	(131)	$	(222)
Add: subsidy expense for direct loans disbursed during the reporting years by component:				
Interest rate differential costs				
Default costs (net of recoveries)				
Fees and other collections				
Other subsidy costs				
Total of the above subsidy expense components	$	-	$	-
Adjustments:				
Loan Modification				
Fees received				
Foreclosed property acquired				
Loans written off				
Subsidy allowance amortization	$	103		234
Other				
End balance of the subsidy cost allowance before reestimates	$	103	$	234
Add or subtract subsidy reestimates by component:				
(a) Interest rate reestimate		(247)		(104)
(b) Technical/default reestimate		(85)		(39)
Total of the above reestimate components	$	(332)		(143)
Ending Balance of the subsidy cost allowance	$	(360)	$	(131)

EPA has not disbursed Direct Loans since 1993.

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, 2012 and 2011:

		FY 2012		FY 2011
Intragovernmental:				
Accounts Payable	$	2,610	$	62
Accrued Liabilities		52,411		52,386
Total	$	**55,021**	$	**52,448**

Non-Federal:		**FY 2012**		**FY 2011**
Accounts Payable	$	107,294	$	69,505
Advances Payable		11		3
Interest Payable		7		7
Grant Liabilities		460,835		503,249
Other Accrued Liabilities		207,134		344,002
Total	$	**775,281**	$	**916,766**

Other Accrued Liabilities primarily relate to contractor accruals.

Note 9. General Property, Plant, and Equipment, Net

General property, plant, and equipment (PP&E) consist of software, real property, EPA and contractor-held personal property, and capital leases.

As of September 30, 2012 and 2011, General PP&E consist of the following:

	FY 2012 Acquisition Value	FY 2012 Accumulated Depreciation	FY 2012 Net Book Value	FY 2011 Acquisition Value	FY 2011 Accumulated Depreciation	FY 2011 Net Book Value
EPA-Held Equipment	$ 261,279	$ (157,259)	$ 104,020	$ 255,049	$ (147,219)	$ 107,830
Software	615,090	(231,599)	383,491	527,603	(190,302)	337,301
Contractor Held Equip.	59,812	(18,711)	41,101	66,808	(22,104)	44,704
Land and Buildings	672,096	(201,140)	470,956	653,518	(188,382)	465,136
Capital Leases	35,440	(24,987)	10,453	35,440	(23,612)	11,828
Total	**$ 1,643,717**	**$ (633,696)**	**$ 1,010,021**	**$ 1,538,418**	**$ (571,619)**	**$ 966,799**

Note 10. Debt Due to Treasury

The debt due to Treasury consists of borrowings to finance the Asbestos Loan Program. The debt to Treasury as of September 30, 2012 and 2011 is as follows:

All Other Funds	FY 2012 Beginning Balance	FY 2012 Net Borrowing	FY 2012 Ending Balance	FY 2011 Beginning Balance	FY 2011 Net Borrowing	FY 2011 Ending Balance
Intragovernmental:						
Debt to Treasury	$ 2,593	$ (1,530)	$ 1,063	$ 4,844	$ (2,251)	$ 2,593

Note 11. Stewardship Land

The Agency acquires title to certain property and property rights under the authorities provided in Section 104(j) CERCLA related to remedial clean-up sites. The property rights are in the form of fee interests (ownership) and easements to allow access to clean-up sites or to restrict usage of remediated sites. The Agency takes title to the land during remediation and transfers it to state or local governments 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 under the terms of 104(j).

As of September 30, 2012, the Agency possesses the following land and land rights:

	FY 2012	FY 2011
Superfund Sites with Easements		
Beginning Balance	36	35
Additions	0	1
Withdrawals	0	0
Ending Balance	36	36

	FY 2012	FY 2011
Superfund Sites with Land Acquired		
Beginning Balance	34	32
Additions	0	4
Withdrawals	0	2
Ending Balance	34	34

Note 12. Custodial Liability

Custodial Liability represents the amount of net accounts receivable that, when collected, will be deposited to the Treasury General Fund. Included in the custodial liability are amounts for fines and penalties, interest assessments, repayments of loans, and miscellaneous other accounts receivable. As of September 30, 2012 and 2011, custodial liability is approximately $119 million and $57 million, respectively.

Note 13. Other Liabilities

Other Liabilities consist of the following as of September 30, 2012:

Other Liabilities – Intragovernmental		Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
Current						
Employer Contributions & Payroll Taxes	$	25,304	$	-	$	25,304
WCF Advances		1,294		-		1,294
Other Advances		23,505		-		23,505
Advances, HRSTF Cashout		34,341		-		34,341
Deferred HRSTF Cashout		604		-		604
Non-Current						
Unfunded FECA Liability		-		10,472		10,472
Payable to Treasury Judgment Fund		-		22,000		22,000
Total Intragovernmental	$	**85,048**	**$**	**32,472**	**$**	**117,520**
Other Liabilities - Non-Federal						
Current						
Unearned Advances, Non-Federal	$	72,728	$	-	$	72,728
Liability for Deposit Funds, Non-Federal		9,335		-		9,335
Non-Current						
Capital Lease Liability		-		23,005		23,005
Total Non-Federal	$	**82,063**	**$**	**23,005**	**$**	**105,068**

Other Liabilities consist of the following as of September 30, 2011:

Other Liabilities – Intragovernmental		Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
Current						
Employer Contributions & Payroll Taxes	$	25,495	$	-	$	25,495
WCF Advances		1,337		-		1,337
Other Advances		38,981		-		38,981
Advances, HRSTF Cashout		34,979		-		34,979
Resources Payable to Treasury		3		-		3
Non-Current						
Unfunded FECA Liability		-		10,115		10,115
Payable to Treasury Judgment Fund		-		22,000		22,000
Total Intragovernmental	$	**100,795**	**$**	**32,115**	**$**	**132,910**
Other Liabilities - Non-Federal						
Current						
Unearned Advances	$	70,084	$	-	$	70,084
Liability for Deposit Funds		9,194		-		9,194
Non-Current						
Capital Lease Liability		-		24,711		24,711
Total Non-Federal	$	**79,278**	**$**	**24,711**	**$**	**103,989**

Note 14. Leases

Capital Leases:

The value of assets held under Capital Leases as of September 30, 2012 and 2011 are as follows:

Summary of Assets Under Capital Lease:	FY 2012	FY 2011
Real Property	$ 35,285	$ 35,285
Personal Property	155	155
Total	**$ 35,440**	**$ 35,440**
Accumulated Amortization	$ 24,987	$ 23,612

EPA had two capital leases for land and buildings housing scientific laboratories and computer facilities. Both leases include a base rental charge and escalation 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 two leases terminate in FY 2013 and FY 2025.

The total future minimum capital lease payments are listed below.

Future Payments Due:

Fiscal Year	Capital Leases
2013	$ 5,714
2014	4,215
2015	4,215
2016	4,215
After 5 years	35,125
Total Future Minimum Lease Payments	53,484
Less: Imputed Interest	$ (30,479)
Net Capital Lease Liability	23,005
Liabilities not Covered by Budgetary Resources	**$ 23,005**

(See Note 13)

Operating Leases:

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

EPA had two direct operating leases for land and buildings housing scientific laboratories and computer facilities. The leases include a base rental charge and escalation 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 leases expire in FY 2017 and FY 2020. These charges are expended from the EPM appropriation.

The total minimum future operating lease costs are listed below:

Fiscal Year		Operating Leases, Land and Buildings
2013	$	89
2014		89
2015		89
2016		89
Beyond 2017		195
Total Future Minimum Lease Payments	**$**	**551**

Note 15. FECA 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 as of September 30, 2012 and 2011 was $46.9 million and $44.8 million, respectively. The FY 2012 present value of these estimated outflows is calculated using a discount rate of 2.293 percent in the first year, and 3.138 percent in the years thereafter. The estimated future costs are recorded as an unfunded liability.

Note 16. Cashout Advances, Superfund

Cashout advances are funds received by EPA, a state, or another PRP under the terms of a settlement agreement (e.g., consent decree) to finance response action costs at a specified Superfund site. Under CERCLA Section 122(b)(3), cashout funds received by EPA are placed in site-specific, interest bearing accounts known as special accounts and are used for potential future work at such sites in accordance with the terms of the settlement agreement. Funds placed in special accounts may be disbursed to PRPs, to states that take responsibility for the site, or to other Federal agencies to conduct or finance response actions in lieu of EPA without further appropriation by Congress. As of September 30, 2012 and 2011, cashouts are approximately $736 million and $790 million respectively.

Note 17. Unexpended Appropriations – Other Funds

As of September 30, 2012 and 2011, the Unexpended Appropriations consist of the following:

Unexpended Appropriations:		**FY 2012**		**FY 2011**
Unobligated				
Available	$	602,413	$	1,151,603
Unavailable		82,346		74,517
Undelivered Orders		9,127,111		10,236,478
Total	$	**9,811,870**	$	**11,462,598**

Note 18. Commitments and Contingencies

EPA may be a party in various administrative proceedings, 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.

As of September 30, 2012 and 2011 total accrued liabilities for commitments and potential loss contingencies is $25.2 million and $10.2 million, respectively. Further discussion of the cases and claims that give rise to this accrued liability are discussed immediately below.

Litigation Claims and Assessments

There is currently one legal claim which has been asserted against the EPA pursuant to the Federal Tort Claims and Fair Labor Standards Acts. This loss has been deemed probable, and the unfavorable outcome is estimated to be between $10 million and $15 million. EPA has accrued the higher conservative amount as of September 30, 2012. The maximum amount of exposure under the claim could range as much as $15 million in the aggregate.

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.

Judgment Fund

In cases that are paid by the U.S. Treasury Judgment Fund, EPA must recognize the full cost of a claim regardless of which entity 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, 2012, there are no material claims pending in the Treasury's Judgment Fund. However, EPA has a $22 million liability to the Treasury Judgment Fund for a payment made by the Fund to settle a contract dispute claim.

Other Commitments

EPA has a commitment to fund the United States Government's payment to the Commission of the North American Agreement on Environmental Cooperation between the Governments of Canada, the Government of the United Mexican States, and the Government of the United States of America (commonly referred to as CEC). According to the terms of the agreement, each government pays an equal share to cover the operating costs of the CEC. EPA paid $3 million to the CEC in the period ended September 30, 2012 and $3 million in the period ended September 30, 2011.

EPA has a legal commitment under a non-cancellable agreement, subject to the availability of funds, with the United Nations Environment Program (UNEP). This agreement enables EPA to provide funding to the Multilateral Fund for the Implementation of the Montreal Protocol. EPA made payments totaling $9.48 million in FY 2012. Future payments totaling $11 million have been deemed reasonably possible and are anticipated to be paid in fiscal years 2013 through 2015.

Note 19. Earmarked Funds

Balance sheet as of September 30, 2012	**Environmental Services**	**LUST**	**Superfund**	**Other Earmarked Funds**	**Total Earmarked Funds**
Assets					
Fund Balance with Treasury	$ 325,719	$ 35,310	$ 95,604	$ 22,518	$ 479,151
Investments	-	1,315,101	3,305,130	-	4,620,231
Accounts Receivable, Net	-	-	374,791	10,017	384,808
Other Assets	-	332	114,354	3,924	118,610
Total Assets	325,719	1,350,743	3,889,879	36,459	5,602,800
Other Liabilities	$ -	$ 13,837	$ 1,055,191	$ 29,573	$ 1,098,601
Total Liabilities	$ -	$ 13,837	$ 1,055,191	$ 29,573	$ 1,098,601
Cumulative Results of Operations	$ 325,719	$ 1,336,906	$ 2,834,688	$ 6,886	$ 4,504,199
Total Liabilities and Net Position	$ 325,719	$ 1,350,743	$ 3,889,879	$ 36,459	$ 5,602,800
Statement of Changes in Net Cost for the Period Ended September 30, 2012					
Gross Program Costs	$ -	$ 137,234	$ 1,705,893	$ 81,780	$ 1,924,907
Less: Earned Revenues	-	67,468	305,301	58,796	431,565
Net Cost of Operations	$ -	$ 69,766	$ 1,400,592	$ 22,984	$ 1,493,342
Statement of Changes in Net Position for the Period ended September 30, 2012					
Net Position, Beginning of Period	$ 302,677	$ 3,575,201	$ 3,143,619	$ 5,666	$ 7,027,163
Nonexchange Revenue- Securities Investments	-	60,572	26,879	3	87,454
Nonexchange Revenue	23,042	170,497	6,517	12	200,068
Other Budgetary Finance Sources	-	(2,400,000)	1,033,250	23,345	(1,343,405)
Other Financing Sources	-	402	25,015	844	26,261
Net Cost of Operations	-	(69,766)	(1,400,592)	(22,984)	(1,493,342)
Change in Net Position	$ 23,042	$ (2,238,295)	$ (308,931)	$ 1,220	$ (2,522,964)
Net Position	$ 325,719	$ 1,336,906	$ 2,834,688	$ 6,886	$ 4,504,199

Balance sheet as of September 30, 2011	Environmental Services	LUST	Superfund	Other Earmarked Funds	Total Earmarked Funds
Assets					
Fund Balance with Treasury	$ 302,677	$ 60,558	$ 114,540	$ 19,500	$ 497,275
Investments	-	3,535,052	3,577,145	-	7,112,197
Accounts Receivable, Net	-	-	445,303	16,866	462,169
Other Assets	-	347	118,355	4,415	123,117
Total Assets	302,677	3,595,957	4,255,343	40,781	8,194,758
Other Liabilities	$ -	$ 20,757	$ 1,111,724	$ 35,114	$ 1,167,595
Total Liabilities	$ -	$ 20,757	$ 1,111,724	$ 35,114	$ 1,167,595
Cumulative Results of Operations	$ 302,677	$ 3,575,200	$ 3,146,619	$ 5,667	$ 7,030,163
Total Liabilities and Net Position	$ 302,677	$ 3,595,957	$ 4,258,343	$ 40,781	$ 8,197,758
Statement of Changes in Net Cost for the Period Ended September 30, 2011					
Gross Program Costs	$ -	$ 209,613	$ 1,908,317	$ 124,214	$ 2,242,144
Less: Earned Revenues	-	-	532,006	110,839	642,845
Net Cost of Operations	$ -	$ 209,613	$ 1,376,311	$ 13,375	$ 1,599,299
Statement of Changes in Net Position for the Period ended September 30, 2011					
Net Position, Beginning of Period	$ 273,416	$ 3,539,217	$ 3,340,498	$ (749)	$ 7,152,382
Nonexchange Revenue- Securities Investments	-	93,156	27,266	7	120,429
Nonexchange Revenue	29,261	152,127	3,596	-	184,984
Other Budgetary Finance Sources	-	-	1,120,663	18,342	1,139,005
Other Financing Sources	-	314	27,907	1,441	29,662
Net Cost of Operations	-	(209,613)	(1,376,311)	(13,375)	(1,599,299)
Change in Net Position	$ 29,261	$ 35,984	$ (196,879)	$ 6,415	$ (125,219)
Net Position	$ 302,677	$ 3,575,201	$ 3,143,619	$ 5,666	$ 7,027,163

Earmarked funds are as follows:

Environmental Services Receipt Account: The Environmental Services Receipt Account authorized by a 1990 act, “To amend the Clean Air Act (P.L. 101-549),”, 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 can only be appropriated to the S&T and EPM appropriations to meet the expenses of the programs that generate the receipts if authorized by Congress in the Agency's appropriations bill.

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

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

Other Earmarked Funds:

Oil Spill Liability Trust Fund: The Oil Spill Liability Trust Fund, was authorized by the Oil Pollution Act of 1990 (OPA). Monies are appropriated from the Oil Spill Liability Trust Fund to EPA's Oil Spill Response Account each year. 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 specific oil spill cleanup actions is provided through the U.S. Coast Guard from the Oil Spill Liability Trust Fund through reimbursable Pollution Removal Funding Agreements (PRFAs) and other inter-agency agreements.

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

Pesticide Registration Fund: The Pesticide Registration Fund authorized by a 2004 Act, "Consolidated Appropriations Act (P.L. 108-199),", and reauthorized in 2007 for five more years, 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 Amendments of 1988, are to be paid by industry and deposited into this fund group.

Reregistration and Expedited Processing Fund: The Revolving Fund, was authorized by the FIFRA of 1972, as amended by the FIFRA Amendments of 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 re-registration and reassessment of tolerances for pesticides used in or on food and animal feed, as required by law.

Tolerance Revolving Fund: The Tolerance Revolving Fund, 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 collection of these fees is prohibited by statute, enacted in the Consolidated Appropriations Act, 2004 (P.L. 108-199).

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

Note 20. Intragovernmental Costs and Exchange Revenue

Exchange, or earned revenues on the Statement of Net Cost, include income from services provided to Federal agencies and the public, interest revenue (with the exception of interest earned on trust fund investments), and miscellaneous earned revenue. Intragovernmental costs relate to the source of goods or services, not the classification of the related revenue.

	FY 2012			FY 2011		
	Intragovernmental	With the Public	Total	Intragovernmental	With the Public	Total
Clean Air						
Program Costs	$ 184,695	$ 1,027,551	$ 1,212,246	$ 159,456	$ 1,035,680	$ 1,195,136
Earned Revenue	12,171	1,372	13,543	13,586	1,034	14,620
NET COST	$ 172,524	$ 1,026,179	$ 1,198,703	$ 145,870	$ 1,034,646	$ 1,180,516
Clean and Safe Water						
Program Costs	$ 380,760	$ 5,177,804	$ 5,558,564	$ 252,748	$ 5,125,894	$ 5,378,642
Earned Revenue	8,220	33,654	41,874	7,333	1,458	8,791
NET COSTS	$ 372,540	$ 5,144,150	$ 5,516,690	$ 245,415	$ 5,124,436	$ 5,369,851
Land Preservation & Restoration						
Program Costs	$ 358,603	$ 2,175,713	$ 2,534,316	$ 390,431	$ 2,180,996	$ 2,571,427
Earned Revenue	79,371	255,421	334,792	124,874	494,249	619,123
NET COSTS	$ 279,232	$ 1,920,292	$ 2,199,524	$ 265,557	$ 1,686,747	$ 1,952,304
Healthy Communities & Ecosystems						
Program Costs	$ 184,459	$ 593,659	$ 778,118	$ 335,757	$ 1,289,505	$ 1,625,262
Earned Revenue	12,092	37,106	49,198	12,010	38,725	50,735
NET COSTS	$ 172,367	$ 556,553	$ 728,920	$ 323,747	$ 1,250,780	$ 1,574,527
Compliance & Environmental Stewardship						
Program Costs	$ 216,865	$ 605,163	$ 822,028	$ 192,243	$ 614,514	$ 806,757
Earned Revenue	5,877	76,542	82,419	3,607	1,455	5,062
NET COSTS	$ 210,988	$ 528,621	$ 739,609	$ 188,636	$ 613,059	$ 801,695
Total						
Program Costs	$ 1,325,382	$ 9,579,890	$ 10,905,272	$ 1,330,635	$ 10,246,589	$ 11,577,224
Earned Revenue	117,731	404,095	521,826	161,410	536,921	698,331
NET COSTS	$ 1,207,651	$ 9,175,795	$ 10,383,446	$ 1,169,225	$ 9,709,668	$ 10,878,893

Note 21. Cost of Stewardship Land

There were no costs related to the acquisition of stewardship land for September 30, 2012 and $438 thousand for September 30, 2011. These costs are included in the Statement of Net Cost.

Note 22. Environmental Cleanup Costs

As of September 30, 2012, EPA has 2 sites that require clean up stemming from its activities. Two claimants' chances of success are characterized as probable with costs amounting to $180 thousand, may be paid out of the Treasury Judgment Fund. For sites that had previously been listed, it was determined by EPA's Office of General Counsel to discontinue reporting the potential environmental liabilities for the following reasons: (1) although EPA has been put on notice that it is subject to a contribution claim under CERCLA, no direct demand for compensation has been made to EPA; (2) any demand against EPA will be resolved only after the Superfund cleanup work is completed, which may be years in the future; and (3) there was no legal activity on these matters in FY 2012 or in FY 2011.

Accrued Cleanup Cost:

EPA has 14 sites that will require permanent closure, and EPA is responsible to fund the environmental cleanup of those sites. As of September 30, 2012 and 2011, the estimated costs for site cleanup were $21.6 million and $20.84 million, respectively. Since the cleanup costs associated with permanent closure were 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.

Note 23. State Credits

Authorizing statutory language for Superfund and related Federal regulations requires states to enter into Superfund State Contracts (SSC) 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 it 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. The 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, 2012 and 2011, the total remaining state credits have been estimated at $24.7 million and $22.2 million, respectively.

Note 24. 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 them 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, 2012, EPA had 3 outstanding preauthorized mixed funding agreements with obligations totaling $4.7 million. As of September 30, 2011, EPA had 4 such agreements for $11.5 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 25. Custodial Revenues and Accounts Receivable

	FY 2012	FY 2011
Fines, Penalties and Other Miscellaneous Receipts	**$ 184,211**	**$ 126,351**
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts:		
Accounts Receivable	$ 214,530	$ 236,313
Less: Allowance for Uncollectible Accounts	(99,606)	(184,366)
Total	**$ 114,924**	**$ 51,947**

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

Note 26. Reconciliation of President's Budget to the Statement of Budgetary Resources

Budgetary resources, obligations incurred and outlays, as presented in the audited FY 2012 Statement of Budgetary Resources will be reconciled to the amounts included in the FY 2013 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2012 has not yet been published. We expect it will be published by early 2013, and it will be available on the OMB website at http://www.whitehouse.gov/. The actual amounts published for the year ended September 30, 2011 are listed immediately below:

FY 2011		Budgetary Resources		Obligations		Offsetting Receipts		Net Outlays
Statement of Budgetary Resources	$	15,488,427	$	11,990,577	$	1,291,761	$	12,066,123
Expired and Immaterial Funds*		(172,802)						
Rounding Differences**		375		423		5,239		877
Reported in Budget of the U. S. Government	**$**	**15,316,000**	**$**	**11,991,000**	**$**	**1,297,000**	**$**	**12,067,000**

* Expired funds are not included in Budgetary Resources Available for Obligation 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 27. 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 for September 30, 2012 and 2011:

		FY 2012		FY 2011
Recoveries of Prior Year Obligations - Downward adjustments of prior years' obligations	$	571,576	$	270,664
Temporarily Not Available - Rescinded Authority		(450)		(553)
Permanently Not Available:				
Payments to Treasury		(1,529)		(2,508)
Rescinded authority		(58,203)		(157,166)
Canceled authority		(30,116)		(20,019)
Total Permanently Not Available	**$**	**(89,848)**	**$**	**(179,693)**

Note 28. Unobligated Balances Available

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

The unobligated balances available consist of the following as of September 30, 2012 and 2011:

		FY 2012		FY 2011
Unexpired Unobligated Balance	$	2,609,303	$	3,325,991
Expired Unobligated Balance		177,101		171,859
Total	**$**	**2,786,404**	**$**	**3,497,850**

Note 29. Undelivered Orders at the End of the Period

Budgetary resources obligated for undelivered orders at September 30, 2012 and 2011 were $10.60 billion and $11.91 billion, respectively.

Note 30. Offsetting Receipts

Distributed offsetting receipts credited to the general fund, special fund, or trust fund receipt accounts offset gross outlays. For FY 2012 and 2011, the following receipts were generated from these activities:

		FY 2012		FY 2011
Trust Fund Recoveries	$	45,413	$	97,623
Special Fund Environmental Service		23,271		29,257
Trust Fund Appropriation		1,075,367		1,156,073
Miscellaneous Receipt and Clearing Accounts		19,685		8,808
Total	**$**	**1,163,736**	**$**	**1,291,761**

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

Appropriation Transfers, In/Out:

For FY 2012 and 2011, the Appropriation Transfers under Budgetary Financing Sources on the Statement of Changes in Net Position are comprised of non-expenditure 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. Details of the Appropriation Transfers on the Statement of Changes in Net Position and reconciliation with the Statement of Budgetary Resources follows for September 30, 2012 and 2011:

Transfers In/Out Without Reimbursement, Budgetary:

Fund/Type of Account		FY 2012		FY 2011
Army Corps of Engineers	$	5	$	1,750
U.S. Navy				
Total Appropriation Transfers (Other Funds)	$	5	$	1,750
Net Transfers from Invested Funds	$	3,683,571	$	1,370,349
Transfers to Another Agency		-		1,750
Allocations Rescinded		389		476
Total of Net Transfers on Statement of Budgetary Resources	$	**3,683,960**	$	**1,372,575**

For FY 2012 and 2011, Transfers In/Out under Budgetary Financing Sources on the Statement of Changes in Net Position consist of transfers between EPA funds. These transfers affect Cumulative Results of Operations. Details of the transfers-in and transfers-out, expenditure and nonexpenditure, follows for September 30, 2012 and 2011:

Type of Transfer/Funds	FY 2012		FY 2011	
	Earmarked	Other Funds	Earmarked	Other Funds
Transfers-in (out) nonexpenditure, Earmark to S&T and OIG funds	$ (32,018)	32,018	$ (35,410)	$ 35,410
Capital Transfer	(5,000)			
Transfers-in nonexpenditure, Oil Spill	23,344		18,342	
Transfers-out, Superfund to Oil Spill	(5,099)			
Transfer-out LUST	(2,400,000)		-	-
Total Transfer in (out) without Reimbursement, Budgetary	$ **(2,418,773)**	$ **32,018**	$ **(17,068)**	$ **35,410**

Transfers In/Out Without Reimbursement, Other Financing Sources:

For FY 2012 and 2011, Transfers In/Out without Reimbursement under Other Financing Sources on the Statement of Changes in Net Position are comprised of transfers of property.

The amounts reported on the Statement of Changes in Net Position are as follows for September 30, 2012 and 2011:

Type of Transfer/Funds	FY 2012		FY 2011	
	Earmarked	Other Funds	Earmarked	Other Funds
Transfers-in property	$ -	$ -	$ (1)	$ 180
Transfers (out) of prior year negative subsidy to be paid following year				(256)
Total Transfer in (out) without Reimbursement, Budgetary	$ -	$ -	$ **(1)**	$ **(76)**

Note 32. Imputed Financing

In accordance with SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” Federal agencies must recognize the portion of employees’ pensions and other retirement benefits to be paid by the OPM trust funds. These amounts are recorded as imputed costs and imputed financing for each agency. Each year the OPM provides Federal agencies with cost factors to calculate these imputed costs and financing that apply to the current year. These cost factors are multiplied by the current year’s salaries or number of employees, as applicable, to provide an estimate of the imputed financing that the OPM trust funds will provide for each agency. The estimates for FY 2012 were $151.6 million ($24.1 million from Earmarked funds, and $127.5 million from Other Funds). For FY 2011, the estimates were $164.4 million ($25.8 million from Earmarked funds, and $138.6 million from Other Funds).

SFFAS No. 4, “Managerial Cost Accounting Standards and Concepts” and SFFAS No. 30, “Inter-Entity Cost Implementation,” requires Federal agencies to recognize the costs of goods and services received from other Federal entities that are not fully reimbursed, if material. EPA estimates imputed costs for inter-entity transactions that are not at full cost and records imputed costs and financing for these unreimbursed costs subject to materiality. EPA applies its Headquarters General and Administrative indirect cost rate to expenses incurred for inter-entity transactions for which other Federal agencies did not include indirect costs to estimate the amount of unreimbursed (i.e., imputed) costs. For FY 2012 total imputed costs were $6.5 million ($2.2 million from Earmarked funds, and $4.3 million from Other Funds).

In addition to the pension and retirement benefits described above, EPA also records imputed costs and financing for Treasury Judgment Fund payments made on behalf of the Agency. Entries are made in accordance with the Interpretation of Federal Financial Accounting Standards No. 2, "Accounting for Treasury Judgment Fund Transactions." For FY 2012 entries for Judgment Fund payments totaled $10.0 million (Other Funds). For FY 2011, entries for Judgment Fund payments totaled $2.6 million (Other Funds).

The combined total of imputed financing sources for FY 2012 and FY 2011 is $168.1 million and $178.6 million, respectively.

Note 33. Payroll and Benefits Payable

Payroll and benefits payable to EPA employees for the years ending September 30, 2012 and 2011 consist of the following:

FY 2012 Payroll & Benefits Payable		**Covered by Budgetary Resources**		**Not Covered by Budgetary Resources**		**Total**
Accrued Funded Payroll & Benefits	$	72,799	$	-	$	72,799
Withholdings Payable		31,511		-		31,511
Employer Contributions Payable-TSP		4,163		-		4,163
Accrued Unfunded Annual Leave		-		158,254		158,254
Total - Current	$	**108,473**	$	**158,254**	$	**266,727**

FY 2011 Payroll & Benefits Payable						
Accrued Funded Payroll and Benefits	$	73,432	$	-	$	73,432
Withholdings Payable		32,050		-		32,050
Employer Contributions Payable-TSP		4,008		-		4,008
Accrued Unfunded Annual Leave		-		162,845		162,845
Total - Current	$	**109,490**	$	**162,845**	$	**272,335**

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 cancellation of funds that expired 5 years earlier. These amounts affect Unexpended Appropriations.

		Other Funds FY 2012		**Other Funds FY 2011**
Rescissions to General Appropriations	$	64,991	$	157,208
Canceled General Authority		23,252		19,978
Total Other Adjustments	**$**	**88,243**	**$**	**177,186**

Note 35. Non-exchange Revenue, Statement of Changes in Net Position

Non-exchange Revenue, Budgetary Financing Sources, on the Statement of Changes in Net Position as of September 30, 2012 and 2011 consists of the following items:

		Earmarked Funds FY 2012		Earmarked Funds FY 2011
Interest on Trust Fund	$	87,454	$	120,429
Tax Revenue, Net of Refunds		170,392		152,437
Fines and Penalties Revenue		6,624		3,286
Special Receipt Fund Revenue		23,053		29,261
Total Nonexchange Revenue	**$**	**287,523**	**$**	**305,413**

Note 36. Reconciliation of Net Cost of Operations to Budget

		FY 2012		FY 2011
RESOURCES USED TO FINANCE ACTIVITIES				
Budgetary Resources Obligated				
Obligations Incurred	$	13,782,833	$	11,990,577
Less: Spending Authority from Offsetting Collections and Recoveries		(1,154,627)		(1,020,941)
Obligations, Net of Offsetting Collections	$	12,628,206	$	10,969,636
Less: Offsetting Reciepts		(3,544,465)		(1,282,958)
Net Obligations	$	9,083,741	$	9,686,678
Other Resources				
Donations of Property	$	-	$	50
Transfers In/Out without Reimbursement, Property		-		(178)
Imputed Financing Sources		168,142		178,654
Other Resources to Finance Activities		(76)		-
Net Other Resources Used to Finance Activities	$	168,066	$	178,526
Total Resources Used to Finance Activities	$	9,251,807	$	9,865,204
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS:				
Change in Budgetary Resources Obligated	$	1,138,862	$	1,031,615
Budgetary Offsetting Collections and Receipts that				
Do Not Affect Net Cost of Operations:				
Credit Program Collections Increasing Loan Liabilities for				
Guarantees or Subsidy Allowances:		6,777		2,759
Offsetting Reciepts Not Affecting Net Cost		69,098		126,885
Resources that Finance Asset Acquisition		(145,656)		(190,101)
Other Resources Not Affecting Net Cost		76		-
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	$	1,069,157	$	971,158
Total Resources Used to Finance the Net Cost of Operations	$	10,320,964	$	10,836,362
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:		**FY 2012**		**FY 2011**
Components Requiring or Generating Resources in Future Periods:				
Increase in Annual Leave Liability	$	(4,590)	$	(823)
Increase in Environmental and Disposal Liability		722		484
Increase in Unfunded Contingencies		15,000		5,807
Upward/ Downward Reestimates of Credit Subsidy Expense		189		394
Increase in Public Exchange Revenue Receivables		(35,266)		(231,519)
Increase in Workers Compensation Costs		2,429		(221)
Other		1,242		1,563
Total Components of Net Cost of Operations that Require or Generate Resources in Future Periods	$	(20,274)	$	(224,315)
Components Not Requiring/ Generating Resources:				
Depreciation and Amortization	$	96,481	$	73,640
Expenses Not Requiring Budgetary Resources		(13,725)		193,206
Total Components of Net Cost that Will Not Require or Generate Resources	$	82,756	$	266,846
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	$	62,482	$	42,531
Net Cost of Operations	$	10,383,446	$	10,878,893

Note 37. Amounts Held by Treasury (Unaudited)

Amounts held by Treasury for future appropriations consist of amounts held in trusteeship by Treasury in the Superfund and LUST Trust Funds.

Superfund

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

The following reflects the Superfund Trust Fund maintained by Treasury as of September 30, 2012 and 2011. The amounts contained in these notes have been provided by Treasury. As indicated, a portion of the outlays represents amounts received by EPA's Superfund Trust Fund; such funds are eliminated on consolidation with the Superfund Trust Fund maintained by Treasury.

SUPERFUND FY 2012	**EPA**	**Treasury**	**Combined**
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 1,723	$ 1,723
Total Undisbursed Balance	-	1,723	1,723
Interest Receivable	-	4,530	4,530
Investments, Net	3,171,409	129,191	3,300,600
Total Assets	$ 3,171,409	$ 135,444	$ 3,306,853
Liabilities & Equity			
Equity	$ 3,171,409	$ 135,444	$ 3,306,853
Total Liabilities and Equity	$ 3,171,409	$ 135,444	$ 3,306,853
Receipts			
Corporate Environmental	-	(104)	(104)
Cost Recoveries	-	45,413	45,413
Fines & Penalties	-	1,176	1,176
Total Revenue	-	46,485	46,485
Appropriations Received	-	1,075,367	1,075,367
Interest Income	-	26,879	26,879
Total Receipts	$ -	$ 1,148,731	$ 1,148,731
Outlays			
Transfers to/from EPA, Net	$ 1,221,693	$ (1,221,693)	$ -
Total Outlays	1,221,693	(1,221,693)	-
Net Income	$ **1,221,693**	$ **(72,962)**	$ **1,148,731**

In FY 2012, the EPA received an appropriation of $1.08 billion for Superfund. 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, 2012 and 2011, the Treasury Trust Fund has a liability to EPA for previously appropriated funds of $3.17 billion and $3.37 billion, respectively.

SUPERFUND FY 2011	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 15	$ 15
Total Undisbursed Balance	-	15	15
Interest Receivable	-	4,362	4,362
Investments, Net	3,368,754	204,030	3,572,784
Total Assets	$ 3,368,754	$ 208,407	$ 3,577,161
Liabilities & Equity			
Receipts and Outlays	-		-
Equity	$ 3,368,754	$ 208,407	$ 3,577,161
Total Liabilities and Equity	$ 3,368,754	$ 208,407	$ 3,577,161
Receipts			
Corporate Environmental	-	310	310
Cost Recoveries	-	97,623	97,623
Fines & Penalties	-	1,755	1,755
Total Revenue	-	99,688	99,688
Appropriations Received	-	1,156,073	1,156,073
Interest Income	-	27,266	27,266
Total Receipts	$ -	$ 1,283,027	$ 1,283,027
Outlays			
Transfers to/from EPA, Net	$ 1,292,883	$ (1,292,883)	$ -
Total Outlays	1,292,883	(1,292,883)	-
Net Income	$ **1,292,883**	$ **(9,856)**	$ **1,283,027**

LUST

LUST is supported primarily by a sales tax on motor fuels to clean up LUST waste sites. In FY 2012 and 2011, there were no fund receipts from cost recoveries. Revenue provisions in section 40201 of Public Law 112-141 transferred and appropriated $2.4 billion of LUST funds to the Highway Trust Fund. The amounts contained in these notes are provided by Treasury. Outlays represent appropriations received by EPA's LUST Trust Fund; such funds are eliminated on consolidation with the LUST Trust Fund maintained by Treasury.

LUST FY 2012	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ (2,717)	$ (2,717)
Total Undisbursed Balance	-	(2,717)	(2,717)
Interest Receivable	-	2,442	2,442
Investments, Net	-	1,312,659	1,312,659
Total Assets	$ -	$ 1,312,384	$ 1,312,384
Liabilities & Equity			
Equity	$ -	$ 1,312,384	$ 1,312,384
Receipts			
Highway TF Tax	$ -	$ 159,325	$ 159,325
Airport TF Tax	-	11,082	11,082
Inland TF Tax	-	90	90
Total Revenue	-	170,497	170,497
Interest Income	-	128,040	128,040
Total Receipts	$ -	$ 298,537	$ 298,537
Outlays			
Transfers to/from EPA, Net	$ 2,504,142	$ (2,504,142)	$ -
Total Outlays	2,504,142	(2,504,142)	-
Net Income	$ **2,504,142**	$ **(2,205,605)**	$ **298,537**

LUST FY 2011	EPA	Treasury	Combined
Undistributed Balances			
Uninvested Fund Balance	$ -	$ 1,295	$ 1,295
Total Undisbursed Balance	-	1,295	1,295
Interest Receivable	-	11,252	11,252
Investments, Net	-	3,523,800	3,523,800
Total Assets	$ -	$ 3,536,347	$ 3,536,347
Liabilities & Equity			
Equity	$ -	$ 3,536,347	$ 3,536,347
Receipts			
Highway TF Tax	$ -	$ 141,301	$ 141,301
Airport TF Tax	-	10,751	10,751
Inland TF Tax	-	75	75
Total Revenue	-	152,127	152,127
Interest Income	-	93,156	93,156
Total Receipts	$ -	$ 245,283	$ 245,283
Outlays			
Transfers to/from EPA, Net	$ 112,875	$ (112,875)	$ -
Total Outlays	112,875	(112,875)	-
Net Income	$ **112,875**	$ **132,408**	$ **245,283**

Note 38. Antideficiency Act Violations

The EPA experienced an Antideficiency Act violation on November 18 and 19, 2010 in the agency's Oil Spill Response Account in the amount of $502,215. The violation occurred when the EPA made an expenditure in excess of the funds available in the account. The EPA was participating in the response to the Deepwater Horizon oil spill while simultaneously responding to a major inland oil spill in Enbridge, Michigan. The violation was rectified on November 20, 2010, when the EPA was reimbursed with funds from the U.S. Coast Guard. On October 25, 2011 EPA transmitted, as required by OMB Circular A-11, Section 145, written notifications to the (1) President, (2) President of the Senate, (3) Speaker of the House of Representatives, (4) Comptroller General, and (5) the Director of OMB.

Environmental Protection Agency
Required Supplementary Information (Unaudited)
As of September 30, 2012
(Dollars in Thousands)

1. Deferred Maintenance

Deferred maintenance is maintenance that was not performed when it should have been, that was scheduled and not performed, or that was delayed for a future period. Maintenance is the act of keeping property, plant, and equipment (PP&E) in acceptable operating condition and includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it can deliver acceptable performance and achieve its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from or significantly greater than those originally intended.

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. The deferred maintenance as of September 2012 is:

		2012
Asset Category:		
Buildings	$	4,927
EPA Held Equipment		70
Total Deferred Maintenance	$	4,997

2. Stewardship Land

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

Environmental Protection Agency
Required Supplementary Information (Unaudited)
As of September 30, 2012
(Dollars in Thousands)

3. Supplemental Combined Statement of Budgetary Resources
For the Period Ending September 30, 2012

	EPM	FIFRA	LUST	S&T	STAG	OTHER	TOTAL
BUDGETARY RESOURCES							
Unobligated Balance, Brought Forward, October 1:	$ 293,816	$ 2,141	$ 7,834	$ 188,313	$ 858,529	$ 2,147,217	$ 3,497,850
Unobligated balance brought forward, October 1, as adjusted	293,816	2,141	7,834	188,313	858,529	2,147,217	3,497,850
Recoveries of Prior Year Unpaid Obligations	169,984	9	4,373	40,865	166,688	189,657	571,576
Other changes in unobligated balance	(14,536)	-	-	(7,281)	(6,788)	(3,034)	(31,639)
Unobligated balance from prior year budget authority, net	449,264	2,150	12,207	221,897	1,018,429	2,333,840	4,037,787
Appropriations (discretionary and mandatory)	2,678,222	-	2,504,142	793,728	3,567,937	2,404,370	11,948,399
Spending authority from offsetting collections (discretionary and mandatory)	50,824	22,011	157	34,783	970	474,306	583,051
Total Budgetary Resources	$ 3,178,310	$ 24,161	$ 2,516,506	$ 1,050,408	$ 4,587,336	$ 5,212,516	$ 16,569,237
STATUS OF BUDGETARY RESOURCES							
Obligations incurred	$ 2,876,321	$ 21,781	$ 2,508,755	$ 870,817	$ 4,268,252	$ 3,236,907	$ 13,782,833
Unobligated balance, end of year:							
Apportioned	183,217	2,380	4,072	145,400	306,662	1,967,396	2,609,127
Unapportioned	118,772	-	3,679	34,191	12,422	8,213	177,277
Total unobligated balance, end of period	301,989	2,380	7,751	179,591	319,084	1,975,609	2,786,404
Total Status of Budgetary Resources	$ 3,178,310	$ 24,161	$ 2,516,506	$ 1,050,408	$ 4,587,336	$ 5,212,516	$ 16,569,237
CHANGE IN OBLIGATED BALANCE							
Unpaid Obligations, Brought Forward, October 1 (gross)	$ 1,406,648	$ 1,430	$ 167,950	$ 421,966	$ 9,011,098	$ 1,765,802	$ 12,774,894
Uncollected customer payments from Federal Sources, brought forward, October 1	(123,384)	-	-	(38,781)	-	(276,263)	(438,428)
Obligated balance, start of year (net), before adjustments	1,283,264	1,430	167,950	383,185	9,011,098	1,489,539	12,336,466
Obligated balance, start of year (net), as adjusted	1,283,264	1,430	167,950	383,185	9,011,098	1,489,539	12,336,466
Obligations incurred	2,876,321	21,781	2,508,755	870,817	4,268,252	3,236,907	13,782,833
Outlays (gross)	(2,813,687)	(20,771)	(2,543,892)	(864,502)	(5,223,536)	(3,207,921)	(14,674,309)
Change in uncollected customer payments from Federal sources	(13,380)	-	-	(7,316)	-	(112,218)	(132,914)
Recoveries of prior year unpaid obligations	(169,984)	(9)	(4,373)	(40,865)	(166,688)	(189,657)	(571,576)
Obligated balance, end of period							
Unpaid obligations, end of year (gross)	1,299,298	2,431	128,440	387,416	7,889,126	1,605,131	11,311,842
Uncollected customer payments from Federal sources, end of year	(110,004)	-	-	(31,465)	-	(164,045)	(305,514)
Obligated balance, end of period (net)	$ 1,189,294	$ 2,431	$ 128,440	$ 355,951	$ 7,889,126	$ 1,441,086	$ 11,006,328
BUDGET AUTHORITY AND OUTLAYS, NET:							
Budget authority, gross (discretionary and mandatory)	$ 2,729,046	$ 22,011	$ 2,504,299	$ 828,511	$ 3,568,907	$ 2,878,676	$ 12,531,450
Actual offsetting collections (discretionary and mandatory)	(64,203)	(22,011)	(156)	(42,100)	(970)	(586,525)	(715,965)
Change in uncollected customer payments from Federal sources	(13,380)	-	-	(7,316)	-	(112,218)	(132,914)
Budget authority, net (discretionary and mandatory)	$ 2,651,463	$ -	$ 2,504,143	$ 779,095	$ 3,567,937	$ 2,179,933	$ 11,682,571
Outlays, gross (discretionary and mandatory)	$ 2,813,687	$ 20,771	$ 2,543,892	$ 864,502	$ 5,223,536	$ 3,207,921	$ 14,674,309
Actual offsetting collections (discretionary and mandatory)	(64,203)	(22,011)	(156)	(42,100)	(970)	(586,525)	(715,965)
Outlays, net (discretionary and mandatory)	2,749,484	(1,240)	2,543,736	822,402	5,222,566	2,621,396	13,958,344
Distributed offsetting receipts	-	-	-	-	-	(1,163,736)	(1,163,736)
Agency outlays, net (discretionary and mandatory)	$ 2,749,484	$ (1,240)	$ 2,543,736	$ 822,402	$ 5,222,566	$ 1,457,660	$ 12,794,608

Environmental Protection Agency
Required Supplemental Stewardship Information
For the Year Ended September 30, 2012
(Dollars in Thousands)

INVESTMENT IN THE NATION'S RESEARCH AND DEVELOPMENT:

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

Among the Agency's highest priorities are research programs that address: the development of alternative techniques for prioritizing chemicals for further testing through computational toxicology; the environmental effects on children's health; the potential risks and effects of manufactured nanomaterials on human health and the environment; the impacts of global change and providing information to policy makers to help them adapt to a changing climate; the potential risks of unregulated contaminants in drinking water; the health effects of air pollutants such as particulate matter; the protection of the nation's ecosystems; and the provision of near-term, appropriate, affordable, reliable, tested, and effective technologies and guidance for potential threats to homeland security. EPA also supports regulatory decision-making with chemical risk assessments.

For FY 2012, the full cost of the Agency's Research and Development activities totaled approximately $714M. Below is a breakout of the expenses (dollars in thousands):

	FY2008	FY2009	FY2010	FY2011	FY2012
Programmatic Expenses	597,080	600,552	590,790	597,558	580,278
Allocated Expenses	103,773	119,630	71,958	80,730	133,637

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

INVESTMENT IN THE NATION'S INFRASTRUCTURE:

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

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

Congress set 1990 as the last year that funds would be appropriated for Construction Grants. Projects funded in 1990 and prior will continue until completion. 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 investments in the nation's Water Infrastructure are outlined below (dollars in thousands):

	FY 2008	FY 2009	FY2010	FY2011	FY2012
Construction Grants	11,517	30,950	18,186	35,339	14,306
Clean Water SRF	1,063,825	836,502	2,966,479	2,299,721	1,925,057
Drinking Water SRF	816,038	906,803	1,938,296	1,454,274	1,240,042
Other Infrastructure Grants	388,555	306,366	264,227	269,699	196,085
Allocated Expenses	396,253	414,460	631,799	548,375	777,375

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

HUMAN CAPITAL

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

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

	FY 2008	FY 2009	FY2010	FY2011	FY2012
Training and Awareness Grants	30,768	37,981	25,714	23,386	21,233
Fellowships	9,650	6,818	6,905	9,538	10,514
Allocated Expenses	7,025	8,924	3,973	4,448	7,311

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements
Balance Sheet for Superfund Trust Fund
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)
(Unaudited)

		FY 2012		FY 2011
ASSETS				
Intragovernmental:				
Fund Balance With Treasury (Note S1)	$	95,604	$	114,540
Investments		3,305,130		3,577,146
Accounts Receivable, Net		6,353		10,560
Other		7,595		8,076
Total Intragovernmental	$	3,414,682	$	3,710,322
Accounts Receivable, Net		368,438		454,606
Property, Plant & Equipment, Net		105,921		109,272
Other		838		1,006
Total Assets	$	**3,889,879**	**$**	**4,275,206**
LIABILITIES				
Intragovernmental:				
Accounts Payable and Accrued Liabilities		40,941		53,778
Other		48,662		61,080
Total Intragovernmental	$	89,603	$	114,857
Accounts Payable & Accrued Liabilities	$	137,260	$	141,464
Pensions & Other Actuarial Liabilities		8,137		7,778
Cashout Advances, Superfund (Note S2)		735,837		790,069
Payroll & Benefits Payable		47,546		47,174
Other		36,808		30,244
Total Liabilities	$	1,055,191	$	1,131,587
NET POSITION				
Cumulative Results of Operations		2,834,688		3,143,619
Total Net Position		2,834,688		3,143,619
Total Liabilities and Net Position	**$**	**3,889,879**	**$**	**4,275,206**

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

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements
Statement of Net Cost for Superfund Trust Fund
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)
(Unaudited)

	FY 2012	FY 2011
COSTS		
Gross Costs	$ 1,705,893	$ 1,908,317
Expenses from Other Appropriations (Note S5)	161,844	71,457
Total Costs	1,867,737	1,979,774
Less:		
Earned Revenue	305,301	532,006
NET COST OF OPERATIONS	**$ 1,562,436**	**$ 1,447,768**

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

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements
Statement of Changes in Net Position for Superfund Trust Fund
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)
(Unaudited)

		FY 2012 Earmarked Funds		FY 2011 Earmarked Funds
Cumulative Results of Operations:				
Net Position - Beginning of Period		3,143,619		3,340,498
Beginning Balances, as Adjusted	$	3,143,619	$	3,340,498
Budgetary Financing Sources:				
Nonexchange Revenue - Securities Investment		26,879		27,266
Nonexchange Revenue - Other		6,517		3,596
Transfers In/Out		(42,117)		(35,410)
Trust Fund Appropriations		1,075,367		1,156,073
Income from Other Appropriations (Note S5)		161,844		71,457
Total Budgetary Financing Sources	$	1,228,490	$	1,222,982
Other Financing Sources (Non-Exchange)				
Transfers In/Out		-		1
Imputed Financing Sources		25,015		27,906
Total Other Financing Sources	$	25,015	$	27,907
Net Cost of Operations		(1,562,436)		(1,447,768)
Net Change		(308,931)		(196,879)
Cumulative Results of Operations	$	**2,834,688**	$	**3,143,619**

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

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements
Statement of Budgetary Resources for Superfund Trust Fund
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)
(Unaudited)

	FY 2012	FY 2011
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1:	$ 2,035,484	$ 2,059,687
Unobligated balance brought forward, October 1, as adjusted	2,035,484	2,059,687
Recoveries of Prior Year Unpaid Obligations	168,015	154,843
Other changes in unobligated balance	-	1
Unobligated balance from prior year budget authority, net	2,203,499	2,214,531
Appropriations (discretionary and mandatory)	1,211,593	1,292,883
Spending authority from offsetting collections (discretionary and mandatory)	230,695	375,452
Total Budgetary Resources	$ 3,645,787	$ 3,882,867
STATUS OF BUDGETARY RESOURCES		
Obligations incurred	$ 1,766,377	$ 1,847,383
Unobligated balance, end of year:		
Apportioned	1,875,277	2,033,533
Unapportioned	4,133	1,951
Total unobligated balance, end of period	1,879,410	2,035,484
Total Status of Budgetary Resources (Note S6)	$ 3,645,787	$ 3,882,867
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations, Brought Forward, October 1 (gross)	$ 1,570,749	$ 1,692,915
Uncollected customer payments from Federal Sources, brought forward, October 1	(122,402)	(123,366)
Obligated balance, start of year (net), before adjustments	1,448,347	1,569,549
Obligated balance, start of year (net), as adjusted	1,448,347	1,569,549
Obligations incurred	1,766,377	1,847,383
Outlays (gross)	(1,767,406)	(1,814,706)
Change in uncollected customer payments from Federal sources	(107,125)	(965)
Recoveries of prior year unpaid obligations	(168,015)	(154,843)
Obligated balance, end of period		
Unpaid obligations, end of year (gross)	1,401,705	1,570,749
Uncollected customer payments from Federal sources, end of year	(15,277)	(122,402)
Obligated balance, end of period (net)	$ 1,386,428	$ 1,448,347
BUDGET AUTHORITY AND OUTLAYS, NET:		
Budget authority, gross (discretionary and mandatory)	$ 1,442,288	$ 1,668,336
Actual offsetting collections (discretionary and mandatory)	(337,820)	(751,805)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(107,125)	(965)
Budget authority, net (discretionary and mandatory)	$ 997,344	$ 915,566
Outlays, gross (discretionary and mandatory) (Note S6)	$ 1,767,406	$ 1,814,706
Actual offsetting collections (discretionary and mandatory) (Note S6)	(337,820)	(376,417)
Outlays, net (discretionary and mandatory)	1,429,586	1,438,289
Distributed offsetting receipts (Notes S6)	(45,413)	(97,623)
Agency outlays, net (discretionary and mandatory)	$ 1,384,173	$ 1,340,666

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

Environmental Protection Agency
Supplemental Information and Other Reporting Requirements
Related Notes to Superfund Trust Financial Statements
For the Periods Ending September 30, 2012 and 2011
(Dollars in Thousands)
(Unaudited)

Note S1. Fund Balance with Treasury for Superfund Trust

Fund Balance with Treasury for the Superfund as of September 30, 2012 and 2011 is $95.6 million and $114.5 million, respectively. Fund balances are available to pay current liabilities and to finance authorized purchase commitments (see Status of Fund Balances below).

Status of Fund Balances:		**FY 2012**		**FY 2011**
Unobligated Amounts in Fund Balance:				
Available for Obligation	$	1,875,277	$	2,033,533
Unavailable for Obligation		4,133		1,951
Net Receivables from Invested Balances		(3,171,409)		(3,368,754)
Balances in Treasury Trust Fund		1,723		15
Obligated Balance not yet Disbursed		1,385,880		1,447,795
Totals	$	**95,604**	$	**114,540**

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

Note S2. Cashout Advances, Superfund

Cashout Advances are funds received by EPA, a state, or another PRP under the terms of a settlement agreement (e.g., consent decree) to finance response action costs at a specified Superfund site. Under CERCLA, Section 122(b)(3), cashout funds received by EPA are placed in site-specific, interest bearing accounts known as special accounts and are used for potential future work at such sites in accordance with the terms of the settlement agreement. Funds placed in special accounts may be used by EPA or disbursed to PRPs, to states that take responsibility for the site, or to other Federal agencies to conduct or finance response actions in lieu of EPA without further appropriation by Congress. As of September 30, 2012 and 2011, cashout advances are $736 million and $790 million.

Note S3. Superfund State Credits

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

Once EPA has reviewed and approved a state's claim for credit, the state must first apply the credit at the site where it was earned. The state may apply any excess/remaining credit to another site when approved by EPA. As of September 30, 2012, the total remaining state credits have been estimated at $24.7 million. The estimated ending credit balance on September 30, 2011 was $22.2 million.

Note S4. Superfund Preauthorized Mixed Funding Agreements

Under Superfund preauthorized mixed funding agreements, PRPs agree to perform response actions at their sites with the understanding that EPA will reimburse them 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, 2012, EPA had 3 outstanding preauthorized mixed funding agreements with obligations totaling $4.7 million. As of September 30, 2011, EPA had 4 such agreements for $11.5 million. A liability is not recognized for these amounts until all work has been performed by the PRP and has been approved by EPA for payment. Further, EPA will not disburse any funds under these agreements until the PRP's application, claim, and claims adjustment processes have been reviewed and approved by EPA.

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

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

During FYs 2012 and 2011, the EPM appropriation funded a variety of programmatic and non-programmatic activities across the Agency, subject to statutory requirements. This appropriation was created to fund personnel compensation and benefits, travel, procurement, and contract activities. This distribution is calculated using a combination of specific identification of expenses to Reporting Entities, and a weighted average that distributes expenses proportionately to total programmatic expenses. As illustrated below, this estimate does not impact the consolidated totals of the Statement of Net Cost or the Statement of Changes in Net Position.

	FY 2012			FY 2011		
	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect	Income from Other Appropriations	Expenses from Other Appropriations	Net Effect
Superfund	$ 161,844	(161,844)	$ -	$ 71,457	(71,457)	$ -
All Others	(161,844)	161,844	-	(71,457)	71,457	-
Total	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

Note S6. Reconciliation of the Statement of Budgetary Resources to the President's Budget

Budgetary resources, obligations incurred, and outlays, as presented in the audited FY 2012 Statement of Budgetary Resources, will be reconciled to the amounts included in the FY 2013 Budget of the United States Government when they become available. The Budget of the United States Government with actual numbers for FY 2012 has not yet been published. We expect it will be published by early 2013, and it will be available on the OMB website at http://www.whitehouse.gov. The actual amounts published for the year ended September 30, 2011 are listed immediately below:

FY 2011		Budgetary Resources		Obligations		Offsetting Receipts		Net Outlays
Statement of Budgetary Resources	$	3,882,867	$	1,847,384	$	97,623	$	1,438,289
Rounding Differences**		133		616		377		(289)
Reported in Budget of the U. S. Government	**$**	**3,883,000**	**$**	**1,848,000**	**$**	**98,000**	**$**	**1,438,000**

* Balances are rounded to millions in the Budget Appendix.

Note S7. Superfund Eliminations

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

	FY 2012	FY 2011
Advances	$ 6,152	$ 5,506
Expenditure Transfer Payable	$ 18,243	$ 28,663
Accrued Liabilities	$ 1,765	$ 950
Expenses	$ 30,060	$ 25,337
Transfers	$ 32,018	$ 35,410

U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

Audit of EPA's Fiscal 2012 and 2011 Consolidated Financial Statements

Report No. 13-1-0054 **November 15, 2012**

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Abbreviations

CFC	Cincinnati Finance Center
EPA	U.S. Environmental Protection Agency
FFMIA	Federal Financial Management Improvement Act of 1996
FMFIA	Federal Managers' Financial Integrity Act of 1982
FY	Fiscal Year
GAO	U.S. Government Accountability Office
GL	General Ledger
IFMS	Integrated Financial Management System
LVFC	Las Vegas Finance Center
OARM	Office of Administration and Resources Management
OCFO	Office of the Chief Financial Officer
OEI	Office of Environmental Information
OIG	Office of Inspector General
OMB	Office of Management and Budget
RMDS	Resource Management Directive System
RSSI	Required Supplementary Stewardship Information
RTPFC	Research Triangle Park Finance Center
SOD	Statement of Differences
SSP	System Security Plan

Hotline

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fax: 202-566-2599
online: http://www.epa.gov/oig/hotline.htm

write: EPA Inspector General Hotline
1200 Pennsylvania Avenue NW
Mailcode 2431T
Washington, DC 20460

U.S. Environmental Protection Agency
Office of Inspector General

13-1-0054
November 15, 2012

At a Glance

Why We Did This Review

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

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

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.

This report addresses the following EPA Goal or Cross-Cutting Strategy:

- *Strengthening EPA's Workforce and Capabilities*

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

The full report is at:
www.epa.gov/oig/reports/2013/20121115-13-1-0054.pdf

Audit of EPA's Fiscal 2012 and 2011 Consolidated Financial Statements

EPA Receives an Unqualified Opinion

We rendered an unqualified opinion on EPA's consolidated financial statements for fiscal 2012 and 2011, meaning that they were fairly presented and free of material misstatements.

Internal Control Material Weakness/Significant Deficiencies Noted

In October 2011, EPA replaced the Integrated Financial Management System with a new system, Compass Financials (Compass), and we determined that Compass reporting and system limitations represented a material weakness. In addition, we noted the following significant deficiencies, some of which involve Compass and contributed to the material weakness:

- Posting models in Compass materially misstated general ledger activity and balances.
- Compass reporting limitations impair accounting operations and internal controls.
- EPA did not reverse approximately $108 million in expense accruals.
- Compass system limitations impair internal controls of financial operations.
- Accounts receivable internal controls contained numerous deficiencies.
- EPA did not timely clear Fund Balance with Treasury Statement of Differences transactions.
- Compass did not have sufficient controls over personal property entries.
- Compass and the Maximo property system cannot be reconciled.
- EPA did not monitor the testing of networked information technology assets to identify commonly known vulnerabilities.
- EPA lacks reliable information on security controls for financial systems.

Noncompliance With Laws and Regulations Noted

EPA has limited assurance that its Compass service provider's controls are designed and operating as intended.

Recommendations and Planned Agency Corrective Actions

The Agency disagreed with most of our findings but accepted many of our recommendations. In particular, the Agency stated it identified and then fixed or remediated most of the limitations of its new Compass system and, thus, there were no material issues during the preparation of the financial statements. The Agency characterized the errors we found as normal problems during collection and verification activities. However, we disagree that was the case. The errors we found occurred primarily because of posting models deficiencies in the new system and the failure of internal controls to detect and correct the errors.

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

THE INSPECTOR GENERAL

November 15, 2012

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal 2012 and 2011 Consolidated Financial Statements
Report No. 13-1-0054

FROM: Arthur A. Elkins, Jr. Charles Sheehan for

TO: Barbara J. Bennett
Chief Financial Officer

Craig E. Hooks
Assistant Administrator for Administration and Resources Management

Cynthia Giles
Assistant Administrator for Enforcement and Compliance Assurance

Attached is our report on the U.S. Environmental Protection Agency's (EPA's) fiscal 2012 and 2011 consolidated financial statements. We are reporting a material weakness and 10 significant deficiencies. We also identified an instance of noncompliance with laws and regulations related to reviewing controls over financial reporting. Attachment 3 contains the status of recommendations related to significant deficiencies reported in prior years' reports. The significant deficiencies included in attachment 3 also apply for fiscal 2012.

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

In accordance with EPA Manual 2750, you are required to provide a written response to this report within 60 calendar days of the final report date. The response should address all issues and recommendations contained in attachments 1 and 2. For corrective actions planned but not completed by the response date, reference to specific milestone dates will assist us in deciding whether to close this report in our audit tracking system. Your response will be posted on the OIG's public website, along with our memorandum commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of Section 508 of the Rehabilitation Act of 1973, as amended. The final response should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal along with corresponding justification.

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

Attachments

cc: See appendix III, Distribution

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Inspector General's Report on EPA's Fiscal 2012 and 2011 Consolidated Financial Statements

The Administrator
U.S. Environmental Protection Agency

We have audited the consolidated balance sheet of the U.S. Environmental Protection Agency (EPA) as of September 30, 2012, and September 30, 2011, and the related consolidated statements of net cost, net cost by goal, changes in net position, and custodial activity; and the combined statement of budgetary resources for the years then ended. These financial statements are the responsibility of EPA management. Our responsibility is to express an opinion on these financial statements based upon our audit.

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

The financial statements include expenses of grantees, contractors, and other federal agencies. Our audit work pertaining to these expenses included testing only within EPA. The U.S. Treasury collects and accounts for excise taxes that are deposited into the Leaking Underground Storage Tank Trust Fund. The U.S. Treasury is also responsible for investing amounts not needed for current disbursements and transferring funds to EPA as authorized in legislation. Since the U.S. Treasury, and not EPA, is responsible for these activities, our audit work did not cover these activities.

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

In our opinion, the consolidated financial statements, including the accompanying notes, present fairly, in all material respects, the consolidated assets, liabilities, net position, net cost, net cost by goal, changes in net position, custodial activity, and combined budgetary resources of EPA as of and for the years ended September 30, 2012 and 2011, in conformity with accounting principles generally accepted in the United States of America.

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

We obtained information from EPA management about its methods for preparing Required Supplementary Stewardship Information (RSSI), Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis, and reviewed this information for consistency with the financial statements. The Supplemental Information includes the unaudited Superfund Trust Fund financial statements for fiscal 2012 and 2011, which are being presented for additional analysis and are not a required part of the basic financial statements. However, our audit was not designed to express an opinion and, accordingly, we do not express an opinion on EPA's RSSI, Required Supplementary Information, Supplemental Information, and Management's Discussion and Analysis.

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

Evaluation of Internal Controls

As defined by OMB, internal control, as it relates to the financial statements, is a process, affected by the Agency's management and other personnel, that is 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 in accordance with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
>
> **Compliance with applicable laws, regulations, and government-wide policies**—Transactions are executed in accordance with laws governing the use of budget authority, government-wide policies, laws identified by OMB, and other laws and regulations that could have a direct and material effect on the financial statements.

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

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a deficiency, or combination of deficiencies, that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected in a timely manner. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed below involving the internal control and its operation that we consider to be significant deficiencies, four of which contribute to an overall material weakness. The material weakness and significant deficiencies are summarized below and detailed in attachment 1.

Material Weakness

Compass System Limitations are a Material Weakness to EPA's Accounting Operations and Internal Controls

In October 2011, EPA replaced the Integrated Financial Management System (IFMS) with a new system, Compass Financials (Compass). The Agency operated IFMS but a contractor manages Compass. EPA replaced IFMS to improve the operation of financial management systems, standardize business processes, and strengthen internal controls. The system replacement required a major systems conversion and data migration to Compass. As with any major system conversion, problems were to be expected. We found that when the Agency converted its accounting system, it had not yet developed all the reports and functions required to generate all the information it needs. The lack of useful reports and system limitations significantly impaired the effectiveness of EPA's accounting operations and internal controls. We determined that the Compass reporting and system limitations represented a material weakness. Several significant internal control deficiencies contributed to the material weakness:

- Posting model errors caused multiple misstatements. We found several material errors, caused by posting model errors, in the draft financial statements that could have potentially materially misstated the financial statements if not detected.
- Compass could not produce the reports EPA needed for many accounting applications, which caused delays in completing some accounting functions and material errors in general ledger (GL) balances.
- Material amounts of expense accruals did not reverse properly because of a Compass system configuration error.
- EPA discontinued the GL account analysis for fiscal year (FY) 2012. Without performing account analysis, EPA did not have an effective monitoring control to assess the accuracy and reasonableness of GL accounts and detect errors.

The Agency has over 8,000 posting models for posting transactions in the financial system. We found errors in multiple posting models that we examined. However, the financial system has many other posting models that we were not able to examine. Our test work and analyses indicate that while the Agency has been able to correct some posting model errors during the year, there are additional posting models the Agency needs to evaluate.

These significant deficiencies in accounting operations and internal controls resulted in material misstatements of the draft financial statements that were not prevented or detected; thus, they represent a material internal control weakness. Further details on each significant deficiency follow below.

Significant Deficiencies

Posting Models in Compass Materially Misstated GL Activity and Balances

EPA's Compass system materially misstated GL activity and balances due to incorrect posting models. We found incorrect posting models in numerous accounts for obligations, disbursements, receivables, collections, and revenue. EPA did not properly and thoroughly review the posting models before migration from IFMS to Compass. Further, EPA did not properly review balances in the financial statements that were a result of incorrect posting models; a posting model is a reference for document entry that provides default values for posting business transactions in GL accounts. Incorrect posting models reflect an internal control weakness and an indication that EPA did not exercise proper oversight over how transactions are processed in its GL. As a result, the draft financial statements contained material errors that were undetected by the Agency. We noted $331 million in misstatements in the draft financial statements that Agency management did not detect.

Compass Reporting Limitations Impair Accounting Operations and Internal Controls

EPA has been unable to obtain the reports it needs from Compass for many accounting applications in FY 2012. OMB requires financial management systems to provide complete, reliable, consistent, timely, and useful financial information. Compass reporting limitations prevented EPA from producing many reports it needed for accounting operations. When the Agency converted its accounting system to Compass, it had not yet developed all the reports and functions required to generate all the information it needs. The lack of useful reports and information significantly impairs the effectiveness of EPA's accounting operations and internal controls.

EPA Should Improve Controls Over Expense Accrual Reversals

EPA did not reverse approximately $108 million of FY 2011 year-end expense accruals in FY 2012. EPA policy requires the liability reported in the financial statements to reflect the value of goods and services received and accepted but unpaid. The Agency did not reverse the accrual transactions because the Compass posting configuration for the applicable fund category was inaccurate and staff recorded the FY 2011 accrual entries without including the reversal period. By not reversing the accruals timely, EPA overstated the accrued liability and expense amounts by $108 million and materially misstated the quarterly financial statements.

Compass System Limitations Impair Internal Controls of Financial Operations

Compass experienced several impairments to processing financial transactions. The impacted transactions included five payment accounting lines that exceeded the related obligation accounting lines, three transactions posted to an incorrect accounting period, and a payment against a canceled appropriation. U.S. Government Accountability Office (GAO) guidance states that application controls should ensure completeness, accuracy, authorization, and validity of all transactions during application processing. The Department of the Treasury Financial Management Manual states that canceled appropriation account balances are not available for obligation or expenditure for any purpose. Compass did not prevent the posting of these invalid transactions because EPA did not have system controls in place to reject them. The Compass impairments limit EPA's assurance that account balances are accurate and Agency managers have useful and reliable financial information for managing day-to-day operations.

EPA Should Improve Compliance With Internal Controls for Accounts Receivable

We found numerous deficiencies in EPA's compliance with accounts receivable internal controls in FY 2012. Various factors contributed to EPA not properly following its internal control procedures to ensure timely and accurate recording of accounts receivable. EPA policies require accurate and timely recording of accounts receivable and proper separation of duties. Noncompliance with accounts receivable controls affects the reliability and integrity of accounts receivable on the financial statements.

EPA Is Not Clearing Fund Balance with Treasury Statement of Differences Timely

EPA did not clear Fund Balance with Treasury differences reported on the U.S. Department of the Treasury's Statement of Differences within 2 months. Treasury guidance requires that the Agency clear deposit and disbursement activity differences within "two months of occurrence." However, various problems resulting from the Agency's conversion from IFMS to Compass contributed to the failure to timely clear Statement of Differences transactions. The problems included the Agency being unable to process transactions, and encountering posting and accounting model deficiencies with the new system. EPA reported a combined total of $6,115,632 in differences from October 2011 through February 2012. The failure to clear Statement of Differences transactions compromises the reliability of EPA's account balances and misstates disbursement and deposit activity reported monthly to the Treasury.

Property Internal Controls Need Improvement

Compass does not sufficiently reject personal property information entries that are not accurate. As a result, the Agency could lose accountability and control over property. FMFIA, 31 U.S.C. § 3512(c)(1)(B), requires that property and other assets be safeguarded against waste, loss, unauthorized use, or misappropriation. However, we identified personal property items for which the location was not properly identified, as well as personal property items for which the last recorded inventory dates or acquisition dates were in the future. The failure to properly configure Compass data fields to reject unreasonable entries contributed to the inaccurate property records.

Compass and Maximo Cannot Be Reconciled

EPA cannot reconcile capital equipment property management data within its property management subsystem—Maximo—to relevant financial data within Compass. OMB Circular A-123, *Management's Responsibility for Internal Controls*, states that one of the objectives of internal control is the reliability of financial reporting. The inability to reconcile the property subsystem with Compass can compromise the effectiveness and reliability of financial reporting. Maximo and Compass primarily cannot be reconciled because historical property data did not migrate properly from IFMS to Compass.

EPA Needs to Remediate System Vulnerabilities That Place Financial Data at Risk

Office of the Chief Financial Officer (OCFO) officials did not monitor the testing of its networked information technology assets to identify commonly known vulnerabilities or take action to remediate those weaknesses. EPA policy requires senior Agency officials to ensure security control reviews are performed for general support systems and major applications under their organization's responsibility. We found that the lack of monitoring exists, in part, because EPA's Office of Environmental Information took almost 3 years to resolve a long-standing recommendation to define duties and responsibilities for testing networked resources managed under EPA's service support contract. Also, OCFO officials should improve the office's process to ensure known vulnerabilities are remediated for the equipment it uses to access the Agency's core financial application. Information technology assets used by finance center personnel contained 286 commonly known vulnerabilities that, if exploited, could potentially undermine EPA's financial reporting capability and serve as available points to compromise the Agency's network.

OCFO Financial Systems Security Documentation Needs Improvement

EPA lacks reliable information on the implementation of required security controls for key financial applications at the Research Triangle Park Finance Center. Our analysis disclosed that key applications' system security plans contained numerous instances of incomplete or inaccurate information for the four minimally required control areas reviewed. Federal guidance requires key documents such as system security plans and contingency plans to be annually reviewed and updated as needed. OCFO had not implemented a process to review the completeness and accuracy of system security plans information, delineated what organizations within OCFO were responsible for maintaining this documentation, or ensured that personnel performing key information security duties were trained to assume those duties. Inaccurate information calls into question the veracity and credibility of the processes OCFO uses to authorize its systems to operate, and places into doubt whether OCFO implemented security controls necessary to protect the confidentiality, integrity, and availability of EPA's financial data.

Attachment 3 contains the status of issues reported in prior years' reports. The issues included in attachment 3 should be considered among EPA's significant deficiencies for FY 2012. We reported to the Agency on less significant internal control matters in writing during the course of the audit. We will not issue a separate management letter.

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

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

For financial statement audit and financial reporting purposes, OMB defines material weaknesses in internal control as a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

The Agency reported that no material weaknesses had been found in the design or operation of internal controls over financial reporting as of June 30, 2012. We identified several significant deficiencies related to EPA's Compass system that, when considered together, represent a material internal control weakness. Details concerning our findings on the material weakness and significant deficiencies can be found in attachment 1.

Tests of Compliance With Laws and Regulations

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

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. A number of ongoing investigations involving EPA's grantees and contractors could disclose violations of laws and regulations, but a determination about these cases has not been made. The results of our tests of compliance with laws and regulations are summarized below and detailed in attachment 2.

EPA's Compass Service Provider Needs to Assess Controls Over Business Processes Affecting EPA

EPA has limited assurance that its Compass service provider's controls over business processes affecting EPA are designed and operating as intended. Compass, EPA's new core financial application, is managed and hosted by a service provider through a contract. Federal guidance requires agencies using service providers for financial management to ensure that these service providers assess the design and operating effectiveness of internal controls over financial reporting. Industry accounting standards require service providers to evaluate controls over those activities affecting its customers' financial reporting. EPA did not identify its critical business processes that impact financial reporting or require its service provider to identify and assess those processes it performs on the Agency's behalf. Without an assessment of its service provider's control environment, EPA faces the potential that a critical business failure by the service provider could impact the Agency's ability to provide reliable financial reporting.

FFMIA Compliance

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. To meet the FFMIA requirement, we performed tests of compliance with FFMIA Section 803(a) requirements and used the OMB guidance, *Memorandum M-09-06, Implementation Guidance for the Federal Financial Management Improvement Act,* dated January 9, 2009, for determining substantial noncompliance with FFMIA. The results of our tests did not disclose any instances in which the Agency's financial management systems did not substantially comply with FFMIA requirements.

No other significant matters involving compliance with laws and regulations came to our attention during the course of the audit. We will not issue a separate management letter.

Our audit work was also performed to meet the requirements in 42 U.S. Code §9611(k) with respect to the Hazardous Substance Superfund Trust Fund, to conduct an annual audit of payments, obligations, reimbursements, or other uses of the fund. The significant deficiencies reported above also relate to Superfund.

Prior Audit Coverage

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

- Financial system user account management.
- Accounts receivable documentation not provided timely.
- Uncollectible debt misstated.

Attachment 3 summarizes the current status of corrective actions taken on prior audit report recommendations related to these issues.

Agency Comments and OIG Evaluation

The Agency disagreed with most of our findings but accepted many of our recommendations. The Agency stated it identified and then fixed or remediated most of the limitations of its new Compass system and, thus, there were no material issues during the preparation of the financial statements. The Agency characterized the errors we found as normal problems during collection and verification activities. However, we disagree that was the case. Further, along with the errors that we found and communicated to the Agency during the course of our audit, we found additional errors at year end. We maintain that the Agency materially misstated quarterly financial reports to OMB and the draft financial statements. Because the errors were not detected during the year or during the preparation of the quarterly and draft financial statements, we do not agree with the Agency's position that it would have identified the errors. The errors we found were not detected by the Agency because they were part of everyday postings in the Compass system and occurred primarily because of posting models deficiencies in the new system and the failure of internal controls to detect and correct the errors.

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

Paul C. Curtis
Director, Financial Statement Audits
Office of Inspector General
U.S. Environmental Protection Agency
November 15, 2012

Internal Control Material Weakness and Significant Deficiencies

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1—Compass System Limitations Are a Material Weakness to EPA's Accounting Operations and Internal Controls

In October 2011, EPA replaced IFMS with Compass. Although the Agency had operated IFMS a contractor manages Compass. EPA replaced IFMS to improve the operation of financial management systems, standardize business processes, and strengthen internal controls. The system replacement required a major systems conversion and data migration to Compass. As with any major system conversion, problems were to be expected. We found that when the Agency converted its accounting system, it had not yet developed all the reports and functions required to generate all the needed information. The lack of useful reports and system limitations significantly impaired the effectiveness of EPA's accounting operations and internal controls. We determined that the Compass reporting and system limitations represented a material weakness. Several significant internal control deficiencies contributed to the material weakness:

- Posting model errors caused multiple misstatements. We found several material errors, caused by posting model errors, in the draft financial statements that could have potentially materially misstated the financial statements if not detected.
- Compass could not produce the reports EPA needed for many accounting applications, which caused delays in completing some accounting functions and material errors in GL balances.
- Material amounts of expense accruals did not reverse properly because of a Compass system configuration error.
- EPA discontinued the GL account analysis for FY 2012. Without performing account analysis, EPA did not have an effective monitoring control to assess the accuracy and reasonableness of GL accounts and detect errors.

The Agency has over 8,000 posting models for posting transactions in the financial system. We found errors in multiple posting models that we examined. However, the financial system has many other posting models that we were not able to examine. Our test work and analyses indicate that while the Agency has been able to correct some posting model errors during the year, there are additional posting models the Agency needs to evaluate.

The significant deficiencies in accounting operations and internal controls resulted in material misstatements of the financial statements that were not prevented or detected; thus, they represent a material internal control weakness. Further details on each significant deficiency follow.

Agency Comments and OIG Evaluation

The Agency did not concur with our finding that Compass system limitations are a material weakness. The Agency believes it has fixed or remediated the Compass limitations so that only normal problems of information collection and verification existed during the preparation of the financial reports. EPA stated that during the fiscal year it dedicated resources to:

- Creating alternate methods of obtaining and analyzing data
- Reviewing and correcting the posting logic

- Updating its methods of GL account analytical review
- Identifying and correcting system and user errors.

We believe that EPA focused on correcting errors to present accurate year-end financial statements. However, EPA did not acknowledge the high risk of material errors that may have occurred in FY 2012 and had not been detected. EPA emphasized its efforts to review posting models and correct errors, but it did not comment on the specific multiple misstatements and several material errors caused by posting model errors. EPA highlighted Compass' robust reporting capacity, but it did not acknowledge that it could not produce reports for many accounting applications. EPA claimed that it did not discontinue its GL account analysis process, but prepared a quarterly account analysis at the financial statement line-item level. We believe EPA's account analysis process was not effective because our analyses at the GL account level uncovered material misstatements that EPA did not detect.

We found many significant deficiencies in EPA's accounting operations and internal controls. Regardless of EPA's efforts to correct the errors we identified, the Compass system limitations are a material weakness because there were material undetected errors in the draft financial statements and, accordingly, there was more than a remote chance that errors could occur and not be detected.

2—Posting Models in Compass Materially Misstated GL Activity and Balances

Compass materially misstated GL activity and balances due to incorrect posting models. We found incorrect posting models in numerous accounts for obligations, disbursements, receivables, collections, and revenue. EPA did not properly and thoroughly review the posting models before migration from IFMS to Compass. Further, EPA did not properly review balances in the financial statements that were a result of incorrect posting models; a posting model is a reference for document entry that provides default values for posting business transactions in GL accounts. Incorrect posting models reflect an internal control weakness and an indication that EPA did not exercise proper oversight over how transactions are processed in its GL. As a result, the draft financial statements contained material errors that were undetected by the Agency. We noted $331 million in misstatements in the draft financial statements that Agency management did not detect.

GAO's *Standards for Internal Control in the Federal Government* require accurate and timely recording of transactions and events. The FMFIA Act emphasizes the need for Agencies to provide reasonable assurance that accounts are properly recorded and accounted for to ensure reliability of financial reporting.

EPA's Contract for the Financial System Modernization Project states the Transaction Definitions Maintenance table is used to define and store document type, transaction type, and process activity for use across EPA. The GL Accounting Entry is an EPA-defined code that dictates what debits and credits are posted for a transaction. The United States Standard GL accounting guidance on budget policy defines "Upward Adjustments of Prior-Year Undelivered Orders – Obligation" as the amount of upward adjustments during the current fiscal year to obligations that were originally recorded in a prior fiscal year in "Undelivered Orders – Obligations." The Treasury Financial Manual states "Upward Adjustments of Prior Year Undelivered Orders" is credited when the expended amount is more than the undelivered order. Conversely, "Downward Adjustments of Prior-year Undelivered Orders" is debited when the expended amount is less than the undelivered order.

During our audit we found multiple posting errors. Posting models were incorrect for upward adjustments, downward adjustments, obligations with miscellaneous vendor codes, receivables, collections, revenue, and revenue and expenses for EPA's Working Capital Fund. The Agency was able to fix some of the errors that we found before the draft financial statements were prepared. However, our later analysis of the draft financial statements found more posting model errors that resulted in material misstatements to the draft financial statements. The errors resulted in the following misstatements:

- Earned Revenue was overstated by $184 million.
- Net Costs, intra-entity operating expenses was overstated by $184 million.
- Miscellaneous Receipt Revenue was understated by $87 million.
- Obligations Incurred and Recoveries of Prior Year Unpaid Obligations were misstated by $52 million

- EPA's Gain on Sale of Investments was overstated by $7 million.
- EPA's Working Capital Advance account was overstated by $1 million.

In addition to the misstatements identified above, we found the following:

- Earned Revenue for the Federal Insecticide, Fungicide, and Rodenticide Act fund was understated by $14.9 million.
- Earned Revenue for the Pesticide Registration Improvement Act fund was understated by $7.2 million.
- Earned Revenue for Superfund special accounts was understated by $3.3 million.
- Superfund federal accounts receivable transactions totaling about $20 million did not post to the correct GL accounts.
- Over $236 million in Superfund cost recovery accounts receivable were recorded in an improper GL account.
- Collection transactions totaling about $29 million that impacted incorrect cash, advance, and allowance GL accounts were recorded incorrectly.
- Intergovernmental payment transactions totaling about $81 million were not recorded to the correct GL account.
- EPA did not post the proper entry to record about $3 million in a loan from its Environmental Program Management fund to its reimbursable Oil Spill fund.
- EPA did not properly record about $3 million of earned revenue related to Superfund cashouts.
- Current year new obligations totaling about $368 million were incorrectly recorded in upward adjustment accounts. (These transactions represent our sample items and are not representative of all transactions improperly recorded to the upward adjustment accounts.)
- Federal obligations of about $234 million were incorrectly recorded as non-federal obligations.
- Accrued liabilities totaling about $14 million were not properly recorded.

EPA did not verify that the posting models in Compass were accurate prior to migration from IFMS. Specific reasons include:

- Mapping errors posted intra-entity activity to incorrect revenue and expense accounts; when EPA eliminated the intra-entity activity for financial statement purposes, those accounts were understated. The error was not caught on management review.
- New obligations with a prior budget fiscal year were recorded as upward adjustments to prior-year obligations.
- Accounting models for reimbursable payroll disbursements, accruals, and grant refunds failed to recognize corresponding revenue and reduce unearned advances.
- Adjustments to obligations with a prior budget fiscal year were recorded as Upward and Downward Adjustments of Prior-Year Undelivered Orders, increasing both.
- Obligations with a vendor name "Miscellaneous" were recorded by default as a non-federal entity even if it was a federal obligation. The error is highlighted in the GL when expenditures are made against the obligation, creating an ever growing negative balance.

- Compass contains flexible definitions for posting entries based on whether transactions are, for example, federal versus non-federal or exchange versus non-exchange. The default entries should not be used and transactions should be recorded within specified and defined accounting entries.
- EPA incorrectly set up accounting models for reimbursable payroll disbursements, accruals, and grant refunds as non-exchange transactions rather than as reimbursable expenditures.
- EPA did not perform analytical reviews of account activity to identify unusual activity resulting from incorrect posting models.

We found $330.9 million in misstatements on EPA's draft financial statements, caused by incorrect transactional postings. The transactions posted incorrectly because the posting models associated with those transactions were not mapped to the correct accounts and internal controls failed to detect and correct the errors. The misstatements in the draft financial statements are listed below:

Table 1: Draft financial statement misstatements

Financial statement line items	Amount (millions)
Earned revenue and net costs	$18
Miscellaneous receipt revenue understated	87
Obligations incurred and recoveries of prior year unpaid obligations	52 [1]
Gain on sale of investments	7
Working capital advance	1
Total	**$331**

Source: OIG analysis

[1] Estimated amount

Incorrect posting models also distort the use of funds as they do not differentiate between current and prior year activity and federal and non-federal activity, and do not represent accurate activity.

Recommendations

We recommend the Chief Financial Officer:

1. Perform a thorough review of all posting models to ensure the proper accounts are impacted.

2. Correct activity in accounts incorrectly impacted by improper posting models.

3. Develop internal control procedures to confirm the proper accounts are impacted for all transactions.

4. Perform analytical reviews of account activity on a quarterly basis to verify account activity is reasonable.

Agency Comments and OIG Evaluation

The Agency concurred with our recommendations. However, the Agency did not agree that incorrect posting models resulted in materially misstated GL activity and balances or that the significant GL errors and misstatements in the draft financial statements were internal control weaknesses. The Agency stated that posting models were not the cause of certain errors and misstatements and provided alternative reasons for the errors and misstatements. We do not believe that EPA's alternative reasons are consistent with our audit findings. Regardless of the origin of the error or misstatement, the numerous significant GL errors and misstatements represent a material weakness.

The Agency also stated that it would have caught the errors in its year-end analysis, but the Agency did not detect the errors we found in the draft financial statements or in its quarterly financial statement submissions to OMB. We do not believe the Agency would have prevented the material misstatements had we not brought them to the Agency's attention.

3—Compass Reporting Limitations Impair Accounting Operations and Internal Controls

EPA has been unable to obtain the reports it needs from Compass for many accounting applications in FY 2012. OMB requires financial management systems to provide complete, reliable, consistent, timely, and useful financial information. Compass reporting limitations prevented EPA from producing many reports it needed for accounting operations. When the Agency converted its accounting system to Compass, it had not yet developed all the reports and functions required to generate all the information it needs. The lack of useful reports and information significantly impairs the effectiveness of EPA's accounting operations and internal controls.

OMB Circular A-127, *Financial Management Systems*, requires financial management systems to provide complete, reliable, consistent, timely, and useful financial information for federal government operations. GAO's *Standards for Internal Control in the Federal Government* states that internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations, including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use.
- Compliance with applicable laws and regulations.

EPA could not obtain needed reports from Compass in several accounting areas:

- Accounts Receivable – The Compass Business Objects GL report did not contain the beginning balances at the security organization (finance center) level which finance centers need to reconcile accounts receivable reports. The Cincinnati Finance Center (CFC), Las Vegas Finance Center (LVFC), and Research Triangle Park Finance Center (RTPFC) could not properly perform monthly accounts receivable reconciliations from October 2011 through March 2012. LVFC submitted non-certifications to the Reporting and Analysis Staff for their reconciliations. RTPFC submitted certifications documenting that it could not perform the reconciliations. CFC did not submit certifications but notified headquarters by e-mail of its difficulties with validating accounts receivable balances.

- Allowance for Doubtful Accounts – Compass reports needed to estimate allowances, such as allowance for doubtful accounts and GL reports, were not available at the finance center level. EPA has not developed the reports or functions CFC needed to update its collectibility estimates for past due accounts receivable. For the first and second quarters of FY 2012, CFC updated the allowance estimates only for its new FY 2012 receivables greater than $100,000, and did not update allowance estimates for any prior year accounts receivable converted from IFMS to Compass. LVFC and RTPFC did not update the allowance for doubtful accounts estimates for the first two quarters of FY 2012.

- Fund Balance with Treasury – EPA was not able to obtain accurate data from Compass for sections II and III of the monthly Statement of Transactions (SF-224) report. Compass could not read the Treasury-formatted data files necessary to generate accurate monthly activity reports. We identified this problem at CFC, LVFC, Washington Finance Center, Reporting and Analysis Staff, and headquarters payroll (security organization PYRL). The problem began at the beginning of FY 2012 and still existed when we reviewed internal controls during the third quarter of FY 2012. EPA staff manually reconciled and reported Sections II and III of the SF-224 report submitted to Treasury.

- Suspense Accounts – Compass does not have the capability to generate the suspense account detailed report for tracking the transactions in suspense accounts 68F3875 and 68F3885. CFC generates the suspense report by obtaining suspense transactions from the system and comparing them to transactions in the Interagency Document Online Tracking System. LVFC maintains a hard copy of each suspense transaction processed along with the supporting documentation in a folder and manually tracks every suspense transaction to ensure they are cleared timely. RTPFC manually checks the Statement of Transactions and the cash difference reports to identify transactions not cleared within 60 days. The Washington Finance Center did not generate suspense reports. Reporting and Analysis Staff have been unable to provide the finance centers a monthly report of balances in the suspense accounts. This problem hinders the finance centers' ability to classify and transfer transactions in suspense to the appropriate GL account. We found that the problem began at the beginning of FY 2012 and still existed when we reviewed the February and March 2012 suspense reports.

- Property – Compass cannot produce a property report by security organization (location). Maximo, a fixed asset subsystem of Compass, accepts only one security organization (EPA) and does not recognize the individual finance centers. Therefore, EPA cannot reconcile property management data within Maximo to the relevant financial data within Compass for accountable personal property. We identified this limitation at RTPFC and LVFC.

- Direct Asbestos Loans – Compass cannot produce the direct loans Treasury Report on Receivables. LVFC tracked individual asbestos loans in Compass via debt accounts as recommended during migration planning by the contractor that developed Compass. However, Compass cannot use debt accounts to produce a Treasury Report on Receivables. LVFC must manually produce the direct loans Treasury Report on Receivables, which it submits to the Reporting and Analysis Staff for Treasury reporting.

- GL Account Analysis – The finance centers have not performed a GL account analysis since the implementation of Compass at the beginning of FY 2012. In prior years, the finance centers conducted annual 6-month, 9-month, and year-end GL account analyses. EPA used the GL account analysis to monitor and assess the accuracy and reasonableness of its GL accounts and the effectiveness of internal controls. Compass could not produce FY 2012 GL data for account analysis comparable to FY 2011 data. Compass does not have beginning balances by finance office, and the transaction codes and types were not comparable between FYs 2011 and 2012. OCFO temporarily discontinued the GL account analysis for FY 2012, except for CFC's quarterly analysis of Agency activity for intragovernmental balances.

Compass reporting limitations prevented EPA from producing many reports it needed. When the Agency converted its accounting system from IFMS to Compass in October 2011, it had not yet developed all the reports and functions required to generate all the information needed. OCFO's FY 2012 annual assurance letter to the Administrator dated August 20, 2012, stated that "…Compass is being modified to correct defects and meet certain requirements that were not expressed during system development." OCFO's FY 2012 assurance letter further stated that "OCFO continues to work with NPMs [National Program Managers] and regions to identify any residual problems and implement solutions. OCFO anticipates that the majority of the remaining implementation issues will be resolved in the coming months."

The lack of useful reports and information significantly impairs the effectiveness of EPA's accounting operations and internal controls. We found the following impairments:

- The inability to perform some accounting functions. This adversely impacted EPA's OMB Circular A-123 internal control reviews by limiting the number of effective controls available for testing. For example, LVFC and RTPFC were not able to perform the first quarter allowance for doubtful accounts calculations because the Compass GL reports did not have the beginning balances at the finance center level, which finance centers need to reconcile accounts receivable reports to the GL. Therefore, EPA omitted tests of the allowance for doubtful account calculation and the allowance adjustment transaction approval.

  CFC omitted some OMB Circular A-123 tests of accounts receivable because CFC could not perform monthly accounts receivable reconciliations. Compass could not provide an accurate report of accounts receivable opening balances needed for the reconciliations. OCFO reported on October 11, 2012, that reports needed for accounts receivable reconciliations are now in Compass. However, the reports were not available during A-123 testing conducted from January through June 2012, and EPA did not test the related internal controls.

  In the area of cost recovery accounting, RTPFC omitted A-123 tests to confirm appropriate documents were scanned into the Superfund Cost Recovery Package Imaging and On-Line System (known as SCORPIOS) and to confirm all invoices were redistributed. RTPFC was unable to perform Compass queries to obtain the needed reports. Therefore, invoices may not be redistributed properly, resulting in inaccurate expenses reported in the financial statements.

  For the first and second quarters of FY 2012, RTPFC omitted A-123 property tests performed to verify that EPA properly recorded assets in the Fixed Assets Subsystem and Compass, and to confirm that quarterly financial statements were reviewed and confirmed to be accurate. RTPFC could not perform monthly property reconciliations because Compass could not provide reports with GL beginning balances. OCFO reported on October 11, 2012, that "the majority of reports related to this process are now in

Compass. Additional reports are under review and undergoing system testing." However, the reports were not available during A-123 testing, and EPA did not test the related internal controls.

- Delays in the accurate completion of some accounting functions. For example, OCFO temporarily discontinued the GL account analysis for FY 2012. CFC delayed the calculation of Superfund unbilled oversight cost accruals until year-end because it was not able to retrieve billings reports from Compass needed to complete the accrual spreadsheet. CFC worked around the problem by posting quarterly accruals based on the average of the previous four quarterly accruals.

- Material errors in GL balances. We identified errors in GL balances totaling over $600 million in our 7-month testing and documented them in our audit difference entries. The net effect of the errors did not materially misstate the financial statements but indicates the potential for material misstatements.

- The expenditure of time and resources on workarounds. EPA personnel in finance centers spent time preparing workarounds for Sections II and III of the SF-224 reports to Treasury, tracking the suspense accounts, and generating accurate numbers for the direct loans Treasury Report on Receivables.

When taken as a whole, the Compass reporting limitations and the resulting impairments of EPA's accounting operations and internal controls represent a material internal control weakness. Several factors impact the effectiveness of EPA's internal controls and increase the risk of a material misstatement to the financial statements:

- Lack of reliable reports
- Impairment of accounting operations
- Exclusion of some internal control tests
- Delays in the accurate completion of some accounting functions
- Material errors in GL balances
- Time and resources expended on workarounds

These deficiencies in accounting operations and internal controls resulted in material misstatements of the draft financial statements that were not prevented or detected; thus, they represent a material internal control weakness.

Recommendation

We recommend that the Chief Financial Officer:

5. Identify Compass reporting problems and develop reports to provide users with accurate data on a timely basis.

Agency Comments and OIG Evaluation

The Agency concurred with our recommendation. However, the Agency did not agree that the reporting limitations we identified in several accounting areas significantly impair the effectiveness of the Agency's accounting operations and internal controls. EPA claimed that it was not impaired in the following areas that we addressed:

- Accounts receivable
- Allowance for doubtful accounts
- Fund Balance with Treasury
- Suspense accounts
- Property
- Direct asbestos loans
- GL account analysis
- A-123 internal control reviews
- Delays in completion of some accounting functions
- Material errors in GL balances
- Expenditure of time and resources on workarounds

EPA characterized Compass reporting limitations as an opportunity to take advantage of the many features of the modern system to best meet the Agency's business needs. For example, when Compass did not have the reports EPA needed to reconcile receivables at the servicing finance office level, EPA reported that Compass allowed it to streamline accounts receivable processes by moving to a centralized approach. EPA canceled its policy that required finance centers to perform monthly receivable reconciliations. We believe that EPA's response weakened its internal controls instead of strengthening them.

EPA emphasized the alternative approaches it developed, the eventual creation of useful reports, and the correction of errors. EPA characterized the conditions that it experienced with Compass reporting limitations as "quite normal" in the implementation of a new system. We disagree with EPA's assessment. Proper planning before the system implementation could have reduced the significant impairments to EPA's accounting operations and internal controls.

4—EPA Should Improve Controls Over Expense Accrual Reversals

EPA did not reverse approximately $108 million of FY 2011 year-end expense accruals in FY 2012. EPA policy requires the liability reported in the financial statements to reflect the value of goods and services received and accepted but unpaid. The Agency did not reverse the accrual transactions because the Compass posting configuration for the applicable fund category was inaccurate and staff recorded the FY 2011 accrual entries without including the reversal period. By not reversing the accruals timely, EPA overstated the accrued liability and expense amounts by $108 million and materially misstated the quarterly financial statements.

EPA Policy Announcement No. 95-11, *Policies and Procedures for Recognizing Year-End Accounts Payable and Related Accruals*, requires EPA "to recognize and report all accounts payable and related accruals in its year-end financial reports. The liability reported in the annual financial statements shall reflect the value of all goods and services received and accepted but unpaid regardless of whether an invoice has been received.… Accruals and unvouchered accounts payable shall be input using the reversal period field in IFMS [since replaced by Compass]."

OMB Circular A-123, *Management's Responsibility for Internal Control*, states, "Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.… In addition, periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel."

We notified the Agency that numerous expense accrual transactions from FY 2011 accounting periods 12 through 15 did not reverse in FY 2012. EPA found that $107,812,171 of the $820,113,515 in total automated accruals did not reverse and post to the proper GL accounts in FY 2012. EPA stated that it updated the Compass configuration and subsequent posting logic in the second quarter of FY 2012. We found that first quarter automated accruals reversed properly in the second quarter. In addition, we identified $44,957 of FY 2011 year-end expense accruals that did not reverse in FY 2012. EPA recorded the accrual reversals of $107,812,171 and $44,957 in Compass at the FY 2012 year-end and the beginning of FY 2013, respectively. Table 2 illustrates the expense accruals not reversed timely in Compass.

Table 2: Expense accruals not reversed in Compass

Expense accrual amount	Accrual amount reversed in FY 2012	Accrual amount not reversed in FY 2012
$820,113,515	$712,301,344	$107,812,171[1]
$44,957	$0	$44,957[1]

Source: OIG analysis of EPA data

[1] EPA reversed the $107,812,171 and $44,957 accrual amounts by recording manual standard voucher adjustments in the FY 2012 fourteenth month accounting period and FY 2013 first month accounting period, respectively.

Compass did not reverse the accrual transactions for the trust fund category because, in the implementation of Compass, EPA set the trust fund category configuration to null post (do not post) to the GL. These accruals did not automatically reverse in the first quarter of FY 2012. The system posted the accrual reversals for the trust fund category to the transaction and accounting journals but not the general journal. EPA did not:

- Check the "Should Post to General Journal Flag" in the accounting journal record.
- Reverse accruals that did not have the reversal period for the FY 2011 accrual transactions in IFMS.
- Detect the omission of the reversal period when Compass processed the accrual reversals.
- Have adequate internal controls in place to monitor the accrual reversals and reconcile the accruals and reversals.

By not reversing the accruals timely, EPA overstated the accrued liability and expense amounts by approximately $108 million and materially misstated the FY 2012 quarterly financial statements. EPA reversed the accruals when we notified it of the error. If we had not brought the error to EPA's attention, it might have materially misstated the year-end financial statements.

Recommendation

We recommend that the Chief Financial Officer:

6. Update EPA's policy for recognizing year-end accruals to require reconciliations of accruals and accrual reversals.

Agency Comments and OIG Evaluation

The Agency concurred with our finding and recommendation.

5—Compass System Limitations Impair Internal Controls of Financial Operations

EPA's new Compass system experienced several impairments to processing financial transactions. The impacted transactions included five payment accounting lines that exceeded the related obligation accounting lines, three transactions posted to an incorrect accounting period, and a payment against a canceled appropriation. GAO guidance states that application controls should ensure completeness, accuracy, authorization, and validity of all transactions during application processing. The Department of the Treasury Financial Management Manual states that canceled appropriation account balances are not available for obligation or expenditure for any purpose. Compass did not prevent the posting of these invalid transactions because EPA did not have system controls in place to reject them. The Compass impairments limit EPA's assurance that account balances are accurate and Agency managers have useful and reliable financial information for managing day-to-day operations.

Grant Payments Exceeded the Related Obligation Accounting Lines

We found five grant payment accounting lines that exceeded the related obligation accounting lines. EPA did not set the proper controls and tolerance levels to reject a payment over the obligation line amount to prevent grant payments from exceeding obligated line amounts. GAO's *Standards for Internal Control in the Federal Government* states that with respect to control activities for information systems, "This category of control is designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing." None of the expenditures exceeded the total amounts obligated for each grant. However, when payment accounting lines exceed the obligation accounting lines, the financial system may not accurately reflect the obligation account balances. Project officers and grant specialists may not have accurate information to manage grant funds. EPA prepared journal vouchers to correct the overpaid accounting lines, as illustrated in table 3.

Table 3: Grant payments exceeding obligation line amounts

Journal voucher	Document number	Line number	Obligation line amount	Expended line amount
3312SV121	I00E24007	2	$169,900	$171,666
3312SV122	C999467405	1	3,194,600	3,194,794
3312SV120	XA00E79301	1	55,000	57,795
3312SV119	XP99574309	3	959,627	1,097,138
3312SV117	L96683801	2	273,445	273,880
		Total	**$4,652,572**	**$4,795,273**

Source: OIG analysis

Transactions Posted to an Incorrect Accounting Period

Compass allowed redistribution disbursement transactions to post to an incorrect accounting period. EPA's accounting periods correspond to the calendar months, with additional periods for year-end adjustments. CFC posted the April 2012 transactions to redistribute payments, illustrated in table 4, to the U.S. Department of Justice. The transactions posted to the March 2012 accounting period because EPA left the March accounting period open in April. GAO's *Standards for Internal Control in the Federal Government*, states that "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded." EPA's posting to an incorrect accounting period overstated the March balances and understated April balances. Because Compass did not prevent the improper posting, EPA cannot ensure that it records transactions in the proper period, closes accounting periods timely, and prohibits adjustments to prior period balances.

Table 4: April transactions posted to the March accounting period

Compass document number	Agency location code	Dollar amount	Payment date
IG B2001140563	68010727	$20,868	April 10, 2012
IG B2001140589	68010727	64,316	April 10, 2012
IG B2001140571	68010727	54,666	April 10, 2012
	Total	**$139,851**	

Source: OIG analysis

Payment Against a Canceled Appropriation

EPA made a payment against a canceled appropriation. RTPFC recorded a payment for $3,338 on May 14, 2012 against appropriated funds that EPA canceled in FY 2011. RTPFC recorded the payment in document number B2094647550, to treasury symbol 6803/040108, budget fiscal year 2003/2004, fund B.

OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, Section 130-14, provides guidance on the payment process for obligations with canceled funds. According to A-11, "Legitimately incurred obligations that have not been disbursed (i.e., paid) at the time a TAFS [Treasury Appropriation Fund Symbol] is canceled cannot be disbursed from the canceled obligated or unobligated balances of the canceled TAFS."

According to Treasury Financial Management Manual 2-4200, *Agency Reporting on Unexpended Balances of Appropriations and Funds*, Section 4245, "Canceled appropriation account balances are not available for obligation or expenditure for any purpose."

When EPA canceled the funds at the end of FY 2011, the funds should not have been available for obligation or expenditure. However, Compass did not have the system controls in place to prevent their availability. EPA cannot ensure that Compass prevents payments against canceled appropriations.

Recommendation

We recommend that the Chief Financial Officer:

7. Correct the Compass system limitations that allowed (a) payments to exceed the related obligation accounting lines, (b) transactions to post to an incorrect accounting period, and (c) a payment to impact a canceled appropriation.

Agency Comments and OIG Evaluation

The Agency did not concur with our recommendation because it has already made the corrections. The Agency stated that in December 2011 it updated proper controls and tolerance levels to prevent grant payments from exceeding the related obligation accounting lines. In May 2012, EPA corrected the issue of preventing the improper posting of transactions to prior accounting periods. EPA confirmed that it fixed the Compass table to prevent spending against canceled appropriations. Therefore, we concluded that no further action is required.

6—EPA Should Improve Compliance With Internal Controls for Accounts Receivable

We found numerous deficiencies in EPA's compliance with accounts receivable internal controls in FY 2012. Various factors contributed to EPA not properly following its internal control procedures to ensure timely and accurate recording of accounts receivable. EPA policies require accurate and timely recording of accounts receivable and proper separation of duties. Noncompliance with accounts receivable controls affects the reliability and integrity of accounts receivable on the financial statements.

EPA Resources Management Directive Systems (RMDS) 2540-9-1, *Billing and Collecting*, requires the originating offices/action officials to forward all action documents to the finance center within 5 business days. Finance centers must establish an accounts receivable in the Agency financial system of record within 3 business days of receiving documentation from the originating offices. RMDS Policy Number 2540-09 requires that EPA maintain records at the transaction level that "provide clear audit trails of financial transactions, which include all materials created in support of a financial transaction or event." RMDS 2550D, Chapter 14, T1, *Superfund Accounts Receivable and Billings*, also requires forwarding all action documents to the finance center within 5 business days. RMDS 2550D, Chapter 14, includes requirements similar to RMDS 2540-09 as discussed above, and further provides that all delinquent statutory Superfund accounts receivable arising under judicial or administrative order be referred to the U.S. Department of Justice for enforcement or collection.

RMDS 2540-9-P2, *Non-Federal Delinquent Debt,* state that finance centers must "maintain a debt/accounts receivable file that includes copies of all bills, demand letters, and all other correspondence with the debtor." The finance center is responsible for reviewing debt/accounts receivable files and the referral to Treasury of any uncollectible debt/accounts receivable monthly.

RMDS 2540-02, *Internal Controls: Separation of Duties*, states that EPA employees must not be in a position to both perpetrate and conceal errors or irregularities by controlling multiple key aspects of a financial transaction. Separation of duties is one of the fundamental elements of internal controls that reduce risks.

RMDS 2540-09-P1, states that a letter of Final Determination is issued by the Action Official who disallows grant expenses and determines that EPA is owed funds. This letter demands payment and advises the debtor that if payment is not made within thirty (30) days, any applicable interest, penalty, and administrative costs will accrue on the debt/accounts receivable. In addition, "the LVFC records the debt/accounts receivable into Agency Financial System of Record for billings."

Our review of EPA's compliance with its internal controls for establishing accounts receivable found a number of instances of noncompliance with accounts receivable control procedures, which indicates that noncompliance is prevalent. Specifically, we found that EPA did not:

- Accurately record a $38 million Superfund receivable in the proper fund. EPA staff incorrectly recorded the transaction as a Superfund special account past cost receivable

instead of a future cost receivable. Superfund special account past cost receivables impact a different fund, different GL accounts, and sections of the financial statements than future cost receivables.
- Timely receive 33 legal documents for receivables totaling $31,971,741, which resulted in late recording of receivables.
- Timely record 15 accounts receivable totaling $40,555,244 in the financial accounting system (within 3 business days).
- Accurately record 2 installment civil penalties in the financial accounting system. EPA had received the collections for both receivables, which were recorded in liability accounts for several months.
- Follow procedures when recording accounts receivable in the financial accounting system. EPA established a $1,220,000 receivable prior to receiving the official action document that represented EPA's claim to the receivable. Staff established the receivable based only on an e-mail from the project officer.
- Maintain adequate separation of duties for some interagency agreement billings and collections.
- Maintain adequate supporting documentation in the accounts receivable files for correction transactions.
- Adequately pursue collection efforts for 4 accounts receivable.
- Include in grant final determination letters the required provisions for interest, handling, and penalties if payment was not made within 30 days.

Various factors contributed to EPA's noncompliance with accounts receivable controls.

- Staff did not correctly interpret the language in the settlement agreement.
- Regional counsel, enforcement, and program offices did not timely provide legal documents to the finance center within 5 workdays of the document effective date.
- The EPA accountant was unfamiliar with the type of the bankruptcy claim and did not realize the claim should be recorded as a receivable until performing a review of the files a few months later.
- Staff were not aware of the requirement to document when changes were made to accounts receivable.
- Staff did not consider the process of billing and collecting interagency agreements as a separation of duties issue because interagency collections are processed through the Treasury system. However, personnel then control multiple aspects of a financial transaction, the processing of interagency agreement receivables, collections, and cash.
- Staff did not properly maintain accounts receivable files.
- Finance center staff did not obtain and examine the official action document to verify the validity of the receivable prior to recording the receivable.
- EPA's conversion of its accounting system from IFMS to Compass put additional demands on finance center staff. As a result, finance center staff did not review files monthly and did not include on file "all other correspondence with the debtor" relating to collection efforts. Finance center staff did not monitor the status of delinquent debts on an ongoing basis and adjust the overdue status code accordingly.

- EPA's Office of Grants and Debarment, within the Office of Administration and Resources Management, does not have guidance or procedures to ensure that grant final determination letters are provided to the finance center. As a result, the audit follow-up coordinator was unaware of the requirements to provide the final determination letter to the finance center or to include provisions for late payment.

Untimely and inaccurate recording of receivables misstates accounts receivable in the financial statements and affects the quality of data available to manage EPA resources. Without accurate data, management cannot make informed decisions. Violation of the separation of duties principle increases the risk that errors and irregularities will not be identified and corrected. Lack of adequate supporting documentation may raise questions about the validity and integrity of financial information in the accounting system. Without adequate documentation, EPA does not have an adequate audit trail, and without an adequate audit trail EPA lacks transparency and increases the risk of fraud.

Recommendations

We recommend the Assistant Administrator for Enforcement and Compliance Assurance:

8. Forward judicial documents to the financial center.

We recommend that the Chief Financial Officer:

9. Reinforce procedures to monitor all tracking reports. Follow up with regional offices and the U.S. Department of Justice to obtain legal documents to ensure accounts receivable are recorded timely in the financial accounting system.

10. Institute standard operating procedures for entering, tracking, and monitoring accounts receivable, and ensure adherence to EPA policies and procedures for entering receivables timely and maintaining adequate and easily accessible source documentation.

11. Ensure proper separation of duties by having separate individuals perform billing and collection functions.

We recommend that the Assistant Administrator for Administration and Resources Management direct the Director of the Office of Grants and Debarment to:

12. Create guidance to ensure that grant final determination letters contain required provisions for late payment and a process for forwarding final determination letters to finance centers within 5 days of the effective date.

Agency Comments and OIG Evaluation

The Agency disagreed with our finding and recommendation for the Office of Enforcement and Compliance Assurance to forward judicial documents to the finance center. However, the Agency responded that the Office of Enforcement and Compliance Assurance will engage U.S. Department of Justice management to assess the extent to which improvements are needed to ensure the timely transmittal of judicial documentation to the finance center. The Agency also responded that the Office of Enforcement and Compliance Assurance takes responsibility for working with the regions and headquarters offices, where applicable, to ensure that administrative penalty documentation is provided to the finance office within 5 business days. The Office of Enforcement and Compliance Assurance will concentrate additional efforts on those regions whose performance needs improvements.

The Agency also disagreed with our finding and recommendation about ensuring proper separation of duties. The Agency cited receiving a waiver on October 11, 2012, after the end of the audit period, and that reimbursable collections do not involve physical cash or checks. The OIG believes that separation of duties is a sound internal control practice and should not be waived.

The Agency agreed with our other findings and recommendations and stated it already began taking corrective action.

7—EPA Is Not Clearing Fund Balance with Treasury Statement of Differences Timely

EPA did not clear Fund Balance with Treasury differences reported on the U.S. Department of the Treasury's Statement of Differences (SOD) within 2 months. Treasury guidance requires that the Agency clear deposit and disbursement activity differences within "two months of occurrence." However, various problems resulting from the Agency's conversion from IFMS to Compass contributed to the failure to timely clear SOD transactions. The problems included the Agency being unable to process transactions, and encountering posting and accounting model deficiencies with the new system. EPA reported a combined total of $6,115,632 in differences from October 2011 through February 2012. The failure to clear SOD transactions compromises the reliability of EPA's account balances and misstates disbursement and deposit activity reported monthly to the Treasury.

The Treasury Financial Manual Reconciliation Procedures, require that the Agency identify and clear disbursement and deposit differences between EPA and Treasury transaction activity within 2 months of occurrence. OMB Circular A-127, *Financial Management Systems,* requires financial management systems to provide reliable and timely financial management information of federal government operations.

We found that EPA did not clear differences reported on Treasury's SOD within 2 months as required. Specifically, LVFC, CFC, RTPFC, Office of Financial Services, and Reporting and Analysis Staff did not clear or provide explanations for differences reported to Treasury. These SOD transactions, totaling $6,115,632, occurred between October 2011 and February 2012. The transactions reported on the SOD were not cleared prior to May 2012. Some finance centers took as long as 5 months to clear differences reported to the Treasury.

Various problems occurred as a result of the Agency's conversion from IFMS to Compass. Specifically:

- CFC was unable to timely clear refund transactions reported on the SOD because there was no accounting model in Compass to record refunds for advanced payments from the U.S. Army Corp of Engineers.

- SOD delays at LVFC were the result of Compass' inability to process cancelled checks issued by RTPFC. When Treasury cancels un-cashed checks, the funds are returned to EPA through the Intra-governmental Payment and Collection system. Compass has the capability to process the transaction, but closed miscellaneous obligation documents over 1-year old were not converted to Compass.

- RTPFC was unable to clear SOD transactions because Intra-governmental Payment and Collection collections could not be processed in Compass. The Compass GL posting model caused the Intra-governmental Payment and Collection collections to reject.

- Both the Office of Financial Services (Washington Finance Center) and Reporting and Analysis Staff said the unreconciled disbursement and deposit differences were the result of timing differences. However, no additional explanations were provided. Also, Office of Financial Services staff responsible for payroll said a posting error in Compass caused differences.

The FMS-224, *Statement of Transactions*, is a monthly report required by Treasury that shows an agency's disbursement, collections, and receipts. The report uses transactional data that impact the agency's Funds Balance with Treasury GL accounts. These transactions include Treasury payment confirmations, Intra-governmental Payment and Collection system collections and payments, and manual collections and payments. On the last day of every month, agencies are required to reconcile transactions recorded in their GLs with the Treasury and identify and resolve any deposit and disbursement differences within a 2-month period. Failure to timely resolve SOD transactions impacts the effectiveness of EPA's internal controls and increases the risk of misstatements on the financial statements. In addition, unresolved differences compromise the reliability of Fund Balance with Treasury balances and financial reports submitted to the Treasury.

Recommendation

We recommend that the Chief Financial Officer:

13. Require the Director, Office of Financial Management, to correct the Compass accounting and posting model errors so that users have the ability to process Fund Balance with Treasury transactions to clear SODs accurately and timely.

Agency Comments and OIG Evaluation

The Agency retracted its initial concurrence to the finding and recommendation dated November 5, 2012. OCFO explained that in December 2011 it proactively discovered and disclosed all of the issues cited by the OIG. Early in the year, the Agency was in the midst of learning the intricacies of the new system and applying this knowledge to reengineer day-to-day business processes. The Agency explained that while there were initial delays, it is now able to clear differences in a timely manner. OCFO said it updated the accounting model and resolved the SOD backlogs by the end of September 2012.

We acknowledge the learning curve imposed upon OCFO with the intricacies of a new financial system and reengineering business processes. We also acknowledge the actions that OCFO has taken to reduce the backlog of SOD in September, and appreciate the actions that the finance centers have taken to clear these differences. However, we believe that a problem still exists with processing the SOD transactions in Compass since the Agency is still working with the contractor for Compass to clear transactions reported on the SOD. We believe OCFO should verify that all accounting and posting models for processing Fund Balance with Treasury transactions have been updated.

8—Property Internal Controls Need Improvement

Compass does not sufficiently reject personal property information entries that are not accurate. As a result, the Agency could lose accountability and control over property. FMFIA, 31 U.S.C. § 3512(c)(1)(B), requires that property and other assets be safeguarded against waste, loss, unauthorized use, or misappropriation. However, we identified personal property items for which the location was not properly identified, as well as personal property items for which the last recorded inventory dates or acquisition dates were in the future. The failure to properly configure Compass data fields to reject unreasonable entries contributed to the inaccurate property records.

OMB Circular A-123, *Management's Responsibility for Internal Controls*, states that the three objectives of internal control are (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with laws and regulations. The safeguarding of assets is a subset of all of these objectives. Accurate property records are an essential element of proper internal control and are necessary for the safeguarding of assets. In our audits of EPA's FYs 2011 and 2010 financial statements, we reported that EPA headquarters could not account for 1,284 and 1,134 personal property items, respectively. Inaccurate property records can contribute to an inability to account for personal property items.

We found that EPA property records contained 135 personal property items, with total acquisition costs of $2.9 million that were physically located in accountable areas different than the locations identified in EPA's property system. We also found that EPA property records contained 15 personal property items in which the property records showed that the items were last inventoried on a date sometime in the future, and 13 additional personal property items whose recorded acquisition dates were in the future. These examples show that EPA does not have adequate internal control over its personal property, which could result in the loss or unauthorized use of its assets.

When we brought these problems to the attention of Agency officials, we were told that Compass data fields were not configured correctly to prevent such errors. The 135 property items that were physically located in accountable areas different than the locations identified in EPA's property system resulted either from users not notifying their custodial officers or custodial officers not accurately updating the property system.

Recommendations

We recommend that the Chief Financial Officer:

14. Require the Director, Office of Technology Solutions, to work with the contractor that developed Compass to build defaults into the Compass software that will eliminate or minimize property record errors.

15. Correct the property data errors described above.

Agency Comments and OIG Evaluation

The Agency concurred with our finding and recommendations.

9—Compass and Maximo Cannot Be Reconciled

EPA cannot reconcile capital equipment property management data within its property management subsystem—Maximo—to relevant financial data within Compass. OMB Circular A-123, *Management's Responsibility for Internal Controls*, states that one of the objectives of internal control is the reliability of financial reporting. The inability to reconcile the property subsystem with Compass can compromise the effectiveness and reliability of financial reporting. Maximo and Compass primarily cannot be reconciled because historical property data did not migrate properly from IFMS to Compass.

OMB Circular A-123, states that the three objectives of internal control are (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with laws and regulations. The inability to reconcile capital equipment as recorded in the property management subsystem with its core financial system can result in inaccurate or incomplete property records, and compromise the reliability of EPA's financial reporting and accountability for Agency property.

EPA has had a requirement since 2001—as set out in Comptroller Policy Announcement No. 01-06—that the Agency must conduct a monthly reconciliation for capitalized property between its property subsystem (Fixed Asset Subsystem) and the IFMS capital equipment GL accounts. The primary purpose of this reconciliation is to ensure that all capitalized property is properly recorded. This reconciliation is the responsibility of the property management offices, financial management offices, and offices within OCFO. Compass limitations do not allow a reconciliation of capitalized property between Compass and Maximo. Because of these limitations the OCFO rescinded the Comptroller Policy that requires capital property reconciliation.

Recommendation

We recommend that the Chief Financial Officer:

16. Develop procedures to reconcile capitalized property in the Agency's financial system with Maximo.

Agency Comments and OIG Evaluation

The Agency did not agree with our finding but agreed with our recommendation. The Agency stated that capital equipment within its property management subsystem (Maximo) can be reconciled to relevant data within Compass and that the finance centers recently completed this reconciliation. The Agency indicated the Office of Financial Management will develop these reconciliation procedures by the second quarter of FY 2013. Once these procedures have been developed we will evaluate their effectiveness.

10—EPA Needs to Remediate System Vulnerabilities That Place Financial Data at Risk

OCFO officials did not monitor the testing of its networked information technology assets to identify commonly known vulnerabilities or take action to remediate those weaknesses. EPA policy requires senior Agency officials to ensure security control reviews are performed for general support systems and major applications under their organization's responsibility. We found that the lack of monitoring exists, in part, because EPA's Office of Environmental Information (OEI) took almost 3 years to resolve a long-standing recommendation to define duties and responsibilities for testing networked resources managed under EPA's service support contract. Also, OCFO officials should improve the office's process to ensure known vulnerabilities are remediated for the equipment it uses to access the Agency's core financial application. Information technology assets used by finance center personnel contained 286 commonly known vulnerabilities that, if exploited, could potentially undermine EPA's financial reporting capability and serve as available points to compromise the Agency's network.

While OCFO personnel are not directly responsible for managing the desktop equipment, EPA's Information Security Policy places with the Senior Information Official the responsibility "to ensure that effective processes and procedures and other directives as necessary are established to implement the policies, procedures, control techniques, and other countermeasures identified under the EPA Information Security Program and enforced within their respective offices or regions." As such, OCFO needed to establish a collaborative process with OEI, which is responsible for overseeing the desktop service provider contractors, to ensure that OCFO offices received regular information regarding the identification and remediation of vulnerabilities.

OEI officials had not sufficiently taken steps until September 2012 to act on a long-standing recommendation to define the responsibilities of its service support contractor responsible for managing the desktops and printers used at EPA finance centers. As reported in OIG Report No. 10-P-0028, *Improved Security Planning Needed for the Customer Technology Solutions Project,*[2] November 16, 2009, EPA did not have a process in place to test equipment for known vulnerabilities. The cornerstone for putting a process in place was for OEI to define the contractor's responsibilities so that EPA offices could better monitor the security practices protecting its networked resources. However, OEI took almost 3 years to define the responsibilities and this left the finance centers without standards with which they could hold the service provider accountable for delivering the desired results. While we consider OEI's actions sufficient to address the outstanding recommendation, ongoing oversight by OCFO is warranted to ensure vulnerabilities are remediated and its personnel can safely use the provided equipment to conduct its mission.

As noted in table 5, our tests identified 286 critical-risk, high-risk, and medium-risk vulnerabilities at EPA finance centers. Our tests disclosed critical vulnerabilities at each finance center where OCFO personnel remotely access EPA's core financial application. If these

[2] Customer Technology Solutions was the Agency's Working Capital Fund service provider for providing and coordinating all information technology end user support and services for EPA headquarters program offices until September 30, 2012. On October 1, 2012, EZ Tech replaced Customer Technology Solutions as the Agency's provider of information technology end user support and services.

vulnerabilities are not eliminated, they could be exploited to cause critical system flaws that are likely to have a catastrophic impact on financial data and reporting. These weaknesses could also be used to compromise the credentials that finance center personnel use to access the Agency's core financial application. Furthermore, these vulnerabilities could result in unauthorized access to the financial application and unauthorized processing of financial transactions that may go undetected because the transactions were processed using an authorized account.

Table 5: Number of vulnerabilities identified at each finance center

Finance center	Critical-risk	High-risk	Medium-risk	Total
CFC	14	18	131	163
LVFC	2	2	59	63
RTPFC	4	12	44	60
Total	**20**	**32**	**234**	**286**

Source: OIG analysis

It is incumbent upon OCFO officials to have a process to closely monitor the contractor to ensure it conducts its responsibilities for testing the finance centers' networked resources as prescribed and that the contractor immediately remediates all noted vulnerabilities.

Recommendations

We recommend that the Chief Financial Officer direct the Senior Information Official to:

17. Document a review of OCFO's processes for conducting vulnerability assessments and create oversight procedures for monitoring the service provider's testing of networked resources and the remediation of any identified weaknesses.

18. Request and monitor to ensure that OEI provides a status update for all identified critical-risk, high-risk, and medium-risk vulnerabilities contained in this report. The status update should include the date when OEI will remediate all the identified vulnerabilities.

19. Request and monitor to ensure that OEI creates plans of action and milestones for all vulnerabilities that cannot be corrected within 30 days of this report.

20. Request and monitor to ensure that OEI performs a technical vulnerability assessment test of the finance centers' network resources to confirm completion of remediation activities and provide written certification to OCFO that vulnerabilities have been remediated.

Agency Comments and OIG Evaluation

The Agency did not concur with our finding and recommendations. OCFO stated that it currently conducts vulnerability assessments for all general support systems and major applications under its ownership as directed by National Institute of Standards and Technology guidelines. OCFO also stated that OEI is responsible for vulnerability discovery and remediation and believes that it is not incumbent upon OCFO officials to have process to closely monitor the contractor to ensure it conducts its responsibilities for testing the finance centers' networked resources as prescribed and that the contractor immediately remediates all noted vulnerabilities. OIG analysis disclosed that Agency finance center information security officers had been responsible for working with OEI to remediate identified vulnerabilities. This process led to inconsistent remediation of vulnerabilities in some cases and no remediation of vulnerabilities in others. The OIG believes that OCFO officials must ensure that vulnerabilities are identified and remediated by its contractor because EPA's Information Security Policy places responsibility with program office senior information officials to ensure that information systems under its control are secure.

11—OCFO Financial Systems Security Documentation Needs Improvement

EPA lacks reliable information on the implementation of required security controls for key financial applications at RTPFC. Our analysis disclosed that key applications' system security plans (SSPs) contained numerous instances of incomplete or inaccurate information for the four minimally required control areas reviewed. Federal guidance requires key documents such as SSPs and contingency plans to be annually reviewed and updated as needed. OCFO had not implemented a process to review the completeness and accuracy of SSP information, delineated what organizations within OCFO were responsible for maintaining this documentation, or ensured that personnel performing key information security duties were trained to assume those duties. Inaccurate information calls into question the veracity and credibility of the processes OCFO uses to authorize its systems to operate, and places into doubt whether OCFO implemented security controls necessary to protect the confidentiality, integrity, and availability of EPA's financial data.

Review of SSPs for key financial applications at RTPFC contained numerous instances of inaccurate or incomplete information for the minimally required information security controls reviewed. Table 6 provides a summary of our analysis. Until August 2012, OCFO operated these applications from a server room maintained by OARM that was in the same building as RTPFC and subsequently moved these applications into EPA's datacenter also located on the Research Triangle Park campus.

Table 6. Summary of information system security documentation deficiencies

System reviewed	Access control	Contingency planning	Continuous monitoring	Software integrity
Fellowship Payment System (FPS)	X	X	X	X
Grants Payment System (GPAS)	X	X		X
Contract Payment System (CPS)	X	X		X
Small Purchase Information Tracking System (SPITS)	X	X	X	X

Source: OIG analysis

National Institute of Standards and Technology Special Publication 800-18, *Guide for Developing Security Plans for Federal Information Systems*, states that it is important to assess SSPs when system changes occur and that SSPs must be reviewed at least annually and updated as needed. Also, Special Publication 800-53, *Recommended Security Controls for Federal Information Systems and Organizations*, requires that the information systems be reviewed on an ongoing basis including documenting changes to the system or its environment of operation.

The lack of updated SSP information resulted, in part, because OCFO did not implement a process to proactively keep SSP information current for applications at RTPFC. We noted that OARM was responsible for documenting security controls for two OCFO applications. However, this overreliance on OARM to maintain security documentation resulted in OCFO not taking steps to maintain an SSP with the new security controls protecting the application's data.

Furthermore, during FY 2012, OCFO made organizational changes that moved the OCFO technical staff responsible for the maintenance and operation of these applications from under the direction of RTPFC to OCFO's Office of Technology Solutions. When this change occurred, OCFO had not directed who would maintain and update security documentation. As a result, OCFO was not able to provide us with information regarding who was responsible for updating information security documentation for these applications. This also caused RTPFC to appoint a new Information Security Officer to oversee the computer security program within the center, but OCFO had not ensured that the person performing this key information security duty was trained as required by OMB guidance.

Without proper oversight of security documentation for OCFO systems, OCFO cannot state with certainty that information security controls for these systems are designed and operating effectively. Likewise, without establishing clear responsibilities for handling critical tasks such as maintaining SSP documentation for key financial systems, OCFO risks making flawed risk-based decisions regarding the continued operations of its applications. Furthermore, having trained Information Security Officers is important because they serve as the first line of defense for monitoring the office's computer security program. As such, untrained personnel pose the risks that the Agency will be delayed in responding to attacks against its network because personnel are not sufficiently familiar with common threats for which they should alert management.

Recommendations

We recommend that the Chief Financial Officer direct the Senior Information Official to:

21. Develop and implement a process to review SSP information for accuracy and completeness.

22. Issue a memorandum to the Office of Technology Solutions Director outlining the roles and responsibilities for reviewing and maintaining the SSP documentation for financial applications formerly maintained by the RTPFC technical personnel.

23. Document a review of the skills and qualifications of OCFO Information Security Officers and provide necessary specialized training that would equip them to perform their duties as required by federal government policy.

24. Document a review of SSPs for all OCFO-owned and managed financial applications located at Research Triangle Park and have them updated to reflect current information as required by the National Institute of Standards and Technology.

Agency Comments and OIG Evaluation

The Agency concurred with our recommendation.

Compliance With Laws and Regulations

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12—EPA's Compass Service Provider Needs to Assess Controls Over Business Processes Affecting EPA 41

12—EPA's Compass Service Provider Needs to Assess Controls Over Business Processes Affecting EPA

EPA has limited assurance that its Compass service provider's controls over business processes affecting EPA are designed and operating as intended. Compass is managed and hosted by a service provider through a contract. Federal guidance requires agencies using service providers for financial management to ensure that these service providers assess the design and operating effectiveness of internal controls over financial reporting. Industry accounting standards require service providers to evaluate controls over those activities affecting its customers' financial reporting. EPA did not identify its critical business processes that impact financial reporting or require its service provider to identify and assess those processes it performs on the Agency's behalf. Without an assessment of its service provider's control environment, EPA faces the potential that a critical business failure by the service provider could impact the Agency's ability to provide reliable financial reporting.

Currently, EPA has limited assurance that its Compass service provider's controls over business processes affecting EPA are designed and operating effectively. OMB Circulars A-127, *Financial Management Systems*, and A-123, *Management's Responsibility for Internal Control*, outline agencies' responsibilities for providing reliable financial information and maintaining and reporting on the effectiveness of internal controls. The guidance requires external providers or service organizations to provide its customers with an audit report that assesses internal controls over financial reporting. Furthermore, in 2011, the American Institute of Certified Public Accountants published expanded guidance, in Statement on Standards for Attestation Engagements No. 16, that requires service providers to test internal controls over financial reporting. This standard also outlines a broader range of information service providers must provide its customers as a result of this testing. Although Compass is managed and hosted by a contractor (a third-party service provider), EPA's former core financial application (IFMS) was managed and hosted by the Agency.

Prior to the deadline for EPA to certify the sufficiency of controls over financial reporting, the OIG met with OCFO representatives to discuss the office's plans for testing controls over financial reporting. OCFO representatives acknowledged that the new accounting guidance required its service provider to expand the scope of controls testing beyond that of previous years. OCFO further specified that its service provider would perform the expanded controls review stipulated under the American Institute of Certified Public Accountants guidance and provide a report of those findings by July 2012.

We noted that the service provider's report provided an assessment of the information technology controls surrounding the data center that hosts Compass. However, the report did not contain an assessment of the critical business processes, such as software change management; database administration and management; and data input, processing, and transmission controls that EPA relies upon the contractor to perform on its behalf. These vital processes directly impact the underlying integrity of the financial data that EPA uses and typically are not performed within the data center that was assessed. As such, the provided report did not contain a sufficient testing of controls that EPA could rely upon to know whether controls over financial reporting were effective.

EPA relies upon its service provider to provide a range of software support services for its core financial application. In this regard, assessing how the service provider delivers these services and understanding whether these services work as intended is critical for EPA to ensure it can perform financial reporting as required by federal guidance. Without an assessment that tests effectiveness of internal controls impacting financial reporting, EPA cannot make risk-based decisions for continued operation of its financial systems, or implement compensating controls to help mitigate risks resulting from critical failures of its service provider.

Recommendations

We recommend that the Chief Financial Officer direct the Director of the Office of Technology Solutions to:

25. Identify the critical business processes performed by the service provider upon which EPA relies for financial reporting.

26. Require the service provider to assess the identified critical business process controls and report the results as part of the annual review of controls over financial reporting.

Agency Comments and OIG Evaluation

The Agency did not concur with our finding and recommendations. The Agency stated it owns Compass and, implicitly, the reporting functionality therein. Therefore, the Agency believes that its service provider has no impact on Agency financial reporting. The Agency also stated that internal controls over financial reporting were evaluated during the Agency's A-123 review and no material weaknesses or significant deficiencies were identified. The OIG agrees that Compass is owned by EPA, but its service provider performs development, hosting, and maintenance duties for Compass on behalf of EPA. In order to perform these duties, EPA's service provider must have access to Compass testing and production environments. In particular, the production environment is where EPA financial data used by the Agency for financial reporting resides. The OIG believes that EPA must ensure that its service provider has adequate controls over processes performed by its service provider that could impact EPA financial data maintained within Compass. Therefore, in the opinion of the OIG, EPA must work with its service provider to identify the processes performed by its service provider that could impact EPA financial data and assess the design and operation of controls over those processes.

Status of Prior Audit Report Recommendations

EPA is continuing to strengthen its audit management to address audit follow-up issues and complete corrective actions expeditiously and effectively to improve environmental results. The Chief Financial Officer is the Agency audit follow-up official and is responsible for ensuring that corrective actions are implemented. During FY 2012, OCFO completed an update of EPA Order 2750, *EPA's Audit Management Process*. This update, EPA Manual 2750, *Audit Management Procedures,* is a comprehensive audit management guide that addresses OIG, GAO, and Defense Contract Audit Agency audits. OCFO continued to issue a quarterly report that highlights the status of management decisions and corrective actions. This report is shared with program office and regional managers throughout the Agency to keep them informed of the status of progress on their audits. Additionally, OCFO continued to conduct reviews of national and program offices, which it initiated in fiscal 2009. The reviews focus on offices' audit follow-up procedures and their use of the Management Audit Tracking System, or MATS. The reviews are designed to promote sound audit management; increase Agency awareness of, and accountability for completing unimplemented corrective actions; and ensure that audit follow-up data are accurate and complete. OCFO completed five of these on-site reviews in FY 2012, including three regional offices and two national program offices. These reviews will be performed on an ongoing, rotating basis.

The Agency has continued to make progress in completing corrective actions from prior years. The status of issues from prior financial statement audits and other audits with findings and recommendations that could have an effect on the financial statements, and have corrective actions that are not completed or have not been demonstrated to be fully effective, are listed in the following table.

Table 7: Significant deficiencies—issues not fully resolved

• **Financial Management System User Account Management Needs Improvement** EPA has made significant strides to complete corrective actions associated with the segregation of duties issue noted during the fiscal 2009 financial statement audit (recommendation 27). To date, the Agency has implemented a segregation of duties policy, detective systems controls, and automated segregation of duties controls for the general ledger of Compass. However, automated segregation of duties controls have not been implemented for other Compass modules beyond the general ledger. This deficiency exists because the Agency did not expend resources to complete agreed-upon corrective actions to ensure that the Agency's new financial system includes automated controls to enforce separation of duties. Additionally, the OIG recommended that the new financial management system include automated controls to link to human resources data (recommendation 32 in the fiscal 2009 financial statement audit report). To date, EPA has not implemented any corrective actions in response to this recommendation.

• **Accounts Receivable Source Documentation Not Provided Timely** During fiscal 2011, we found that EPA regional and headquarters offices did not timely submit accounts receivable supporting documentation to CFC. EPA made significant progress in completing the corrective actions to improve the timeliness of these submissions in fiscal 2012, but has not yet completed all corrective actions. In fiscal 2012, EPA issued guidance creating a metric for headquarters and regional offices to provide documentation to CFC within the 5-business-day requirement 95 percent of the time. EPA provided training and presented a webinar to reinforce the process and the importance of providing accounts receivable source documents timely to CFC. EPA also prepared quarterly reports and began following up with regional offices that did not meet the timeliness performance measure. In December 2012, EPA is scheduled to provide an annual report to senior enforcement managers on headquarters and regional office performance in meeting the fiscal 2012 performance metric.
• **EPA Misstated Uncollectible Debt and Other Related Accounts** In our fiscal 2011 audit we found that EPA did not review the collectibility of 10 federal receivables outstanding from 4 to 11 years totaling $793 thousand. CFC did not document efforts to collect the federal debt or determine the debt's status after the 3-year delinquent period. In fiscal 2012, we found that CFC established allowances for the 10 receivables. We did not receive the file support documenting CFC's collection effort in time to be considered in this report.

Source: OIG analysis.

Attachment 4

Status of Current Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	**Page No.**	**Subject**	**Status[1]**	**Action Official**	**Planned Completion Date**	**Claimed Amount**	**Agreed To Amount**
1	15	Perform a thorough review of all posting models to ensure the proper accounts are impacted.	U	Chief Financial Officer			
2	15	Correct activity in accounts incorrectly impacted by improper posting models.	U	Chief Financial Officer			
3	15	Develop internal control procedures to confirm the proper accounts are impacted for all transactions.	U	Chief Financial Officer			
4	15	Perform analytical reviews of account activity on a quarterly basis to verify account activity is reasonable.	U	Chief Financial Officer			
5	20	Identify Compass reporting problems and develop reports to provide users with accurate data on a timely basis.	U	Chief Financial Officer			
6	23	Update EPA's policy for recognizing year-end accruals to require reconciliations of accruals and accrual reversals.	U	Chief Financial Officer			
7	26	Correct the Compass system limitations that allowed (a) payments to exceed the related obligation accounting lines, (b) transactions to post to an incorrect accounting period, and (c) a payment to impact a canceled appropriation.	C	Chief Financial Officer			
8	29	Forward judicial documents to the financial center	U	Assistant Administrator for Enforcement and Compliance Assurance			
9	29	Reinforce procedures to monitor all tracking reports. Follow up with regional offices and the U.S. Department of Justice to obtain legal documents to ensure accounts receivable are recorded timely in the financial accounting system.	U	Chief Financial Officer			
10	29	Institute standard operating procedures for entering, tracking, and monitoring accounts receivable, and ensure adherence to EPA policies and procedures for entering receivables timely and maintaining adequate and easily accessible source documentation.	U	Chief Financial Officer			
11	29	Ensure proper separation of duties by having separate individuals perform billing and collection functions.	U	Chief Financial Officer			

		RECOMMENDATIONS				POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
12	29	Direct the Director of the Office of Grants and Debarment to create guidance to ensure that grant final determination letters contain required provisions for late payment and a process for forwarding final determination letters to finance centers within 5 days of the effective date.	U	Assistant Administrator for Administration and Resources Management			
13	32	Require the Director, Office of Financial Management, to correct the Compass accounting and posting model errors so that users have the ability to process Fund Balance with Treasury transactions to clear SODs accurately and timely.	U	Chief Financial Officer			
14	33	Require the Director, Office of Technology Solutions, to work with the contractor that developed Compass to build defaults into the Compass software that will eliminate or minimize property record errors.	U	Chief Financial Officer			
15	33	Correct the property data errors described above.	U	Chief Financial Officer			
16	34	Develop procedures to reconcile capitalized property in the Agency's financial system with Maximo.	U	Chief Financial Officer			
17	36	Direct the Senior Information Official to document a review of OCFO's processes for conducting vulnerability assessments and create oversight procedures for monitoring the service provider's testing of networked resources and the remediation of any identified weaknesses.	U	Chief Financial Officer			
18	36	Direct the Senior Information Official to request and monitor to ensure that OEI provides a status update for all identified critical-risk, high-risk, and medium-risk vulnerabilities contained in this report. The status update should include the date when OEI will remediate all the identified vulnerabilities.	U	Chief Financial Officer			
19	36	Direct the Senior Information Official to request and monitor to ensure that OEI creates plans of action and milestones for all vulnerabilities that cannot be corrected within 30 days of this report.	U	Chief Financial Officer			
20	36	Direct the Senior Information Official to request and monitor to ensure that OEI performs a technical vulnerability assessment test of the finance centers' network resources to confirm completion of remediation activities and provide written certification to OCFO that vulnerabilities have been remediated.	U	Chief Financial Officer			
21	39	Direct the Senior Information Official to develop and implement a process to review SSP information for accuracy and completeness.	C	Chief Financial Officer			

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
22	39	Direct the Senior Information Official to issue a memorandum to the Office of Technology Solutions Director outlining the roles and responsibilities for reviewing and maintaining the SSP documentation for financial applications formerly maintained by the RTPFC technical personnel.	O	Chief Financial Officer	1/31/13		
23	39	Direct the Senior Information Official to document a review of the skills and qualifications of OCFO Information Security Officers and provide necessary specialized training that would equip them to perform their duties as required by federal government policy.	O	Chief Financial Officer	3/31/13		
24	39	Direct the Senior Information Official to document a review of SSPs for all OCFO-owned and managed financial applications located at Research Triangle Park and have them updated to reflect current information as required by the National Institute of Standards and Technology.	O	Chief Financial Officer	4/30/1213		
25	42	Direct the Director of the Office of Technology Solutions to identify the critical business processes performed by the service provider upon which EPA relies for financial reporting.	U	Chief Financial Officer			
26	42	Direct the Director of the Office of Technology Solutions to require the service provider to assess the identified critical business process controls and report the results as part of the annual review of controls over financial reporting.	U	Chief Financial Officer			
		Note: We identified $0.9 million in inactive funds that are no longer needed and can be deobligated.				$900	

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

EPA's Fiscal 2012 and 2011 Consolidated Financial Statements

Provided separately.

Agency Response to Draft Report

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

November 9, 2012

OFFICE OF THE
CHIEF FINANCIAL OFFICER

MEMORANDUM

SUBJECT: Audit of EPA's Fiscal Year 2012 and 2011 Consolidated Financial Statements

FROM: Barbara J. Bennett ***/s/ Original Signed By Maryann Froehlich for:***
Chief Financial Officer

TO: Arthur A. Elkins, Jr.
Inspector General

This memorandum transmits the agency's response to the Office of Inspector General's Draft Audit Report, dated November 6, 2012. Detailed corrective action plans will be provided to you and your staff within 90 days of the issuance of the final audit report.

Implementing our new financial system, Compass, was a tremendous undertaking for the agency this year. While implementation of the system presented its challenges, it also presented opportunities for the EPA to develop business process changes and enhancements that will strengthen the EPA's financial management. We worked with our agency partners with a focus on strengthening fiscal integrity, enhancing core business operations and contributing to agencywide performance management systems. We engaged all parts of the agency in fiscal stewardship yielding significant results. We are proud of the accomplishments we made during this period of transition.

Thank you for identifying additional areas for improvement in the Draft Audit Report. The audit work performed will help shape the agency's future financial management initiatives. Please let me know if you have any questions or your staff can contact Stefan Silzer, Director, Office of Financial Management of (202) 564-5389 regarding the audit.

Attachment

cc: Craig Hooks, Assistant Administrator, Office of Administration and Resources Management
Cynthia Giles, Assistant Administrator, Office of Enforcement and Compliance Assurance
Melissa Heist, Assistant Inspector General for Audit
Maryann Froehlich, Deputy Chief Financial Officer
Nanci Gelb, Principal Deputy Assistant Administrator, OARM
Lawrence Starfield, Principal Deputy Assistant Administrator, OECA
Joshua Baylson, Associate Chief Financial Officer
Stefan Silzer, Director, Office of Financial Management
Raffael Stein, Director, Office of Financial Services
Quentin Jones, Director, Office of Technology Solutions
Robert Hill, Deputy Director, Office of Technology Solutions
David Bloom, Director, Office of Budget
Ruth Soward, Director, Office of Resources Information Management
Kathy O'Brien, Director, Office of Planning Analysis & Accountability
Renee Page, Director, Office of Administration
Howard Corcoran, Director, Office of Grants and Debarment
Jeanne Conklin, Deputy Director, Office of Financial Management
Paul Curtis, Director, Financial Statements Audit
Jim Wood, Director, Cincinnati Finance Center
Doug Barrett, Director, RTP Finance Center
Dany Lavergne, Director, LV Finance Center
Christopher Osborne, Staff Director, Reporting and Analysis Staff
John O'Connor, Staff Director, Financial Policy and Planning Staff

Response to Draft OIG Audit of EPA's Fiscal 2012 and 2011 Consolidated Financial Statements

1 - Compass System Limitations are a Material Weakness to EPA's Accounting Operations and Internal Controls

"In October 2011, EPA replaced the Integrated Financial Management System (IFMS) with a new system, Compass Financials (Compass). The Agency operated IFMS, but a contractor manages Compass. EPA replaced IFMS to improve the operation of financial management systems, standardize business processes, and strengthen internal controls. The system replacement required a major systems conversion and data migration to Compass. As with any major system conversion, problems were to be expected. We found that when the Agency converted its accounting system, it had not yet developed all the reports and functions required to generate all the information it needs. The lack of useful reports and system limitations significantly impaired the effectiveness of EPA's accounting operations and internal controls. We determined that the Compass reporting and system limitations represented a material weakness."

Response: Do Not Concur.

Agency Position on Finding: We disagree with this conclusion. Initial challenges with implementation of a new financial system were overcome during the fiscal year. Resources were fully dedicated to create alternate methodologies for obtaining and analyzing data. Posting logic was reviewed and corrected. The methods for GL account review and analysis were updated and we continue to analyze GL accounts. System-created and new-to-Compass-user errors were identified and corrected. The general limitations of a new system and changes to the "old way" of doing things were challenges that required additional effort and interim manual procedures. The limitations were the early problems of the implementation. These limitations have been effectively identified and fixed or mediated so that there were no material issues during the preparation of the financial reports, only the normal problems that occur in the collections and verification of information to be included.

- **Posting models** - The EPA conducted a thorough review of the system's accounting models to ensure the integrity of the accounting transactions and financial statements. This was a priority and a major area of focus prior to and post system migration. We completed a review of the accounting models prior to Compass implementation by October 18, 2011. Our verification activities, included:

    - verifying that all accounting models were USSGL compliant;
    - validating the "tie point" accounting model relationships for the posting models;
    - validating that budgetary accounts were only offset by other budgetary accounts and validating that proprietary accounts were only offset by other proprietary accounts;
    - validating that each current-year appropriation level posting model was accurate to ensure that the agency's current-year authority postings were properly set up for accurate reporting in Compass and in FACTS II;
    - tracing individual general ledger accounts through the accounting models to ensure that they were posted consistently though all documents (e.g., EPA verified that the

general ledger accounts posted by each level of the budget were consistent with adjacent levels.); and

- validating agency-specific postings for accuracy.

After migration, EPA continued to proactively analyze and validate accounting models. During the first and second quarters of FY 2012, EPA identified accounting model issues, corrected them, and made any necessary adjustments in Compass. In May 2012, OCFO proactively established an internal weekly meeting to continue the identification of accounting model issues. OCFO prioritized and tracked progress in resolving accounting model issues. Our accounting model tracker spreadsheet documents this effort. An earlier version of the tracker was provided to the OIG after the July 31, 2012 audit status meeting. We continue to remain vigilant in our efforts to ensure that Compass accounting models are properly recording transactions.

- **Compass Reports –** The EPA has over 300 reports that are available for our financial community. On June 5, 2012, at OIG's request, EPA provided a complete inventory of financial reports that existed for Compass at that time. New and existing reports are continually developed or refined based on user requirements. During the learning and transition process, EPA experienced some challenges initially, but adapted as our understanding grew of Compass' more robust reporting capacity. Where tools and reports were no longer available in some areas, manual processes and reviews were implemented to ensure the same level of support for processing transactions, completing functions and detecting errors. EPA uses a combination of Compass financial reports, business objects reports, and analytical review software to review and reconcile accounting activities. EPA missed no major reporting deadlines related to completion of accounting functions. Additionally, there are no material errors in the EPA's general ledger balances.

- **Expense Accruals –** EPA uses Flexible Definition functionality in Compass. This allows specific posting entries to be assigned based on transaction data. The SV 17 document type and transaction type is configured to post by Fund Category. For Fund Category of TF, the posting model was configured to post to a NULL accounting entry that does not update the General Ledger. The posting model was corrected to remove the NULL to SV17 accounting entry. The postings associated with the SV reversals with Fund Category TF that used the NULL accounting entry were processed in FY 2012 Q4 and included in the Final Statements.
  This eliminated any impact that the initial NULL posting may have had on the FY 2012 Financial Statements. To date, there have been no other impacted transactions identified related to this posting model issue.

- **GL Account Analysis –** EPA did not discontinue its GL account analysis processes. The Reporting and Analysis Staff in the Office of Financial Management does a quarterly comparative GL account analysis at the financial statement line-item level as well as other analysis, as needed.

2 – Posting Models in Compass Materially Misstated General Ledger Activity and Balances

"EPA's Compass system materially misstated GL activity and balances due to incorrect posting models. We found incorrect posting models in numerous accounts for obligations, disbursements,

receivables, collections, and revenue. EPA did not properly and thoroughly review the posting models before migration from IFMS to Compass. Further, EPA did not properly review balances in the financial statements that were a result of incorrect posting models; a posting model is a reference for document entry that provides default values for posting business transactions in GL accounts. Incorrect posting models reflect an internal control weakness and an indication that EPA did not exercise proper oversight over how transactions are processed in its GL. As a result, the draft financial statements contained material errors that were undetected by the Agency (the final financial statements were not completed at the time of our review). We noted $331 million in misstatements in the draft financial statements that Agency management did not detect."

We recommend that the Chief Financial Officer:

1. Perform a thorough review of all posting models to ensure the proper accounts are impacted.

2. Correct activity in accounts incorrectly impacted by improper posting models.

Response to Recommendations 1 and 2: Concur.

Agency Position on Finding: EPA does not agree that incorrect posting models resulted in material misstated GL activity and balances. EPA has aggressively reviewed posting models to ensure that transactions are properly posting to the EPA's financial accounts and will continue to do so. However, we will continue to hold weekly meetings with the Finance Centers and other OCFO offices to address accounting model issues. This approach has served the agency well in 2012 and resulted in over 130 model issues and related transactions being identified and corrected. Finally, per milestones agreed upon with the OIG, the agency delivered the draft financial statements prior to completing its variance analysis, which likely would have identified these errors.

3. Develop internal control procedures to confirm the proper accounts are impacted for all transactions.

Response to Recommendation 3: Concur.

Agency Position on Finding: The EPA already has in place a number of internal control procedures. For instance, the Finance Center staff compares feeder system interfaced transactions to hard copy documentation and approves them. We also periodically review the status of all documents in Compass to make sure all transactions processed properly. None of these reviews revealed any significant problems or issues with internal controls. When errors are found, they are reviewed, corrective actions identified, approved and entered into Compass. OFM will continue to evaluate and by March 2013 develop internal control procedures to confirm the proper accounts are impacted for all transactions.

OFM provides oversight and development of accounting models and their impacts through GL analyses. If discrepancies are found, they are investigated and reviewed for their impact on transactions and the GL to determine the nature of the matter. Issues are tracked through the resolution and validation processes. These activities provide reasonable assurance that our GL balances are correct.

4. Perform analytical reviews of account activity on a quarterly basis to verify account activity is reasonable.

Response to Recommendation 4: Concur.

Agency Position on Finding: OFM already performs a quarterly comparative analysis based on the financial statement line. This analysis highlights unusual variances between fiscal years. The EPA will continue to conduct these analytical reviews of account activity on a quarterly basis and more frequently, if deemed necessary.
In addition, the agency does not agree with significant internal controls deficiencies identified in the report as contributing internal control weaknesses based on the below reasons.

- **Posting models were incorrect for upward/downward adjustments –** The Momentum system, upon which Compass is based, is fully compliant with federal requirements for processing upward and downward adjustments, and is performing this activity correctly per the confirmed Compass configuration implemented for this process. In the case of the $54M in Table 2, OIG has to view spending adjustment data differently in Compass than in IFMS. Adjustments must be viewed individually by the system date and time minute, not aggregated by day. For example, in below table showing adjustment data, on July 20, 2012, a user made two separate corrections to the Grant Obligation. At 11:52AM, the user decreased the obligation lines. At 12:00PM, the user increased the obligation lines. The system determines the spending adjustments as transactions process.

Table 1: Example of pending adjustment data

IO	GO	V96558801	1	Correct	1	7/20/2012 11:52	USD	USD	48710012	Debit	$500,000.00
IO	GO	V96558801	2	Correct	1	7/20/2012 11:52	USD	USD	48710012	Debit	$500,000.00
IO	GO	V96558801	3	Correct	1	7/20/2012 11:52	USD	USD	48710012	Debit	$139,666.00
IO	GO	V96558801	4	Correct	1	7/20/2012 11:52	USD	USD	48710012	Debit	$3,600,000.00
IO	GO	V96558801	5	Correct	1	7/20/2012 11:52	USD	USD	48710012	Debit	$4,300,000.00
IO	GO	V96558801	1	Correct	1	7/20/2012 12:00	USD	USD	48810012	Credit	($500,000.00)
IO	GO	V96558801	3	Correct	1	7/20/2012 12:00	USD	USD	48810012	Credit	($139,666.00)
IO	GO	V96558801	4	Correct	1	7/20/2012 12:00	USD	USD	48810012	Credit	($3,600,000.00)
IO	GO	V96558801	2	Correct	1	7/20/2012 12:00	USD	USD	48810012	Credit	($500,000.00)
IO	GO	V96558801	5	Correct	1	7/20/2012 12:00	USD	USD	48810012	Credit	($4,300,000.00)

➢ **Misstatements in the EPA's Draft Financial Statements**

Table 2: Financial Statement Line Items identified by the OIG

Financial Statement Line Items	Amount (millions)
Earned Revenue and Net Cost	$184
Miscellaneous receipt revenue understated	87
Obligations incurred and recoveries of prior year unpaid obligations	54
Gain on sale of investments	7
Working capital advance	2
Total	$331

Earned Revenue and Net Cost: The error resulted from a failure by OFM to do one of two required elimination entry adjustments for WCF revenue. This was human error and not a posting model issue. The need for the elimination entry was identified in the 3rd quarter variance analysis and shared with OIG. Compass has two ledgers that needed to be eliminated, whereas IFMS only had one. We failed to do the elimination entry for the second ledger. It is highly likely we would have caught this mistake in our year-end variance analysis. Going forward we will ensure that we make both elimination entries.

Miscellaneous Receipt Revenue understated and Gain on Sale of Investments overstated: OFM corrected the $87 million and $7 million identified in Table 3 in the 15th Month on documents RAS12568JAN and RAS12569JAN, respectively. These errors were not the result of accounting model issues. These errors occurred because the Finance Center filled out the input forms in COMPASS incorrectly. They were provided with the wrong transaction type, entered months as years causing depreciation errors and followed IFMS practices for disposal causing revenue to be earned and recorded. OFM processed JV's in the 15th Month to correct the errors.

Table 3: From OFM 3rd Quarter Analysis

5200	**Revenue From Services Provided**	**95,904,042.17**	**0.47**	**The variance is primarily due to the elimination entry adjustments for the working capital intra-agency activity where the balance eliminated was much lower in the FY 2012 3rd quarter compared to the FY 2011 3rd quarter.**

<u>3 – Compass Reporting Limitations Impair Accounting Operations and Internal Controls</u>

"EPA has been unable to obtain the reports it needs from Compass for many accounting applications in FY 2012. OMB requires financial management systems to provide complete, reliable, consistent, timely, and useful financial information. Compass reporting limitations prevented EPA from producing many reports it needed for accounting operations. When the Agency converted its accounting system to Compass, it had not yet developed all the reports and functions required to generate all the information it needs. The lack of useful reports and information significantly impairs the effectiveness of EPA's accounting operations and internal controls."

We recommend that the Chief Financial Officer:

5. Identify Compass reporting problems to provide users with accurate data on a timely basis.

Response to Recommendation 5: Concur.

Agency Position on Finding: OCFO already analyzes the agency's financial reports, identifies any concerns and develops new reports for users as needed and will continue to do so.

All of the issues cited by the OIG were based upon observations made during the first six months of the operation of Compass Financials, the agency's new financial system. At that time, EPA was in the midst of learning the intricacies of the new system and applying this knowledge to reengineer day-to-day business processes. This allowed the agency to take advantage of the many features of the modern system to best meet the agency's business needs. EPA disclosed and discussed this approach with the OIG in December 2011.

To the maximum extent practicable, EPA adapted our business practices to take immediate advantage of the new system. For example, Compass allowed us to streamline accounts receivable processes by moving from reconciliation of accounts receivable based on Servicing Finance Offices to a centralized approach. Reconciliation of ARs at the SFO level was a "hold over" practice prior to the establishment of our current finance center structure when our regional offices performed accounting functions. As we adopted a centralized approach, we found that we were able to cancel a policy on
July 11, 2012, that required the finance centers to perform monthly reconciliations of ARs. See http://intranet.epa.gov/ocfo/policies/direct/2540-09-t2.pdf

In other cases, we decided to defer adoption of automated features available in Compass. For example, we deferred adoption of the full capabilities of Compass to support the Fund Balance with Treasury. Instead, we utilized a process within Compass very similar to the process used in the Integrated Financial Management System, the agency's previous financial management system. The EPA adopted this approach based on hands-on daily experience with Compass gained during the first six months of operations and in consideration of change management principles for the successful implementation of financial systems.

In addition, the agency does not agree that reporting limitations identified in the report significantly impair the effectiveness of the agency's accounting operations and internal controls in the following areas.

- **Accounts receivable reconciliation -** EPA successfully corrected the accounts receivable beginning balances along with interest penalty and handling charges in Compass. The Finance Centers manually computed beginning balances for interest and handling penalty charges. CGI made configuration changes to calculate the FY 2012 amounts. Although the Finance Centers did not perform monthly accounts receivable reconciliations and certifications, they reconciled, at the detail level, the beginning balances and current year activities to the accounts receivable documents for FY 2012. As discussed in an August 24, 2012 meeting, The OFM performed and completed in August a reconciliation that verified the general ledger balances to the subsidiary ledger balances. Additionally, the OFM issued Resource Management Directive System 2540-9, "Receivables and Billings, Technical Release 2," to rescind the requirement for monthly reconciliations and certification while a new procedure is being developed for Compass in FY

2013. A copy of RMDS 2540-9-T2 is available online at http://intranet.epa.gov/ocfo/policies/direct/2540.htm

- **Allowance for doubtful accounts -** Allowances for Doubtful Accounts reports were never automatically generated in IFMS; Finance Centers manually computed the ADA in spreadsheets. There is, however, an ADA report in CBOR which is now available as of the end of FY 2012 and in use. Issues preventing calculation and recording of ADA were resolved. All Finance Center accounts receivable, now reflect the correct balances for principal, interest, penalty and handling charges. For FY 2012, we booked the ADA for year end.

- **Fund balance with Treasury -** EPA agrees with the stated condition that sections II and III of the Compass SF-224 are inaccurate. However, the EPA has historically manually reconciled and reported data from sections II and III. The fact that the EPA continues to use manual reconciliation in the Compass environment is consistent with the EPA's past practices and does not create vulnerability or any workload impacts. Due to the changing Treasury reporting process, a determination not to automate the Compass SF-224 was made at this time. The agency will continue to use a manual process.

- **Suspense accounts -** The monthly CBOR report that allows Finance Centers to review and clear suspense accounts is now available. The OFM will provide the first FY 2013 report to Finance Centers in November 2012, and reports subsequent to November 2012 will be provided by the 10^{th} of the following month. In FY 2012, the EPA Finance Centers tracked their suspense accounts manually and currently they are being cleared in a timely manner. The OFS Certification was provided to the OIG on October 18, 2012.

- **Property -** The security organization problem was fixed in July 2012. We now have the capability to reconcile property from Maximo to Compass.

- **Direct asbestos loans -** The Direct Loans Treasury Report on Receivables was not generated automatically in IFMS. Since all remaining asbestos loans are scheduled to be collected by the end of FY 2013, the EPA determined it was not cost effective to pursue automating the Direct Asbestos Loans TROR and preferred to manually produce it. Manually creating the report does not pose a significant workload to staff nor have any errors been identified because of the lack of an automated report.

- **General Ledger account analysis –** OFM performed GL analysis in all four quarters of FY 2012. However, at Compass conversion GL analysis by SFO was stopped due to change in Compass business procedures. To replace GL analysis by SFO, OFM developed procedures to conduct reconciliation in Compass. Compass capabilities allow a central organization to conduct GL analysis. GL analysis is one of the areas where we created new reporting tools and adapted business methods to meet the agency's financial management needs. The Agency piloted and finalized a new methodology in the last two quarters of FY 2012 and will perform on a routine quarterly basis starting in FY 2013.

- **A-123 internal control reviews -** The agency conducted A-123 reviews as scheduled, and met with process owners to identify areas where internal controls needed strengthening. During internal EPA review, the agency observed and documented areas where testing could not be performed because previously designed tools used to conduct internal control reviews were no longer compatible with the Compass environment. This approach is consistent with A-123 principles, and was a tremendous undertaking. The agency was able to establish and maintain internal controls to achieve the objectives of reliable financial reporting and compliance with applicable laws and regulations.

- **Delays in the completion of some accounting functions -** The EPA did not discontinue its GL account analysis processes. The Reporting and Analysis Staff in the Office of Financial Management does a quarterly comparative GL account analysis at the financial statement line-item level as well as other analysis, as needed. Also, CFC posted an estimate for the Unbilled Oversight Accrual for quarters 1 through 3 for fiscal 2012. For the fourth quarter of fiscal 2012 CFC was provided the report needed to complete the Unbilled Oversight Accrual under normal procedures. In addition to completing the fourth quarter accrual, CFC staff updated the accrual spreadsheet for quarters 1 through 3.

- **Material errors in GL balances** - Though there were errors, EPA detected most and corrected all the material GL errors. We understand there is always a potential for misstatement, regardless of the controls in place, but we were vigilant in our stewardship over GL accounts and balances to detect any anomalies and errors. In fact, we detected the majority of the GL adjustments and corrections that were needed during the internal review processes before they were discovered or reported by others.

- **The expenditure of time and resources on workarounds** - The EPA has historically manually reconciled and reported data from sections II and III. The fact that the EPA continues to use manual reconciliation in the Compass environment is consistent with the EPA's past practices and does not create vulnerabilities or workload impacts. Due to the changing Treasury reporting process, a determination not to automate the Compass SF-224 was made at this time. In terms of the Direct Loans Treasury Report on Receivables, it was not generated automatically in IFMS. The Agency determined it was not cost effective to pursue automating the Direct Asbestos Loans TROR because all remaining asbestos loans are scheduled to be collected by the end of FY 2013. Manually creating the report does not pose a significant workload to staff nor have any errors been identified as a result of the lack of an automated report.

- **When taken as a whole, the Compass reporting limitations and the resulting impairments of the EPA's accounting operations and internal controls represent a material internal control weakness** - These conditions are quite normal in the implementation of a new system for accounting and reporting. Though they may stress or even strain the internal controls, it does not indicate that the controls are not working. The risk does increase, but risk is not a criterion in the evaluation of the accuracy and completeness of the published information of the reports or effectiveness of internal controls. It is the existence rather than the possibility of existence that is taken into consideration. Risk determines the intensity of the audit testing required to validate the data is presented correctly and fairly represents the financial condition of the reporting entity. The discovery and correction of a large number of errors is also perfectly normal in a new system implementation of large magnitude. This does not mean the resulting reports are in error because they were challenges to produce them and that it required extra manual review and correction.

4 - EPA Should Improve Controls Over Expense Accrual Reversals

"EPA did not reverse approximately $108 million of FY 2011 year-end expense accruals in FY 2012. EPA policy requires the liability reported in the financial statements to reflect the value of goods and services received and accepted but unpaid. The Agency did not reverse the accrual transactions because the Compass posting configuration for the applicable fund category was inaccurate and staff recorded the FY 2011 accrual entries without including the reversal period. By not reversing the accruals timely, EPA overstated the accrued liability and expense amounts by $108 million and materially misstated the quarterly financial statements."

We recommend that the Chief Financial Officer:

6. *Update EPA's policy for recognizing year-end accruals to require reconciliation of accruals and accrual reversals.*

Response to Recommendation 6: Concur.

Agency Position on Finding: EPA has already updated its internal control to ensure automated accrual reversals to occur. EPA posted the necessary adjustments. The agency will update EPA Policy Announcement Number No. 95-11, "*Policies and Procedures for Recognizing Year-End Accounts Payable and Related Accruals,"* by March 2013.

5 – Compass System Limitations Impair Internal Controls of Financial Operations

"Compass experienced several impairments to processing financial transactions. The impacted transactions included five payment accounting lines that exceeded the related obligation accounting lines, three transactions posted to an incorrect accounting period, and a payment against a canceled appropriation. U.S. Government Accountability Office (GAO) guidance states that application controls should ensure completeness, accuracy, authorization, and validity of all transactions during application processing. The Department of the Treasury Financial Management Manual states that canceled appropriation account balances are not available for obligation or expenditure for any purpose. Compass did not prevent the posting of these invalid transactions because EPA did not have system controls in place to reject them. The Compass impairments limit EPA's assurance that account balances are accurate and Agency managers have useful and reliable financial information for managing day-to-day operations."

We recommend that the Chief Financial Officer:

7. Correct the Compass system limitations that allowed (a) payments to exceed the related obligation accounting lines, (b) transactions to post to an incorrect accounting period, and (c) a payment to impact a canceled appropriation.

Response to Recommendation 7: Do Not Concur.

Agency Position on Finding: The OCFO has already made the corrections. Proper controls and tolerance levels to prevent grant payments from exceeding the related obligation accounting lines were updated in December 2011 (Remedy #316877). In May 2012, the issue of preventing the improper posting of transactions to prior accounting periods, except via SV and JV transactions, was corrected (Remedy #359953). OCFO confirmed the Compass table was fixed to prevent spending against canceled appropriations.

6 - EPA Should Improve Compliance with Internal Controls for Accounts Receivable

"We found numerous deficiencies in EPA's compliance with accounts receivable internal controls in FY 2012. Various factors contributed to EPA not properly following its internal control procedures to ensure timely and accurate recording of accounts receivable. EPA policies require accurate and timely recording of accounts receivable and proper separation of duties. Noncompliance with accounts receivable controls affects the reliability and integrity of accounts receivable on the financial statements."

We recommend that the Assistant Administrator for Enforcement and Compliance Assurance:

8. Forward judicial documents to the financial center.

Response to Recommendation 8: Do Not Concur.

Agency Position on Finding: In Recommendation 8, the OIG recommends that the Office of Enforcement and Compliance Assurance (OECA), presumably the Regions, as appropriate, forward judicial documents to the Financial Centers. Underlying this recommendation is the assumption that the EPA's attorneys first receive and then provide to the Department of Justice (DOJ) documentation of civil judicial obligations requiring the payment of amounts certain. Such payments to the United States include civil penalties, amounts due in the recovery of costs incurred under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA also known as "Superfund"), or cash-out payments to resolve CERCLA liability.

In fact, DOJ and not the EPA first receives entered consent decrees or other civil judicial orders that require the payment of sums certain in enforcement cases filed on behalf of the EPA. Typically, the DOJ attorney of record in a civil environmental enforcement case receives a copy of the order entering a civil judicial consent decree or other order imposing the obligation for the defendant to pay an amount certain. The DOJ attorney of record then provides the consent decree or other order to the EPA attorney assigned to the case, which can take several days. Accordingly, DOJ, not the EPA, is in the best position to provide documentation in civil judicial cases to the Cincinnati Finance Center (CFC) within five business days of the date on which the consent decree or other order is entered by the court.

For this reason, the EPA already has a process in place whereby DOJ's Environment and Natural Resources Division (ENRD) has agreed to transmit judicial documents to CFC. In the case of payments due to the U.S. under cases referred to DOJ under CERCLA, the EPA has an Interagency Agreement (IAG) in place with DOJ. Under the IAG, once a case has been settled under the terms of an entered consent decree or other court judgment, DOJ is responsible for transmitting the supporting documentation to CFC so that it can promptly record the required accounts receivable for those cases. Specifically, the IAG requires that "[w]ithin seven [calendar] days of receipt of notice of entry of a consent decree or other Federal court judgment that requires payment of a sum certain to the EPA, DOJ ENRD will send electronic notification of such entry, and attach a copy of the consent decree and/or judgment, as entered, to accountsreceivable.cinwd@epa.gov."

In the case of non-CERCLA cases referred to DOJ, ENRD has also agreed to provide civil judicial documents to CFC under the same process followed for CERCLA cases. Indeed, 2540-9-P3 (Procedure 3) of the Resource Management Directive System (RMDS), which governs non-CERCLA cases, provides that it is the responsibility of the DOJ to email CFC supporting documentation for all penalty payments owed to the U.S. pursuant to a judicial order.

Rather than require all the EPA attorneys who are involved in civil judicial matters to duplicate the work of DOJ in providing documentation to CFC, OECA will engage DOJ management on whether and the extent to which improvements are needed to ensure the timely transmittal to CFC of judicial documentation of accounts receivable arising from civil judicial enforcement cases.

Unlike civil judicial cases, administrative enforcement actions are initiated and managed exclusively by the EPA, usually in the Regional offices. Accordingly, OECA takes responsibility for working with the Regions and Headquarters offices, where applicable, to ensure that penalty documentation in CERCLA and non-CERCLA *administrative* enforcement actions is provided to CFC within 5 business days. Headquarters and the Regions have made significant progress in meeting the 5-business standard. From May through September 2011, the EPA met this standard 77 percent of the time. As a result of OECA/CFC-provided training, OECA's communications with senior Regional management, and mid-course process improvements, the national performance level has risen from 80 percent for the first half for FY 2012 to an annual average of 85 percent for 3rd and 4th quarters of FY 2012. Because most of the Regions are now meeting or exceeding the 95 percent performance level, OECA will be concentrating its additional efforts on those Regions whose performance is not yet at the 95 percent level.

We recommend that the Chief Financial Officer:

9. Reinforce procedures to monitor all tracking reports. Follow up with regional offices and the U.S. Department of Justice to obtain legal documents to ensure accounts receivable are recorded timely in the financial accounting system.

Response to Recommendation 9: Concur.

Agency Position on Finding: CFC already utilizes the DOJ Debt Assessed Report, DOJ 30 Day Tracking Reports, and the Integrated Compliance Information System (ICIS) Tracking Reports to review and follow up on documents not received by CFC. CFC compares these reports to the Compass Data Warehouse (CDW) to determine if receivables have been established. While there were some delays early in the year due to obtaining CDW query information, these reconciliations were completed timely by the 4th quarter. CFC will work with staff to ensure these reports are reviewed timely and fully utilized in obtaining missing documentation.

10. Institute standard operating procedures for entering, tracking, and monitoring accounts receivable, and ensure adherence to EPA policies and procedures for entering receivables timely and maintaining adequate and easily accessible source documentation.

Response to Recommendation 10: Concur.

Agency Position on Finding: The CFC will develop standard operating procedures, by June 2013, for the various types of receivables managed within the office, and will ensure these procedures are in line with agency policy. This has been a transition year for CFC in that some files are now electronically maintained in Compass. CFC will clarify to staff the requirements for electronic files.

11. Ensure proper separation of duties by having separate individuals perform billing and collecting functions.

Response to Recommendation 11: Do Not Concur.

Agency Position on Finding: On October 11, 2012, CFC obtained a waiver for IA staff to input reimbursable billing and collection documents. This waiver was based on the fact that reimbursable collections do not involve physical cash or checks; they are processed through the Intergovernmental Payment and Collection (IPAC) System. There are controls in place to ensure that IPAC collections are recorded in Compass correctly and that the SF-224 is not out of balance.

We recommend that the Assistant Administrator for Administration and Resources Management direct the Director of the Office of Grants and Debarment to:

12. Create guidance to ensure that grant final determination letters contain required provisions for late payment and a process for forwarding final determination letters to finance center within 5 days of the effective date.

Response to Recommendation 12: Concur.

Agency Position on Finding: The OARM's Office of Grants and Debarment (OGD) and OCFO already created guidance in place to address the issues raised by this recommendation. Specifically, Part II Section B.3 of the recently revised EPA Audit Manual 2750, Assistance Agreement Audits, contains, among other things:

- A provision requiring the Agency Action Official to ensure that the appropriate Financial Management Officer is notified of Management Decisions having disallowed costs so that debt collection can occur (Section B.3., page 55); and

- Provisions requiring the Agency Action Official, when notifying a recipient in writing of the Agency's Management Decision, to include standard payment instructions and notification of the appropriate Finance Center of any disallowed costs so that an accounts receivable can be established in accordance with the requirements of RMDS 2540-9 (Section B.4., page 67).

- OGD will highlight these provisions in revised IPERA guidance issued to the Agency's Grants Management Officers. This will include emphasizing the need for standard payment instructions and a reminder to copy the Las Vegas Finance Center on Management Decision Letters to recipients to ensure compliance with the 5-day requirement in RMDS 2540-9-1.

7 - EPA Is Not Clearing Fund Balance with Treasury Statement of Differences Timely

"EPA did not clear Fund Balance with Treasury differences reported on the U.S. Department of the Treasury's Statement of Differences within 2 months. Treasury guidance requires that the Agency clear deposit and disbursement activity differences within "two months of occurrence." However, various problems resulting from the Agency's conversion from IFMS to Compass contributed to the

failure to timely clear Statement of Differences transactions. The problems included the Agency being unable to process transactions, and encountering posting and accounting model deficiencies with the new system. EPA reported a combined total of $6,115,632 in differences from October 2011 through February 2012. The failure to clear Statement of Differences transactions compromises the reliability of EPA's account balances and misstates disbursement and deposit activity reported monthly to the Treasury."

We recommend that the Chief Financial Officer:

13. Require the Director, Office of Financial Management, to correct the Compass accounting and posting model errors so that users have the ability to process Fund Balance with Treasury transactions to clear SODs accurately and timely.

Response to Recommendation 13: Do Not Concur.

Agency Position on Finding: In December 2011, OCFO proactively discovered and disclosed all of the issues cited by the OIG. Early in the year, the EPA was in the midst of learning the intricacies of the new system and applying this knowledge to reengineer day-to-day business processes. There was a significant learning curve. The Finance Centers experienced a high volume of rejects because of tighter budget controls and project notebook edits that occur in Compass. The Centers are now proficient at resolving rejects and as a result clear cash difference more timely. We also designed new reports to assist our accountants in performing the reconciliation. In July 2012, we updated the accounting model and by end of September 2012, the agency resolved the backlog of all the transactions that required clearing and submitted SF224 reports to Treasury. While there were delays initially, we are now able to clear differences in a timely manner. The majority of the SOD differences were the result of timing differences (i.e. difference in reported month of activity) rather than dollar differences. Since the reported values in the financial reports agreed exactly with the Treasury balance, the discrepancies in the SOD did not affect the accuracy of the financial reports.

8 – Property Internal Controls Need Improvement

"Compass does not sufficiently reject personal property information entries that are not accurate. As a result, the Agency could lose accountability and control over property valued in the millions of dollars. FMFIA, 31 U.S.C. § 3512(c)(1)(B), requires that property and other assets be safeguarded against waste, loss, unauthorized use, or misappropriation. However, we identified personal property items for which the location was not properly identified, as well as personal property items for which the last recorded inventory dates or acquisition dates were in the future. The failure to properly configure Compass data fields to reject unreasonable entries contributed to the inaccurate property records."

We recommend that the Chief Financial Officer:

14. Require the Director, Office of Technology Solutions, to work with the contractor that developed Compass to build defaults into the Compass software that will eliminate or minimize property record errors.

Response to Recommendation 14: Concur.

Agency Position on Finding: The OTS is already working with the contractor to build the default into Maximo that will eliminate property record errors and will continue to do so. OARM submitted a remedy ticket to the Help Desk (Ticket #456982).

15. Correct the property data error described above.

Response to Recommendation 15: Concur.

Agency Position on Finding: Corrective action was taken in August 2012 to reflect correct inventory dates for the 28 property items that had future acquisition dates (Reference OARM/David Shelby's response to Point Sheets 2 & 3). In September 2012, Agency Property Officers reconciled property records to ensure that the system reflected the correct location for the $2.9 million in assets. Agency Property Officers will continue to manually monitor until the automated fix is implemented. In September 2012, OARM conducted a system analysis to ensure that no other assets had the same discrepancy; none were discovered.

<u>9 – Compass and Maximo Cannot be Reconciled</u>

"EPA cannot reconcile capital equipment property management data within its property management subsystem—Maximo—to relevant financial data within Compass. OMB Circular A-123, Management's Responsibility for Internal Controls, states that one of the objectives of internal control is the reliability of financial reporting. The inability to reconcile the property subsystem with Compass can compromise the effectiveness and reliability of financial reporting. Maximo and Compass primarily cannot be reconciled because historical property data did not migrate properly from IFMS to Compass."

We recommend that the Chief Financial Officer:

16. Develop procedures to reconcile capitalized property in the Agency's financial system with Maximo.

Response to Recommendation 16: Concur.

Agency Position on Finding: The EPA can reconcile property in Maximo and will document the procedures for reconciling capitalized property. The Office of Financial Management will develop these procedures by the second quarter of FY 2013. EPA can reconcile capital equipment within its property management subsystem – Maximo – to relevant data within Compass. The Finance Centers recently completed this reconciliation.

<u>10 – EPA Needs to Remediate System Vulnerabilities That Place Financial Data At Risk</u>

"Office of the Chief Financial Officer (OCFO) officials did not monitor the testing of its networked information technology assets to identify commonly known vulnerabilities or take action to remediate those weaknesses. EPA policy requires senior Agency officials to ensure security control reviews are performed for general support systems and major applications under their organization's responsibility. We found that the lack of monitoring exists, in part, because EPA's Office of Environmental Information took almost 3 years to resolve a long-standing recommendation

to define duties and responsibilities for testing networked resources managed under EPA's service support contract. Also, OCFO officials should improve the office's process to ensure known vulnerabilities are remediated for the equipment it uses to access the Agency's core financial application. Information technology assets used by finance center personnel contained 286 commonly known vulnerabilities that, if exploited, could potentially undermine EPA's financial reporting capability and serve as available points to compromise the Agency's network."

We recommend that the Chief Financial Officer direct the Senior Information Official to:

17. Document a review of OCFO's processes for conducting vulnerability assessments and create oversight procedures for monitoring the service provider's testing of networked resources and the remediation of any identified weaknesses.

18. Request and monitor to ensure that OEI provides a status update for all identified crucial-risk, high-risk, and medium-risk vulnerabilities contained in the report. The status update should include the date when OEI will remediate all the identified vulnerabilities.

19. Request and monitor to ensure that OEI creates plans of action and milestones for all vulnerabilities that cannot be corrected within 30 days of this report.

20. Request and monitor to ensure that OEI performs a technical vulnerability assessment test of the finance centers' network resources to confirm completion of remediation activities and provide written certification to OCFO that vulnerabilities have been remediate.

Response to Recommendation 17, 18, 19 and 20: Do Not Concur.

Agency Position on Finding: OCFO currently conducts vulnerability assessments for all our general support systems and major applications as directed by National Institutes of Standards and Technology (NIST) guidelines, specifically adhering to NIST 800-37, "Guide for Applying the Risk Management Framework to Federal Information Systems," and NIST 800-53, "Recommended Security Controls for Federal Information Systems and Organizations." All general support systems and major applications undergo risk assessments (as mandated by NIST Risk Management Framework certification) every three years or as the affected application or system implements major modifications. Per the NIST guidelines and EPA policy, a Plan of Action and Milestones are created to address and remediate any weakness or threats identified by the scans.

OEI is responsible for providing continuous monitoring assessments for the network and general support system that OCFO relies on. The description of the Working Capital Fund Customer Technology Solutions Service (CT) clearly states that "CTS support services provide procurement, configuration, installation, and asset management of all personal computing and printing services for all EPA Headquarters Program Offices, their respective remote locations, and on-site contractors." Moreover, the technical terms and conditions state that "CTS equipment is installed with the latest EPA approved software and up-to-date computer security protection." It is not in OCFO's purview to monitor OEI's contractors. Therefore it is **not** "incumbent upon OCFO officials to have a process to closely monitor the contractor to ensure it conducts its responsibilities for testing the finance center's networked resources as prescribed and that the contractor immediately remediates all noted vulnerabilities."

11 – OCFO Financial Systems Security Documentation Needs Improvement

"EPA lacks reliable information on the implementation of required security controls for key financial applications at the Research Triangle Park Finance Center. Our analysis disclosed that key applications' system security plans contained numerous instances of incomplete or inaccurate information for the four minimally required control areas reviewed. Federal guidance requires key documents such as system security plans and contingency plans to be annually reviewed and updated as needed. OCFO had not implemented a process to review the completeness and accuracy of system security plans information, delineated what organizations within OCFO were responsible for maintaining this documentation, or ensured that personnel performing key information security duties were trained to assume those duties. Inaccurate information calls into question the veracity and credibility of the processes OCFO uses to authorize its systems to operate, and places into doubt whether OCFO implemented security controls necessary to protect the confidentiality, integrity, and availability of EPA's financial data."

We recommend that the Chief Financial Officer direct the Senior Information Official to:

21. Develop and implement a process to review SSP information for accuracy and completeness.
Response to Recommendation 21: Concur.

Agency Position on Finding: OCFO already has a process in place and is using it. The Application Security Officer prepares the SSP. The individual office Information Security Officer (ISO); e.g., OTS, reviews the document before it is forwarded to the OCFO Information Security Officer, Information Management Officer, and Senior Information Official for review and approval.

22. Issue a memorandum to the Office of Technology Solutions Director outlining the roles and responsibilities for reviewing and maintaining the SSP documentation for financial applications formerly maintained by the RTPFC technical personnel.

Response to Recommendation 22: Concur.

Agency Position on Finding: The SIO will issue this memorandum by January 2013.

23. Document a review of the skills and qualifications of the OCFO Information Security Officers and provide necessary specialized training that would equip them to perform their duties as required by federal government policy.

Response to Recommendation 23: Concur.

Agency Position on Finding: The OCFO will conduct and document such a review by March 2013.

24. Document a review of SSPs for all OCFO-owned and managed financial applications located at Research Triangle Park and have them updated to reflect current information as required by the National Institute of Standards and Technology.

Response to Recommendation 24: Concur.

Agency Position on Finding: The OTS, as the system owner for the RTP systems, will review the consolidated SSP under development for the payment systems by April 2013.

12 – EPA Needs To Improve Its Process for Reviewing Controls Over Financial Reporting

"EPA has limited assurance that Compass internal controls over financial reporting are designed and operating as intended. Compass, EPA's new core financial application, is managed and hosted by a service provider through a contract. Federal guidance requires agencies using service providers for financial management to ensure that these service providers assess the design and operating effectiveness of internal controls over financial reporting. Industry accounting standards require service providers to evaluate controls over those activities affecting its customers' financial reporting. EPA did not identify its critical business processes that impact financial reporting or require its service provider to identify and assess those processes it performs on the Agency's behalf. Without an assessment of its service provider's control environment, EPA faces the potential that a critical business failure by the service provider could impact the Agency's ability to provide reliable financial reporting."

We recommend that the Chief Financial Officer direct the Director of the Office of Technology Solutions to:

25. Identify the critical business processes performed by the service provider upon which EPA relies for financial reporting.

Response to Recommendation 25: Do Not Concur.

Agency Response to Finding: The EPA owns Compass and implicitly, the reporting functionality therein. Therefore, the EPA does not rely on the service provider for financial reporting.

Compass is COTS software EPA procured from CGI and modified to meet the Agency's requirements. Compass has a life of two years or more, is not intended for sale, and has been constructed with the intention of being used by the EPA only.

Compass falls under the definition in SFFAS #10 paragraph 9 as internal use software. Under SFFAS #10 paragraph 15 entities should capitalize the cost of software when such software meets the criteria of general, plant, and equipment. In its basis for conclusion (SFFAS #10 paragraph #38), the FASAB board clarified that internal use software meets the criteria of PP&E specifically identifiable, can have determinate lives of 2 years or more, is not intended for sale in the ordinary course of operations, and has been acquired or constructed with the intention of being used by the entity

- **SFFAS Paragraph 9 Definition of Internal Use Software**

  This definition of internal use software encompasses the following:

  a. **Commercial off-the-shelf** (COTS) software: COTS software refers to software that is purchased from a vendor and is ready for use with little or no changes

  b. **Developed software:** (1) Internally developed software refers to software that employees of the entity are actively developing, including new software and existing or purchased software that are being modified with or without a contractor's assistance. (2) **Contractor-developed**

software refers to software that a federal entity is paying a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

- **SFFAS Software Used as General PP&E Paragraph 15**

  15. Entities should **capitalize** the cost of software when such software meets

  The criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services.

- **Basis for Conclusion Paragraph #38**

  The Board believes that the cost of software acquired or developed for internal use that meets the SFFAS No. 6 criterion for general PP&E should be capitalized. Internal use software is specifically identifiable, can have determinate lives of 2 years or more, is not intended for sale in the ordinary course of operations, and has been acquired or constructed with the intention of being used by the entity.

26. Require the service provider to assess the identified critical business process controls and report the results as part of the annual review of controls over financial reporting.

Response to Recommendation 26: Do Not Concur.

Agency Position on Finding: Compass internal controls were evaluated during the Office of Technology Solution's FY 2012 A-123 review and no material weaknesses or significant deficiencies were identified.

Responsible Managers:

Original Signed By: November 9, 2012

____Signature/Date

Stefan Silzer, Director, Office of Financial Management

Original Signed By: November 9, 2012

____Signature/Date

Raffael Stein, Director, Office of Financial Services

Original Signed By Robert Hill for: November 8, 2012

____Signature/Date

Quentin X. Jones, Director, Office of Technology Solutions

Original Signed By Nanci Gelb for: November 8, 2012

____Signature/Date

Craig Hooks, Assistant Administrator for Administration and Resources Management

Original Signed By: November 8, 2012

____Signature/Date

Cynthia Giles, Assistant Administrator for Enforcement and Compliance Assurance

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Director, Office of Site Remediation Enforcement, Office of Enforcement and Compliance Assurance
Director, Office of Technology Operations and Planning, Office of Environmental Information
Director, Office of Budget, Office of the Chief Financial Officer
Director, Office of Financial Management, Office of the Chief Financial Officer
Director, Office of Financial Services, Office of the Chief Financial Officer
Director, Research Triangle Park Finance Center, Office of the Chief Financial Officer
Director, Cincinnati Finance Center, Office of the Chief Financial Officer
Director, Las Vegas Finance Center, Office of the Chief Financial Officer
Director, Office of Planning, Analysis, and Accountability, Office of the Chief Financial Officer
Director, Reporting and Analysis Staff, Office of the Chief Financial Officer
Director, Office of Technology Solutions, Office of the Chief Financial Officer
Director, Financial Policy and Planning Staff, Office of the Chief Financial Officer
Acting Director, Accountability and Control Staff, Office of the Chief Financial Officer
Director, Payroll Management and Outreach Staff, Office of the Chief Financial Officer
Agency Audit Follow-Up Coordinator
Audit Follow-Up Coordinator, Office of the Administrator
Audit Follow-Up Coordinator, Office of the Chief Financial Officer
Audit Follow-Up Coordinator, Office of Administration and Resources Management
Audit Follow-Up Coordinator, Office of Enforcement and Compliance Assurance
Audit Follow-Up Coordinator, Office of Solid Waste and Emergency Response
Audit Follow-Up Coordinator, Office of Environmental Information
Audit Follow-Up Coordinator, Office of Grants and Debarment, Office of Administration and Resources Management
Audit Follow-Up Coordinator, Office of Financial Management, Office of the Chief Financial Officer
Audit Follow-Up Coordinator, Office of Financial Services, Office of the Chief Financial Officer

Section III

Other Accompanying Information

SCHEDULE OF SPENDING

Money Management

The Schedule of Spending (SOS) presents an overview of how and where EPA is spending money. The SOS that follows reflects total budgetary resources available to the Agency, gross outlays, and fiscal year-to-date total obligations for the Agency.

	FY 2012
What Money is Available to Spend?	
Total Resources	**$ 16,569,237**
Less Amount Available but Not Agreed to be Spent	2,609,127
Less Amount Not Available to be Spent	177,277
Total Amounts Agreed to be Spent	**$ 13,782,833**

How was the Money Spent?

Goal	Clean Air	Clean & Safe Water	Land Preservation & Restoration	Healthy Communities & Ecosystems	Compliance & Environmental Stewardship
Contracts	$ 255,815	$ 401,296	$ 2,313,558	$ 156,773	$ 99,987
Financial Transfers			2,400,000		
Grants	438,205	4,686,426	634,774	70,841	35,983
Payroll	512,031	565,306	762,946	555,550	704,365
Rent, Communications and Utilities	3,582	1,998	2,355	1,816	1,836
Structures and Equipment	10,963	6,209	9,690	4,529	2,699
Travel	4,558	5,969	13,919	4,140	6,190
Total Spending	**$ 1,225,154**	**$5,667,204**	**$ 6,137,242**	**$ 793,649**	**$ 851,060**

Total Spending	**$ 14,674,309**
Amounts Remaining to be Spent	(891,476)
Total Amounts Agreed to be Spent	**$ 13,782,833**

MANAGEMENT INTEGRITY AND CHALLENGES

Overview of the EPA's Efforts

Management challenges and integrity weaknesses represent vulnerabilities in program operations that may impair EPA's ability to achieve its mission and threaten the agency's safeguards against fraud, waste, abuse and mismanagement. These areas are identified through internal agency reviews and independent reviews by EPA's external evaluators, such as the Office of Management and Budget, the Government Accountability Office, and the EPA's Office of Inspector General. This section of the AFR discusses in detail two components related to challenges and weaknesses: 1) key management challenges identified by the EPA's OIG, followed by the Agency's response and 2) a brief discussion of the EPA's progress in addressing its FY 2012 integrity weaknesses.

Under the FMFIA, all federal agencies must provide reasonable assurance that policies, procedures and guidance are adequate to support the achievement of their intended mission, goals and objectives. (See Section I, "Management Discussion and Analysis," for the Administrator's assurance statement.) Agencies also must report any material weaknesses identified through internal and/or external reviews and their strategies to remedy the problems. Material weaknesses are vulnerabilities that could significantly impair or threaten fulfillment of the Agency's programs or mission. In FY 2012, one new material weakness was identified by the OIG. (See following subsection for a discussion of new, existing and corrected weaknesses and significant deficiencies.)

The Agency's senior managers remain committed to maintaining effective and efficient internal controls to ensure that program activities are carried out in accordance with applicable laws and sound management policy. Agency leaders meet periodically to review and discuss EPA's progress in addressing issues raised by OIG and other external evaluators, as well as progress in addressing current weaknesses and emerging issues. The Agency will continue to address its remaining weaknesses and report on its progress.

2012 KEY MANAGEMENT CHALLENGES

The EPA's Top Major Management Challenges As Identified and Reported by the Office of Inspector General	FY 2010	FY 2011	FY 2012	Link to Agency Strategic Goal
The Need for a National Environmental Policy: Environmental quality depends on policies related to farming, energy, water, transportation and federal land management. A national environmental policy would help the EPA and other federal agencies go beyond existing, fragmented coordination efforts to set national environmental goals and set regulatory standards, particularly for problems that cross state or national borders or pose risks to future generations.	●	●		Cross-Goal
Water and Wastewater Infrastructure: Many drinking water and wastewater systems across the country are unable to maintain compliance with federal water standards due to needed repairs and new constructions. Over the next 20 years, the EPA estimates that approximately $633 billion will be needed to pay for water and wastewater infrastructure. The EPA needs to lead in developing a coherent Federal strategy with states and local governments to assess and organize resources to meet water and wastewater infrastructure needs.	●			Goal 2
Oversight of Delegations to States: Due to differences between state and federal policies, interpretation, strategies and priorities. The EPA needs to more consistently and effectively oversee its delegation of programs to the states assuring that delegated programs are achieving their intended goals.	●	●	●	Cross-Goal
Safe Reuse of Contaminated Sites: The common practice of not removing all sources of contamination from hazardous sites is inhibited by a regulatory structure that places key responsibilities for monitoring and enforcing the long-term safety of contaminated sites on non-EPA parties that may lack necessary resources, information, and skill; changes in site risks as site conditions change over time; and existing weaknesses in the EPA's oversight of the long-term safety of sites as well funding deficiencies.	●	●	●	Goal 3
Limited Capability to Respond to Cyber Security Attacks: The EPA is highly vulnerable existing external network threats, despite reports from security experts that Advanced Persistent Threats, designed to steal or modify information without detection are becoming more prevalent throughout the government. Currently, the EPA has reported that over 5,000 servers and user workstations may have been compromised from recent cyber security attacks along with national security and confidential business and personal data. (Previous years reported under Homeland Security)	●	●	●	Cross Goal
Reducing Domestic Greenhouse Gas: In response to a Supreme Court ruling in April 2007, the EPA issued an endangerment finding that current and projected atmospheric concentrations of six GHGs threaten the public health and welfare of current and future generations. However, the EPA must take significant actions to address the adverse impacts of these air pollutants.	●			Goal 1
EPA's Framework for Assessing and Managing Chemical Risks: The EPA's effectiveness in assessing and managing chemical risks is limited by its authority to regulate chemicals under the Toxic Substances Control Act. Chemicals manufactured before 1976 were not required to develop and produce data on toxicity and exposure, which are needed to properly and fully assess potential risks.	●	●	●	Goal 4 Goal 5
Workforce Planning: EPA's human capital is an internal control weakness in part due to requirements released under the President's Management Agenda. The OIG identified significant concerns with EPA's management of human capital. EPA has not developed analytical methods, or collected data needed to measure its workload and the corresponding workforce levels necessary to carry out that workload.			●	Cross-Goal

Key Management Challenges

The Reports Consolidation Act of 2000 requires OIG to identify, briefly assess and report annually the most serious management and performance challenges facing the Agency. In FY 2012, OIG identified five areas it considers EPA's most pressing management challenges. EPA has made progress in addressing the issues OIG identified and will continue to work diligently in assessing and resolving vulnerabilities before they become serious management issues. The following pages provide the entire OIG's Management Challenges report along with EPA's response to each challenge.

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

JUL -5 2012

THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: EPA's Fiscal Year 2012 Management Challenges

TO: Lisa P. Jackson
Administrator

We are pleased to provide you with a list of areas the Office of Inspector General considers as key management challenges confronting the U.S. Environmental Protection Agency (EPA). According to the Government Performance and Results Act Modernization Act of 2010, major management challenges are programs or management functions, within or across agencies, that have greater vulnerability to waste, fraud, abuse, and mismanagement, and a failure to perform well could seriously affect the ability of an agency or the federal government to achieve its mission or goals.

The Reports Consolidation Act of 2000 requires our office to report what we consider the most serious management and performance challenges facing the Agency. Given this requirement, our list includes management challenges and significant performance issues facing EPA. We used audit, evaluation, and investigative work, as well as additional analysis of Agency operations, to identify challenges and weaknesses. Additional challenges and weaknesses may exist in areas that we have not yet reviewed, and other significant findings could result from additional work. We provide detailed summaries of each challenge in the attachment.

Management Challenges	Page
Oversight of Delegations to States	1
Safe Reuse of Contaminated Sites	3
Limited Capability to Respond to Cyber Security Attacks	8
EPA's Framework for Assessing and Managing Chemical Risks	13
Workforce Planning	16

This year we deleted one management challenge from the prior year (Need for Greater Coordination of Environmental Efforts) because we recognize that cross-Agency coordination is not something over which EPA has exclusive control. We have begun an effort to update our Catalog of Federal Environmental Programs which, along with work by the U.S. Government Accountability Office on duplicative federal programs, could identify duplicative programs that warrant consideration as a future management challenge.

We welcome the opportunity to discuss our list of challenges and any comments you might have.

Arthur A. Elkins, Jr.

Attachment

Oversight of Delegations to States

The U.S. Environmental Protection Agency's (EPA's) oversight of state programs remains a key management challenge. The U.S. Government Accountability Office (GAO) and our office have reported that EPA has made some progress in this area but the effectiveness of Agency oversight still has a number of limitations.

To accomplish its mission to protect human health and the environment, EPA develops regulations and establishes programs that implement environmental laws. Many of the federal statutes establish federal and state regulatory programs in which states are given the opportunity to enact and enforce such laws, meeting minimum federal criteria, to achieve the regulatory objectives which Congress has established. As such, EPA may authorize state, local, or tribal governments to implement these laws when they request authorization and EPA deems that government capable of operating the program consistent with federal standards. EPA relies heavily on authorized state and tribal agencies to obtain performance data and to implement compliance and enforcement programs.

EPA does not abrogate its oversight responsibility when it has delegated implementation and enforcement responsibility. Federal intent is to ensure national minimum level environmental protection standards. In addition, federal requirements establish consistency for businesses and within industries nationwide. States' discretion adds flexibility to address specific circumstances and local issues, but joint implementation and enforcement leads to special challenges in interpretations, strategies, and priorities. Therefore, EPA performs oversight of state, local, and tribal programs to provide reasonable assurance that they achieve national goals.

Improving EPA-state relationships is a priority for EPA,[1] and EPA has begun to improve its oversight by implementing the State Review Framework. However, GAO reported that while EPA has made substantial progress in improving priority setting and enforcement planning with states, its oversight needed further enhancement.[2] The framework is intended to provide a consistent approach for overseeing programs and identifying weaknesses and areas for improvement, but EPA has not implemented it in a consistent manner. For example, evaluations of the State Review Framework show that EPA has limited ability to determine whether states are performing appropriate enforcement in a timely manner, and whether penalties are applied to environmental violators in a fair and consistent manner within and among states. In response to these findings, EPA made changes to the State Review Framework and initiated a Clean Water Act Action Plan, which among other things is aimed at strengthening Agency oversight of state water quality compliance and enforcement.[3]

We have continued our work on this topic over the past year, and our recent reports demonstrate that this challenge persists. Most apparent throughout these reports is EPA's inadequate and inconsistent oversight of a variety of state activities—from state revolving fund projects to state enforcement of major environmental laws. Oversight of state activities requires that EPA establish consistent national baselines that state programs must meet, and monitor state programs

[1] EPA, Administrator Lisa Jackson's *Seven Priorities for EPA's Future*.
[2] GAO, *EPA-State Enforcement Partnership Has Improved, but EPA's Oversight Needs Further Enhancement*, GAO-07-883, July 2007.
[3] EPA, Clean Water Act Action Plan, October 15, 2009.

to determine whether they meet federal standards. Our work identified the absence of national baselines and a lack of consistent and robust state oversight of multiple programs within the Clean Water Act (CWA), Clean Air Act, and Resource Conservation and Recovery Act.

- EPA's oversight of states did not ensure that requirements of the American Recovery and Reinvestment Act of 2009 (ARRA) were met on Clean Water State Revolving Fund projects. We found that the ARRA inspection checklist did not include enough detailed questions to facilitate EPA oversight of state programs. Further, the Office of Water was not conducting and documenting reviews of state programs in a timely manner and did not use the resulting reports to make national program decisions. Office of Water management did not make completion of the review reports a priority and did not use all of the ARRA funding Congress allocated for oversight. As a result, the EPA oversight process could not ensure that states were complying with ARRA program requirements.[4]

- EPA takes a variety of approaches to correcting underperforming state programs. These include making recommendations under the State Review Framework process, overfiling on states, and taking independent actions when states choose not to act. We found that EPA does not maximize its resources so that it can take the most stringent step—revoking state authorization—when a state is underperforming. EPA primarily identifies underperforming state programs through the State Review Framework process. While the process is generally positive, it is not consistent. EPA's criteria for state performance varied from region to region and state to state, depending on factors like state resources and varying environmental priorities. This means that citizens in different states cannot expect the same baseline of protection from pollution and human health risks. By establishing stronger organizational structures, EPA can directly implement a national enforcement strategy that ensures all citizens have, and industries adhere to, a baseline level of environmental protection. EPA could make more effective use of its resources by directing a single national workforce instead of 10 inconsistent regional enforcement programs.[5]

- Region 4 gave Georgia's Concentrated Animal Feeding Operation (CAFO) program a positive assessment. However, an EPA Office of Inspector General (OIG) review identified CAFOs that were operating without National Pollutant Discharge Elimination System (NPDES) permits or Nutrient Management Plans, inspection reports were missing required components, and the state was not assessing compliance with permit conditions. The report recommended implementing controls to require enforcement data tracking between EPA and the state, assuring CAFO inspections are complete, and taking timely and appropriate enforcement actions.[6]

- EPA Region 4 has not adequately implemented management controls to assure that North Carolina NPDES permits comply with CWA and applicable federal regulations concerning thermal discharges. Region 4 determined that the thermal limits for four of the six facilities reviewed were renewed based on insufficient documentation. Most of the

[4] EPA OIG report, *EPA and States Should Strengthen Oversight of Clean Water State Revolving Fund Recovery Act Projects*, Report No. 11-R-0519, August 24, 2011.
[5] EPA OIG, *EPA Must Improve Oversight of State Enforcement*, Report No. 12-P-0113, January 30, 2012.
[6] EPA OIG, *Region 4 Should Strengthen Oversight of Georgia's Concentrated Animal Feeding Operation Program*, Report No. 11-P-0274, June 23, 2011.

draft permits we reviewed were missing critical information needed to allow EPA and the public an opportunity for review and comment as required. Public notices for five draft permits did not contain the required statements describing the proposed thermal variance.[7]

While EPA has renewed its attention to the oversight of programs delegated to states, much work remains. The Agency must address limitations in the availability, quality, and robustness of program data, and limitations in implementation across environmental statutes to provide effective oversight. Effective oversight of delegations to states also requires an organizational structure capable of maintaining clear lines of accountability. If EPA does not adequately oversee states' authorized enforcement programs, it cannot hold states accountable for meeting their enforcement responsibilities. As a result, EPA would not be able to ensure Americans that states maintain a baseline level of environmental protection. Significant improvements are required before this challenge can be removed. We are continuing to review these issues and will provide additional recommendations to EPA in the future.

Safe Reuse of Contaminated Sites

In the last decade, EPA has increasingly emphasized the reuse of contaminated or once-contaminated properties. In its 2011–2015 Strategic Plan, EPA announced a shift in the definition of success at a Superfund site from "construction complete" of a site cleanup to when a site is "ready for anticipated use."[8] EPA's fiscal year (FY) 2013 budget states that it will continue to place emphasis on promoting site reuse in affected communities,[9] and Agency guidance states that revitalizing communities and ensuring the long-term protection of human health and the environment remains a high priority for EPA at Superfund sites.[10] The Agency currently has an active effort to encourage communities, developers, industry, states, and local governments, or anyone interested to reuse contaminated sites for renewable energy development (e.g., wind, solar, biomass) facilities.[11]

EPA has successfully turned some actual or perceived problem sites into properties that reinvigorated communities and created jobs.[12] Contaminated properties have become viable again as retail stores, public recreation areas, housing complexes, sports stadiums, and commercial office space. Recycling and reusing contaminated property can produce measured economic benefits, provide environmental benefits that result from preserving undeveloped lands, and improve quality of life for communities. While EPA's recycle and reuse goals are notable and may have made positive contributions in difficult economic times, EPA's duty is to ensure that contaminated sites are safe for humans and the environment. EPA faces significant and increasing challenges in this area due to: (1) the common practice of not removing all contamination sources from hazardous sites; (2) a regulatory structure that places key responsibilities for monitoring and enforcing the long-term safety of contaminated sites on non-EPA parties that may lack necessary resources, information, and skill; (3) varying risks as site conditions change over time; and (4) weaknesses in EPA's oversight of long-term site safety.

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[7] EPA OIG, *Oversight of North Carolina's Renewals of Thermal Variances*, Report No. 11-P-0221, May 9, 2011.
[8] EPA, *FY 2011–2015 Strategic Plan*, page 38.
[9] EPA, *FY 2013 EPA Budget in Brief.*
[10] EPA, *Office of Solid Waste and Emergency Response, FY 2013 National Program Manager's Guidance*, Draft – February 17, 2012 Publication Number 530P12001, page 23.
[11] EPA website, *"RE-Powering America's Land."*
[12] EPA website, *"Superfund Redevelopment."*

Many contaminated sites, such as Superfund sites, must be monitored in the long term (i.e., 30 years or more) because known contamination is often not fully removed or remediated, and controls that prevent prohibited activities at sites must be maintained and enforced. New controls or monitoring may be required if previously undetected or new contaminants emerge,[13] which can be a direct result of site changes brought about by reuse. Ineffective or missing long-term safety controls at reused contaminated sites can pose significant risks to human health and the environment. The New York Department of Environmental Conservation released a report listing hundreds of "old" Superfund, brownfields, and other cleanup cases that were reopened to investigate potential new threats from vapor intrusion.[14] Improvements in analytic techniques and knowledge gained from site investigations has increased awareness of soil vapor as a medium of concern and of the potential for human exposure from the soil vapor intrusion pathway.[15] However, EPA has yet to finalize guidance on assessing or addressing potential risks from vapor intrusion and does not estimate that it will do so until late 2012.[16]

EPA has acknowledged challenges to ensuring the long-term safety of contaminated sites. In 2005, the Agency released a report that examined a range of long-term stewardship issues[17] and challenges it faced, as well as the role of non-EPA parties (e.g., states, tribes, and other federal agencies) in ensuring long-term safety of contaminated sites.[18] EPA identified five categories of challenges: (1) understanding roles and responsibilities; (2) implementing and enforcing institutional controls;[19] (3) implementing, enforcing, and monitoring engineering controls;[20] (4) estimating long-term stewardship costs and obtaining funding and resources; and (5) managing and communicating information to prevent breaches of controls and ensuring consistent information in databases. The report made a number of recommendations that generally rely on partnerships and relationships to share, communicate, and exchange necessary information on roles, responsibilities, and costs associated with long-term stewardship responsibilities. The report encouraged non-EPA parties to adhere to legal provisions for implementing institutional controls where applicable (e.g., Uniform Environmental Covenants Act).[21]

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[13] EPA, *Brownfields Technology Primer: Vapor Intrusion Considerations for Redevelopment*, EPA 542-R-08001, March 2008.

[14] New York State Department of Environmental Conservation, *Status of Vapor Intrusion Evaluations at Legacy Sites*, February 11, 2009.

[15] New York State Department of Environmental Conservation, *Strategy For Evaluating Soil Vapor Intrusion at Remedial Sites in New York*, DER-13, October 18, 2006.

[16] EPA OIG, *Lack of Final Guidance on Vapor Intrusion Impedes Efforts to Address Indoor Air Risks*, Report No. 10-P-0042, December 14, 2009.

[17] EPA generally characterizes long-term stewardship activities as activities that ensure (1) ongoing protection of human health and the environment, (2) the integrity of remedial or corrective actions so they continue to operate properly, and (3) the ability of people to reuse sites in a safe and protective manner.

[18] EPA, *Long-Term Stewardship: Ensuring Environmental Site Cleanups Remain Protective Over Time: Challenges and Opportunities Facing EPA's Cleanup Programs*, EPA 500-R-05-001, September 2005.

[19] Institutional controls are legal or administrative controls intended to minimize the potential for human exposure to contamination by limiting land or resource use. A local government is often the only entity that has legal authority to implement certain types of institutional controls (e.g., zoning restrictions).

[20] Engineering controls are the engineered physical barriers or structures designed to monitor and prevent or limit exposure to the contamination.

[21] The Uniform Environmental Covenants Act confirms the validity of environmental covenants (i.e., institutional controls/land use controls) by ensuring that land use restrictions, mandated environmental monitoring requirements, and a wide range of common engineering controls designed to control the potential environmental risk of residual contamination will be reflected in land records and effectively enforced over time. Currently, about one-half of U.S. states have passed a Uniform Environmental Covenants Act. The Uniform Environmental Covenants Act was drafted by the National Conference of Commissioners on Uniform State Laws in August 2003.

In response to a GAO report on institutional controls, EPA has also taken some steps to better manage the implementation of institutional controls at Superfund sites.[22] However, many sites remain for which the implementation status of institutional controls is not available.[23] In 2010, EPA completed an internal evaluation to determine whether the required and necessary institutional controls were in place at national priority Superfund sites.[24] EPA's review disclosed that controls to protect human health were not in place at a number of sites they reviewed. EPA made recommendations to improve the implementation of these controls to protect human health at sites where risks remained. In November 2010, EPA also revised Agency guidance and sought public comment on its "interim final guidance," *Institutional Controls: A Guide to Planning, Implementing, Maintaining, and Enforcing Institutional Controls at Contaminated Sites.*[25] This guidance, although not final, communicates a number of important EPA expectations about planning for, implementing, and monitoring institutional controls. The guidance is a noteworthy improvement in the Agency's management of this important issue. Recognizing the critical role of non-EPA parties in ensuring effective institutional controls, the guidance states that regions should conduct an analysis to determine whether the state and local agencies responsible for oversight and management of the controls have the ability and capacity to implement, maintain, and enforce the controls. The guidance states that "institutional controls can only be a reliable component of site cleanup if the responsible agencies have the ability, willingness and capability to oversee and manage these controls."[26]

Over the last several years, our work has identified additional and ongoing challenges that EPA faces in ensuring effective long-term monitoring or stewardship of contaminated sites. We found that some states were not financially prepared to take over their long-term monitoring and maintenance responsibilities for Superfund cleanups.[27] In 2010, Michigan's Department of Environmental Quality believed it would run out of money for its hazardous waste cleanup program.[28] We have reported on state failures to enforce cleanup agreements,[29] EPA's failure to follow Superfund site deletion guidance[30] and Five-Year Review procedures,[31] and EPA's lack of systems to determine whether a site cleanup is noncompliant.[32] In our February 2011 report,[33] we found that EPA relies on the self-certification of a third-party environmental professional to determine whether statutorily required environmental due diligence has been performed at

[22] GAO, *Hazardous Waste Sites: Improved Effectiveness of Controls at Sites Could Better Protect the Public,* GAO 05-163, January 28, 2005. See also EPA's website "Institutional Controls."
[23] EPA website, "Published Institutional Controls."
[24] EPA, *Summary of Program Evaluations for FY 2010 Annual Performance Report.*
[25] OSWER 9355.0-89 EPA-540-R-09-001 November 2010 Interim Final.
[26] EPA, *Institutional Controls: A Guide to Planning, Implementing, Maintaining, and Enforcing Institutional Controls at Contaminated Sites*, OSWER 9355.0-89 EPA-540-R-09-001 November 2010 Interim Final, page 9.
[27] EPA OIG, *Some States Cannot Address Assessment Needs and Face Limitations in Meeting Future Superfund Cleanup Requirements,* Report No. 2004-P-00027, September 1, 2004.
[28] *The Detroit News*, "Michigan Out of Cash to Clean Up Toxic Sites," March 4, 2010.
[29] EPA OIG, *Improved Controls Would Reduce Superfund Backlogs*, Report No. 08-P-0169, June 2, 2008.
[30] EPA OIG, *EPA Decisions to Delete Superfund Sites Should Undergo Quality Assurance Review*, Report No. 08-P-0235, August 20, 2008.
[31] EPA OIG, *EPA Has Improved Five-Year Review Process for Superfund Remedies, But Further Steps Needed,* Report No. 2007-P-00006, December 5, 2006; EPA OIG, *EPA's Safety Determination for Delatte Metals Superfund Site Was Unsupported*, Report No. 09-P-0029, November 19, 2008.
[32] EPA OIG, *EPA Needs to Track Compliance with Superfund Cleanup Requirements*, Report No. 08-P-0141, April 28, 2008.
[33] EPA OIG, *EPA Must Implement Controls to Ensure Proper Investigations Are Conducted at Brownfields Sites*, Report No. 11-P-0107, February 14, 2011.

Brownfields sites funded by EPA grants. In a sample of environmental due diligence investigations we reviewed, environmental professional certifications failed to meet federal requirements and therefore failed to assure that a proper environmental investigation occurred. EPA also conducts no oversight of the requirement to meet "continuing obligations" at Brownfields properties funded by EPA. Continuing obligations include land use controls and institutional controls designed to prevent unacceptable use of contaminated properties.[34] Weaknesses or lapses in meeting environmental due diligence or continuing obligations requirements can result in undetected or undisclosed contamination and property reuse that may pose unacceptable risk to humans. In response to our February 2011 report, EPA agreed to develop outreach materials and conduct training for Brownfields grantees and regional Brownfields staff to increase compliance with federal requirements for environmental due diligence investigations. EPA committed to completing these activities by the end of FY 2012.

Our January 2010 report found new contamination at a delisted Superfund site in Delaware where EPA conducted informal and undocumented oversight of the site reuse plans.[35] The current site owner had nearly finalized plans for reusing the site for public recreation but in a manner inconsistent with the site cleanup plan. EPA had not kept current with the current owner's site reuse plans. In addition, EPA did not issue a Ready for Reuse (RfR) determination for this site because it believed it was not necessary. An RfR could potentially address some of the internal challenges to ensuring safe reuse of contaminated sites. However, there is no requirement to complete RfRs, and they have been treated as discretionary. Nonetheless, EPA has held up RfRs as providing the necessary "limitations that need to be followed to ensure [site] protectiveness." An RfR was not issued for the site reviewed in our January 2010 report because site managers believed an RfR was only needed to aid the real estate market. At another Superfund site, we also found that EPA did not take action to address a 6-year gap in environmental sampling that the state should have conducted.[36] This type of oversight weakness can result in a failure to detect conditions that indicate a cleanup remedy does not protect human health and the environment.

In August 2011, we reported the results of a review of hyperspectral imaging data taken of Superfund sites that had been remediated and deleted from the National Priorities List.[37] At two of the sites, imaging data showed new contamination and changed site conditions. At one former industrial site, we found that the site owner was building a residence on top of the site although levels of contamination detected at the site exceeded residential safety levels and the site contained buried drums and other potential human health hazards.

EPA's management of the long-term oversight and monitoring requirements for the safe reuse of contaminated sites has lagged behind its marketing of site reuse opportunities and showcasing of successes. Only in the last several years has EPA focused attention on the long-term stewardship aspects of contaminated sites across its cleanup programs. This gap promises to increase substantially as EPA continues to heavily promote the reuse of contaminated sites and create new

[34] EPA, *Brownfields Fact Sheet, EPA Brownfields Grants CERCLA Liability and All Appropriate Inquiries*, EPA 560-F-09-026, April 2009.
[35] EPA OIG, *Changes in Conditions at Wildcat Landfill Superfund Site in Delaware Call for Increased EPA Oversight*, Report No. 10-P-0055, January 27, 2010.
[36] EPA OIG, *EPA Should Improve Oversight of Long-term Monitoring at Bruin Lagoon Superfund Site in Pennsylvania*, Report No. 10-P-0217, September 8, 2010.
[37] EPA OIG, *Observed Conditions at Five Deleted Superfund Sites*, Report No. 11-P-0433 August 3, 2011.

incentives, such as establishing specific program goals for site reuse, without investing in tools needed to ensure the safe, long-term use of these sites. Many Superfund sites are now moving to the long-term monitoring phase, with more sites expected to do so in the future.[38] EPA's December 2008 report on future Superfund workload needs states that the "post-construction" workload will require the greatest increase in coming years and will increase by 89 percent over the current full-time equivalent (FTE) distribution.[39] EPA will continually need to assess challenges it faces, as well as challenges among the diverse group of non-EPA parties it must work with, to ensure that sites are safely reused. In its assessments, EPA should consider new or expanded authorities and regulations, new organizations, measures and goals, new methods of sharing information, and dedicated funding and resources for long-term stewardship activities.

In 2009, EPA agreed with this challenge.[40] In its 2010[41] and 2011[42] responses to this challenge, EPA stated that it had several tools it actively promotes to ensure appropriate and safe reuse of sites and that it will continue to explore new tools and approaches to sharing risk information to ensure that sites remain safe in their future uses. EPA has stated that its Superfund Five-Year Review process addresses the vast majority of "emerging contaminant" situations observed at Superfund National Priorities List sites and conveyed that the Five-Year Review process worked well. Specific "tools" EPA has said it promotes to ensure appropriate and safe reuse of sites are: (1) RfR determinations, (2) comfort and status letters, (3) prospective purchaser inquiry calls, (4) EPA-funded reuse planning offers, and (5) site reuse fact sheets.[43] In 2011, EPA also identified these tools as things they can offer to ensure that reuse is appropriate and will enhance long-term protectiveness.[44]

While the above tools appear to serve a purpose in enhancing reuse, reducing possible stigma associated with a contaminated property, or addressing legal obligations, their use and effectiveness as management controls for ensuring long-term human health protection has not been evaluated. However, EPA has recently taken significant steps to address and remedy vulnerabilities in the Superfund Five-Year Review process. Several actions have been in response to our findings. In 2009, EPA completed a review of the quality of Five-Year Reviews.[45] The Agency identified many reviews that needed additional support and some that needed to modify their safety determinations. Additional actions such as modifying the Agency's 2001 guidance on Five-Year Reviews may be forthcoming. In a February 2012 report, we recognized important improvements in EPA's review and oversight of Five-Year Reviews.[46] EPA has implemented national review of Five-Year Reviews to improve their consistency and quality. Still, in our February 2012 report, we identified additional opportunities for EPA to

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[38] EPA, *Long-Term Stewardship: Ensuring Environmental Site Cleanups Remain Protective Over Time: Challenges and Opportunities Facing EPA's Cleanup Programs,* EPA 500-R-05-001, September 2005.
[39] EPA, *Superfund Workload Assessment Report*, OSWER Document 9200-2-81, December 2, 2008. Post-construction workload can refer to all activities after a cleanup remedy is constructed (including long-term monitoring and reuse activities).
[40] EPA, *Performance and Accountability Report for Fiscal Year 2009*, section IV, page 43.
[41] EPA, *Fiscal Year 2010 Agency Financial Report,* section III, pages 37-40.
[42] EPA, *Fiscal Year 2011 Agency Financial Report*, page 174.
[43] EPA, *Fiscal Year 2010 Agency Financial Report,* section III, page 39.
[44] EPA, *Fiscal Year 2011 Agency Financial Report*, pages 174-175.
[45] EPA, *Assessing Protectiveness for Asbestos Sites: Supplemental Guidance to Comprehensive Five-Year Review Guidance,* December 3, 2009.
[46] EPA OIG, *Stronger Management Controls Will Improve EPA Five-Year Reviews of Superfund Sites,* Report No. 12-P-0251 February 6, 2012.

improve its national review process to ensure Five-Year Reviews conducted in the regions are based on quality data and adhere to Agency guidance. We believe that the Superfund Five-Year Review process is and should be a "safety-net" for detecting new contamination or other changing site conditions that may identify new potential human health risks. However, our reviews of the Five-Year Review process and conditions at deleted Superfund sites continue to demonstrate that the Five-Year Review process needs to be a stronger safety-net.

We will review and recognize EPA efforts to address the significant challenge of ensuring the long-term safety of contaminated sites. Our work and the Agency's work have shown that EPA can address some of the internal challenges through improved oversight and management of EPA-directed activities inherent to successful long-term stewardship of contaminated sites. However, successful long-term stewardship also depends on having properly resourced and informed non-EPA parties who have ongoing access to current information, are actively involved in compliance, and conduct appropriate due diligence and oversight of contaminated sites. EPA is highly limited in addressing this challenge when state or local governments with primary responsibility for addressing many long-term safety issues have neither the money nor the apparent will to do so. The lessons from recent issues such as vapor intrusion show that site reuse can generate new environmental risks. In its 2011–2015 Strategic Plan, EPA notes:

> Complications can arise when new scientific information concerning contaminants at a site suggests that a risk assessment that was protective when a remedy was selected is no longer protective given the contaminant levels remaining at a site and their potential exposure pathways. . . . EPA must incorporate emerging science into decision making to maintain its commitment to provide permanent solutions.[47]

EPA needs new strategies that take the Agency beyond merely encouraging the accountable parties to fulfill requirements, and focus on providing EPA and other accountable parties the information, resources, and authorities to ensure long-term safety of reused sites.

Limited Capability to Respond to Cyber Security Attacks

As technology continues to advance and the Agency increases its use of automated systems to further integrate EPA data and services with external users via the Internet,[48] having a strong information technology (IT) infrastructure that addresses security at the enterprise architecture level is critical to protecting the Agency against cyber-attacks. This growth in computer connectivity places EPA at increased risks of disruption to its critical operations as well as the possibility of unauthorized access to sensitive data. As such, it is imperative that EPA management continues efforts to strengthen practices to guard against Advanced Persistent Threats (APTs). Security experts continue to report that such attacks remain prevalent against government networks.[49]

EPA acknowledges that APTs pose a significant challenge for the Agency and has committed to making significant progress in enhancing situational awareness across the infrastructure and

[47] EPA, *FY 2011–2015 Strategic Plan*, page 25.
[48] The Environmental Information Exchange Network presentation "Introduction to the Exchange Network."
[49] InfoWorld, "Massive 'Lurid' APT attack targets dozens of government agencies," September 26, 2011.

increasing visibility into network activities. Management stated that to address this challenge, it has identified specific automated tools to deal with cyber security concerns in a secure manner. Management also indicated it fully deployed a Security Information and Event Management (SIEM) tool to facilitate greater vigilance in log reviews and activity monitoring. Additionally, the Agency indicated that its Computer Security Incident Response Capability (CSIRC) team is working to build stronger relationships with internal organizations, such as the Office of Homeland Security, for threat intelligence sharing.[50]

EPA uses a vast array of security devices and software such as firewalls, intrusion detection systems, and the SIEM tool to monitor its network in conjunction with the CSIRC to ensure the availability, integrity, and confidentiality of network services. Our ongoing analysis shows that EPA has made great strides in addressing the cyber security challenge over the last 2 years. However, our audit work continues to identify areas where management must close the gaps between putting in place basic infrastructure for monitoring security over Agency assets to building a strong cyber security capability and using it to effectively and efficiently reduce security risk. In particular:

Enhancing Situational Awareness: EPA continues to take steps to address the need to monitor network traffic flowing within and into the Agency's network boundaries. To this end, EPA has completed the transition to the Managed Trusted Internet Protocol (IP) Services, which now gives it the ability to monitor network traffic flowing through both of its Internet points of presence. However, EPA still needs to take steps to improve its operational practices to better and more quickly synthesize information obtained from the variously deployed monitoring tools in order to prepare an effective response to network attacks.[51] Management indicated that part of its situational awareness strategy was to establish a Network Security Operations Center,[52] which it did in April 2012. EPA officials indicated that co-locating its incident response capability and network security operations would enhance information exchange between the two units and reduce the time needed to respond to attacks. However, management has not yet defined or developed service level agreements for the two contractors running the incident response capability and the network security operations center. Nor has management developed its internal agreements between the two EPA organizations responsible for providing contractor oversight. Lastly, for EPA to be able to share relevant situational information with senior leaders, it must first strengthen the Agency's asset management capability in order to associate IP addresses to the critical network assets and associated data. In 2008, we reported that EPA needed to improve management of IP addresses in order to associate discovered attacks and vulnerabilities with network assets for a more timely and effective incidence response.[53] As such, EPA implemented a market leading solution for automating IP address management services across the Agency's network.[54] EPA officials briefed us on its plans for updating the network infrastructure and shared with us

[50] FY 2011 Agency Financial Report, page 183.
[51] EPA OIG, *Improvements Needed in EPA's Network Traffic Management Practices,* Report No. 11-P-0159, March 14, 2011.
[52] Technology & Information Security Staff Strategic Plan, FY 2011-2016, version 1.0.
[53] EPA OIG, *Management of EPA Headquarters Internet Protocol Addresses Needs Improvement*, Report No. 08-P-0273, September 23, 2008.
[54] EPA meeting notes, September 21, 2011.

strategic planning documents.[55] However, continued management vigilance is required to ensure the remaining outlined actions come to fruition.

Implementing Automated Tools: EPA acknowledged that many of its continuous monitoring efforts pivot around the successful implementation of its SIEM tool.[56] In our draft audit report released to the Agency in March 2012, we found that EPA lacks a fully developed strategy to include the Agency's headquarters offices within the SIEM's environment.[57] While EPA documents showed a strategy that included each of EPA's regional offices within the SIEM's environment,[58] our ongoing analysis disclosed that efforts to include headquarters offices fell short due to turnover of technical staff and EPA's discontinued meetings with headquarters personnel.[59] EPA officials indicated they have since updated the SIEM project plan and have also hired two new personnel within the CSIRC and headquarters to become subject matter experts on the tool. EPA officials indicated that this should also help facilitate implementing the SIEM tool in headquarters.

Building Greater Relationships: EPA has made progress in increasing its ability to process intelligence information and has taken steps to widen its relationships with other federal agencies by participating in working groups, task forces, and national exercises. However, more must be done to increase the sharing of security incident information within the Agency. The need for increased information sharing to combat cyber threats is necessary and emphasized as a major effort within proposed legislative language. In particular, the proposed Cybersecurity Act of 2012 prescribes that agencies must develop policies and procedures that include reporting information security incidents to relevant OIGs.[60] Currently, EPA is working on a Memorandum of Understanding (MOU) with the EPA OIG to define roles and responsibilities in coordinating responses to intrusion activities associated with EPA's networks. The implementation of this MOU and the information gathered by the Agency's IT staff is not only necessary for the continued protection of EPA's operational mission but is necessary to preserve the crime scene associated with the intrusion event to allow us to employ our investigative mission.

Developing a Vulnerability Remediation Program: In September 2009, we reported that project delays continued to prevent EPA from implementing an Agency-wide information security vulnerability management program. Our audit highlighted both the need for the Agency to implement a tool to continuously monitor Agency assets for vulnerabilities and a management process to ensure identified vulnerabilities are remediated.[61] Since this audit, EPA has taken steps to procure a vulnerability management tool and established an Agency-wide methodology for continuously

[55] Technology & Information Security Staff Strategic Plan, FY 2011-2016, version 1.0.
[56] Fiscal 2011 Agency Financial Report, page 183.
[57] EPA OIG, *Draft Report: Improvements Are Needed in EPA's Security Monitoring Program*, Project No. OMS-FY11-0005.
[58] EPA Security Information and Event Management (SIEM) Infrastructure, SIEM Concept of Operations (CONOPS), June 12, 2011.
[59] EPA OIG, *Draft Report: Improvements Are Needed in EPA's Security Monitoring Program*, Project No. OMS-FY11-0005.
[60] Cybersecurity Act of 2012, Section 3354, Agency Responsibilities.
[61] EPA OIG, *Project Delays Prevent EPA from Implementing an Agency-wide Information Security Vulnerability Management Program*, Report No. 09-P-0240, September 21, 2009.

identifying vulnerabilities on Agency assets. However, current audit work disclosed that, despite this effort, EPA offices continue to face challenges in eradicating known vulnerabilities from its assets.[62] This happens, in part, because the Agency has not implemented a process that requires offices to remediate identified vulnerabilities. Current discussions with EPA officials indicate that management plans to establish a Patch and Vulnerability Management Group to address this issue. However, formal policies, procedures, and organization structure are not yet approved. Until then, EPA will continue to provide potential attackers an unnecessarily large window of opportunity to exploit system weaknesses, which could ultimately compromise the Agency's network. As such, closing the time behind vulnerability identification and remediation is key in protecting EPA's critical assets and data.

Implementing Information Security at the Enterprise Level: During 2011, we reported that EPA has not clearly defined the Information Management segment within its current Enterprise Transition Plan (ETP). The Information Management segment, which addresses information security at an enterprise architecture level, is identified as "notional," or not in planning. The ETP describes EPA's overarching strategy for modernizing the Agency's infrastructure to achieve its target architecture. The ETP does not clearly define the actions it will take to achieve its security target architecture. Given the rapid rise of APTs on EPA's network, the absence of a clearly defined plan for implementing the Information Management segment shows a lack of commitment on the part of the Agency to address information security from an enterprise-wide perspective. Without this strategy, EPA executives may not be able to make proper investment decisions regarding the necessary tools to combat APTs with an Agency-wide approach.[63] In its September 26, 2011, response to this finding, EPA indicated that during FY 2012 it would take steps to achieve the security target architecture. As such, the Agency indicated it has baselined the information security architecture and drafted the target architecture. However, management emphasis is still needed to ensure completion of the needed gap analysis and implementation plans, as outlined in the Agency's corrective action plan.[64]

Increasing Skills for Personnel with Significant Security Responsibilities: Our ongoing analysis disclosed that while EPA suspects that skill gaps exists, EPA has not undertaken studies to develop strategies to align the Agency's needs and priorities with those of its workforce to ensure it can meet its legislative, regulatory, and organizational objectives. Having personnel with the right skills in the right position is critical for EPA to respond effectively to cyber-attacks. EPA recognizes that not all Information Security Officers (ISOs) perform the same functions nor do they possess comparable technical knowledge and abilities.[65] We initiated an audit to evaluate the qualifications, skills, and

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[62] EPA OIG website listing FYs 2009-2012 reports on technical vulnerability assessments of EPA's network.
[63] EPA OIG, *EPA Has Taken Steps to Address Cyber Threats but Key Actions Remain Incomplete, Allocation of Controls Based on Enterprise Security Architecture*, Report No. 11-P-0277, June 23, 2011.
[64] Memorandum from EPA Assistant Administrator for Environmental Information to EPA Inspector General, Subject: OEI [Office of Environmental Information] Corrective Action Plan for OIG Audit: 11-P-0277, *EPA Has Taken Steps to Address Cyber Threats but Key Actions Remain Incomplete*, September 26, 2011.
[65] EPA OEI, Powerpoint Presentation, *Dual ISO Designations*, presented at September 20, 2011, Quality and Information Council Meeting.

competencies of personnel with significant information security responsibilities.[66] As implementers of the Agency's information security program, ISOs as well as others with significant security responsibility are key to ensuring that risk mitigation processes are carried out as prescribed by organizational policy. As results of this audit become available, the Agency should take steps to close any identified gaps within its information security program.

Increasing User Awareness: Our on-going analysis notes that EPA has made great strides in ensuring user awareness of security threats and establishing the organizational processes for reporting security incidents. EPA officials cited the new awareness videos that have appeared on the Agency's Intranet as one of the many actions taken and outlined other key actions planned to increase users' exposure to awareness information. As cyber-attacks become more advanced and targeted, it is vital that EPA officials continue their efforts to promote personal responsibility and influence positive behavioral changes throughout its user population. As such, management should commit itself to completing plans to establish rotating awareness messages displayed on the EPA Intranet home page and work to conduct social engineering tests for users. This would help to ensure that all personnel, regardless of their specific job responsibilities, know how to apply information security basics necessary to protect vital Agency information.

Improving the Overall Information Security Program: In the broader context of its information security program, EPA officials indicated that they have begun steps to strengthen the Agency risk management governance by: (1) providing EPA executive reports on system authorizations and plans of actions and milestones in order to elevate the level of review and awareness of system statuses; (2) transitioning to conducting third party control assessments annually, with all Agency systems expected to be on this cycle by the end of FY 2014; and (3) defining an enterprise level risk management process and taking steps to implement a Risk Executive Board to ensure acceptable and cost effective system authorizations. While we are encouraged by management efforts in these critical areas, our ongoing analysis disclosed that a significant amount of the data reported under these new processes derive from an EPA information source that is unreliable for assessing the Agency's information security program. Our audit work disclosed that unsubstantiated responses for self-reported information contribute to data quality problems and that EPA conducts limited independent reviews or follow-up to correct data inaccuracies.[67] EPA indicated it would not remediate the report's recommendations until the first quarter of 2013.[68] Without taking steps to improve data used in EPA's risk management program, it is doubtful that senior executives would be provided sufficient, reliable information to make informed decisions over system authorizations.

As a continuation of this management challenge from last year, EPA leadership must continue to meet this challenge head-on by sufficiently funding the development of a real time capability to identify and investigate attacks against EPA's computer and network systems. Not only is taking

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[66] EPA OIG Memorandum, *Notification Memorandum for Project No. OMS-FY12-0006, Assessment of the Qualifications of Environmental Protection Agency Personnel with Significant Security Responsibilities*, February 15, 2012.
[67] EPA OIG, *Self-reported Data Unreliable for Assessing EPA's Computer Security Program*, Report No. 10-P-0058, February 2, 2010.
[68] EPA OEI, Memorandum, *Request for Extension of Corrective Action*, January 31, 2012.

steps to address these issues paramount, but EPA must ensure it establishes a robust cyber security program that is adaptive to the myriad challenges facing the Agency. Whether it is integrating smartcards into the operating environment, providing secure access to network resources as agencies expand the use of unscheduled flexiplace, or the securing of the new types of smart devices provided to Agency employees, these various access points, from sometimes unknown origins, provide multiple potential gateways into the Agency's network. Until EPA moves beyond deploying tools to being able to use the generated information for effective decision-making and risk management, the Agency will continue to be at risk as cyber-attacks grow in sophistication and persistency.

EPA's Framework for Assessing and Managing Chemical Risks

In 1976, Congress passed the Toxic Substances Control Act (TSCA), authorizing EPA to collect information on, and to regulate the production and distribution of, chemicals. TSCA required EPA to (1) create an inventory of "existing chemicals" already in commerce, (2) regulate unreasonable risk from "new chemicals" introduced into commerce subsequent to the act, and (3) make health and safety information available for examination while protecting manufacturers' confidential business information. The TSCA inventory of chemicals in commerce now exceeds 84,000 chemicals.[69] Periodic TSCA chemical data reporting indicates that there are approximately 7,000 chemicals currently produced at volumes of 25,000 pounds or greater. Under TSCA, EPA is charged with the responsibility of assessing the safety of these commercial chemicals and acting upon those chemicals if there are significant risks to human health or the environment. EPA believes that this significant and long-term challenge can best be met via legislative reform of TSCA to improve EPA's chemical management authorities. However, until reform is achieved, EPA's responsibility to create a sustained and effective existing chemicals program must be carried out under current authorities. Given the vast number of chemicals, the high cost to EPA of performing comprehensive risk assessments, the need for risk management, and the Agency's responsibility to protect human health and the environment, EPA has developed the following multi-pronged approach for its existing chemicals management program:

1) Risk assessment and risk reduction
2) Data collection and screening
3) Public access to chemical data and information

The Agency intends to perform risk assessments and, if appropriate, risk management for those chemicals with well-characterized hazard concerns and which present the possibility of significant exposure. These are likely to be a relatively small number of chemicals, compared to the size of the universe of commercial chemicals. While risk assessments are being conducted for this small group of chemicals, EPA will be developing an approach to screen the thousands of other compounds to determine which ones warrant further attention, which could include comprehensive risk assessments or additional data development addressing either hazard or exposure. Many chemicals will likely be judged as being of lower concern. Finally, EPA will work toward making chemical information available. In particular, the Agency will work to ensure that hazard and exposure data are available to the public in a manner that is most useful to those who will be using the information. Taking this approach to address multiple aspects of the

[69] EPA, TSCA Chemical Substance Inventory "Basic Information" website – "Background" link.

chemicals management challenge simultaneously should allow the Agency to be more comprehensive in its efforts despite the large number of high-production chemicals.

In the absence of new legislation, we found that EPA could better manage existing authorities. In 2010, we published a report on the New Chemicals Program that showed that EPA did not have integrated procedures and measures in place to ensure that new chemicals do not pose an unreasonable risk to human health and the environment.[70] We recommended that EPA better coordinate risk assessment and oversight activities by establishing a management plan that contains new goals and measures that demonstrate the results of EPA actions. Additionally, we recommended that EPA establish criteria for selecting chemicals or classes of chemicals for low-level exposure and cumulative risk assessments, and develop confidential business information classification criteria to improve EPA's transparency and information sharing. Finally, we recommended that EPA develop a management plan for Core TSCA enforcement that includes training, consistent enforcement strategies across regions for monitoring and inspection protocols, and a list of manufacturers and importers of chemicals for strategic targeting. The Agency agreed with our recommendations, and in November 2010 we accepted the Agency's corrective action plan outlining the steps it intends to take to address our recommendations.

In 2011, we continued to identify challenges to EPA's ability to assess and manage chemical risks. When we evaluated how effectively EPA manages the human health and environmental risks of nanomaterials, we found that it does not currently have sufficient information or processes to effectively manage human health and environmental risks. Though EPA has the statutory authority to regulate nanomaterials, it lacks the environmental and human health exposure and toxicological data to do so effectively. EPA has proposed mandatory reporting rules for nanomaterials under the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) and is also developing proposed rules under TSCA. After we found that EPA lacked a formal process to coordinate the dissemination and utilization of the potentially mandated information, the Agency agreed to our recommendation to establish a process.

This past year we also evaluated EPA's efforts to identify and manage the unique chemical risks to children. Specifically, we evaluated whether the outcomes of EPA's Voluntary Children's Chemical Evaluation Program (VCCEP) met its original goal and the goals outlined under the Chemical Right-to-Know Initiative.[71] The goal of the initiative was to give citizens information on the effects of chemicals to enable them to make informed choices in the home and marketplace. The initiative directed EPA to undertake testing of chemicals to which children are disproportionately exposed. EPA accordingly established the VCCEP pilot. We found that the VCCEP pilot did not achieve its goals to design a process to assess and report on the safety of chemicals to children. The pilot's design did not allow for desired outcomes to be produced. Specifically, the pilot had a flawed chemical selection process and lacked an effective communication strategy. Programmatic effectiveness was hampered by industry partners who chose not to voluntarily collect and submit information, and EPA's decision not to exercise its regulatory authorities under TSCA to compel data collection. EPA has not demonstrated that it can achieve children's health goals with a voluntary program.

[70] EPA OIG, *EPA Needs a Coordinated Plan to Oversee Its Toxic Substances Control Act Responsibilities*, Report No. 10-P-0066, February 17, 2010.
[71] EPA OIG, *EPA's Voluntary Chemical Evaluation Program Did Not Achieve Children's Health Protection Goals*, Report No. 11-P-0379, July 21, 2011.

As we concluded in previous years, EPA's framework for assessing and managing chemical risks has not yet achieved the goal of protecting human health and the environment.[72] EPA's effectiveness in assessing and managing chemical risks is hampered in part by limitations on the Agency's authority to regulate chemicals under TSCA. When TSCA was enacted, it authorized the manufacture and use, without any evaluation, of all chemicals that were produced for commercial purposes in 1976 or earlier years. Thus, manufacturers of these grandfathered chemicals were not required to develop and produce data on toxicity and exposure, which are needed to properly and fully assess potential risks. Further compounding this problem, the statute never provided adequate authority for EPA to evaluate existing chemicals as new concerns arose or as new scientific information became available. As enforcement is critical to ensuring environmental protection, while TSCA authorizes EPA to conduct inspections, issue subpoenas, and impose civil penalties for violations, the statute lacks the broad information-gathering and enforcement provisions found in other major environmental protection statutes. For example, TSCA does not provide EPA the administrative authority to seek injunctive relief, issue administrative orders, collect samples, and quarantine and release chemical stocks.

EPA's framework for assessing and managing chemical risks from endocrine disruptors is also failing to show results. In August 1996, Congress passed both the Food Quality Protection Act[73] and amendments to the Safe Drinking Water Act,[74] calling for the screening and testing of chemicals and pesticides for possible endocrine-disrupting effects (i.e., adverse effects on the development of the brain and nervous system, the growth and function of the reproductive system, and the metabolism and blood-sugar levels). EPA established the Endocrine Disruptor Screening Programin 1998 to use validated methods for the screening and testing of chemicals to identify potential endocrine disruptors. In 2000, EPA estimated that approximately 87,000 chemicals would need to be screened for potential endocrine-disrupting effects. As of February 25, 2010, EPA issued test orders to industry for 67 pesticide active ingredients and high-production volume chemicals with some pesticide inert uses. Thus, 14 years after the passage of the Food Quality Protection Act and amendments to the Safe Drinking Water Act, EPA has yet to regulate the endocrine-disrupting effects of any chemicals.[75]

We continue to evaluate EPA tools, procedures, and practices for assessing and managing chemical risks. One current effort includes reviewing EPA's use of the Integrated Risk Information System (IRIS). The objective is to determine how EPA program offices and regions utilize IRIS in their work and products.[76] We are also evaluating management of EPA's TSCA and FIFRA enforcement tools to determine whether the intended outcomes are efficiently and effectively achieved.[77] Given our completed and ongoing work, coupled with the significance of this issue, we believe this issue warrants being retained as an Agency management challenge.

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[72] EPA OIG, EPA's Key Management Challenges in 2010 and 2011.
[73] EPA, "Pesticides – Regulating Pesticides" website, background on the Food Quality Protection Act of 1996.
[74] EPA, "Water – Safe Drinking Water Act" website, background on the Safe Drinking Water Act Amendments of 1996.
[75] EPA OIG, *EPA's Endocrine Disruptor Screening Program Should Establish Management Controls to Ensure More Timely Results*, Report No.11-P-0215, May 3, 2011.
[76] EPA OIG, *Congressional Inquiry Regarding EPA's Integrated Risk Information System*, Project No. OPE-FY12-2734.
[77] EPA OIG, *Evaluation of Penalties for FIFRA and TSCA*, Project No. OPE-FY11-0018.

Workforce Planning

In 2002, EPA acknowledged human capital as an Agency internal control weakness in part due to requirements released under the President's Management Agenda[78] and audit findings that identified significant concerns with EPA's management of human capital.[79] Since that time, EPA developed a number of strategic documents to direct its human capital efforts focusing on the skills, competencies, and occupations needed to carry out its mission.[80] While knowing the required skills and competencies is useful, EPA has not developed analytical methods, nor does it collect data needed, to measure its workload and the corresponding workforce levels necessary to carry out that workload. In 2008, EPA removed human capital from the list of Agency weaknesses and added the more specific topic of Workforce Planning as an Office of the Chief Financial Officer (OCFO) office-level weakness. Both our office and GAO have recommended in previous reports that EPA strengthen internal controls—policies, procedures, and methods—for workforce planning. However, the need for systematic Agency-wide analysis of workload and workforce levels is broader than OCFO and impacts the ability of EPA programs to efficiently and effectively carry out their mission. For example, EPA's December 2008 report on future Superfund workload needs states that the "post-construction" workload will require the greatest increase in coming years and will increase by 89 percent over the current full-time equivalent distribution.[81] Due to the broad implications of workforce planning on accomplishing EPA's mission, we are including it as an Agency management challenge for 2012.

In December 2010, we reported that EPA did not have controls or a defined methodology to determine workforce levels based upon the workload of the Agency.[82] EPA's OCFO establishes budget workforce levels based on the prior year's levels and proposed funding levels. EPA's program and regional offices are not conducting systematic workload analysis or identifying workforce needs for budget justification purposes and have not done so in over 20 years.

In 2011, we reported[83] that EPA does not require program offices to collect and maintain workload data, and the programs do not have databases or cost accounting systems in place to collect data on time spent on specific mission-related outputs. Without such data, program offices are limited in their ability to analyze their workload and justify resource needs.

GAO also reported that EPA's process for budgeting and allocating resources does not fully consider the Agency's current workload. In March 2010, GAO reported that it has brought this issue to the attention of EPA officials in successive reports in 2001, 2005, 2008, and 2009.[84] In response, EPA stated that it recognized the need to improve its ability to understand and quantify

[78] EPA, *EPA Strategic Alignment – Human Capital Planning*, January 3, 2008, page 1.
[79] EPA, OCFO, *2007 Performance Accountability Report*, pages 205-06.
[80] EPA, *EPA Strategic Alignment – Human Capital Planning, Green Summary*, January 3, 2008, page 1.
[81] EPA, *Superfund Workload Assessment Report*, OSWER Document 9200-2-81, December 2, 2008.
Post-construction workload can refer to all activities after a cleanup remedy is constructed (including long-term monitoring and reuse activities).
[82] EPA OIG, *EPA Needs to Strengthen Internal Controls for Determining Workforce Levels*, Report No. 11-P-0031, December 20, 2010.
[83] EPA OIG, *EPA Needs Workload Data to Better Justify Future Workforce Levels*, Report No. 11-P-0630, September 14, 2011.
[84] GAO, *Workforce Planning: Interior, EPA, and the Forest Service Should Strengthen Linkages to Their Strategic Plans and Improve Evaluation*, GAO-10-413, March 31, 2010, page 19.

the relative workload of its component organizations and to make allocation decisions based on those assessments. EPA said that it was committed to improving its analytical capabilities and examining appropriate measures of workload to support the resource allocation process.

In February 2010, we reported that EPA does not enforce a coherent program of position management to assure the efficient and effective use of its available workforce.[85] Without an Agency-wide position management program, EPA leadership lacks reasonable assurance that it is using personnel in an effective and efficient manner to achieve mission results. For example, in our report issued in 2011,[86] we found that EPA's Office of Enforcement and Compliance Assurance (OECA) is constrained from actively managing its resources to direct them to the most important state enforcement problems. Under the current resource planning structure, EPA regions divide their resources among several enforcement priorities, including state oversight. If EPA regions report that they are having problems with state enforcement, OECA cannot reallocate FTEs among regions to address the problems because OECA does not control enforcement resources in the regions. Therefore, priority enforcement issues may not receive needed resources.

Since 2005, various EPA offices have attempted to assess their workloads. EPA paid contractors nearly $3 million, but EPA generally did not take action or widely share the results of these efforts. For example, in 2006, OCFO awarded a contract to gather information on methods that other government agencies used to assess workload and staffing needs, identify their advantages and disadvantages, and gauge their relevance to EPA. EPA planned to use this information to develop methods for assessing staffing in relation to workload, validate current levels, and identify areas of concern, as well as explore alternative ways to assess and benchmark staffing levels against workload shifts. The results of the analysis showed that there were not significant similarities among agencies. The contractor recommended that OCFO develop its own approach for assessing and adjusting workforce allocation to align with workload. Various offices within EPA conducted other studies. In 2009, OCFO awarded another contract to conduct a workload assessment to assist EPA in exploring ways to better assess and benchmark current staff levels against workload shifts. The analysis targeted key functions that EPA shares with other federal agencies, such as (1) regulatory development, (2) scientific research, (3) enforcement, (4) financial management, (5) environmental monitoring, and (6) permitting. The contractor completed this most recent effort in September 2011.

In April 2012, EPA issued a report[87] that highlights fundamental changes EPA is planning to develop a more robust civil rights program. One of the key recommendations from this effort was developing a staffing plan for Agency civil rights functions. The recommendation calls for the same types of workforce actions we have been encouraging the Agency to undertake, including:

- Identifying the essential functions based upon data
- Determining the skills and numbers of employees to carry out those functions
- Developing a staffing plan
- Requesting needed FTEs/resources through the budget process

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[85] EPA OIG, *EPA Needs Better Agency-Wide Controls over Staff Resources*, Report No. 11-P-0136, February 22, 2011.
[86] EPA OIG, *EPA Must Improve Oversight of State Enforcement*, Report No. 12-P-0113, December 9, 2011.
[87] EPA, *Developing a Model Civil Rights Program for the Environmental Protection Agency*, Final Report, Civil Rights Executive Committee, April 13, 2012.

While this process is just getting underway, we believe it is a step in the right direction.

EPA has recently developed draft tools and circulated these tools among Agency subject matter experts for input and feedback. The tools will subsequently be circulated for senior management review. EPA is also in the process of developing options for implementing workforce planning but has yet to implement workforce analysis Agency-wide. EPA's ability to assess its workload and accurately estimate workforce levels necessary to carry out that workload is critically important to mission accomplishment. Given the significance of this issue and the need for progress Agency-wide, we have elevated workforce planning from an internal control weakness to an Agency management challenge.

Challenge #1 – Oversight of Delegations to State

Agency Response: EPA acknowledges that state oversight is a very complex and changeable arena. Through federal statutes, implementing regulations, and program design, states are allowed flexibility in how they manage and implement environmental programs. Within EPA, national program managers are directly responsible for state oversight of individual programs. The Agency has committees, workgroups, special projects, and initiatives to continuously improve Agency programs delegated to states.

In FY 2012, the Agency identified the oversight of state delegations as a strategic priority and developed a key performance indicator (KPI) in the FY 2012 Action Plan for Strengthening State, Tribal, and International Partnerships. Specifically, the KPI requires EPA to establish an Agencywide workgroup (national program managers, regions, and HQ support offices) to plan and implement an Agencywide effort to collect available information to define, describe, and assess EPA's processes, practices, and tools for overseeing state delegations and authorizations. The workgroup will report its findings to the Deputy Administrator and propose options for next steps, as needed, to ensure that the Agency is carrying out its oversight responsibilities in a coordinated, transparent, and accountable manner. The Agency believes establishing a KPI for state oversight will help sustain senior management attention and is a strategic and coordinated approach to address the issue.

Challenge #2 – Safe Reuse of Contaminated Sites

Agency Response: Cleaning up contaminated sites and ensuring their safe reuse over the long term is an Agency priority and central to EPA's mission. EPA and state and tribal response programs continue to make progress in cleaning sites to protect public health and the environment and support the safe use of cleaned and stabilized properties. The Agency believes that it is communicating site risks and remedies and information needed to ensure protectiveness.

Whenever waste is left in place at sites on the National Priorities List, the Comprehensive Environmental Response, Compensation and Liability Act requires that the remedy at the site be reviewed at least once every five years to ensure its continued protectiveness. EPA's national Superfund program reviews five-year reports at all sites and tracks any recommendations for necessary further action to ensure implementation.

EPA and our state and tribal co-implementers may select institutional controls to control land and resource use where residual contamination remains in place. Institutional controls (ICs) help minimize the potential for exposure to contamination and/or protect the integrity of engineered components. As remedial actions, ICs are subject to five-year reviews as well as other periodic monitoring. The Agency has developed cross-program guidance, *Institutional Controls: A Guide to Planning, Implementing, Maintaining and Enforcing Institutional Controls at Contaminated Waste Sites,* which stresses the need for EPA site managers and attorneys to coordinate with tribes, state and local governments, communities, and other stakeholders to ensure that ICs are properly implemented, maintained, and enforced over their lifetime. The Agency will continue to encourage state and tribal response program funding of tracking and management systems for land use and institutional controls.

The Agency has developed general education and outreach materials about institutional controls and their importance in supporting safe land reuse. EPA continues to include training sessions on institutional controls, as well as panel discussions between local government and state programs, as part of its national brownfields conference. EPA will also continue to develop and maintain information systems like "Cleanups in My Community" (http://www.epa.gov/cimc) to educate and inform the public regarding federally funded contaminated site assessment and cleanup activities.

Promoting reuse involves communities in cleanup and reuse discussions. EPA will continue to explore new tools to ensure appropriate reuse and enhance long-term protectiveness, including:

- *Ready for Reuse Determinations* (environmental status reports on site reuse)

- *Comfort and Status Letters* (which convey status of the site remediation and liability issues)

- *EPA Funded Reuse Planning* (which helps ensure sites are put into productive use after cleanup)

- *Site Reuse Fact Sheets* (which highlight critical remedial components in place, long-term maintenance activities, and institutional controls)

Challenge #3 – Limited Capability to Respond to Cyber Security Attacks

Agency Response: EPA acknowledges that advanced persistent threats pose a significant challenge to itself and to all federal agencies. Many of the OIG's concerns and assertions are based on an audit report that has not been released to the Agency and proposed legislation that has cleared neither the Senate nor the House of Representatives.

EPA continues to make significant progress toward enhancing situational awareness across the Agency and increasing visibility into network activities. EPA continues to build strong alliances with other Agency partners, as well as coordinating internally.

Challenge #4 – EPA's Framework for Assessing and Managing Chemical Risks

Agency Response: The GAO continues to identify "Transforming EPA's Processes for Assessing and Controlling Chemicals" as a high-risk area, and the OIG continues to identify "EPA's Framework for Assessing and Managing Chemical Risks" as a management challenge. In October 2009, EPA acknowledged "Streamlining Chemical Assessments Under IRIS" as an Agency-level weakness under FMFIA and has made progress in addressing concerns raised by both oversight organizations.

<u>Improving IRIS.</u> In May 2009, the Agency released a new IRIS process for completing health assessments. The goals of the new process are to strengthen program management, increase transparency, and expedite the timeliness of health assessments. Since then, the Agency's National Center for Environmental Assessment has completed over 20 assessments, more than the number of assessments completed in the previous five years. Key major assessments recently posted include trichloroethylene and dichloromethane.

The Agency is making significant progress on health hazard assessments of numerous high-priority chemicals (i.e., trichloroethylene, perchloroethylene, dichloromethane, chromium VI, methanol, benzo[a]pyrene, and Libby asbestos), including the completion of milestones for interagency science consultation, external review, or posting on the IRIS website. Progress on these assessments and other IRIS assessments is available at http://www.epa.gov/IRIS/. In addition, EPA's IRIS program is developing assessments of health effects for chemicals found in environmental mixtures, including PAHs, dioxins, phthalates, and PCBs. These cumulative assessments will increase the number of chemicals that are addressed by IRIS and are based on the expressed needs of the Agency. The Human Health Risk Assessment Program will continue to lead innovation in risk assessment science based on expanding scientific knowledge.

EPA continues to implement the new database that facilitates public access to the scientific studies that underpin key regulatory decisions. The Health and Environmental Research Online database contains the key studies that EPA uses to develop environmental risk assessments and makes them available to the public. It includes references and data supporting IRIS, which supports critical Agency policymaking for chemical regulation. Draft IRIS assessments now routinely include HERO links and cited references. The HERO database is publicly accessible, so anyone can review the scientific literature behind EPA's science assessments. The HERO database strengthens the transparency of the science supporting Agency decisions.

Assessing and Managing Chemical Risks. EPA has taken a number of steps over the past several years to strengthen related programs within existing authorities. The Agency has announced its principles to strengthen U.S. chemical management laws, initiated a comprehensive effort to enhance its current chemical management program within the limits of existing authorities, and is proposing an expansion of that effort in the FY 2013 President's Budget. (A listing of the principles is available at http://www.epa.gov/oppt/existingchemicals/pubs/principles.html.) This new approach was introduced in EPA's *FY 2011–2015 Strategic Plan* and further developed and implemented during FY 2010 and FY 2011. In February 2012, EPA issued its Existing Chemicals Program Strategy, explaining that the Agency intends to pursue a multi-pronged approach focusing on risk assessment and risk reduction, data collection, and screening, and furthering public access to chemical data and information. (See http://www.epa.gov/oppt/existingchemicals/pubs/Existing_Chemicals_Strategy_Web.2-23-12.pdf.)

As part of this effort, EPA identified a group of TSCA Work Plan Chemicals for risk assessment to help focus and direct the activities of the Existing Chemicals Program over the next several years (http://www.epa.gov/oppt/existingchemicals/pubs/workplans.html). These activities are supported by EPA's FY 2013 budget request, which will allow the Agency to sustain its success in managing the potential risks of new chemicals entering commerce and to continue making substantial progress in assessing and ensuring the safety of existing chemicals.

In addition, in FY 2013, EPA will continue preventing the entry into the U.S. market of chemicals that pose unreasonable risks to human health or the environment. Each year, EPA's New Chemicals Program reviews and manages the potential risks from approximately 1,000 new chemicals, products of biotechnology, and chemical nanoscale materials prior to their entry into the marketplace.

Endocrine Disruptor Screening Program (EDSP) Comprehensive Management Plan. More recently, in response to the OIG's May 2011 evaluation report, "*EPA's Endocrine Disruptor Screening Program Should Establish Management Controls to Ensure More Timely Results,*" on June 28, 2012, the Agency issued its EDSP Comprehensive Management Plan (www.epa.gov/endo). The EDSP management plan describes a three-part plan for implementing the EDSP: 1) scientific advancement of Tier 1 data reviews and Tier 2 assay development and validation (including advancing the state of the science in chemical priority setting and screening); 2) test order management and implementation, including prioritizing chemicals, developing policies and procedures, and issuing and managing test orders; and 3) data management by developing an enhanced and consolidated information infrastructure.

Challenge #5 – Workforce Planning

Agency Response: Examining EPA's workforce to improve the Agency's resource planning is a broad and lengthy process requiring extensive reporting and analysis. EPA continually reviews how to maximize the productivity of its limited staff and other resources. As part of its annual budget process, EPA plans and tracks the use of resources at a detailed level in terms of organization and media and by strategic planning goals. These data are analyzed to inform the relative allocation of resources, staffing, and funding. EPA complements these management and planning efforts and data by strengthening both workforce planning (Agency-led research into the type of staff and skills needed) and workload analytics (Agency-led efforts to understand and calculate the level of staffing needed for particular tasks). In both these efforts, the lead program offices worked extensively with experts in all the Agency's program offices.

In FY 2010, the Agency surveyed more than 1,000 managers to capture their best estimates of their unit levels of work required to complete six critical functions (scientific research, environmental monitoring, regulatory development, permitting, enforcement, and financial management) as well as major tasks within each function, work drivers, and products. In FY 2011, the Agency benchmarked workload analytical efforts of 23 other federal agencies. In FY 2012, the Agency led a collaborative workforce planning initiative that focused on identifying the critical occupations required to meet current and future mission objectives. Each program/regional office linked its occupations to *Strategic Plan* goals and projected occupational shifts through FY 2015. This information was used to 1) analyze future gaps, 2) plan for projected growth in scientific and specialized technical occupations and projected reductions in unspecialized and administrative roles, 3) develop position management options, and 4) design strategies to recruit for needed skills and develop these skills internally (e.g., training, succession planning). Additionally, in FY 2012, the Agency developed mid-level workload analyses for the air and water permitting programs and is working to develop one for Superfund cost recovery. This work has created a process and template for EPA to perform additional analyses.

PROGRESS IN ADDRESSING FY 2012 WEAKNESSES AND SIGNIFICANT DEFICIENCIES

In FY 2012, EPA continued to address its Agency-level internal control weaknesses and significant deficiencies. This section discusses the weaknesses and significant deficiencies EPA resolved in FY 2012, as well as those that are new or for which corrective actions are still underway.

Material Weaknesses

Compass System Limitations

The OIG identified the material weakness, "Compass System Limitations are a Material Weakness to EPA's Accounting Operations and Internal Controls," in their FY 2012 Financial Statement Audit. In its report, the OIG stated that when the agency converted its accounting system, it had not yet developed all the reports and functions required to generate all the information it needs. The EPA disagrees with this conclusion.

For much of FY 2012, EPA was in the midst of learning the intricacies of the new system, including reporting and business process changes, necessary to effectively utilize the new Compass Financials system. The Agency undertook an aggressive effort to identify, prioritize and resolve issues and modify business processes.

By the end of FY 2012, the vast majority of system implementation issues, including those that could materially impact the financial statements, were resolved. The agency will continue to analyze the agency's financial reports and business processes, identify any concerns and develop or improve reports or modify business processes as needed.

FY 2012 Weaknesses and Significant Deficiencies

Material Weaknesses

1. *Compass System Limitations*/***

Agency Weaknesses

1. *Strengthening the Agency's Implementation of FMFIA**
2. *Permit Compliance System*
3. *Streamlining EPA's Process for Developing Chemical Assessments Under IRIS*
4. *Electronic Content Management*

Significant Deficiencies

1. *Reconciling Unearned Revenue for Superfund State Contract Costs**
2. *Collectability of Federal Receivables**
3. *Headquarters Personal Property Controls*
4. *EPA Double Counted Contractor-Held Property*
5. *Federal Reimbursable Costs Not Billed Timely*
6. *EPA Is Withholding Payments Related to Deepwater Horizon Oil Spill Cleanup**
7. *EPA Recognized Earned Revenue in Excess of Expenditures**
8. *Accounts Receivable Detail Not Provided Timely By Regions*
9. *Posting Models in Compass Materially Misstated GL Activities and Balances** (mw)*
10. *Compass Reporting Limitations Impair Accounting Operations and Internal Controls** (mw)*
11. *EPA Should Improve Controls Over Expense Accrual Reversals** (mw)*
12. *Compass System Limitations Impair Internal Controls of Financial Operations** (mw)*
13. *EPA Should Improve Compliance With Internal Controls for Accounts Receivable***
14. *EPA Is Not Clearing Fund Balance With Treasury Statement of Differences Timely***
15. *Property Internal Controls Need Improvement***
16. *Compass and Maximo Cannot Be Reconciled***
17. *EPA Needs to Remediate System Vulnerabilities That Place Financial Data at Risk***
18. *OCFO Financial Systems Security Documentation Needs Improvement***

** All corrective actions were completed in FY 2012*
*** Items identified as new in FY 2012*
(mw) Contributed to new material weakness in FY 2012

Agency Weaknesses

Strengthening the Agency's Implementation of the Federal Managers' Financial Integrity Act (FMFIA)

In FY 2009, EPA declared *Strengthening the Agency's Implementation of FMFIA* as an Agency-level weakness. The Office of Inspector General believed that the Agency's management integrity guidance for FY 2008 and FY 2009 did not require adequate reporting on compliance with all five of the Government Accountability Office's (GAO's) "Standards for Internal Control in the Federal Government," as referenced in *OMB Circular A-123*.

The Agency has taken steps to strengthen its FMFIA process and address OIG concerns. Specifically, the Agency has:

- *Enhanced senior management engagement.* The Administrator (in February 2010) and Deputy Administrator (in January 2011and February 2012) issued "kickoff" messages to senior managers calling attention to the FMFIA program, emphasizing the importance of maintaining effective internal controls over programmatic operations and financial activities, and clarifying expectations for senior leadership personal oversight and accountability.

- *Completed onsite compliance reviews in all regions and national program offices.* This comprehensive three-year effort involved FMFIA presentations, face-to-face interviews with senior managers/staff, and information exchanges on current practices and opportunities for improvement. The reviews provided training opportunities for Management Integrity Advisors and program managers and resulted in Agency questions, concerns, and best practices, which the Agency used to develop its FY 2010, 2011, and 2012 management integrity guidance.

- *Improved technical guidance.* In March 2010, the Agency issued new technical guidance to senior resource officials to ensure compliance with the five GAO standards and to help establish a solid foundation for reviewing internal controls over program operations and preparing Assistant Administrator (AA) and Regional Administrator (RA) annual assurance letters to the Administrator. The guidance included templates for developing program review strategies (which require reporting on all five GAO standards) and multiyear review plans. FY 2011 and FY 2012 management integrity guidance built on that foundation and further clarified national program versus regional office roles and responsibilities for conducting reviews and assessing internal controls over programmatic operations.

- *Instituted mandatory training.* In March 2011, the Agency delivered new online mandatory FMFIA training for Agency senior managers and for all Management Integrity Advisors. More than 2,000 individuals—100 percent of those required to take the training—completed the course. In response to Agency feedback, the online training was updated in FY 2012 to include a new risk assessment module. AAs and RAs certified in their FY 2011 and 2012 annual assurance letters that appropriate managers/staff completed the training.

- *Strengthened communication.* The Agency revised and improved its management integrity intranet site to provide tools and materials for MIAs and Agency staff, and developed a new wiki site to facilitate communication between MIAs and the Agency's Management Integrity Team. In March 2011, EPA held a training workshop for Agency MIAs to enhance their knowledge of internal controls, risk assessment, and the Agency's management integrity program.

The Agency has completed all corrective actions in response to the OIG's 2009 Early Warning Report recommendations. With contractor support, the Agency validated changes/improvements in EPA's implementation of FMFIA based on data gathered and assessed through the program compliance reviews and applying a policy compliance verification tool. The Agency will continue to analyze regional and program offices’ FY 2010, FY 2011, and FY 2012 assurance letters to assess progress and ensure that statements on the effectiveness of controls over programmatic and financial operations are adequately supported and documented. In particular, the Agency is developing an inventory of and database tool for the Agency’s program review strategies and multiyear plans to enable review and analysis in FY2013 and beyond, and to facilitate effective communications between national programs and regions. The Agency will also use reviews conducted by OIG and other oversight agencies, as appropriate, to determine the effectiveness of corrective actions.

The Agency intends to continue conducting program compliance reviews in national program and regional offices to assess Agency FMFIA implementation and the needs for guidance, training, and other tools and assistance. In addition, EPA will update online training periodically and establish a mandatory training schedule.

With contractor support, the Agency gathered data (through its program compliance reviews) and applied a policy compliance verification tool that validated changes/improvements in the Agency's implementation of FMFIA and progress toward strengthening the FMFIA process. The Agency will continue to analyze regional and program offices' FY 2010, FY 2011, and FY 2012 assurance letters to assess progress and ensure that statements on the effectiveness of controls over programmatic and financial operations are adequately supported and documented. In particular, the Agency is developing an inventory and database tool of the Agency's Program Review Strategies and multiyear plans to enable review and analysis in FY 2012 and beyond, and to facilitate effective communications between national programs and regions. The Agency will also use reviews conducted by the OIG and other oversight agencies, as appropriate, to determine the effectiveness of corrective actions.

Permit Compliance System (PCS)

In FY 1999, EPA declared PCS as an Agency-level weakness. The weakness focuses on the need for EPA to revitalize or replace PCS to provide an information system that both the states and EPA can use to ensure complete and accurate National Pollutant Discharge Elimination System (NPDES) permit and discharge data.

Although EPA has now developed and successfully implemented a modern, national information system designed to meet the needs of today's NPDES permitting and enforcement program, not all the states have been migrated from PCS to the new system, Integrated Compliance Information System (ICIS). Currently, 35 states, two tribes, eight territories, and the District of Columbia are using the new system. That leaves 15 states remaining to be migrated to ICIS, all of which are authorized to manage the NPDES program. The plan is to complete the modernization of PCS and migrate those 15 states from PCS to ICIS in FY 2013.

In FY 2012, the Agency implemented the second release of the full batch component of ICIS. The development of the second release of the “full batch” component of ICIS allows for the electronic submission of NPDES inspection data from state systems to ICIS via the National Environmental Information Exchange Network and CDX. One additional state was migrated and incorporated into ICIS in a March 2012 “full batch” release. Specific actions taken in FY 2012 include:

- Implemented Wave 2 of ICIS-NPDES Full Batch (electronic reporting of NPDES inspection data from states to ICIS-NPDES) functionality.
- Migrated Delaware to ICIS-NPDWES from PCS
- Completed Software Development for Wave 3 of ICIS-NPDES Full Batch functionality.
- Began functional and integration testing of Wave 3 of ICIS-NPDES Full Batch functionality.

- Continued work with remaining 15 PCS Wave 3 states to meet their data threshold for data migration from Legacy PCS to ICIS-NPDES.

- Began user validation and acceptance testing for Wave 3 of ICIS-NPDES Full Batch functionality.

The closure date for this Agency-level weakness is projected to be the end of fourth quarter FY 2013. This completion date is based on various assumptions and estimates.[1]

Streamlining EPA's Process for Developing Chemical Assessments Under IRIS

In FY 2009, EPA declared *Streamlining EPA's Process for Developing Chemical Assessments Under Integrated Risk Information System (IRIS)* as an Agency-level weakness. GAO identified "Transforming EPA's Processes for Assessing and Controlling Toxic Chemicals" as a high-risk area in its January 2009 High-Risk Series. In its report, GAO states that the Agency needs to take actions to increase the transparency of IRIS and enhance its ability under the Toxic Substances Control Act (TSCA) to obtain health and safety information from the chemical industry.

In May 2009, the Agency released a new IRIS process for completing health assessments. The goal of the new process is to strengthen program management, increase transparency, and expedite the timeliness of health assessments. Since that time, the Agency's National Center for Environmental Assessment has completed 16 assessments, more than the number of assessments completed in the previous three years. Additionally, the Agency is making significant progress on health hazard assessments of numerous high-priority chemicals (e.g. formaldehyde, trichloroethylene, perchloroethylene, dichloromethane, arsenic, chromium VI, methanol, benzo[a]pyrene and Libby asbestos), including the completion of milestones for interagency science consultation, external review, or posting on the IRIS Web page. Progress on these and other IRIS assessments is available at http://www.epa.gov/IRIS/. In addition, the Agency is developing assessments of health effects for chemicals found in environmental mixtures, including Polycyclic Aromatic Hydrocarbons (PAH), dioxins, phthalates, and Polychlorinated Biphenyls (PCB). These cumulative assessments will increase the number of chemicals that are addressed by IRIS and are based on the expressed needs of the Agency. EPA's Human Health Risk Assessment program will continue to lead innovation in risk assessment science based on expanding scientific knowledge.

EPA continues to implement the new database that facilitates public access to the scientific studies that underpin key Agency decisions. The Health Environmental Research Online database contains the key studies EPA uses to develop environmental risk assessments for the public. It includes references and data supporting IRIS, which supports critical Agency policymaking. The Healthy Environmental Research Online (HERO) database is publicly accessible, so anyone is able to review the scientific literature behind the EPA science assessments. The HERO database strengthens the transparency of the science supporting Agency decisions.

The Agency has asked the Science Advisory Board to develop an independent, standing subcommittee to review IRIS assessments, and it has contracted with the National Academy of Sciences to review the IRIS assessment development process. EPA will continue to track progress to determine if new timelines need adjustment. The closure date for this Agency-level weakness is projected to be FY 2015.

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[1] This completion date is based on various assumptions about the future and, therefore, any changes to the assumptions would impact the schedule. For FY 2012 and beyond, we assumed that annual funding will continue at $ 7.5 million. (If the President's budget level of only $6.7 continues in FY 2012 and beyond, the schedule would likely move several quarters into the future, with a shut down date for PCS delayed until FY 2014). Further, as with any project, extended timelines for completion add risk to the project, and predictions about when the project will be completed become more speculative.

Electronic Content Management

In FY 2009, the EPA declared Electronic Content Management at EPA as an Agency-level weakness. Although the Agency has a formal, structured, and vigorously managed records management program in place that has met past records management requirements, its roots can be found in traditional paper-based records management, maintenance, and access. The Agency's inconsistencies in how electronic content is stored, maintained, and assessed have started to have an impact on critical processes related to electronic records management.

To implement effective changes to content management practices within the Agency, corrective actions must be addressed enterprisewide. An enterprise approach will allow for integration with the Agency's lines of business and replace current piecemeal or ad hoc approaches. To accomplish this, the Agency is implementing a system for the effective management of its information assets that will include a governance structure for content management and the selection of enterprise tools, as well as the formulation of new policies for content management responsibilities and processes.

The Agency has taken the following corrective actions to address this weakness:

- Established a new Quality Information Council Electronic Content Subcommittee
- Developed a charter for the subcommittee
- Established two enterprisewide workgroups under the subcommittee
- Developed interim procedures to address the storage and preservation of electronically stored information.
- Launched two pilot projects to evaluate tools for eDiscovery and the management of email records. The results of the pilot projects will be used to inform the subcommittee's decisions on future policy or tool implementation.

The Agency will develop a validation strategy to assess the effectiveness of various activities undertaken to redress the identified weakness. The validation strategy will consist of processes that allow the Agency to review and determine whether policies and tools are being implemented and utilized. The closure date for this Agency-level weakness is projected to be FY 2013.

Significant Deficiencies

Improvement Needed in Billing Costs and Reconciling Unearned Revenue for Superfund State Contract Costs

During the FY 2009 Financial Statement Audit, the OIG identified as a material weakness the failure of EPA to properly review the calculations used to reconcile unearned revenue for Superfund State Contract (SSC) costs. To remedy the material weakness, the Agency improved accountability for the SSC contract requirements and site status information by researching transactions in older funds to determine validity, strengthening the review/verification process for reconciling Superfund site costs, and ensuring data and calculations used are consistent and properly supported. In FY 2010, based on the corrective actions taken, the issue was downgraded to a significant deficiency.

In FY 2011, the Agency continued to provide instructions to the regions for careful review of the "closed" sites and the steps necessary to complete the closure activity. Extra measures and verifications were taken to ensure that data entered on the spreadsheets were correctly transferred into the financial system. For instance, the review of the SSC spreadsheets was added to the FY 2011 regional review of internal controls over financial activities. The regional review process included ensuring that the spreadsheets were completed for all sites; that contract values and percentages were updated; and that credits were not only included, but were for the correct amounts.

As part of the quarterly SSC accrual process, the Agency continues to send requests to the regions emphasizing the need to review all sites they have listed as “closed” to make sure they are taking care of all actions. This includes, but is not limited to, billing a particular state for its share of the costs, adjusting the contract values and/or percentages, and reclassifying appropriated disbursements where applicable. The Agency includes language in its quarterly call for regional input into the spreadsheets to ensure billings are done in a timely manner.

The Agency has completed all corrective actions for this significant deficiency. The Agency will continue to review the SSC process as part of its review of internal controls over financial activities.

Assess Collectability of Federal Receivables and Record Any Needed Allowances for Doubtful Accounts

During the FY 2010 financial statement audit, the OIG found that EPA overstated federal accounts receivable by not establishing an allowance for doubtful accounts or processing write-off entries for uncollectable federal debt. This finding was largely related to several Superfund debts with the Department of the Army for their liability related to the Twin City Army Ammunition Dump sites, in which the OIG recommended that an allowance should be established. Historically, EPA has not established allowances for delinquent federal debts because it considered all federal debts to be collectible.

To remedy this significant deficiency, the Agency reviewed its open federal debts to ensure accurate status. Additionally, the Agency established new procedures to bill federal agencies in a timely manner and issued a new policy to address delinquent federal receivables, Resources Management Directives System, 2540-12- P1, *Intragovernmental Business Rules – Delinquent Federal Accounts Receivable.* In 2011, the Agency established an allowance for the delinquent Department of the Army debt for the Twin Cities Superfund sites. The debts were settled at a reduced amount in the fourth quarter of FY 2011, and the remaining balance, deemed uncollectable, was written off.

The Agency has completed all corrective actions for this significant deficiency. On an annual basis, the Agency will send requests for updates to collectability assessments on outstanding debts for the purpose of calculating the allowance for doubtful accounts.

Improvements Needed in Controls for Headquarters Personal Property

During the FY 2010 financial statement audit, the OIG identified improvements needed in the controls for EPA headquarters. The Agency acknowledged several significant challenges with tracking personal property in the headquarters accountable area.

To remedy this significant deficiency, the Agency developed mandatory training for all managers and supervisors that is being monitored and tracked by the Agency property management officer. In FY 2012, the Agency conducted “wall to wall” inventory and significantly reduced the unaccounted assets identified in 2010 and 2011 by more than 250 assets. Over the past two years, this process has recovered approximately 1,700 items representing an asset value exceeding $6 million. The Agency’s property management workgroup has analyzed and addressed current industry best practices to ensure that current business practices are reflected in the forthcoming revised policy and procedures manual.

The Agency anticipates that all remaining corrective actions for this significant deficiency will be completed in FY 2013.

EPA Double Counted Contractor-Held Property

During the FY 2011 Financial Statement Audit, the OIG stated that EPA double counted contractor-held property in its financial system because it did not remove from its financial system property that had been transferred to contractors.

To remedy this issue, EPA reviewed current policies and procedures and revised them as needed to ensure that the Agency addresses responsibilities for removing from its financial system property that is transferred to contractors. In FY 2012, the Agency has taken the following actions to address this deficiency:

- Completed 10 desk audits on contracts with contractor-held property to ensure property items assigned to the contract did not appear in the Agency's inventory. Property duplications identified were corrected.

- Developed draft guidance for inclusion in the Property Management Manual to reflect changes in the April 2, 2012 Federal Acquisition Regulations. The guidance will assist contracting officers and property managers in deciding whether property should be assigned to a contract or included in the Agency inventory.

- Conducted two webinars for contracting officers and property managers to review parameters for contractor-held property management.

The Agency will continue to perform desk audits during the fiscal year to ensure that contractor-held property is not being double reported and counted. The Agency anticipates that all remaining corrective actions for this significant deficiency will be completed in FY 2013.

Federal Reimbursable Costs Not Billed Timely

During the FY 2011 Financial Statement Audit, the OIG stated that EPA did not bill other federal agencies for reimbursable costs in a timely manner. The Agency works diligently to research, resolve, and bill outstanding reimbursable costs and will continue to research and resolve unbilled costs, particularly before the funding period is cancelled.

To remedy this significant deficiency, the Agency reviews interagency agreements quarterly and will continue processing bills for new expenses to individual agreements. The Agency is working to use functionality within its financial system so that all costs charged will be linked to a reimbursable agreement, thereby eliminating unidentified reimbursable costs.

The Agency will work to resolve unbilled costs by billing for costs prior to cancellation of the fund. The Agency will pursue collectability information for those not identified with an agreement to move or write off costs that cannot be billed. Additionally, the Agency will create a process for removing reimbursable cost in cancelling funds if they cannot be reconciled to a reimbursable agreement. The Agency will review and clear prior year charges before cancelling the funds.

The Agency anticipates that all remaining corrective actions for this significant deficiency will be completed in FY 2013.

EPA Is Withholding Payments Related to the Deepwater Horizon Oil Spill Cleanup

During the FY 2011 Financial Statement Audit, the OIG stated that EPA withheld payments related to the Deepwater Horizon Oil Spill. The delay of the payments was due to the Agency not having cash available to make the payments without going into a negative balance.

To remedy this significant deficiency, the Agency resumed payments to the oil spill contractors as soon as adequate funds were available; informed the contractor of the interest penalties prescribed by the Prompt Payment Act (this was included in the payments to the contractor); and developed a Memorandum of Understanding with the U.S. Coast Guard that includes a description of acceptable cost documentation in an effort to streamline and expedite reimbursements. The Agency paid $20,112.82 in interest penalties on invoices totaling $2,817,256.99 (less than 1 percent).

The Agency has completed all corrective actions for this significant deficiency.

EPA Recognized Earned Revenue in Excess of Expenditures

During the FY 2011 Financial Statement Audit, the OIG stated that EPA recorded earned revenue without recognizing corresponding expenses.

To remedy this issue, the Agency reviewed and verified that the General Ledger (GL) postings and accounting models in the financial system (Compass) are proper. Additionally, the Agency performed preliminary reconciliations on September 30, 2012, and a final reconciliation on October 3, 2012, of federal revenues and expenses to ensure that revenue adjustments were posted for expenses that have not yet been matched. The Agency reviewed the GL postings in the financial system and found that in most cases, revenue and expenses were posted simultaneously.

The Agency has completed all corrective actions for this significant deficiency.

Accounts Receivable Detail Not Provided Timely By Regions

During the FY 2011 Financial Statement Audit, the OIG found that the Agency was not timely in providing supporting documentation of penalty debts to the Cincinnati Finance Center to ensure prompt recording of accounts receivable for all penalty debts.

In response to this finding, and to remedy the significant deficiency, the Agency developed new procedures, issued in April 2011, which require regions and/or headquarters to provide documentation of penalty debts to CFC within five business days of receipt of the final administrative penalty order. Specifically, within five business days, the final order is filed with the Regional Hearing Clerk, Headquarters Hearing Clerk, or the Clerk for the Environmental Appeals Board. Under annual guidance, the Agency is required to meet this five business day standard 95 percent of the time. Also the Agency created corrective actions to improve EPA-wide performance in providing timely accounts receivable, which has resulted in improved performance and is expected to continue in the coming fiscal year.

Additionally, the Agency has completed numerous activities to improve EPA-wide performance in providing timely accounts receivable. For example, in November 2011 and May 2012, webinars were held on "Improving EPA's Financial Integrity by Financial Reporting of Administrative Penalty Accounts Receivable". The Agency worked internally to provide FY 2012 performance data to regions to identify inaccuracies and enable needed changes to improve performance.

The Agency will continue to monitor performance and will engage with senior regional and headquarters management to ensure that this deficiency is corrected. The Agency anticipates that all remaining corrective actions for this significant deficiency will be completed in FY 2013.

Posting Models in Compass Materially Misstated GL Activities and Balances

During the FY 2012 Financial Statement Audit, the OIG declared that Compass materially misstated GL activity and balances due to incorrect posting models. EPA has already aggressively reviewed posting models to ensure that transactions are properly posting to the Agency's financial accounts. Additionally, weekly meetings are held with Agency Financial Centers and other offices to address known and potential accounting model issues. This approach has served the agency well in 2012, identifying and correcting more than 30 models and related transactions.

The Agency has in place a number of internal control procedures. For instance, the Finance Center staff compares feeder system interfaced transactions to hard copy documentation and approves them. Periodic status reviews are performed on all documents in Compass to make sure all transactions processed properly. None of these reviews revealed any significant problems or issues with internal controls. When errors are found, they are reviewed, corrective actions identified, approved and entered into Compass. The Agency will continue to evaluate and by March 2013 develop internal control procedures to confirm the proper accounts are impacted for all transactions. In addition, EPA provides oversight and development of accounting models and their impacts through GL analyses. If discrepancies are found, they are investigated and reviewed for their impact on transactions and the GL to determine the nature of the matter. Issues are tracked through the resolution and validation processes. These activities provide reasonable assurance that our GL balances are correct.

The Agency also performs a quarterly comparative analysis based on the financial statement line. This analysis highlights unusual variances between fiscal years. EPA will continue to conduct these analytical reviews of account activity on a quarterly basis and more frequently, if deemed necessary.

Compass Reporting Limitations Impair Accounting Operations and Internal Controls

During the FY 2012 Financial Statement Audit, the OIG declared that EPA has been unable to obtain the reports it needs from Compass for many accounting applications.

The Agency continues to analyze agency financial reports, identifies any concerns and develops new reports for users as needed. For much of FY 2012, EPA was in the midst of learning the intricacies of the new system and applying this knowledge to reengineer day-to-day business processes and fix the errors that resulted in reporting discrepancies. The reengineering and advanced user training will allow the agency to take advantage of the many features of the modern system to best meet the agency's business needs. The Agency disclosed and discussed this approach with the OIG in December 2011.

To the maximum extent practicable, EPA adapted its business practices to take immediate advantage of the new system. As we adopted a centralized approach, we found that we were able to cancel a policy on July 11, 2012, that required the finance centers to perform monthly reconciliations of ARs.
In other cases, the Agency decided to defer adoption of automated features available in Compass. For example, we deferred adoption of the full capabilities of Compass to support the Fund Balance with Treasury. Instead, we utilized a process within Compass very similar to the process used in the Integrated Financial Management System, the agency's previous financial management system. EPA adopted this approach based on hands-on daily experience with Compass gained during the first six months of operations and in consideration of change management principles for the successful implementation of financial systems.

EPA Should Improve Controls over Expense Accrual Reversals

During the FY 2012 Financial Statement Audit, the OIG declared that the agency did not reverse approximately $18 million of FY 2011 year-end expense accruals in FY 2012. The Agency is updating its policy for recognizing year-end accruals to require reconciliation of accruals and accrual reversals. The Agency anticipates completing corrective actions for this significant deficiency in FY 2013.

Compass System Limitations Impair Internal Controls of Financial Operations

During the FY 2012 Financial Statement Audit, the OIG declared that Compass experienced several impairments to processing financial transactions. The EPA has already corrected the impairments.

Proper controls and tolerance levels to prevent grant payments from exceeding the related obligation accounting lines were updated in December 2011. In May 2012, the issue of preventing the improper posting of transactions to prior accounting periods, except via Standard Voucher and Journal Voucher transactions, was corrected. The Agency confirmed the Compass table was fixed to prevent spending against canceled appropriations.

EPA Should Improve Compliance With Internal Controls for Accounts Receivable

During the FY 2012 Financial Statement Audit, the OIG found numerous deficiencies in EPA's compliance with accounts receivable internal controls in FY 2012.

The Agency already has a process in place whereby the Department of Justice Environment and Natural Resources Division transmits judicial documents to EPA's Cincinnati Finance Center. Rather than require all EPA attorneys involved in civil judicial matters to duplicate DOJ's provision of documentation to CFC, the Agency's Office of Enforcement and Compliance Assurance will engage with DOJ management to determine whether and the extent to which improvements are needed to ensure the timely transmittal to the Agency of judicial documentation of accounts receivable arising from civil judicial enforcement cases.

Additionally, EPA already utilizes the DOJ Debt Assessed Report, DOJ 30 Day Tracking Reports, and the Integrated Compliance Information System Tracking Reports to review and follow up on documents not received by the Agency. The appropriate Finance Center compares these reports to the Compass Data Warehouse to determine if receivables have been established. While there were some delays early in the year due to obtaining CDW query information, these reconciliations were completed timely by the 4th quarter. The CFC will work with staff to ensure these reports are reviewed timely and fully utilized in obtaining missing documentation.

The Agency anticipates completing corrective actions for this significant deficiency in FY 2013.

EPA Is Not Clearing Fund Balance with Treasury Statement of Differences Timely

During the FY 2012 Financial Statement Audit, the OIG found EPA did not clear Fund Balance with Treasury differences reported on the U.S. Department of Treasury's Statement of Differences within two months.

The Agency has already taken steps to remedy these timing differences. Early in the year, EPA was involved in learning the intricacies of the new Compass system and applying this knowledge to reengineer day-to-day business processes. There was a significant learning curve. The Agency experienced a high volume of rejects because of tighter budget controls and project notebook edits that occur in Compass. New reports have been designed to assist the Agency in performing the reconciliation. In July 2012, the Agency updated the accounting model and by end of September 2012, resolved the backlog of all the transactions that required clearing and submitted SF224 report to Treasury. While there were delays initially, the Agency is now able to clear differences in a timely manner. The majority of the Statement of Differences (SOD) were the result of timing differences (i.e. difference in reported month of activity) rather than dollar differences. Since the reported values in the financial reports agreed exactly with the Treasury balance, the discrepancies in the SOD did not affect the accuracy of the financial reports. Through diligent effort, this was fully corrected and is no longer an issue with either the posting logic or reconciliation process.

Property Internal Controls Need Improvement

During the FY 2012 Financial Statement Audit, the OIG declared that Compass does not sufficiently reject inaccurate personal property information entries.

The Agency is already working with its contractor to build into Maximo the default which will eliminate property record errors. Corrective action was taken in August 2012 to reflect correct inventory dates for the 28 property items that had future acquisition dates. In September 2012, Agency Property Officers reconciled property records to ensure that the system reflected the correct location for the $2.9 million in assets, and will continue to monitor manually until the automated fix in implemented. In September 2012, the OARM conducted a system analysis to ensure that no other assets had the same discrepancy; none were discovered.

The agency anticipates completing remaining corrective actions for this significant deficiency in FY 2013.

Compass and Maximo Cannot be Reconciled

During the FY 2012 Financial Statement Audit, the OIG found that EPA cannot reconcile capital equipment property management data within its property management subsystem, Maximo.

The Agency can reconcile property in Maximo and will document the procedures for reconciling capitalized property during FY 2013. Additionally, the Agency can reconcile capital equipment within its property management subsystem – Maximo – to relevant data within Compass; the Agency's Finance Centers recently completed this reconciliation.

EPA Needs to Remediate System Vulnerabilities That Place Financial Data at Risk

During the FY 2012 Financial Statement Audit, the OIG found that EPA officials did not monitor the testing of the Agency's networked information technology assets to identify commonly known vulnerabilities or take action to remediate those weaknesses. The Agency currently conducts vulnerability assessments for all our general support systems and major applications as directed by National Institutes of Standards and Technology (NIST) guidelines, specifically adhering to NIST 800-37, "Guide for Applying the Risk Management Framework to Federal Information Systems," and NIST 800-53, "Recommended Security Controls for Federal Information Systems and Organizations." All general support systems and major applications undergo risk assessments (as mandated by NIST Risk Management Framework certification) every three years or as the affected application or system implements major modifications. Per the NIST guidelines and EPA policy, a Plan of Action and Milestones is developed to address and remediate any weakness or threats identified by the scans.

OCFO Financial Systems Security Documentation Needs Improvement

During the FY 2012 Financial Statement Audit, the OIG found the EPA lacks reliable information on the implementation of required security controls for key financial applications at the Research Triangle Park Finance Center.

The Agency has already established and is using a process covering security controls for key financial applications. The Application Security Officer prepares the System Security Plans, and office Information Security Officers, review the documents before they are forwarded to EPA's Office of the Chief Financial Officer Information Security Officer, Information Management Officer, and Senior Information Official for review and approval.

The agency anticipates completing remaining corrective actions for this significant deficiency in FY 2013.

Summary of Financial Statement Audit*

Audit Opinion	**Unqualified**
Restatement	**No**

Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Compass Systems Limitations	0	1	0	0	1
Total Material Weaknesses	0	1	0	0	1

Summary of Management Assurance*

Effectiveness of Internal Control Over Financial Reporting (FMFIA § 2) (A-123 Appendix A)

Statement of Assurance	**Unqualified**

Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Compass System Limitations	0	1	1	0	0	0
Total Material Weaknesses	0	1	1	0	0	0

Effectiveness of Internal Control Over Operations (FMFIA § 2)

Statement of Assurance	**Unqualified**

Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Total Material Weaknesses	0	0	0	0	0	0

Conformance With Financial Management System Requirements (FMFIA § 4)

Statement of Assurance	**Systems Conform to Financial Management System Requirements**

Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Total Non-Conformances	0	0	0	0	0	0

Compliance With FFMIA

	Agency	Auditor
Overall Substantial Compliance	**YES**	**NO***
1. System Requirement	**YES**	
2. Accounting Standards	**YES**	
3. USSGL at Transaction Level	**YES**	

NOTE: See “EPA Holds Itself Accountable” in Section I of this report for additional information on FMFIA 2, FMFIA 4 and FFMIA presented in the summary graphs above.”

__*Explanation of Summary Differences__ – The OIG identified the material weakness, “Compass System Limitations are a Material Weakness to EPA’s Accounting Operations and Internal Controls,” in their FY 2012 Financial Statement Audit. In its report, the OIG stated that when the agency converted its accounting system, it had not yet developed all the reports and functions required to generate all the information it needs. The EPA disagrees with this conclusion. Many of the issues cited by the OIG to support the finding of a material weakness were identified in the Spring of 2012. At that time, the agency was still working out system implementation issues, including reporting and business process changes, necessary to effectively utilize the new Compass Financials system. The agency undertook an aggressive effort to identify, prioritize and resolve issues and modify business processes. By the end of FY 2012, the vast majority of system implementation issues, including those that could materially impact the financial statements, were resolved. The agency will continue to analyze the agency’s financial reports and business processes, identify any concerns and develop or improve reports or modify business processes as needed.

IMPROPER PAYMENTS

In accordance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA), which amends the Improper Payments Information Act (IPIA) of 2002, EPA reviews its programs and activities for improper payments. The Agency is committed to improving program performance by taking corrective action for any programs that are determined to be susceptible to significant improper payments. IPERA defines an improper payment as "any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. Incorrect amounts are overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for the incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law). In addition, when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment." Improper payment reviews are conducted in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control,* Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments.*

Risk Assessments

OMB Circular A-123, Appendix C, requires executive agencies to conduct risk assessments of their programs or activities to determine if they are susceptible to significant improper payments. Given the unique nature of EPA's programs, OMB has approved the Agency's method of reporting on improper payments by payment stream. Every year, the Agency conducts quantitative risk assessments of its principal payment streams, which include grants, contracts, commodities, and the Clean and Drinking Water State Revolving Funds (SRFs). For improper payment reporting purposes, the SRF program is a combination of the Clean Water SRF and the Drinking Water SRF. It is also a former Section 57 program for which OMB requires detailed reporting. Results from the Agency's risk assessments are published in Section IV, "Improper Payment Reporting." The quantitative risk assessments determine whether the Agency's payment streams are "susceptible to significant improper payments," defined by IPERA and OMB guidance as exceeding both $10 million of improper payments and 2.5 percent of program outlays or $100 million of improper payments, regardless of the rate.

Statistical Sampling

A) State Revolving Funds

The SRFs are state-administered programs that provide federal funds to the states and Puerto Rico to capitalize revolving loan fund programs. The states receive invoices from fund recipients, review them for eligibility and accuracy, and electronically submit cash draw requests for batches of invoices to EPA. The Agency makes payments to the revolving loan funds and conducts annual onsite reviews in each state. The Agency also conducts transaction testing, reviews invoices for eligibility, confirms that the total amount of invoices matches the amount of cash draw, and examines accounting records to confirm that the states made matching deposits.

The American Recovery and Reinvestment Act of 2009 (ARRA) provided the SRFs with an additional $6 billion of spending authority. As a result, during the FY 2010 and FY 2011 improper payments reporting cycles, the SRF program broadened its sampling process to include state expenditures of ARRA funds. This involved testing eight ARRA cash draws in addition to the four base appropriation cash draws per state, per year. A cash draw is a disbursement from Treasury for the payment of state grants. Each disbursement can refer to a single invoice or a batch of invoices, which are reviewed by the Agency for improper payments. During the FY 2012 improper payments review, SRF sampling was reduced to reflect the testing of two ARRA cash draws in states that had yet to disburse all ARRA funds, while continuing to test four base cash draws per state. Of the total $2.7 billion in SRF outlays during FY 2012, approximately $450 million consisted of ARRA funds. Furthermore, of the total $13.38 million of improper payments identified by transaction testing, approximately $400,000 originated from ARRA funding while $13.0 million originated from base appropriations. As of September 30, 2012, approximately 97 percent of SRF ARRA dollars have been disbursed.

It should be noted that as a result of the Office of the Inspector General's FY 2011 report on IPERA compliance, the Agency has revised its methodology for computing the SRF improper payment rate. The error rate is now based on the dollar value of amounts tested rather than the full universe of SRF outlays.

Finally, transaction testing conducted by the Agency during FY 2012 pertains to expenditures made by the states during state fiscal year 2011. In most cases, the state fiscal year begins on July 1 and ends on June 30. Given the time lapse between the states' expenditures of SRF funds and the initiation of EPA's onsite reviews, the Agency has obtained OMB's approval to use the preceding state fiscal year rather than the current federal fiscal year as its alternative 12-month reporting period for SRF improper payments.

B) Grants

Each November, the Agency's Office of Grants and Debarment randomly selects a number of its recipients with active grant awards for advanced monitoring reviews. The Agency stratifies its active grant recipients into five categories: states, local governments, tribes, universities, and nonprofits. It then selects a proportionate number from each group for review during the following calendar year (CY). Using a standard protocol, the Agency performs an onsite or desk review and examines each selected recipient's administrative and financial management of their grant projects. The review includes an examination of the recipient's administrative policies and procedures and testing of a number of transactions of grant funds drawn for the period.

The final results of advanced monitoring reviews, enforcement actions, and decisions for Single Audit Act (SAA) and Office of Inspector General audits completed and closed in CY 2011 are presented in Section IV B, "Improper Payments Reporting – Grants." In FY 2012, the Agency is publishing the results of grantee reviews conducted during CY 2011. Due to the amount of time involved in the appeals process, the Agency previously obtained OMB's approval to use an alternative 12-month period for reporting improper payments in grants. As a result, EPA uses the prior calendar year as its 12-month reporting period for grants.

The CY 2012 grants advanced monitoring reviews are currently underway, as are the Agency's continuous enforcement and audit resolution actions. Results of the reviews and audits that are final and closed in CY 2012 will be published in the Agency's FY 2013 improper payments report.

C) Commercial Payments (contracts and commodities)

In February 2006, EPA centralized all commercial payments at the Research Triangle Park Finance Center. The consolidation resulted in much greater discipline with regard to management and internal controls through the Center's Standard Operating Procedures and sophisticated payment systems.

The Agency does not use a statistical sampling methodology in its audit of commercial improper payments, as each payment is subject to financial review, invoice approval, and payment certification. Various post-audits are performed as well. Below is a brief summary of process controls in place on the Agency's commercial invoice payment process.

The payment processing cycle requires that all invoices be subjected to rigorous review and approval by separate entities. Steps taken to ensure payment accuracy and validity, which serve to prevent improper payments from occurring, include: 1) the Finance Center's review for adequate funding and proper invoice acceptance; 2) comprehensive system edits to guard against duplicate payments, exceeding ceiling cost and fees, billing in wrong period of performance dates, and payment to wrong vendor; 3) electronic submission to Agency Project Officers and Approving Officials, with a copy of the invoice, for validation of proper receipt of goods and services, period of performance dates, labor rates, appropriateness of payment, citing disallowances or disapprovals of costs if appropriate; and 4) review by the Finance Center of suspensions and disallowances, if taken, prior to the final payment certification for Treasury processing. Additional preventive reviews are performed by the Finance Center on all credit and re-submittal invoices. Additionally, EPA Contracting Officers perform annual review of invoices on each contract they administer, and the Defense Contract Audit Agency (DCAA) performs audits on cost-reimbursable contracts at the request of the Agency.

Furthermore, monthly Finance Center Improper payment reports are provided to Agency management. This information tracks the number and dollar amount of improper payments, the source and reason for the improper payment, the number of preventive reviews conducted, and the dollar amount of recoveries made for current and prior years.

According to IPERA, an improper payment includes "any payment that does not account for credit for applicable discounts." In applying this definition, EPA considers that an improper payment would arise if the wrong percentage discount were taken or if a discount were taken beyond the specified discount period. Discounts not taken are detected during the monthly review process for commercial payments and are reported as improper payments if it is both advantageous and within the Agency's control to take the discount. There are certain situations beyond the Agency's control that may prevent EPA from taking a discount. Since these situations are beyond the Agency's control, EPA does not consider them to be improper payments. For example, the late receipt of an invoice from the vendor could prevent the Agency from claiming the discount within the specified discount period. Similarly, project officers are required to conduct their due diligence by thoroughly reviewing invoices and are sometimes unable to approve an invoice before the discount period expires. EPA does not consider these situations to be improper payments. However, the Agency makes every effort to claim offered discounts. In FY 2012, the Agency claimed 56% of all offered discounts, and the remaining $122,000 in missed discounts were determined not to be improper payments.

Corrective Actions

Since the enactment of the Improper Payments Information Act of 2002, OMB has always considered the SRF program to be risk susceptible due to the large dollar volume of payments associated with the program. However, FY 2012 was the first year in which the SRFs actually exceeded the threshold for significant improper payments set forth by IPERA and OMB guidance ($10 million and 2.5 percent of program outlays or $100 million of improper payments, regardless of the rate). This was partially due to the adoption of a more stringent approach to calculating the error rate, as well as the identification of high dollar errors in each of a few states largely resulting from incorrect state/federal proportionality ratios and confusion over overhead eligibility.

All improper payments identified in the SRF program are Administrative and Documentation errors, which are defined as being "caused by the absence of supporting documentation necessary to verify the accuracy of the claim; or inputting, classifying, or processing applications or payments incorrectly by a relevant Federal agency, State agency, or third party who is not the beneficiary." Since the errors were discovered, corrective actions have been put into place to prevent a recurrence including clarifying state match and proportionality ratio guidance, updating model spreadsheets, modifying the "group project" approach to draw downs, strengthening state procedures and standard operating procedures for internal controls, and providing training on eligible overhead costs. The SRF program is the only EPA program that is susceptible to significant improper payments, and in FY 2013, the Agency will work with OMB to refine its methodology for sampling and estimating improper payments in the SRFs in order to ensure that these types of errors are identified early in the performance period.

Improper Payment Reporting

A) State Revolving Funds

Prior to IPERA, EPA established an overall improper payment target of 0.30 percent for the SRFs. This target remains an ambitious one, and the Agency had been consistent in meeting it over the years. However, this target was based in part on an old methodology that the OIG recommended for revision. Previously, the SRF error rate was calculated by dividing the amount of improper payments identified in the sample by the amount of outlays in the entire payment stream. This led to underreporting of SRF improper payments. Based on the OIG's recommendation, the Agency revised its methodology for calculating the SRF error rate and now divides the amount of improper payments identified in the transaction testing sample by the dollar value of the sample.

Transaction testing conducted in FY 2012 identified $13.38 million in improper payments out of $459 million of SRF disbursements reviewed, which equates to an error rate of 2.91 percent. As previously discussed, an abnormality was detected during FY 2012 transaction testing in the Puerto Rico CWSRF program, in which approximately $3.5 million of ineligible overhead and interest payments was identified in the sample of cash draws reviewed for improper payments. The $3.5 million is included as part of the $13.38 million of improper payments identified by transaction testing in the SRF program. The Agency initiated a secondary review to determine the full extent of the issue. An additional $29.5 million of ineligible payments was identified in the Clean Water program, as well as an additional $2.8 million of ineligible overhead payments in the Drinking Water program. These errors are reported in Table 6, "Overpayments Recaptured Outside of Payment Recapture Audits" but do not factor into the FY 2012 improper payment rate calculation since they were identified in secondary reviews conducted outside the scope of the current transaction testing methodology.

SRF improper payment data for the past five fiscal years are summarized in Figure 1, "Clean Water and Drinking Water SRFs." It should be noted that Tables 1-6 in this report correspond with Tables 1-6 in OMB Circular A-136, and Figures 1 through 4 are supplementary tables provided by EPA to demonstrate results of the Agency's internal payment recapture audit program.

Figure 1: Clean Water and Drinking Water SRFs

(Figures 1-4 provide information on EPA's payment streams, supplementing Tables 1-6 from OMB Circular A-136)

Fiscal Year	Outlays	Outlays Tested	Improper Payments	Estimated Improper Payments (1)	Error Rate
2008	$2.1 billion	n/a	$8.3 million	n/a	0.39 percent
2009	$1.9 billion	n/a	$1.1 million	n/a	0.06 percent
2010	$4.8 billion	n/a	$1.8 million	n/a	0.04 percent
2011	$3.64 billion	n/a	$14.18 million	n/a	0.39 percent
2012	$2.67 billion	$459.7 million	$13.38 million	$77.96 million(2)	2.91 percent (3)

(1) In previous fiscal years, the SRF error rate was not extrapolated to the full universe of SRF outlays. In FY 2012, EPA began extrapolating the error rate in order to determine an overall estimate of improper payments in the SRFs.

(2) Calculated by multiplying "Outlays" of $2,677,600,000 by "Error Rate."

(3) Reflects the new methodology for calculating the SRF improper payment rate, based on an OIG recommendation from the FY 2011 IPERA compliance audit. Calculated by dividing "Improper Payments" by "Outlays Tested."

Table 1: Improper Payment Reduction Outlook

(Dollars in Millions; Tables 1-6 refer to the corresponding tables in OMB Circular A-136)

Program	FY11 Outlays	FY11 IP%	FY11 IP $	FY12 Outlays	FY12 IP%	FY12 IP $	FY12 Over-pmt	FY12 Under-pmt	FY13 Outlays	FY13 IP%	FY13 IP $	FY14 Outlays	FY14 IP%	FY14 IP $	FY15 Outlays	FY15 IP%	FY15 IP $
Clean Water and Drinking Water SRFs (1)	$3,645	0.30 target 0.39 actual	$14.2	$2,678	0.30 target 2.91 actual	$77.96	$77.96	$0	$2,585 [est.]	0.30 target	$7.76 [est.]	$2,525 [est.]	0.30 target	$7.56 [est.]	$2,439 [est.]	0.30 target	$7.32 [est.]

(1) Per OMB Circular A-136, this chart shows information on the Agency's risk susceptible programs.

B) Grants

The Agency continues to monitor grantees to ensure payment accuracy and respond to SAA and OIG audits to recover improper payments when they are found. In CY 2011, the Agency closed 229 grant recipient and SAA and OIG audit reviews, including 36 ARRA reviews, to identify improper payments. Of these 229 reviews and audits, 23 had actual improper payments or unallowable costs.

Results from the past five annual improper payment reviews are provided in Figure 2, which also updates information on recovered costs for these years. For CY 2011, results of the Agency's grant recipient reviews, enforcement actions, and audits that were final and closed that year are presented.

Figure 2: Grantees Review/Audit Results

Nonprofit Grantees Review/Audit Results	CY 2007 Review	CY 2008 Review	CY 2009 Review	CY 2010 Review	CY 2011 Review
Totally grant outlays less SRFs	n/a	n/a	n/a	n/a	$2,283,853,375
Total dollars tested	$22,544,462	$120,209,284	$10,258,129	$21,242,755	$118,531,428
Actual erroneous payments (unallowable costs)	$13,433	$111,329	$12,697	$7,110	$610,131
Costs that have been recovered	$13,433	$111,329	$4,647	$7,110	$465,462
Percent of erroneous payments	0.059%	0.093%	0.124%	0.033%	0.515%
Estimated improper payments	n/a	n/a	n/a	n/a	$11,761,845

(1) For CY2006-CY2010, the amounts reported were the total dollars drawn by the sampled recipients.
(2) In previous fiscal years, grants improper payments were not extrapolated across the full universe of grants outlays. For the CY 2011 review, EPA began extrapolating to determine an estimate of improper payments from all non-SRF grants.

In addition to the sampling process described above, the Agency maintains internal controls to help prevent the occurrence of improper payments in grants. Since 2008, EPA has implemented annual "baseline" monitoring of all active assistance agreements that review fund drawdowns for appropriateness. As part of the baseline monitoring, each assistance agreement is reviewed programmatically by a Project Officer and administratively by a Grants Specialist, both of whom review financial drawdowns for consistency with the project's duration and progress. Any irregularities found are examined with the recipient and further scrutinized when warranted. Project Officers also review quarterly reports submitted by recipients, to ensure projects are on schedule and progress matches the amount of funding used. Additionally, the agency's Las Vegas Finance Center (LVFC) routinely monitors grant payments made under the Agency's Automated Standard Application Payment system for irregularities, and in FY 2013, LVFC will institute daily payment cross checks and weekly vendor cross checks against the Department of Treasury's "Do Not Pay" solution.

C) Commercial Payments

Due to the historical low percentage of improper payments in the contracts and commodities payment streams, the Agency relies on its internal review process to detect and recover improper payments. EPA reviews all payments processed rather than using a sampling methodology, which reduces the potential for improper payments. Additional post-audit findings (OIG, A-123, DCAA) that identify improper payments are captured in Table 6, "Overpayments Recaptured Outside of Payment Recapture Audits." The agency continues to use its monthly improper payment reports for contracts and commodities as its primary tool for monitoring improper payments. Contracts and commodities data for the past five fiscal years are summarized below.

Contracts:

Figure 3: Results of EPA's Improper Contract Payments Report

Fiscal Year	Number of Erroneous Payments	Erroneous Payments (Dollars in Thousands)	Error Rate for Dollars
2008	12 (of 32,043)	$324.0	0.03%
2009	31 (of 35,929)	$716.4	0.05%
2010	35 (of 39,060)	$882.6	0.08%
2011	21 (of 38,965)	$162.9	0.01%
2012 (1)	29 (of 33,473)	$953.7	0.06%

(1) DCAA audit results are presented in Table 6.

Commodities:

Figure 4: Results of EPA's Improper Commodity Payments Report

Fiscal Year	Number of Erroneous Payments	Erroneous Payments (Dollars in Thousands)	Error Rate for Dollars
2008	48 (of 43,629)	$215.4	0.08%
2009	32 (of 41, 585)	$193.7	0.07%
2010	34 (of 39,571)	$166.3	0.05%
2011	44 (of 40,083)	$2,178.5	0.67%
2012	50 (of 34,908)	$363.6	0.13%

D) ARRA Policy Verification Review

In addition to the agency's existing improper payment reviews, EPA initiated an agency-wide effort in FY 2011 to review and verify implementation of the Recovery Act Stewardship Plan (RASP), which is the agency's comprehensive risk assessment and risk mitigation strategy for its ARRA-funded activities. Title XV of the Recovery Act established a stringent framework for government-wide accountability and transparency. In response to these provisions and to ensure the sound financial management and oversight of ARRA-funded activities, the Agency developed the RASP and reviewed ARRA expenditures for improper payments. The ARRA Policy Verification Review included a statistical random sample of 110 awards across seven functional areas, including grants, contracts, and interagency agreements. The agency developed a review protocol based on the risks identified in the RASP and the policies and procedures designed to mitigate these risks. Detailed, onsite reviews were conducted for each sample award in all EPA regions, finance centers and headquarters program offices.

In FY 2011, the OCFO, in collaboration with the agency's Regional Comptrollers, initiated an agency-wide effort to review and verify implementation of the RASP. The population of ARRA awards subject to review consisted of 850 awards, totaling $7.18 billion. Based on guidance established in OMB Memorandum M-03-13 (issued May 21, 2003), the Agency contracted with a statistician to draw a sample of 110 awards totaling $3.88 billion, which included 79 grants ($3.72 billion), 25 contract actions ($94 million) and six interagency agreements ($68.5 million).

During the onsite visits, the agency reviewed documentation associated with each sample award for evidence demonstrating that each control activity established in the RASP was completed appropriately. Results provided an impartial review of internal controls, as well as an assessment of improper payments in ARRA awards. Although the final report is pending, approximately $11.7 million of improper payments was identified. The agency has already instituted corrective actions and recovered all funds. Results from the ARRA Policy Verification review are published in Table 6, "Overpayments Recaptured Outside of Payment Recapture Audits."

Recapture of Improper Payments

EPA maintains an internal payment recapture audit program run by Agency employees who continuously monitor the Agency's payment streams to prevent, identify, and recover improper payments. The Agency's payment recapture audit program reviews grants, contracts, commodities, and the SRFs for improper payments, and no programs or activities are excluded from these reviews.[2]

The agency's internal payment recapture audit program has recovered approximately $32.3 million across all payment streams over time. This amount consists of approximately $2.7 million from contracts and $4.3 million from commodities (beginning in FY 2004 for each), $622,000 from grants (beginning with the CY 2006 review), and $24.7 million from the SRFs (beginning with the state fiscal year 2009 review).

[2] A-123 reviews of payroll, travel, and purchase card efforts are an integral internal control mechanism for reducing improper payments, but these areas are not required for reporting under IPERA. Because they involve payments to federal employees, they are exempt from the definition of improper payments, per OMB M-11-16, question 2.

Table 2: Payment Recapture Audit Reporting

(Tables 1-6 refer to the corresponding tables in OMB Circular A-136)

Program or Activity	Type of Payment	Amount Subject to Review for CY Reporting	Actual Amount Reviewed and Reported (CY)	Amount Identified for Recovery (CY)	Amount Recovered (CY)	% of Amount Recovered of Amount Identified (CY)	Amount Outstanding (CY)	% of Amount Out-standing of Amount Identified (CY)	Amount Determined Not to be Collectable (CY)	% of Amount Determined Not to be Collectable of Amount Identified (CY)	Amounts Identified for Recovery (PYs)	Amounts Recovered (PYs)	Cumulative Amounts Identified for Recovery (CY + PYs)	Cumulative Amounts Recovered (CY + PYs)	Cumulative Amounts Outstanding (CY+PYs)	Cumulative Amounts Determined Not to be Collectable (CY+PYs)
SRFs (1)	grants	2,677,600,000	459,666,551	13,382,373	9,857,237	73.7%	3,525,136	26.3%	$0	0%	14,892,375	14,892,375	28,274,748	24,749,612	3,525,136	$0
Grants (2)	grants	2,283,853,375	118,431,528	610,131	465,462	76.3%	144,669	23.7%	83,714 (5)	13.7%	183,736	156,317	793,867	621,779	172,088 (5)	83,714 (6)
Contracts (3)	contracts	1,496,607,743	1,496,607,743	929,457	898,259	96.6%	31,199	3.4%	$0	0%	1,792,780	1,792,780	2,722,237	2,691,039	31,199	$0
Commodities (4)	small purchases	289,557,789	289,557,789	296,603	265,326	89.5%	31,278	10.5%	$0	0%	3,999,032	3,993,998	4,259,635	4,259,324	34,745	1,217

(1) In Tables 2 through 6, "Current Year" results are from state FY 2011 transaction testing, and "Prior Year" results are from transaction testing for state FY 2009 and 2010.
(2) For grants, in Tables 2 through 6, "Current Year" results are from reviews performed in CY 2011, and "Prior Year" results are from reviews performed in CYs 2006 through 2010.
(3) For contracts and commodities, "Current Year" refers to FY 2012, and "Prior Year" refers to FY2004-2011.
(4) Prior year amounts have changed slightly from FY 2011 reporting due to recalculation.
(5) In certain instances, recipients continue to appeal the Agency's unallowed cost determinations for prior years.
(6) This debt has been referred to the Cincinnati Finance Center Claims Processer / Department of Treasury for collection per OCFO procedure 2540-9-P2 on delinquent debts.

Table 3: Payment Recapture Audit Targets

Program or Activity	Type of Payment	CY Amount Identified	CY Amount Recovered	CY Recovery Rate (Amount Recovered / Amount Identified)	CY +1 Recovery Rate Target	CY + 2 Recovery Rate Target	CY + 3 Recovery Rate Target
SRFs	grants	$13,382,373	$9,857,237	73.7%	89%	90%	90%
Grants	grants	$610,131	$465,462	76.3%	85%	87%	87%
Contracts	contracts	$929,457	$898,259	96.6%	91%	92%	92%
Commodities	small purchases	$296,603	$265,326	89.5%	91%	92%	92%

Table 4: Aging of Outstanding Overpayments

Program or Activity	Type of Payment	CY Amount Outstanding (0 to 6 months)	CY Amount Outstanding (6 months to 1 year)	CY Amount Outstanding (over 1 year)
SRFs (1)	grants	$3,525,136	$0	$0
Grants (2)	grants	$0	$0	$144,669 (3)
Contracts	contracts	$31,199	$0	$0
Commodities	small purchases	$31,277	$0	$0

(1) For the SRFs, "Current Year" refers to state FY 2011. This table shows amounts outstanding for the SRFs, beginning Oct. 1, 2010.

(2) For grants, "Current Year" results are from reviews and audits closed in CY 2011.

(3) $83,714 of this amount has been referred to the Department of Treasury for collection, per Office of the Chief Financial Officer (OCFO) procedure 2540-9-P2 on delinquent debts.

Table 5: Disposition of Recaptured Funds (1)

Program or Activity	Type of Payment	Agency Expenses to Administer the Program	Payment Recapture Auditor Fees	Financial Management Improvement Activities	Original Purpose	Office of Inspector General	Returned to Treasury
SRFs (2)	grants	$54,900	$0	$0	$0	$0	$0
Grants	grants	$32,200	$0	$0	$0	$0	$0
Contracts	contracts	$38,600 (3)	$0	$0	$0	$0	$0
Commodities	small purchases	$38,600	$0	$0	$0	$0	$0

(1) No recoveries originated from expired funds appropriated after the enactment of IPERA. Therefore, all recoveries were returned to their original appropriation.

(2) Since the SRFs are revolving loan funds, all SRF recoveries automatically return to the program (per OMB Circular A-123, Appendix C, Part I).

(3) The same cost estimate applies to both contracts and commodities.

Table 6: Overpayments Recaptured Outside of Payment Recapture Audits

Source of Recovery	Amount Identified (CY)	Amount Recovered (CY)	Amount Identified (PY)	Amount Recovered (PY)	Cumulative Amount Identified (CY+PYs)	Cumulative Amount Recovered (CY+PYs)
SRF Single Audits	$0	$0	$10,504	$10,504	$10,504	$10,504
SRF State Reporting	$5,413,070	$5,413,070	$379,758	$379,758	$5,792,828	$5,792,828
DCAA Audits	$0	$0	$97,198	$97,198	$97,198	$97,198
Grant OIG and Single Audits (1)	$100,980	$100,980	n/a	n/a	$100,980	$100,980
Secondary Review in Puerto Rico (Clean Water SRF) (2)	$29,985,095	$0	n/a	n/a	$29,985,095	$0
Secondary Review in Puerto Rico (Drinking Water SRF)	$2,827,209	$0	n/a	n/a	$2,827,209	$0
ARRA Policy Verification Review	$11,684,171	$11,684,171	n/a	n/a	$11,684,171	$11,684,171

(1) These amounts are included in the Table 2 values for Grants.

(2) Puerto Rico secondary reviews were conducted as a follow-up to the $3.5 million in improper payments identified through SRF transaction testing.

Accountability

As previously outlined, the Agency continues to strengthen internal controls in key payment processes. Information on erroneous payments from reviews and audits of the two SRFs, the Agency's largest grant programs, is reported semi-annually to management in two headquarters offices at EPA. In all cases, action is taken with the appropriate officials to ensure that improper payments are recovered and to help prevent future improper payments.

Agency Information Systems and Other Infrastructure

The Agency's internal controls, human capital, information systems, and other infrastructure are sufficient to monitor the reduction of improper payments to targeted levels.

In FY 2013, EPA plans to implement the Do Not Pay solution, which is a government-wide tool designed to ensure that awardees meet federal funding eligibility criteria. The Agency's vendor file and payment file will be regularly checked against the Do Not Pay databases, and any matches will be investigated to determine whether future payments should be stopped.

In addition, the Agency is using GSA's System for Award Management (SAM) to verify the eligibility of recipients before an award is made. SAM consolidates nine award management systems into one centralized acquisition and award support system. This streamlines pre-award processes, eliminating the need to enter the same data multiple times, and consolidates hosting to make the process of doing business with the government more efficient.

EPA's adoption and use of both SAM and the Do Not Pay solution will achieve efficiencies in pre-award eligibility verification and will help prevent improper payments from being made to ineligible recipients.

Statutory or Regulatory Barriers

None.

Conclusions

The Agency commits to the following activities in FY 2013:

Report results from the expanded CY 2012 review of state and local government, university, tribe, and nonprofit grantees.

Expand statistical sampling of the SRF programs to be consistent with levels required of "risk susceptible" programs in OMB Circular A-136.

Institute daily payment cross checks and weekly vendor cross checks with the Department of Treasury's "Do Not Pay" solution to help prevent improper payments.

Appendix A

Public Access

The EPA invites the public to access its website at www.epa.gov to obtain the latest environmental news, browse Agency topics, learn about environmental conditions in their communities, obtain information on interest groups, research laws and regulations, search specific program areas, or access the EPA's historical database.

American Recovery and Reinvestment Act of 2009: www.epa.gov/recovery

EPA newsroom: www.epa.gov/newsroom

- News releases: www.epa.gov/newsroom/newsreleases.htm
- Regional newsrooms: www.epa.gov/newsroom/#regions

Laws, regulations, guidance and dockets: www.epa.gov/lawsregs

- Major environmental laws: www.epa.gov/lawsregs/laws/index.html
- EPA's Federal Register website: www.epa.gov/fedrgstr

Where you live: www.epa.gov/epahome/whereyoulive.htm

- Search your community: www.epa.gov/epahome/commsearch.htm
- EPA regional offices: http://www.epa.gov/epahome/regions.htm

Information sources: www.epa.gov/epahome/resource.htm

- Hotlines and clearinghouses: www.epa.gov/epahome/hotline.htm
- Publications: www.epa.gov/epahome/publications.htm

Education resources: www.epa.gov/epahome/students.htm

- Office of Environmental Education: www.epa.gov/enviroed

About EPA: www.epa.gov/epahome/aboutepa.htm

- EPA organizational structure: www.epa.gov/epahome/organization.htm

EPA programs with a geographic focus: www.epa.gov/epahome/places.htm

Partnerships: www.epa.gov/partners

- Central Data Exchange: www.epa.gov/cdx
- Business Guide to Climate Change Partnerships: www.epa.gov/partners/Biz_guide_to_epa_climate_partnerships.pdf

EPA for business and nonprofits: www.epa.gov/epahome/business.htm

- Small Business Gateway: www.epa.gov/smallbusiness
- Grants, fellowships, and environmental financing: www.epa.gov/epahome/grants.htm

Budget and performance: www.epa.gov/performance/

Careers: www.epa.gov/careers

- EZ Hire: www.epa.gov/ezhire

EPA en Español: www.epa.gov/espanol

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EPA 한국어: www.epa.gov/korean

Appendix B

Acronyms and Abbreviations

AFR	Agency Financial Report
APR	Annual Performance Report
ARRA	American Recovery and Reinvestment Act
ASSERT	Automated System Security Evaluation and Remediation Tracking
BPD	Bureau of Public Debt
CBI	Confidential Business Information
CERCLA	Comprehensive Environmental Response Compensation and Liability Act
CFC	Cincinnati Finance Center
CFO	Chief Financial Officer
CO	Contracting Officer
CPC	Contractor Property Coordinator
CPIC	Capital Planning and Investment Control
CWA	Clean Water Act
DCAA	Defense Contract Audit Agency
DHS	U.S. Department of Homeland Security
DOJ	U.S. Department of Justice
DOT	U.S. Department of Transportation
DWSRF	Drinking Water State Revolving Fund
EAS	U.S. Environmental Protection Agency Acquisition System
ECHO	Enforcement and Compliance History Online
EPA	U.S. Environmental Protection Agency
EPM	Environmental Programs and Management
FAS	Fixed Assets Subsystem
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FECA	Federal Employees Compensation Act
FERS	Federal Employees Retirement System
FFDCA	Federal Food, Drug and Cosmetic Act
FFMIA	Federal Financial Management Improvement Act of 1996
FIFRA	Federal Insecticide, Fungicide and Rodenticide Act
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act of 1982
FQPA	Food Quality Protection Act
FSSRC	Federal Standing Science Review Committee
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GIS	Geographical Information System
GSA	U.S. General Services Administration
HPV	High Production Volume
ICIS	Integrated Compliance Information System
ICR	Information Collection Request
IFMS	Integrated Financial Management System
IP	Improper Payment
IPERA	Improper Payments Elimination and Recovery Act

IPIA	Improper Payments Information Act
IRIS	Integrated Risk Information System
IUR	Inventory Update Reporting
LUST	Leaking Underground Storage Tank
NAS	National Academy of Sciences
NPDES	National Pollutant Discharge Elimination System
NPL	National Priorities List
OCFO	Office of the Chief Financial Officer
ODD	Operating Division Director
OECA	Office of Enforcement and Compliance Assurance
OEI	Office of Environmental Information
OFM	Office of Financial Management
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
ORD	Office of Research and Development
PAH	Polyaromatic Hydrocarbon
PAR	Performance and Accountability Report
PCBs	Polychlorinated Biphenyls
PCOWS	Partnership Council of the Office of Water and States
PCS	Permit Compliance System
PM	Performance Measure
PMN	Pre-Manufacture Notice
PP&E	Plant, Property and Equipment
PRP	Potential Responsible Parties
QIC	Quality Assurance/Quality Control
R&D	Research and Development
RA	Remedial Action
RAM	Regional Acquisition Manager
RASP	Recovery Act Stewardship Plan
RCRA	Resource Conservation and Recovery Act
RMDS	Resource Management Directives System
RP	Responsible Party
RTP	Research Triangle Park
SARA	Superfund Amendments and Reauthorization Act of 1986
SDWA	Safe Drinking Water Act
SDWIS	Safe Drinking Water Information System
SFFAS	Statement of Federal Financial Accounting Standards
SNUR	Significant New Use Rule
SRF	State Revolving Fund
SSC	Superfund State Contracts
STAG	State and Tribal Assistance Grants
TMDL	Total Maximum Daily Load
TSCA	Toxic Substances Control Act
TVA	Tennessee Valley Authority
TWG	Targeted Watershed Grants

UST	Underground Storage Tanks
UV	Ultraviolet
WCF	Working Capital Fund

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U.S. Environmental Protection Agency
Fiscal Year 2012 Agency Financial Report
EPA-190-R-12-006
November 15, 2012