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

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Washington, DC 20460

U.S. Environmental Protection Agency
Office of Inspector General

13-1-0054
November 15, 2012

At a Glance

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

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

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

Attachment 1

Internal Control Material Weakness and Significant Deficiencies

Table of Contents

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

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

SECTION II
FINANCIAL SECTION

Principal Financial Statements

Financial Statements

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

Notes to Financial Statements

Notes to Financial Statements (continued)

Required Supplementary Information (Unaudited)

Required Supplementary Stewardship Information (Unaudited)

Supplemental Information and Other Reporting Requirements (Unaudited)

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.

Environmental Protection Agency
Notes to the Financial Statements
Fiscal Year Ended September 30, 2012 and 2011
(Dollars in Thousands)

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			FY 2011		
	Acquisition Value	Accumulated Depreciation	Net Book Value	Acquisition Value	Accumulated Depreciation	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			FY 2011		
	Beginning Balance	Net Borrowing	Ending Balance	Beginning Balance	Net Borrowing	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
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.

	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

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

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

		FY 2012		FY 2011
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:				
Components Requiring or Generating Resources in Future Periods:				
Increase in Annual Leave Liability	$	(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
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
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.

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

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

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

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

The Agency's 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

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

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

"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.**

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."

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 10th 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.

<u>7 - EPA Is Not Clearing Fund Balance with Treasury Statement of Differences Timely</u>

"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."

<u>11 – OCFO Financial Systems Security Documentation Needs Improvement</u>

"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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Associate Administrator for External Affairs and Environmental Education
Deputy Chief Financial Officer
Associate Chief Financial Officer
Director, Office of Policy and Resource Management, Office of Administration and Resources Management
Director, Office of Grants and Debarment, Office of Administration and Resources Management
Director, Office of Administration, Office of Administration and Resources Management
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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