

# Summary of OIG's Audit Report

Audit Report 2004-1-00021, November 21, 2003

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## Inspector General's Report on EPA's Fiscal 2003 and 2002 Financial Statements

The Administrator  
U.S. Environmental Protection Agency

We have audited the consolidating balance sheets of the U.S. Environmental Protection Agency (EPA, or the Agency) and its subsidiary funds, the Superfund Trust Fund (Superfund) and All Other Appropriated Funds (All Other), as of September 30, 2003 and 2002, and the related consolidating statements of net cost, changes in net position and financing, and consolidated statements of net cost by goal, custodial activity, and combined statements of budgetary resources for the years then ended. These financial statements are the responsibility of EPA's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial statements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements include expenses of grantees, contractors, and other Federal agencies. Our audit work pertaining to these expenses included testing only within EPA. Audits of grants, contracts, and interagency agreements performed at a later date may disclose questioned costs of an amount undeterminable at this time. In addition, the United States Treasury collects and accounts for excise taxes that are deposited into the Superfund and Leaking Underground Storage Tank Trust Funds.<sup>2</sup> The United States Treasury is also responsible for investing amounts not needed for current disbursements and transferring funds to EPA as authorized in legislation. Since the United States Treasury, and not EPA, is responsible for these activities, our audit work did not cover these activities.

As more fully described in Note 36 to the financial statements, the Superfund Trust Fund, managed by the U.S. Treasury Bureau of Public Debt, transferred funds to EPA in excess of the assets available to be transferred by \$82.7 million in fiscal 2003. EPA's view is that the shortfall for fiscal 2003 will be covered by the collection of cost recoveries

<sup>2</sup> The Leaking Underground Storage Tank Trust Fund is included in the All Other Appropriated Funds column of the financial statements.

and receipt of interest income over time. In our opinion, because cost recoveries have declined and the investment principal upon which the interest is earned has steadily decreased, the current deficit of \$82.7 million and future Superfund Trust Fund appropriations would have to be covered by appropriations from the Treasury's general fund in order for the Superfund Trust Fund to continue operations.

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

In our opinion, the consolidating financial statements present fairly, in all material respects, the consolidated and individual assets, liabilities, net position, net cost, net cost by goal, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations and custodial activity of the U.S. Environmental Protection Agency and its subsidiary funds, the Superfund Trust Fund and All Other Appropriated Funds, as of and for the years ended September 30, 2003 and 2002, in conformity with accounting principles generally accepted in the United States of America.

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

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

We did not identify any material inconsistencies between the information presented in EPA's financial statements and the information presented in EPA's RSSI, Required Supplemental Information, and Management Discussion and Analysis. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report, as Required Supplemental Information, their intragovernmental assets and liabilities by Federal trading partner. We did find EPA continues to experience difficulties in reconciling some of its intragovernmental transactions due to some Federal entities not providing information for reconciliations (see Attachment 2 for additional details on this issue).

#### EVALUATION OF INTERNAL CONTROLS

As defined by OMB, internal control, as it relates to the financial statements, is a process, effected by the Agency's management and other personnel, designed to provide reasonable assurance that the following objectives are met:

**Reliability of financial reporting.** Transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and RSSI in accordance with generally accepted accounting principles; and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

**Reliability of performance reporting.** Transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

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

In planning and performing our audit, we considered EPA's internal controls over financial reporting by obtaining an understanding of the Agency's internal controls, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as supplemented by an OMB memorandum dated January 4, 2001, *Revised Implementation Guidance for the Federal Financial Management Improvement Act*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal controls and, accordingly, we do not express an opinion on internal controls.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. We noted certain matters discussed below involving the internal control and its operation that we consider to be reportable conditions, although none of the reportable conditions is believed to be a material weakness.

In addition, we considered EPA's internal control over the RSSI by obtaining an understanding of the Agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on these internal controls and, accordingly, we do not express an opinion on such controls.

Finally, with respect to internal controls related to performance measures presented in EPA's *Fiscal Year 2003 Annual Report*, Section 1, Overview and Analysis (which addresses requirements for a Management's Discussion and Analysis), we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not express an opinion on such controls.

## REPORTABLE CONDITIONS

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

### *Documentation and Approval of Standard Vouchers*

EPA's Financial Reports and Analysis Branch did not always adequately document standard vouchers for transfer requests from Treasury to EPA Trust Fund accounts (Superfund and Leaking Underground Storage Tank Trust Funds) prior to the transactions being entered into the Integrated Financial Management System (IFMS). The Branch uses a formula to determine the amount of the monthly transfer, but occasionally requests additional funds to be transferred along with the calculated amount. Specifically, the Agency requested additional funds in 10 transfers with no documentation to support the request. Establishing written procedures to calculate the monthly transfer process would reduce the potential for errors occurring.

### *Improvement Needed in EPA's Interagency Agreement Invoice Approval Process*

EPA project officers did not always fulfill their oversight duties related to reviewing and approving interagency agreement invoices. We continued to find instances where project officers at EPA did not receive supporting cost documentation to substantiate invoice amounts and approve invoices for payment. We found instances in five program offices where project officers regularly approved invoices without the detailed documentation to support costs. Without proper identification of accounting information and a review of the cost documentation, transactions may be recorded in the accounting system with limited assurance that invoices are valid, appropriate, and allowable under the terms and conditions of the interagency agreement, and that costs are charged to the appropriate goal/objective. We recommend that the Agency determine the root cause of the problem and develop effective procedures to ensure that project officers properly manage the entire process.

### *Improvement Needed in Reconciling State Superfund Contracts Unearned Revenue*

EPA did not reconcile the unearned revenue from State Superfund Contracts (SSC). When EPA assumes the lead for a Superfund site remedial action in a State, the SSC clarifies EPA's and the State's responsibilities to complete the remedial action. EPA records a liability (unearned revenue), when billing a State for its share of the estimated site costs. EPA recognizes earned revenue as costs are incurred on the site. We found that EPA did not reconcile the unearned revenue from SSCs to the general ledger. Financial Management Division did not prepare a reconciliation because they relied on an analysis of current year account activity. As a result, EPA could not ensure the accuracy of the SSC unearned revenue accounts, which totaled approximately \$29 million.

### *EPA Did Not Promptly Record Marketable Securities Received in Fiscal 2003*

EPA did not promptly record marketable securities received in fiscal 2003 from companies in settlement of debts. As of September 30, 2003, stocks and warrants with an aggregate value of \$1,922,512 were not recorded in EPA's accounting system. The securities were not recorded because the regional financial management offices receiving the securities either were waiting on guidance from headquarters, or were awaiting receipt of a settlement agreement.

### *IFMS Suspense File Needs to Be Reconciled to General Ledger*

For fiscal 2003, the IFMS suspense file was not in compliance with Joint Financial Management Improvement Program (JFMIP) requirement TD-04 — that the Application Program Interface provide internal controls, such as control totals and record counts, to ensure integrity. Specifically, no formal process or written procedures existed for reconciling financial data processed from the suspense file to the general ledger accounts. The suspense file is important because it receives input of financial transactions from IFMS users and many other financial and mixed systems, which are to be posted to the general ledger accounts. The IFMS contractor created custom reports for analysis purposes, which represented the best available data, although the contractor would not confirm that either the status or dollar amount were accurate. Our subsequent analysis of the account did not indicate that the suspense file contained transactions that were not posted to the proper accounting period. However, we are still concerned about the number of uncleared transactions that could remain in the suspense file due to the current lack of automated controls. These incomplete, rejected, and held transactions could be incorrectly processed in the wrong fiscal period, creating the potential to affect the Agency's financial data.

### *Automated Application Processing Controls for IFMS Could Not Be Assessed*

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

### *Further Improvements Needed in Managing EPA's Accounts Receivable*

We noted two issues that negatively impact EPA's accounting for accounts receivable. First, we noted numerous instances where the financial management offices did not timely record receivables due to late submission of supporting documentation from Department of Justice, Regional Counsel, or the program offices. Failure to record receivables promptly could result in EPA not collecting monies due timely. Second, one regional financial management office did not properly calculate its allowance for doubtful accounts as the region did not prepare quarterly allowance calculations and update its percentage analysis formulas. As a result, the allowance was overstated \$35,772,165 and \$8,052,967 for "Superfund" and "All Other," respectively. The Agency subsequently properly adjusted the accounts.

### *Internal Controls for Correcting Errors in IFMS Need Improvement*

EPA's Financial Systems Branch bypassed IFMS manual online data entry controls when making a systemic correction of erroneous transactions. Rather than using the journal voucher process to correct the errors, the Branch had a programmer reverse the transactions by processing negative debits and positive credits. The correction resulted in 7,336 negative debit and positive credit transactions totaling \$222 million. As a result, the audit trail for these transactions was hidden and basic evidence requirements for the transactions were circumvented.

Attachment 1 describes each of the above reportable conditions in more detail, and contains our recommendations on actions that should be taken to correct these conditions. We have also reported other less significant matters involving the internal control structure and its operation in separate position papers during the course of our audit. We will not be issuing a separate management letter.

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

OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, requires us to compare material weaknesses disclosed during the audit with those material weaknesses reported in the Agency's Federal Managers Financial Integrity Act (FMFIA, or Integrity Act) report that relate to the financial statements and identify material weaknesses disclosed by audit that were not reported in the Agency's FMFIA report. EPA reported on Integrity Act decisions in EPA's *Fiscal Year 2003 Annual Report*. For a discussion on Agency-reported Integrity Act management issues, please refer to EPA's *Fiscal Year 2003 Annual Report*, Section I, Overview and Analysis.

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

For financial statement audit purposes, OMB defines material weaknesses in internal control as reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements or RSSI being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The Agency did not report any material weaknesses for fiscal 2003 as part of the Integrity Act process. Our financial statement audit did not detect any material weaknesses that should have been reported as part of the Integrity Act process.

### TESTS OF COMPLIANCE WITH LAWS AND REGULATIONS

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

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. There are a number of ongoing investigations involving EPA's grantees and contractors that could disclose violations of laws and regulations, but a determination about these cases has not been made.

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

#### *Federal Financial Management Improvement Act Noncompliance*

Under FFMIA, we are required to report whether the Agency's financial management systems substantially comply with the Federal financial management systems requirements,

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

The results of our tests did not disclose any instances where the Agency's financial management systems did not substantially comply with the applicable Federal accounting standard, the United States Standard General Ledger at the transaction level, or the Federal financial management system requirements.

We recognize improvements the Office of the Chief Financial Officer (OCFO) has made in cost accounting and believe that while there are still noncompliance issues with cost accounting, those noncompliances no longer meet OMB's definition of substantial noncompliance. However, the Agency was not in compliance with Statement of Federal Financial Accounting Standards No. 4 that requires EPA to provide full costs per output to management in a timely fashion.

We identified two other FFMIA noncompliances, related to reconciliation of intragovernmental transactions and completion of the fiscal 1999 FFMIA remediation plan. However, these noncompliances do not meet the definition of substantial noncompliance as described in OMB guidance.

Our tests also noted one other instance of noncompliance with laws and regulations, related to the Treasury Financial Manual for preparation of SF 224 "Statement of Transactions."

Attachment 2 provides additional details, as well as our recommendations on actions that should be taken on these matters. We have reported other less significant matters involving compliance with laws and regulations in position papers during our audit. We will not be issuing a separate management letter.

### PRIOR AUDIT COVERAGE

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

- Reconciliation and reporting intragovernmental transactions, assets and liabilities by Federal trading partner.
- Complying with Statement of Federal Financial Accounting Standards No. 4, including accounting for the cost to achieve goals and identifying and allocating indirect costs.
- Accounting for capitalized property.
- Recording accrued liabilities for grants.
- Interagency Agreement invoice approval process.
- Documenting EPA's IFMS.

- Complying with Federal financial management system security requirements.
- Accounting for payments for grants funded from multiple appropriations.
- Preparation and Reconciliation of Statements of Transactions
- Documentation and approval of journal vouchers.
- Timely repayment of Asbestos Loan Debt to Treasury.
- Assessing automated application processing controls for IFMS.
- Reconciling Unearned Revenue for State Superfund Contracts.

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

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

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

#### AGENCY COMMENTS AND OIG EVALUATION

In a memorandum received November 10, 2003, OCFO responded to our draft report. OCFO noted that it is continuing to make progress in enhancing managerial cost accounting. Regarding our concerns related to the Superfund Trust Fund shortfall and the decline in cost recoveries, OCFO indicated the Superfund program will continue to operate as long as Congress continues to appropriate funds for it, and noted EPA's fiscal 2003 appropriation came from Trust Fund assets and the general fund. Further, OCFO indicated it would like to work with the OIG to allay concerns about suspense fund records.

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

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



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Office of Inspector General  
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